

# Maryland Policy Report

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No 2012-06

December 19, 2012

## \$500 MILLION LICENSE FEE FOR MGM/NATIONAL HARBOR CASINO

*Recommended by The Maryland Tax Education Foundation and  
The Maryland Public Policy Institute*

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**BY JEFF HOOKE**

CASINO OPERATORS IN OTHER STATES have paid market-based license fees, and the National Harbor Casino can afford to pay the state of Maryland a \$500 million up-front license fee. Any other option would be a giveaway, corporate welfare, or taxpayer rip-off, and meanwhile, such license fees are deductible for federal and state income tax purposes. As things stand, the casino will be a state-sanctioned monopoly in the middle of a prosperous metro area with a population of five million. Profitability is thus assured.

### **INTRODUCTION**

The following analysis incorporates the author's experience in the gambling field (see attachments), his contacts within the industry, and publicly available data on casino revenues and expenses on Securities and Exchange Commission (SEC) and state government websites.

The analysis presumes a "luxury destination casino" with appropriate amenities, similar to a scaled-down Bellagio or MGM (Las Vegas) facility. Another alternative being discussed by state officials is a mid-range casino like Maryland Live! in Anne Arundel County.

### **ANALYSIS**

We divide the analysis into three parts: (1) up-front construction and start-up investment (2) projected income (3) affordability of a \$500 million license fee.

**TABLE 1: TOTAL UP-FRONT CASINO BUILDING INVESTMENT = \$250 MILLION**

	(\$MM)
SLOTS	\$75
TABLE GAMES	75
OTHER	100
<b>TOTAL</b>	<b>\$250</b>

**TABLE 2: TOTAL UP-FRONT INVESTMENT**

	(\$MM)
CASINO	\$250
AMENITIES	80
	330
HOTEL	140
<b>TOTAL</b>	<b>\$470</b>

**PART I:  
UP-FRONT INVESTMENT**

**Casino Construction Costs:** Similar cost data are available within the industry and within casino company SEC filings.

**Slots-Related Building Costs:** 3,000 slot machines require 50 square feet (of space) per machine times \$500 per square foot building cost.  $3,000 \times 50 \times \$500 = \$75$  million.

**Table Games-Related Building Costs:** \$75 million

**Land, Parking Lots, Soft Costs, and Start-up Expenses:** \$100 million. A parking structure may cost \$15,000 per parking space, while a surface lot might be 40% of that cost.

**Hotel Construction Costs:** \$400,000 per room for a 350-room hotel, including furniture and fixtures. Construction costs per room can vary substantially, depending on hotel quality. We use an upscale cost figure. National Harbor suggested 500 rooms in a 4,000 slot scenario, versus the 3,000 slots authorized, so we use a smaller hotel.  $350 \times \$400,000 = \$140$  million. Note that the existing Gaylord National Harbor Hotel is running around 66% occupancy, so it has room availability.

**TABLE 3: NATIONAL HARBOR PROJECTED CASINO INCOME STATEMENT**

	(\$MM)
CASH REVENUE	
SLOTS	\$350
TABLE GAMES	175
FOOD & BEVERAGE	60
	\$585
CASH OPERATING EXPENSES	
SLOTS (STATE TAXES @ 56%)	(196)
TABLE GAMES (STATE TAXES @ 20%)	(35)
SLOTS OPERATING EXPENSES	(93)
TABLE GAMES OPERATING EXPENSES (70%)	(96)
FOOD & BEVERAGE	(42)
CASINO CASH OPERATING PROFIT BEFORE OTHER BUSINESSES	123
ADDITIONAL:	
RETAIL, RESTAURANTS AND ENTERTAINMENT	+15
HOTEL INCOME	+10
<b>CASINO CASH OPERATING PROFIT</b>	<b>148</b>
NON-CASH DEPRECIATION EXPENSE (20 YRS)	(24)
<b>EARNINGS BEFORE INCOME TAXES (EBT)</b>	<b>\$124</b>

**Amenities**

**Retail, Spa, Restaurants, and Entertainment Centers:** 200,000 square feet times \$400 per square foot. See National Harbor promotional literature for square footage estimates.  $200,000 \times \$400 = \$80$  million.

**Total Up-front Investment**

By comparison, 2012 construction costs for casinos in Columbus, Ohio (3,000 slots plus table games) and Toledo, Ohio (2,000 slots plus table games) were \$350 million and \$320 million, respectively, according to SEC filings. Neither facility has a hotel. Incidentally, the state of Ohio referendum incorporated a fixed license fee, but the state government subsequently negotiated higher license fees.

The Borgata, a luxury casino resort in Atlantic City, cost \$1.1 billion to construct in 2003, with 2,000 rooms versus 350 rooms at the assumed new hotel at National Harbor.

**TABLE 4: CASINO COMPARISONS (IN MILLIONS)**

CASINO	MONOPOLY MARKET	METRO POPULATION	REVENUES	EBT
<b>National Harbor (Est.)</b>	<b>Washington, DC</b>	<b>5</b>	<b>\$585</b>	<b>\$124</b>
Charles Town (Actual)	Washington, DC	5	550	160
Lawrenceburg (Actual)	Cincinnati, OH	2	500	160

## **PART 2: PROJECTED REVENUES AND PROFIT**

### **Revenue**

Total annual revenue after startup period is \$585 million.

**Slots:** 3,000 slot machines x \$320 per day ‘win’ per machine x 365 days = \$350 million per year.

By comparison, Aqueduct Casino in Queens, New York, with a similar captive market as National Harbor, generates a \$375 per-machine win per day on 4,900 machines. Maryland Live! produced about \$280 per machine per day with 3,800 machines, and then decreased win per day as the number of machines increased to 4,750.

**Table Games:** \$175 million per year, or 50 percent of slots revenue.

The Charlestown, West Virginia casino has table games revenue equal to 40 percent of slots revenue. National Harbor will be slightly more upscale, attracting more ‘high rollers’ who like table games. Thus, we use 50%.

Peterson Companies, BREA (Business Research and Economic Advisors), the Department of Legislative Services (DLS), gambling consultant Charles Vickery, and MTEF’s own analysis were the sources for the slots and table games revenue estimates. MTEF’s revenue projections fall between DLS (see Fiscal Note on Senate Bill 1) and BREA (see June 2012 slide show, p. 5). We believe our estimates are realistic, based on similarly-situated monopolies in the United States. On a per day basis, the revenue estimates reflect over five million visitors per year, losing an average of \$105 per daily visit.

**Casino Food and Beverage Revenue:** \$12 per visitor per day = \$60 million. The \$12 statistic is corroborated by industry data.

### **Cash Expenses**

**Cash Operating Expenses for Slots:** \$85 per day x 3,000 machines x 365 days = \$93 million. This expense includes machine rental. See Empire Resorts and Dover Downs Entertainment SEC filings to reference “per day cash expenses by machine.”

**Cash Operating Expenses for Table Games:** 55 percent of table games’ revenues. An approximation based on discussions with industry participants.

**Cash Operating Expenses for Casino Food and Beverage:** 70 percent of revenues.

### **Other Business Income**

The retail, restaurant, and entertainment venues run economically with \$15 million in net profit. With \$10 million in profit, the hotel runs at a lower return because of complimentary rooms for gamblers.

For illustration, Table 4 shows “comparable casino” revenue, and earnings before income taxes (EBT). The revenues for Charles Town will decline once National Harbor begins operations, since National Harbor is much closer to the population. Our projection for National Harbor is consistent with these existing properties.

The sources of Charlestown and Lawrenceburg revenues and EBT, respectively, were Penn National Corp. SEC filings.

**TABLE 5: NATIONAL HARBOR CASINO PROFITS AFTER LICENSE FEE (IN MILLIONS)**

CASINO EBT	\$124
INTEREST ON MORTGAGE	(30)
CASINO PRE-TAX PROFIT AFTER LICENSE FEE	94
NON-CASH AMORTIZATION OF LICENSE FEE	(25)
	69
INCOME TAXES @ 30%*	21
<b>PROJECTED NET INCOME</b>	<b>\$48</b>

\* The 30% differs from the 35% federal statutory (plus state tax) rates due to use of accelerated tax depreciation.

**TABLE 6: NATIONAL HARBOR CASINO RETURN ON INVESTMENT AFTER LICENSE FEE (IN MILLIONS)**

CASINO CASH OPERATING PROFIT	\$148
LESS: INTEREST	(30)
LESS: CASH INCOME TAXES	(21)
LESS: ANNUAL CAPITAL INVESTMENT	(15)
ANNUAL CASH RETURN	\$82
UP-FRONT INVESTMENT	÷470
<b>PROJECTED ANNUAL RETURN</b>	<b>17%</b>

### PART 3: AFFORDABILITY OF \$500 MILLION LICENSE FEE

Debt Service: Assume the casino borrows the \$500 million at an interest rate of six percent. The annual cash payment (on a 15-year mortgage payment basis) is \$57 million. The casino's cash operating profit easily covers the debt service, by 2.6 times (i.e.,  $148/57 = 2.5x$ ).

Return on Equity Investment: The first year's interest on the mortgage is \$30 million. After the interest, the casino pre-tax profit is \$94 million per year per year, and the after-tax profit is \$48 million.

The cash return on the \$470 million equity investment is a healthy 17 percent per year, as indicated above in Table 5. Twenty-year U.S. Treasury Bonds return 2 percent, and the stock market is expected to return 9 percent. As a state sanctioned monopoly, National Harbor has minimal risk, so 17 percent per year is more than adequate compensation.

Casino Return Excludes Benefit to Existing National Harbor Development: Peterson Companies and other investors in National Harbor will see significant new customer traffic, which should increase the value of their now-depressed holding. The benefit could be tens of millions of dollars, which are not included in this analysis.

**JEFFREY C. HOOKE** is managing director of Focus, LLC, an investment bank based in Washington, D.C. Previously, Hooke operated his own consulting firm, was a director of Emerging Markets Partnership (a \$5 billion private equity partnership), a principal investment officer of the World Bank Group, and an investment banker with Lehman Brothers and Schroder Wertheim. Hooke is the author of four books: *The Dinosaur Among Us: The World Bank and Its Path to Extinction* (2007); *The Emerging Markets* (2001); *Security Analysis on Wall Street* (1998); and *M&A: A Practical Guide to Doing the Deal* (1996). Mr. Hooke is the volunteer, unpaid Chairman of the Maryland Tax Education Foundation (MTEF).

*His studies on casino-style gaming have led to testimony on the value of gaming licenses and the prospective revenues from state-sanctioned gaming expansion before the legislatures of Indiana, Kentucky, Maryland, Massachusetts, Pennsylvania and Texas. His views on gaming expansion have been referenced in numerous publications. Hooke's reports, testimony and media work has led to taxpayers receiving over \$2 billion in additional revenue from casino operations, principally through the sale (instead of giveaway) of casino licenses and through higher tax rates (Pennsylvania - \$600 million, Indiana - \$500 million, New York - \$400 million, Maryland - \$600 million, and Illinois - \$325 million). His work influenced the Government of Singapore in determining up-front payments for its \$4 billion casino project.*

1 The value represents license value only. In several instances, the values of casino structure, horse racing track, jai alai track, or relevant real estate were deducted from the transaction value in order to determine the actual license value. For Pennsylvania transactions/offers, the value includes the \$50 million license fee that was paid by the license holder. The Maryland 2009 license awards have been excluded since the sizable tax rate (67 percent) precluded high initial fees and the bidding process was not open, but rather skewed towards certain landowners. Most of the licenses related to 'slots-only' casinos, but holders were later awarded the rights (at no charge to the license holder) to offer table games. Table games increase the revenues of a 'slots-only' casino by about 25 percent.

2 Miami Valley Gaming, a joint venture between Churchill Downs and Delaware North, will pay \$10 million cash, \$50 million note, and \$10 million earnout for Lebanon Raceway in suburban Cincinnati. The JV will also pay for the \$50 million state casino license fee. From this \$120 million total, the calculation subtracts a presumed \$5 million value for the harness track.

3 Aqueduct racetrack slots. The gross amount is \$380, minus \$200 for a state contribution to construction costs. The low price is partly due to New York's high gaming tax rate and high purse contributions. The slots operator keeps only 35 percent or so of the net revenue.

4 Trilliant Gaming offered \$435 million upfront for a Rosemont, Illinois location. The state, however, awarded the license to Midwest Gaming for a Des Plaines, Illinois location for \$125 million upfront and \$300 million to be paid at \$10 million per year for 30 years. The total NPV of the Midwest proposal is \$247 million at an 8 percent rate. We view the \$435 million bid as determinative.

5 Oliver Racing paid \$53.5 million for a 34 percent interest, plus a \$250 million license fee.

6 PITG agreed to pay a \$7.5 million annual fee to City of Pittsburgh to subsidize a new hockey arena. Hooke Associates estimated the "present value" of the annuity at \$110 million, plus the \$50 million license fee.

7 \$30 million value of racetrack subtracted from \$200 million price (i.e., \$170 million, net) and \$50 million license fee added, in order to provide a \$200 million license value.

8 \$13 million appraised value (tax records) of jai alai fronton excluded from \$153 million purchase price.

9 Isle of Capri offered to build a \$290 million hockey arena and to pay \$50 million for the license.

10 Mohegan Tribe paid \$290 million (after post-purchase adjustment) for the license plus the track worth \$30 million. We add the \$50 million license fee for a value of \$310 million (i.e., \$290 minus \$30 plus \$50).

11 In exchange for a 50 percent interest, Harrah's put up over \$400 million in cash to construct a casino and racetrack in Chester, Pennsylvania.

12 Excludes 'brick and mortar' cost of the casino, as set forth in the SEC filings.

13 Chippewa's buyout of a 40 percent interest, indicating a 100 percent interest at \$663 million.

Source: Jeff Hooke, Managing Director, Focus Securities

**APPENDIX:****CASINO GAMING LICENSE VALUES TRANSACTIONS AND OFFERS**

<b>IMPLIED VALUE' (MILLIONS)</b>	<b>DATE</b>	<b>METRO LOCATION</b>	<b>BUYER/SELLER</b>	<b>TRANSACTIONS/ OFFERS</b>
\$115	July 2012	Cincinnati	Miami Valley Gaming	Transaction <sup>2</sup>
180	October 2011	New York City	Genting (Malaysia)/ State of New York	Transaction <sup>3</sup>
435	December 2008	Chicago	Trilliant Gaming/State of Illinois	Offer/Transaction <sup>4</sup>
407	August 2007	Indianapolis	LHT Capital (Paul Estridge)/ Oliver Racing (Indiana Downs)	Transaction <sup>5</sup>
250	April 2007	Indianapolis	Indiana Downs/ State of Indiana, Hoosier Park/ State of Indiana	Two transactions at \$250 million each
160	December 2006	Pittsburgh	PITG Gaming (Don Barden)/ City of Pittsburgh	Transaction <sup>6</sup>
220	November 2006	Pittsburgh	Millennium/Magna	Transaction <sup>7</sup>
140	June 2006	Dania Beach (Ft. Lauderdale)	Dania Jai Alai/Boyd Gaming	Transaction <sup>8</sup>
340	April 2006	Pittsburgh	Isle of Capri City	Offer <sup>9</sup>
500	January 2005	Catskills	Seneca Ind./New York State	Offer
310	October 2004	Poconos	Mohegan/Penn National	Transaction <sup>10</sup>
442	July 2004	Philadelphia	Harrah's/Inv. Group	Transaction <sup>11</sup>
518	March 2004	Chicago	Isle of Capri/State of Illinois	Offer
750	January 2001	Cincinnati	Argosy/Inv. Group	Transaction <sup>12</sup>
663	November 2000	Detroit	Chippewa/Inv. Group	Transaction <sup>13</sup>

Note: The Cincinnati license faces three close-in competitors. The New York license has much higher tax rates. Most of the licenses are "slots only" facilities, whereby a facility incorporating "table games" would typically have a higher value.

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