



by James M. Klas

## Space: The Final (Gaming) Frontier

Revenue per square foot is one of the oldest and most commonly used measures of success for many businesses, including a casino gaming floor. Slot machines generate such rapid returns, if demand is available, that it made sense in the past to pack in as many machines as possible to generate the most profit. The old rule of thumb was 20 sq. ft. per machine and 200 sq. ft. per table. In more recent years, with larger machines and changing customer tastes, the average space per machine has increased to between 30 and 40 sq. ft. At the same time, the mix of machines to table games has shifted to increase the former and decrease the latter. Still, the basic concept of maximum gaming positions in minimum space, within safety and customer preference limits, remained the standard operating procedure in casinos until March of this year. Then COVID-19 changed everything.

Historically, capacity for any public space was determined by fire safety and egress. Indeed, capacity is still measured that way for the moment. However, in the pandemic and post-pandemic era, capacity is now being set by public health considerations to allow for adequate spacing. So far, public health adjustments to capacity are achieved by setting a percentage of the old listed capacity, 25 percent, 50 percent, and the like. Eventually, it is likely that capacity will revert to a simple maximum occupancy number as in the past, but one determined not only by emergency egress, but also by public health considerations. That occupancy number will almost certainly remain smaller than it was in the past, even after the pandemic is over.

Casinos have dealt with the emergency space constraints by simply shutting down some of their machines and restricting guest counts. This is a necessary short-term response to a crisis, but hardly a satisfactory long-term solution. Eventually, casinos will need to rearrange and reallocate space to create an attractive and functional permanent environment that conforms to new spacing guidelines. That, in turn, requires a radical reimagining of space usage and space needed for the gaming floor.

While it flies in the face of conventional wisdom, the new paradigm for gaming space in the pandemic and post-pandemic era will emphasize total space available – total square footage, to maximize revenue. With current and expected future capacity rules, the average square footage per gaming position will likely increase to somewhere between 50 and 75 sq. ft., depending upon regional regulations and competitive patterns. Fortunately, the same economics that make the addition of another gaming machine worthwhile even if it is only used on weekends and other peak periods, make the addition of the space

needed to house that gaming machine equally worthwhile.

The math for adding another gaming position is simple and well known. If a gaming machine captures \$100 per day in revenue and costs \$20,000 to purchase, it pays for itself in nine to eighteen months, depending upon operating costs. As expensive as it is to add space, the same math holds true.

Assume, for example, that you need to add 75 sq. ft. to your gaming floor to be allowed to increase your capacity by one more gaming machine. If that space costs \$500 per square foot to build out and finish, the total cost for the space is \$37,500. Assume also that when you add the machine to the new space, you drop 50 percent of the gaming win from that machine to the bottom line, probably higher than your overall average EBITDA, but reasonable for a marginal return analysis where your fixed costs do not change appreciably. With these assumptions, the new machine would need to capture an average of \$102.75 in gaming revenue per day to achieve a two-year payback for the space added: [ $\$37,500/730 \text{ days}/50\% \text{ operating profit} = \$102.75$ ]. Use the same calculation for 50 sq. ft. and you get only \$68.50 per day in average win needed. You can vary the square footage needed, the cost per square foot, the operating profit percentage and even the desired payback period to get the exact measure that fits your situation. Any way that you run it, there is plenty of justification for adding space as needed to get to the number of gaming positions that fits your market demand. To illustrate the point, the adjacent graph shows a range of average win requirements for a two-year payback assuming 65 sq. ft. per position and a 50 percent marginal profit for a range of space costs per square foot. Even at \$1,000 per sq. ft., the average win needed remains under \$200 per day.

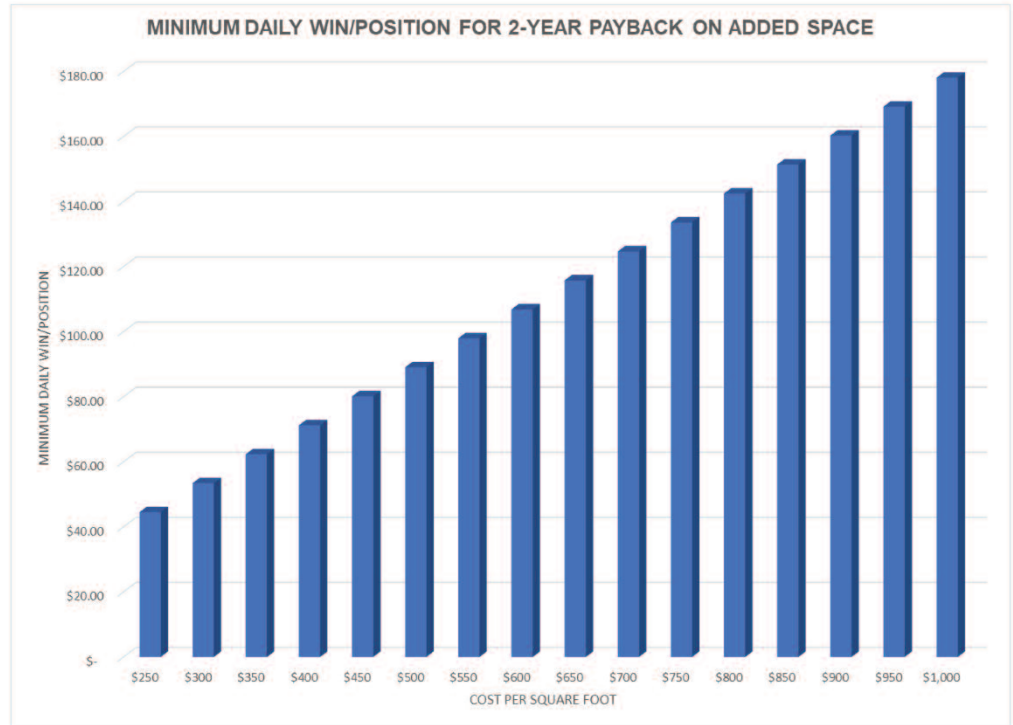
While constructing entirely new space to increase gaming capacity is one option, it may not be possible for all tribal casinos, given trust land limits or other space constraints. Fortunately, another option exists. Under the new space paradigm, the size and character of restaurants, bars, nightclubs, buffets, function space, event centers and entertainment facilities will also need to change to keep ancillary facilities properly balanced with gaming capacity. The trend toward increasing the size and revenue potential of non-gaming amenities that has dominated the Las Vegas Strip for years and spread to Indian gaming will be reversed to some degree. Ancillary facilities face the same issues with public health constraints on capacity affecting the gaming floor, but without the same ability to capitalize on high-value patrons and pay for increased space. Combined with the limits on gaming capacity and the need to focus on high-value

gamers, the capacity constraints on ancillary facilities will lead to a reduction in scale. Even the amount and type of lodging is likely to change.

As casino resorts reevaluate their space needs for gaming and ancillary facilities, the potential exists for excess ancillary space to be converted to gaming space to restore gaming capacity levels. Buffets, function space and some event centers, in particular, may provide lower cost and faster conversion options to managers looking to get gaming capacity back to prior levels. In some cases, the spaces will not be conveniently located to the main gaming floor and there may be other impediments to conversion. In those cases, newly constructed gaming space may still be required. Under such circumstances, former ancillary space may also be used to expand back of house capacity, another area that will require recalibration.

To avoid supply shortages and to create the added space needed for employees to maintain safe distances while on breaks and at beginning and end of shift, back of house space for inventory storage, break rooms, lockers, employee ingress/egress and even administrative office and workspace will need to expand. It is harder to justify such expansion with increased profits, but the space is no less necessary to add. Already, the impacts of employee outbreaks of COVID-19 are causing costly secondary shut downs of reopened casinos. It will be critical to take appropriate steps to minimize the possibility for employees to spread the infection internally. While masks are a necessary component, they are not a substitute for adding space in high contact areas. Finding the lowest cost means of adding back of house space will be important.

Once the current pandemic has passed, the industry has recovered and new growth has taken hold, it is possible, perhaps even likely that capacity parameters will eventually shift away from public health concerns and back to traditional fire safety and egress as the driving force. Prior to COVID-19, capacity was not governed in any manner by the impact of the Spanish Flu 100 years ago despite the fact that it killed more than five times the number of people in the U.S. that Covid-19 has killed to date. However, it is also possible that the public health aspect will remain part of the capacity equation



permanently, at least to some degree, just as fire disasters and trampling episodes caused permanent changes in building codes over the decades. It is also possible, of course, that some other global pandemic of this magnitude may arise faster than the 100-year gap from the Spanish Flu, further reinforcing the importance of public health considerations in building capacities.

Even if public health considerations eventually recede from capacity calculations, they will not do so quickly. The pandemic itself is likely to remain in place through at least the first quarter of next year. Recovery will take another 18 to 24 months after that. Once it takes place, fear of repeating the current crisis with some new and equally unexpected disease will undoubtedly remain in the public consciousness for some time. As a result, it is reasonable to expect that public health considerations will remain a factor in capacity rules for at least the next five years, if not longer. With two-year (or quicker) paybacks for added gaming space easily achievable, active consideration of such expansion to restore gaming capacity is clearly warranted. ♣

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