

**Report on Rexall Place, the Edmonton Oilers and Plans for a New Arena\***

**By**

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## Introduction

While Rexall Place is one of the oldest arenas in the NHL<sup>1</sup> and lacks certain modern amenities and revenue-generating accoutrements, it enables the Edmonton Oilers to generate a highly competitive level of net operating income. Indeed, with the favorable lease terms between the Oilers and Northlands and the deep base of support for the team in the Edmonton CMA and beyond, estimates by credible third parties, including CSL and Forbes, indicate the Oilers are in the top tier of NHL franchises in terms of operating income.

Indeed, other than the New York Rangers, the only franchises in the NHL that have consistently experienced positive annual profits are the league's six Canadian franchises. The Edmonton Oilers is one of those teams with consistent profits: according to *Forbes*, the Oilers had profits of \$9.4 million in 2008-09, \$11.8 million in 2007-08, \$9.9 million in 2006-07, and \$10.7 million in 2005-06. Thus, in the years since the 2004-05 lockout, the Oilers have averaged \$10.5 million in annual profits according to *Forbes*. Even in a league that was not struggling, this would be a solid performance.

Since the Oilers' appearance in the Stanley Cup in 2006, the team's on ice performance has not been competitive. It has finished in last place or next-to-last place in its division every year. Despite this performance, Oilers fans continue to fill the arena at every game. The Oilers are one of the few NHL franchises that has played consistently to capacity crowds each year since the lockout.

Thus, while one might identify areas where the Oilers' revenue stream could be further enhanced (and some of that enhancement might occur at Rexall Place), on balance the team is doing very well by NHL standards.

Forbes' estimates are supported by the NHL's own internal analysis of team ticket revenues. The Edmonton Oilers in 2007-08 earned an average of \$1.2 million

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<sup>1</sup> Rexall Place was built in 1974. Only the home arenas of the New York Islanders (1972) and the New York Rangers (1968) were built before the Oilers' arena.

in ticket revenues per game, tied for sixth place out of the thirty NHL teams.<sup>2</sup> Together the six Canadian teams accounted for 31 per cent of the \$1.1 billion (U.S.) in league ticket revenue.<sup>3</sup>

Absent hard data from the Oilers or the NHL, the best public source of information on the finances of professional hockey is *Forbes* magazine. In its annual report on the financial state of the NHL, in November 2009 *Forbes* estimated that 14 of the league's 30 franchises lost money in 2008-09. In the previous two years, *Forbes* estimated that 12 and 15 teams lost money. Both the number of teams losing money and the sum of money lost appear to be underestimated by *Forbes*. For instance, while *Forbes* puts the Phoenix Coyotes losses in 2008-09 at \$18.5 million, media reports suggest that the team's losses may have \$10 million or more above this. Other teams have been reported to be on the brink of bankruptcy. Even the Columbus Blue Jackets, supposedly benefitting from a successful arena-anchored, integrated development project and not in a southern city, is reportedly losing \$12 million a year on its hockey operations.<sup>4</sup>

Given the fact that Rexall Place has the smallest seating capacity in the NHL, these results are testimony to (a) the strength of support for hockey in greater Edmonton, (b) effective arena management and (c) the extraordinarily favorable

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<sup>2</sup> Further, the Oilers' ticket revenue grew by 20 percent between 2006-07 and 2007-08, compared to the NHL mean ticket revenue growth of 9.9 percent.

<sup>3</sup> Rick Westhead, "Canadian NHL Teams Mean Money," *Toronto Star*, May 30, 2008.

<sup>4</sup> Robert Vitale, "Point Person Named on Blue Jackets' Financial Situation," *The Columbus Dispatch*, December 4, 2009. The Blue Jackets reportedly pay \$5 million a year rent to use the arena and then lose another \$4 million annually as the arena's operator.

lease terms offered to the Oilers<sup>5</sup> by Northlands and the City of Edmonton. While the Oilers only receive a small portion of the receipts from third party events at Rexall Place, and in this regard seem to be in a disadvantageous position relative to other teams, such as Flames and the Canucks, the reality is that the Flames, the Canucks and other teams have to pay arena operating and other expenses that the Oilers do not pay.

The general trend in the sports industry, for facilities that are not privately owned, is for teams to pay rent, retain all of the NHL-related revenues and pay all of the expenses. In addition, the majority of NHL teams or their affiliates are responsible for capital contributions or debt payments...A review of all NHL-only arena leases indicates that 60 percent of all teams pay an annual

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<sup>5</sup> Under the terms of this agreement, Northlands continues the management and operations of Rexall Place. The License Agreement grants EIGL the right to receive all Oiler game revenues, including net Oiler food and beverage and novelties/merchandise receipts. . EIGL is also entitled to all building advertising and sponsorship revenues, and suite rental revenues, Further EIGL receives 50 percent of Rexall Place parking lot revenue. Northlands is responsible for building operating and capital costs, including the building event costs related to the playing of professional hockey. Under the Agreement, Northlands receives from EIGL building rent of \$1 per annum plus a contribution towards operating costs of \$73,180 per month or \$878,166 per annum for the period July 1, 2004 to June 30, 2014, this sum is adjusted annually based on the Consumer Price Index. The License Agreement includes an additional annual contribution of \$270,272 for the use of the scoreboard until September 30, 2021 to pay off the loan for the scoreboard. However, if the Oilers cease to play at Rexall Place during the term of the loan, EIGL no longer has to make the loan payments. Effective June 30, 2008, Rexall Sports Corporation purchased the Edmonton Oilers from EIGL. The License Agreement remains valid with Rexall Sports Corporation.

rental fee with the average rent for a team playing in an NHL-only facility of approximately \$1.3 million annually.<sup>6</sup>

Thus, when the team revenues are netted out by team costs, the Oilers' arena economics today are superior to the vast majority of other NHL teams. Further, there appear to be opportunities at Rexall Place to increase hockey-related revenues going forward.

The Oilers have deep roots in the greater Edmonton community. These roots enable the team, which has not made the playoffs since 2006, to sell-out every home game and do so despite ticket prices that are above the NHL average.<sup>7</sup> Although I have not made a systematic study of arena management, the ability of the team to generate league-leading net revenues at Rexall Place also suggests that arena management and its provision of services to fans is highly effective. The arena's location, a short distance to the north of downtown (just 2.2 miles from City Hall), adjacent to an LRT station, a major highway artery and ample parking surrounding the arena, is convenient not only for in-town fans, but also for the roughly 40 percent of the season ticket holders who come from outside the Edmonton CMA.

That said, the age of the arena, its reduced seating capacity, its relatively narrow concourses and sub-standard features in the luxury suites make it advisable to consider serious proposals for a new arena or for a significant renovation to Rexall Place that would bring the venue up to current NHL standards. HOK Sport's Rexall Place Renovation Study (March 2007) outlined the following recommendations that could be considered.

Based on HOK's experience with this building type, the extent of modifications required to bring the building up to current NHL standards, it was determined that the building would need to be renovated from its

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<sup>6</sup> CSL Executive Summary Arena Analysis Spring 2009.

<sup>7</sup> According to the last analysis by Team Marketing, in 2008 the Oilers' ticket prices were \$4.51 above the NHL average. *Team Marketing Report*, October 2008.

structural frame up...the building [would be] expanded to provide better circulation through more room for stairs, elevators and wider concourses.<sup>8</sup>

However, because the economic performance of Rexall Place is, at worst, well above the NHL average and fan experience appears to be good, I believe that it would behoove the city to proceed deliberately in considering future options. The current situation probably could be improved upon (and this is true to different extents for virtually all NHL arenas), but there is little reason for policy makers to feel any urgency. The Edmonton CMA's current difficult fiscal circumstances and high vacancy rates, due to the widespread financial crisis, also support a methodical and deliberate approach, as alternative plans for a new arena district are explored. A clear vision for a new arena and possible surrounding development must be financially viable and in the best interest of the broader community.

A general sketch of a preliminary plan has been put forward to build an arena downtown in the area south of 104th Avenue and between 101st and 103<sup>rd</sup> streets. The targeted real estate is 16.7 acres and is intended to incorporate mixed-use activities (possibly including a practice ice rink, condos, two hotels, student dormitories, office buildings, a casino and a winter garden park).

### The Economics of Sports Facilities and Teams

To understand the potential impact of such an arena-anchored, integrated development project, it is useful to review the scholarly literature of the economic impact of sports facilities and professional sporting teams in general. The virtually unanimous conclusion that has come out of the academic literature on this subject is that a city, county or state should not anticipate a positive economic development or fiscal impact from a new sports facility. That is, a new sports facility by itself should not be expected to raise employment or per capita income levels in a community. The primary reasons for this outcome are fourfold.

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<sup>8</sup> Rexall Place Renovation Study, March 2007, HOK Sport p. 4.

First, despite their large cultural presence, sports teams are modestly-sized businesses. Depending on the sport and the city, team revenues vary generally from \$100 million to \$400 million. Front offices generally employ between 60 and 160 full-time workers – approximately the equivalent of a medium-size department store.

Second, most families have a relatively fixed budget for leisure activities. If a family spends \$250 going to a hockey game, it is \$250 it does not have to spend at local theaters, concerts, bowling alleys or restaurants. Thus, a good share of money spent at sporting contests is money that is not spent elsewhere in the local economy – one form of entertainment expenditure substitutes for another.

Third, there are generally larger leakages out of the local economy associated with the professional sports dollar. For instance, NBA players earn about 57 percent of league revenue. The average NBA player earns over \$5 million in salary. His nominal, federal marginal tax rate is close to 40 percent and he normally has a high savings rate. Less than one-third of NBA players make their permanent residence in the same city in which they play.<sup>9</sup> Federal taxes, of course, go to Washington or Ottawa and leave the local economy. Savings enter the world's money market, and, generally, also leave the local economy. A significant share of a player's income finds its way back to his hometown. Thus, a higher share of the money spent at entertainment venues other than professional sports stadiums and arenas stays in the city.

Fourth, in the vast majority of cases, arena and stadium projects create a budgetary gap. This is because over the last twenty years approximately two-thirds of the development costs for the average professional sports facility in the United States has been publicly funded and the typical lease has shared little facility revenue with local government.<sup>10</sup> When sports facilities create a budgetary gap, this gap

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<sup>9</sup> John Siegfried and Andrew Zimbalist, "A Note on the Local Impact of Sports Expenditures," *The Journal of Sports Economics*, vol. 3, no. 4 (December 2002).

<sup>10</sup> According to CSL, on average for all NHL teams, the annual rent payment to the public sector was just over 2 percent of net arena revenues.

must be compensated for by either higher taxes or a reduction of services – either of which puts a drag on the local economy.

Although the foregoing applies most cogently to the case of a standalone sports facility, it is important to point out that the econometric work on the impact of stadiums and arenas encompasses cases of both standalone facilities and facilities with surrounding development. An argument made by several scholars, including myself and Mark Rosentraub, is that under certain financial and economic conditions, a sports facility can anchor a broader, more integrated development in the downtown core. The potential revitalization of the core can, in turn, improve the image of the city and possibly set off a dynamic that stimulates a more thoroughgoing transformation of the downtown area.

In his essay “Sport Facilities, A New Arena in Edmonton, and the Opportunities for Development and a City’s Image: Lessons from Successful Experiences,” Rosentraub trumpets the positive effects of integrated development projects in Columbus, Ohio, Indianapolis, Indiana, Los Angeles, California and San Diego, California. While these experiences certainly have positive elements, it is important to look at them more closely before concluding that they offer a roadmap for Edmonton.

The general notion of a sport facility anchor for an integrated development project is that, due to the prominent position of sports in our society, with a modest public investment in support of an arena or stadium, a city can leverage a much larger private investment in the surrounding neighborhood. If the project reaches a critical mass, then the elements of the project can begin to reinforce each other and engender a self-sustaining growth process.

Even in the latter “success” case, the basic result is a relocation of economic activity within a larger metropolitan area. Such relocation can be beneficial because it may serve to improve the city’s image which can have other salutary effects. Yet, at least as far as it has been quantified to date, there appears to be *no* significant increase in the levels of employment or income per capita in the greater metropolitan

area. It is, therefore, advisable to approach the consideration of such a project with a healthy dose of caution, rather than of boosterism.<sup>11</sup>

The first case discussed by Rosentraub is Columbus, Ohio. Rosentraub relates some anecdotes about new developments around the hockey arena in Columbus and to its north. He also conveys that the new arena was 100 percent privately funded (90 percent by Nationwide Insurance and 10 percent by the owners of a local newspaper.) Nationwide, in turn, was granted certain development rights and tax privileges by the city. An issue in Columbus and in each of the other cases in the

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<sup>11</sup> It is peculiar Rosentraub himself seems to have switched his posture from the former to the latter. For instance, some 23 years after the beginning of the integrated development project in Indianapolis, Rosentraub wrote the following: “Unfortunately, in virtually all communities the news that a new sports facility is to be built also has meant that local taxes will increase. Meanwhile, the private-sector partners, the teams, retain most, if not all, of the revenues. These arrangements have created a new welfare system for some of the most economically privileged people in our society. The passage of sales, property, hotel, car-rental or restaurant taxes or the establishment of a lottery usually is justified by citing the economic development that will occur as a result of the new facility or the image benefits to a city generated by a team.... I do not approve of providing subsidies to profitable businesses, nor do I believe that the owners of any team and the players deserve welfare. Professional team sports generate sufficient revenue to build the desired facilities without tax subsidies.... Some argue that teams are valuable because they attract other firms to an area as a result of the publicity they generate. Statistically, economists have found no relationship between growth and the presence of a team.... Last, in terms of economic benefits, many argue that downtown facilities will revitalize depressed areas. The most recent work suggests that the presence of a facility in the downtown area has little impact on the decentralization of the American economy and lifestyle.” Mark Rosentraub, “Are Tax-Funded Sports Arena a Good Investment for America’s Cities? No: Beware of Capital-Improvement Projects that Usually Turn Out to Be Welfare for the Rich,” *Insight*, September 22, 1997.

Rosentraub essay is the likelihood that the new investments around the arena came at the expense of economic activity elsewhere in the city. This likelihood rises to a near certainty where there is already an excess supply of commercial and residential properties. Indeed, Rosentraub observes: “While the downtown mall continues to suffer and there has been no development of residential properties in the downtown area, Columbus has a new downtown.” If Columbus is to serve as a model for Edmonton, then it behooves Edmonton to take notice that the owners of the NHL’s Columbus Blue Jackets are now seeking additional public support and have raised the spectre of a franchise relocation to another city.

The second case addressed by Rosentraub is Indianapolis, Indiana. Despite the fact that Indianapolis’ sports-led development plan began in the early 1970s with the construction of a convention center and the Market Square arena, Indianapolis’ population fell from 744,624 in 1970 to 700,807 in 1980, and still remained below the 1970 level in 1990. Finally, by 2000, the city’s population rose just above where it had been in 1970.<sup>12</sup> Rosentraub heralds the Indianapolis experience as a striking success. He notes that between 1974 and 1999 there was \$4.4 billion spent to rebuild downtown (actually this sum refers to building within a two-mile radius of downtown, plus one building outside this radius); of this, the city only contributed \$578 million or 13.2 percent of the total. That is, for every dollar the city spent of public money, there was \$7.58 of private spending.

The third “success” story is that of Los Angeles. Here the city committed \$71.1 million out of a total of \$375 million for the construction of Staples Arena. The debt service on this \$71.1 million was covered by a ticket tax levied on events at the arena. Around the arena, a concert hall, hotels, television studios, and condos, among other buildings, were built and the area was dubbed by some to be the Broadway of the west coast. Rosentraub maintains that this integrated development transformed downtown Los Angeles from a slum into a thriving entertainment center. Others maintain that this area is an enclave of wealth that has had next to no

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<sup>12</sup> More precisely, in 2000, Indianapolis’ population had grown by roughly 5,000 relative to its population in 1970, or by less than seven-tenths of one percent.

effect on the rest of the downtown area. Whatever the growth in the few blocks surrounding the Staples Center, there remains the question of whether this growth cannibalized economic activity in the greater metropolitan area. There is no evidence presented in the Rosentraub essay that the Staples Center development produced greater employment or income in the Los Angeles MSA.<sup>13</sup> The larger problem in citing the Staples Arena development as an example for Edmonton is that the two areas have next to nothing in common. The largest difference, of course, is that the Staples Arena is home to two NBA teams, plus one NHL team. It is also located in the second largest media market in North America and an area of enormous wealth.

The fourth and final “success” story is that of San Diego and the construction of Petco Park for MLB’s San Diego Padres. In order to procure roughly two-thirds public funding for the construction of the new stadium, then Padres’ owner John Moores agreed to fund approximately one-third of the facility’s building costs and to guarantee that he would invest at least \$450 million in surrounding real estate development. Further, Moores provided a letter of credit (LOC), so that if he did not make the promised real estate investments, the LOC would fund the entire debt service on the public’s stadium investment. In the end, the public share of the total investment in the development was \$300 million out of a total \$3.5 billion, according to Rosentraub. The area under development was contiguous to the growing area in south San Diego known as the Gaslamp Quarter, and was likely to develop in the near term in any event.

Beyond the “success” stories related by Rosentraub, there are other integrated development plans that have been delayed or have hit rough financial patches,

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<sup>13</sup> Rosentraub produces a modicum empirical evidence, but it is premised on the false assertion that 2007 represented the “height of the mortgage and credit crisis in the United States.” The financial problems were certainly brewing in 2007, but the crisis and its impact on markets did not hit until the middle of 2008.

including: Ballpark Village in St. Louis<sup>14</sup>, Atlantic Yards in Brooklyn<sup>15</sup>, Victory Project in Dallas<sup>16</sup> and Consol Energy Center in Pittsburgh. Thus, there is no guarantee that integrated development plans will materialize. If they do materialize, many questions remain. Nonetheless, in the “success” stories cited by Rosenberg it is notable that financing arrangements contain a large majority of private funding, even including a letter of credit in one case to back up the projected increase in property tax revenue in the event of a shortfall.

Generally, each of the “success” stories, in varying degrees, relies upon the public’s investment to be covered by increased tax revenues from the new economic activity associated with the development project. In the United States, this funding mechanism is referred to as Tax Increment Financing (TIF); in Canada, the similar terminology is Community Revitalization Levy (CRL). Each mechanism offers the prospect to the city of a free lunch; that is, redevelopment of the city’s downtown core without any net cost.

While TIF/CRL plans can work to a city’s benefit, there are also some important risks. First, there is a strong possibility that incentives to develop one area will result in the relocation of economic activity from other areas of the city, and not in the creation of new activity. Hence, any increase in tax revenue from redeveloped

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<sup>14</sup> Ballpark Village has been stalled to disagreements between the team and the city as well as difficulty in obtaining financing.

<sup>15</sup> Atlantic Yards was delayed for some five years due to local political resistance, the country's financial crisis and difficulty in arranging financing.

<sup>16</sup> The Victory Project did not see any additional development until more than five years after the American Airline Center opened. The delay occurred in part because the initial agreement with the developer was scrapped and the plan was forced to start over from scratch. Today, ten years after the arena opened, there has been more than \$1 billion in new construction development, but most of the retail stores and restaurants in the project area have failed and much of the residential property is vacant. The developer, Hillwood Development, has sold its equity interests in the project to a third party.

area A may be offset by a decrease in tax revenue from area B, leaving the city with no additional funds to pay the debt service on the public's new investment. If the new integrated development is launched at a time when the economy is weak and commercial and residential vacancy rates are appreciable, then the likelihood of this cannibalization effect is greater.

Second, the TIF/CRL district may yield tax revenue increases from the normal inflationary process. This process usually engenders generalized increases in property values as inflation proceeds over time. Such tax revenue increases would have occurred with or without the new development. Indeed, in some cases, the district may have developed on its own without any special public intervention.

Third, as an area develops, the need for new public services grows as well. The city must provide additional public safety, sanitation, infrastructure, and perhaps education, *inter alia*. Thus, even if the total tax revenue grows in the city as a result of the new development, the net tax revenue (after incremental costs) will be smaller.

The foregoing discussion is not meant to disqualify any plan to stimulate an arena-anchored, integrated development in downtown Edmonton. Rather, it is intended to point out the complexity of the process and the uncertainty of its outcome. Among other things, it commends the most deliberate attention be given to the details of the plan and its financing.

### Moving Forward

The available evidence suggests that the Oilers are one of the strongest franchises financially in the NHL. Nonetheless, the end of the team's lease at Rexall Place in four years and the arena's age are reasons to ask questions about future plans.

As the team, and various orders of government continue to explore future possibilities, it makes sense to consider an arena-anchored, integrated development in downtown Edmonton. If such a project is pursued, the experience with the cases

reviewed above indicate that it would be prudent to follow certain financing guidelines.

First, in each of the “success” cases discussed by Rosentraub, the public sector’s share in the totaling financing of the project was under 20 percent. There is nothing magical about the 20 percent threshold, but the notion of the public paying for over three quarters of a projected \$450 million arena (and cost overruns usually mean that the final price tag is considerably higher than the initially approved budget) and the possibility of only modest additional funds being committed for the remainder of a \$1.5 billion-plus envisioned development<sup>17</sup> is a challenging model for moving ahead -- one that is inconsistent with the recent Canadian model for privately financed arena developments .

Second, any financing scheme that depends significantly on CRL or TIF to cover the public’s debt service is highly risky. New developments can be expected to draw economic activity away from other parts of the metropolitan area. Incremental tax revenues raised in the designated district may be fully or largely offset by revenue diminutions elsewhere in the city. Thus, the plan should deduct from increased district tax revenues any decrease in revenues from elsewhere in the city (after adjusting for any inflationary or trend growth in those areas.)

Therefore, project financing should only include incremental revenues in the district, if the city wants to avoid a budgetary gap. Moreover, the new development will require city services (public safety, sanitation, infrastructure, among others) and the costs of these services should also be deducted before CRL financing is applied to any public debt service.

To these caveats it is important to add one more. Each of the above steps is based on projections, not certainties. As in San Diego, it is important for the private developers in any private/public partnership to guarantee the funding for public debt

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<sup>17</sup> The Katz group has committed \$100 million to the arena construction and has suggested that another \$100 million of private funds may go to the broader development.

service if the budgeted mechanism proves deficient. The private developers stand to profit from the partnership, and they should bear a good part of the risk. A letter of credit to meet any potential shortfall could be considered.