

Department of Legislative Services
Maryland General Assembly
2007 Special Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 3

(The President) (By Request – Administration)

Budget and Taxation

Ways and Means

Maryland Education Trust Fund - Video Lottery Terminals

This Administration bill authorizes up to 15,000 video lottery terminals (VLTs) at five locations; provides for one-time and ongoing license fees; provides for the distribution of VLT proceeds; creates the Education Trust Fund (ETF) and other special funds; and continues the current prohibition on additional forms of commercial gaming.

The bill is contingent on the passage of Senate Bill 4/House Bill 4, a constitutional amendment authorizing VLT gaming, and its ratification by voters in November 2008.

Fiscal Summary

State Effect: Special fund revenues increase in FY 2010 and beyond due to one-time license fees and VLT revenues. General fund revenues decrease beginning in FY 2011 due to decreased lottery sales; future year losses increase with VLT implementation, totaling \$56.8 million in FY 2013. General fund expenditures increase in FY 2009 due to lottery start-up costs and in FY 2010 and beyond due to lottery and other State agency expenditures, offset by a decrease in general fund expenditures beginning in FY 2010 due to the availability of ETF revenues. Special fund revenues and expenditures increase for the purposes specified in the bill beginning in FY 2011. Special fund expenditures for education begin in FY 2010. **Appendix 1** shows the revenues and expenditures by fund in greater detail.

(in dollars)	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
GF Revenue	\$0	\$0	(\$6,181,100)	(\$41,358,600)	(\$56,840,000)
SF Revenue	0	90,000,000	106,564,600	687,502,100	918,617,300
GF Expenditure	2,362,400	(86,607,600)	(67,302,800)	(464,105,600)	(621,505,200)
SF Expenditure	0	90,050,000	106,614,500	687,502,100	918,617,300
Net Effect	(\$2,362,400)	\$86,557,600	\$61,071,800	\$422,747,000	\$564,665,200

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: Revenues for localities with VLT facilities would increase by approximately \$8.6 million in FY 2011, increasing to \$74.9 million in FY 2013. Local expenditures increase significantly for local governments with VLT facilities.

Small Business Effect: A small business impact statement was not provided by the Administration in time for inclusion in this fiscal note. A revised fiscal note will be issued when the Administration’s assessment becomes available. Legislative Services advises small businesses would benefit from the business investment account and horse industry investments created in the bill. Additional benefits from the construction and operation of VLT facilities would be partially offset by the substitution of VLT wagering for other expenditures.

Analysis

Bill Summary: The major provisions of the bill are detailed below:

Contingency	Contingent on passage of constitutional amendment (HB 4/Chapter 5) authorizing video lottery gaming in Maryland and ratification by the voters of Maryland at the general election in November 2008.
Oversight	<p>Nine-member State Lottery Commission:</p> <ul style="list-style-type: none"> • no elected officials may be appointed to the commission; • addition of four members to existing five-member commission; and • member of Lottery Commission as liaison to Racing Commission and vice versa. <p>State Lottery Commission owns/leases video lottery terminals (VLTs) and central monitor and control system.</p>
Licenses	<p>Up to five licenses to be awarded (eligible locations specified).</p> <p>No more than one in any county.</p>

<p>Locations and Number of VLTs</p>	<p>15,000 machines:</p> <ul style="list-style-type: none"> • 4,750 VLTs at a location in Anne Arundel County within two miles of Route 295; • 3,750 VLTs in Baltimore City, in a nonresidential area within one-half mile of Interstate 95 and Route 295, on city-owned land that is not adjacent to or within one-quarter mile of residential property; • 2,500 VLTs at a location in Worcester County within one mile of the intersection of Route 50 and Route 589; • 2,500 VLTs at a location in Cecil County within two miles of Interstate 95; and • 1,500 VLTs on State property in Allegany County associated with the Rocky Gap State Park in a building physically separate from the Rocky Gap Lodge and Golf Resort. <p>VLT Facility Location Commission may alter allocations if warranted by an evaluation of market and other factors; however, no more than 4,750 VLTs may be placed at any one location.</p>
<p>VLT Facility Location Commission</p>	<p>Seven members:</p> <ul style="list-style-type: none"> • three appointed by the Governor, including the chair; • two appointed by the Senate President; and • two appointed by the House Speaker. <p>Members may not be an elected official and must file annual financial disclosure statements.</p>
<p>Limits on License Ownership</p>	<p>Prohibits ownership in more than one video lottery operation license.</p>
<p>License Fees</p>	<p>Initial license fee of at least \$3 million for every 500 VLTs (as a result, up to \$90 million to accrue to the Education Trust Fund) due with bid submission by February 1, 2009.</p>
<p>License Duration</p>	<p>15 years (must reapply at the end of license term).</p>

<p>License Award Factors</p>	<p>Video Lottery Facility Location Commission to evaluate competitive sealed bids based on:</p> <ul style="list-style-type: none"> • 70% on business and market factors, including the highest potential benefit to the State and percentage of MBE equity ownership; • 15% on economic development factors; and • 15% on location siting factors.
<p>Business Investment</p> <p>Lottery (Administration)</p> <p>Local Government</p> <p>Horse Racing Industry</p> <p>Licensee (Operator)</p> <p>Education Trust Fund</p>	<p><u>Percentage of Gross VLT Revenue</u></p> <p>1.5% to a small, minority, and women-owned business investment account;</p> <p>2% to the State Lottery for administrative costs, with other costs provided for in the annual State budget;</p> <p>5.5% to local governments in which a video lottery facility is operating, 18% of which would go for 15 years (starting in fiscal 2012 and ending in fiscal 2027) to Baltimore City through the Pimlico Community Development Authority and to Prince George’s County for the community surrounding Rosecroft (\$1 million annually).</p> <p>7% to a purse dedication account to enhance horse racing purses and funds for the horse breeding industry, not to exceed \$100 million annually;</p> <p>2.5% for an eight-year period to a Racetrack Renewal Fund, not to exceed \$40 million annually;</p> <p>no more than 33% to video lottery operation licensees; and</p> <p>remainder to Education Trust Fund (48.5-51.0%).</p>
<p>Education Trust Fund</p>	<p>To be used for the Bridge to Excellence in Public Schools Act funding (including the Geographic Cost of Education Index), public school construction, and public higher education construction, including community colleges.</p>

<p>Purse Dedication Account</p>	<p>Provides for the distribution to be allocated with 80% of the funds for the thoroughbred industry and 20% of the funds to the standardbred industry:</p> <ul style="list-style-type: none"> • from the proceeds allocated to the thoroughbred industry: <ul style="list-style-type: none"> – 85% to thoroughbred purses; – 15% to the Maryland-bred Race Fund; and – \$100,000 to Fair Hill. • from the proceeds allocated to the standardbred industry: <ul style="list-style-type: none"> – 85% to standardbred purses; and – 15% to the Standardbred Race Fund. <p>Requires the State Racing Commission to conduct a study on the account’s impact on the racing industry, and make a recommendation regarding the account’s continuation by 2014.</p>
<p>Racetrack Facility Renewal Account</p>	<p>Provides for distribution of the funds in matching grants:</p> <ul style="list-style-type: none"> • 80% to Pimlico, Laurel, and Timonium; and • 20% to Rosecroft and Ocean Downs. <p>\$1 million per year for five years allocated to Timonium with no matching fund requirement.</p>
<p>Construction and Procurement</p>	<p>License applicant must meet State Minority Business Enterprise (MBE) requirements for construction/procurement contracts and to the extent possible meet county MBE requirements if they exceed the State requirement. Requirement sunsets on July 1, 2011.</p> <p>License applicant must invest \$25 million in construction and related costs for every 500 VLTs proposed in bid.</p>
<p>Small, Minority, and Women-owned Business Investment</p>	<p>1.5% of gross VLT proceeds to support investment capital and loans to small, minority, and women-owned businesses (at least 50% to fund businesses near a VLT facility).</p>

<u>Eligibility for Purse Subsidies and Racetrack Renewal Funds</u>	
Racing Days	Laurel/Pimlico must maintain a combined minimum of 220 live racing days to be eligible for racetrack renewal funds; Rosecroft must maintain at least 90 live racing days and Ocean Downs at least 40 live racing days to be eligible. The Racing Commission is required to award at least 40 racing days to Pimlico Race Course.
Preakness Stakes	The VLT and/or horse racing licensee conducting the Preakness must run the event at Pimlico – or conditionally, another location in Maryland – to maintain eligibility for a VLT license and/or racetrack renewal funds.
Racing Improvement Plans	<p>Horse racing licensees must develop a racing improvement plan to improve the quality and marketing of horse racing – including \$1.5 million of annual capital maintenance and improvements at horse racing facilities to be eligible for purse subsidies/racetrack renewal funds.</p> <p>A video lottery operation licensee that holds a horse racing license must also meet the above requirements as a condition of holding the video lottery operation license.</p>
Laurel Park	<p>If a video lottery operation license is issued to Laurel Park:</p> <ul style="list-style-type: none"> • the licensee must maintain Bowie Training Center operations or convey the training center property to the State under Program Open Space; and • local impact grants would be distributed: <ul style="list-style-type: none"> – 70% to Anne Arundel County; – 13% to Howard County; – 5% to Prince George’s County; and – 12% to the City of Laurel.
Allegany	Allegany County government must enter into a negotiated payment in lieu of taxes agreement with a video lottery facility owner/operator for county property taxes. For the agreement’s term the facility is exempt from the county property tax.
Baltimore City	Baltimore City and the video lottery operation licensee will enter into a partnership for use of the city-owned land. From the revenues received through this partnership, Baltimore City must use not less than 95% of the received revenues to reduce real property taxes and construct/rehabilitate public schools.

<p>Worcester</p>	<p>MDOT may pay for and undertake road construction along Route 589 near the area where the facility is located.</p> <p>Within a 10-mile radius of the facilities, the video lottery operation licensee may not build public accommodations (<i>e.g.</i>, a hotel), a conference/convention center, or amusement rides. Moreover, dancing, live music, and live entertainment are not allowed.</p> <p>Local impact grants would be distributed: 70% to Worcester County, 20% to Ocean City, and 10% to the Town of Berlin.</p>
<p>Local Development Council</p>	<p>Creation of Local Development Council in each area where a VLT facility is located to advise, comment, and make recommendations on county plans regarding local government revenue.</p>
<p>Problem Gambling Fund and Prevalence Study</p>	<p>\$425 annual fee per VLT terminal to be paid by VLT licensees for a Problem Gambling Fund administered by DHMH (15,000 VLTs = \$6.4 million annually).</p> <p>Requires DHMH to conduct a problem and pathological gambling prevalence study to measure the rate of problem and pathological gambling in the State.</p>
<p>Annual VLT Payout Percentage</p> <p>Age Restrictions</p>	<p>87% average.</p> <p>Individuals under the age of 21 or intoxicated are prohibited from playing VLTs.</p>
<p>Free Food and Beverage Restrictions</p> <p>Mandatory Exclusion Policy</p> <p>Voluntary Exclusion Policy</p> <p>State Lottery Games</p>	<p>Free food and alcoholic beverages are generally prohibited.</p> <p>By regulation, the commission shall establish a list of individuals who are mandatorily excluded from VLT facilities.</p> <p>VLT facilities required to develop procedures that permit self-exclusion from facilities for individuals with gambling problems.</p> <p>VLT facility may offer any State Lottery games.</p>

Paycheck Cashing	Prohibits consumers from cashing paychecks.
Additional Consumer Protections	<p>Commission to adopt regulations to reduce or mitigate the effects of problem gaming including:</p> <ul style="list-style-type: none"> • limits on dollar amount accepted by VLTs; • payout of winnings above a certain amount by check; • limits on ATM numbers, locations, and maximum withdrawals; conspicuous disclosures related to VLT payouts and odds; and • consumer records of spending levels to the extent that marketing measures track spending.
Campaign Finance	Requires entities contributing more than \$10,000 to a campaign regarding the constitutional amendment to report four weeks before the November 2008 referendum.

Current Law: Specified types of gambling are allowed in Maryland. This includes the State lottery and wagering on horse racing. Bingo, bazaars, and gaming nights are allowed for some nonprofit organizations on a county-by-county basis. Several counties permit for-profit bingo. In addition, some nonprofit organizations in Eastern Shore counties are allowed to operate up to five slot machines, provided that at least 50% of the proceeds go to charity. VLTs are not authorized for operation in the State. For more information on gambling and horse racing in Maryland, consult the *Legislators’ Guide to Video Lottery Terminal Gambling*.

Background: Over the past several legislative sessions, various proposals have been introduced to authorize VLTs at the State’s horse racing tracks or other destinations in the State. In 2005, separate legislation was passed by the Senate and House of Delegates, but differences in the bills were never reconciled.

Regional VLT Markets

Numerous states have authorized VLT gambling. **Exhibit 1** presents the Maryland sites proposed in the bill and the VLT facilities in the states surrounding Maryland. The number of VLTs currently operating at each site is also shown. The number of VLTs approved for a specific location can be higher. The map also includes additional facilities currently under construction in the southern portion of Pennsylvania. The proposed Maryland sites are circumscribed with a 50-mile radius – potential visitors frequenting the Maryland gaming venues are most likely to travel within 50 miles.

The Department of Legislative Services (DLS) advises that Marylanders who travel out-of-state to partake in gambling opportunities do so largely within the states of Delaware, New Jersey (Atlantic City), and West Virginia. To date, DLS estimates limited participation by Marylanders in Pennsylvania, as Pennsylvania facilities have only begun operating in the last year, and West Virginia and Delaware gambling facilities provide closer alternatives. In contrast to Atlantic City, the facilities in Delaware, Pennsylvania, and West Virginia can be thought of as focusing more on individuals taking day trips. The out-of-state gambling facilities closest to Maryland are Charles Town Races & Slots in West Virginia and the three Delaware facilities: Dover Downs, Harrington, and Delaware Park. **Exhibit 2** provides VLT statistics for Delaware, Pennsylvania, and West Virginia.

Exhibit 1 Maryland VLT Locations

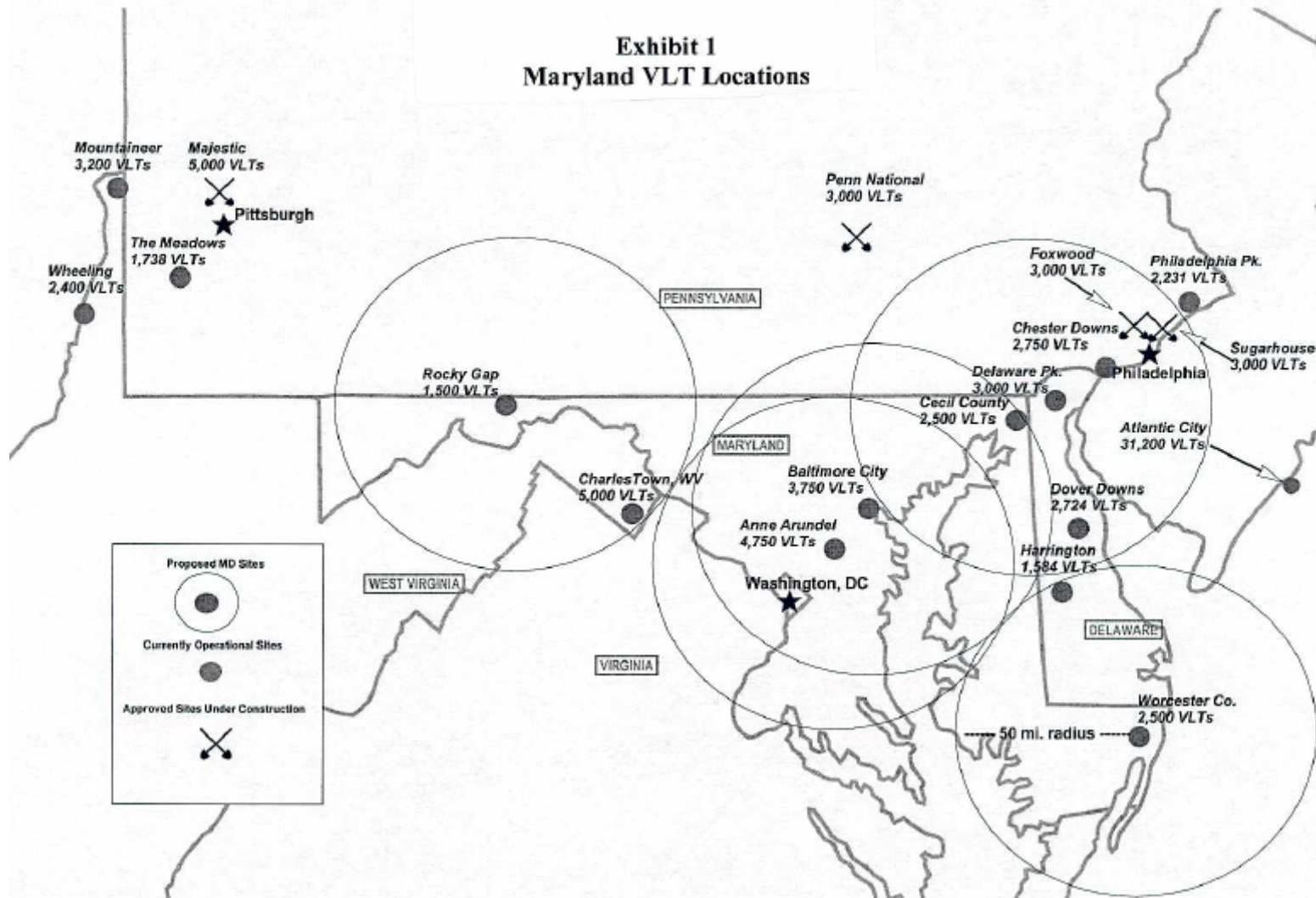


Exhibit 2
VLT Facilities in Surrounding States

	Delaware	Pennsylvania	West Virginia
Location/ Number of Machines	<u>Racetracks:</u> 7,300 VLTs at 3 tracks	<u>Racetracks</u> 10,100 VLTs at 5 tracks 2,500 VLTs at 1 nontrack location 61,000 machines authorized at 14 locations; expect 31,400 machines in 2008	<u>Racetracks:</u> 12,400 VLTs at 4 tracks Restricted access facilities: 8,100 limited video lottery (LVL) terminals at 1,650 locations
Ownership	Racetrack licensees	Racetrack licensees; private establishments	Racetrack licensees; private establishments
Annual Gross VLT Revenues/ Average Win- per-day (WPD)	\$652 million \$255 average WPD	\$746 million \$250 average WPD (partial year)	\$971 million \$235 average WPD LVLs: \$362 million \$123 average WPD
Marylanders Participation	Approx. \$230 million spent per year; 175,000 – 225,000 gamblers	TBD	Approx. \$170 million spent per year; 150,000 – 200,000 gamblers
Notes	VLTs approved in 1994; bets range from 5 cents to \$100; payout: 87% to 95%	VLTs approved in 2004; first facilities opened in late 2006; payouts required to be > 85%; Payout average 91%	VLTs authorized at 4 horsetracks (subject to local referendums) in 1994; a total of 9,000 LVLs authorized in 2001; 3 of 4 tracks also have table games (not Charles Town); bets range from 5 cents to \$5, no maximum prize; payouts 85% to 92%

Source: West Virginia Lottery; Delaware Lottery, Pennsylvania Gaming Control Board; Department of Legislative Services

Note: All data from 2006.

For more historical and background information, consult the *Legislators' Guide to Video Lottery Terminal Gaming*.

Education Funding

The Bridge to Excellence in Public Schools Act of 2002 (Chapter 288) altered the State's school finance structure to align with a concept of "adequate funding" and phased in the enhanced State funding for public education over a six-year period. The legislation included a new program to adjust State aid to reflect regional cost differences. The Maryland State Department of Education oversaw the development of an acceptable Geographic Cost of Education Index (GCEI) to adjust State aid beginning in fiscal 2005. However, the Attorney General's Office determined that funding for the GCEI was not mandated in the Thornton bill. A GCEI was subsequently codified in the Budget Reconciliation and Financing Act (BRFA) of 2004 (Chapter 440); however, the 2004 BRFA did not mandate funding for the index.

The Education Trust Fund established in this bill provides funding for continuation of the Bridge to Excellence Act formulas and programs including GCEI funding. Public school construction and capital projects at public institutions of higher education, including community colleges, are also eligible for funding.

State Revenues: For each location, an initial license fee of \$30 million for every 500 VLTs is to be submitted by February 1, 2009. Assuming that the commission awards 15,000 VLTs to all five of the VLT operator licenses and licensees opt to participate and pay their license fee by the required deadline, Education Trust Fund revenues would increase by \$90 million in fiscal 2010.

VLT Revenues

Five locations in the State may be licensed to operate a total of 15,000 VLTs. As a result, total revenues generated – after payouts to winning players, but **before** any other distributions are made – could total approximately \$156.5 million in fiscal 2011, \$1,019.1 million in fiscal 2012, and \$1,361.6 billion in fiscal 2013.

These estimates assume that (1) five licenses will be awarded; (2) facilities will initially operate at 50% capacity and reach full capacity one year later; and (3) all 15,000 VLTs are awarded. It is assumed that the locations with existing facilities are awarded licenses and begin operations in February 2011, two years after bid submission, and locations without facilities begin operations six months later in August 2011. Revenues will be potentially higher (lower) than estimated to the extent that facilities begin operations earlier (later) than estimated in temporary or permanent facilities.

WPD estimates for the VLT facilities are based on the locations and number of VLTs at each location specified in the bill and an independent analysis of the market for VLTs in Maryland by DLS. The market analysis includes the impact of recent VLT expansions in

Delaware and West Virginia, the opening of VLT facilities in Pennsylvania, and the proximity of proposed Maryland locations to other VLT facilities and population centers. Legislative Services advises that the gross VLT revenue estimates could be higher or lower than estimated depending on the actual locations awarded VLT licenses and the economic and market conditions that develop as the bill is implemented, including expansion of gaming in the surrounding states.

In addition, the bill specifies the maximum number of VLTs at each location, which constrains the maximum revenue potential at certain locations. DLS advises that to the extent VLTs are re-allocated to locations based on an analysis of the expected or actual performance of the VLTs (*i.e.*, higher WPD) by the Video Lottery Facility Location Commission, as authorized in the bill, as it analyzes bids based on, among other factors, the highest potential benefit to the State, revenues could be significantly higher.

Exhibit 3 details many of the important assumptions in these estimates.

Exhibit 3
Assumed Status of Operation
and Win-per-day (WPD)

<u>Location</u>	<u>VLTs</u>	<u>WPD</u>	<u>Begin Operations</u>	<u>Full Capacity</u>
Anne Arundel	4,750	\$315	February 2011	February 2012
Baltimore City	3,750	315	August 2011	August 2012
Cecil	2,500	210	August 2011	August 2012
Worcester	2,500	150	February 2011	February 2012
Rocky Gap	1,500	115	August 2011	August 2012

Other Assumptions

- VLTs will operate 365 days a year, once operational.
- Virginia and Washington, DC do not authorize VLT gambling.
- West Virginia and Delaware do not expand VLT operations, either by adding additional VLT facilities or authorizing casino-style gambling.
- Pennsylvania does not expand gambling beyond VLT facilities authorized in 2004.

Exhibit 4 details the revenue distribution resulting from VLTs for fiscal 2010 through 2013.

Exhibit 4
Distribution of VLT Revenues
(\$ in Millions)

	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>	<u>FY 2013</u>
Total Annual Gross	\$0.0	\$156.5	\$1,019.1	\$1,361.6
ETF (48.5-51.0%)	0.0	75.9	494.3	660.4
Licensees (no more than 33%)	0.0	51.7	336.3	449.3
Purses (7%)	0.0	11.0	71.3	95.3
Local (5.5%)	0.0	8.6	56.0	74.9
Racetrack Renewal (2.5%)	0.0	3.9	25.5	34.0
Lottery Operations (2%)	0.0	3.1	20.4	27.2
Minority Business Investment (1.5%)	0.0	2.3	15.3	20.4

Exhibit 5 details the estimated revenue that will be generated at each facility for fiscal 2010 through 2013.

Exhibit 5
Estimated Revenues Generated by Facility
(\$ in Millions)

	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>	<u>FY 2013</u>
Anne Arundel	\$0.0	\$125.2	\$477.9	\$546.1
Baltimore City	0.0	0.0	265.0	426.7
Cecil	0.0	0.0	117.8	189.6
Worcester	0.0	31.4	119.8	136.9
Rocky Gap	0.0	0.0	38.7	62.3
Total	\$0.0	\$156.5	\$1,019.1	\$1,361.6

Effect on Lottery Sales

DLS estimates that VLTs, when fully implemented, will cause a permanent reduction in lottery revenues of 10% annually versus what is currently forecasted. This estimate is based on the experience of other states that have authorized additional gambling and experienced substantial decreases in lottery sales. In addition, for those states where data are available, Maryland has substantially greater lottery operations, measured on both a

gross volume and per capita basis. Therefore, it is possible that lottery sales might decrease more sharply than these other states. **Exhibit 6** details the estimated decline in general fund revenue in each fiscal year as a result of decreased lottery sales. The impact on lottery revenues incorporates current lottery revenue forecasts and increases with increased VLT implementation.

Exhibit 6
Estimated Loss in General Fund Revenues
Due to Decreased State Lottery Sales
(\$ in Millions)

<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>	<u>FY 2013</u>
--	\$6.2	\$41.4	\$56.8

The Lottery Agency estimates that lottery revenues would decline by 1% in fiscal 2009, 5% in fiscal 2010, 3% in fiscal 2011, and 1% in fiscal 2012 before rebounding in fiscal 2013 and beyond.

Problem Gambling Fund

Approximately \$6.4 million annually, based on \$425 per VLT at full implementation, will be credited to the Problem Gambling Fund administered by the Department of Health and Mental Hygiene (DHMH). The fund must be used to establish a 24-hour hotline, provide counseling for problem gamblers, and establish problem gambling prevention programs and other support services.

Indirect State Revenues

Economic Development Impacts

In addition to the direct revenues generated, the introduction of VLTs could generate other revenues due to the increased economic activity associated with VLTs. As a result of the licensure requirements in this bill, if the maximum 15,000 VLTs are awarded VLT facilities would undertake \$750 million in one-time capital improvements and construction costs. In addition, racetrack facilities would spend up to \$40 million in matching funds for eight years and \$1.5 million annually for capital improvements and maintenance to the horse racing track facilities.

The construction jobs associated with VLT facilities and track improvements could bring dollars into the areas surrounding the locations, providing an economic boost to the local economy. By way of example, construction costs of \$750 million compare roughly to the cost of building two to three professional sports arenas. To the extent that the annual capital improvements are not being currently done, the local economy will receive a boost from annual capital improvements. New jobs would generate new incomes which would be subject to the income tax – revenues that are not currently generated. If substitute jobs are higher (lower) paying than the previously held jobs, taxes paid by those individuals would be higher (lower) than paid previously.

Substitution and Cross-border Effects

The group of potential VLT players at a Maryland facility can be divided into four cohorts. The theoretical impact of each of these cohorts on direct and indirect revenues to the State are illustrated in **Exhibit 7**.

Exhibit 7
Cross-border and Substitution Effect Impacts

<u>Cohort</u>	<u>Cross-border and/or Substitution Impact</u>
Marylanders who currently travel out-of-state to play VLTs	Additional direct and indirect revenue to the State
Marylanders who do not currently travel out-of-state to play VLTs but would play in Maryland	Additional direct revenue to the State, offset by any lost revenue from substitution effects
Out-of-state residents who currently play VLTs elsewhere but who would come to Maryland to play VLTs	Additional direct and indirect revenues to the State
Out-of-state residents who do not currently play VLTs elsewhere but who would come to Maryland to play VLTs	Additional direct revenue to the State. If VLT spending substitutes for other consumption in Maryland, then other tax revenues could decline

For all four cohorts, direct revenue to the State increases as a result of VLT gambling. Indirect State revenues increase as a result of (1) the recapture of Marylanders who play VLTs out-of-state; and (2) out-of-state residents who travel to Maryland explicitly to play VLTs and would not have otherwise visited Maryland in the absence of VLTs.

Indirect State revenues decrease as a result of out-of-state residents and Marylanders who substitute playing VLTs for other forms of taxable activities. For instance, out-of-town conventioners may opt to go to Pimlico and play VLTs instead of attending an Orioles game. In this case, the State gains VLT gaming revenue but would lose the admissions and amusement tax that would have been generated if the conventioner attended the Orioles game. Part of the substitution effect for Marylanders is captured by the estimated decline in lottery revenues resulting from individuals opting to play VLTs instead of purchasing lottery tickets. To the extent that Marylanders substitute playing VLTs for additional forms of taxable entertainment and consumption, indirect State revenues will decrease further. Examples of this include a Marylander opting to play VLTs instead of going to a bar or out to dinner which generate alcohol and sales taxes respectively.

Estimates vary as to the share of total VLT revenues that each cohort will contribute. Of particular interest has been the amount of VLT revenue that would be recaptured from Marylanders playing VLTs in neighboring states. Legislative Services estimates that approximately \$400 million or approximately one-third of total revenue generated by West Virginia and Delaware VLT facilities comes from Marylanders. Further, it is estimated that these Marylanders contribute approximately \$150 million in revenue to West Virginia and Delaware local and state governments. Authorizing VLTs will not recapture all of this revenue; the number of players recaptured depends on multiple factors. In addition, Pennsylvania continues to open VLT facilities increasing from 4 in late 2006 to a total of 14 with final opening dates in late 2008/early 2009, which could impact the annual revenue “recaptured” by Maryland VLT facilities.

State Expenditures:

Maryland State Lottery Agency

The bill provides that operating costs greater than the 2% of gross VLT revenues dedicated in the bill will be provided in the State budget. The Maryland State Lottery Agency estimates costs to be 5.5% of gross revenues. The agency indicates that to the extent expenses are lower than the agency’s estimate, the unused proceeds would be redistributed back to the ETF.

DLS estimates that VLT leasing costs will directly correlate with VLT gross revenues. All other costs will be annual operating costs. Total administration costs, including VLT leasing, incurred by the Lottery Agency are expected to be 4.8% of VLT gross revenues. The bill provides for 2% Lottery Agency administrative costs from VLT proceeds, resulting in a general fund expense of \$1.1 million in fiscal 2009 and \$38.0 million by fiscal 2013, as shown in **Exhibit 8**.

Exhibit 8
Total VLT Program Costs
(\$ in Millions)

	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>	<u>FY 2013</u>
VLT Leasing Costs	-	-	\$7.0	\$45.9	\$61.3
Operating Costs	<u>\$1.1</u>	<u>\$2.6</u>	<u>3.9</u>	<u>3.9</u>	<u>4.0</u>
Total Costs	\$1.1	\$2.6	\$10.9	\$49.8	\$65.3
2% VLT Proceeds	\$0	\$0	\$3.1	\$20.4	\$27.2
Net Impact on General Fund	\$1.1	\$2.6	\$7.9	\$29.4	\$38.0

Numbers may not total due to rounding.

Due to the size of the expected Maryland VLT market in relation to surrounding states, the Lottery Agency expects to gain from economies of scale when entering into VLT leasing arrangements. The bill exempts the Lottery Agency from the requirements of State procurement law (with the exception of MBE laws). Consequently, the Lottery Agency expects to enter into equitable profit-sharing leasing arrangements with the various vendors supplying VLTs to the State. The Lottery Agency has advised that competitive VLT costs in the out-years will be 4.5% of the VLT gross proceeds. DLS concurs. If the Lottery Agency decides to purchase VLTs, costs would initially be less but the stock of VLTs will become outdated.

In future years, DLS assumes that certain costs associated with supplying systems, staff, supplies, and facilities to provide for the Lottery Agency's sundry games and VLT program will be shared costs. The Lottery Agency currently plans to lease a separate central computer system for the VLT program in exchange for a portion of the VLT gross proceeds. DLS advises that the Lottery Agency could utilize a combined operation, monitoring, and accounting platform that includes VLTs and lottery games – once the current contract expires June 2010. DLS assumes lease and maintenance costs for the central computer system can be obtained through a contractual arrangement at a fixed, annual rate.

The Lottery Agency states that it will need 47 additional employees at an estimated cost of \$3 million, including benefits. Similar lottery programs in West Virginia and Delaware have 30 and 10 employees, respectively, within their VLT divisions. DLS estimates the Lottery Agency will need the following 30 positions with an associated cost of approximately \$2 million, including benefits: 1 VLT division director, 1 assistant

director, 3 additional IT employees, 21 security investigators, 5 support staff, and 1 accountant.

For the first two years of operation, the Lottery Agency states it will need \$1 million to hire consultants. DLS estimates consulting fees for these two years to be \$300,000. In fiscal 2009, a five-month start-up delay is assumed due to the November 2008 referendum. Annualized costs begin in fiscal 2010.

Office of the Attorney General

The Office of the Attorney General would incur increased general fund expenditures of approximately \$289,300 in fiscal 2009 as a result of hiring two assistant Attorneys General and one legal secretary to provide legal support to the VLT program.

Department of State Police

Based on previous expenditure estimates provided by the Department of State Police, general fund expenditures would increase by approximately \$280,000 in fiscal 2009 as a result of equipment costs and hiring two full-time troopers and one office secretary to handle the anticipated volume of background checks.

DHMH Expenditures – Prevalence Study

DHMH estimates that a prevalence study will cost between \$1.0 and \$1.2 million. This estimate is based on conducting a three- to four-month study that samples 38,000 Marylanders or approximately 1% of the State adult population. DLS estimates that the first study required would cost approximately \$500,000 to conduct.

Education Expenditures

The Education Trust Fund is a nonlapsing, special fund to be used for continued funding of the Bridge to Excellence formulas and programs, including the GCEI. The fund may also be used to support capital projects for public schools, public colleges and universities, and community colleges. In light of the substantial structural deficit currently forecasted for fiscal 2009 through 2013, it is assumed that all of the available ETF proceeds are used to support operating programs and therefore offset general fund expenditures.

Video Lottery Facility Location Commission and Other Studies

The bill requires DLS to staff the Video Lottery Facility Commission and hire an independent consultant to assist the commission in analyzing bids. This estimate

assumes three contractual employees are needed to staff the commission (two professional staff and one support staff) and the consultant's contract is \$250,000.

The bill also requires two studies regarding specified aspects of the MBE requirements of the bill and reports to the Legislative Policy Committee by December 15, 2010 for the first study and September 30, 2013 for the second study. DLS estimates that the studies will cost \$50,000 each.

Purse Dedication Account

Seven percent of VLT revenues are to be distributed to a purse dedication account to enhance horse racing purses and funds for the horse breeding industry. **Exhibit 8** lists the breakdown of PDA revenues by fiscal year. Annual revenues are not to exceed \$100 million annually.

Exhibit 8
Purse Dedication Account
(\$ in Millions)

	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>	<u>FY 2013</u>
<i>Thoroughbred (80%)</i>				
Purses	\$0	\$6.8	\$44.4	\$59.4
Bred Fund	0	0.8	5.5	7.3
<i>Standardbred (20%)</i>				
Purses	0	2.9	19.0	25.4
Bred Fund	0	0.4	2.4	3.1
Total Expenditures	\$0	\$11.0	\$71.3	\$95.3

Infrastructure Costs

The State and local governments could also incur significant costs associated with infrastructure and transportation upgrades at each of the VLT locations. The actual costs are site specific and could range from extending water and sewer lines and increasing police personnel to significantly altering existing traffic routes and adding access from other major thoroughfares. The Maryland Department of Transportation states that estimating these costs is not possible until plans are developed and traffic studies are completed.

Indirect State Expenditures

In addition to the positive indirect effects to the economy, negative impacts could be expected as well. These effects could include increased levels of crime, unemployment, and personal bankruptcies which could result in a need to significantly increase the State and local spending directed toward these effects. Although these costs cannot be reliably estimated, DLS estimates that these costs are likely to be greater than the funds dedicated to the Compulsive Gambling Fund under this bill. For a more in-depth discussion about the possible social costs as a result of authorizing VLTs, consult the *Legislator's Guide to Video Lottery Terminal Gambling*.

Local Revenues: The bill provides local impact aid for jurisdictions in which VLT operations are located. Eighteen percent of the total is allocated to the Pimlico Community Development Authority for 15 years beginning in fiscal 2012, of which \$1 million must be allocated annually to Prince George's County for the Rosecroft community. The remaining 82% is allocated to the five jurisdictions based on each jurisdiction's share of the gross VLT revenues. This aid is to be used for infrastructure, facilities, services, and other improvements.

The distribution of local aid to counties in which VLT facilities are located is shown in **Exhibit 9**.

Exhibit 9
Local Distributions
(\$ in Millions)

	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>	<u>FY 2013</u>
Anne Arundel ¹	\$0.0	\$6.9	\$21.6	\$24.6
Baltimore City	0.0	0.0	12.0	19.2
Cecil	0.0	0.0	5.3	8.6
Worcester ¹	0.0	1.7	5.4	6.2
Rocky Gap	0.0	0.0	1.7	2.8
Pimlico Development Authority ²	0.0	0.0	10.1	13.5
Total	\$0	\$8.6	\$56.0	\$74.9

¹These distributions are subject to specific allocations in the bill if VLT operation licenses are awarded to Laurel Park and Ocean Downs.

²Prince George's County will receive \$1 million annually for the community surrounding Rosecroft.

Indirect Local Revenues

The local jurisdictions where VLT facilities are located would also benefit from increased real property tax collections. In addition, if the Lottery Agency decides to lease VLTs from a VLT manufacturer, local jurisdictions would benefit from increased personal property taxes assessed on VLT machines and paid by the lessor. To the extent that expenditures on items subject to admissions and amusement taxes are transferred to VLT wagering, local revenues could decline. Local revenues would also be affected by any changes in property values, positive or negative, occurring because of the introduction of VLTs. This effect cannot be reliably estimated at this time.

Local Expenditures: VLT facilities will have a substantial impact on the local areas in which they are located and will necessitate additional local expenditures.

Baltimore City estimates that annual operating costs for public safety, sanitation, and transportation associated with site development would total approximately \$9.3 million. In addition to these recurring costs, the city estimates approximately \$1.8 million in one-time operating start-up costs to acquire equipment. It is also estimated that approximately \$14.8 million in transportation-related capital improvements would be necessary to accommodate the expected influx of activity in and around a site proposal. These improvements include intersection improvements, signal system installations, and street widening and rehabilitation.

Using previously supplied Prince George's County information, DLS advises that if Laurel is awarded a license it would incur expenditures of up to \$10.0 million in one-time costs and \$2.1 million annually as a result of infrastructure improvements and expanded public services.

The City of Laurel estimates that expenditures would increase by approximately \$1.4 million annually if Laurel Park is awarded a license. This reflects hiring additional police and public works personnel as well as other operating costs. Howard County states that if Laurel Park is awarded a license, the county would need to hire additional police personnel and widen access roads to Laurel Park.

According to estimates provided by Anne Arundel County, annual operating costs for public safety, infrastructure, and social services would total \$8.0 million if Laurel Park is awarded a license. In addition to these recurring costs, the county estimates approximately \$1.2 million in one-time operating start-up costs to acquire equipment.

In addition, the other VLT facilities will likely increase local expenditures in the county(s) in which they are located.

Small Business Effect: The Administration did not provide a small business impact statement for this bill. Regardless, Legislative Services advises that to the extent that VLT facilities purchase goods from local businesses that are small businesses, these small businesses would benefit. Small business horse industry breeders and owners in the thoroughbred and standardbred racing industry would benefit. Some small businesses would benefit from additional tourists, partially offset by some small businesses that would be harmed as a result of tourists substituting VLT wagering for other expenditures. Expenditures from the Small, Minority, and Women-owned Business Investment Account created and funded in the bill would benefit small businesses.

Other small businesses will be harmed by the substantial substitution of consumer spending away from other consumption to gambling. Small businesses in the entertainment and retail food service near VLT facilities could be particularly harmed.

Additional Information

Prior Introductions: Similar (but not identical) bills were introduced in each of the past three sessions (*e.g.*, SB 950 of 2007, SB 225 of 2006, SB 205/HB 255 and HB 1361 of 2005). Separate legislation was passed by the Senate (SB 205) and the House (HB 1361) in 2005, but the differences in the House and Senate versions were not reconciled.

Cross File: HB 3 (The Speaker) (By Request – Administration) – Ways and Means.

Information Source(s): City of Laurel, Cecil County, Allegany County, Worcester County, Board of Public Works, Comptroller’s Office, Department of State Police, Anne Arundel County, Department of Health and Mental Hygiene, Maryland Department of Transportation, Baltimore City, Office of the Attorney General, Department of Legislative Services

Fiscal Note History: First Reader - November 1, 2007
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Revised - Enrolled Bill - December 6, 2007

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Appendix 1

	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>
Gross VLT Revenues	\$0	\$0	\$156,522,266	\$1,019,077,148	\$1,361,606,836
Licensees	\$0	\$0	\$51,652,348	\$336,295,459	\$449,330,256
Special Fund Revenues					
Education Trust Fund	-	\$90,000,000	\$75,913,299	\$494,252,417	\$660,379,315
Purse Dedication Account	0	-	10,956,559	71,335,400	95,312,479
Local Distributions	0	-	8,608,725	56,049,243	74,888,376
Racetrack Renewal	0	-	3,913,057	25,476,929	34,040,171
Lottery VLT Administrative	0	-	3,130,445	20,381,543	27,232,137
Minority Business Investment Account	0	-	2,347,834	15,286,157	20,424,103
Problem Gambling	0	-	1,694,688	4,720,378	6,340,690
Total SF Revenues	-	\$90,000,000	\$106,564,605	\$687,502,06	\$918,617,270
GF Revenues					
Lost Lottery Revenue		0	(6,181,081)	(41,358,637)	(56,840,000)
Total GF Revenues	\$0	\$0	(\$6,181,081)	(\$41,358,637)	(\$56,840,000)
Special Fund Expenditures					
Education Trust Fund	-	\$90,000,000	\$75,913,29	\$494,252,417	\$660,379,315
Purse Dedication Account	0	-	10,956,559	71,335,400	95,312,479
Local Distributions	0	-	8,608,725	56,049,243	74,888,376
Racetrack Renewal	0	-	3,913,057	25,476,929	34,040,171
Lottery VLT Administrative	0	-	3,130,445	20,381,543	27,232,137
Minority Business Investment Account	0	-	2,347,834	15,286,157	20,424,103
Problem Gambling	0	-	1,694,688	4,720,378	6,340,690
Transportation – Studies	0	50,000	50,000	0	0
Total SF Expenditure	-	\$90,050,000	\$106,614,605	\$687,502,067	\$918,617,270
GF Expenditures					
VLT Facility Commission	\$430,000	\$180,000	\$180,000	\$180,000	\$180,000
Attorney General	289,282	302,300	315,903	330,119	344,974
State Police	0	277,239	206,890	211,247	262,484
DHMH -Prevalence Study	500,00				
Lottery VLT Admin & Studies	1,143,085	2,582,872	7,857,667	29,375,439	38,036,672
MBE Studies		50,000	50,000	50,000	50,000
Education - ETF	-	(90,000,000)	(75,913,299)	(494,252,417)	(660,379,315)
Total GF Expenditures	\$2,362,367	(\$86,607,589)	(\$67,302,839)	(\$464,105,613)	(\$621,505,186)
Net Effect	(\$2,362,367)	\$86,557,589	\$61,071,758	\$422,746,975	\$564,665,186

