Transaction Details, Security Provisions & I-91 Compliance

July 5, 2012

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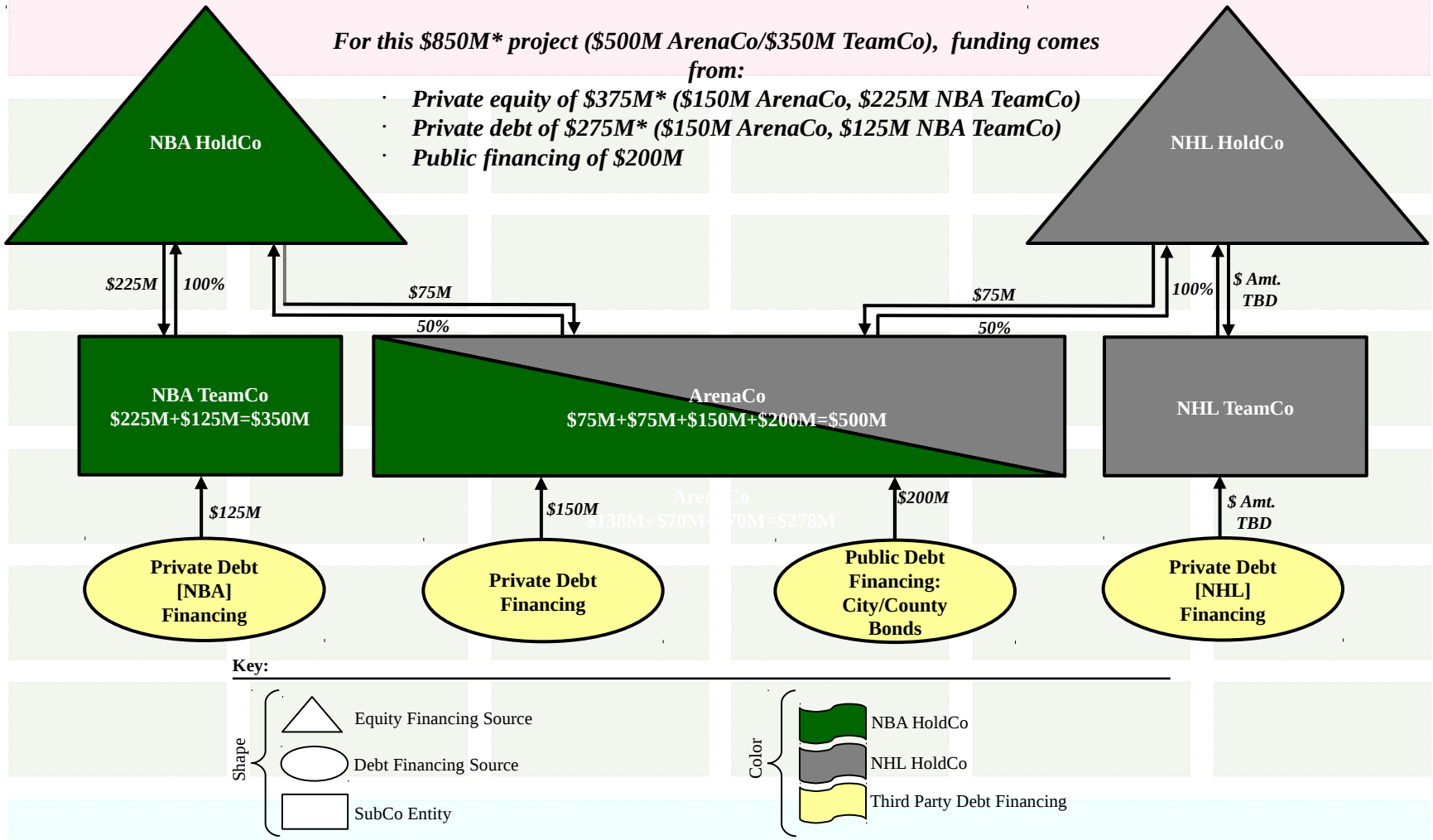
Project Financing Structure

NBA HoldCo will own a 50% interest in ArenaCo and 100% of NBA TeamCo

For this $850M* project ($500M ArenaCo/$350M TeamCo), funding comes from:

- ***Private equity of $375M* ($150M ArenaCo, $225M NBA TeamCo)***
- ***Private debt of $275M* ($150M ArenaCo, $125M NBA TeamCo)***
- ***Public financing of $200M***



Note: Excludes NHL TeamCo Equity and Debt Contribution

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Arena and Team Holding Company Structure

ArenaCo EBITDA projected to be over 5x greater than Basketball TeamCo EBITDA

NBA HoldCo

NHL HoldCo

NBA TeamCo

ArenaCo

NHL TeamCo

Revenues
- Tickets
- Local TV/Radio
- Team Sponsors
- National TV
- National Licensing

Expenses
- **Rent**
- Player Compensation
- Coaching Staff Comp
- GM and Scouts Comp
- Benefits and Insurance
- Travel
- Ticket Sales
- Sales and Marketing
- Community Relations
- Administration: Finance, Legal, IT
- Game Day Expenses
- Taxes
- Private Debt Costs

Revenues
- Suites
- Club Seat Premiums
- Naming Rights
- Arena Sponsors
- Concessions
- Merchandise
- Parking
- Concerts and Other Events
- Private Rentals
- Rent From Teams

Expenses
- **Rent**
- **Additional Rent**
- Event staffing
- Utilities
- Insurance
- Security
- Maintenance
- ArenaCo Salaries,
- Taxes

- Private Debt Costs

**Hockey TeamCo shown for illustrative purposes only; revenues and expenses expected to be generally similar to that of Basketball TeamCo*

**ArenaCo Private Debt Costs to be paid after ArenaCo expenses, rent, and local taxes*

Note: Diagram is intended for illustrative purposes only; EBITDA projections are subject to change

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Funding Sources

There are three clearly defined sources of revenue that pay the debt service on the City and County bonds:

- Guaranteed minimum rent of $2 million paid to the City and the County by the investor group (NBA HoldCo)
- The incremental tax revenue generated by the arena and NBA and NHL teams that would not be available to either the City or the County were it not for the arena being built
- If the revenues from the two previous sources are not enough to cover the cost of repaying the bonds, the investor group has agreed to pay additional rent to make up the difference (The City and County's base case assumption is $5 million in year 1)

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Review of Security Provisions

In addition, we have built into the Memorandum of Understanding further guarantees which include:

- Agreeing to a specific performance lease with the city, insuring the team will stay for the entire life of the lease
- Agreeing to cover any cost overruns of the Arena construction
- Agreeing to fund a major maintenance and capital investment fund to ensure that the facility's long-term capital maintenance needs are met (13c in MOU)
- Agreeing to apply any excess tax streams to a separate reserve fund which can be used to only fund arena repairs and improvements (which will be owned by the City and County) or to retire the Public Debt early
- Agreeing to pay Arena base rent and additional rent ahead of other arena lenders and investors
- Agreeing to a reserve fund of one year's debt service to be drawn upon in the event we fail to pay our base rent or additional rent
- Agreeing to maintain a level of Arena profitability (EBITDA) that would provide 2x debt service coverage (two times the total public debt service payments, not simply the base rent or additional rent, and thus a MUCH higher multiple of actual debt service)
- Agreeing to increase the reserve fund by a proportional amount if the Arena profitability (EBITDA) totals less than 2x debt service
- In the extremely unlikely case of a default that requires the ownership group to sell the team, the City and County also have first right to the proceeds of the sale after obligations to the NBA are satisfied
- Agreeing to sell the City/County the land and building (the most valuable and enduring assets), which they will hold directly as security in the unlikely event of a default by investors

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Practical Considerations (Tax Revenue)

- Baseline Arena tax revenue assumptions are conservative
  - Our Admission assumptions are based on league average ticket prices and league average attendance
  - No Playoffs for 30 years for either NBA or NHL (Playoffs add 5-30% more admission revenue)
  - NBA history in Seattle is better on attendance, ticket prices, and playoffs
  - **City/County's tax assumptions are significantly more conservative**
  - **City/County's assumptions are $7.1M in year 1, versus our estimate of over $9.5M**
- Tax Revenues from the Arena can't be zero unless the team relocates or there is a multiple year lockout
  - Property and leasehold excise taxes are stable
  - B&O taxes are on contracted revenue streams (national broadcast revenues, local broadcast revenues, naming rights, suites, etc.) which are fixed for multiple years
  - Admissions revenue can't be zero as attendance can't be zero
  - Sales Tax on merchandise and concession revenue can't be zero as attendance can't be zero
- While debt service will rise by 1% per year for the first 10 years and is then flat thereafter, inflation is likely to rise much faster – which will result in revenues/taxes growing much faster than debt service
- For these reasons, excluding a lockout we believe tax revenues will not be less than $5 million even under the most conservative of assumptions. **Admission revenues could fall to less than 40% of NBA and NHL league averages and we project that the "additional rent" would be no more than $7M**

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Practical Considerations (Payment of Rent)

- As previously described, the ArenaCo is estimated to be 5x more profitable than the TeamCo
  - ArenaCo has relatively low expenses compared to TeamCo (largely do to player salaries)
- The vast majority of ArenaCo's revenues (75%+) such as naming rights, building sponsorship, suites, etc. are contracted on a multi-year basis, which significantly reduces the volatility and uncertainty of ArenaCo revenues and profits
- City/County has a first priority payment position for rent and additional rent
  - Rent (and additional rent) is an operating expense for the Arena
  - Required to be paid in the waterfall before any debt service or dividend distributions to TeamCo
- Because so much of the economics have been directed to ArenaCo, the NBA HoldCo (Investor Group) is highly dependent on dividend distributions from ArenaCo
- Investors will maintain a "security reserve fund" equal to one year's debt service
- The NBA HoldCo (Investor Group) has guaranteed to maintain ArenaCo EBITDA (Earnings before interest, taxes, depreciation and amortization) of 2.0x annual debt service
  - If profitability falls below this coverage ratio, the investor group is required to contribute the shortfall amount in the security reserve fund within 30 days
  - **The importance of this protection should not be dismissed. Because the vast majority of ArenaCo revenues are contracted on a multi-year basis if ArenaCo revenues and profitability were to decline it would tend to be gradually, which would necessitate extra security reserve fund deposits years in advance of ArenaCo having any profitability issues**
- Investor Group has given the City/County a "security interest" in the NBA HoldCo, which will have the group's equity in both the ArenaCo ($75 million) and TeamCo ($225 million or more)

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Practical Considerations (Payment of Rent, Cont.)

Given that the investor group has given the City/County a security interest in the NBA HoldCo ($75M in ArenaCo equity, $225M+ NBA TeamCo equity), it would not make sense under any reasonable economic circumstance for the investor group to not make its rent or additional rent payment

- If rent payment, or additional rent payment is not made by the investors, **the rent payment must be made by the Collateral Trustee overseeing the reserve fund**
- If the Investor group (or another party) does not replenish the reserve fun in 30 days, ArenaCo would be in default and the City/County would have the right to exercise their security interest and assume the investors $300M+ equity position in the NBA HoldCo
- Given the disparity between the rent payment (rent plus additional rent should not exceed $9M even under extremely conservative assumptions) and the investor equity of over $300M, it would not make economic sense for the investor group to default
  - Each individual partner of the NBA Investor Group would have the right to make the rent/additional rent payment and dilute the other partners to protect his equity position
  - The NHL Investor Group could make the payment on behalf of the NBA group and vice versa
  - It would be in the NBA Investor Group’s best interest to sell the franchise before skipping a rent/additional rent payment

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Practical Considerations (“Strategic Default”)

- A “strategic default” would not be a viable negotiating tactic given the contractual provisions afforded the City/County in the MOU
  - While some skeptics have tried to compare this situation to the Portland Arena (Rose Garden) default and claim we could strategically default to get a better deal, this would not be feasible under the contractual and legally binding terms of this MOU
  - Portland did not pledge its TeamCo Equity against the ArenaCo loan
  - Thus when Portland defaulted on the ArenaCo obligations and placed the ArenaCo into bankruptcy, the TeamCo equity was not a source of collateral for the ArenaCo lender
  - Given that the City/County control the land/building outside of ArenaCo and have a security interest on the NBA HoldCo which controls the NBA investor group’s $300M in equity ($75M ArenaCo, $225M+ NBA TeamCo) – a default on the ArenaCo’s obligations would cause the investors to risk their entire equity position

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What if Investor Group Defaults on Rent Payments?

- Given that the Investor Group has provided a security interest against the NBA HoldCo, a default on its rent obligations would result in a the City/County assuming control of its equity position in the NBA HoldCo
  - NBA investor group's $300M+ in equity in the Arena and the NBA TeamCo would be available as collateral to the City/County in addition to it owning the land and the building on its balance sheet
  - **Given the amount of equity value imbedded in the ArenaCo and TeamCo, it is <u>extremely likely</u> another private party would step in and make the rent payment and "cure" the loan and thus take control of our equity stake in the Arena and Team**
  - These private parties could include parties that are part of the transaction like:
  - The NHL ownership group
  - The ArenaCo private lender
  - The ArenaCo operator
  - The NBA or NHL
  - These private parties could also include parties that are not party to the transaction like:
  - A new NBA or NHL investor group that would step in and take control
  - An arena operator like Global Spectrum, AEG or Live Nation acting on its own behalf
  - An arena operator appointed by the ArenaCo private lender

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What if ArenaCo Still Defaults on Rent Payments?

- If no other private party cures and ArenaCo defaults, the City/County would still have the leverage and collateral to insure it is fully repaid
  - The City/County would own the land and building outside of ArenaCo, giving it tremendous leverage over the ArenaCo and TeamCo in a liquidation
  - The City/County would have the option of selling ArenaCo to a private arena operator, or hiring a private arena operator to operate ArenaCo on its behalf
  - The City/County would also have the right to exercise its security interest in the NBA HoldCo, which controls the majority equity interest in the NBA TeamCo – which the City/County could sell to a private party approved by the NBA
  - The lease and non-relocation provisions would remain in place

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What if There is a Team Insolvency and Liquidation?

- In the EXTREMELY unlikely event of a TeamCo insolvency and NBA HoldCo liquidation the City/County would have sufficient collateral to insure bond repayment in full
  - Keep in mind, there has not been a NBA bankruptcy in the last 20 years
  - If this is a dual ownership building as we plan, this would imply the NHL ownership group has simultaneously defaulted and become insolvent
  - We believe the chances of simultaneous NBA and NHL franchise insolvency are below 1/10th of 1%
  - The City/County would own the land and building on its own balance sheet, which it could sell to a new arena operator or a new NBA or NHL ownership group
  - In the unlikely event the City/County did not get an acceptable offer it could demolish the Arena and sell the land
  - When the NBA TeamCo is auctioned off, the City/County's security interest in the NBA HoldCo would mean it is first in line to receive any proceeds after the NBA's obligations have been paid
  - NBA TeamCo debt senior to the City has been capped at $125 million or 40% of franchise value
  - Liquidation of NBA TeamCo alone would provide for entire amount of City/County's bond's if team value is in excess $325 million
  - **Combination of proceeds from the sale of land/arena and the auction of the NBA and NHL franchises should exceed $200M even under the most "draconian" of assumptions**
  - **Outstanding debt of the city will be declining while the NBA franchise value will be increasing over the 30 years period**
  - **We believe the probability of there being less than $200M in recoverable collateral to pay the City/County's debt from these sources is significantly less than 1/10th of 1% (.001)**

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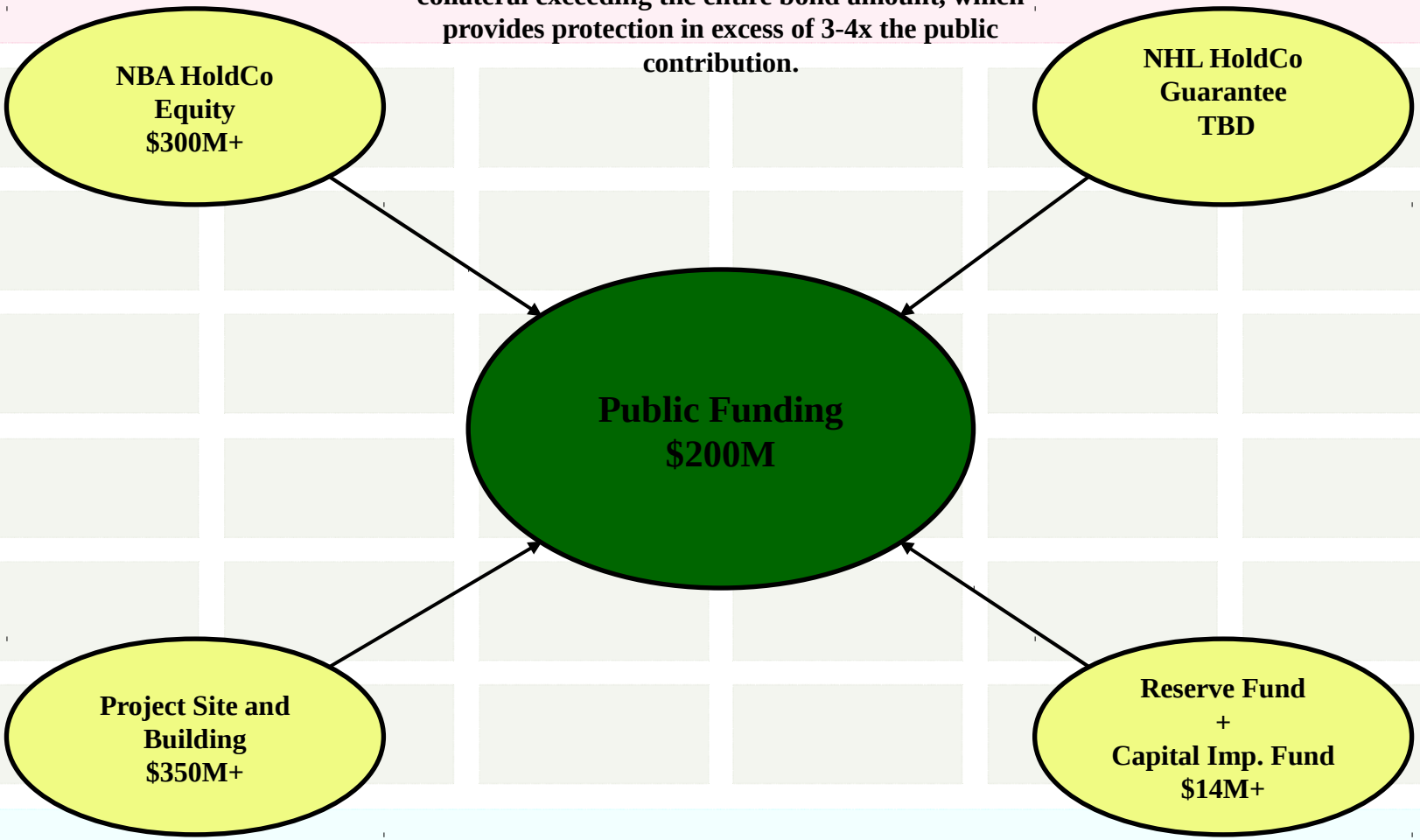
Sources of Hard Collateral

The public will be protected by 4 different sources of collateral exceeding the entire bond amount, which provides protection in excess of 3-4x the public contribution.



Note: Diagram is intended for illustrative purposes only; EBITDA projections are subject to change

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How Would This Change Without the NHL?

- **We would again just like to re-iterate that our plan remains to build an NHL Arena and attract an NHL team**
- But in the event we were unsuccessful in our efforts the City/County's risk would decline
  - Burden would fall on investor group to raise the extra $75 million
  - City/County investment would be capped at $120 million
  - While tax revenue would decline, debt service payments should decline by more
  - **Decline in face value of bonds would result in debt service declining by 37.5%**
  - **We do not believe tax revenue would decline by this much as many NHL dates would be replaced by concerts and other events that charge admissions tax**
- **Collateral against the $120 million would provide more security to the City/County**
  - All MOU security provisions would remain intact
  - City/County would still own 100% of the land/building on its balance sheet (outside of ArenaCo)
  - City/County would still have security interest in NBA HoldCo, and thus a first claim on proceeds from sale of NBA franchise in the event of a team insolvency/bankruptcy
  - City/County would now need to recover just $120 million from sale of land/arena and NBA TeamCo as opposed to $200 million under dual ownership scenario
  - **We believe the probability of there being less than $120M in recoverable collateral to pay the City/County's debt from these sources is significantly less than 1/10th of 1% (.001)**

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The Arena is Compliant with I-91

- **We believe the annual return to the City/County is likely to be in the 8-10%**
  - This return significantly exceeds the return required by I-91 (30 year Treasury Return)
  - This significantly exceeds the return expected by the private investors on the aggregate private capital (over $600 million) required for the project

- **Using very conservative assumptions we believe the project will generate an annual return of 7.4% for the city**
  - Assumes only annual cash flow to the city is the debt service as Ancilary taxes generated merely offset the substitution effect
  - Assumes Arena is worthless at the end of 30 years, and is sold for raw land value only

- **We believe the analysis provided by the City Of Seattle Staff is inaccurate**
  - It is an undisputable fact that the Arena (owned by the City) will have value at the end of 30 years
  - It is an undisputable fact that there will be incremental taxes the city/county will receive as out of City/County arena patrons spend money on outside of the arena goods and services (Bars, restaurants, Hotels, rental cars, team merchandise, etc.)
  - **A financial analysis of the expected returns to the City/County that fails to acknowledge or account for these two sources of investment returns is incomplete/inaccurate.**

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I-91 Definition

- Consideration for the value of goods, services, real property or facilities provided or leased by the City of Seattle to for-profit professional sports organizations … must be at or above the fair value of the goods, services, real property or facility being provided or leased

- Fair Value is defined as no less than the rate of return on a U.S. Treasury Bond of 30 years duration at the time of inception – which is currently at 2.7%

- Return shall be computed on the net cash on cash return

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I-91 Compliance

- Investment Amount – City County are investing $200 million in the form of bond proceeds

- City and County will receive:
  1. Land and Arena building with a cost basis/replacement value of well over $300 million
  2. New tax revenue that would not exist were it not for the construction of the Arena and NBA and NHL Franchises being operated in Seattle
  3. Rent and additional rent to cover tax shortfalls over life of the investment
  4. Security provisions that will insure that the taxes and base rent paid meet the City/County's debt service cost on the $200 million
  5. Additional tax revenue from out of city/county arena patrons who purchase goods and services outside of the Arena

- **When all of these factors are taken into account, we believe the City/County's rate of return on the $200 million will be in the 8-10% range – well in excess of the 2.7% rate required**

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I-91 Compliance – Real Estate Appreciation

- **For this analysis we have made the very conservative assumption that the Arena will be worthless at the end of year 30 despite the MOU requirement for the Investor Group to maintain the Arena to standards acceptable to the City/County and the investors cost**
- We believe the cost to demolish the Arena would be roughly $12M in today's dollars, which would increase to $30M in year 31 assuming a 3% inflation rate
- Excluding all soft costs, we believe a conservative assumption for the cost/value of the arena land is $50 million
- Conversely, we have assumed the land will increase in value by 5% per year for 31 years
- At this 5% appreciation rate, this would equate to a future value of $227M in year 31
- Deducting the $30 million in demolition costs would yield a $197 million net value in year 31

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I-91 Compliance -Tax and Rent Revenue

- Under terms of the MOU, the combined tax and rent revenue must equal the debt service rate on $200 million – or $14 million in year 1 and growing at 1% per year for the first ten years and then flat for the remaining 20
- The City/County forecast new tax revenue to be $7M in year 1, while rent and additional rent will make up the balance ($7 million)
- The aforementioned Security Protections in the MOU reduce the risk that the city will not receive its debt service payment to close to zero
  - Reduced risk level needs to be taken into account in evaluating the City/County's return on the project

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I-91 Compliance – Substitution Effect is Minimal

- **The first factor here is that it is an undisputable fact that there is no substitution effect on the following:**
  - Sales tax on Arena construction
  - B&O Taxes on the NBA and NHL franchises that would not otherwise exist
  - Leasehold Excise Taxes
  - Increased Property Taxes on the value of the Arena
- **There is minimal substitution for Admissions Taxes**
  - The city does not collect admissions taxes for events at Safeco or Century Link, and the vast majority of competing entertainment options (restaurants, bars, etc.) do not charge admissions tax.
  - The only direct substitution from an admissions tax standpoint is from other events that charge admissions tax, like concerts or movie theaters– and that is minimal.
  - **While other forms of entertainment would be subject to sales taxes, the City's general fund's portion of Sales is just 0.85%, or one sixth the admissions tax rate.**
  - The substitution effect on admissions taxes needs to be reduced further to take into account that over 50% of Arena patrons come from outside the City Of Seattle (30%+ outside the county), which will be close to 100% new tax revenue to the City/County as out of City/County patrons bring their spending/taxes from outside the City/County to within the City/County tax jurisdiction
- **Sales of Merchandise and Concessions Substitution effect is Modest**: While there will be a substitution effect on the sales taxes on Merchandise and Concessions sales in the Arena from City/County arena patrons, substitution does not apply to the patrons that come from outside of the City/County's limits.
- **Accordingly, we believe the "substitution effect" on taxes would be less than 10%, or less than $1 million of the $10-11 million in year 1 tax revenue we are projecting (City/County's is projecting $7 million)**

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I-91 Compliance–City/County Will Receive Ancillary New Taxes

It is an UNDISPUTABLE FACT The City/County Will Receive Incremental Tax Streams that are not a part of the MOU:

- **Sales Tax Revenue From Goods and Services outside of the Arena:** The sales tax on goods (i.e. team merchandise sales outside of the arena) and services (i.e. a drink at a bar after a game) from Arena Patrons from outside of the City/County is almost all incremental.
- **Hotel Taxes:** The city of Seattle receives 0.85% of the tax (County recieves 0.15%), although that is amount is currently deferred until the PFD bonds are paid off on Safeco and Century link.
- **Increased Property Values:** The city will see a further increase in its property tax revenue resulting from increased property values of land surrounding the new Arena. Our group alone has already purchased ancillary real estate surrounding the Arena at a significant premium to its appraised value.
- **Parking Taxes on street parking and non-affiliated lots:** The City will receive parking tax revenues from arena patrons for lots not covered under the city's MOU.
- **Multiplier Effect:** In total the salaries from the direct jobs created by the construction and operations of the Arena and incremental spending brought to the city from out of town Arena guests, will recycle through the local community and create further incremental revenues (as when Arena employees and construction workers spend their income) and thus new taxes for the city of Seattle. While opinions as to the correct multiplier to use vary, the typical range assumed by most economists is 1.5-2.0x
- **COMBINED WE BELIEVE THESE "ADDITIONAL TAXES" WOULD BE WELL IN EXCESS OF $1 MILLION AND SIGNIFICANTLY OUTWEIGH THE MODEST SUBSTITUTION EFFECT AND THUS SIGNIFICANTLY ENHANCE THE CITY/COUNTY's RETURN**

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I-91 – Conservative Return Calculation

- Based on the assumptions above, the annual “cash on cash” return would be calculated by as follows:
  - Total investment of $200 million in year 1
  - Income stream of $14 million growing at 1% per year for 10 years, and flat for years 11-30
  - Land sold for $197 million in year 31 after Arena is demolished (and deducting $30M in demolition costs)
  - This analysis gives no credit for ancillary/out of arena new tax revenue described on the previous slide other than that it will negate the substitution effect

- **Solving for the IRR of this stream of revenues yields an annual return to the city of 7.4%**
  - **If value of ancillary taxes was taken into consideration, we believe the City/Count’s annual return would rise to 8-10% per year**
  - **We believe the City’s annual return is significantly higher than the return on the aggregate private investment in the project**