Request for City Council Committee Action from the Departments of Finance and Community Planning & Economic Development

Date: April 12, 2007

To: Council Member Lisa Goodman, Community Development Committee
Council Member Paul Ostrow, Ways and Means/Budget Committee
Commissioner Lisa Goodman, Operating Committee

Referral to: MCDA Board of Commissioners

Subject: Public Hearing on New Lease and Management of Target Center and Related Agreements

City Council Recommendation:

1. Approve the selection of AEG Facilities, Inc. ("AEG") as the new operator and execution of an Arena Lease, Operating, Management, Use and Assurances Agreement ("Operating Agreement") with AEG as described in the term sheet attached to this report as Exhibit A.

2. Consent to the assignment by Midwest Entertainment Group LLC ("MEG") and assumption by AEG of Arena agreements, assets and obligations as described in this report.

3. Authorize the proper City and MCDA officials to execute these agreements and any related documents necessary to implement the above referenced transactions.

4. Authorize the Finance Officer to transfer funds and adjust 2007 appropriations as necessary to implement the above referenced transactions.

5. Refer this report to the MCDA Board of Commissioners for its concurrence and approval.

MCDA Board Recommendation:

1. Concur and approve the above actions as forwarded.

Previous Directives: On March 10, 1995, the City Council and MCDA Board of Commissioners approved the terms and authorized i) the execution of the Target Center Purchase Agreement and related lease and financing documents, and ii) the issuance of $84,650,000 in bonds.

On May 19, 2000, the MCDA Board of Commissioners authorized the issuance of a Notice of Termination to Ogden Entertainment, Inc. and the execution of an Assignment and Assumption Agreement with SFX Entertainment Corporation ("SFX") and amendments to related Target Center documents for SFX to assume the duties and obligations of "Operator."

On April 2, 2004, the City Council and MCDA Board of Commissioners approved principal terms and authorized the execution of an Agreement Regarding Assignment and Assumption of Arena Lease, Operating, Management, Use and Assurances Agreement by and among the Minneapolis Community Development Agency, SFX, and MEG for MEG to assume the duties and obligations of "Operator."

On June 16, 2006, the City Council and MCDA Board of Commissioners authorized the execution of an Amendment to the Target Center Arena Lease, Operating, Management, Use and Assurances Agreement which included a 90-day termination period for the "Operator" and appropriated $1,200,000 to be used for fifty percent of any operating losses on a monthly basis through June 2007.

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Approved by:	Patrick Born, Finance Officer ______________
	Lee Sheehy, CPED Director _______________
Presenter in Committee:	Patrick Born, Finance Officer

Financial Impact

Actions will require an appropriation increase to the Operating Budget. Actions will use current fund balance.

Community Impact

Supports the City goal and strategic direction: A Premier Destination – Visitors, Investment and Vitality; Leverage our Entertainment Edge.

Supporting Information

Target Center's Impact

Target Center is a significant asset to the entire state. In addition to being the home of the NBA's Timberwolves and WNBA's Lynx, Target Center hosts dozens of first class events each year—from family shows like Sesame Street Live to big name concerts like Elton John, Coldplay, and U2. Every year, more than one million people attend over 200 events at Target Center. These events generate in excess of $3.7 million in sales and liquor tax revenue to the State of Minnesota and $2.0 million in sales, restaurant, liquor, and entertainment tax revenue to the City of Minneapolis as well as parking revenue to the City's parking fund.

In addition to attending Target Center's events, many guests enjoy an afternoon or evening in downtown Minneapolis and frequent restaurants, shops, and hotels. Their impact is felt in terms of street life and at the cash register—local restaurateurs, for instance, often speak of the robust business they do when there is an event in the Arena. Target Center is clearly a vibrant facility and has a vital role to the City, region, and State.

Industry Dynamics and Financial Performance

The Arena Operator's financial performance is being affected by a significant change in the national concert industry and facility competition. Artists and their promoters are demanding greater economic returns and now access revenue streams (such as concessions) that formerly flowed to the operators. In order to book certain events, the Arena Operator has given up revenues and as a result has experienced losses.

Another factor that affects the Operator's financial performance is the reduction of revenue-share as a consequence of existing contractual arrangements that over time have worked to the Operator's disadvantage.

As a result of these market changes and contractual agreements, the operation has seen profitability decline since 2000 and has operated at a loss which is not projected to improve under the current operating structure.

It is important to note that the Target Center situation is not unique. Within the past 12 months, building operators, NBA teams, and government officials in Portland, Seattle, and Milwaukee have been addressing similar financial issues in their facilities.

Preceding Management Changes

There are three key agreements governing the rights and obligations of the three primary stakeholders at the Arena portion of Target Center:

- The Arena Lease, Operating, Management, Use and Assurances Agreement ("Operating Agreement") between MCDA and Operator;
- The Arena Use Agreement ("Use Agreement") between Taylor Partnership and Operator; and
- The Basketball Playing Agreement ("Playing Agreement") between MCDA and Taylor Partnership.

Through the Operating Agreement, the MCDA contracted with Ogden Entertainment, Inc., as part of the Target Center purchase in 1995, to be the Operator of the Arena for a term that ends on June 30, 2025. Ogden had been the Operator for the previous Arena ownership. The Use Agreement allocates Arena use rights and revenues between the Taylor Partnership and the Operator. Because of this critical partnership between the Taylor Partnership and the Operator, the Playing Agreement, which obligates the team to play in the Arena through June 30, 2025, allows the Taylor Partnership to operate the Arena or select an operator acceptable to MCDA in the event that Ogden or its successor is terminated.

In 2000, Ogden announced the pending sale of its entertainment division to Aramark Corporation. Due to the uncertainty of the timing and effect of the pending sale to Aramark, the Taylor Partnership requested that MCDA terminate the Operating Agreement with Ogden and assign the Operating Agreement to SFX Entertainment Corporation. This was authorized by the MCDA Board of Commissioners. Shortly after assuming the Operating Agreement, SFX was acquired by Clear Channel Entertainment (CCE).

On January 30, 2004, MCDA received a request and proposal from representatives of the Taylor Partnership and Nederlander Company to consent to the assignment of the Operating Agreement from CCE to Midwest Entertainment Group LLC ("MEG"), a Minnesota limited liability company formed for the specific purpose of managing and promoting Target Center for the remaining term of the Operating Agreement (June 30, 2025). MEG ownership was comprised 50 percent by an entity comprised of members of the Taylor Partnership (TC Arena Group LLC), and 50 percent by an entity comprised of James M. Nederlander and other Nederlander Company owners (Nederlander West Coast). The assignment had the support of CCE, and MEG assumed the duties and obligations of Operator on May 1, 2004.

In March 2006, TC Arena Group LLC (the Taylor half of MEG) indicated its intent to acquire Nederlander's 50% share in MEG and work in close partnership with the City to improve the performance and competitiveness of the Arena, although they also indicated that it was not their intention to continue long-term as the operator of the facility.

On June 16, 2006, the City Council approved an amendment to the Operating Agreement. The amendment had three key points. First, it granted the Operator the right to terminate the Operating Agreement with a 90-day notice. Second, the amendment obligated the MCDA to pay fifty percent of monthly operating losses through June 2007 with a maximum monthly contribution of $200,000 and a total contribution of no more than $1.2 million. Lastly, as a condition of the MCDA sharing in future operating losses, the Taylor Partnership waived its right to assume the rights and obligations of MEG under the Operating Agreement pursuant to the Playing Agreement.

Current Status

On February 1, 2007, MEG notified the MCDA that it would no longer operate the Arena effective May 2, 2007. In the 2000 and 2004 Arena operator transitions, the Taylor Partnership had requested the MCDA's consent to assign the various agreements to an entity selected by the Taylor Partnership. The current transition differs in that the Taylor Partnership has waived its right to identify a new Arena Operator. Instead, the MCDA must select an operator or manage the Arena itself.

New Management Firm

On February 15, 2007, the City issued a request for qualifications (RFQ) to a number of national and local arena operators including MSE, the operator of the Xcel Energy Center. Responses were due on March 1, 2007. Three firms—AEG, Global Spectrum, and SMG—submitted information and were deemed qualified. After initial discussions, each firm was allowed to conduct a document review and other due diligence at Target Center and was requested to submit a final proposal by March 22, 2007. AEG and Global Spectrum submitted proposals as described below; SMG did not submit a final proposal.

AEG proposed an at-risk management structure which capped MCDA annual losses and contained revenue sharing incentives to improve financial performance and enhance Arena vitality.

Global Spectrum proposed a fee-based management structure which also included incentives.

Both proposers are nationally respected organizations whose responses indicate that they have the experience, capacity and talent to successfully assume management of the facility within the short time-frame available and continue to manage it to high standards.

AEG, however, proposes to share the financial risk with City in a way that protects the City against growth in future annual operating losses and establishes benchmarks to reward improvement in financial and operational performance.

Additionally, AEG - through their affiliate AEG Live – provides the Target Arena with expanded access to a variety of entertainment that would contribute to the vitality of the facility.

For these reasons, an inter-departmental staff group comprised of staff from Finance, CPED and the Minneapolis Convention Center continued with a more detailed analysis and appropriate due diligence, and now recommend 1) the selection of AEG as the new operator, and 2) that the MCDA enter into an operating lease with AEG consistent with the term sheet attached as Exhibit A.

Overview of Key Financial Terms

- AEG agrees that the City's obligation to support Arena operating losses will be annually limited to the amounts shown on Attachment B of the Term Sheet. These limitations are better than the recent average operating losses of the Center and improve yearly through the term of the agreement.

- AEG will make a $2,000,000 one-time upfront capital investment in the Center to fund improvements and enhancements as reasonably determined by AEG and approved by the City's contract administrator.

- AEG will share in improvements to annual net income in accordance with the schedule shown on Attachment B of the Term Sheet which sets a graduated scale that increases the AEG revenue share as specific improvement benchmarks are met.

- This is an 18-year agreement with termination rights by the City in the eighth and thirteenth years if certain financial and performance benchmarks identified in Exhibit A are not met by AEG.

- AEG has an option to terminate at the end of the eighth and thirteenth years as specified in the Term Sheet with notice to be given no later than June 30 of the terminating year. This provides a minimum of 6 months for the City to obtain a new operator if this option is exercised.

These terms alone will not eliminate City subsidization of the Center's operating expense. They do, however, establish a limit to the City's annual obligation which is currently unlimited, and provide financial incentives to the operator for continued financial improvement toward the goal of non-subsidization.

Event Related Terms

AEG agrees to performance benchmarks for their success in providing Center events. As detailed in Exhibit A, these benchmarks apply to the consideration of contract continuation in years 8 and 13.

AEG will open a regional booking office in Minneapolis by September 30, 2007 with an initial staff of no less than 2 people.

AEG will actively and aggressively promote the Center to all other industry promoters and producers of events.

Other Key Terms

A complete list of terms is found in Exhibit A, but other key elements of the proposed terms include:

Non-Compete

AEG agrees to the non-competition language in the prior agreement, but moreover agrees not to pursue any development of a "live-entertainment venue" in direct competition with the Center in Minneapolis, St. Paul or any other jurisdiction within the Minneapolis/St. Paul metropolitan area without the prior approval of the City Council.

Marketing & Sales

AEG will provide a plan for re-branding the Center within 120 days of commencing operations. Upon approval by the City's contract administrator, AEG will implement the rebranding plan. The plan will include but not be limited to: venue image; attendee experience, including food and beverage services; loyalty programs; national, regional and local awareness.

AEG will assist other City facilities, such as the Minneapolis Convention Center, for cross promotional and marketing purposes. Further, AEG will actively participate with Meet Minneapolis in seeking events and promoting Minneapolis and the City venues.

Transfer of Assets and Liabilities

It is anticipated that MEG will transfer existing agreements, equipment and other Center assets and liabilities to AEG as of May 2, 2007. City and AEG staffs have reviewed MEG's agreements, including collective bargaining agreements. AEG intends to assume all of the identified contracts with concurrence, when required, from the City or contractor. Final balance sheet reconciliation will be completed in the next few weeks.

Revenue Reallocation

The City has proposed amending the Arena Use Agreement to reallocate certain commercial rights and revenues in a manner more favorable to the City. The Taylor Partnership is considering the City's proposal, but has not committed to any specific adjustments. AEG and the City have, however, agreed that any changes negotiated by the City prior to the transfer date will benefit the City and any changes negotiated with the assistance of AEG post-closing will be distributed per the revenue sharing formula outlined in the Term Sheet. Staff expects to update the Council in the near future regarding this undertaking.