Fiscal Analysis Department
Minnesota House of Representatives

# ISSUE BRIEF:

## Summary of the 2002 Stadium Act

(Chapter 397 – H.F. No. 2214)
June 2003

*(H.F. 2214 passed the House May 18, 2002 and the Senate May 19, 2002, and was signed by Governor Ventura on May 22, 2002)*

### Current status of baseball stadium act

The act required voter approval of local taxes by referendum no later than September 30, 2002. Because no agreement was reached between a city (or cities) and the Minnesota Twins, *no referendum was held*.

### Stadium cost and description

*Roof-ready stadium* with construction costing *no more than $330 million*. In addition to the $330 million in construction costs, local governments could have spent up to *$50 million (but no more) on public infrastructure* – street improvements, parking, and utility connections. *Construction cost overruns* would be borne by the Minnesota Twins.

**Stadium location**

Must be in the *Twin Cities metropolitan area*, and local government funding is limited to *a city or cities*. (There was no authorization for counties to participate.)

**Costs borne by Minnesota Twins[1]**

- $120 million in cash upfront.
- Rent payments to cover all costs of repair, maintenance, and replacement of equipment or property in the baseball park

**Costs borne by city/cities**

- *At least $12 million per year* to make payments on ballpark loan.
- Infrastructure costs of up to *$50 million* (plus land acquisition costs).
- Property tax exemption for real and personal property at the stadium (including parking facilities) until the loan is repaid.

[1] The act requires the city and team to jointly agree to make payments on the baseball loan of at least $12 million per year. Although cities might negotiate to have the team pay a portion of this amount, it was generally assumed that this would all be paid by the city or cities. The entire amount is shown here as a cost to the city.

**Revenue sources for municipality (with required referendum)**[2]

- Food and beverage taxes (including on-sale liquor) – up to 5%.
- Lodging tax – up to 5%.
- Parking tax or surcharge – not less than $2 per vehicle per event (both public and privately owned facilities used for stadium event parking).

**State participation**

The state would sell bonds to finance stadium construction – but at no cost to the state. The state would sell up to *$330 million in revenue bonds – the full amount needed to cover construction costs*.[3] No state money would be used to repay the bonds, though, and the act asserts that *"the state neither makes nor has a moral obligation to pay the bonds if the pledged revenues and other legal security for them is insufficient."*[4]

The state bonds would provide a benefit through *arbitrage*. The state can sell bonds at a lower rate of interest than the expected rate of return from investing the $120 million up-front deposit from the Twins. The financial plan took advantage of this difference in interest rates. Annual bond payments would pay only the interest, with a single balloon payment of principal after 30 years. At the time the bill passed, the finance department assumed the state could sell bonds at 6.75 percent interest, while earning 8.5 percent interest on money in the debt service fund.[5] The difference between the 8.5 percent investment return and the 6.75 percent interest payment helped reduce the overall cost of the stadium.

*Appendix B* illustrates cash flow under the following assumptions:

| | |
|---|---|
| Total bonds sold: | $330 million at 6.75% interest, sold at end of 2002. |
| Twins' upfront payment: | $120 million, at the end of 2002. |
| Interest earned on investments: | 6.5% in 2003, rising 0.5% per year to 8.5% in 2006 and after.[6] |
| Local tax revenue: | $12 million in 2003, rising by 3% each year (assuming tax base growth). |
| Bonds paid off: | $330 million principal repaid in a balloon payment in 2025.<br>(In earlier years, payments of interest only.) |

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[2] The city may limit the food, beverage, and lodging taxes to a part of the municipality if desired. The lodging tax may exempt some hotels and motels based on the number or rooms. The city would define the area subject to the parking tax. *Appendix A* shows estimates of the revenue that these local taxes would raise in selected cities.

[3] Alternatively, the act allows some or all of the bonds to be sold by local municipality if the commissioner of finance finds that this would allow bonds to be sold at a lower interest rate.

[4] The bonds would be repaid using only (1) the principal and any investment return on assets in the debt service account, (2) payments from the municipality and team under the loan agreement, and (3) other pledged revenue.

[5] More specifically, the investment return was assumed to be 6.5% in 2003, 7% in 2004, 7.5% in 2005, 8% in 2006, and 8.5% in 2007 and later years. There are federal restrictions on arbitrage gains using revenue from tax-exempt bonds, but these were assumed to be taxable bonds.

[6] Following the method used by the department of finance, investment interest is actually calculated at half the stated rate every six months, so annual rate = $(1+i/2)^2-1$, which is slightly higher due to compounding. For example, the stated rate of 8.5% is actually 8.68%. (In contrast, the department of finance states the interest rate paid on bonds as an annual rate.)

Under these assumptions (as shown at the bottom of the table in Appendix B), the total $330 million cost of stadium construction (excluding land acquisition and infrastructure costs) would be financed as follows:[7]

| | | |
|---|---|---|
| Upfront payment by Twins: | $120 million | ( 36%) |
| Local taxes: | $174 million | ( 53%) |
| Gain from arbitrage: | $ 36 million | ( 11%) |
| Total construction cost: | $330 million | (100%) |

The only direct cost to the state would be the *sales tax exemption for stadium building materials* (a one-time cost estimated at $10.7 million).[8]

**Risks**

**A. Construction costs or construction delays**

Performance bonds would be required, along with a signed no-strike no-lockout agreement between the Twins and the unions for the period of construction. The team was required to pay for any cost overruns.

**B. Team bankruptcy and economics of baseball**

Several provisions are designed to reduce the risk that a professional baseball team might not remain in Minnesota. First, major league baseball was required to guarantee the presence of a major league team in the metropolitan area for the greater of 30 years or the term of the bonds.[9] Second, bond sales were permitted only if the executive council determined that financial reform in major league baseball would make the Minnesota stadium financially viable over the life of the bonds.[10] The remaining risk falls primarily on the investors buying the stadium bonds and on the local government.

**C. Bond risk**

The risk of the bonds depends partly on the sufficiency of the dedicated revenue sources and partly on the potential for downward variance in the investment return earned on the debt service fund.

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[7] Future dollars are discounted at the assumed bond interest rate (6.75%) and stated in present value terms. This is the way economists usually compare the size of payments made at different times. A dollar received today is equivalent to $(1.0675)^{20}$ = $3.69 received 20 years from now if the interest rate is 6.75 percent.

[8] In future years, the local property tax exemption might also increase the state cost for property tax refunds to renters and homeowners, to the extent that property taxes are shifted to residential properties. The department of revenue estimated a state cost of $270 thousand per year starting in FY 2006.

[9] The team was also required to agree that the team name and logo become the property of the municipality if the team relocates to another state, and to settle an outstanding court case relating to the disclosure of financial information (unless the court case is dismissed).

[10] The executive council consists of the governor, lieutenant governor, secretary of state, state auditor, and attorney general (2002 MS 9.011).

Before bonds could be sold, the commissioner of finance was required to determine that the municipality had the financial capacity to make the annual payments. (See *Appendix A* for information on the revenue potential of the specified local taxes in selected cities.)

If actual investment performance in the debt service fund fell short of the expected 8.5 percent rate of return, the local government was authorized to levy a baseball park admissions tax of up to 5 percent to fill the gap.[11] With attendance at two million and average ticket price at $15, the full 5 percent admissions tax would provide backup tax revenue of $1.5 million per year.

Although spreadsheets provided by the department of finance during legislative hearings showed repayment of principal as a lump-sum in the 30th year, the assumed pattern of tax collections and investment returns would have made it possible to discontinue the local taxes and pay off the principal after 22 years (in 2025). This provided a considerable cushion if principal repayment could be delayed until the 30-year bonds matured.[12]

### D. Risk to the State

Under the financing plan, the state would have had no general or moral obligation to bondholders. In case of default, though, investors might be somewhat less willing to buy other Minnesota state bonds, but there is no direct risk of state funds.

## Football stadium provisions

The act appropriated $500 thousand to the University of Minnesota to be used, in consultation with the Minnesota Vikings, to develop a design for a joint-use football stadium. Although the design work was done, the deadline of December 1, 2002 passed without an agreement between the University of Minnesota and the Vikings.

The act also requires that revenues from the future sale of the Metrodome be deposited in a football stadium account.

## Future prospects

The 2002 stadium act is likely to be the starting point for future stadium finance bills. There have been proposals, for example, to allow counties to participate in local funding, rather than limiting local participation to municipalities.

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[11] Investment performance was to be reviewed at the end of the second year after the baseball park began operations and every four years thereafter. The admissions tax would have been levied in one-half percent increments as needed, at the request of the commissioner of finance.

[12] If bond repayment were delayed until the end of the 30th year, but the other assumptions of Appendix B were unchanged (and local taxes continued for 30 years), the total amount in the debt repayment fund would have grown to $885 million – which would be $555 million more than the principal repayment of $330 million.

## APPENDIX A: Potential Revenue from Local Taxes

The city submitting a successful bid for the stadium had to agree to pay at least $12 million per year from an assortment of taxes – on food and beverage, on-sale liquor, lodging, and parking. According to the Department of Revenue, a parking tax/surcharge of $2 per vehicle could raise about $1 million if the tax were collected *only* on those parking and attending the 81 home games for the Twins. (This was based on the assumption of two million fans per year and one car for every four fans.) If some other game-day vehicles were also charged the tax (or if the tax rate were higher than $2 per car), revenue could be higher.

Assuming that a parking surcharge raises $1 million, Table A-1 illustrates some possible options to raise the remaining $11 million.[13]

Table A-1.
Rough Estimate of Increase in Tax Rates Needed to Raise $11 million in 2003

| City | | Increase in Tax Rate on: | | |
|---|---|---|---|---|
| | | Food and Beverage | On-Sale Liquor | Lodging |
| Minneapolis downtown district (except lodging*) | Option 1 | 2% | 2% | 2% |
| | Option 2 | 2.75% | 2.75% | 0% |
| | Option 3 | 2.5% | 2.5% | 1% |
| | Option 4 | 1% | 3% | 3% |
| | Option 5 | 1.5% | 1.5% | 3% |
| Minneapolis (entire city) | Option 1 | 1.35% | 1.35% | 1.35% |
| | Option 2 | 1.75% | 1.75% | 0% |
| | Option 3 | 1.5% | 1.5% | 1% |
| | Option 4 | 1.25% | 3% | 0% |
| | Option 5 | 1% | 1% | 2.75% |
| St. Paul (entire city) | Option 1 | 2.4% | 2.4% | 2.4% |
| | Option 2 | 2.7% | 2.7% | 0% |
| | Option 3 | 2% | 4% | 2% |
| | Option 4 | 2% | 2% | 5% |

*Lodging tax increase is assumed to apply to the entire city.

Tables A-2 and A-3 on the next page provide further details on the revenue raised by these local taxes, along with information on current tax rates in selected cities.

[13] The May 24 *Star-Tribune* article, on page B5, cited an estimate that the parking tax in Minneapolis would raise $1.6 million.

## APPENDIX A (continued)

| Table A-2. Estimated Revenue from Food & Beverage, On-Sale Liquor, and Lodging Taxes | | | |
|---|---|---|---|
| | FY 2003 (Dollars in $1000s) | | |
| City | 1% Food & beverage tax | 1% On-sale liquor tax | 1% Lodging tax |
| St. Paul | $3,300 | $ 800 | $ 600 |
| Minneapolis (entire city) | $4,900 | $1,700 | $1,700 |
| Minneapolis (downtown district only) | $2,900 | $1,000 | *Unknown* |
| Brooklyn Park | $ 350 | $ 50 | $ 200 |

Source: Minnesota Department of Revenue Research Division. "Food and beverage tax" includes prepared food (as in restaurants) and *non*alcoholic beverages.

| Table A-3. Existing Total Tax Rates in Selected Cities | | | |
|---|---|---|---|
| | Total tax rate (including state and local general sales tax rates) | | |
| City | Food & Beverage | On-sale liquor & beer^ | Lodging (50+ rooms / <50 rooms) |
| Minneapolis | | | |
| Downtown district | 10% / 13%* | 12.5% / 15.5%* | 13% / 10% |
| Rest of Minneapolis | 7% / 10%* | 9.5% / 12.5%* | 13% / 10% |
| St. Paul | 7% | 9.5% | 13% / 10% |
| Bloomington | 6.5% | 14%** | 12.5% / 12.5% |

^State sales tax rate on liquor and beer is currently 9%. Note that this rate falls to 6.5% on 1/1/2006.
*The higher rate applies to locations with live entertainment, which are subject to the 3% Minneapolis entertainment tax.
**Department of Revenue Tax Handbook lists a 5% on-sale liquor & beer tax.

Some other metro cities impose a *lodging tax* at a 3% rate to fund tourism programs. For these cities, the total tax rate on lodging (including the state general sales tax) would be 9.5%.

| | | |
|---|---|---|
| Brooklyn Center | Eagan | Maple Grove |
| Brooklyn Park | Fridley | Richfield |
| Burnsville | Hastings | Shakopee |

## APPENDIX B: Stadium Finance Plan under Finance Dept. Assumptions
### (but assumes local tax started 1/1/03 and bonds paid off in 2025)

| Investment interest rate: | Variable, from 6.5% first year to 8.5% starting year 5* | Upfront payment: | **$120,000** |
|---|---|---|---|
| Bond interest rate: | **6.75%** | Annual payments: | $12 million starting 1/1/03; revenue grows 3.0% per yr |

| Year | Balance in debt repayment fund (at end of year) | Interest earned on debt repayment fund | Bond principal payments ($330 million in bonds) | Interest paid on bonds | Local Taxes ($12 million growing 3%/yr) | Interest earned during construction |
|---|---|---|---|---|---|---|
| | | | *(All dollars in $1000s)* | | | |
| 2002 | $120,000 | | | | | |
| 2003 | $121,179 | $7,927 | $0 | -$22,275 | $12,000 | $3,527 |
| 2004 | $123,236 | $8,631 | $0 | -$22,275 | $12,360 | $3,341 |
| 2005 | $124,221 | $9,416 | $0 | -$22,275 | $12,731 | $1,114 |
| 2006 | $125,196 | $10,136 | $0 | -$22,275 | $13,113 | |
| 2007 | $127,294 | $10,868 | $0 | -$22,275 | $13,506 | |
| 2008 | $129,981 | $11,050 | $0 | -$22,275 | $13,911 | |
| 2009 | $133,317 | $11,283 | $0 | -$22,275 | $14,329 | |
| 2010 | $137,374 | $11,573 | $0 | -$22,275 | $14,758 | |
| 2011 | $142,225 | $11,925 | $0 | -$22,275 | $15,201 | |
| 2012 | $147,953 | $12,346 | $0 | -$22,275 | $15,657 | |
| 2013 | $154,648 | $12,843 | $0 | -$22,275 | $16,127 | |
| 2014 | $162,409 | $13,424 | $0 | -$22,275 | $16,611 | |
| 2015 | $171,341 | $14,098 | $0 | -$22,275 | $17,109 | |
| 2016 | $181,562 | $14,873 | $0 | -$22,275 | $17,622 | |
| 2017 | $193,198 | $15,761 | $0 | -$22,275 | $18,151 | |
| 2018 | $206,390 | $16,771 | $0 | -$22,275 | $18,696 | |
| 2019 | $221,287 | $17,916 | $0 | -$22,275 | $19,256 | |
| 2020 | $238,056 | $19,209 | $0 | -$22,275 | $19,834 | |
| 2021 | $256,874 | $20,665 | $0 | -$22,275 | $20,429 | |
| 2022 | $277,940 | $22,298 | $0 | -$22,275 | $21,042 | |
| 2023 | $301,465 | $24,127 | $0 | -$22,275 | $21,673 | |
| 2024 | $324,138 | $26,169 | $0 | -$22,275 | $18,779 | |
| 2025 | $0 | $28,137 | -$330,000 | -$22,275 | $0 | |

***Present Value Analysis using 6.75% interest rate.***

| | | | |
|---|---|---|---|
| (A) | Up-front payment: | $120,000 | 36% |
| (B) | Local Govt. Taxes: | $173,452 | 53% |
| (D)-(A)-(B)-(C) | Interest arbitrage: | $36,548 | 11% |
| (D) | Total | $330,000 | 100% |

*Investment interest calculated at half this rate every six months, so annual rate = $(1+i/2)^2-1$, which is slightly higher due to compounding. The stated bond interest rate is an annual rate.

**Further information**

The text of the 2002 Act (Chapter 397) can be found online at:

http://www.revisor.leg.state.mn.us/slaws/2002/c397.html

The House Research Department bill summary of the stadium bill (H.F.2214) – written by Joel Michael and Wendy Simons – can be found online at:

http://www.house.leg.state.mn.us/perl/billsum.pl?fname=HF2214&session=82

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