Sports in the Public-Private Arena
City of Toronto
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Over the past decade or two, many municipalities have entered into public-private partnerships (P3s) to provide sports and recreation facilities for their communities. Most of these projects have involved the creation or extensive renovation of medium-scale facilities, which often host minor league professional sports teams as well as community events. Municipalities usually use some form of P3 for these projects in order to achieve the following objectives:

■ Limiting the municipality’s financial exposure
■ Taking advantage of private-sector financial resources
■ Taking advantage of private-sector expertise in facility design, marketing, and facility operations.

Toronto recently completed two of these projects. The outcomes differed sharply, leading to several recommendations that might be useful for other municipalities contemplating similar projects in the future:

■ Carefully examine the demand forecasts, and structure the sharing of project returns and liabilities accordingly.
■ Select a private partner with suitable experience, and make sure this partner’s interests align with those of the municipality.
■ Where possible, ensure that projects are located on government-owned property.

HOCKEY AT EXHIBITION PLACE

In 2005, Toronto entered into a public-private partnership for the conversion of the Coliseum at the city-owned Exhibition Place into an 11,000-seat hockey arena. The partnership included a private-sector firm that owned the American Hockey League (AHL) Roadrunner team, which was the farm team for the National Hockey League (NHL) Edmonton Oilers, an infrastructure investment firm that receives its capital primarily from the Ontario Municipal Employees Retirement System, and the City of Toronto. The Coliseum was an older arena built primarily for livestock and horse shows, and it was in significant need of refurbishment. As its principal investment in the project, the AHL franchise owners contributed the Roadrunners hockey team; and the infrastructure firm and the city each contributed capital for the renovation, with the city further guaranteeing third-party debt.

The team owners forecasted average attendance of 8,000 per game, which would generate the core revenues required to pay back the partners’ investments in the project. Each of the partners was to receive a share of the net revenues, after debt servicing,
through a “waterfall” arrangement, which compensated the city and infrastructure investment firm first by providing each with a return on capital with the residual, if any, flowing to the team owners.

Despite a variety of marketing efforts, actual attendance during the first season turned out to be only 1,200 per game, which led to a significant operating loss for the arena. Fortunately for the city, the agreements called for the hockey team owner to make up for this initial loss through a security it had posted specifically for this purpose.

Although average attendance during the first season was low, it was relatively high when the AHL St. John’s Maple Leafs (the farm team for the NHL Toronto Maple Leafs) came to play against the Roadrunners, which suggested that a better outcome could be achieved with a different team. After the owners of the Roadrunners left the venture at the end of the first season, the city and the infrastructure company struck a new deal with the owners of the AHL Maple Leafs, which moved their team to the Coliseum from St. John’s, Newfoundland, intending to take advantage of synergies arising from close proximity to the new firm’s home base, which was in Toronto.

Confident of higher attendance at the AHL Maple Leaf (renamed the Marlies) games, the team owners entered into a flat rental agreement with the city and the infrastructure firm, in which the city would receive essentially the same rent regardless of attendance. Since the Marlies team owners moved the new team to the Coliseum and took over operations, however, attendance has remained stubbornly low. As a result, the flat rental agreement has been highly favorable to the city, as that rent is sufficient to secure the third-party debt guaranteed by the city and also provide the city with a return on its cash investment.

**PROFESSIONAL SOCCER AT EXHIBITION PLACE**

The city’s other P3 project — the construction and operation at Exhibition Place of a new 20,000-seat outdoor stadium designed primarily for professional soccer — has worked out differently. In this case, attendance forecasts for the Toronto FC soccer team games have been greatly exceeded. The stadium was sold out during the first season and is sold out in the second season as well.

Because of contract provisions that result in profit- and loss-sharing between the city and the soccer team owner, the success of the stadium operations has generated significant operating surpluses.

**DEMAND FORECASTS AND SHARING OF RETURNS AND LIABILITIES**

Business models for medium-sized facilities usually rely on income generated from ticket sales to sports and other entertainment events held at these facilities. This revenue is necessary to repay the original construction costs, earn a return for the private partners, and help achieve other civic goals such as urban revitalization.

However, forecasting the demand for these events — estimating the number of tickets that will be sold, which often drives other revenues such as concession and parking — is difficult, and success often eludes even industry veterans. Toronto has experienced a full spectrum of underestimating and overestimating the demand for its facilities. The city has also applied a number of approaches to sharing project returns and liabilities with its private partners.

**FORECASTING ERRORS**

Predicting the outcome of these types of projects is always difficult. Consumers are more fickle with their entertainment expenditures than they are with their consumption of basic products such as water and electricity, and there is considerable competition for entertainment expenditures from a very wide range of competing products.

One of the critical issues in forecasting attendance is understanding the market substitutes for the product and experience being sold at the facility. In the case of minor league hockey at the Coliseum, it had been assumed that the AHL games would act as a less expensive substitute for Toronto’s NHL games. However, it is likely that AHL events at the Coliseum were competing with a wide range of alternatives, including staying home and watching NHL events on television. Given the example of the Coliseum project, there was concern that soccer fans would also prefer to stay home and watch European soccer on TV rather than pay to watch live
Major League Soccer (MLS), the top-tier North American league, at the stadium. Therefore, it seemed prudent to gain an up-front capital contribution from the soccer team owner in return for the stadium naming rights. Because of timing constraints, these naming rights could not be broadly marketed to other parties before the city committed to the project.

It now appears that Toronto soccer fans do perceive the ability to watch live MLS games as a relatively unique product with limited substitutes. Therefore, there has been considerable interest in soccer events at the stadium, and the naming rights have turned out to be unusually valuable.

**ADDRESSING THE POTENTIAL RISKS**

Before making a commitment to a specific arrangement with private partners, a municipality needs to carry out extensive due diligence of the demand model for the facility. In hindsight, given the extensive investments involved, some direct opinion surveys of sports fans would likely have been a worthwhile way of confirming potential interest in AHL hockey in Toronto. If these surveys had highlighted considerable uncertainty, the city could have chosen not to proceed or could have taken steps to offload a greater portion of the risk to its private partners.

In general, however, significant uncertainty will always exist with this type of project. Furthermore, taxpayers do not expect the municipality to enter into highly risky ventures, even if there is significant potential financial upside. Therefore, an agreement that transfers most of the risk to the private partners is usually the best approach.

**SELECTING AN EXPERIENCED PRIVATE PARTNER AND ALIGNING INTERESTS**

The city was able to allocate an important portion of the financial risk associated with the Coliseum hockey project primarily as a result of the infrastructure firm’s participation. When the project agreements were being negotiated, the infrastructure firm negotiated the provision requiring the owners of the Roadrunners to post a performance security that could be cashed by the other two partners — the infrastructure firm and the city — if attendance did not meet expectations. This security was cashed at the end of the first season, covering the losses that would have otherwise been incurred by the infrastructure firm and the city as a result of the poor attendance at AHL events. When the team owners were subsequently removed from the project, the infrastructure firm was able to make use of its extensive business contacts and establish negotiations with both the owners of the Toronto Marlies and other potential arena users. The infrastructure firm was effective at managing the negotiation process in a way that maintained creative tension between the parties and resulted in the best possible outcome under very tight time constraints. The city could rely heavily on this firm because it held a relatively straightforward equity investment that ensured a strong interest in the project’s success.

In the soccer stadium project, on the other hand, the soccer team owners wear three hats: one as investor in the stadium project, one as stadium operator, and one as team owner. As a result, the city could not give it a free hand in establishing financial arrangements for the Toronto FC soccer team. This situation has created challenges in, for instance, establishing the appropriate facility renewal charge to apply to soccer tickets. This firm, however, has proven to be a successful manager of the construction of the facility, just as the infrastructure firm was with the construction of the Coliseum. This firm brought its extensive experience with sports facility construction to bear in making sure the stadium was completed on a tight schedule and on budget.

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fails, the assets can revert to government ownership. This is particularly useful when part of the financing package comes by way of a government loan guarantee. Both the Toronto hockey and soccer facilities were located on city-owned property, which helped reduce the risks to the city.

CONCLUSIONS

Toronto’s sports and recreation projects have presented considerable challenges. On balance, however, they have resulted in significant benefits for the city. For instance, the Coliseum renovation created a new, improved home for the Royal Winter Fair and preserved a building with an important role in Toronto history. The terms of the new agreement with the Marlies team owners will likely result in the project’s initial construction costs being repaid to the city together with a modest return on its investment.

The investment in the soccer stadium gave Toronto the opportunity to host the 2007 FIFA Under-20 Championship. As a result, Toronto received considerable worldwide media exposure with a relatively small capital investment. If the current attendance rates are maintained, the project will also generate significant operating surpluses that can be used to fund other activities on the Exhibition Place campus. In addition, the city has been able to secure the use of the stadium by community groups at modest and in some cases no cost.

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