Increased Gaming Competition in the United States and How to Respond

The number and types of gaming venues in the United States grew steadily since the emerging markets boom of the mid 1990's, slowing only briefly during periods of economic uncertainty then reviving to provide new sources of tax revenues and economic stimuli to support declining State budgets and job growth. As casino development increased, the types of facilities evolved from modest local-oriented properties to destination facilities with world class amenities. Markets have introduced VLT's and slots at racetracks, ambient forms of gaming, as well as route operations. Internet gaming will soon be available providing a new delivery channel for the sector. Along the way, the competitive landscape has become quite complex.

The growth witnessed the last few decades yields significant competition, and operators and regulators are responding through various strategies to increase or maintain their market share. The Innovation Group assesses the evolution that brought us to the current competitive US marketplace we have today. The various strategies regulators and operators are utilizing to maintain or increase their market share include:

- Reducing or eliminating taxes;
- Expanding slot-only facilities to include table games;
- Developing attractive non-gaming amenities;
- Focusing on Customer Service to enhance the patron's gaming experience; and/or
- Legalizing internet gaming.

The Evolution of US Casino and Competition from the Early 1990's

The Riverboat States

The "Riverboat Gaming" sector emerged when Iowa, Illinois, Louisiana, Indiana and Missouri legalized casinos in response to a declining revenue base due to the 1991 recession. The competitive landscape in these markets unfolded in a "domino effect." Gaming legislation initially restricted play primarily to cruising riverboats; which were in most markets. Later, these markets allowed them to become more competitive land based facilities. Restrictions were placed on volume of licenses, gaming positions and hours of operation. Louisiana, Iowa and Indiana also approved casino gaming at the pari-mutuel facilities located within the state. The authorization of casino gaming in Louisiana and Iowa lead to compacts with area Tribes.

Mississippi authorized casino gaming during this timeframe; however, the regulators utilized Nevada's "laissez-faire" format. This allowed the market to determine the number of casinos operational within the state. The only restriction was where the casinos could be developed. The sites required voter approval for sites along the Mississippi River and the Gulf Coast. A low, graduated state tax of 8% is assessed on gross gaming revenue. Mississippi now hosts over 30 commercial gaming facilities and allowed the Choctaw Tribe of Mississippi to successfully negotiate a Class III compact, eventually developing the Pearl River Resort, complete with hotels, an entertainment center and a world class golf course.

More Mid-west

Robust Tribal and commercial gaming markets also developed throughout the mid-west. Minnesota, Wisconsin and Michigan currently have some of the most successful Tribal casinos in the US. In 1996, a statewide referendum approved three landbased casinos near Detroit in an effort to revitalize lakefront and surrounding urban neighborhoods through capital developments and infrastructure improvements. The first temporary casino opened in 1999 and by 2007, the three casinos generated a combined total of $365 million in tax revenue to the state. In 2009, Ohio joined the three mid-west states and passed Issue 3, the casino initiative; authorizing the construction of casinos in Cincinnati, Cleveland, Columbus and Toledo. The Horseshoe Casino in Cleveland and Cincinnati and The Hollywood Casino in Toledo and Columbus opened shortly after. Within one fiscal year Ohio's 2013 Gross Gaming Revenue was more than $690 million with approximately $225 million in tax collections for state.

Way Out West

Meanwhile, small commercial casinos, a massive Tribal gaming expansion and competition ensued in the west. South Dakota and Colorado legalized gaming in their state through a statewide referendum during the early 1990s. Casino gaming was used for historic preservation restricted to western mining towns such as Deadwood in South Dakota, and Central City, Black Hawk, and Cripple Creek in Colorado. Restrictions were placed on betting limits and hours of operations in each state until 2008, when Colorado residents voted to eliminate the betting restrictions, add table games and extend operating to 24 hours.

California's Proposition 5, also called the "Tribal State Gaming Compacts Initiative," was approved in 1998 with 62% of voters in favor. Fifteen years later, according to the 2013 Casino City Indian Gaming Report, California now hosts 62 gaming facilities and generated $6.9 billion in annual revenue in 2011 as one of the most directly competitive markets in the US. Nearly every other western state joined in, entering Tribal compacts, including New Mexico, Arizona, Oregon, Washington as well a the majority of plains states such as Oklahoma, Kansas and Nebraska.

First Wave in the Northeast

Casinos outside of Atlantic City in the Northeast emerged ahead of many of the markets cited above, starting with competition in Connecticut. After originally opening their facility in 1986 as a high stakes bingo hall, the Manshantucket Pequot Tribal Nation signed a compact with Connecticut in 1993, and would eventually expand to being one of the largest casino in the world. Mohegan Sun, in 1996, opened featuring approximately 2,500 slot machines. The resort expanded, developing more than 1,000 hotel rooms, about 350,000-sqft of gaming space, a host of branded restaurants and retail outlets.

Rhode Island, West Virginia and Delaware also approved gaming following the recession; however a public private partnership format was utilized. The state would own VLTs at pari-mutuel facilities and the operators would receive a portion of revenues through management agreements. A percentage of the revenues were distributed to the horsemen in order to increase purses and to supplement the operating budgets of the racing industry.

FOCUS: The 2001 and 2008 Recessions and the New Northeast

Pennsylvania, Maryland and Maine joined New York in authoring casino gaming in the 2000s. Commercial casino gaming in New York was legalized in 2001 at nine racetrack casino venues with publicly run VLTs and distributions given to the operators and horsemen. In 2012, statewide revenue totaled $1.8 billion and annual tax revenue was $822 million. The state already obtained several Native American facilities operating Class II casinos on the reservations. Class III compacts were eventually negotiated with the state in 2011, yielding $921 million in annual revenue in 2011 according to the Casino City 2013 Indian Gaming Report.

In 2004, Pennsylvania authorized 12 casinos at a combination of landbased and racetrack facilities in an effort to relieve the property tax burden of its citizens, reinvestment in the horseracing industry, and increase general economic benefits. Annual statewide revenues totaled $3.2 billion from 11 gaming facilities in 2012, overtaking New Jersey as the second largest statewide gaming market. The Pennsylvania Gaming Control Board is currently reviewing six applicants for the second casino in Philadelphia; the state's 12th and final license.

Meanwhile, Maine currently hosts a landbased casino and racino featuring slot machines and table games in Bangor and Oxford. Casino gaming was authorized in 2004, allowing for the development of two casinos; however, only one was approved locally. In 2010, the Maine voters approved to expand gaming in Maine and allow a casino in Oxford County. Table games were introduced in March 2012 and the state's second casino, the Oxford Casino opened in June 2012.

In 2007, Maryland enacted legislation authorizing up to five video lottery licenses for the primary purpose of raising revenue for public education. Approved by a subsequent referendum, up to 15,000 VLTs were allowed statewide with one license to be awarded in Anne Arundel, Cecil, Worcester and Allegany Counties plus Baltimore City. November 2012, Maryland voters approved an amendment authorizing 24 hour gaming, dice and card games in addition to a sixth casino license to be developed in Prince George's County.

Maryland's first casino opened in 2010 and now hosts casinos in Berlin, Perryville, Hanover and Cumberland, Maryland. The first three were operating in 2012 and generated $377 million in annual gaming revenue and $218 million in tax revenue. Rocky Gap Casino Resort, located in Cumberland, opened in 2013 and YTD revenue through August 2013 is $485 million. Construction is underway for the fifth license, a $400 million Horseshoe Casino in Baltimore City expected to open in 2014.

The Maryland Lottery is reviewing proposals for the sixth license to be located in Prince George's County; potentially one of the most lucrative markets on the east coast. The Lottery is expected to award the final license by the end of 2013 and is projecting an opening date of 2016 for the new casino resort.

In response to the latest recession, New York and Maine explored new options to continue expanding gaming to generate revenue for the declining tax base. New York passed legislation allowing a referendum on a constitutional amendment to legalize up to four commercial casinos upstate, followed by additional casinos in the New York City area after seven years. Voters will decide the fate of expanded NY gaming in November 2013.

The 2012 legislative session in Maine witnessed an explosion of resident initiated casino proposals. All proposed gaming expansion legislation was put on hold until a special legislative commission comprised of a group of lawmakers, casino owners, and representatives from the state's tribes and veteran groups could develop the framework for a competitive bidding process for future casino and slot machine licenses. In September 2013, the commission voted 10 to 8 in favor for recommending an expansion of gambling in Maine. Opportunities included: allowing the Passamaquoddy Tribe to operate slot machines and table games in Washington County and veterans' organizations to put slot machines at their posts. The Veterans and Legal Affairs Committee is expected to consider the legislation in January 2014.

In November 2011, Gov. Patrick of Massachusetts signed a bill to legalize three statewide casinos with an $85 million license fee and a minimum of $500 million investment. A license will be awarded to each of the three zones (eastern, western and southern) as defined by the gaming legislation. Each zone has multiple applicants and must have local support though a local referendum in order to compete for a license. One slot parlor license was approved with a $25 million license fee and a minimum $125 million investment which features up to 1,250 machines. The casino would tax at 25% of gross gaming revenues while the slot parlor would tax at 40% of gross gaming revenue.

Finally, a New Hampshire legislative committee hired a consultant to draft a gaming bill which will provide the framework for regulating and licensing casinos after several proposed bills from

Governor Maggie Hassan and other legislators were rejected. The committee hopes to have the regulatory issues figured out and a new bill for the legislatures to review by this December.

How Are States and Operators Now Differentiating Themselves?

As neighboring states began to authorize various forms of gaming or natural disasters and economic crisis began to impact revenues generated at their host casinos, regulators began to review the policies that authorized gaming within the state in an effort to maintain and/or grow market share.

Many states initially requiring actual or phantom cruising soon dropped the restrictions and allowed dockside and landbased gaming. For example, Louisiana eliminated admission taxes at the riverboat casinos, reduced landbased casino tax rates, and authorized upscale F&B and hotel amenities to help compete with properties in Mississippi.

Regulators across numerous jurisdictions commissioned in-depth statewide analyses for potential cannibalization and optimal revenue production before authorizing new casino developments. Tax rates were adjusted in several markets so operators could compete with neighboring competitive casinos. Promotional allowances and free play taxes were either eliminated or taxed at a lower rate. Some jurisdictions with slot only products expanded to table games to make their properties more competitive. Meanwhile, casino operators aimed to distinguish their properties through non-gaming products such as upscale F&B, luxury hotels, spas, convention and retail, golf course and multi-use entertainment centers. Foxwoods recently broke ground on a $120 million Tanger outlet mall. The mall is expected to open in November 2014 or Spring 2015 with brand name manufactures offering merchandise at 30% to 70% off retail prices. The stores will only be accessible to those inside the casino.

Customer Service Training is resurfacing as important tools casinos are utilizing to help differentiate their casino product from their competitors. In today's gaming market most of the slots and table games are basically the same from state to state and the gaming experience for the patron is the most significant measure. Operators are conducting more focus groups, mystery shopping and monitoring of social media review websites in an effort to understand and better serve their customers and develop brand loyalty.

Internet gaming is another potential source of gaming revenue that states will be using to generate additional tax revenue. The Nevada and Delaware gaming regulators already authorized the legalization of online poker; however, the game is restricted to the residents of Nevada and Delaware. New Jersey also authorized internet gaming as operational by the end of 2013.Its legislations allow games played at the city's 12 casinos to be available online. The legislation restricts the online licenses to the 12 casinos currently operating in Atlantic City. The ability to play online games will initially be available for New Jersey residents only and eventually to other states willing to partner with the State.

Northeast Gaming Market Case Study

The Northeast US is arguably one of the most competitive gaming markets. States like Massachusetts and New Hampshire as well as other casinos are under development in Philadelphia and Baltimore. In response to the casino development in the northeast gaming market, Rhode Island voters were presented with a referendum to allow table games at the Twin River Casino. Voters overwhelmingly approved the amendment and Twin Rivers began operating approximately 66 table games in July 2013. YOY gaming revenue increased by more than 15% from July through August. Twin River Casino's CEO, John Taylor, reported that "the success of the table games operations led the Rhode Island Lottery to approve another 14 table games at the facility." Mr. Taylor also stated that the table games expanded the customer base of the casino primarily from a younger demographic; however, companion play has slightly increased attendance at the casino.

The following table illustrates statewide casino revenue market share by state from the year 2000 through August 2013 for gaming facilities in the northeastern region. The obvious trends illustrate the declining market share of the New Jersey and Connecticut facilities; however, the matrix does show Rhode Island's slight increase in overall market share during the 2013 reporting period, although table games have been operational for only three of the nine months. Connecticut's and New Jersey's largest drop in gaming revenue occurred between 2006 and 2007 when the Pennsylvania casinos opened. New York's racinos increased their market share from 11.9% to 16.8% in 2012 with a full year of revenue from the Resorts World Casino in New York City.

Northeast Casino Revenue Market Share by State

Period	Total NE Casino Gaming Revenue	New Jersey	Connecticut8	Rhode Island	Delaware	New York	Maine	Pennsylvania	Maryland
2000	$6,305,112,917	68.2%	20.7%	3.3%	7.7%				
2001	$6,485,675,642	66.3%	21.6%	3.9%	8.1%				
2002	$6,766,012,607	64.8%	22.5%	4.4%	8.4%				
2003	$6,909,948,788	65.0%	22.9%	4.8%	7.3%				
2004	$7,581,958,026	63.4%	21.7%	5.1%	7.3%	2.5%			
2005	$7,987,805,878	62.8%	21.1%	5.1%	7.3%	3.7%	0.1%		
2006	$8,468,301,246	61.3%	20.4%	4.8%	7.7%	5.0%	0.4%		
2007	$9,533,019,958	51.4%	17.6%	4.7%	6.4%	8.6%	0.5%	10.9%	
2008	$9,742,948,266	46.4%	16.0%	4.9%	6.0%	9.7%	0.5%	16.5%	
2009	$9,400,732,901	41.7%	15.3%	4.9%	6.0%	10.8%	0.6%	20.8%	
2010	$9,600,937,769	37.0%	14.3%	4.9%	5.8%	11.3%	0.6%	25.7%	
2011	$10,083,535,863	32.5%	13.3%	5.1%	5.2%	11.9%	0.6%	29.8%	1.5%
2012	$10,657,090,806	28.4%	11.4%	4.9%	4.7%	16.8%	0.9%	29.4%	3.5%
2013 YTD**	$7,396,654,891	26.7%	10.6%	5.0%	3.5%	17.8%	1.2%	28.8%	6.6%

Source: The Innovation Group, Various State Gaming Commissions and Boards Websites

**Slot Revenue Only*

***January through August 2013*