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Structured Finance and Football Clubs: an Interim Assessment of the use of Securitisation

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ABSTRACT

Securitisation is a financing technique that rests upon a complex legal foundation. Its purpose is to allow companies to raise low-cost finance from the capital markets. This technique has been used successfully in a range of businesses over many years, but it was only adopted by football clubs in much more recent times. Between late 1999 and 2003 there were a number of football securitisations and these raised many millions of pounds for the clubs. The technique appeared to be successful and as a result of this more clubs expressed an interest in securitisation. However, instead of seeing a continuing growth of securitisations in the football sector, the process came to sudden halt in late 2003. A series of insolvencies among football clubs revealed certain weaknesses in the legal and financial structures of football securitisations. These weaknesses resulted in financial losses for some investors and it had the effect of discouraging others from risking their money in future securitisations. This led to

speculation that there was little or no future for securitisation in the football sector. However, it is possible that the recent improvement in football finances and the current benign climate for bond investors may encourage a revival of the technique, particularly if the lessons of past mistakes can be absorbed. Arsenal instigated the largest football securitisation to date, in July 2006, to raise £260 million and there has been press speculation that other clubs may follow Arsenal's lead. Under these circumstances it may be useful to make an interim assessment of the use of securitisation in football. The paper shall examine why securitisations were popular with clubs and why they came to a sudden halt in 2003. It shall then seek to discover what lessons can be learned from football's initial, but traumatic, experience with this financing technique. Finally, the paper shall consider whether there is a realistic possibility that more football clubs might be able to reassure investors that it will be safe to participate in football securitisations in the future.

KEYWORDS

Structured finance - special purpose vehicles - football revenues - securitisation

INTRODUCTION

Commercial companies in the UK have been using a special form of securitisation, called asset backed securitisation (ABS), to raise significant sums of money in the capital markets since the late 1980s (Thompson, 1995, p. 116). As this financial technique has developed in scope and sophistication, an increasing number of businesses have been using it with success (Morrison, 1993, p. 3). The growing confidence of business borrowers and bond investors in the apparent strength and stability of asset backed securitisations in the UK has encouraged football clubs to use this financing technique. Since 1999 a number of clubs have used securitisations as an efficient device to raise millions of pounds, and this money has been principally used to re-develop the clubs' stadiums. 1

The main attraction of securitisation is that it offers the football clubs access to relatively cheap finance, compared to the borrowing terms offered to them by the traditional lenders, such as the banks (Henderson & Scott, 1988, p. 3; Benjamin, 2000, p. 288). As a result, nine football securitisations were carried out between 1999 and 2003. Yet, despite the initial enthusiasm among the clubs and the investors for securitised football bonds, investor confidence in the bonds had evaporated by 2004. The rising rate of insolvency among football clubs (including some of the clubs that had engaged in securitisations) caused most investors to abandon football securitisations. 2

No new football securitisations took place between 2003 and 2006 and this caused some to wonder if the technique would ever be used on such a scale again. However, the recent £260 million securitisation carried out by Arsenal in July 2006, which is by far the largest football securitisation to date, has raised the question of whether there could be a revival of the technique in football. Some investors are clearly prepared to risk their money in football bonds again and there has been press speculation that Manchester United may be keen to follow Arsenal's lead. Improving football finances and a favourable 3

economic climate for bond investments may increase the chances of further football securitisations, particularly for the purpose of retiring expensive debt and replacing it with lower-cost securitised debt. Yet it is far from clear that this will lead to a large scale revival of the technique. At present investors seem to be interested only in the largest clubs with the most loyal supporters, perhaps because they view these clubs as less of a credit risk than the smaller Premiership clubs.

THE ORIGINS AND EARLY SUCCESS OF FOOTBALL SECURITISATIONS: 1999-2003

By the end of 1999 the stock markets' interest in football shares was over. The share prices of many listed clubs fell and then failed to recover. This was largely as a result of the clubs' inability to keep their costs under control (Harverson, 1999, p. 27). Even although there were substantial revenues coming into the game, particularly from the exploitation of broadcasting rights, this was not being turned into increased profits for stock market investors. Instead, most of the revenues were being used by the clubs to buy players in the hope of achieving greater success on the field (Buraimo et al, 2006 pp. 32-35). By the end of 1999, only five of the twenty quoted clubs saw their share price rise and only three of those out-performed the broader market. The majority of the listed clubs saw substantial falls in their share prices. For example, in 1999 Sunderland suffered a 11.9% fall in its share price, Aston Villa saw its share price drop by 21.8% and Newcastle United experienced a 26.8% fall in its share price by the end of 1999 (Harverson, 1999, p. 27). As a result, there was no appetite on the part of investors to put more money into the clubs through equity investments. Yet the clubs continued to need finance, not only to build the strength of their teams, but also to redevelop their stadiums and to invest in other long-term projects such as youth academies for up-and-coming talent. One obvious alternative to equity capital was to borrow the required sums for capital investment from the banks (Morrow, 2003, p. 156). The problem with this course of action was that the banks would want a relatively high rate of return on their loans to reflect the risk of lending to football clubs. They would also typically want to restrict the loan period to between 5 to 10 years (Pennington, 1987, p. 11). The banks would also want security for their loans, in terms of fixed and floating charges over the club's assets, as well as a suitable range of financial covenants, which would restrict the club's freedom of management (pp. 20-24). The restrictive nature of bank borrowing and the relatively limited sums the banks would be prepared to lend for capital projects meant that clubs were willing to consider other options. The main alternative offered by advisors to the clubs was the option of securitisation. This is a special financing technique, which was being employed in other business sectors with a high degree of success (Brinkworth, 2002, p. 13).

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The advantages of securitisation were numerous. This financial technique could lower the costs of borrowing, offer longer-term loans (e.g. up to thirty years), encourage investment from a wider range of investors and offer the clubs' directors more managerial freedom than would be the case with typical bank covenants (p. 14). With the availability of long-term securitised funds, clubs would no longer have to finance their capital investment by short-term bank loans, but could match their long-term debt obligations by long-term revenue streams (mainly from gate receipts). Working capital could therefore be used to finance shorter-term investments such as buying players (Morrow, 2003, p. 158). Securitisation is also a technique that can be used by both public limited companies and private limited companies; thus Everton, Manchester City, Ipswich Town and Norwich City were able to raise funds through securitisation by means of private placements with a limited number of large investors, and this could be regardless of their private company status.

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WHAT IS SECURITISATION?

John Deacon gives one of the clearest definitions of securitisation as a concept (Deacon, 2004). He defines securitisation as:

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(T)he process of converting cash flows from underlying assets or debts (receivables) due to the originator (the entity which created the receivables) into a smooth repayment stream, thus enabling the originator to raise asset-backed finance through a loan or an issue of debt securities—generically known as asset-backed securities or ABS—which is limited recourse in nature to the credit of the receivables rather than that of the originator as a whole, and with the finance being self-liquidating in nature (Deacon, 2004, p. 1).

In law, the basic arrangements that are normally required to create a successful securitisation involve the originator selling the receivables to a bankruptcy remote special purpose vehicle (SPV), which in turn pays for these rights by issuing bonds or commercial paper (e.g. fixed and floating notes) on the capital markets. In football securitisations, the originator is the club; the receivables are usually gate receipts and hospitality revenues, and the special purpose vehicle is normally a private company.

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In the standard asset-backed securitisation structure used by most businesses, the originator will seek to ensure that the special purpose vehicle is insolvency remote from the originator by incorporating the SPV as a separate company and avoiding or minimising the organisational links between the two entities. This strategy normally works efficiently because in the UK, the principle of the separate personality of a

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company is one that has been strongly endorsed in the British courts ever since the *Salomon* judgment ([1897] AC 22). Even within seemingly closely interconnected groups of companies the individual companies that make up the group still enjoy separate corporate personality in law and the courts do not lightly disregard that principle and lift the veil of incorporation as is evident from cases such as *Woolfsen v Strathclyde Regional Council* 1978 SC 90 HL, *Adams v Cape Industries* [1990] Ch 433, *Lonrho Ltd v Shell Petroleum Co Ltd* [1980] 1WLR 627 HL and *Re Polly Peck International plc (in Administration)* [1996] 2 All ER 433. As a consequence, it is unlikely that creditors of the originator will be able to make successful claims on the assets of the SPV should the originator become insolvent. This corporate structure also serves to lower the credit risk for investors and helps to improve the credit rating of the bonds that are subsequently issued by the SPV.

The potential investors in securitised football bonds may be persuaded to buy the bonds if they are rated as 'investment grade' securities by the credit rating agencies and therefore offer investors reasonable rates of return. Credit rating agencies such as Moody's Investor Service, Fitch and the Standard & Poor Corporation provide investors with an assessment of the riskiness of the securities by assigning grades to securities. Each agency has its own grading system, but generally, a triple "A" grade means that the company issuing the bonds has an extremely strong capacity to pay its coupon on time and the risk of default is negligible. However, low grades from BB to D indicate that the securities are very risky. In Fitch's grading, a C grade means "default is imminent." Thus, in order to get a suitable rating as "investment grade" bonds, the credit risk of the SPV in a football securitisation structure must be very low. This can be achieved in a number of ways, including credit enhancement measures, which need to be put in place at the time of the deal. Credit enhancement can take various forms, such as a bank letter of credit to back the issue, or by issuing bonds in tranches, with the junior tranche bearing the risk of all the initial losses, leaving the senior tranches with a much-reduced anticipated default rate (Davidson et al, 2003, pp. 294-297). In a football securitisation the club may purchase the junior tranche to reduce the risk for the senior bondholders. Another form of credit enhancement is over-collateralisation. Over-collateralisation occurs where the pool of assets is of greater value than is needed to support the payments due to the investors. This is designed to help to ensure that if there is a shortfall in the cash expected from the revenue-generating assets, there should be surplus funds available within the SPV to cover that shortfall (Thompson, 1995, p. 25).

However, securitisation structures come in a variety of different forms in order to meet the needs of different types of businesses. In the case of football, the securitisation model that has been employed differs somewhat from the standard asset-backed securitisation described above. The reason for this stems largely from the type of cash flow selected by the clubs to pay off the debt. Clubs do not tend to have a significantly large static asset pool of contractual debts to securitize. Instead, their main source of revenue still tends to come from ticket sales. Therefore, in most football securitisations the most important selected cash flows are the anticipated future gate receipts, usually supplemented by hospitality income. The utilisation of such cash flows by the clubs makes sense financially because the long-term future revenues would be helping to pay off the low cost, long-term finance that the club has raised to fund modernisation or expansion of the club's stadium (Morrow, 2003, p158). However, the traditional asset-backed securitisation structure, which tends to be based upon a discrete pool of existing revenue generating assets (e.g. contractual obligations), may not be appropriate for football's finances. The particular models of securitisation that have been selected by the football clubs as being the most appropriate models for utilising anticipated future cash flow are the so called "secured loan securitisation" model and the "whole business securitisation" model.

THE SECURED LOAN AND THE WHOLE BUSINESS SECURITISATION STRUCTURES

In the secured loan structure there can be no true sale transfer of assets to a SPV as will be the case in most ABS-type arrangements because of the nature of the cash flow. However, the lack of a true sale transfer could be risky for investors and may act as a disincentive to invest, unless the general operating cash flows associated with the football stadium (the club's main collateral) can be effectively ring-fenced from the claims of other creditors of the clubs. The goal of avoiding the credit risk of the football club (and its parent company) is usually achieved by means of a secured loan. Stuart Brinkworth, a lawyer who is involved in football securitisations, has described the typical legal structure adopted by the clubs. The parent company that owns the football club creates a subsidiary company ("Stadco") to hold title to the stadium. The football club then leases the stadium from the new company and covenants to play its home games in the stadium. Stadco then borrows the required sum of money for the securitisation from a SPV. This SPV would have been set up by the parent company to issue bonds or notes in the capital markets. The loan is secured in favour of the SPV by Stadco granting security (i.e. mortgage) over all its assets supported by an unsecured guarantee from the football club and also by a secured guarantee from the parent. The parent guarantee would be secured by a fixed charge over its shares in Stadco together with a light weight floating charge over all of its assets, which is only enforceable if steps are taken to place the parent in liquidation (Brinkworth, 2004, 23). Finally, the SPV would grant a security over all its assets

in favour of a trustee for the investors.

With the revenue generating assets thus ring-fenced from the general creditors, the structure can be rated by the credit rating agencies and the bonds can be issued in various series to allow for differing repayment terms and maturities. The bonds or notes can also be issued in different tranches, which would allow the clubs to raise the sums of money in instalments to match their need to make periodic payments to the builders of their stadiums at various stages of the each stadium's development. The great advantage of this securitisation structure is that it allows a club to retain control over its business. In addition, it prevents gross over-collateralisation because any money that comes from the gate receipts and hospitality income, which is not used for debt service or for a debt reserve fund, should flow back to the football club. Thus, the club retains the surplus cash generated by the asset as well as the residual value in the asset itself at the end of the financing (Brinkworth, 2002, p. 14). 12

An alternative to the secured loan structure is the whole business securitisation. This is a more recent development in football securitisation. The first (and so far the only) whole business securitisation has been that of Norwich City (in April 2003) with its £15 million securitisation (Eversheds, 2003). This was an interesting securitisation because £7.5 million of the sum raised went to increase the capacity of the stadium and the other half of the fund was used to re-finance the club by clearing the club's costly short and medium term debt. The whole business securitisation technique uses a variant of the concept of a secured loan rather than a true sale structure (Davidson et al, 2003, pp. 459-460). The essential difference between the two models is that in a whole business structure it is the cash flows from the entire range of operating revenues generated by a whole business, or a segregated part of a larger business, that are securitised. Deacon defines the nature of the whole business deal as a " transaction [that] does not attach to certain contractual payments over time (as is the case with mortgage or auto loan transactions) and does not operate within a particular contractual framework (such as the customer card agreement for a credit card transaction). It also cannot be defined by means of eligibility criteria (as in the case of future flows receivables), but rather attaches to the general cash flow arising from a business" (Deacon, 2004, p. 173). This means that a wider range of assets could be offered to support the securitisation, which in some cases might lead to larger sums being raised. However, this type of deal can also be more costly to establish because of, *inter alia*, the additional legal costs of setting up the appropriate corporate structures to manage the cash flows and the additional costs of arranging the necessary credit enhancements and appropriate covenants to achieve a high credit rating from the credit rating agencies. 13

The structure of the whole business securitisation is very similar to that of the secured loan model insofar as the aim of the structure is to ring-fence the operating cash flows from both the claims of other creditors of the club and from the risk of the club's insolvency. The basic structure of the WBS rests upon the parent company of the club incorporating a wholly owned subsidiary to hold all the shares in a second subsidiary, which operates the business, owns the assets and borrows the money from the SPV. The SPV will also be a wholly owned subsidiary of the parent and it will act as the issuer of the bonds and its memorandum of association will restrict its activities to the activities required by the transaction. The bondholders obtain security for this deal by this corporate group granting the investors fixed and floating charges over all of the group's assets. Often the securities are not given to the SPV directly, but to a security trustee who holds them on trust for the SPV. The SPV will typically give a fixed and floating charge over all of its assets to the security trustee, who will hold that security on trust for the bondholders. This structure is also likely to be supported by an unsecured guarantee from the football club and a secured guarantee from the parent. 14

THE COVENANTS

A key element in a securitisation structure is the loan agreement between the operating companies and the SPV. The covenants within this agreement play a crucial part in helping to reduce the risk for investors. Both types of securitisation structures will require the parent company, the football club and Stadco to sign various covenants to reassure the investors. These covenants would consist of financial covenants (i.e. undertakings restricting the level of indebtedness of the group and undertakings restricting the level of dividend payments by the parent, etc) and operational covenants (e.g. undertakings restricting the business operations of Stadco). According to Brinkworth (2002, p. 14), the investors would typically want to restrict the level of debt that the group as a whole could incur to a certain fixed percentage of its consolidated income after excluding the gate receipts. Investors would also demand restrictions on the level of dividend payments made by the parent. The amount of debt that a club would be allowed to incur will usually be reduced if the football club is relegated because the investors naturally fear that relegation will lead to a fall in revenues for the club. Investors will also want a debt service reserve to be created by Stadco to protect them from payment defaults. From Brinkworth's findings, the amount set aside for the debt service reserve is typically, "at least 50% of the next payment of interest and principal due" (p. 15). The other standard terms would include covenants promising to conduct the business in a proper and efficient manner, and not to make any changes to the nature of the 15

business without the approval of the bondholders. In addition, there is often an obligation to furnish copies of audited accounts and also non-audited quarterly or half-yearly accounts to the trustee for the bondholders (Pennington, 1987, p. 21). However, because the focus of the secured loan securitisation is on the gate receipts, the football club has normally been given more flexibility in the operation of its general business than would typically be the case with bank loans (Brinkworth, p 15). This has given the clubs an opportunity to borrow against other revenue streams, such as media payments and sponsorship deals.

THE BIG CLUBS EMBRACE SECURITISATION

Although other businesses in the UK have been using asset-backed securitisations as a method of obtaining relatively low cost financing since the late 1980s/ early 1990s, it took until the end of 1999 for the first securitisation to take place in football. In December of that year Newcastle United securitised its gate and hospitality receipts for the sum of £55 million (Weston, 2002, pp 50-51). Other clubs soon followed this lead. By the end of 2001, five clubs raised the following sums from asset-backed securitisations: Ipswich Town (£25m), Leicester City (£28), Southampton (£25m), Everton (£30m) and Leeds United (£60 million) (Garrahan, 2002b, p. 23). Manchester City completed a securitisation deal with Bear Stearns in the period 2002-3 for a total of £44 million in two stages (Garrahan, 2002a, p. 17) and Tottenham Hotspur concluded a £75 million securitisation in November 2002 (Garrahan, 2002c, p 21). In April of 2003, Norwich City concluded its £15 million whole business securitisation deal and there was speculation that more securitisations would follow by the end of that year. In the summer of 2003 it was reported in the press that Chelsea was on the verge of launching a £120 million securitisation, but this plan was abandoned shortly before Roman Abramovich bought the club (Garrahan, 2002c, p. 21). In addition, some of the other clubs that had thousands of dedicated supporters who were ready to turn up to matches regardless of how badly their team was performing on the pitch were receiving favourable investor attention as being good potential candidates for securitisations. For example, in 2003 Liverpool was reported as being interested in using a securitisation to build a new £80 million stadium in Stanley Park (Credit, 2003, p. 1). So the demand from the clubs for this type of financing was growing steadily. Unfortunately for these clubs, the market for securitisations dried up between 2003 and 2006 because investors lost interest in football bonds following the insolvency of some of the clubs that had engaged in securitisations.

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WHAT WENT WRONG?

There are a number of reasons for the precipitous fall in the number of football securitisations. By 2003 it became plain to investors that football securitisations might not be robust enough to protect them from the credit risk associated with the companies that operate the football clubs. The typical covenants supporting these securitisations proved to be largely ineffective when some of the clubs could not meet their repayment obligations. The result was that in some cases the bondholders found that they were unable to extract themselves from the declining financial fortunes of the clubs without suffering serious financial losses. To preserve their financial stake, these investors had to become involved in the financial recovery of the clubs in question. In the case of Leeds United, which was the biggest financial failure among the securitised football clubs, the investors did in fact suffer significant financial losses when they tried to realise their claims in order to be able to exit the business. This experience has made investors much more wary of football securitisations.

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The problems with football securitisations became apparent when Leicester City and Ipswich Town went into administration and when Leeds United, teetering on the brink of insolvency, defaulted on its repayments after reporting a pre-tax loss of £50 million at the end of 2003 (Garrahan, 2003, p. 22). The reasons for these difficulties were structural, economic and managerial. Many clubs had spent too much of their money on buying new players and on paying increased wages to the existing players. They did this either to ensure that the club in question stayed in the top league, or to enable the club to remain in the upper echelons of the league and thus take part in the lucrative European competitions. Leicester City, Ipswich Town and Leeds United were prime examples of clubs that had spent too much money on players. In the case of Leicester City, its financial difficulties began when the club was relegated from the lucrative Premier League and its general revenues fell significantly. Leicester City, like so many other clubs was heavily reliant upon its gate receipts and its media revenues to operate its business. When the club was relegated it had hoped that its parachute payments from the Premier League and its expected share of the new media revenues for lower league clubs would enable it to rebuild its squad and thereby help it to regain its place in the top league. A considerable portion of this money was expected to come from the collective sale of broadcasting rights to ITV Digital, which promised to pay the lower league clubs a total of £315 million (Morrow, 2003, p. 18). However, the collapse of ITV Digital in 2002 and the consequential loss of much of its anticipated revenue meant that Leicester could no longer meet its financial obligations and the club went into administration (Owen, 2002, p. 22). The collapse of the ITV Digital deal also pushed the relegated Ipswich Town into administration for similar reasons when its reduced revenues were insufficient to pay the players' wages (Morrow, 2003, pp. 18-19).

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In the case of Leeds United, its financial difficulties stemmed largely from poor management decisions rather than the trauma of relegation. The club had spent a substantial part of its £60 million fund on its players. The aim of the club was to qualify for the Champions League competition and thereby earn an estimated £15 million from the tournament. This, of course, was something of a gamble and unfortunately for Leeds United, this gamble did not pay off. Leeds United failed narrowly to qualify for the European competition and the resulting shortfall in its funds meant that it had to sell off some of its best players to maintain its working capital. The financial woes of Leeds United were compounded when it started to lose matches as a result of fielding a less competitive team. Fewer supporters were prepared to attend matches to watch the team lose and Leeds United began to tumble down the league – and towards insolvency. This ultimately caused it to default on its securitisation repayments (Brinkworth, 2004, p. 22). 19

When these clubs got into financial difficulty the investors had thought that the various covenants they had in the original agreement would protect their interests in the event of default, but this proved not to be the case. The main financial covenant was the limitation on the level of debt that the football club could incur. But under these existing securitisation structures the clubs were allowed to borrow sums up to £10 million (and even in some cases up to £20 million) in additional debt (p. 22). This level of indebtedness was permitted because the expected revenues of the clubs were estimated to be considerably in excess of that which was required to service the securitised loan. What the bondholders had not expected was that so much of this excess revenue would be spent on players' wages. In the ten years leading up to these securitisations, football revenues had soared. There had been a relentless rise in the amount of money flowing into the game from television revenues, bigger crowds, better sponsorship deals and a much more professional approach to merchandising (Johnson, 2001, p. 62). Deloitte and Touche estimated that the average turnover of the English Premier clubs has gone up by 500% in the decade to 2001 (Deloitte & Touche, 2002). Unfortunately for the investors, wages also rose relentlessly and these payments would eventually exceed the revenues of some clubs. Ultimately it would be this imbalance that would jeopardise a number of securitised deals. However, at the time of concluding these deals, the bondholders felt secure because of the perceived strength of the secured loan securitisation structure in minimising credit risks. Under this securitisation structure, if a club became insolvent, the bondholders had the ultimate power to enforce their security by seizing the stadium if they could not recover their money in full from the credit enhancement measures or third party guarantees. In theory, the stadium could be operated by the bondholders (through a receiver) as an independent company. Unfortunately, the operators of a football stadium may find it difficult to find ways of generating revenues from it beyond hosting football matches. One problem would be that no other football club would want to use the stadium, apart from the current football club. Other possible options for the use of the stadium are also fraught with potential difficulties. The stadium could perhaps make money as a venue for pop bands, but outside the very large urban areas, it is not likely that any pop band on a tour of the provincial towns and cities would be able to fill the stadium. So the option of raising revenues from leasing the stadium to others might not help the bondholders very much. The other option for the bondholders would be to sell the stadium for re-development. In some cities, like Edinburgh and London this may be profitable, but in other towns and cities the clubs may not be in the most desirable areas for redevelopment, even if planning permission were granted by the relevant authorities. In addition, any attempt by the bondholders to destroy a stadium to clear the land for other uses would inevitably meet a great deal of local hostility and generate a lot of bad publicity for the bondholders. This is because local teams are usually valued as being symbols of the civic pride of the local area (Morrow, 2003, p. 1). Normally, faced with these difficulties the bondholders may have little option but to negotiate with the insolvent club to help it out of its financial difficulties. In doing so the bondholders may hope that they might recover a reasonable portion of their money. In the case of Leicester City Football Club, the bondholders did, in fact, renegotiate the loan to keep the club afloat. However, they also took ownership of the stadium to secure repayments from leasing the stadium back to the club. By doing this the investors became tied to the playing and financial fortunes of the club, which was not their original intention when they bought the securitised bonds (Brinkworth, 2004, p. 24). 20

What these examples proved to investors was that the financial covenants they had accepted as a means of minimising credit risk were not strict enough to prevent the clubs from damaging the revenues on which the success of these securitisations depended. It also showed that the attempts by the investors to ring fence the operational assets from the credit risk of the football clubs had been ineffective. With the benefit of hindsight, it is clear that the investors had under-estimated the peculiar risks associated with football securitisations and over-estimated the level of security they had against the various risks that might arise in football. There could be a number of reasons for this misjudgement. Investors may have focused too much on the positive aspects of these securitisations and paid insufficient attention to what might happen if things go wrong. The football bonds seem to offer good returns and the early securitisations of Newcastle United and Southampton proved to be very successful. These highly successful securitisations served to dispel any initial concerns that the football industry posed special risks for investors. The securitisation structures that were used in football were based on the models that had been used successfully in other commercial securitisations and these seemed to be robust in the general commercial context. The basic structure seemed to offer layers of protection for the investors, ranging 21

from covenants on financial ratios to provisions for over-collateralisation. Seizure of the stadium was seen as an action of last resort, to be used only if all the other protective devices failed to operate effectively. Many of the significant investors were American institutions and it could be argued that they might have failed to appreciate fully how volatile the cash flows of the football industry can be, especially for relegated clubs. In addition, it is not unknown for sophisticated investors to include a great many covenants in their agreements and then to over-estimate the protective value of these covenants. For example, in 2005 some of Europe's biggest investors lost money on bonds they purchased from commercial companies because these investors failed to anticipate the negative effects on their bonds caused by some leveraged buy-outs of investment grade companies by private equity buyers. What began to happen was that some of the companies acquired by private equity groups had their corporate credit ratings reduced to non-investment grade status. This meant that the bonds began to be traded at a level significantly below par. It then became apparent that despite the existence of a large number of covenants in these loan arrangements the investors had no protective covenant covering this particular event, despite the fact that private equity groups had been buying large public companies for some years before the increasing scale of their operations provoked this crisis for bondholders (Oakley, 2006, p. 41).

COULD THERE BE A REVIVAL OF FOOTBALL SECURITISATIONS?

Three years after what many football club directors would hope to be the nadir of football securitisations, changed economic conditions could help revive their use. There has been an improvement in the general investment climate as far as bonds are concerned and there is a rising demand for securitised issues by investors. Although much of this demand is currently focused on mortgaged-backed bonds and asset-backed bonds from commercial companies, the climate may be favourable for a return of securitised football bonds as investors seek new and potentially more profitable investment opportunities. Secondly, there has been an improvement in the revenues flowing into the game since 2003. Thirdly, the football clubs, chastened by their financial failures, are showing signs of becoming more aware of the need to act commercially to control costs and boost revenues. Indeed, some clubs are proving to be quite imaginative in seeking additional sources of income. Finally, lessons can be drawn from past mistakes to make future securitisations more attractive to potential investors. However, one of the biggest obstacles to a revival of this method of financing remains the strategic orientation of the clubs that seek this particular form of finance. Clubs have been criticised for failing to act like normal, profit-maximising businesses. In the competitive sporting environment, the goal of the clubs has been success on the field, almost regardless of the cost. This would need to change for the simple reason that loss-making businesses are not good prospects for securitisations. Let us now consider each of these issues in some detail. 22

There is now a greater market for securitised bonds and the European Securitisation Forum is forecasting another record-setting issuance year for 2006 with an expected €325 billion being raised in Europe (up 15% from 2005) (European Securitisation Forum, 2006, p. 1). In the wider economy, many institutional investors (and particularly the pension funds) have been moving some of their money out of equities and into the gilts and bonds (Skypala, 2005, p. 3). There is now a strong demand for suitably rated corporate bonds and for securitised issues from both domestic investors and institutional investors from abroad (Davies, 2006, p. 43). 23

There are also some signs that there has been an improvement in football revenues. The Deloitte and Touche Annual Review of Football Finance for 2006 reported that the English Premiership produced revenues of almost €2 billion in 2004/5 and it forecast continuing revenue growth for the Premiership clubs of around 6% for 2006/7. The Review also predicts that by 2007/8 overall revenues for the twenty Premiership clubs will be in excess of £1.7 billion, largely as a result of the increased revenues expected from the recent sale of broadcasting rights to Sky and Setanta. Furthermore, the Review notes that costs are now being held in check by the Premier League Clubs with most of these clubs showing operating profits for 2004/5. Furthermore, if Chelsea is excluded from the aggregate figures, the Review claims that most of the Premiership clubs are profitable at a pre-tax level for the first time since 1998/99. In addition, the Review notes that "for the first time in the history of the Premiership, total wages and salary costs fell," although the fall was in fact only 3%. 24

With this favourable economic background there are also some signs (however faint) of a growing commercial awareness in football, at least among some of the larger clubs. There is evidence that some clubs are seeking to exploit new opportunities to increase their revenues. If revenues can be improved it may be easier to avoid insolvency and repay the securitised loans. In addition, new or improved revenue streams beyond those coming from gate receipts could be used to support a whole business securitisation, if these new cash flows were sufficiently strong and predictable. The issue here is whether the revenue-generating initiatives in football are sufficiently widespread to convince potential investors in securitisations that the clubs are becoming more business-like in their outlook. 25

There is some evidence that some clubs are willing to think more imaginatively about exploiting their brands and are entering into joint ventures or other commercial relationships to boost revenues. To 26

provide a few examples, Glasgow Rangers recently assigned the rights to sell the Rangers merchandise to JJB Sports for a lump sum of £18m and a minimum annual income of £3m over the next ten years in order to reduce the club's debt and to provide funds to invest in the team and in new facilities (Magee, 2006, p. 1; Gibbons, 2006, p. 70). Meanwhile, Manchester United entered into a joint venture with Ladbroke, the bookmaker, for an online gambling venture (Davies, 2001, p. 23). Most clubs have invested in their Internet sites, and the big ones in particular are now able to reach fans all over the world who might buy their merchandise. The emerging technology would also allow the clubs to broadcast clips of their matches or the goals scored in key matches via the fans' mobile phones for a suitable fee.

In a further effort to increase revenues, some clubs have been prepared to diversify into other business ventures. Sheffield United runs health and fitness clubs and is considering buying a football team in China to exploit the country's growing interest in the sport (Wilson, 2005, p. 24). Kilmarnock FC owns and manages hotels, as does Chelsea (Morrow, 2003, pp. 27-28). The success of these ventures could encourage others to do the same. However, this strategy is not without its problems. There is always the risk that these attempts at diversification may not prove to be profitable. As Morrow notes (p. 196), Tottenham Hotspur failed to make a success of the sportswear and women's fashion business with which it became involved in the late 1980s. 27

There is the prospect of significantly more money coming to the game as a result of the recent sale of broadcasting rights through the improved competitive bidding structure, demanded by the European Commission. The European Commission was worried about the dominance of BskyB and has changed the structure of the sale for broadcasting rights for three seasons starting in 2007/8. Under this new arrangement the Premier League sold the rights to live football in six balanced packages of 23 similarly attractive matches. No bidder was allowed to win more than five packages, in an attempt to ensure that there would be at least two rival broadcasters of these matches. In the auction that followed, Sky paid a total of £1.3 billion for four packages to show 92 live games, and Setanta paid £392 million for the remaining two packages with the rights to broadcast 46 Premiership matches. This auction increased the Premiership's broadcasting revenues by a staggering 66% (Owen and Terazano, 2006, p. 15). 28

Thus, the general economic outlook and the recent revival of football finances would seem to provide a propitious setting for a revival of football securitisations. 29

LEARNING FROM THE PAST

It should be possible for investors to learn from the mistakes of past securitisations and insist on new measures that better protect their interests if they decide to take advantage of the improving finances of football. 30

One of the most important lessons has been that the secured loan securitisation structure has failed, in practice, to protect bondholders from the credit risk of the football club. This is because the gate receipts from the stadium were inextricably linked to the wider fortunes of the club. In future, the bondholders will have to seek additional covenants to reduce their credit risk. For example, in the past the level of permitted indebtedness for the clubs has proved to be too high. This problem could be solved if the investors were to reduce the financial ratios or even to insist upon an absolute cap on the player/wage turnover ratio (Brinkworth, 2004, p. 23). Furthermore, the investors may wish to design covenants that ensure that the money raised in future securitisations is applied to long-term capital projects and not spent on players wages, as happened in the case of Leeds United (Weston, 2002, pp. 51-52). 31

Investors could also prevent clubs from claiming any excess revenues in the securitisation deal through better covenants. These excess revenues can arise from the following situation. Where the clubs have securitised their gate receipts based on the existing capacity of the stadium this would allow the club to benefit from extra revenues as the stadium expands and more ticket purchasers are accommodated. In the past some clubs have been able to keep the additional revenues that have resulted from the expanded capacity of the newly refurbished stadiums (Brinkworth, 2004, p. 24). This can be easily prevented in the future by a suitably worded covenant. 32

Investors could also reduce their exposure to the risks of default by insisting upon over-collateralisation, so that there will be more assets available to them in the event of a default and by insisting on the issuer providing financial guarantees to support the bonds. Another lesson of the past is that investors would need to be more careful in their selection of clubs. Most of the difficulty that investors have experienced has come from clubs that have been relegated or have been in danger of relegation. Investors would need to be wary of investing in such clubs in the future. Another issue that could be addressed is the degree of managerial discretion enjoyed by the directors of the club. In the securitisation arrangements the clubs have been allowed a great deal of flexibility in the operation of their general business, but this would need to change. For example, investors may want to place tight controls on players' contracts and wages to avoid the problem of salaries exceeding revenues and thereby putting the investors' interests at risk. 33

Potential investors are also likely to demand higher returns on their investment to compensate them for accepting the extra credit risks that have been associated with football clubs in past securitisations. All of these could make securitisations more expensive and less flexible for the clubs. The key issue would then become whether the clubs would be prepared to enter securitisation transactions with all of these new limitations and additional costs? Clearly, much would depend on how much a club really needed this type of financing and its ability to repay the securitised loan.

BOND REPAYMENTS AND THE CONFLICT BETWEEN COMMERCIAL AND SPORTING GOALS

One major unresolved issue is the extent to which those football clubs that wish to use securitisation are also prepared to act like normal commercial businesses by focusing on controlling costs and producing profits. Profit generating businesses are more likely to be attractive to potential bondholders. Where there have been conflicts between the commercial goals of a football club and its sporting ambitions, football directors have traditionally tended to give priority to achieving success on the field, sometimes regardless of the cost (Stone, 1980, pp 31-34). As Mr Perez Farguell, the managing director of Barcelona Football Club once said, "I know that if we win a cup, the whole town will celebrate; but if we have a budget surplus, nobody cares" (The Economist, June 2002, p. 7). This attitude would have to change, if investors are to be encouraged to invest in securitised football bonds. Although costs are coming under control and revenues are set to rise further for the top clubs, financial discipline may be hard to enforce in a competitive league. Another problem is that some of the larger clubs are now owned by very rich men whose priority is to create successful teams. These rich owners are not constrained by the need to produce profits to satisfy shareholders and this lack of restraint can have an inflationary effect on players' wages. Furthermore, as long as the football rules permit clubs to bid for the best players there will always be the tendency for some clubs to over-spend in the hope of gaining success on the field. One foreseeable problem with future securitisations is that the level of repayments on very large securitisations like that of Arsenal's may reduce the money available to the club to buy new players and this, together with the more exacting covenants, may restrict the club's ability to raise wages beyond a certain level to retain good players. This could place those clubs with securitised debt at a competitive disadvantage compared to those clubs financed by rich benefactors. The clubs with rich owners may operate with virtually no pay constraints and may well acquire the best squads. If this were to happen then the clubs with the securitised debts might ultimately fail, both in football terms and in financial terms. Such clubs may start to lose games regularly against stronger opponents and as a consequence there is a danger that the fans begin to drift away.

RECENT DEVELOPMENTS

One important recent development that may affect the future of whole business securitisations (and by implication the secured loan structure) is the Enterprise Act 2002 (which came into force in September 2003). The effect of this Act on securitisation transactions is likely to restrict the number of clubs that can reasonably consider this type of securitisation. Indeed, future securitisations are likely to be the preserve of the richest football clubs. The reason for this is simple. Under the previous law (the Insolvency Act 1986, s. 10(2)(b)), the holders of the floating charge could veto the appointment of an administrator and appoint a receiver to run the business. This was a valuable right because even although the receiver would normally have to have regard to the interests of the creditors generally, as well as of any employees of the business, his main task was to put the interests of his debenture holders first. This enabled the investors to recover as much money as they reasonably could to diminish the sums owed to them. However, under s. 72A of the Enterprise Act, bondholders with floating charges have lost the power to control the insolvency proceedings. The floating charge holder is now prohibited from appointing an administrative receiver. Instead, an administrator must be appointed for the benefit of all the company's creditors, and a moratorium will be put in place to give the administrator time to rescue the business, if this is possible.

An important exception to this rule specifically concerns securitisations. Under s. 72B (the "Capital Market" exception), bondholders with floating charges can appoint an administrative receiver, but only if the deal is worth at least £50 million. This is a high threshold for the vast majority of football clubs. Five of the nine football securitisations before 2003 were significantly under that figure and few clubs have the exploitable brand names and the high numbers of loyal supporters to be able to produce the revenues that would enable the club to afford the repayments on securitisations at, or above this minimum level.

The other significant recent development was the £260 million Arsenal securitisation, launched in July 2006. It confirms that the recent combination of propitious economic circumstances and improving football finances have indeed encouraged investors to think again about football securitisations. Furthermore, as we analyse the Arsenal deal it will become apparent that past mistakes have been avoided by making sure that the deal is over-collateralised, guaranteed by a triple "A" rated insurer and subject to strict covenants with appropriate liquidity provisions. However, the stadium remains the ultimate security for the deal and to that extent investors still have an interest in the club's success on the

field of play and its impact on attendances.

Arsenal's aim was to refinance the expensive debt it incurred in building the Emirates Stadium with a new crowd capacity of 60,000. With the lump sum of £260 million raised by the issue of fixed rate and floating rate notes, Arsenal paid off its existing debts and replaced them with lower cost securitised debt saving around £1.2 million on annual interest payments (Murray-Wilson, 2006). The Arsenal securitisation is a secured loan structure, based on anticipated ticket revenues over the next 25 years. However, it also resembles a whole business securitisation insofar as fixed and floating charges are placed over other sources of revenue, such as the income from broadcasting rights and sponsorship deals to support the loan repayments, if the gate receipts should happen to fall, perhaps as a result of the club's failure to qualify for the Champions' League, or perhaps as a result of the club being relegated (Reuters Business News, 29th June 2006). There are appropriate covenants in place to protect investors from the possibility of the club becoming over-indebted to other creditors and thereby jeopardising the repayments to securitised bondholders. There are covenants to restrict the amount that can be paid in dividends to the club's shareholders and covenants to protect the investors against prepayment risk. There are also the standard covenants to ensure that the stadium, as the ultimate collateral for the deal, is properly maintained and insured. The Royal Bank of Scotland and Barclays Capital are providing liquidity facilities to the SPV to cover any seasonal variations where the operating business's income may not be enough in a particular period to cover the full amount of the interest payments due under the loan agreement. Under this arrangement the banks will provide funds to cover any shortfalls (for a suitable fee) so that the bondholders can obtain smooth and regular repayments. 38

The investors have also been reassured by the fact that Arsenal obtained a third party guarantee (or "credit wrap") from Ambac Assurance to support the securitisation. Ambac Assurance is an AAA rated insurer and this has helped the SPV to obtain investment grade status for those notes from the credit rating agencies. 39

One special feature of this securitisation is that Arsenal incorporated a public limited company, Arsenal Securities plc, to issue the notes publicly. This is the first time that this has been done in football and this has drawn in a wider group of investors, some of whom are new to football investments. In contrast, all the previous football securitisations have been privately placed with a very limited number of institutional investors (e.g. just three or six big investors) and some of these former investors are now very vary of football securitisations. 40

The robust structure and the apparent success of this largest ever securitisation may encourage other clubs to offer investors similar deals. There has been press speculation that securitisation may be used by Malcolm Glazer, owner of Manchester United, to refinance some of the £500 million debt he incurred in his highly leveraged purchase of the club in 2005 (Walsh 2006, p. 4; Murray-Wilson, 2006). The plan would appear to be a securitised loan structure based on gate receipts. However, some worry about the potential size of the securitisation, which is anticipated to be larger than that of Arsenal's. The repayments on a multi-million pound securitisation will be very high and this may mean that there is relatively little money left over to buy new players. There is a concern that this could have a negative impact on the club's competitive success on the field and could possibly reduce attendances at Manchester United's games. 41

CONCLUSIONS

It would appear that securitisation is still likely to be an option for football clubs. The Arsenal securitisation has encouraged clubs, financiers and investors to consider the prospect of further securitisations, especially if these deals are high value deals. The question remains as to how many clubs might be in a realistic position to engage in securitisations. The Enterprise Act has, in effect, made securitisations more expensive, with investors likely to demand that any future deals be over the £50 million threshold. This threshold figure is likely to deter the majority of football clubs from commencing securitisations because of the higher costs of such deals and the higher level of repayments required from future revenues. According to a number of financiers who have worked on football securitisations, there may be a very limited number of clubs with the necessary credit and cash flows to be able to securitize at that level. Some think that only eight to ten Premiership clubs might fall within this category (Credit, 2003, p. 1). 42

Investor appetite for future securitisations might similarly be restricted to a small number of potential investors because, despite improvements in insurance, credit enhancement provisions, and covenant protection, securitisations in the football sector are still more risky than in other business sectors. The deals ultimately depend upon the clubs' successes on the field. These sporting successes are necessary to generate sufficient future revenues to finance the repayments terms of the securitisations. Unfortunately, based on past experience, football finances have proved to be highly volatile because some clubs have experienced mixed results on the field of play (Buraimo, et al, 2006, pp. 29-46). Furthermore, success on 43

the field still remains the true prime purpose of the clubs rather than the goal of maximising shareholders' returns. Thus, potential bondholders are probably right to be wary about buying bonds from a business sector that lacks a proper profit motive. If investors do decide to buy football bonds or notes they are probably also correct to demand credit enhancements, high returns and strict conditions on their investments, even although these exacting demands may discourage some clubs from participating in securitisations. The lessons of the past have shown that the risks associated with football investments can only be minimised, but not eliminated, and that the ring-fenced securitisation structures cannot completely isolate the bondholders from the clubs' fortunes on the field.

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