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**Edmonton Northlands Park  
Skyreach Centre  
Review of Financial and Operating Information**

February 26, 2003

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# Edmonton Northlands Park Skyreach Centre

## Review of Financial and Operating Information

### Introduction

The City Manager and the General Manager of Corporate Services requested that the Office of the City Auditor (OCA) assist with a due diligence review in preparation for negotiations leading toward the renewal of the City's support agreement with Northlands. In accordance with the City's agreement, Northlands submits audited Skyreach Centre Operating Statements annually to the City for their review. These statements are prepared consistently with the City's agreement and Canadian Generally Accepted Accounting Principles.

The OCA's objective for this project was to conduct a review of financial and operating pro forma financial information pertaining to Skyreach Centre within the context of the current support agreement. Descriptions of the historical events leading to the current support agreement are attached as Appendix 1. Major assumptions used in this report are described in Appendix 2.

### Scope and Methodology

The scope of this review is limited to a financial and operational review of Skyreach Centre within the context of the current support agreement. The OCA's methodology included the following steps:

- Reviewed historical information including Administrative and OCA reports
- Reviewed key historical documents including agreements, financial statements, annual reports, bylaws, and capital plans
- Interviewed key staff from both the City and Northlands
- Reviewed pro forma income statements and supporting information

Northlands' management team was very cooperative in providing unrestricted access to their operating staff and financial backup information, and responded in a timely manner to all requests. Because of the confidential and sensitive nature of the information underlying particular revenues and expenditures, details at the line item level are not disclosed in this report.<sup>1</sup>

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<sup>1</sup> Freedom of Information and Protection of Privacy (FOIP) Act, Revised Status of Alberta 2000, Chapter F-25 with amendments in force as of January 1, 2002. (Section 16(1) Disclosure harmful to business interests of a third party.)

## Analysis

Northlands submitted pro forma income and expense statements for Skyreach Centre to the City covering the years 2003 – 2009, including a listing of key assumptions. They also provided a capital and major maintenance program for the years 2003 – 2014.

### Revenues and Expenditures

Table 1 presents a summary of Skyreach Centre revenues and expenditures (non-hockey events only) based on four time periods:

- 1994 - 1997: Northlands receives annual rental fee of \$2.8M under Northlands' agreement with Hockey Corp. During 1994, Northlands entered into a 10-year facility management agreement allowing Edmonton Oilers Hockey Corp. and Coliseum Management Inc. (collectively called Hockey Corp.) to operate Skyreach Centre in exchange for an annual rental fee of \$2.8M.
- 1999 - 2001: Average of the first three years of operation under the support agreement between the City of Edmonton and Northlands. Revenues include the 1999 event income from the Brier in Edmonton. Also included is flow-through revenue and matching expense of \$2.5M from the Edmonton Oilers Ticket Surcharge. Prior to 2002, Northlands would collect the surcharge and transfer it directly to the Edmonton Investors Group Ltd. Thus there are matching revenue and expense items in Northlands' statements. Under the terms of the Admission Surcharge Agreement drawn between Northlands, the Edmonton Investors Group Ltd. (EIGL) and the City of Edmonton on November 20, 2001, hockey and Oilers event ticket surcharges collected in 2002 and in future years go directly to EIGL.
- 2003: The base year in the pro forma leading up to the current negotiations.
- 2009: The longest projection presented in the pro forma.

**Table 1: Overview of Skyreach Centre Revenues and Expenditures  
(Presentation in \$millions)**

Skyreach Operations	Year			
	1994-1997	1999-2001	2003	2009
Operating Revenue (non-Oilers events only for 1999 onward)	2.8+	8.9	6.1	7.3
Edmonton Investors Group contribution	0	0.6	0.8	0.9
Total Revenue	~2.8	9.5	6.9	8.2
Total Expenditures	~0	9.8	8.2	9.9
Operating Profit (Deficit)	~2.8	(0.3)	(1.3)	(1.7)
City of Edmonton contribution	0	2.4	2.4	2.8
Net operating position	~2.8	2.1	1.1	1.1
Unfunded Capital Liability (as discussed in a subsequent section)	N/A	N/A	0.7 average	1.5 average

Inherent in the assumptions underlying the current agreement with Northlands is the notion that they should remain in the same or close to the same financial position, as they were when they received \$2.8M of rent from Coliseum Management Inc. It was

Northlands' stated position in 1998 that since concessions made to Coliseum Management Inc. in 1994 were 100% absorbed by Northlands, they could not afford further erosion of revenues (a position that was expressed using the concept of "remaining whole"). Northlands' rationale was accepted by the City in formulating the current agreement and remains a key assumption in Northlands' forecasts.

### **Activity Levels**

Based on historical usage patterns, Northlands' estimates of the number of future events (concerts, family shows, one of a kind events like skating and curling championships, etc.), will remain at current levels. Projecting the number of events several years into the future has substantial risk because of influences that are beyond the control of Northlands (the competitive environment in Western Canada, etc.). Where appropriate, Northlands conducted a sensitivity analysis on its attendance forecasts.

Table 2 summarizes utilization rates for Skyreach Centre (all events). In the long term, the utilization rate for Skyreach Centre is estimated to be in the range of 40% to 42%. This rate is congruent with the assumptions made on forecasts pertaining to total event revenues over the reporting period.

**Table 2: Skyreach Centre Utilization Patterns Over Time**

Reported Year	Utilization (%)
1999	42.5
2000	40.4
2001	37.6
2002	46.2
2003	42.0
Long Term Utilization Rate Goal	40.0 – 42.0

The OCA was not successful in its attempt to obtain comparative benchmark information from similar organizations operating large hockey/entertainment facilities. Our initial goal was to obtain high level comparative data on facility utilization and unit figures for key elements in both the revenue and expenditure streams. Without such benchmarking information, the OCA had to rely on historical patterns at Skyreach Centre in conducting its analysis.

### **2003 – 2009 Operating Pro Forma**

The OCA compared Northlands' pro forma financial information for the Skyreach Centre against audited financial statements of the Skyreach Centre for the years ending 1999 to 2001. This comparison posed some difficulties because Northlands has revised its allocation of costs between the different business segments within Skyreach to better reflect the use of its resources.

Based on the OCA's review and analysis of the pro forma financial information supplied to the City and supporting documentation, the revenue estimates in the pro forma appear to be reasonable reflections of Northlands' prior experience. It should be noted

that revenues will naturally fluctuate due to the nature of Skyreach Centre's business (e.g., some concert acts will be a bigger draw than others).

The OCA's analysis of the pro forma statements indicated that expenditures reflect only changes due to CPI inflationary assumptions. This appears to be optimistic since actual expenditures rose approximately 18% from 1999 to 2001. The OCA also noted that wages are approximately \$1 million lower on the 2003 pro-forma statements than the actual for 2001. Northlands has confirmed that the base for 2003 expenses was understated.

### **2003 – 2014 Capital Budget**

The pro forma includes estimates for capital and major maintenance from 2003 to 2014. Two clauses in the current support agreement are particularly important with regard to the capital budget. The first requires that Northlands maintain the Coliseum in good repair as a first class facility and the second requires Northlands to allocate \$800,000 per year for major maintenance, with an allowance to accumulate a reserve of up to \$1,600,000 (adjusted for CPI) whereupon it must be expended.

Table 3 presents yearly forecast averages for project work as presented in the pro forma compared to historical averages.

**Table 3: Project Work Profile (Presentation in \$000's/year)**

Description	Historical Averages (1999 – 2002)	Forecast Averages	
		(2003 – 2007)	(2008-2014)
Funded Capital / Replacement Projects	1,513	135	221
Funded Major Maintenance Projects	550	657	635
Total Funded Project Work	2,063	792	856
Northlands Unfunded Program for Skyreach	N/A	724	1,469
Total (Funded and Unfunded Projects)	2,063	1,516	2,325

The American Public Works Association (APWA) suggests that appropriate levels of investment in maintenance and repair of public buildings are between 2% and 4% of replacement cost per annum.<sup>2</sup> Over the last 4 years, total project work expenditures at Skyreach have averaged \$2M per annum. Applying the APWA investment standard to an estimated replacement value for Skyreach Centre of \$81M, the annual budget for project work should be in the range of \$1.62M - \$3.24M per annum. Northlands' forecast for combined funded and unfunded projects of \$1.5M during the 2003 – 2007 time period is below the lower range of industry standards. During the 2008 – 2014 time period, the forecast of \$2.3M per annum is near the mid-range of industry standards. The source of funds for the unfunded portion has not been determined.

<sup>2</sup> Committing to the Cost of Ownership, Maintenance and Repair of Public Buildings Building Research Board, National Research Council, American Public Works Association – Special Report #60.

During 2002, the City conducted a high-level overview of the capital requirements for Skyreach Centre. Table 4 presents the unfunded capital program for Skyreach Centre that was presented in the City's 5-year Capital Priorities Plan (CPP) for 2003 – 2007 that was included in the 2003 budget package submitted to City Council. The City's proposed program is based on maintaining the physical and operating integrity of Skyreach Centre and ensuring that it conforms to present building code and occupational health and safety standards. The program elements include a replacement of boilers, air handling units, fan units, heat exchangers, compressors, accessibility improvements, and structural work. Consistent with the City Policy A1424 – Project Management for Projects, Asset Management & Public Works planned to undertake some study and design work in 2003 to more fully understand the scope and costs of work involved if the capital program had been funded. The City's forecast included only items that contribute to the longevity of the physical asset.

**Table 4: City's 5-Year Capital Program (Unfunded) (Presentation in \$000's/yr)  
AMPW – Land and Buildings (capital project XX-75-4695)**

Year	2003	2004	2005	2006	2007	Total	Average
Program Estimate	570	1,650	750	550	100	3,620	724

## Observations

### *Enhancement of Project Work Definitions*

The current definitions of "maintenance" and "capital" in the agreement need to be enhanced during negotiations to clarify expectations for all parties involved. From the perspective of Northlands, as a service provider, the definition of a first class facility translates into a capital program that has an emphasis on Skyreach Centre's operating functionality and aesthetics (e.g., concession areas, food & beverage infrastructure, etc.). The emphasis and focus of the Edmonton Investors Group is on a capital program that focuses on improvements mandated by the NHL (e.g., rink boards, arena lighting, etc.). The City's focus as the owner of the lands, improvements (buildings, parking lots, etc.), and fixtures is on a capital program that conserves the asset. Further clarity with respect to responsibility for maintenance and capital expenditures amongst the stakeholders is encouraged during negotiations.

### *Reasonableness of Estimates*

Skyreach Centre's original unfunded capital program estimates submitted in the pro forma were based on information from several sources. Northlands retained a consultant to undertake a high-level assessment of the various building subsystems. The consultant's report presented an improvement program for architectural, structural, mechanical and electrical components including cost estimates for the necessary work. Of concern to the OCA is the reasonableness of those estimates. One particular estimate – replacement of two heating boilers at an estimated cost of \$312,000 – contrasts with the City's estimate of \$1.3M based on a similar project at the Stanley A. Milner Library in 2002. The OCA believes that a formalized process between the City

and Northlands needs to be developed to more accurately define a long-term infrastructure program for Skyreach Centre that will meet the needs of all stakeholders. Because Skyreach Centre is 29 years old, several building subsystems are approaching or have exceeded the expected end of their useful life. Reasonably accurate long range planning information is critical to adequately support strategic decisions such as future replacement of the building versus major repair and maintenance since the building has a forecast useful life of 50 years.

Until the questions regarding the accuracy of cost estimates and the establishment of a formal approach to identification and costing of long term infrastructure requirements are resolved, the City and Northlands are exposed to significant risk of escalating project costs. The OCA expects that long-term expenditure requirements for maintenance and repair at Skyreach Centre will move upward from the current lower end of the APWA standard.

## **Conclusions**

This entire analysis has assumed that the Oilers stay in Edmonton. If that does not happen, other options need to be considered.

From the operating perspective (excluding capital requirements and assuming the annual financial support by the City continues), the revenue assumptions made in the pro forma appear to be reasonable reflections of Northlands' prior experience. However, expenditure estimates reflect only changes due to CPI inflationary impacts. These estimates may be optimistic given historical expense increases and the understatement of wages in the pro forma. Significant efforts in promoting and attracting new events in Skyreach Centre would have to take place to alter the overall financial position. Although Northlands has assumed inflationary increases for the City's operating grant, that commitment has not been made.

From the capital perspective, Northlands has planned insufficient funds to ensure adequate long-term investment in the maintenance and repair of the facility. The City of Edmonton, as the ultimate owner of this asset, needs to appropriately address preservation of the remaining useful life of the facility. The OCA has identified four basic options:

1. Northlands funds all capital needs and the City continues to provide its operating grant.
2. The City assumes capital needs required to preserve the useful life of Skyreach Centre, Northlands funds other capital needs, and the City continues to provide its operating grant.
3. As in 2, but the City deducts its capital expenses from the operating grant.
4. Northlands funds all capital needs and the City withdraws its support for Skyreach Centre.

The City of Edmonton needs to annually review and analyze the information received from Northlands to ensure compliance with all applicable agreements. In addition, the City should consider an overall financial review of Edmonton Northlands Park as a whole prior to the renewal of the City's support agreement.

## **Appendix 1 – Historical Overview**

In the summer of 1989, the City and Northlands Park Ltd. ratified a site lease agreement that recognized the City's ownership of the land and improvements operated by Northlands and granted Northlands the right to use the land and improvements for an annual fee of \$1.00. On July 1, 1998 the City of Edmonton and Northlands entered into a support agreement that the City would provide an annual maximum contribution of \$2.4M to offset operation and maintenance costs at Skyreach Centre (formerly the Coliseum). This support agreement expires on June 30, 2004, as does the Edmonton Investors Group Skyreach License Agreement. Both agreements expire in the same year that the collective bargaining agreements between the National Hockey League Players Association and Team Owners reopen.

### ***Historical Overview of the Current Skyreach Centre License***

Prior to 1994, Northlands operated the Skyreach Centre and received all revenues from facility rentals, food and beverage concessions, and certain advertising as well as a percentage of gate revenue for professional sport games played in Skyreach Centre. During 1994, Northlands entered into a 10-year facility management agreement allowing Edmonton Oilers Hockey Corp. and Coliseum Management Inc. (collectively called Hockey Corp.) to operate Skyreach Centre in exchange for an annual rental fee of \$2.8M.

In May 1998, Edmonton Investors Group acquired the Edmonton Oilers Franchise and all related contracts and commitments including the 1994 License Agreement and any related obligations to Northlands. As a condition of the purchase, Edmonton Investors Group entered into covenants and restrictions similar to those contained in the 1994 Location Agreement, which grants substantial control to Northlands, the City, and Economic Development Edmonton over attempts to move the Oilers from the City.

A new License Agreement was executed with the Edmonton Investors Group for a period of 6 years beginning July 1, 1998. Under the terms of this agreement, Northlands resumed the management and operation of Skyreach Centre. The new License Agreement grants Edmonton Investors Group the right to receive all hockey-related revenues. This includes Oilers ticket sales, net food and beverage contributions, all building advertising and sponsorship revenues (except for national, international and internal events that are non-hockey related), suite rental revenues (except for some suite sales), ticket surcharge revenues, and Skyreach Centre parking lot revenues. Northlands is responsible for the operating and capital costs for the building, including building event costs related to the playing of professional hockey. Under the current agreement, Northlands receives from Edmonton Investors Group building rent of \$1 per annum plus a contribution towards operating costs of \$700,000 per annum for the period 1999 to 2004. The Edmonton Investors Group contributions are eligible for annual adjustment based on the CPI.

As discussed previously, inherent in the assumptions underlying the support agreement with Northlands is the notion that they should remain in the same or close to the same financial position, as they were when they received \$2.8M of rent from Coliseum Management Inc. It was Northlands' stated position in 1998 that since concessions made to Coliseum Management Inc. in 1994 were 100% absorbed by Northlands they could not afford further erosion of revenues (a position that was expressed using the concept of "remaining whole").

In 1998, Northlands and the City agreed to a partnership proposal whereby the City would contribute a maximum of \$2.4M annually to the projected "operating shortfall" of \$4.8M (\$2M deficit plus \$2.8M forgone rent). The support agreement stipulates that any operating profits are to be shared 50/50 between the City and Northlands by reducing the City's contribution on a sliding scale as Skyreach Centre's profitability increases. For purposes of the support agreement, operating profit is defined as operating revenues (including operating grants from the City and other public sources) minus operating expenditures. The support agreement contains a detailed description of the elements that make up operating revenues and expenses and includes, as an expense item, the \$2.8M in forgone rent. In effect, this provision allows Northlands to recover the \$2.8M before profit sharing with the City begins (based on the remaining whole concept).

## Appendix 2 – Assumptions

### *Overview of Major Assumptions*

Two fundamental assumptions in Northlands' pro forma are that the Oilers stay in Edmonton and that the Consumer Price Index (CPI) will increase at 3% annually, unless otherwise stated.

Revenue assumptions include:

- City retains the ticket surcharge bylaw.
- City grant of \$2.4M continues and is indexed for CPI (2009 - \$2.8M).
- No major secondary tenant is likely in recognition of West Edmonton Mall's planned development of an 8,000-seat facility.
- Northlands will assume contractual control and operation of the food and beverage operations.
- Edmonton Investors Group continues to provide their contribution towards operating costs starting at \$0.7M and indexed for CPI with 1998 being the base year (2003 - \$0.8M).
- Major events planned include the Canadian Figure Skating Championship in 2004 and the Brier in 2005.
- Edmonton Investors Group retains revenue streams from advertising and sponsorship.
- Northlands retains revenue from row 2 suite ticket sales for repetitive non-hockey events that last for more than two events.
- Food and beverage revenues increase by 5% in 2002. No other increase is planned in subsequent years in order to remain competitive in the Alberta market.

Expense assumptions include:

- Utility rates increase initially by 3% and then 5% every other year.
- Insurance rates increase 10% in 2003, 10% in 2004, and 5% in subsequent years.
- Significant major maintenance increase due to critical components exceeding their projected life spans. Amounts do not include other large projects for which Northlands is exploring alternative funding sources (e.g., the City's 5-year Capital Priorities Plan).

Between 2003 – 2009, the projected revenue stream in Northlands' pro forma statements includes a modest increase of approximately 3% annually. Internal expenditure forecasts also include a modest increase of approximately 3% annually during the same time period. Therefore, the sub-total operating shortfall also grows by approximately 3% per year. Northlands' expectation is that the City's annual subsidy will be indexed for the CPI. Over time, Skyreach Centre's operating shortfall after the contribution continues to increase marginally.

Historically, audited Skyreach Centre Operating Statements (as defined in the support agreement) have shown an operating shortfall after recognizing the City's contributions under the terms of the City of Edmonton Support Agreement. The identified shortfall was \$2.2M in 2000 and \$2.9M in 2001. However, one of the expense items listed in the audited operating statements is the \$2.8M in forgone rent that was discussed previously. Therefore, the reported operating shortfall as defined in the agreement is not the same as an operating deficit.