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Analysis of Virginia Arena Deal Documents

This memo provides an analysis of the Virginia incentive offer to Monumental Sports and Entertainment (Monumental), based on the December 2023 briefing documents prepared by JP Morgan and provided to the Major Employment and Investment (MEI) Project Approval Commission in the Virginia General Assembly.[1]

Overview

The project would be completed in several phases, with Phase 1 comprising the arena, Monumental office space, four residential buildings, two hotels, a concert venue, and a 2,500-spot parking garage. Phases 2 and 3, estimated to be completed in 2031 and 2036, respectively, are generally not included in the financial estimates provided in the briefing documents.

Although the briefing documents include estimates of the size of development proposed and the associated jobs, no supporting documentation was provided. This analysis focuses on the fiscal elements contained in the documents.

Actual Cost of New Virginia Arena

Cost of debt service	$4,153,739,000
Project revenue bonds	*$3,077,693,000*
Lease revenue bonds	*$1,076,046,000*
Maintenance	$599,934,000
Transportation infrastructure	$198,400,000
Alexandria contribution	$106,321,000
Monumental contribution	$403,321,000
Total project cost	**$5,461,715,000**
Total cost to taxpayers	**$5,058,394,000**

Note: if the transportation infrastructure and Alexandria contribution amounts are borrowed, the actual cost, including debt service, will likely be several times higher, around $450 million and $250 million each, respectively.

Based on our review of these documents, the project is very advantageous to Monumental, as it allows the company to consolidate all of its operations into one location and – more importantly - places the construction, maintenance, and finance risks of this new campus almost exclusively on Virginia taxpayers. This contrasts with the situation in the District of Columbia, where Monumental owns the Capital One Arena, and is financially responsible for the facility's upkeep. In Virginia, the state and city propose to assume those risks in order to lure Monumental to Alexandria.

While the reporting on the project has stated it will cost about $2 billion, the MEI briefing documents provide a better estimate of the project's total cost, including interest payments and maintenance costs. **In all, the documents indicate the arena project cost is at least $5.5 billion, and likely more.**

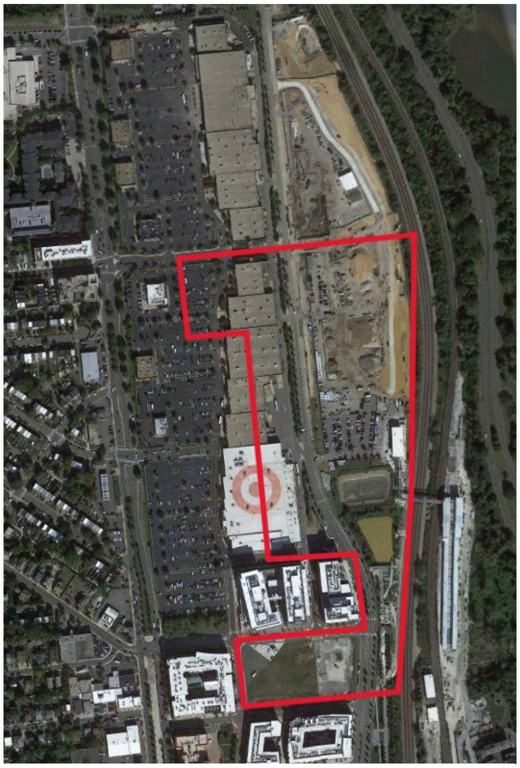
[1] This is an analysis of the briefing documents provided to the General Assembly and does not include an in-depth analysis of existing VA law or pending legislation.

COSTS

Bonds

The project would use approximately $1.5 billion in bond proceeds to finance the development of the arena, concert venue, Monumental offices, practice facilities, and the parking garage. The documents envision two sets of bonds: the first, referred to as the project revenue bonds, would be financed with incremental taxes generated at the site, along with ticket taxes, parking revenues, and naming rights money; the second set of bonds, referred to as lease revenue bonds, would be backed by the lease payments from Monumental. The project revenue bonds would contribute about $1 billion to construction of the arena, and the lease revenue bonds would contribute about $400 million, for a total of about $1.5 billion in bond proceeds.

However, the estimate of $1.5 billion is not the actual cost of the bonds to taxpayers, but instead the amount of money that is borrowed. Like a mortgage, the $1.5 billion that will be borrowed to pay for the development will actually cost Virginia taxpayers significantly more over the life of the bonds. In fact, the total cost of the debt service, including principal payments and interest, is estimated to be approximately $4.2 billion, according to the MEI documents. If the $198.4 million transportation infrastructure funding and the $106.3 million contribution from Alexandria are borrowed, the actual cost of debt service will likely be several times higher, around $450 million and $250 million respectively, bringing the cost of the debt service to $4.8 billion.


Approximate location of proposed arena and Phase 1 development.

Maintenance

The briefing documents include another cost to the project that hasn't been widely covered: maintenance costs. A key difference between Capital One Arena in the District and the proposed Alexandria arena is that the state would own the arena; in the District, the arena is owned by Monumental, and the company is responsible for any repairs or upgrades to the arena. With the new Alexandria arena, the state, via the new sports authority, would be required to pay for routine maintenance, as well as any upgrades to the arena. Monumental would not be required to pay for any such costs.

The MEI documents provide an estimate for an Operations and Maintenance fund and a Repair and Replacement fund, starting with an annual contribution of $12 million in 2029 and growing by 2% every year over 34 years, for a total of about $600 million. These funds would, in the words of the mayor of Alexandria, "avoid the obsolescence that ultimately occurred at Capital One

Arena" by providing for the ongoing renovations and upgrades the arena needs.[2] There is no explanation for why this is an appropriate amount, or what the actual expected maintenance costs might be.

This $600 million has not been included in any public accounting of the costs of the project, and it is not part of the $1.5 billion in bond financing or contributions from Alexandria or Monumental.[3]

Furthermore, even this estimate in the briefing documents is likely only a small part of what will be needed. For example, according to Monumental's request to the District, the 26-year-old Capital One Arena requires $800 million in renovations, on top of the $200 million Monumental has invested in just the last decade in capital improvements.[4]

At the new Alexandria arena, the state will need to fund repairs not just to the arena, but also to the Monumental office space, practice facility, broadcasting center, concert venue, and 2,500 space underground parking lot.

It seems improbable that the campus will only require $600 million in repairs and upgrades over the next 40 years; given inflation and the rising cost of sports arenas, state taxpayers should expect to pay $1 billion or more on the arena campus, even after initial construction. The source of these funds have not been publicly identified.

Cost Overruns

Sports facilities almost always cost more to build than the initial estimates from when the plans were first announced. **For instance, of the seven most recent football arenas built, every single one cost more than the initial cost estimates used to pitch the arena. These cost increases were, on average, more than $300 million above the first public estimates.** Presumably, the state, through the new sports authority, would be responsible for paying for any such cost increases at the new arena, since Monumental would not own the arena. The briefing documents suggest that the project will have a fixed-cost construction contract, which would help limit the state's liability once the project began, but such a contract is years away from being signed and does not prevent cost increases due to inflation or changes in scope or design.

It is also unclear if the tax increment generated from the site would be sufficient to cover additional debt to pay for any cost overruns. Additional borrowing against the taxes raised from the development could lower debt coverage ratios (the amount of excess money above debt service costs; a lower ratio indicates a potentially riskier investment), increase borrowing costs, and raise

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[2]Justin Wilson, "The Council Connection," January 1, 2024, retrieved from https://myemail.constantcontact.com/January-2024-Council-Connection.html?soid=1109043704255&aid=jA8iBD4OiVY

[3] The Virginia House of Delegates released a new version of the bill on February 9, which appears to limit the use of the maintenance fund to about $340 million over the life of the project. However this version is subject to further legislative negotiation, and it does nothing to stop the teams from asking for more money from the state, especially since the fund is likely too small for the expected future maintenance costs.

[4] Tom Gulitti, NHL.com, "Capitals' ownership interested in move to proposed arena in Virginia," retrieved from https://www.nhl.com/news/washington-capitals-interested-in-move-to-proposed-virginia-arena

the total cost of debt service to Virginia taxpayers. If the taxes cannot support additional debt, Virginia will need to rely on yet-to-be identified alternative resources to pay for cost overruns.

TAXES

The briefing documents estimate several new revenue streams generated by the development, specifically ticket tax revenue, parking revenue, hotel taxes, personal income taxes, corporate taxes, campus naming rights, and several fees, such as the Potomac Yard Special Tax District. Below is an analysis of some of these revenue streams.

- Ticket taxes
    - The briefing documents indicate there would be a 10% tax on tickets, generating about $1.9 billion over 34 years, starting in 2029 with $38 million estimated in ticket taxes collected annually.
    - Capital One Arena is projected to generate about $24 million in ticket taxes for the District in 2029. **Therefore, the briefing documents imply the new arena will create a 60% increase in ticket tax revenue, which is unlikely.**
    - Since the new arena will have approximately the same seating capacity as Capital One Arena, it is likely that most, if not all, of the 60% increase would have to come in the form of higher ticket prices. While the new arena will have more premium seats than the current Capital One Arena, it is not clear if an improved fan experience can sustain such a large ticket increase.
    - Alexandria's admissions tax is currently capped at 50 cents per ticket. **This revenue stream would therefore require the imposition of a new tax at either the state or local level,** such as the new 10% ticket tax included in the House of Delegates' revised arena legislation released on February 9.
- Hotel taxes
    - The documents estimate the two hotels in the project will generate $550 million over the life of the project, with $11.5 million collected in the first year of operation ($3.5 million in state hotel taxes, $8 million in *local* hotel taxes).
    - **The entire city of Alexandria is projected to collect $11.2 million in *local* hotel taxes in FY 2024, meaning the project expects these two hotels will increase the city's local hotel tax collection by almost 75% ($8 million in new local hotel taxes on top of the $11.2 million).**[5] Alexandria currently has at least 13 hotels with over 4,500 hotel rooms.[6]
    - Hotel Heron will open in Old Town Alexandria in May 2024, as a 4-star, 133-room hotel. In a 2021 application to the state, Alexandria projected the hotel would generate about $400,000 a year in hotel taxes for the city.[7] It is unclear why the two

[5] City of Alexandria, "FY 2024 Approved Operating Budget, Section 7, Revenues," retrieved from https://www.alexandriava.gov/sites/default/files/2023-06/Section%2007%20Revenues%20Summary%20FY%2024%20Approved_0.pdf
[6] City of Alexandria, "FY 2023 Annual Comprehensive Financial Report," retrieved from https://www.alexandriava.gov/sites/default/files/2024-01/fy2023_alexandria_final_acfr_2.pdf
[7] "Tourism Development Financing Program, Tourism Development Plan," retrieved from https://alexandria.legistar.com/View.ashx?M=F&ID=10383443&GUID=25A4CA36-5474-4C85-8EE4-294170F7C8B5

hotels in the arena project would each generate about ten times more in local hotel taxes as the Hotel Heron.

- Personal income taxes
    - The MEI documents predict there would be $1.1 billion in personal income tax revenue collected over 34 years, with $23 million collected in 2030.
    - It is unclear where the income tax revenue is coming from. **The agreement to move Monumental's headquarters to Virginia does not require Monumental to create any new jobs.** About 1/3 of Monumental's employees currently live in Virginia, are already subject to Virginia's state income tax, and would not generate any new incremental income tax revenue. The remaining 2/3 of Monumental employees presumably live in Maryland and the District, and would not be subject to Virginia income taxes due to the existing reciprocity agreements between the states.
    - The approximately $20 million in personal income taxes estimated to be generated annually by the arena portion could represent a "jock tax" being charged on out-of-state professional athletes and performers playing in the new arena. (Due to Home Rule Act restrictions on taxing nonresidents' income, the District does not have a jock tax, meaning the move from Capital One Arena to the new Virginia arena will subject every visiting professional basketball and hockey athlete to a new income tax.) However, a jock tax might not explain the entire $20 million estimate. For instance, Pittsburgh, Pennsylvania's jock tax, currently being challenged as unconstitutional, is forecast to bring in $4.4 million in FY 2024 on a 3% tax (Pittsburgh has professional hockey, football, and baseball teams in the city).[8]
    - The income tax estimates do not include any income tax from the residential buildings contemplated in the development, and the bulk ($20 million) of the income tax appears to be coming from the arena portion of the project.
- Property taxes
    - The report estimates about $740 million in property taxes over the life of the project, with about $15 million in 2030.
    - It is not clear what is generating this amount of property tax, since the land for the arena will likely be owned by the authority and thus not subject to property taxes. However, the briefing documents show the arena paying over $80 million in property taxes. This may indicate leasehold interest taxes (similar in concept to the District's possessory interest tax), but the briefing documents do not specify. It is reasonable to expect these properties to generate a fair amount of property taxes, however $15 million is more than three times the property taxes currently being paid by the recent developments to the south of the proposed arena site.
    - There is no information about how much land the new authority will own, potentially affecting Alexandria's property tax revenues. How much land is the authority going to purchase? The draft language introduced in the General Assembly does not specify a geographic boundary limiting the authority in any way.[9] Could the authority purchase additional land outside of the initial proposed

[8] City of Pittsburgh, "FY 2024 Operating Budget & Five Year Plan," December 18, 2023, retrieved from https://apps.pittsburghpa.gov/redtail/images/23689_2024_Operating_Budget.pdf
[9] The revised House of Delegates arena legislation released on February 9 does have a geographic boundary limitation for the new authority, but it remains subject to further legislative negotiations.

development? Will it own any of the land for the hotels or residential buildings? How much tax revenue will Alexandria be losing by having the authority own the land for the arena and associated development?
    - The answers to these questions also implicate the estimated $140 million projected to be raised in the development by the existing Potomac Yard Special Tax District.
- Parking revenue
    - The MEI documents estimate the underground garage would bring in $1.5 billion in revenue over the life of the project, starting with $25 million in 2029.
    - It is unclear what this estimate is based on, such as how many cars are expected per day or for how much. Limited on-site parking space, coupled with abundant Metro-accessible parking options in the area and game day traffic congestion, may limit how much the garage could charge attendees.
    - It is not clear if the estimate includes the cost of operating or maintaining the garage.
- Other taxes
    - There are several other revenue streams for the arena project, which are difficult to analyze. This includes about $550 million in sales taxes, which could be a mix of sales and meals tax revenues. There's another estimated $570 million in business income taxes, most likely from Monumental, although it isn't clear how much business income tax Monumental is already paying in Virginia.
    - The briefing documents also estimate $500 million in naming rights for the campus, averaging almost $15 million a year (Monumental, despite not owning the arena, gets to keep any naming rights revenue for the arena itself). It is difficult to analyze this estimate, as there are few, if any, campus naming rights deals to compare to. Having competing naming rights, for the campus and arena, may lower the value of the two revenue streams.

Practice facility

The plans include constructing a new practice facility for the Wizards. However, the Wizards are contractually obligated to continue playing at the Entertainment and Sports Arena in the District until 2037. Therefore, it is not clear when this practice facility will be constructed. Will it be built in 2029 with the arena itself, and remain empty for eight years? Will it not be built until 2037? If so, will a portion of the bonds remain unused until then?

The District of Columbia built the Entertainment and Sports Arena six years ago for $69 million. The lease requires the Wizards to practice at the facility, and the Go-Go and Mystics basketball teams to play their games at the facility, until 2037.

Transportation

The impacts of addressing transportation issues such as congestion on Route 1, providing off-site parking incentives, or expanding the Potomac Yards Metro station were not part of the December MEI analysis. Therefore, they have not been analyzed here, but it is likely the site will face significant transportation challenges.