THE INNOVATION GROUP

Statement of the Innovation Group Regarding Commercial Connecticut Casino

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INNOVATION GROUP WRITTEN STATEMENT ON CONNECTICUT

Introduction

This Innovation Group report discusses issues related to potential commercial casino development in Connecticut ("Third Casino"). This report:

- Reviews an April 2015 document by Pyramid Associates, "Satellite Gaming Facilities in Connecticut: Market Feasibility & Economic Impact Analysis: Executive Summary" authored by Dr. Clyde Barrows, and commissioned by the Mohegan Tribe of Indians of Connecticut and the Mashantucket Pequot Tribe;
- Compares the gaming development and job-creation potential of Southwestern vs. North Central markets, and;
- Discusses best practices in the gaming industry for implementing new commercial gaming licensing and development.

If the primary goal of the Third Casino is to recapture the customer spending and associated economic activity (particularly jobs) that are anticipated to be lost to new casinos in Massachusetts and New York, then the Pyramid document does not offer complete information for policy makers interested in achieving that goal.

1. It does not offer a "Southwestern-only" scenario as it does for a "North Central-only" scenario.
2. It does not detail the inputs that went into the gravity modeling—the participation rates or even the population figures.
3. It relies on IMPLAN for direct employment estimates instead of custom-tailored staffing models.
4. Most significantly, it fails to assess the impact of the Third Casino on the existing tribal casinos.

This last point is especially salient to policy makers, since Pyramid's estimated impact on Connecticut employment from the Third Casino fails to account for the jobs that would potentially be lost at the two existing casinos in the state. In a separate report from March 2015, Pyramid estimated the impacts of Massachusetts and New York on Connecticut. In that report, "Mohegan Sun Casino & Foxwoods Resort Casino: Potential Impact of Gaming Expansion in Massachusetts & New York," Pyramid estimated the staff layoffs that would result from decreased revenue and visitor volume.

However, for the satellite facility analysis, Pyramid simply estimated the total gross number of jobs at the Third Casino without accounting for any staff reductions at Mohegan Sun and Foxwoods.

Review of the Pyramid Association Document

The Pyramid Associates Executive Summary is an incomplete document lacking the details necessary for independent replication or policy evaluation. It does not show the inputs that went into the gravity modeling—the participation rates or even the population figures. Therefore, it is not possible to fully evaluate either of the two scenarios.

From a policy perspective, the most significant shortcoming of the Pyramid document involves the jobs analysis. First of all, Pyramid apparently relied on IMPLAN for estimates of direct jobs at the Third Casino property. The Innovation Group also utilizes IMPLAN for economic impact studies, and acknowledges that IMPLAN is an industry leader for estimating indirect and induced impacts. However, for direct employment—particularly in the gaming industry—it is always preferable to conduct a staffing proforma analysis to account for the specific market factors of a given facility and its competitive environment. It should be noted that Pyramid's estimate of 2,871 direct jobs is already being walked back, with the latest estimate by MMCT being 1,700 jobs necessary to staff the facility. This latest estimate is much more consistent with the estimate of 1,926 by Oxford Economics ("Analysis of Expanded Gaming in Connecticut," March 2016) than with Pyramid's.

Moreover, the Pyramid document lacks a cannibalization analysis. If, as Pyramid estimates, casinos in Massachusetts and New York will cause staff reductions at Mohegan Sun and Foxwoods, then consistency demands that the Third Casino will do likewise. However, the Pyramid document does not provide policy makers with that important information. The 2,871 direct jobs and 4,285 total jobs estimated in the document are gross impacts, not net impacts to the state.

North Central vs. Southwestern Market Potential

As discussed previously, the Pyramid document does not contain a "Southwestern-only" scenario.

The Oxford Economics report estimates GGR of $712 million for the Southwestern location compared to $301 million for the North Central location. Unfortunately, the Oxford report does not supply population figures to demonstrate the demand factors underlying this difference.

However, given the revenue generation at casinos closest to New York—Resorts World $832 million (no live tables), Empire $590 million (no live tables), and BethSands $535 million—we believe the Oxford estimate is realistic. In his testimony, Mr. Barrows criticizes the Oxford report for assuming that a casino in the Southwest would warrant a $1.1 billion-dollar investment compared to $553 million in the North Central. That is simply a function of market potential—the larger the population base and greater the market potential, the larger the investment potential and the more jobs created, both one-time construction jobs and on-going operating jobs.

It is worth noting as well that Oxford's estimates are in line with the developers who bid on New York State's open bid process for a casino in the Hudson River Region. Orange County is the closest county to NYC in that gaming zone, and Southwest Connecticut is highly comparable if not better positioned than Orange County from a market potential perspective.

The Oxford report estimates a net gain of 5,735 jobs to Connecticut at a Southwest casino versus 2,081 at the North Central location. These numbers include direct and indirect jobs and account for cannibalization of the existing tribal casinos. It should be noted that Oxford's estimate of direct jobs was based on its own financial modeling that "drew on financial statements released by the commercial enterprises operating each of the facilities, including reported employment levels" (page 20). This is a more precise method of deriving direct impacts than Pyramid's reliance on IMPLAN. The primary value of IMPLAN is in calculating indirect and induced impacts; direct inputs into the IMPLAN modeling are best derived using data specific to the gaming industry.

Casino Bid Process

Given the incomplete information provided by the Pyramid document, and the discrepancies in job creation between it and the Oxford report, it would be advantageous for the State to conduct its own independent analysis to assess the best result for jobs and economic impacts.

States legislatures typically empower independent commissions to steer implementation of new gaming development, and given the high value gaming licenses command in limited-license jurisdictions there is a special responsibility to ensure transparency and an objective process.

Historically, two states actually auctioned licenses to drive up the up-front payment. Illinois for example attempted for years to auction a final gaming license slated for the Chicago area. The license received bids as high as $550 million in 2001 before drawn-out legal battles and a smoking ban ultimately drove the winning price (in 2008) down to $125 million. A similar story unfolded in New York in 2008, where a coveted gaming license for Aqueduct racetrack in New York attracted a winning bid of $370 million. However, the Great Recession and lawsuits intervened, reducing the value of the license and delaying development of the machine-only casino.

More recently, states have adopted competitive development bids—instead of competitive license auctions—to promote long-term economic investment. Other than basic due diligence, the primary criteria for evaluation in states such as Massachusetts and New York are job creation and economic impact. Up-front payments in the form of license fees are generally still significant—to filter out non-competitive developers—but are set at a pre-determined amount. Pennsylvania set a precedent in 2004 by requiring an upfront license fee of $50 million, which has been followed by Ohio, Massachusetts, and New York.

When Indiana passed legislation in 2007 granting a casino duopoly to two Indianapolis-area racetracks (Indiana Downs and Hoosier Park), it required a $250 million license fee and a minimum $100 million capital investment. The Kansas Expanded Lottery Act of 2007 calls for a $25 million "privilege fee" and capital investments of at least $225 million license.

Conclusion

In summary, The Innovation Group finds that:

1. In terms of the Connecticut jobs to be created by the Third Casino, the Pyramid document failed to account for cannibalization of the existing tribal casinos.
2. Moreover, Pyramid's gross estimate of 2,871 jobs needed to operate the facility is not realistic; MMCT's current gross estimate is for 1,700 jobs, similar to Oxford's estimate of 1,926.
3. Cannibalization should be factored in to ascertain how many jobs represent a net gain to Connecticut in realistic North Central and Southwest scenarios.
4. The Oxford Economics analysis is a realistic estimate of the gaming market potential and hence job creation potential of the Southwest location.
5. An independent process directed by the State will deliver optimal net outcomes to Connecticut as has been accomplished in other markets.