Stop Tax-Exempt Arena Debt Issuance Act, The; Legislative Reform

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LEGISLATIVE REFORM

THE STOP TAX-EXEMPT ARENA DEBT ISSUANCE ACT

The reason for new stadiums is economics—the team owners' bottom line. The owner can generate more revenues with a new stadium replete with luxury skyboxes and other amenities. Building new professional sports facilities is fine by me. Let the new stadiums be built. But, please, do not ask the American taxpayer to pay for them.¹

I. INTRODUCTION

Since 1990, twenty-six professional sports stadiums and arenas have been built at a cost exceeding $4.5 billion. Currently, nineteen more facilities are in the developmental stages at a projected cost of $7 billion by the end of this century.² Public financing has been used to build new homes for a diverse group of organizations including baseball's Colorado Rockies ($215 million), basketball's San Antonio Spurs ($186 million), and football's St. Louis Rams ($290 million).³ This construction explosion results from the search for alternative sources of revenue in an era marked by spiraling player salaries and increased competition for entertainment dollars. Unable to rely on the sale of local and national television broadcast rights, team owners have demanded that local municipalities build new stadiums to increase revenue. In addition to providing cleaner, more modern facilities, these new parks are generally equipped with stadium clubs, preferred parking, and luxury boxes. These amenities attract corporate fans, while an array of specialized restaurants, shops, and interactive entertainment centers maintain the core fan base among families.⁴

When local governments balked at the new construction proposals, owners have threatened to take their teams to new cities. In most of the cases where this tactic has been employed, the local electorate quickly expressed outrage at the possibility of losing their ballplayers. Faced with the prospect of running for reelection after “losing” the team, local leaders have put together packages in which the public pays most of the construction debt and the owner keeps most of the revenue generated by stadium operations.⁵

1. 142 Cong. Rec. S6306 (June 14, 1996) (statement of Senator Daniel Patrick Moynihan (D-N.Y.)).
4. Lebowitz, supra note 2, at 1G.
5. Id.
In Parts IA and IB, this article traces the history of stadium finance reform and outlines the problems posed by the legislation which currently governs this area. In Part II, the article introduces the Stop Tax-Exempt Arena Debt Issuance Act, Senator Daniel Patrick Moynihan’s proposed bill to remedy those problems. In Parts IIA and IIB analyze the reasoning behind Senator Moynihan’s bill and its likely impact if passed by Congress. Part III outlines the opposition to the Stop Tax-Exempt Arena Debt Issuance Act, particularly the views of the investment community and city leaders nationwide. In Part IV, this article draws some general conclusions about the bill and proposes two amendments to make its impact more focused and equitable.

A. The History of Stadium Finance Reform

Beginning with the first modern income tax law in this country in 1913, the interest income of government bondholders was not taxable. In addition, the tax code did not limit the purposes for which state and local governments could issue bonds. In 1968, Congress restricted the tax subsidy to capital facilities which benefit the general public. A notable exception to this requirement was sports facilities. This exception allowed tax-exempt bond financing when a team used more than 25% of the stadium’s useful service and when more than 25% of the debt service was paid for with revenue generated by the stadium in the form of rent, ticket sales, and concessions. Local residents accepted these financing fees because no general taxes were being levied to pay for the stadium.

In the past twelve years, Congress has repeatedly tried to curb tax-exempt financing for sports stadiums. With the 1984 Deficit Reduction Act, Congress stated that the proceeds from these types of bonds could not be used to finance the construction of lucrative luxury boxes. In the Tax Reform Act of 1986, Senator Moynihan included conditions which eliminated the “private activity” bond category for stadium bonds in an attempt to completely terminate tax-exempt financing of stadiums. This Act also declared that public financing of stadiums would lose tax-exempt status if more than 10% of the facility’s revenues were used to service the construction debt.

Despite good intentions, these reform attempts have only aggravated the municipalities’ weak bargaining positions, as the amended regulations practically require that publicly financed stadiums provide favorable leases to the team owners. In addition, the burden of paying off the stadium debt is unfavorably redistributed from the owners to the general public. This occurs because general revenue sources such as state lotteries, sales taxes, car-rental fees, and alcohol and tobacco taxes are substituted for stadium related revenues. In this way, the owners reap a windfall as they rent the stadiums for a minimal sum, collect the ticket and concession revenues, and are relieved of having to pay any of the interest on the construction debt.

8. Id. at 8.
9. Id.
10. CONG. REC., supra note 1, at S6306.
13. Zimmerman, supra note 7, at 27.
Under this system, the price for acquiring or retaining a team is very high for a municipal government. The municipal indebtedness grows, sometimes by hundreds of millions of dollars, and the city's credit standing is threatened, which could mean higher borrowing costs for schools and other public investments.\textsuperscript{15} For the federal government the price is equally high, as the tax-free interest payments are lost revenue which must be made up from other sources.\textsuperscript{16} Ironically, in the case of a team like the St. Louis Rams, who left Los Angeles for a new home in the TWA Dome at America's Center, the taxpayers of Los Angeles are paying for the team's new stadium in St. Louis.

Taking these developments into account, Senator Moynihan argues that the goals of the 1986 Tax Reform Act remain viable today. The 1986 Act purported to limit the issuance of tax-exempt bonds to projects with traditional governmental purposes such as schools, roads, and bridges. In addition, it strictly limited the issuance of tax-exempt bonds for private activities to a small number of projects which entail significant public benefits.\textsuperscript{17}

There were essentially four reasons for these changes. First, increasing numbers of tax-exempt bonds drove up interest costs which raised the cost of traditional government improvements. Second, the United States Treasury lost a significant amount of revenue ($18.2 billion) with the proliferation of tax-exempt bonds. Third, the popularity of tax-exempt investment vehicles resulted in an inefficient allocation of capital as investors focused on tax benefits rather than the soundness of the actual investment. Fourth, the sheer number of tax shelters grew too rapidly due to the proliferation of tax-exempt bonds.\textsuperscript{18} Senator Moynihan recently stated that "the legislation I am introducing will do what we intended to do, and thought we did, in 1986. This legislation makes clear that professional sports facilities may not be financed with tax-exempt bonds."\textsuperscript{19}

B. The Problem

Most observers find the circus atmosphere of negotiations between teams and cities amusing, as team owners extract concession after concession from local politicians in order to relocate or retain the team in a particular city. In a free market system, if people in Nashville, Cleveland, or St. Louis want to finance the acquisition or retention of generally mediocre teams for their cities, then they should be able to do so. To achieve this goal, local governments normally offer to finance a sparkling new facility with municipal bonds because they carry lower interest rates to repay bondholders. These bonds qualify as tax-exempt governmental bonds, rather than taxable private activity bonds, because a limited stream of rents is available to pay debt service on the bonds.\textsuperscript{20} The bondholders themselves reap personal benefits from the community pride associated with living in a big league city. They also reap financial benefits because they do not pay taxes on the earned interest and are afforded the security of a

\begin{itemize}
\item \textsuperscript{15} Peirce, \textit{supra} note 11, at 1592.
\item \textsuperscript{16} Lebowitz, \textit{supra} note 2, at 1G.
\item \textsuperscript{17} CONGREC., \textit{supra} note 1, at S6306.
\item \textsuperscript{18} \textit{Id.}
\item \textsuperscript{19} \textit{Id.} at S6307.
\item \textsuperscript{20} Zimmerman, \textit{supra} note 7, at 7.
\end{itemize}
government bond.\textsuperscript{21}

The problem with this scenario is twofold. Stadiums financed with tax-exempt bonds have lower interest costs than those financed with taxable private debt. These lower interest payments translate into foregone federal tax receipts which must be made up by all other taxpayers.\textsuperscript{22} In effect, federal taxpayers subsidize the construction of new stadiums from which the vast majority of them receive no benefit whatsoever. This deficiency is compounded by the fact that these projects can become long-term financial burdens to taxpayers.

The potential long term problems are illustrated by the Gateway Development project in Cleveland, which includes the Indians' Jacobs Field and the Cavaliers' Gund Arena. By most assessments, the Gateway project has been enormously successful. The Indians sold out all of their games before the 1996 baseball season started and the Cavaliers regularly play before sellout crowds. Over the last year, the two facilities have combined to draw five million fans. In addition, they are credited with contributing to a revival of the downtown Cleveland area.\textsuperscript{23}

Despite this success, the project's finances continue to deteriorate. Construction cost-overruns are one problem. More importantly, the quasi-public authority which owns both venues, Gateway Development Corporation, is not collecting enough money from its leases with the two teams to pay the debt service on $120 million in bonds which helped finance the project. As a result, the guarantor of the debt, Cuyahoga County, has been forced to pay about $23 million to cover Gateway's arrears and will probably have to pay an additional $70 million over the next sixteen years before they are able to renegotiate the Indians' lease. At the same time, due to unexpectedly low parking revenues, the city of Cleveland is being forced to subsidize the debt service on $40 million worth of bonds which were used to build two parking garages for the Gateway complex. Cuyahoga County's director of accounting states, "[t]he facilities are beautiful, the teams are minting money, and the county and city taxpayers are left holding the bag."\textsuperscript{24}

II. SENATOR MOYNIHAN'S PROPOSED SOLUTION: THE STOP TAX-EXEMPT ARENA DEBT ISSUANCE ACT

On June 14, 1996, Senator Moynihan introduced S. 1880,\textsuperscript{25} the Stop Tax-Exempt Arena Debt Issuance Act, in an attempt to protect people like the taxpayers of Cleveland and Cuyahoga County who are currently suffering, and will continue to suffer, at the hands of an ill-fated tax-exempt financing scheme. He explains that the current law is one that "ultimately injures State and local governments and other issuers of tax-exempt bonds, that provides an unintended Federal subsidy, and that contributes to the enrichment of persons who need no Federal assistance whatsoever."\textsuperscript{26} Senator Moynihan believes that it is especially inappropriate when tax-exempt financing is used to build stadiums in attempts to lure teams away from their current homes.\textsuperscript{27}

To accomplish his goal, Senator Moynihan proposes to amend Section 141 of the

\begin{thebibliography}{9}
\bibitem{21} Lebowitz, \textit{supra} note 2, at 1G.
\bibitem{22} Zimmerman, \textit{supra} note 7, at 6.
\bibitem{23} Laing, \textit{supra} note 3, at 26.
\bibitem{24} \textit{Id.} at 26-27.
\bibitem{25} S. 1880, 104th Cong. (1996).
\bibitem{26} \textit{CONG. REc.}, \textit{supra} note 1, at S6306.
\bibitem{27} \textit{Id.} at S6310.
\end{thebibliography}
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Internal Revenue Code of 1986. He would add subsection (e):

For purposes of this title, the term “private activity bond” includes any bond issued as part of an issue if the amount of the proceeds of the issue which are to be used (directly or indirectly) to provide professional sports facilities exceeds the lesser of (a) 5 percent of such proceeds, or (b) $5,000,000.28

This section effectively provides that bonds issued to finance professional sports facilities do not qualify for tax-exempt bond financing.

A. The Reasoning Behind Senator Moynihan’s Bill

Senator Moynihan argues that the financing of private gains for owners is not justified by the public use and benefits which accrue from the construction of new stadiums.29 In supporting his argument that the federal subsidies for stadium construction are unwarranted, Senator Moynihan points to a recent study by Dennis Zimmerman of the non-partisan Congressional Research Service.30 In his report, Zimmerman analyzed the amount of subsidies provided by federal, state, and local taxpayers for publicly financed stadiums. In 1989 alone, taxpayers provided a total of $146.4 million in subsidies for twenty-one stadiums, including nearly $36 million for the Superdome in New Orleans.31 Significantly, federal taxpayers shoulder a greater share of the burden as the decrease in interest expense through tax-exempt bonds significantly reduces the burden on both team owners and local taxpayers.32 Zimmerman then analyzed whether the economic benefits of stadiums were sufficient to make them worthwhile investments for taxpayers. Clearly, taxpayers initially lose money with the initial capital infusion from the bonds. The issue is whether the economic impact of the completed stadium then covers the cost of financing the construction.

The benefits of a completed stadium are generally expressed in the forms of income and employment which are both dependent on increases in spending.33 Zimmerman analyzed the economic impact statements for the soon-to-be-built football stadium at Camden Yards in Baltimore and concluded that the cost of attracting the Cleveland Browns to Baltimore will be $127,000 for each job that will be created. This is nearly twenty-one times the cost of creating a job through the state’s official program for economic development.34 Furthermore, Zimmerman cited a study by Lake Forest College economist Robert Baade in which twenty-seven out of thirty metropolitan areas with new stadiums showed no significant relationship between the presence of a stadium and real per capita income growth. In the other three cities, the impact of the new stadium was significantly negative. Baade also noted that adding a stadium to a city does not increase spending by amounts significant enough to create meaningful job growth.35 Finally, Zimmerman explained that new stadiums are almost worthless to the national economy because most stadium spending is using money that

28. Id.
29. Id. at S6307.
31. Id. at 31.
32. Id. at 34-35.
33. Id. at 46.
34. Id. at 57.
35. Id. at 56.
Based on this analysis, Zimmerman proposed two potential solutions. One is a moderate position which simply reverses the effects of the 1986 Tax Reform Act. This solution would deny stadium construction projects access to governmental bond financing, but once again would permit tax-exempt private-activity bond financing subject to certain volume limitations. The second proposal is to completely eliminate tax-exempt bond financing for stadium construction.37

B. The Impact of the Stop Tax-Exempt Arena Debt Issuance Act

As his bill demonstrates, Senator Moynihan advocates the more extreme of the two potential solutions. Since June, the proposed legislation has already had a significant impact on the bond market and, if enacted, could transform the multi-billion dollar municipal arena sector. According to three analysts from Standard & Poor's Corporation, the Stop Tax-Exempt Debt Issuance Act would likely increase interest costs and decrease debt credit quality.38 Also, as a result of this legislation, a greater amount of gate receipts would be used to secure the bonds. Gate receipts are quite volatile because they are based on factors such as weather and the actual success of the team; therefore, they are viewed as less dependable from a credit perspective. Patrick Morrissey, a senior portfolio manager at Banc One Investment Advisers Corporation is a cautious purchaser of stadium bonds for this very reason. Demonstrating his caution, he says, "[f]ans can remain loyal after a few bad years—but not many bad years."39

The Standard & Poor's analysts estimated that making stadium deals taxable would add between 250 and 400 basis points to the borrowing costs of stadium projects. With most new stadium projects costing in excess of $200 million, the changes would place significant new burdens on new stadium construction and could create increased costs reaching hundreds of millions of dollars for future projects.40 In addition, while the bill is targeted towards the country's largest stadiums, many municipally owned facilities which are predominantly used for local school and community purposes, but are occasionally used by minor league teams, would be adversely affected by the legislation.41

Since its introduction, the bill has had a decidedly negative impact on the stadium bond market.42 Recognizing that the bill had no chance of passing during this congressional term, Senator Moynihan made the effective date for the bill retroactive to June 14, 1996. Following an outcry from cities who have stadium projects currently in the developmental stages, Senator Moynihan proposed changes to the bill which provide exceptions for Nashville, Pasadena, Cleveland, Mesa, and Broward County.43

36. Id. at 2.
37. Id. at 64-74.
42. Fitzsimmons, supra note 39, at C23.
43. Frank Shafroth, Arena Finance Reform Will Keep Cities' Plans In Holding Pattern, NATION'S
Under the exceptions, debt which had already received voter approval was exempted from the legislation.\textsuperscript{44} However, in cities like Cincinnati, where two facilities expected to cost approximately $540 million are under consideration, the projects are not developed enough to receive an exemption.\textsuperscript{45} Due to the uncertainty caused by Senator Moynihan's bill, these cities are forced to use two sets of financial projections, one with low-interest tax-exempt bonds and the other with taxable bonds in case the Act becomes law.\textsuperscript{46} Although Nashville did not have any trouble selling bonds for its stadium even after Moynihan's proposal, the uncertainty surrounding the legislation has significantly reduced subsequent trading in stadium bonds.\textsuperscript{47}

\section*{III. OPPOSITION TO THE STOP TAX-EXEMPT ARENA DEBT ISSUANCE ACT}

City leaders and some members of the investment community reacted to Senator Moynihan's introduction of the Stop Tax-Exempt Arena Debt Issuance Act swiftly and angrily. One bond trade group, the Public Securities Association, said that the proposal sets a "dangerous precedent."\textsuperscript{48} The Public Securities Association also stated that the bill "would represent a fundamental departure from existing tax policy and inappropriately impose federal restrictions on state and local decision-making."\textsuperscript{49} House Speaker Newt Gingrich stated adamantly that "[n]o bill will go through the House in terms of the NFL that doesn't include the Oilers being in Nashville."\textsuperscript{50} A spokesman for Senate Majority Whip Don Nickles said that the legislation was not "on the radar screen" of the Republican leadership.\textsuperscript{51} The Government Finance Officers Association's Federal Liaison Center sent letters of protest to both Senator Moynihan and House Speaker Gingrich.\textsuperscript{52} In addition, investment banks, bond underwriters, sports leagues, the Council of Mayors, and the League of Cities have undertaken a massive lobbying effort to halt the bill.\textsuperscript{53}

Senator Moynihan responded to Speaker Gingrich's specific objection when he revised the bill to give cities like Nashville an exemption which allowed them to follow through with a $60 million bond sale to help finance their new $292 million stadium.\textsuperscript{54} However, the remaining opposition will be difficult to overcome. Investment bankers and bond underwriters oppose the bill because it raises costs on stadium projects. For example, in the financing of a new hockey arena for the Florida Panthers, the difference in interest rates if the county were forced to sell only taxable bonds would raise Broward County's debt service from $13.5 million to $17.1 million per year.\textsuperscript{55} This would make stadium projects more difficult to sell and have a negative impact on the bond market. John Gillespie, a managing director of Bear Stearns' sports

44. Fitzsimmons, supra note 39, at C23.
45. Id.
46. Lebowitz, supra note 2, at 1G.
47. Fitzsimmons, supra note 39, at C23.
48. Peirce, supra note 11, at 1592.
50. Peirce, supra note 11, at 1592.
51. Id.
52. Fitzsimmons, supra note 39, at C23.
54. Fitzsimmons, supra note 39, at C23.
55. Lebowitz, supra note 2, at 1G.
facility banking team, estimates that a switch from tax-exempt to taxable financing would increase the cost of a typical ($200 million) stadium project by 15-20%. In some of the more tenuous financing situations, the increased costs could simply kill deals altogether.56 City leaders are also dismayed by the retroactive date attached to the bill, which has stalled progress on stadium arena plans. Currently, city bond counsels are unable to issue clear opinions about whether their planned bond sales would be taxable. This is because the retroactive effective date has effectively made the bill the law for all remaining stadium projects until such time as it is defeated. In letters to the chairmen of the House and Senate tax-writing committees, the National League of Cities, along with six other state and local organizations, noted that “the introduction of the bill mandates immediate, new costs on local governments,” and in one recent transaction “the borrowing rate was approximately 30% higher than it would have been if there were not the uncertainty caused by this pending legislation.”57 Declaring this to be an unwarranted invasion of local rights by the federal government, National League of Cities President Greg Lashutka said:

The process of determining local priorities is difficult enough without having millions of dollars of planning work at the local level jeopardized by a single member of Congress who has different priorities. If the entire Congress and the President wish to debate this issue: fine, go ahead. But to allow any member to assert his or her priorities over all the citizens of a community and to throw out hundreds of hours of planning and preparation for a community facility clearly permitted under existing federal law is simply wrong.58

The National League of Cities was particularly upset that numerous cities in Senator Moynihan’s home state of New York completed financing for their new facilities before the introduction of the bill.59 In addition, they criticize the breadth of the bill, specifically the inclusion of municipal recreation facilities which are primarily used by schools and the general public, but will be adversely affected because of occasional use by a professional sports team.60

IV. IS THE STOP TAX-EXEMPT ARENA DEBT ISSUANCE ACT AN EFFECTIVE LEGISLATIVE REFORM?

Senator Moynihan’s bill is a logical solution to a gaping loophole in the federal tax laws. In 1986, Congress intended to functionally eliminate tax-exempt bond financing of new stadium construction. Instead, Congress inadvertently created a vehicle which allowed team owners to force local politicians to finance the construction of profitable new stadiums with public money. While the public is saddled with increased debt and new taxes to pay the debt, team owners rake in profits from the operation of the popular new stadiums.

In addition, the general purpose bonds that are being used to finance the stadiums are intended for traditional public purposes such as roads, sewers, schools, and

56. Laing, supra note 3, at 26.
57. Shafroth, supra note 41, at 9.
60. Id. at 5.
libraries. In a time when the federal budget is expected to contract each year, it is impossible to justify the subsidization of profitable ventures run by multimillionaires when necessary public programs are constantly facing reduced funding.

At the same time, Senator Moynihan's bill needs two significant revisions. First, the bill is too broad in scope. While it is clearly intended to affect the owners and stadiums associated with the top professional sports leagues, such as Major League Baseball, the National Basketball Association, the National Football League, and the National Hockey League, the bill will ultimately claim a significant number of innocent victims. Minor league franchises are often run on very tight budgets and based in smaller communities which may depend on the financing advantages of tax-free bonds. In addition, many facilities at local schools and parks where professional teams practice would be adversely affected by the legislation if it is enacted.

More importantly, the immediate effective date which Senator Moynihan included with the bill is an unwarranted interference in state and local politics. As Senator Moynihan conceded, his legislation had no chance of even coming to a vote during the recently completed session of Congress. Although he plans to reintroduce the bill in 1997, the retroactive effective date is a usurpation of state and local autonomy. Facing an uncertain legislative future, planning in dozens of cities has been disrupted as local leaders are forced to rework financial projections in case the bill is enacted. Functionally, Senator Moynihan has single-handedly changed the law simply by introducing the legislation and assigning the retroactive effective date. Certainly, this is contrary to the democratic political philosophy on which this country is built. While the overall goal of the Stop Tax-Exempt Arena Debt Issuance Act is valid, local governments and team owners have the right to operate under the law as it is currently written until such time as the bill is made law.

The Stop Tax-Exempt Arena Debt Issuance Act is a welcome attempt to reduce the financial burden on federal taxpayers. In attempting to close loopholes in the federal tax laws which allow team owners to exploit local politicians at the expense of taxpayers like those in Cleveland and Cuyahoga County, Senator Moynihan has made an excellent start. However, to fully realize the potential benefits of this legislation to citizens across the country, Senator Moynihan should revise the bill to exempt minor league, amateur, and scholastic facilities. In addition, Senator Moynihan should eliminate the retroactive effective date so that cities can manage their finances under current law without wasting resources on alternative financing plans.

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