

SUMMARY

**Effects of Revisions to the Racetrack Video Lottery Act of 1994
and of the West Virginia Lottery
Racetrack Table Games Act of 2007
on the West Virginia Race Horse Industry**

by

**Thalheimer Research Associates (TRA, Inc.)
Lexington, Kentucky (rthal@gte.net)**

for

**Charles Town HBPA, Charles Town, WV (cthbpa@yahoo.com)
and
Mountaineer HBPA, Chester, WV (hbpa@raex.com)**

October 30, 2009

An Examination of the Effects of Revisions to the Racetrack Video Lottery Act of 1994 and of the West Virginia Lottery Racetrack Table Games Act of 2007 on the West Virginia Race Horse Industry

**Thalheimer Research Associates (TRA, Inc.)
for
Charles Town HBPA and Mountaineer HBPA**

October 30, 2009

Following is the summary section from the 31 page report entitled, “An Examination of the Effects of Revisions to the Racetrack Video Lottery Act of 1994 and of the West Virginia Lottery Racetrack Table Games Act of 2007 on the West Virginia Race Horse Industry”. The full report is available upon request.

Summary and Conclusions

The intent of the West Virginia legislature was clear with passage of the Racetrack Video Lottery Act of 1994. Simply stated, the Video Lottery Act was passed in recognition of the decline in the racing and breeding industries due to increased competition in neighboring states and the need to preserve the parimutuel horse and dog racing and breeding industries with their associated jobs, revenues, and tourism. The West Virginia Lottery Racetrack Table Games Act of 2007 further stressed the importance of horse and dog racing to the state. Racing and breeding are dependent on revenue from purses. For example, largely because of the increase in purses from VLT's, the economic impact of the Charles Town race horse industry \$173 million in spending and the creation of 3,658 jobs in the regional economy. Green space was preserved through the increase in horse farms supported by the increase in purses.

With the intent of the legislature in mind, the purpose of this report was twofold:

- (1) to examine the effects of revisions to the Racetrack Video Lottery Act of 1994, with emphasis on purses and breeder awards for horsemen and breeders at Charles Town and Mountaineer.
- (2) to examine the effects of the West Virginia Lottery Racetrack Table Games Act of 2007 on purses and breeder awards at Charles Town (potential) and Mountaineer (actual).

Revenue Effects of Revisions to the Racetrack Video Lottery Act of 1994

The first major changes to revenue provisions of the Racetrack Video Act of 1994 was in FY01, effective in FY02, and included:

- definition of “excess net terminal revenue” as revenue over a FY01 net terminal revenue ceiling which is not adjusted for inflation. Inflation increased 22% from 2001 to 2008.
- imposition of a 10% surcharge on “excess net terminal revenue” which is distributed 58% to the Lottery and 42% to the racetrack.
- reduction in revenue to all stakeholders by deduction of the 10% surcharge from “excess net terminal revenue”.
- creation of a two-tier rate for the Lottery, racetracks and purses. The Tier 1 rate, that which existed prior to FY02, is applied to net terminal revenue up to the FY01 revenue

	Tier 1 Rate to FY01 Ceiling	Tier 2 Rate on "Excess Revenue"-10% Surcharge
Purses	14%	8%
Lottery	30%	41%
Racetrack	47%	42%

- in addition to revenue from the 10% surcharge, Lottery revenue also increases above the FY01 ceiling.
- revenue to the racetrack is reduced above the FY01 ceiling but the loss is largely offset by revenue from the 10% surcharge.
- revenue to purses is reduced above the FY01 ceiling with no offsetting revenue from the 10% surcharge.

The second major change to revenue provisions of the Racetrack Video Lottery Act of 1994 was in FY05, effective FY06, creating the Workers' Compensation Debt Reduction Fund.

- this fund was created by halving money for purses until an annual total of \$11 million across all racetracks is reached. Upon reaching the \$11 million total, the share of VLT revenue going to purses reverts back to the levels specified in the FY01 revision.

As a result of the FY01 and FY05 revisions to the Racetrack Video Lottery Act, the share of purses and breeder awards has declined from 15.4% of gross VLT revenue in FY01 to:

- 8.9% at Charles Town in FY09
- 12.5% at Mountaineer in FY09
- 10.4% averaged over all racinos in FY09

Revisions to the Racetrack Video Lottery Act have resulted in reductions in potential purse revenues compared to what they would have been at the flat rate of 14% prior to FY02. The losses in potential purse revenue in FY09 were computed to be:

- -43% (-\$26 million) at Charles Town
- -17% (-\$5 million) at Mountaineer

The reduction in purses can be attributed to: (1) deduction of a 10% surcharge on "excess" new revenue distributed to the racetrack and government, (2) the imposition of the lower Tier 2 purse rate on non-inflation-adjusted "excess net terminal income", and (3) transfer of purse monies to the Workers' Compensation Debt Reduction Fund.

These losses do not include additional losses from a fourth change to revenue provisions of the Racetrack Video Lottery Act which became effective September 2009 (FY10). At that time deduction of promotional play credits from gross terminal revenue was permitted. Deductions for the last three weeks in September were as high as 15% at Mountaineer. This benefit to the racetrack operator reduces revenues to others including purses, breeder awards, and government.

In addition to statutory revisions, other factors have affected purses and breeder award revenues at the racinos. Growth in VLT's has increased revenue at both Charles Town and Mountaineer. On the other hand, competition from two Pennsylvania racinos and the introduction of table games has reduced revenue at Mountaineer in recent years.

Revenue Effects of the West Virginia Lottery Racetrack Table Games Act of 2007

The West Virginia Lottery Racetrack Table Games Act of 2007 imposed a 35% tax on gross table games receipts. The remaining 65% reverts to the racetrack. Included in the 35% tax are provisions for a 2% distribution of adjusted gross revenue to breeder awards and 2.5% to purses. Following is a comparison of the effective rates on VLT and table game revenue at Mountaineer.

<i>Stakeholder</i>	<i>VLT Rates</i>	<i>Table Rates</i>
Purses and Breeder Awards	12.5%	4.5%
State/Local Government, Other	42.9%	30.5%
Racino Operator	44.6%	65.0%

- the table games rate for horsemen is 64% lower than from VLT's.
- the table games rate for government/other is 29% lower than from VLT's.
- the table games rate for the racino operator is about 46% higher than from VLT's.
- if table games were permitted at Charles Town the pattern would be similar.

Additional observations on the treatment of table games revenue in West Virginia are that:

- no casino gaming state, nor the Iowa racinos, treat stakeholder shares from slot machines and table games differently.
- West Virginia racinos rank high in the proportion of table games to total revenue. One reason for this may be the difference in after-tax treatment of table games relative to slot machine revenue leading to a profit-driven, shift from slot machine to table games play.

Observed Mountaineer Experience Before and After Table Games and PA Racinos

A comparison of changes in VLT and total (VLT plus table) revenues at Mountaineer in 2008 when table games and competition from Pennsylvania racinos were fully phased-in compared to 2006 when there were no table games or new competition showed that:

- VLT revenue, adjusted for inflation, decreased 26%.
- adding table games offset part of the decline but total revenue still fell 8%.
- if table games revenue allocations to stakeholders had been the same as allocations from VLT's, revenue to government, the race horse industry and the racino operator would each have decreased 8%, equal to the decrease in total (VLT plus table) revenue.
- *the effect of reducing government and race horse industry revenue shares from table games with a corresponding increase in racino operator revenue, created winners and losers at Mountaineer. Total table and VLT revenues to government and the race horse industry fell about 15% while racino operator revenues increased 1.5%.*

Economic-Statistical Analysis of Mountaineer Before and After Table Games

Comparisons of revenue before and after an event such as the introduction of competition and table games in a market may contain useful aggregate information. However, only a statistical analysis can accurately identify the separate effects of different events such as table games and competition occurring over the period. Included in this report is an econometric model of factors affecting VLT wagering at Mountaineer developed by Thalheimer Research Associates. A 208 week period from 2005 through 2008 was used in the analysis. VLT revenue was estimated to have:

- decreased 9%, holding constant changes in other factors such as PA competition, as a result of the introduction of table games which averaged 95 in 2008.
- decreased 19% as a result of combined competition from two PA racinos, Presque Isle and the Meadows, holding constant other factors such as the introduction of table games.
- decreased 1.5% as a result of the increase in the unemployment rate from 5.6% in 2006, the base comparison year, to 6.2% in 2008.
- *decreased 27% as a result of the combined effects of table games, competition from PA racinos, and the increase in unemployment.*

The 27% decline in VLT revenue estimated by the econometric model is remarkably close to the observed 26% impact comparing inflation-adjusted VLT revenue in 2008 to that in 2006. This lends confidence to the estimated separate impacts of table games and competition using the Thalheimer Research Associates econometric VLT wagering model.

Supporting the findings of the statistical analysis of VLT wagering at Mountaineer, results of prior statistical analyses factors affecting slot machine wagering have concluded that:

- slot machine wagering declines 8%-13% with table games at a casino/racino, holding constant other factors such as competition in the market area.
- slot machine wagering increases with live and import simulcast racing.
- on-track horse race wagering declines with the addition of table games at a racino, holding constant other factors such as competition in the market area..

On the positive side, adding table games to the slot machine floor has been found to:

- increase total gaming revenue even with the decline in slot machine revenue.
- increase non-gaming revenue such as from food, beverage and lodging (MTR 10-K 2008).

Final Comments

- revisions to the Racetrack Video Lottery Act have greatly reduced purse revenues relative to revenues from other major stakeholders.
- promotional play credit deductions from gross terminal revenue for racetracks, effective September 2009, will further reduce purses and breeder awards as well as revenue to other stakeholders.
- the introduction of table games causes a decrease in VLT revenue.
- table games revenue will likely offset the table games-induced decline in VLT revenue.
- table games also generate non-wagering revenues from food, beverages and lodging which accrue to the racetrack.
- changing the shares of stakeholder revenue from table games versus VLT's resulted in the creation of unintended winners and losers when VLT revenue decreased.
- the creation of unintended winners and losers when VLT revenue decreases, is not dependent on whether the loss in VLT revenue is from table games, competition, or other factors (ex. changes in the economy).
- new competition from Maryland casinos and/or racinos in the Charles Town market area, should table games be approved, will create winners and losers at current table games rates with purses to horsemen having the greatest relative revenue decline.