



>> Sports Franchises and Real Estate KINGSLEY WHITE PAPER

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Sports Franchises and Real Estate: Birds of a Feather?

What does the Empire State Building have in common with the New York Yankees? Well, obviously, both are in New York and both are worth hundreds of millions of dollars. But what about their similarities as investment products?

The recent market for commercial property has been characterized by an extraordinary amount of money chasing real estate, fuelled by historically low interest rates. This has resulted in increasing sales prices that have outpaced the growth of operating income, which in turn has meant that real estate assets have delivered by providing strong asset appreciation as well as steady (albeit increasingly lower) current income yields. Effectively, the link between NOI and value has been stretched as a result of increasing prices and relatively weak leasing fundamentals.

Are institutional investors becoming increasingly attracted to the appreciation play? According to *National Real Estate Investor*, Beacon Capital Partners recently made a \$165 million profit in just 24 months on the sale of the Bank of America Plaza in Los Angeles. This is just one example of the appreciation many institutional investors are seeing and to which others have been attracted. As the magazine points out, hold times for office properties in particular are shrinking, as owners simply cannot resist taking profits as prices rise. Certainly, many institutional investors see real estate as a relatively high current yield investment. But others may be counting more on asset appreciation and less on regular cash flows from operations. This is where professional sports may offer some parallels.

On the surface, an office building and a professional sports brand appear to be very dissimilar assets. For one thing, the vast majority of the value of a sports franchise is tied up in intangible assets, like tradition, player popularity, and competitive performance. The huge amounts of money spent on player salaries, television contracts, and licensing deals are based on these ethereal concepts. For real property, the situation is reversed, with the intrinsic value of the asset tied up in very tangible things: brick, mortar, land, etc.

Yet sports franchises have long operated under similar market conditions as what we now call “unprecedented” in the real estate industry. For example, according to Forbes magazine, the Washington Redskins are the most valuable franchise in the NFL, the most successful of North America’s four professional sports leagues. With a value somewhere near \$1 billion, the Redskins also generate the most income in the league. Even so, the team only yielded a 7% return in 2003, assuming an effective tax rate of 25% and zero debt. As unimpressive as this is, the league average is even worse, at less than 4%. And this for the most financially stable sports league on the continent!

Despite low current yields, sports franchises have historically appreciated in value independently of NOI. Because NFL franchise transaction data is scarce, a good proxy for a typical team’s value is the expansion fee paid by new entrants into the league. In 1992, the Carolina Panthers and Jacksonville Jaguars paid \$200 million each to join the league. Seven years later, the fee was \$700 million for the Houston Texans, an annualized increase of nearly 20%.

Even in the NHL, which recently cancelled its season due to a labor dispute, franchise values are appreciating. In February, Disney sold the Anaheim Mighty Ducks for a reported \$75 million, according to the *Toronto Star*. Considering that they paid \$50 million to join the league for the 1993-4 season, the franchise value increased over 3% annually, and this in a period when operating incomes in the NHL have actually been *negative!*

There are plenty of theories as to why this pattern exists in sports business, but the more fascinating question is why there is a parallel to the real estate industry. Are there operational similarities between sports franchises and property assets that are driving their similar behavior? For example, are blue-chip tenants like star players? Do owners put other tenants (players) at risk to secure their “franchise” tenants? Regardless, the point remains that today’s “unique”

situation in the commercial real estate market has indeed occurred (and is occurring) elsewhere. The example of sports shows that it is possible to have a stable, thriving industry under such conditions over an extended period of time. Understanding this may help real estate investors, owners, and managers avoid critical mistakes in today's market.

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