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2006

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Daniel A. Rascher

University of San Francisco, RASCHER@USFCA.EDU

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Recommended Citation

Rascher, Daniel A., "Executive Interview: An Interview with Mitchell Ziets for IJSF" (2006). *Kinesiology (Formerly Exercise and Sport Science)*. Paper 13.

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Executive Interview

Interview with Mitchell Ziets for IJSF

Interview conducted by Dr. Daniel Rascher

Mitchell Ziets is the President and CEO of MZ Sports LLC (<http://www.mzsports.com>). Over the past 17 years, he has developed and implemented financing plans for a number of sport facilities nationwide. Because of the media scrutiny and controversy that often surround these projects, Ziets develops plans and strategies that reflect the delicate balance between political, fiscal, legal, and financial realities. His client roster includes some of the US's most well-known sport facilities, including Oriole Park at Camden Yards, Ameritrust Field, M&T Bank Stadium, Miller Park, Paul Brown Stadium, Giants Stadium, the Georgia Dome, Lincoln Financial Field, Citizens Bank Ballpark, Great American Ballpark, Staples Center, Petco Park, and proposed new buildings in Miami, Minnesota, San Francisco, Virginia, Pittsburgh, and Oakland. In addition to these projects, Ziets has advised on collegiate facilities, minor league ballparks, horse racetracks, skating facilities, convention centers, and hotels.

Ziets has also advised on a number of franchise acquisitions. Over the past 18 months, MZ Sports has advised on successful acquisitions of the Los Angeles Dodgers, Cleveland Cavaliers, Anaheim Mighty Ducks, and Georgia Force (Arena Football League). For these transactions, Ziets' role includes due diligence, financial modeling, structuring the purchase, and raising acquisition debt.

The following examples briefly highlight Ziets' experience:

- Served as financial advisor and placement agent to the San Diego Padres for their \$1B new ballpark and redevelopment project, which includes hotels, offices, and retail development
- Advised the San Francisco 49ers on the financing plan and negotiating strategy for their proposed new stadium
- Assisted the Philadelphia Eagles in negotiating financing terms for their new football stadium and practice facility
- Advised the Mayor of New York on new ballparks for the Yankees and Mets—the most expensive sports project (non-Olympics) in US history
- Advised one of the prospective purchasers of the Boston Red Sox, the most expensive MLB franchise acquisition in history
- Crafted the financial structure for the Brewers' new ballpark that achieved tax-exempt status through the unprecedented use of joint ownership
- Implemented a creative forward swap for the Maryland Stadium Authority that saved \$15 million (later used to bring football back to Baltimore)

Ziets received an MS in operations research from the University of California, Berkeley, and is a graduate of the Wharton School at the University of Pennsylvania, where he received a BS in economics with a double major in operations research and actuarial science. Ziets is a board member of the Philadelphia Sports Congress. In 2000, he was selected as one of the Top 40 Under Forty leaders in the Philadelphia region by the *Philadelphia Business Journal* and as one of the top Forty Under Forty Sports Executives by the *SportsBusiness Journal*.

Role and Trends

Q: *What are the essential skills needed for your job?*

A: We run our company a bit differently from other firms in our business. Often, sports advisors are part of an investment bank or commercial bank and thus can rely on their balance sheet to attract clients. As a boutique advisory firm, MZ Sports does not have that luxury. Therefore, we have to go above and beyond in helping our clients understand the business they are about to buy or the sta-

dium effort they are about to undertake. To do this, we implement a rigorous quantitative approach to ensure that the client fully understands the financial impacts of their particular project. Thus, strong quantitative skills are a must. In addition, both our M&A and our stadium projects require a tremendous degree of creativity. We often borrow ideas from other disciplines, be it media, real estate, or municipal finance, to engineer deal structures. It is rare that a deal in this space goes forward without running into some type of potential fatal flaw related to legal, fiscal, or credit issues. For virtually every deal, we are looking at creative ways to reach our clients' objective—implementing interest rate hedges, structuring debt to meet League requirements, and developing creative structures that enable low cost tax-exempt financing. The third skill required is patience. We have a great respect for the intense media scrutiny that come with these projects and understand that stadium deals get played out over a long period of time. Finally, as I often tell my wife, a key part of our job is watching SportsCenter, although that is sometimes a tough sell.

Q: How did you “break into” sports?

A: Unlike most people in this business, I fell into it. As a young analyst at a municipal financial advisory firm, I was assigned to the sports group. This was back in 1988 when there was little to no stadium activity in the US. My firm, Public Financial Management, had just served as advisor on Joe Robbie Stadium, the first privately financed stadium in 25 years. With one stadium under our belt, we were the “expert” in this field. I happened to come on board at the same time we were retained by the Maryland Stadium Authority to structure the financing for a new ballpark for the Orioles. As many people know, the success of Camden Yards was a key factor in the new stadium renaissance. We quickly became the go-to firm on stadium projects in the late 1980s and early 1990s, when a large number of teams were striving to develop new facilities.

Q: What are the typical steps for you when you begin and complete a facility financing project? What is your role in the process?

A: In planning new stadiums, we generally get in early and work side by side with our clients all the way through the process. First, we meet with our clients to understand their overarching objectives, whether it involves value

creation, cash flow, tax strategies, real estate development, or a media play, for example. Second, we spend a large amount of time understanding the issues and constraints specific to that project. This will involve a thorough investigation of legal matters with the team's counsel and local bond counsel, debt constraints as they relate to both the team and the public sector, credit issues, and public sector fiscal constraints. Third, we undertake a thorough review of public funding options, identifying and analyzing various funding alternatives. This will include diving three layers deep into the public sector's financial records to develop refinancing scenarios that will benefit the project. With my background in municipal finance, teams rely on MZ Sports to help them get their arms around the public's labyrinthian financing structure. Fourth, we develop very detailed new stadium pro formas for the team to help them understand what they can afford, based on their objectives. These pro formas have a variety of constituents—teams, the leagues which must approve these transactions, and lenders. Fifth, we will provide background information on comparative deals—both lease terms and financing plans—to help our clients understand how they stack up with their counterparts. Sixth, we advise our clients in all aspects of the lease and development agreement negotiation and support our position with financing models showing the public sector how they can afford their contribution. Seventh, we develop the team's private financing plan. Eighth, we assist in negotiations with project vendors—concessionaires, for example—to ensure consistency with the financing plan. Finally, MZ Sports will execute the team's financing plan including advising on lender selection and negotiating terms including derivative products.

Q: What are the recent trends in sports facility financing?

A: First and foremost, stadium financing plans are driven by the ability to garner public funding for a project. Over the past five years, the trend has been towards more private capital. This is due to a general disdain for public funding of these projects, significant increases in project cost, and the fact that the teams pursuing stadiums during the past five years have tended to be in larger markets, where the teams have less leverage (i.e., they cannot justify threats to relocate). Second, because of the demand for increased private capital, teams are exploring the poten-

tial for real estate development opportunities linked to new stadiums as a means to improve the salability of a project to the public as well as increase the financial viability. We have seen this with recently opened or contemplated projects for the Padres, Lions, Coyotes, Nets, 49ers, Chargers, Anaheim (NFL stadium), and A's. Third, public entities are showing increasing willingness to finance, but not fund, the private contribution. What I mean by that is that a governmental agency will issue and secure debt funded by team revenue streams such as rent payments. Compared to a private financing through a team related entity, this lowers the team's cost of capital, frees up its balance sheet, and extends the debt term. Finally, monoline bond insurers, which guarantee payment of debt service, are increasingly playing in this space, opening up sports projects to a whole new set of buyers—institutions that play in the 'AAA' market.

Q: What changes do you see in the future with regards to sports facility financing?

A: The combination of increased facility costs, less public funding, and team debt limits imposed by the respective leagues will require teams to continue to be creative in raising capital. As opposed to one series of senior debt, we will see more tranching of debt, including mezzanine debt, holding company loans, vendor loans, and debt against real estate projects tied to stadiums. In addition, we will continue to see the proliferation of new buyers of this debt, including hedge funds. Finally, with large debt levels, teams will expect their CFOs to undertake appropriate matching of assets and liabilities through floating rate debt and derivative products where appropriate, much like their corporate brethren. We have recently advised three teams on derivatives to take advantage of the current interest rate environment. Mezzanine debt is subordinate, unsecured debt. Thus, it is riskier than senior secured debt, which gets paid first, both in terms of ongoing operations and in a bankruptcy. As a result, mezz debt lenders require a higher cost of capital. Tranching of debt in this context is simply multiple series of debt. Each series may be similarly secured and just issued at different times and in different amounts to either take advantage of the prevailing interest rate environment or to allow for flexible borrowing needs (i.e., the borrower may not need

the full amount of the committed bank funding depending on actual project costs).

Q: As the professional sports facility market in the US slows down, how do you see the college sport facility market differing?

A: From a financing perspective, NCAA venues differ from professional facilities in several ways. First, it is much more difficult to finance these buildings privately—through stadium revenues—as these buildings generally cannot come close to generating sufficient revenues to warrant project debt. Again, this is generally the case, but there are exceptions in the case of large conference football or basketball programs. Second, there is no deep pockets owner to backstop the debt or the construction risk, again reducing the feasibility of a successful private financing. Third, universities have different financing vehicles at their disposal including using the athletic department budget, the university budget, student fees, or state entities to guarantee debt. Finally, alums can provide a significant portion of the required capital. We happen to subscribe to the theory that NCAA institutions should at least explore the viability of project debt, either as a standalone financing tool or in concert with other forms of university debt in order to minimize the impact on the university's balance sheet.

Q: What about the international market?

A: The international market, we believe, will be the hot facility financing market in the coming years. My sense is that it is still a few years away but when it hits, there will be a tremendous amount of activity. Most of this activity will be in the asset backed, syndicated loan, or project finance markets. The municipal bond market and tax-exempt debt is unique to the United States; thus, I do not see public entities doing much in the way of backing sport facilities. We are starting to see this in the United Kingdom with soccer facilities. As with any project financing, these projects will be required to stand on their own merits. It will be interesting to watch how the natural conflict between emerging markets, which need credit support, and the lack of interest in public participation, plays out.

Details

Q: How is the cost of capital calculated for these investment projects?

A: For private debt, the cost of capital will be a function of the deal structure and credit rating. For a construction loan, these projects will price at a spread to LIBOR consistent with credit quality. Not surprisingly, for a team or owner backed loan, the pricing will be less than a non-recourse project financing (i.e., a loan whereby the lender has a pledge of new building revenue streams only). If the debt is long-term fixed rate private placement, the debt will price with a spread to treasuries consistent with rating, in this case generally “BBB” category. For an insured deal, we are looking at a much lower spread due to a “AAA” rating.

Q: When is bond insurance used? What are the criteria and cost implications of using it?

A: The use of bond insurance is a good example of deploying a product from another line of business. In this case, we borrowed from the municipal bond business. Roughly 50-60% of all muni deals are insured by a small group of monoline bond insurers. These insurers guarantee prompt payment of principal and interest to bondholders. In 1997, AMBAC, one of the largest bond insurers, guaranteed debt for America West Arena in Phoenix. This was quickly followed by another AMBAC deal, this time for the financing of Bank One Ballpark for the Arizona Diamondbacks. Since that time, bond insurance has been used for a number of sports projects. Without bond insurance, the strongest stadium projects are generally rated in the ‘BBB’ category. Bond insurance brings ‘AAA’ ratings to the project and thus increases investor demand for this paper to include buyers of high grade debt. Bond insurers will only take on the strongest projects, however, as they require investment grade ratings by two rating agencies. Generally, we have found that bond insurance is cost effective when available (i.e., the annual or upfront premium is more than offset by the reduced cost of capital).

Q: It often appears that maintenance costs are severely underestimated. Is that the case and if so, why?

A: There are several reasons. First, in the early years teams are spending “maintenance” dollars on items that were initially in the stadium construction budget but were value engineered out. Second, there is little to no long-term experience of new stadiums to fall back on when estimating annual capex. Third, to keep up with the newest build-

ings and remain fresh, teams are funding improvements in their buildings well beyond normal maintenance.

Q: Can you describe the details of how the forward swap deal with the Maryland Stadium Authority works?

A: The Authority issued debt in a high interest rate environment in 1989. Most issuers would simply refinance the debt once rates were low, much as you or I would do with our mortgage. However, in the municipal bond market, investors have call protection, generally for 10 years. This means that even with low rates, you cannot refinance any of the debt due within 10 years. Most municipal issuers simply advance refund the bonds—refinance the bonds in advance of 10 years with the better economics starting in year 11. However, we could not even advance refund the bonds due to legal constraints under which the Authority issued the debt. The Authority had to wait until 1999. Our problem was that we needed funds well in advance of 1999 to fund a football stadium. The solution was a forward starting swap where the Authority would enter into the swap in 1999 but receive the economics of the swap six years earlier. The basics of the swap are as follows: (i) the Authority would refinance the debt in 1999 with floating rate debt; (ii) the swap counterparty would pay the Authority a floating rate equal to the floating rate on the Authority’s debt; (iii) the Authority would pay a fixed rate to the swap counterparty at the current bond rate, but because this bond rate was higher than the 1993 market would suggest, the swap counterparty paid the Authority on a one-time basis the present value of these higher than market rates.

Q: Hotel or restaurant taxes are often part of the mix of public financing sources. Is a decrease in units sold (because of the higher tax rate and total price) considered when determining the increase in taxes generated by raising the tax rate? If so, how is it calculated?

A: Although unproven, it is generally felt that a small increase in a city’s hotel, rental car, or restaurant taxes have virtually no impact on units sold. Keep in mind that when convention planners select a city, tax rates are one of many criteria considered. Location, convention center space, hotel room availability, convention center work rules, cultural amenities, air fares, CVB programs, and assistance all play a large role. Having said that, the bigger impact is the opportunity cost of these tax increases

(i.e., they cannot be used for other public projects). The bottom line is there is no free lunch.

Q: What are the major risks from the institution's perspective when choosing to finance a sports facility? How are those risks mitigated or managed?

A: The major risks include construction risk and performance risk in the form of generating sufficient revenues to cover debt service and reach coverage covenants. Embedded in the performance risk includes premium seat renewal risk, ticket sales, and the risk of a naming rights partner defaulting or disappearing. Construction risks are mitigated through a combination of project contingency funds, owner guarantees for overrun payments, insurance, and an appropriate project delivery mechanism including a guaranteed max price contract and other cost controls. Performance risk is mitigated through coverage covenants, performance reserve funds to limit renewal risk, and controls by the lender in the event of defaults.

Q: In general, what criteria are used to pick the public financing sources used for a project from among the many available (e.g., hotel, restaurant, car rental, sin, sales, general fund, etc.)?

A: Not surprisingly, the optimal funding sources vary by municipality. We focus on the following criteria in selecting the optimal funding source: availability, ability to increase the tax, referendum requirements, competing uses for that funding source, legal and financial restrictions, political considerations, and public reaction. For example, in California, Prop 218 requires a referendum with 2/3 approval for a tax increase if the tax is used for a specific project. Thus, tax increases are frankly not feasible. However, California is one of the few states whereby the local municipality keeps 100% of the hotel tax. Thus, hotel tax revenues, not tax increases, are more feasible as a funding source in California than many other states. This is how the Padres' ballpark was funded.

Q: What are the keys to success in making a public/private partnership work and getting the surrounding economic development to take hold?

A: Public/private partnerships work when there is a level of trust and both sides have the same objectives. Where one side is trying to crush the other in a negotiation for no other reason than bragging rights, the deal is destined

to fail. Surrounding economic development, as we have found in many instances, cannot be forced. Rather, market forces will determine if development around stadiums makes sense.

Examples

Q: On that note, please take us inside the City of San Diego and Padres "Baseball Village" joint venture project. The San Diego ballpark development looks like it will be the most successful private-public partnership yet. What were/are the keys to success? How were they able to induce so much private sector involvement (new Omni Hotel, office space, residential housing, etc.)?

A: Success was predicated on two factors. First, the city invested close to \$300M in the ballpark, at that time the most ever by a municipality for a sports project. In return, the city put our feet to the fire in terms of development. This came in the form of tax incentives tied to development as well as specific development requirements for retail, residential, and hotel units. Thus, the Padres had to keep their eye on the ball in terms of development—a different agreement with the city may have resulted in less development. Second, the market, which fell away in the late 1990s and early this decade, has come back with a vengeance, allowing the Padres to not only fulfill their development requirements, but surpass them. We should keep in mind, however, that the Padres did not want the development obligation due to the tremendous risk. You cannot force development if it does not make economic sense. Fortunately, in this case it did.

Actually, the tax incentives came in two forms. First, the Padres are required to pay property taxes on the ballpark. In return for the team increasing its investment in the ballpark, the city agreed to utilize tax increment financing ("TIF") to help fund the project. Under a TIF, the property taxes paid by the Padres are used to finance a portion of the project under the theory that the taxes are only available due to the ballpark. Thus, only "incremental" taxes are used to pay debt service, no existing city taxes are used. The second use of tax incentives involved the development around the ballpark. The first \$3.5M of taxes generated from this development stay with the ballpark to fund operating expenses. Without this develop-

ment, the team would be on the hook to fund these expenses.

Q: There have been numerous facility deals in which the incentives between the team and local government were misaligned. For instance, suppose a team is responsible for selling PSLs and season tickets, and shares the PSL revenues with the local government as part of the financing deal, but keeps 100% of the season ticket revenue. It is not surprising to see the team not sell PSLs at all or at a very low price, so it can charge a higher price on season tickets because it gets to keep more of the overall revenue this way. Further, suppose the local government is responsible for selling PSLs and the team is responsible for selling season tickets, each getting to keep all of its own revenues. Because the financial stakeholders are separate, each party has an incentive to price its product higher than would be the case if one party were setting both prices and sharing revenues. The result is that the combined price is too high to sell all of the PSLs and season tickets. Are these types of incentive misalignments being recognized and more incentive compatible structures being put into place or should we continue to expect to see problems in this area?

A: There is now an established history of how to best structure these deals and also what types of structures to avoid. Clearly, the scenarios described in this question represent less than optimal structures. We have seen, mostly in situations where the public sector still runs the building, a misalignment of risk and reward as well as improperly placed incentives. More and more, teams are receiving all of the revenues and paying all of the operating expenses as well as funding their stadium investment upfront. This avoids any gaming of the system which hurts both parties and often the fan.

Q: The value of facilities is often a contentious issue. Sometimes “canned” estimates of a limited array of potential values from consultants are presented that typically address totals, rather than value added. Then an intensely critical atmosphere evolves. The public is left with imprecise information on what they are getting for their tax dollars. Why don’t facilities planners solicit the following: (1) an independent panel to frame the analysis, and (2) independent estimates as framed by such a panel of the value of their endeavors along the three lines of value—economic activity value, development value, and

quality of life value? Then, the public wouldn’t be suspicious of the results and more people might be in favor of the public financing.

A: You raise an interesting idea. We have long been of the belief that ever rising stadium costs are one of the largest public relations problems these projects have. However, there are a number of good reasons why independent panels have not been asked to value project costs. First, the team owner makes change orders throughout the project, driving up costs. Second, these buildings have become architectural statements and thus, neither side wants to be restricted on cost. Third, with the teams almost always taking cost overrun responsibility, they want the freedom to raise costs and change the design as they see fit. I do think, however, that with more realistic cost estimates from the start, you eliminate a lot of the partisan rhetoric.

Q: What was the most challenging project you have ever done and why?

A: The Padres ballpark was the most challenging. We were dealing with a small market team, a difficult site, a limit on public funding due to Prop 218, a city which appeared to be inflexible once we had to diverge from the initial financing plan (cost overruns, delays, etc.), onerous development requirements, and serial litigation that delayed the project two years. Despite this, the Padres succeeded in completing the ballpark and creating a model on how a ballpark can reinvigorate a neighborhood.

Future Research

Q: What are some of the big unanswered questions in sport facility finance that you wish you had answers to?

A: I would like to see either better research on actual experience as it relates to economic impacts of new buildings or research that includes non-quantifiable impacts such as cultural benefits or notoriety that a team provides a city. It appears to me that the naysayers always seem to get their message out as to how these projects do not provide benefits to cities and my feeling is that this is simply not true when you include the macro aspects.