ISSN 1744-0718 [Print]
ISSN 1744-0726 [Online]

THE UNIVERSITY *of* LIVERPOOL
MANAGEMENT SCHOOL

Structured Finance and Management in the English Football Industry: The Rise and Fall of Securitisation

David Brookfield and Rory Miller

No. 2006/26

Research Paper Series

Management School
University of Liverpool
Liverpool, L69 7ZH
Great Britain

Structured Finance and Management in the English Football Industry:
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David Brookfield and Rory Miller
University of Liverpool School of Management

Abstract – We investigate the incentives for active management of financial resources and the accessing of securitised finance in a football industry context and reject the conclusions that conventionally arise regarding the motivations for firms in raising this particular form of finance. Our first objective is to assess the nature of private debt provision in the English football industry where questions of covenants, collateral, and asset quality take on a particular meaning that led to the growing use of securitised finance. Second, we examine how financial covenants function and the use to which bankruptcy remote financial vehicles have been applied to protect investors from technical default, and make an assessment of their role. Third, we assess the possible impact of securitisations on groupings of stakeholders that are likely to arise as a function of the particular debt form and suggest that issues of governance might be one important factor in influencing the variable success that has been a feature of this form of financing. Finally, in the light of technical default, we examine the actual functioning of asset quality in its collateral role, arguing that problems relating to asset specificity have possibly been underestimated in the case of this particular industry.

Keywords - football; private debt arrangements; securitisation; structured finance; sports finance.

1. Introduction

The high profile financial collapse of Leeds United early in 2004 led to questions concerning the interaction of debt finance and management capacity in circumstances where the implications of novel financial architectures and occurrence of corporate failure appeared not to have been fully recognised. The novel arrangement in question was the use of securitised financing in an industry that had limited experience of such deals although, in the context of the private debt market as a whole, the United Kingdom has become a leading proponent of its use in Europe[1]. Management in the football industry has received increasing academic attention from the 1990s but it remains relatively understudied in the literature possibly because the industry does not meet the conventional requirements of academic models that pre-suppose a profit or other easily identifiable business objective. Our study is designed to address this by offering a broader assessment than conventional analysis might in circumstances that relate securitisation and corporate failure to the capacity of mid-sized firms in a changing and growing business sector to manage their financial resources.

Our basic position, that we go on to develop, relates the motive for active management of financial resources to a football industry context. In securitisations, the rights to business income streams are typically sold to raise a capital sum and in the football industry this has typically involved the sale of income streams arising from match ticket sales. The finance so raised has been used mainly for stadium development with the stadium itself acting as collateral. From a conventional financial perspective, Skarabot (2001) has demonstrated that securitisations optimise corporate structure under fairly broad conditions. Hill (1997) suggests that the decoupling of the collateralised asset and associated risk from the pool belonging to the firm can also lead to an enhanced valuation of the firm because of the resolution of the information asymmetry problem (highlighted by the market for 'lemons' in Akerlof 1970), that would give rise to underpriced assets. This is explored in Iacobucci and Winter (2005) who explain that, in an efficient capital market, the partitioning of risk does not, of itself, alter the (accurately calculated) average risk perception that capital providers have of an organisation and hence, securitisations cannot alter the cost of capital to the firm which is an average measure. What is needed, they argue, is an information asymmetry problem that is resolved by such partitioning thus leading to a reduction in the 'lemon' premium that adds to the cost of capital of organisations. We develop this notion in the context of explaining how risk partitioning facilitated investment in football clubs but that, ultimately, this approach had built into it structural flaws that were needed at precisely the point where risk was supposed to be partitioned; that is, at the point of financial failure. In a managerial context, the incentive for managers to engage in securitised financing is that it makes more clear and demonstrable their role in the achievement of organisational outputs or goals thus leading to higher performance related remuneration. This view arises from the evidence of successful securitised financing in that it is those parts of the business that are relatively immune to active management intervention and generate relatively stable sources of income that are most likely to be the subject of securitised financing. This suits both lenders and borrowers. For managers, incentive payments are potentially enhanced as their contribution to the achievement of organisational goals is clearer and, for borrowers, low risk and stable parts of the business are built-into the contractual agreement underpinning a securitisation. Our point of departure, however, is that the history of business management in football is not preconditioned on a track record of profitability and we reject the managerial incentive idea on the grounds that performance related pay that is affected by financial structures as an unlikely scenario. More compelling, as we will argue, is the (almost) desperate need to compete at the highest levels and the consequential ill-judged risks that both lenders and borrowers were able to agree involving securitised financing. Thus, in the following section we outline the theoretical rationale for the growth in use of securitised financing and then place this into context with the development of the football industry in recent years and how the needs for such financing emerged. We then discuss the detailed architecture of securitisations used in the football industry before considering case examples of successful and unsuccessful deals. We extend this discussion further by examining the changing role of stakeholders as financial crises develop and indicate how structural deficiencies in such deals were exposed. Our final conclusions and assessments are then made.

2. Securitisations

Skarabot (ibid) identifies three main requirements for a successful securitisation: steady (low volatility) cash flows to service the debt (volatility matching with outflows); charged assets that require little or no managerial involvement (minimum management costs); and a verifiable asset (unambiguous asset value) that could be used as collateral. Subject to the collateralised asset satisfying the basic conditions of a securitisation, the resulting credit enhancement should lead to lower interest costs. This is demonstrated theoretically in Flannery et al (1993) who develop a model of a firm with uncertain risky projects and debt financing and a choice is exercised over available corporate structures for new projects, namely either to maintain projects within the firm as part of a portfolio and raise finance on the combined, diversified cash flows, or to incorporate a single-project venture separately and raise finance on its own specific cash flows.[2] Their conclusions are consistent with the outcome of asset securitisation structures in that it is optimal for the firm (i.e. it enhances firm value) to incorporate separately for projects that have different risks from others that it holds. The single-project ventures have usually taken the form of businesses incorporated for the sole purpose of managing cash flows from the securitisation and taking legal ownership of any collateral. These ventures are generally known as special purpose vehicles, or SPVs. Such a structure assists in the resolution of uncertainty regarding the project cash flows when decoupled from the portfolio of risks held by the firm with the aim of reducing the marginal cost of capital for the project cash flows. Such decoupling of risk has been a particular feature of securitisations in English football. Written in the aftermath of football club flotation but before the advent of more sophisticated methods of debt finance, Szymanski & Kuypers (1999) and Dobson & Goddard (2001) pay little attention to the financial management of football clubs. Morrow (2003) highlights some of the dangers of securitisation, mentioning the Leicester City and Leeds United cases as examples, but was written at a time when a fuller evaluation was not possible. Brinkworth (2002), a corporate lawyer closely involved in structuring securitisation agreements, describes the mechanics from the perspective of a practitioner stressing their advantages. Indeed, he concludes by stating that ‘as long as the media continue to give football the degree of coverage it now enjoys, and corporate sponsors continue to spend huge sums trying to leverage such exposure, it [securitisation] is certainly here to stay’, but not with the fervour with which the first securitisations had been welcomed after the financial collapses that are the subject matter of this paper. The academic literature on management structures and capabilities in football, which is poorly developed anyway, has concentrated on areas such as marketing and sponsorship, or the aspects of risk and crisis management associated with the stadium disasters of the 1980s, ignoring financial management (Elliott and Smith, 1993). Szymanski & Zimbalist (2005) briefly outline financial crises in European football, but analyse the Leeds United case without ever mentioning the club’s debt structure and its resolution.

Our approach hereafter is to consider the use of securitisation in the football industry with two objectives in mind. First, to explore some of the difficulties associated with securitisations, and in particular the problems arising from asymmetric information among borrowers, lenders, and intermediaries. Second, to explore the reasons for the variable outcomes of securitisation, and the insights that this might offer with respect to governance and management in the English football industry, and, by extension the capacity of firms, intermediaries, and lenders to evaluate risk in conditions of rapid expansion and change in a high profile industry.

3. The Financial and Commercial Revolution in Football

The commercial revolution that occurred in English football during the 1990s is normally ascribed to two key events: the Taylor Report following the Hillsborough Disaster of 1989 which recommended that all clubs in the top divisions of British football should convert their stadia into all-seater facilities, and the foundation of the Premier League in 1992 together with the associated BSkyB television contracts.[3] The first such contract, paying the Premiership clubs a total of £40 million a season over five years, was four times the fee previously paid by ITV, but it was dwarfed by the subsequent BSkyB/BBC contract covering the seasons 1997-98 to 2000-01, which gave the twenty Premiership clubs a total of £125 million per season for their collective TV rights (Dobson & Goddard 2001).[4] Financial resources on this scale, helped by official grants, allowed clubs to convert their stadia into much more comfortable places to watch football. The persistent decline in attendances that had taken place since 1949 was reversed, despite much higher ticket prices . Total attendances at Premiership games increased from 9.8 million in its first season to 13.5 million a decade later despite a reduction in the number of games from 461 to 380 (Rollin & Rollin 2003); by then most Premier League clubs were operating at near capacity and many were seeking to fund further stadium improvements or new construction as a result. Along with the growth in attendances, the increase in the turnover of the leading clubs was also striking. The average income of a Premier League club rose from £9.3 million in 1992-93 to £23.2 million in 1996-97, at the end of the first TV contract. By 2002-03, after the first year of the third, even more lucrative, TV contract, it had reached £62.3 million (Deloitte & Touche 2004).

In the middle of the 1990s two further developments occurred. First, the Bosman ruling of 1995 awarded players the right to freedom of movement once their contracts ended, and removed the limitations on clubs fielding 'foreign' players in European competitions. Premier League clubs began to recruit large numbers of overseas footballers, at the cost of a rapidly increasing salaries bill. Then, in 1997-98, the leading European club competition, the Champions' League, was expanded to include teams other than the national champions.[5] As with the Premiership, cleverly planned TV exposure and marketing increased the financial rewards for competing in Europe, stimulating many clubs to pursue the places that could open the way to glory. However, it was not just at the very top level that the financial and commercial revolution occurred. Clubs in Division 1 of the Football League (the second tier of the English league system) also shared in the expansion of demand: attendances there rose from 5.9 million in 1992-93 to 8.5 million a decade later (Rollin & Rollin 2003).[6] Even after relegation to Division 1 popular clubs like Sunderland or Manchester City could still command home attendances averaging between 25,000 and 30,000 a match.

Until the mid-1990s football clubs and corporate financiers hardly came into contact. Clubs were funded by a combination of equity investors and bank overdrafts, and capital investment in new facilities was minimal (one of the reasons for the stadium disasters of the 1980s). However, the growth in clubs' revenues in the 1990s attracted the attention of City institutions. In the mid-1990s 15 English clubs listed on either the London Stock Exchange or AIM (the Alternative Investment Market) (Szymanski & Kuypers 1999).[7] However, the trend to flotation ended abruptly in 1997 once it became clear that most clubs, with the exception of Manchester United, were unlikely to make significant profits due to rapidly increasing player costs. Share prices fell markedly, making financing devices such as IPOs and rights issues unattractive. In the late 1990s outside injections of capital came primarily from media companies such as Sky, NTL and Granada. This brought around £240 million into clubs, but ended once the new Premiership TV contract was awarded in summer 2000. In addition, media companies such as NTL and ITV-Digital themselves ran into financial difficulties, and the payback period for investment in football clubs' internet sites, one of the reasons for their investment, proved to be much longer than anticipated (Banks 2002, Deloitte & Touche 2003).

In this context, with UK interest rates at their lowest levels since the 1960s, new forms of debt finance were developed. Finance houses like Lombard North Central offered medium-term asset finance, while specialised companies like Registered European Football Finance (REFF) began to finance the purchase of players through off-balance sheet sale and leaseback facilities, frequently backed by insurance against default (Morrow 2003). However, by far the most significant source of new capital was securitisation, which accounted for over £350 million of outside investment. Table 1 shows the principal deals that occurred between the first at the end of 1999, and the end of 2003 when the bulk of the research for this paper was undertaken.

Insert Table 1

From the perspective of the financial markets securitisations on this scale do not represent large sums. Few investment banks would consider deals of less than £100 million worth the arrangement costs, and so the market became very specialised with, in effect, two intermediaries, Stephen Schechter, who worked in various capacities, and the US-owned bank, Bear Stearns.[8] It is significant that both these intermediaries have extensive US connections, allowing them to place bonds with insurance companies and pension funds both in Britain and the United States. The most frequent form of securitisation was to borrow for stadium construction or improvements against the income streams arising from increased gate receipts and hospitality income. Interest rates were normally set at between 200 and 300 basis points over rates for gilts. In the financial market conditions of 2001-03 this meant that most clubs were therefore borrowing for income-generating stadium improvements at between 7 and 8 per cent.[9] A further point to note is that securitisation did not depend on the ownership structure of the club: both listed plcs and private companies carried out securitisations, although the latter were slower in doing so.

Table 1 suggests that as a rule of thumb most securitisations were for sums roughly equivalent to the annual turnover of the club at the time of the contract; in cases where annual turnover was significantly less, as at Newcastle United and Southampton, the anticipated increase in revenue from new developments apparently offset the risk. However, the effective floor of around £15 million for a securitisation, given the arrangement costs, did mean that the number of English clubs able to afford such a deal was limited. Although all twenty Premiership clubs were well above this level in 2001/02, only seven Football League clubs exceeded it: even before the collapse of the ITV Digital television contract in the summer of 2002, the average club in Division 1 had an income of only £12.4 million,. Putting this into the context, therefore, of the 92 professional league clubs in England, less than a third of them operated on a scale that would justify securitisation, and only a proportion of these required financing for stadium or other projects of a size that would interest a conventional investment bank. Football securitisation thus became a niche operation, but nonetheless it offers important insights into private debt transactions.

4. The Structure of a Securitisation in Football

The basic architecture of a securitisation deal is to structure an asset class within the originating firm into an identifiable, homogeneous pool to enable collateralisation and facilitate risk assessment by investors. A decoupling from the general class of assets is then required to isolate the risk from the originator's overall exposure. In football, the securitisation of football club gate receipts, in particular season tickets, has normally been the identifiable income stream from which the debt has been serviced and the collateral has been in the form of the stadium.[10] Clearly, the stadium, of itself, required no particular homogenisation since the asset class was unique. Decoupling ownership of the stadium and determining the pathways by which gate receipts were employed to service the debt was then brought about by the legal structure of the agreement. The available collateral, the debt covenants and its trigger points then set the parameters for the risks faced by investors in such deals.[11] Conventionally, covenants are related to the income streams used to service the debt. In the case of football this would typically involve covenants to protect the income-generating asset (normally the stadium), restrictions on overall indebtedness to protect the ability of the club to service the debt, and restrictions on distributions to shareholders. There were also dynamic elements to the covenants (trigger points) that came into effect should certain conditions apply (for example, if a team was relegated, lower overall indebtedness might be required). The major advantage for football clubs was that securitisations allowed debt issues to be rated for credit largely independent of the credit quality of the originator.

Taking the case of a securitisation contract based on a stadium financing and the income from gate receipts, the normal structure of the transaction is shown in Figure 1. This was easily transferred into the football industry from other securitisations in the entertainment industry, and it remained largely unchanged between 1999 and 2003.

Insert Figure 1

The key to the financial structure is the separation of the stadium as an income-generating asset into a bankruptcy-remote SPV in the form of a separate stadium company managed by the club. Both the club and its holding company also guaranteed the loan.[12] Supporting this structure and guaranteeing the bondholders' income required the establishment of a complex series of bank accounts. The club had to keep a sum equivalent to twelve months' coupon payments in a debt service reserve account, in effect tying up this cash for the life of the agreement. In addition, the filling of a separate debt service account to cover the next year's payments took priority in the allocation of income from ticket sales and corporate hospitality.[13] A further level of complexity was added by the need to set aside Value Added Tax from ticket sales and hospitality income in order to make quarterly payments to the UK tax authorities, and, in certain competitions, to share gate income with visiting clubs or the organising bodies. A series of lock-gates between these accounts thus restricted the free cash that the football club could use: some informants reported that the complexity of the arrangements was beyond some of the commercial banks which had previously held football club accounts.

What did investors look for before committing funds? In practice they were concerned most with long-term data on ticket income and attendances, rather than overall earnings; they also had to be assured that these would survive possible relegation from the Premiership, especially in view of the substantial loss of media and commercial income that would normally accompany relegation.[14] In the case of Newcastle United, the first securitisation, the club had to produce matchday attendance figures going back to 1892. It also had to guarantee, as part of the securitisation contract, that it would never play home matches outside the city of Newcastle-upon-Tyne, a clause that reflected US investors' experience of sports franchises moving from city to city. While paying some attention to standard financial information and projections, therefore, investors were particularly interested in the resilience and loyalty of a club's fans in the event of poor performance and relegation. In the words of one Finance Director, 'investors were buying into the club's fanbase'. This was the underpinning for lending to clubs like Newcastle, Southampton, Everton, and Manchester City, clubs known for their long-term capacity to sell season tickets whatever the performance of the team.

5. Methodology

To investigate the workings of securitisations in the English football industry, we adopt a case study approach. By providing a detailed illustration of the dynamics of private debt funding in a specialised sector, we examine the specific relevance of more general hypotheses, particularly, for example, by extending the conventional distinction between tangibles and intangibles into a discussion of the failure of collateral as a consequence of asset specificity in which both tangible *and* intangible assets play a role. Our perspective provides insight into the qualitative differences of funding sources and contract detail, including the functioning of key variables such as asset specificity; the interaction between debt covenants and covenant triggers; the reason for covenant breach as opposed to its statistically observable evidence in terms of covenant triggers being exceeded; and the renegotiation of debt terms in the face of corporate failure. These are all difficult to capture when evidenced on the basis of averages over company groups or within companies over long periods of time.[15]

Over the period from September 2003 to May 2004 we interviewed a number of senior figures within the industry, including club finance directors, two insolvency practitioners, a commercial banker experienced in lending to leading clubs, and two investment bankers who had extensive experience of securitisation and other forms of structured finance. The interviews each lasted approximately two hours: they were normally conducted in the interviewees' offices and took a semi-structured form based on the issues outlined in the appendix. Our principal concerns related to the details of private debt agreements and how they were tailored to the specific funding and risk profile of clubs. Given the concentration of deal making and financing, we were able to discuss aspects of all English securitisations that had taken place with representatives of all the key stakeholders except for the ultimate lenders themselves. Most of the interviews took place on the basis of anonymity, and we did not have access to commercially sensitive information.

The following section examines two contrasting cases of high profile clubs that have undertaken securitisations and look particularly at how risk is assessed in this context and how debt contracts are structured to respond to this assessment. Section 7 analyses the impact of the recent history of securitisations on major stakeholder groupings. Our broad conclusions are that in cases of financial stability stakeholders derive positive benefits from securitisation. However, in circumstances of financial distress, it appears that asset specificity locks the borrowers into the industry to the point where they either have to accept losses and exit, or else become quasi-equity stakeholders in a football club's playing success. The competitive environment of European football means that the margin between success and failure is slim and unpredictable and the consequent financial risks are magnified: this may not have been fully understood by investors, especially those based in the United States that have participated in financing securitisations in England and accustomed to a sports business structured in a very different manner from European football.

6. Two Contrasting Experiences: Newcastle and Leeds

The question with which this research commenced at an empirical level was why securitisation had been adopted as a financing device in football, in view of the industry's notorious financial difficulties and the inability of most clubs to make profits. The question that followed was why some securitisations appeared to have been successful, laying foundations for both playing and commercial success, while others had run into problems. The contrasting experiences of the clubs that undertook the two largest securitisations highlight this.

Newcastle United employed securitisation to meet its pressing need for long-term finance to complete the modernisation of the St James's Park Stadium. The club's holding company, Newcastle United plc, was floated on the London Stock Exchange in April 1997 but had indicated in its prospectus that it did not envisage further share issues. In any event, shortly afterwards the stock market began to turn against football. To meet its long-term financing requirements, therefore, the club began to seek tax-efficient alternatives to the traditional means of financing such construction schemes, 8-10 year project finance arranged through commercial banks or specialist finance houses. Following two years of negotiations Newcastle undertook the first securitisation in the English football industry in September 1999, placing £55 million with six UK and US insurance and pension funds, secured on gate receipts and hospitality income and repayable over 17 years. The capacity of St James's Park was expanded from 36,834 at the beginning of the 1999-2000 season to 52,193 at the beginning of the 2002-03 season (Rollin & Rollin 1999 and 2002). Gross income increased from £44.7 million in 1998-99, the last season before securitisation, to £70.9 million in 2001-02, in part as a result of the increased gate receipts and catering income generated by the stadium development (Deloitte & Touche 2003).[16] In 2002-03 Newcastle's gross earnings, as a result of playing success and increased media revenue, increased further to £96.7 million, and the club posted a pre-tax profit of £4.4 million (Deloitte & Touche 2004).

While Newcastle's securitisation appears to have worked, with interest payments well covered by the increase in receipts, that of Leeds United, the biggest such operation in English football, apparently contributed significantly to the club's financial collapse. In September 2001 Leeds borrowed £60 million over 25 years from three lenders in the US and the UK, primarily to refinance outstanding debts and fund player acquisitions. In the words of the chairman responsible, Peter Ridsdale, Leeds were 'chasing a dream', but it was one that appeared realistic to most observers since the club had reached the lucrative semi-finals of the European Champions League in April 2001. Strengthening the playing squad with youngish incomers whose transfer value was likely to increase, it seemed, would assure European success for the club over the next few years. The dream quickly became a nightmare, however. Leeds had narrowly missed out on a place in the Champions League for 2001-02, and the following summer, having failed again to secure a Champions' League place, the club was forced to raise money by selling a star player, Rio Ferdinand, to Manchester United for a reported sum of £31 million . Shortly afterwards the transfer market unexpectedly collapsed, reducing the value of the players Leeds had purchased with borrowed funds, and the finances of the club steadily disintegrated. Many of the players who had brought the club European success in 2001 departed at fire-sale prices.[17] After posting the largest annual pre-tax losses in English football history in 2002-03 (£49.5 million against revenues of £64.0 million), Leeds ended 2003 desperately trying to raise short-term finance to avoid being placed into administration. In March 2004 a refinancing scheme was eventually put in place, which involved transferring the club to new owners following debt reduction arrangements. Apart from the shareholders the principal losers appear to have been the finance houses which had provided funds for player transfers, in particular

REFF's insurers, Gerling, together with the three investors in the £60 million securitisation, M&G, Teachers, and Metlife, who were reportedly paid off at 20 per cent of the face value of the bonds (*Soccer Investor Daily Bulletin*, 22 March 2004). Without redemption of the securitisation, rescue would have been impossible since the new investors required control of the stadium to provide collateral for fresh funds.

These two cases provide quite contrasting experiences of securitisation in the English football industry. Some academic commentators have accused the Leeds board of financial naivety over the negotiations that led to the securitisation and the subsequent purchase of players (Gerrard 2003b). Certainly, Leeds used their securitisation not for long-term asset development, but for refinancing existing debt and in particular for purchasing players whose value was, under UK accounting regulations, written off over the term of their contract. In other words, this was a clear example of asset/liability term mismatching with borrowing over the long term to purchase assets with a short life, colourfully described by one Finance Director as like 'mortgaging your house to the hilt to buy a clapped out Ferrari'. However, the real problem with the transfers lay in the increased salary costs that they generated. In other words, the securitisation itself was the indirect rather than the direct cause of Leeds' problems. What it did was to give the club freedom to borrow further and this in turn sharply increased its costs (in the form of salaries to which it was committed over long contracts).

Apart from Leeds, two other clubs which negotiated securitisations, Leicester City and Ipswich Town, also ran into serious financial problems and were forced to go into administration following relegation from the English Premier League in 2002 and the collapse of the Football League’s broadcasting deal with ITV Digital. In these cases, unlike that of Leeds, the bondholders were protected and the value of their collateral preserved. Other clubs, however, such as Newcastle United and Southampton, appear not only to have experienced few problems but also to have used the loan finance to provide a foundation for sustained revenue growth.[18] While the Leeds example, therefore, should not be used to condemn football securitisations out of hand, the growth of the crisis and its dénouement do raise further questions about securitisation as a financing device.

7. Risk Assessment, Covenants and Special Purpose Vehicles

The clear motivation for football clubs to enter a securitisation deal was to access sources of funds not otherwise available, especially at the price at which they could be borrowed under such a contract: in financial terms clubs had to reallocate asset risk to match funding sources, which is a well-known motivation to enter securitisation deals generally (Thomas, 1999).

Broadly, the risks faced in a securitisation relate to credit default, interest rate movements, and prepayment risk. Credit default rests ultimately with the originator (borrower) although this is almost entirely determined in the detail of a securitisation agreement. The risk can be lowered by greater participation, or recourse, by the originator in the securitisation deal and by various other credit enhancement mechanisms such as management of cash flows through prioritised ‘lock gates’ and by equity participation in the SPVs set up to manage the risk exposure to the investors. In the United Kingdom securitised bonds are typically fixed rate, at an agreed spread above gilts, and hence interest rate risk is borne by the investors. Prepayment risk arises from early repayment of a loan in a securitisation when investors expected the loan to mature at some time into the future. This expectation may be formalised as part of the agreement, but financial difficulty of the originator may force early repayment irrespective of the agreement’s clauses. When prepayment risk crystallises, investors face cash flow disruption, search costs for reinvestment, and a net reduction in income should long-term interest rates have fallen between the date of the original loan agreement and the date of repayment.[19]

The incorporation of a separate company that owns and manages the cash flows from a securitisation has happened in all football club securitisations in England. In the case of a securitisation to undertake ground improvements, for example, the stadium will be separated into a bankruptcy-remote SPV. Within the SPV, the complex arrangements surrounding a securitisation deal relate to the management of cash inflows to match the payments required under the funding instrument. In addition, assets are secured within the SPV to provide collateral to the investors. The objective of the collateral arrangements is therefore to secure the cash flows entering the SPV with account management techniques to ensure the smooth passage of funds via various lock gates that satisfy both risk and debt servicing objectives. The requirement to translate the securitised cash flows to those resembling the requirements for the debt financing instrument is essentially one of mapping cash flows from a complex organisation into one easily understood by investors, thereby resolving some of the uncertainty referred to in Flannery et al. (1993). Consequently, the debt instrument becomes marketable and manageable within the context of a broader investor portfolio. Moreover, the configuration of club cash inflows into the SPV to the tailored requirements of cash outflows for the benefit of debt holders is a characteristic feature of structured finance and satisfies the requirement for transparency relating to liquidity risk that also helps resolve some of the uncertainty.[20]

Disengaging risk and associated liquidity from a club's relatively stable income streams into an SPV will normally leave the remaining risk more volatile given the (almost) certain probability that the securitised cash flow and the unsecuritised cash flows have a correlation of less than 1. In such circumstances, asset or cash flow disengagement into an SPV as a means to raise further finance will, on the one hand, be value decreasing for the club as the co-insurance effect of diversification is reduced whilst, on the other hand, it will be value increasing since the post-tax cost of debt is clearly lowered.[21] This is particularly important for loss-making clubs that would not otherwise be able to utilise tax allowances relating to interest payments.

More broadly, risks surrounding the securitisation relate to the satisfaction of future cash flows against contractual performance (Kane, 1997). In particular, the allocation of risk will be determined by the securitisation agreement. For example, the lowest interest costs will be achieved by risks being absorbed by the originators (i.e. the clubs) and thus an element of recourse theoretically enhances credit quality.[22] Kane refers to the 'credit enhancement mechanism' that might typically be incorporated into securitisation agreements, which, in an English footballing context, have been in the form of partial recourse to the club; investment by the club of a subordinated interest in the SPV thus directly formalising a recourse element; or by third party guarantees. Contracts with recourse elements to the originators underpin bankruptcy remoteness, described by Okabe (1998) as a technique that enables the isolation of catastrophic risk thus leaving the residual risk to be securitised with a higher credit rating.

Such an argument fits football clubs very well since, as Dobson and Goddard (2001) state, 'through most of the history of English football, profit making clubs have been very much the exception and not the rule'. Recent experience suggests that catastrophic risk in football does not have an insignificant probability associated with it. There was a particularly acute risk associated with relegation from the Premier League: of the twelve clubs relegated between 1999 and 2002, precisely the point at which most securitisation activity occurred, five entered administration at some point during the next three years, while the remainder, for the most part, struggled from one crisis to another and proved unable to regain their place in the Premiership.[23] However, Thomas (1999) argues that firms involved in securitisations increase their value the *lower* is their credit-worthiness. This view is justified on the basis that the funds raised are employed in positive NPV projects and that, within the portfolio of poorly performing income streams, the one that is securitised has, in fact, the potential for high credit quality once de-coupled from the morass of the non-securitised cash flows.

The use of an SPV is also intended to ensure that, in the event of covenant breach or bankruptcy, the debt providers indisputably own the charged assets. In theory this avoids the potential costs associated with bankruptcy in that the SPV could, subject to detailed covenant terms, declare the debt repayable, liquidate the charged asset, and repay the debt holders.[24] Certainly, some US literature (Frost 1997; Hansmann and Kraakman 2000) has employed this result in the context of explaining the trust/corporate structure surrounding a securitisation. A distinguishing feature of a securitisation compared to a conventionally secured straight debt is that the SPV structure removes the collateral from any bankruptcy process of the club itself (thus ameliorating bankruptcy costs and potential risk of conflict over secured asset ownership in the event of bankruptcy). In practice, investors in the debt issue are granted security over all the assets of the SPV as represented in the senior debt that is the securitisation via a trust in favour of the investors.

While the arrangements regarding the establishment of the SPV and associated bank accounts are not confidential, the banking covenants and their trigger points remain somewhat obscure. The most obvious relate to the ratio between net operating revenues (EBTIT or EBITDA) and interest payments, and the total worth of the club (in terms of its share capital and reserves).[25] In some cases restrictions have also been placed on the proportion of a club's gross income spent on salaries. The lenders also require frequent reports on projected income from ticket sales. Relegation would normally trigger changes in the required ratios. This leaves the club free to obtain normal commercial overdrafts, and also to secure other forms of asset finance for further capital expenditure or incoming player transfers as long as the group's assets are not charged.[26] However, the redemption penalties on the securitisation loan are high, which effectively locks up the cash in the debt service reserve account for the duration of the loan unless changes in inflation or interest rates provide an incentive to both parties for renegotiation.[27]

8. Securitisations, stakeholder groups and technical default

8.1 Stakeholder groupings

The evidence of the English football industry offers conclusions that differ somewhat from earlier research based primarily on the United States. We do not wholly separate investors and originators, as other authors do, since in practice the securitisation agreement binds their fortunes in many inseparable ways. In our view, transactions of the kind undertaken in the football industry alter both the reality and self-perception of originators and investors since the essence of the debt agreements with partial recourse to the club, the fact that the quality of debt collateral is so deeply bound into playing success, and the peculiar financial distress costs that have emerged in certain cases, blur the boundaries between debt participation and equity participation. Investors, although nominally investing in debt, may become equity participants by force. We do separate the role of intermediaries since we believe their role to have particular characteristics in these cases.

To some extent the problems for the investors, a significant proportion of whom were US-based insurance and pension funds, lay in the extent to which they understood and factored into their calculations the special features of the football industry. First, the objectives of football clubs, as Sloane (1971) explained in a seminal article, lie not in profit maximisation but in utility maximisation defined by playing success and a sufficient level of financial solvency to maintain the club in existence.[28] These are inter-related. Continuing solvency may be heavily dependent upon playing success on the pitch, since a losing team will suffer shortfalls in anticipated media, sponsorship, and merchandising income, even if it is not actually relegated. Attendances may also fall, although if a club depends heavily on season tickets this may not have a substantial effect on cash flow until renewals in May/June of each year. Second, and this may be a particular problem for US investors accustomed to hermetic sports leagues and franchises, in terms of a club's overall income the costs of failure, whether it is failure to obtain a place in the Champions' League or relegation out of the Premiership, are sudden and substantial.[29] Decisions on both may come down to the last minute of the last match of a nine-month season. The substantial loss of media and commercial income that results has an immediate impact on cash flow, even though gate receipts for a well supported club may not be reduced significantly by relegation.[30] Moreover, until very recently medium-term salary costs, which form the bulk of a club's outgoings, have normally approximated fixed costs, due to the length of player contracts and the absence of downward performance adjustments in their salaries. A further problem for those used to US sports is that in Europe clubs participate in multiple competitions during a season , in knockout cups as well as in leagues, and a good cup run or an early and unexpected exit can also make cash flow much more volatile. Third, transfers are by far the largest operations, other than stadium construction, that the club undertakes, with the result that in the Premier League a small operating profit for the average club before transfers frequently turns into a net pre-tax loss once they are taken into account.[31] Given these particular features of football in Europe, there is a clear potential for information asymmetries to arise, especially in the case of non-European investors.

These factors mean that playing success and financial success are intertwined, and this enhances the risk to investors. Success in retaining spectators whatever the fortunes of the team may provide the long-term underpinning for the securitisation, but the cash flow problems that can result from a sudden change in match results may mean that the only way to preserve the security of the loan is to put the club into administration in order to carry out a financial restructuring. In other words the early investors may have expected that they were buying the fan base of the club and the revenue that it generated; what happened in practice was that they were also buying into playing success, at least at the margin, though to nothing like the extent of the unsecured creditors. In the case of Leicester City and Leeds United it was the loans taken out to purchase new players and the consequent increase in salary costs that were the root of the problems the clubs faced once results deteriorated.[32]

8.2 Technical default

Underlying the motivation to acquire funding is the requirement to satisfy stakeholders in football clubs, an essentially complex mix. However, by far the major advantage to the club is that it accesses an investor base that would otherwise be unavailable.[33] Also, the impact of a securitisation on equity holders may be related to the initial financial condition of the club. For a financially healthy club, a securitisation would be one of rational choice and hence would be a decision that would be arrived at under the most beneficial financial circumstances. In a publicly quoted business with remote equity investors this would generally be expected to induce a positive share price effect and shareholders should therefore benefit.[34] For financially distressed firms, a securitisation amounts to no more than a financial re-structuring and a confirmation of poor financial performance leading up to the securitisation, but may, in any case, be value enhancing if recovery takes place. However, securitisations in such circumstances, for example poorly capitalised banks in the United States, have been associated with value destruction (Lockwood, et al 1996).

The evidence on English football is that the structure of the agreement and covenants surrounding and within an SPV were such that securitisations were feasible sources of finance for loss making clubs. However, the Leeds case suggests that risk was real, and it was enhanced by the club's ability to undertake other forms of debt finance in a competitive market once the securitisation was in place. This raises the question of what happens when the club breaches the covenants on its secured debt.

With respect to clubs at the financial distress boundary, debt at this point takes on many of the characteristics of an equity participation in a football club scenario. The quality of the collateral may have been overstated such that *in extremis* the collateral failed to perform its anticipated function. The transfer of stadium ownership to the investors in the event of loan default cannot, in all reality, alter the use to which a stadium is placed. The specific case of football securitisations, where three clubs faced serious financial difficulties within two years of finalising the loans, can therefore illustrate some of the problems that may arise due to the specificity of the asset used as collateral.

The establishment of the debt service reserve and the early filling of the debt service account specified in the securitisation agreement has the purpose of providing some space to allow the club's managers to search for means to restructure the club financially. This proved to be the case when Leicester City and Ipswich Town entered administration following relegation from the Premier League. However, the power of the investors was circumscribed by the fact that there is no immediate alternative use for a football stadium. Stakeholder pressures in the form of the fan base, local politicians, and intense media scrutiny would almost certainly impede any alternative use, for example the clearing of the land for redevelopment. In effect, the stadium could only be used for the purposes of playing football by the club that agreed to the stadium acting as collateral to a loan. While the stadium may revert legally to the trustee for the lenders in a situation of financial distress, in practice the investors may then become co-owners and co-participants in the prospects and fortunes of the club. This view is supported by the case of Leicester City when, during administration, debt investors took over ownership of the stadium but had little alternative other than to agree a leaseback arrangement with the club under which their income took the form of a share of ticket sales (*Soccer Investor Weekly*, 25 February 2003). Whilst having the image of a securitised gate receipt, the repayment was conditional upon the seat being occupied, which in turn depended on the playing success of the club and the level at which it was playing: hence almost complete equity risk exposure. In essence, a form of debt/equity swap had been agreed.

The case of Leeds United was much more serious, prolonged, and complicated, but illustrates well the problems facing lenders to what in theory should have been a bankruptcy-remote SPV. To the outside world the financial problems that potentially faced Leeds first became clear with the failure to achieve qualification for the Champions' League in May 2002. The publication of the club's annual results later that year showed operating losses for the 2001/02 season of £7.9 million before transfer and interest payments on a turnover of £81.5 million. The pre-tax loss, which took transfer activity into account, was £33.9 million, largely due to the purchase of players. The net debt of the club was £77.9 million (Deloitte & Touche 2003). In order to reduce salary costs the club began to transfer players, but it then became increasingly clear that some had been purchased via off-balance sheet sale-and-leaseback transactions and selling them at a loss did little to alleviate the club's liabilities. What no-one appears to have foreseen was first, the collapse of transfer market, and second, the fact that other clubs would not take on Leeds' players at the salaries they were earning on long contracts at Elland Road. As a consequence Leeds continued to pay certain players part of their salaries after they had left the club. Throughout the following eighteen months the club's finances slithered out of control[35].

What did this mean for the investors? Very few people *within* the football business had anticipated the sudden collapse of the transfer market, so it could hardly be expected that institutional investors with less knowledge of the industry would have factored this into their risk analysis.[36] However, what they had also ignored, it seems, was the range of other claimants on the club and their likely actions in the event of financial distress. As one financier, Harry Philp of Morgan Stanley's sports advisory team, commented after the event:

> The problem with securitisations is that the actual economics on the stadium side were great but the lender didn't pay much attention to putting any controls on the club. At Leeds United, for example, there was nothing to stop the club raising more debt at the club level, which in effect meant that they were double leveraging the whole business! (Quoted in Glendinning 2004)

While the investors in the securitisation were willing to allow the club to draw upon the debt service reserve in December 2003 in order to meet its working capital requirements and to delay a decision on what action to take until the end of the season, when it would become clear whether the club would be relegated, other creditors forced their hand. Unsecured creditors threatened liquidation proceedings; in such an event there was no guarantee that new investors would emerge to save the club, particularly since the ownership of the club's principal fixed assets, the stadium and the training ground, would have reverted to the bondholders (*Soccer Investor Daily Bulletin*, 22 March 2004). The latter thus faced the threat either that the club would go out of business altogether, or that a reconstructed company might look to play home matches elsewhere.[37] In either case bondholders would be left with a stadium with no alternative uses and a public relations catastrophe, since they would be seen to have forced thousands of fans out of their beloved Elland Road.

Investor behaviour did not therefore manifest according to the possible paths anticipated in the securitisation agreement. Securitisation deals in football thus create the potential for two-phase behaviour that reveals the working characteristics of securitisation debt-forms in the private debt market. On the one hand, a firm (club) that is experiencing no financial distress and is meeting its debt servicing commitments with respect to the securitisation agreement does not face a debt obligation that is any different to that experienced under conventionally secured debt agreements. On the other hand, if a club moves, often as a result of adverse results on the pitch, from a *financially stable* phase to a *financially distressed* phase, the advantages and distinctiveness of securitisations may fail the investors. The views of researchers who argue that securitisations emerge as a consequence of bankruptcy cost avoidance because of the protection of asset ownership in an SPV (for example, Frost 1997 and Hansmann & Kraakman 2000) are not supported by the evidence of the football industry.

There is a cost of capital impact on the club of a securitisation that can also be categorised in a two-phase behaviour manner and which has implications for the stakeholders. During a stable phase, the cost of capital to a club is likely to be significantly influenced by the reduction in the gross over-collaterisation of a club's assets that has conventionally been experienced under customary loan or project finance agreements (Brinkworth, 2002). The impact of this is to increase the degree of flexibility in managing non-covenanted assets and income resources, thus otherwise reducing the effective degree of gearing (as determined by the number and severity of covenants placed on non-stadium assets and activities). One might expect the cost of equity to be reduced for profitable businesses in such circumstances. On the other hand, there may be some upward pressure on the cost of equity because the unbundling of securitised receipts into the SPV is equivalent to reducing diversification; because the originator normally provides guarantees or some element of recourse for the SPV to enable credit enhancement for the bonds; and because any debt left with the originator after the SPV has been created is likely to have resulted in higher gearing.[38] However, the overall cost of debt to the originator ought to reduce because of the credit enhancement associated with securitised debt and the resolution of some of the uncertainty surrounding cash flows that comprise part of a portfolio. The overall impact on the cost of capital is therefore a matter to be resolved empirically, but in the case of English football clubs it is not possible to do this with the data to hand.

8.3 Intermediaries

Football club securitisations in England also increased the involvement of financial institutions in the running of the clubs concerned. The closer involvement of commercial banks arises as a necessity, in the first instance, in an attempt to understand the uncertainties arising from particular football clubs' cash flows. An informational advantage then arises as expertise is developed in understanding these cash flows so that the details of securitisations are matched to both originator and investor needs. Alongside the commercial bankers and lawyers, the investment banker or broker in the transaction possesses the specialised knowledge to structure the accounts and contracts that are essential to the successful functioning of the securitisation. For the originator (the club) his expertise and networks, arising from previous non-football transactions, are crucial in writing the prospectus and facilitating the meetings that will attract the cross-border investors willing to lend to a highly specialised business sector. Very few clubs, after all, had ever engaged in structured cross-border debt transactions: indeed, until the move to Stock Exchange listing in the mid-1990s many leading clubs did not even have a finance director at board level, and proper budgeting and risk assessment practices were only slowly becoming normal practice, even in the Premier League.

However, despite the significant level of skill exhibited, *commercial* bankers were well aware that there would be a degree of disintermediation involved in securitisations and that this would grow as debt investors developed a degree of confidence in a particular industry. In terms of transactional difficulty, information asymmetry, and perceived risk in securitisations, the templates for successful securitisations were written at an early stage. There then develop scale economies for a bank in being repeatedly involved in securitisation issues, and hence the transactional difficulties relate to the unique circumstances of each club. Over time, however, informational asymmetry and perceived risks should both diminish since the uncertainties surrounding club-based deals reduce as experience develops. In any case, the structure of securitisations via an SPV was sufficient to entice US investors to fund UK club securitisations in what is arguably a potentially difficult market to understand for non-UK nationals and in an industry in which profitability did not feature significantly. Thus, disintermediation arises in the form of a reduced role for commercial banks in pooling risk since the club itself, with the assistance of an investment banker, can disengage a cash flow stream and identify its risk to the satisfaction of investors. The role of commercial banks is re-focussed on cash flow management within the SPV and in placing the new securities. In essence, securitisations reduce the need for intermediation based on the pooling of funds to fee-based distributors of packages of assets/income streams. The evidence of Thomas (1999) supports this view in that the gains observed to shareholders in his empirical analysis of 236 US securitisations from 1991 to 1996 suggests that they result because of a comparative advantage in asset origination and servicing.

The use of securitisation vehicles thus permitted a degree of disintermediation to arise because the bundling of risk resolved some of the uncertainty and, as argued, reduced the need for a pooling of risk under traditional intermediation roles. Furthermore, because banks could not readily disclose the credit quality of their customers to third parties, the use of a securitisation and disintermediated delegated monitoring by rating agencies who were able to offer credit opinions, unconfined by the customer-bank relationship, further reduced the need for commercial banks in their traditional role (Diamond, 1984). Moreover, as expertise of a particular industry develops, rating agencies become cost efficient: the evidence in the English football industry is that rating agencies are used to perform private ratings, which are not issued to the general investment community. Furthermore, rating agencies have an expertise to deploy in the valuation of assets and resulting income streams on which they may hold a comparative advantage. This may, in fact, enhance the probability for a successful club securitisation where assets and historical gate receipts/attendance may be subject to scrutiny and verification.

In this sense securitisation was part of a broader trend in which the financial arrangements of leading football clubs became more sophisticated, and the commercial banks became confined more to a role in which they maximised their advantages in terms of understanding clubs' cash flows and providing working capital. At the same time new intermediaries and new financial products entered the industry. However, the peculiarities of the football industry meant that they were not always able adequately to assess risk, and investors were thus at a greater disadvantage in terms of the information asymmetries that resulted. The two areas of greatest concern in this respect were off-balance sheet player finance and securitisation, and the experience of the Leeds United collapse certainly shook investor confidence to the point that no further securitisations took place in the English football industry between the middle of 2003 and the middle of 2005.

At the practical level, the future of securitisation in football appeared limited, even before the Leeds United disaster. While some new stadium projects under consideration in England might have been financed in such a way, several had already been completed by 2003/04. Tottenham Hotspur, which had negotiated an innovative securitisation option facility in November 2002, for which they paid an annual fee, failed to draw significantly upon it. The Wembley and Arsenal stadium developments in London, both of which were of sufficient scale to interest conventional securitisation intermediaries, were financed through orthodox project finance arrangements, although securitisation remains a refinancing option.[39] At the other end of the spectrum, with an effective threshold of around £15 million, in terms of the costs involved in due diligence and legal expenditure, there are very few clubs in the United Kingdom of the size required to generate the revenues that would provide adequate cover ratios for the interest payments. While one of the key intermediaries, Stephen Schechter, transferred the model to Germany, completing a Euro 85 million deal for Schalke 04 in 2002, this was helped by the fact that German clubs are relatively well regulated by the football authorities'imposition of a compulsory annual licensing scheme.[40] In the other large football leagues of Europe (Spain and Italy), corporate governance and auditing procedures are not favourable to such deals.[41] Outside these leagues there are few clubs of the size that would justify the intermediation costs.

9. Conclusions

The case of football club securitisations in England illustrates how difficult it is for apparently secure investors to isolate themselves from sudden changes in a firm's financial health in a volatile industry. In practice, one of the major advantages for investors involved in securitisations did not materialise when bankruptcy risk crystallised, with the result that they were not able to remain isolated from negotiations over financial restructuring and were forced either to share the risks inherent in the playing performance of the club or accept the redemption of the debt at a fraction of its nominal value. Securitisations undertaken in the English football industry thus gave rise to an unexpected degree of inflexibility because of the lack of available exit routes just prior to the crystallisation of risks that existed in the bankruptcy phase. This arose because of a concentration of poor asset quality, lack of secure and reliable recourse to the club, lack of alternative sufficient asset sources by the club to offset potential loan default, and extremely poor prospects for meeting debt servicing commitments from alternative sources given the high correlation of residual cash inflows to team performance.

The problems experienced by investors in the Leeds United case unquestionably impacted on prospective securitisations in terms of reducing the perception of credit quality. In the case of any future securitisations in football they might well involve significantly enhanced due diligence procedures, a greater degree of recourse to the club and its directors, tighter covenants, a lower level of gearing, a return to over-collateralisation and, clearly, higher interest costs. This calls into question the viability of football related deals if remaining assets are not of a sufficient quality to underpin asset-backed loans. This conclusion is related, essentially, to the poor quality of collateral in the form of club stadia. The reality is that stadia are a single-use asset with no practical alternative form and whose fortunes (use and income generating capacity) are almost completely determined by the continued existence of a football club using it.

Thomas (1999) notes that one of the advantages of asset securitisation for firms is that they are extracting value from a comparative advantage in asset origination. In essence, this involves utilisation of a class of assets that satisfy the basic requirements for a successful securitisation. For clubs, this has been gate receipts. However, given the evidence concerning the motivation for entering securitisation deals, the class of assets remaining in the clubs are unlikely to be of a quality to be securitised unless an element of change is brought about or innovations in debt financing develop further. Thus, clubs are left with income streams relating to catering and hospitality, branded products, broadcasting rights and ancillary activities that, in most respects, vary directly with the success of the club, and where, in areas like media rights and merchandising, there are indications of market saturation. For investors, this represents a risk that they are unlikely or unwilling to price and hence the funding capacity for clubs might well become exhausted.

A further impact of the rise and fall of securitisation is to call into question the financial acumen of clubs inexperienced in handling such complex debt instruments (and associated player financing methods). Most football clubs did not have Finance Directors at board level until forced to do so by Stock Exchange rules if/when they undertook an initial pubic offering. Other leading clubs remained without a Finance Director. Evidence from surveys of finance directors report that risk management is a key area in which they feel unprepared.

However, there are signs that the financial crisis of football in the early 2000s, in which securitisation, along with innovative player financing deals, and the collapse of TV companies and the international transfer market, played a significant role, might have had a salutary impact on the financial management of clubs. For example, player contracts are increasingly incorporating performance related pay, which is particularly important for teams threatened with relegation. This goes some way towards translating fixed into variable costs and thus lowers the degree of operating risk to which clubs are exposed. For 'journeymen' players, the norm is increasingly one of much shorter contracts which contain provisions to cut pay in the event of relegation. This trend is beginning to confirm predictions that some industry analysts made immediately following the Bosman Judgment along the lines that while the salaries of irreplaceable star players, especially proven goalscorers, would continue to increase, those of 'journeymen' professionals would flatten out and enter a slow decline (Deloitte & Touche 2004).

Our evidence and conclusions thus throw light on the validity of the motivations for undertaking securitisations when the outcome is unexpected. Specifically, SPVs as bankruptcy remote vehicles, do not protect investors in the case of asset specificity; recourse agreements that allow debt holders to attack a firm’s residual income and assets do not appear to reduce risk if the residual income and assets are not of sufficient quality or quantity to support recourse effectiveness; and, the evidence of debt reduction, term renegotiation and debt/equity swaps do not indicate a robust financial architecture. The complexities of the financial outcomes and the difficulties that have been observed in terms, for example, of protracted financial reorganisations are suggestive of poor assessment concerning the safety nets that would have underpinned an untroubled financial repositioning. In this particular case, risk does not appear to have been accurately or adequately assessed, which has been one of the claimed advantages of securitised deals and which has been argued to be a key incentive underpinning active managerial intervention of financial resources. The risks that have crystallised in the case of football have overwhelmed debt investors in a number of cases that have, we would argue, sufficiently common features in terms of poor collateral quality and the cost structures underlying football clubs' finances, to have been foreseeable to a much greater extent than they were.

Appendix

The following represents the basic structure of the interview questionnaire used to support our research. The structure was used in all interviews although was inevitably flexed as interviewees' expertise and experience were explored.

SECURITISATION IN UK FOOTBALL: QUESTIONNAIRE

Preliminaries	Supplementaries
What is your experience of securitisations?	Have they been successful? How did securitisations get started? Did you raise the funds required? Were/are the contract terms onerous on the club? What do the equity backers of the club think of securitisations? Should one differentiate between clubs that are listed on LSE or AIM and clubs that are not listed? Is there a perception of increase in risk (both operational and financial)? What have football clubs done with the money?
What are the particular advantages of securitisation for football clubs?	Discussion of: Issues relating to access to sources of funds not otherwise available Nature of current market conditions (both football's spending patterns and availability of finance generally for this sector)
What are typical contract clauses that clubs might face? (e.g. with respect to recourse?)	What about contingent clauses regarding additional recourse responsibilities that emerge on default? What other covenants are put in place? Are these onerous? How are the excess revenues beyond servicing the debt in SPV conventionally allocated/disposed? Do they have to go into any special reserve? Are there minimum loan sizes? Are there minimum terms? What are the additional administrative complexities beyond the contract negotiation? What additional managerial/monitoring activities have to take place to ensure that default (or other aspects relating to the securitisation) does not take place? Are there onerous/difficult disclosure requirements? What is the role of rating agencies here? Have they had any particular insightful impact? Did you agree with their ratings?
Do you have any particular perspective on the parties involved?	Are football clubs raising this finance for the 'right' reasons? What are the right reasons? Do the lenders understand the nature of the assets they are securitising, especially if they are from overseas? What do other secured creditors in the club think about securitisations? What about non-participating bankers, what do they think?
Where do you think securitisations are going to go from here?	Will there be other innovations in debt financing? What about financing sources like franchising? What other forms of financing might be on the horizon? Is there a limit to growth of football and/or financing? Will there be a greater emphasis on cost control? Will there be the development of other income streams that could possibly be securitised? How are the developments in overseas markets financed? Do they need financing?

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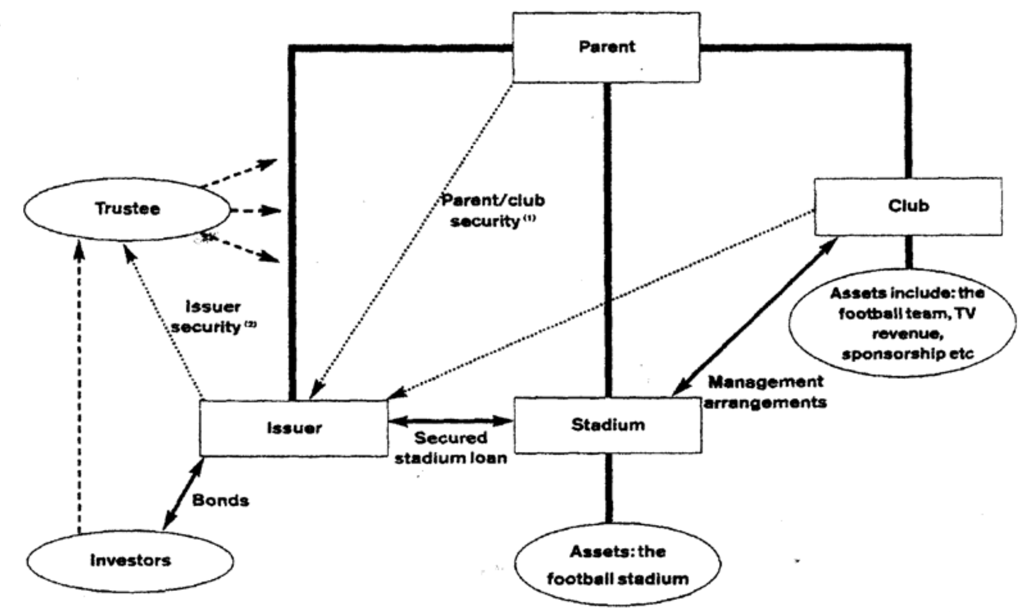
Table 1: Securitisation Deals in English Football

Date	Club	Amount (£ million)	Term (yrs)	Purpose	Security	Intermediary	Status of company at time of securitisation	Revenue, preceding FY end (£ million)	Net assets, preceding FY end (£ million)
Dec 1999	Newcastle United	55	17	Stadium improvement; refinancing	Ticket and corporate hospitality income	Schroder (Schechter)	Listed	44.7	54.5
Dec 2000	Southampton	25	25	New stadium	Ticket and corporate hospitality income	Lazard (Schechter)	Listed	17.1	12.2
Aug 2001	Leicester City	28	25	New stadium	TV and media income; sponsorship income	Lazard (Schechter)	Listed	29.3	12.1
Aug 2001	Ipswich Town	25	25		Ticket and corporate hospitality income	Lazard (Schechter)	Private	31.3	9.9
Sep 2001	Leeds United	60	25	Refinancing; player purchases	Ticket and corporate hospitality income	Lazard (Schechter)	Listed	86.3	35.3
March 2002	Everton	30	25	Refinancing	Ticket and corporate hospitality income	Bear Stearns	Private	32.9	3.7
June 2002	Manchester City (first tranche)	30	24	Stadium improvements	Ticket and corporate hospitality income	Bear Stearns	Private	32.4	18.9
Nov 2002	Tottenham Hotspur *	75	20	Various projects	Ticket and corporate hospitality income	Schechter?	Listed	65.0	37.7
Apr 2003	Norwich City	15	15	Stadium reconstruction; refinancing	Ticket and corporate hospitality income; sponsorship income	Schechter	Private	15.3	7.3
July 2003	Manchester City (second tranche)	14	15	Stadium reconstruction	Ticket and corporate hospitality income	Schechter	Private	49.0	-10.4

The table summarises the principal UK securitisation deals up to July 2003. Note: The Tottenham Hotspur deal was unique in that the facilities were arranged but not, for the most part, drawn down. Spurs paid an annual fee for this facility.
Sources: Deloitte & Touche, various years.

Figure 1: The Structure of a Football Club Securitisation



The figure outlines the cash flows surrounding a conventional securitisation and the parties to a typical securitisation deal. The stadium asset is de-coupled from other club assets whilst the club retains managerial responsibility for the stadium. The parent company owning both club and stadium provides security, normally in the form of recourse, to the securitisation bond issuer. The issuers offers a loan secured on the stadium asset. Investors purchase the bonds for which they receive a return. The trustees operate the special purpose vehicle that then has responsibility to oversee the activities of the club and stadium to ensure the servicing of the bond is maintained according to the securitisation agreement. Source: Brinkworth 2002.

Notes

[1] The UK is the leading European market with, on average, one third of all deals by value since 2000. Deals range over a wide variety of business activity from conventional loan books and mortgages to rental income, bank advances, undrawn loan facilities, leases, credit card revenues, automobile loans, receivables, publishing, and music and TV rights and royalties. Internationally, securitisations also feature in sovereign financing arrangements (Ketkar and Ratha, 2001).
[2] See also John and John (1991).
[3] For surveys of the football boom and crisis see Szymanski & Kuypers 1999; Dobson & Goddard 2001; Banks 2002; Morrow 2003. The *Annual Reviews of Football Finance* which have been published by the Deloitte & Touche Sports Business Group since 1992 are a fundamental source on the period.
[4] These figures are less than the headline rates, because they exclude the share taken by the Football Association. They do include the BBC's payments for match highlights.
[5] Initially the English Premier League had three places in the European Champions' League. Due to good performances this was raised to four from 2002/03.
[6] It should be noted, however, that the number of games per season in Division 1 rose from 461 to 552 over this period. Even so this represents an increase in average attendance of over 21 per cent. Division 1 was rebranded The Championship in 2004.
[7] Three, including Tottenham Hotspur and Manchester United, had already floated.
[8] Schechter worked for Schroders until May 2000, and then for Lazards until March 2002, when he left to establish his own boutique finance house.
[9] Securitisations have tax advantages, described later in this paper, which lower the true cost of debt to the club.
[10] The exception was the securitisation undertaken by Leicester City, which was secured on media and sponsorship income.
[11] As will be described below, the comparative advantage of bankers and advisors to such details is in the close resolution of trigger points appropriate to a club's finances, obligations and pattern of cash flows.
[12] Most leading football clubs in England are now legally subsidiaries of a holding company. This was necessary when the first clubs were floated on the Stock Exchange in order to get round the Football Association's Rule 34 that restricted the payment of salaries to directors, the level of dividend payments, and the distribution of assets in the event of the company being wound up (Banks 2002).
[13] In the initial agreements this account had to be refilled before any further spending could take place; more recent agreements have relaxed this requirement to take account of the seasonality of football clubs' cash flow.
[14] Deloitte & Touche (2003) estimated that the costs of relegation from the Premiership at the end of 2002/03 were £12 million in terms of lost income.
[15] The evidence relating to decisions made by bankers in this context suggest that the complex interaction of key variables such as covenants, collateral, term and wider macroeconomic factors such as the interest rate environment are important in funding decisions (Day and Taylor, 1995).
[16] 38 per cent of Newcastle's income in 2001-02 came from gate receipts, i.e. approximately £27 million. Assuming an interest rate of 7.5 per cent, annual interest payments on the securitised loan would be approximately £4 million, increasing to £6 million annually once the grace period on repayment of the principal ended Since its return to the Premiership in 1993, the club has always operated at over 95 per cent of its capacity.
[17] Using the then generally accepted econometric model of player valuation that he had developed, Gerrard (2003a) estimated the value of the Leeds squad in September 2001 at £198 million. However, transfers between July 2002 and July 2004, which involved the sale of all the valuable players in the 2001 squad, as well as some purchased in 2001-02, raised no more than £80 million (*Daily Telegraph*, 8 July 2004).
[18] Southampton were relegated from the Premier League at the end of the 2004-05 season.
[19] Prepayment risk is potentially significant should interest rates fall since originators may have an incentive to prepay their loans leaving the debt holders reinvesting funds in a lower yield investment.
[20] The recognition of the role of structured finance in a club situation reveals the opportunities for downstream financial developments that typically arise in more conventional securitisation arenas such as Interest Only and Principal Only deals. Potentially, this enables access to an investor base interested in risk hedging.

[21] Gate receipts channelled into the SPV represent the income against which the tax benefits arising from the interest charges are derived and tax allowances are able to be relieved.
[22] In formal models of capital choice the issue of recourse is often omitted as a simplifying assumption (e.g. Skarabot (2001)).
[23] The only one of these twelve clubs to gain promotion back to the Premiership in the two seasons following relegation was Manchester City, but its financial position was by no means secure and its solvency would have been threatened by a further relegation, as seemed possible towards the end of the 2003/04 season. Note that Manchester City negotiated two securitisation deals in 2002 and 2003 (see Table 1).
[24] Citron et al (2003) observe that banks mostly arrange both fixed and floating charges: the first to secure priority over assets and the second to restrict the possibility of other floating charge holders instigating an administrative receivership. The Enterprise Act 2002 reduced the power of floating charge holders to begin such proceedings, although banks are likely to have an exemption through the *Capital Market Exception.* The Act became law in September 2003 and there is no case law to act as guidance to provide any evidence in the context of this paper. In any case, the new provisions would not affect deals arranged before the enactment.
[25] In the football industry the conventional EDITDA measure is often replaced by EBTIT (Earnings Before Transfers, Interest, and Tax) as a means of quantifying a club's capacity to generate revenues.
[26] It is known from confidential sources other than those interviewed for this paper that Newcastle United negotiated player sale-and-leaseback schemes following their securitisation in 2001. The inability of the lenders under these contracts to obtain a tangible security due to securitisation covenants was not a barrier to such transactions, given the competition for the player finance business among lenders and the availability of insurance against default. Such loans were then being offered at a margin of 150 basis points over Base Rate. This was presumably also true in the case of Leeds United.
[27] To redeem the loan the club would have to pay all the remaining interest payments.
[28] As successive Deloitte & Touche reports point out, the proportion of Premier League clubs returning a pre-tax profit has remained a small minority of the total season after season. The assumption of utility rather than profit maximisation retains validity therefore.
[29] On the contrast between the baseball business in the US and the football business in Europe, see Szymanski & Zimbalist 2005.
[30] Sponsorship contracts lasting more than one season, for example, normally include performance clauses. Given the poor viewing figures for Division 1 football, the media exposure of club sponsors at that level is much less than in the Premier League, and they safeguard themselves accordingly.
[31] The average Premiership club in 2001/02 made an operating profit of £4.9 million, but a pre-tax loss of £6.4 million. The major element in this was the amortisation of player registrations (Deloitte & Touche 2003).
[32] Even a cursory look at Leicester City's published financial statements would suggest that its financial problems were of long standing: the only reason why the club remained solvent while still in the Premier League was the sale of Emile Heskey to Liverpool for £11 million in March 2000.
[33] Securitisation also offers a route to effective balance sheet management, particularly with respect to maturity. Generally, clubs do not have access to long term funds (typically, greater than 8-10 years) but securitisations have been issued for 15-25 years in the UK. This allows clubs to match asset terms to the liability, thereby reducing exposure to financial risk arising from interest rate volatility. If the asset relates to the ground then a securitisation of over 25 years would match asset maturities more closely. The danger with asset maturity being longer than liability maturity is that increases in interest rates reduce the value in the asset to a greater extent than the corresponding liability.
[34] Evidence of the impact on remote shareholders by banks is provided in Lockwood, et al (1996). For a sample of large and frequent securitisers Thomas (1999) finds that the benefits of securitisation are related to credit worthiness,.
[35] Off balance sheet transactions of this type appear somewhat odd in relation to financial reporting standards extant at the time. Both FRS 5 (Reporting the substance of transactions) and SSAP 21 (Accounting for leases and hire purchase contracts) would require the substance of such transactions to be reported which would involve the disclosure of the liabilities a club was exposed to. Even if not a finance lease under SSAP21, FRS5 would at least require a narrative description of the nature of the funding of material transactions. Under SSAP21, however, treating the financing of a player as an operating lease would lead only to recording the annual payments made rather than recording, additionally, the full liabilities due over the term of the financing contract. This is what seems to have happened with sale and leaseback transactions being financed by a *non-obligatory* offshore mortgage:

thus, no concrete liability existed. Under International Reporting Standards (the relevant IAS is IAS17 (Leasing)) a similar approach to reporting the substance of transactions is taken although the deals pre-date application of this standard. In any event, the reality is that such financing liabilities are becoming apparent when clubs face financial difficulties. For example, Bradford City, which had engaged in similar player finance arrangements, reported debts at £22m when placed into administration in May 2002, but by August, recorded liability claims on the club amounted to £36.5m (Banks, 2002).

[36] For an example of the way in which risks were underestimated by experts before the Leeds crisis, see *Credit*, (**5:07),** 1 April 2003, <http://db.riskwaters.com/public/showPage.html?page=10851>, accessed 7 September 2004.

[37] Rumours did circulate at the time that some potential new investors in the club were considering an alternative venue for home matches.

[38] The risk relating to the residual cash flows in the originator will almost certainly increase. This may, of course, lead to a reduction in the cost of equity if the net cash flows are negative.

[39] Many industry insiders believe that the serious delays Arsenal faced in securing the finance for the Emirates Stadium were due to the collapse of investor confidence associated with Leeds United's and Chelsea's problems in 2002-03.

[40] In January 2004, at the same time as the Leeds United crisis worsened, there were strong rumours in the press that Schechter had arranged a securitisation of between E70 and E100 million for Borussia Dortmund; this contract appears never to have been completed.

[41] Given the financial problems facing Italian clubs like Lazio and Roma, the accounting scandal of Parmalat (which impacted directly on Parma football club), and the collapse of Fiorentina, it became difficult to imagine further securitisations in Italy, for example, even though this provided the first example of a European football securitisation with Lazio in 1997.