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How High Can It Go?

What Private Equity Needs to Know about How Professional Sports Leagues' Rules Impact Sports Franchise Valuations

By: David Sunkin and Nayan Karanth

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EXECUTIVE SUMMARY

If you had invested in a North American sports franchise between 1991- 2022, you would have earned between at least a seven-fold return on your investment, bettering the return from the S&P 500 over that period of time by a two-to-one ratio. According to Sportico, in the past year alone, the average value of an NFL franchise has increased by 24 percent. The strong growth in the value of these franchises has proven to be particularly attractive to investors, especially in recent years. For example, the sale of the Denver Broncos in 2022 was for a 22% premium over a third party's pre-sale valuation. Valuation premiums are not only limited to sales of controlling investments; in 2023, a minority share of the parent company of the Toronto Raptors, Toronto Maple Leafs and Toronto FC was sold for a similar premium over a recent third-party valuation for the franchises. Not surprisingly, franchise owners have been eager to cash in either in whole or in part.

The prestige of being one of very few franchise owners in each league has always kept values high. But what's been the cause of these more recent soaring valuations? Rules and regulations regarding ownership and debt limits can have an outsized impact on franchise valuations.

In the following pages, we explore why professional sports teams' valuations are soaring and provide a unique look at how each league's rules impact those values. We invite you to read our original research into these valuations and join with us as we continue to explore "How High Can It Go?"

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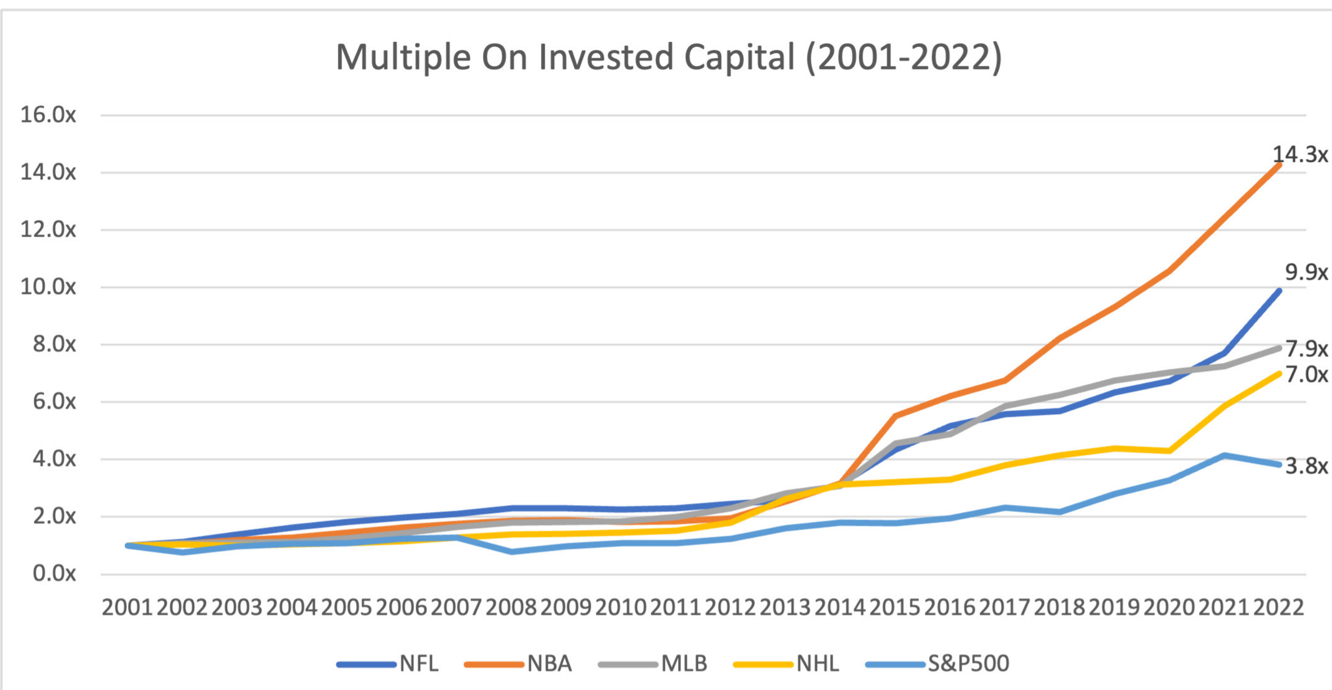
How High Can It Go?

What Private Equity Needs to Know about How Professional Sports Leagues' Rules Impact Sports Franchise Valuations

By: David Sunkin and Nayan Karanth

October 2023

If you had invested in one of the North American sports franchises from 1991- 2022, you would have earned between a seven-fold return (NHL) or over a 14-fold return (NBA) on your investment, bettering the return from the S&P 500 over that period of time by at least a two-to-one ratio. According to Sportico, in the past year alone, the average value of an NFL franchise has increased by 24 percent. The strong growth in the value of these franchises has proven to be particularly attractive to investors, especially in recent years.[1] For example, the sale of the Denver Broncos in 2022 was for a 22 percent premium over a third-party's pre-sale valuation.[2] Valuation premiums are not only limited to sales of controlling investments; in 2023, a minority share of the parent company of the Toronto Raptors, Toronto Maple Leafs and Toronto FC was sold for a similar premium over a recent third-party valuation for the franchises.[3] Not surprisingly, franchise owners have been eager to cash in either in whole or in part.



Based on S&P500 closing share price as of December 31st each year; 2022 closing share price as of December 30th, 2022
NOTE: League and chart data based on latest Forbes' data and rankings as of May 2023 and reflect metrics released by Forbes in each calendar year; NFL data as of August 2022, NBA data as of October 2022, MLB data as of March 2023 (2023 excluded from this graphic) and NHL data as of December 2022.
Source: Forbes and publicly available information

The prestige of being one of very few franchise owners in each league has always kept values high. But what's been the cause of these more recent soaring valuations? The lucrative media rights and sponsorships available for these leagues are a significant contributing factor. Live sports significantly drive cable package sales, accounting for 94 of the top 100 broadcasts in 2022.[4] Streaming has also provided the leagues with an additional revenue stream. Similarly, sponsorships of franchises and commercial signage and naming rights of franchises have also proven to be more and more lucrative. Franchises are also constructing modern, multi-billion-dollar, multi-use stadium venues to not only improve the gameday experience, but also serve as more attractive venues for non-sporting events throughout the year and to become destination locations. Finally, the leagues are leveraging their popularity to enter into a variety of other commercial partnerships, branding and endorsements, such as partnerships with sports betting companies[5], social media companies[6] and collaborations with other media[7] and fashion[8] brands. The leagues have also been expanding their international influence by hosting more exhibition and regular season games in international markets. Franchises themselves have begun to offer franchise equity to players as part of the overall compensation packages, hoping that the franchises' ever-increasing valuations will make them a more attractive destination.[9]

Rules and regulations regarding ownership and debt limits can have an outsized impact on franchise valuations. Historically, the leagues emphasized local family ownership of their franchises, limiting the ability of franchises to raise funds from institutional capital investors. Recently, many leagues (excluding the NFL) have begun to liberalize rules regarding institutional ownership of their franchises, allowing these franchises to start capitalizing on their valuation increases. As franchises begin to routinely trade at multi-billion-dollar valuations, the pool of qualified individual investors has shrunk. Many bidders now must form buyer groups that consist of multiple billionaires who pool their resources to make bids on these precious limited assets. Valuations have soared. For example, the Pittsburgh Penguins were recently purchased by the Fenway Sports Group, a conglomerate with multiple billionaire investors dedicated to purchasing and managing sports franchises. Similarly, Josh Harris' ownership group for the Washington Commanders consists of several billionaires like Mitchell Rales and David Blitzer, who both joined the Apollo Global Management founder to buy the franchise at a record $6.05 billion. Some bidders are also spacing out their purchase of a sports franchise's equity over multiple installments to lessen the initial financial outlay, such as with the recent purchases of the Minnesota Timberwolves and Nashville Predators.[10] As valuations continue to increase, it is likely that owners of minority stakes will explore liquidity options in order to cash in some or all of their investment. How leagues adapt to these economic realities will be important.

Institutional Investor Interest in Sports

Institutional investors are primarily, if not solely, focused on their return on investment, which makes the ever-increasing value of sports franchises an attractive capital investment. What's more, non-controlling investments can come with the right to have their interest bought out at the valuation of the majority owner in a franchise sale.

North American major sports league franchises are attractive investments in part because they lack cyclicality associated with other types of investments. During the Great Recession of 2009, sports franchise valuations resisted the decrease in valuations experienced by other market investments; the opportunity to obtain an asset that seems to be ever increasing in value and resists market forces in economic downturns makes these investments highly sought after for these funds.[11]

However, institutional investors will need to be aware of some of the risks involved with investing in sports franchises. Often money generated by the franchise is fully invested back into the franchise and its operations, making a sale of their minority interest the only source of liquidity for institutional investors, aside from a total sale of the franchise. The pool of potential buyers for any sale of their minority investment will be more limited than with other investments due to both the ever-increasing rise in valuations of sports franchises and the transfer limitations placed on sales by the leagues themselves. Institutional investors are also not allowed to participate in the governance or management of the franchise.

Since leagues have implemented rules allowing for institutional investment, there has been a flurry of institutional activity. Most active has been Arctos Sports Partners; the just three-year old firm has raised more than $2 billion for sports investments in its first fund to buy minority stakes in professional sports franchises. Arctos has moved quickly to retain minority ownership stakes in franchises, holding stakes in six MLB franchises, four NBA franchises, two NHL franchises and two MLS franchises.[12]

This flurry of activity also includes the first investment by a sovereign wealth fund. In June 2023, the Qatar Investment Authority purchased a 5 percent stake in the parent company of the NBA's Washington Wizards, the NHL's Washington Capitals and the WNBA's Washington Mystics at a valuation over $4 billion. If the deal goes through, it will be the first time a sovereign wealth fund has bought an ownership stake in a North American major sports league franchise.[13] However, it remains to be seen how often North American major sports leagues will approve sovereign wealth fund investments, as leagues will have to consider how to avoid any potential backlash that may accompany such investments, as the PGA is currently experiencing in its proposed merger with LIV Golf.

The following chart provides a league-by-league comparison of the rules that apply to private equity investments in their respective franchises:

Private Equity Rules by League

	NBA	NHL	MLS	MLB	NFL
Maximum equity a franchise can sell to multiple funds	30%	30%	30%	30%	N/A
Maximum equity a single fund can own in one franchise	20%	20%	20%	15%	N/A
Maximum number of franchises a fund can invest in	5	5	4	Unlimited	N/A
Minimum investment amount	Unspecified	$20,000,000	$20,000,000	Unspecified	N/A
Minimum fund size	$750,000,000	Unspecified	$500,000,000 (MLS can waive under specific circumstances)	Unspecified	N/A
Diversified capital requirement	Funds where one investor has a greater than 25% interest in a fund will be presumptively not allowed, but exceptions can be made	Unspecified	No single owner/group can own more than 25% of a fund	Unspecified	N/A

Ownership Rules for North American Major Sports Leagues

Regardless of whether or not an investor is getting a controlling or non-controlling interest in a sports franchise, the same league rules will apply to each investment. Below is a brief overview of the ownership and investment rules for each league, along with a summary chart found after the overviews.

NBA

The NBA, which was the first North American major sports league to accept investments from institutional investors and sovereign wealth funds, has the most relaxed ownership requirements among the five North American major sports leagues. Prospective owners are only rejected if they do not satisfy the Commissioner's, Advisory Finance Committee's or Board of Governors' minimum ownership criteria. Likewise, there are no special financial requirements placed on prospective investors by the NBA's governing documents. The NBA lets current players invest in NBA franchises, though currently they are only permitted to do so via the NBA Players Association investing on behalf of all NBA players, and such investment is limited to no more than 5 percent of an NBA franchise. Note that the NBA places additional restrictions (as detailed above) on institutional investors.

NHL

The NHL has followed the NBA's path in broadening its pool of potential investors, as it also allows investments from institutional investors and sovereign wealth funds. Like the NBA, there are no special financial requirements contained in its governing documents placed on prospective investors. The NHL governing documents do specify that, for a controlling ownership, there needs to be evidence of a single individual who is accountable for operations and is empowered to make club decisions. Note that the NHL places additional restrictions (as detailed above) on institutional investors.

MLS

While the MLS has followed the NBA and NHL in relaxing its ownership requirements, its rules are slightly more restrictive. Additionally, the MLS is bound by restrictions imposed by the United States Soccer Federation (USSF). While the MLS does allow for institutional investment, it does not allow for investment from governmental or quasi-governmental authorities, non-profits or charitable organizations/foundations, or any person or entity that does not satisfy the Commissioner's, Advisory Finance Committee's or Board of Governors' minimum ownership criteria. Each franchise's ownership group must have a principal owner who owns 35 percent of the franchise's equity and has the sole authority to bind the franchise. Due to financial issues with previous soccer leagues in North America, the USSF requires that investors in MLS franchises must meet the following financial requirements:

- Show the financial ability to operate a franchise for five years.
- The principal owner must have a net worth of $40 million exclusive of the franchise and their primary residence.
- The entire ownership group must have a net worth of $70 million exclusive of the franchise and their primary residences.

Investors in the MLS must also be aware that they will not be investing in the individual franchises, but in the MLS itself, as the MLS is a single-entity sports league. One way in which the MLS is less restrictive is that it has historically had no restrictions on majority or minority investors holding interests in multiple franchises within the league. Note that MLS places additional restrictions (as detailed above) on institutional investors.

MLB

The MLB's ownership requirements at first glance seem to be about as restrictive as the NBA, NHL and MLS. The MLB requires controlling owners to own 30 percent of the franchise's equity and only restricts trusts, non-profits and charitable entities from investing in franchises. Its governing documents do not impose any strict financial obligations on prospective owners, and it allows for non-controlling owners to fund as many as five different MLB franchises so long as their equity in a single franchise does not exceed 20 percent.

However, all these similarities come with one major caveat: Documents created or modified by the franchise's ownership, including governance and sponsorship agreements, for example, must be approved by the MLB Commissioner's office. Investors looking to purchase ownership interests in baseball franchises need to be aware of the strong centralized oversight that the commissioner's office has over its franchises. Note that MLB has alternative restrictions (as detailed above) on institutional investors.

NFL

In contrast to the other four North American major sports leagues, the NFL's ownership requirements are the most restrictive. The rules do not allow for institutional investors nor sovereign wealth funds to invest in franchises. The rules only allow for 25 individuals to invest in the franchise ownership entity; however, the NFL does allow family companies and trusts to be considered a single individual when calculating that limit. NFL franchises are subject to a $1.1 billion debt limit, a limit that restricts the debt-financing for prospective purchasers of a franchise.

However, one area where the NFL does provide more flexibility than the other North American major sports leagues is in its calculation of what constitutes a controlling interest. Normally, the entity owning an NFL franchise must have the majority of the franchise's equity and voting power invested in one individual; however, the NFL governing documents list the following scenarios as exceptions:

- When the entity is a limited partnership where 30 percent of the equity is owned by a single general partner that has total voting and management control.
- When the entity is an LLC where 30 percent of the equity is owned by a single controlling member with complete voting control of the LLC.
- When the entity is a corporation with multiple classes of stock where 30 percent of the entity's equity is owned by an individual who has full voting control of that corporation.

The NFL also provides existing control owners some flexibility as to their ownership of the franchise's equity for succession and estate planning purposes. For example, controlling owners can reduce their equity interest to 5 percent so long as their ownership, when aggregated with the ownership interests of their immediate family members, is at least 30 percent. The NFL also allows control owners who have owned a franchise for at least 10 years to transfer their controlling interest to an irrevocable family trust for the benefit of their beneficiaries so long as they maintain control of the power to appoint the trustee. Additionally, the NFL deems a successor to the current controlling owner who is set to receive a 20 percent equity interest in the NFL franchise's equity to have a controlling interest in the club so long as that successor has an option to purchase enough equity from others to obtain a 30 percent equity interest.

Ownership Rules Comparison Chart					
	NBA	**NHL**	**MLS**	**MLB**	**NFL**
Owner exclusions	Any person who does not satisfy the Commissioner's, Advisory Finance Committee's or Board of Governors' minimum ownership criteria	None	- Governmental or quasi-governmental authority - Non-profit or charitable organization or foundation - Any person or entity not satisfying Commissioner's, Advisory Finance Committee's or Board of Governors' minimum ownership criteria	- Trusts - Non-profits - Charitable entities -Governmental Funds	- Private equity funds - Governmental funds - Endowment funds - Pension funds - Non-family employees
Financial requirements	None, but limits on indebtedness may be established as needed	None	- Show ability to operate franchise for 5 years - Principal owner who owns 35% of franchise and has authority to bind must have $40 million net worth exclusive of the franchise - Entire ownership group must have $70 million net worth exclusive of the franchise	Must show financial ability not only to make initial investment, but also to meet the ongoing financial obligations, which includes compliance with the Debt Service Rule	$1.1 billion debt limit on the franchise
Limits on number of individuals in ownership entity	Silent	Silent	Silent	Silent	25 individuals
How much equity does the controlling interest holder need to own?	15%	30%	35%	Silent, though rules require evidence of single individual who is accountable for operations and is empowered to make franchise decisions	- Majority beneficial of voting power in one owner except where the entity is a limited partnership, LLC or corporation and a single controlling member has 30% of the equity and total management and voting control - These percentages are allowed for estate planning and succession purposes

Can controlling/non-controlling owners own controlling/non-controlling stakes in other franchises in other leagues?	Yes	Yes	Yes	Yes	Yes
Minimum Ownership Stake	1%	Silent	Silent	Silent	1%

What's Next?

Given the march into 10-digit franchise valuations, the reduction in the pool of super billionaire buyers qualified to participate at these soaring values, and the likely result that more and more minority stakes may hit the market, whether from private equity funds or long-time family owners looking to realize significant gains, or resulting from succession and estate tax pressure, will the leagues feel pressure to adopt rules that keep the valuation party going? Based on the recent softening of rules by the NBA, NHL, MLS and MLB, it seems as though investment into their franchises by institutional investors is here to stay.

Notably, the last league to remain a holdout on accepting institutional capital is the NFL. However, it remains to be seen how long that will continue given that in September 2023 the NFL formed a special committee to evaluate possible changes to its current ownership rules. On the one hand, the NFL's strict 25-member limit on owners in an NFL franchise's ownership entity, coupled with the minimum cost of a minority investment in an NFL franchise quickly becoming a nine-figure sum, vastly reduces the pool of individual or family investors that can even afford to consider investing in an NFL franchise, even with the typical valuation discount applied to minority investments.[14] It also seems that the NFL cannot increase the debt limit enough in order to address these issues, and NFL owners will not want to see franchise values from the other four leagues routinely eclipse their market values.

On the other hand, the NFL is far and away the most popular of the five North American major sports leagues and it does not seem to be ceding that position anytime soon. Of the 94 live sports broadcasts that made the lists of top 100 broadcasts of 2022, the NFL accounted for 82 of the broadcasts and was the only sports league among the five North American major sports leagues to make the list. The NFL is also set to start earning $10 billion per year in media rights for the next ten years—an annual sum that handily tops the media rights deals of the other four leagues combined. The NFL has built its success on the model of the family-run local owner who is active in their franchise's community and, unlike the other four leagues, does not need to risk changing that dynamic to continue its success. If the NFL ever seeks to broaden its pool of potential investors, it will likely do so on an as-needed, case-by-case exception basis rather than creating a blanket rule that would apply to the sale of any potential interests in its franchises.

Conclusion

The business of investing in North American sports franchises has always been a lucrative one and looks to remain lucrative with most leagues broadening their pool of investors to allow for institutional investment. However, each league has its own unique ownership rules, and it is important for potential investors to be aware of each league's ruleswhen seeking to capitalize on these soaring valuations.

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Endnotes

1 NBA Owners Approve Institutional Investors Owning Parts of Franchises – Sportico.com
2 2021 NFL Team Value Ranking – Sportico.com
3 Maple Leafs, Raptors Parent Nears Stake Sale at $8B Valuation – Sportico.com
4 2022 TV Recap: NFL Rules Top 100 Ratings List – Sportico.com
5 NFL announces tri-exclusive official sports betting partners; Press release: MLB names FanDuel a new official sports betting partner in North America; NHL announces North American partnership with FanDuel, BetMGM; NFL, MLB and players unions lead latest investment in Fanatics
6 The NFL Partners With Social Media & Video App TikTok | by Kathryn Kuchefski | Instant Sponsor | Medium; TikTok and MLS enter multiyear partnership to deepen the league's presence on the app | TechCrunch
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14 Sports Team Ownership Shifts From Billionaires To Investment Funds – Sportico.com