

Department of Legislative Services
Maryland General Assembly
2004 Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 197

(The President) (By Request – Administration)

Budget and Taxation

Ways and Means

Public Education Bridge to Excellence - Funding - Video Lottery Terminals

This Administration bill authorizes up to 15,500 video lottery terminals (VLTs) at six locations (three potential horse racing tracks and three nontrack locations), provides for one-time application fees, creates the Education Trust Fund (ETF) and other special funds, increases State aid for primary and secondary education through application of a geographic cost of education index (GCEI); and continues the current prohibition on additional forms of commercial gambling.

The bill takes effect June 1, 2004.

Fiscal Summary

State Effect: Special fund revenues increase in FY 2005 and beyond due to one-time application fees and VLT revenues. General fund revenues decrease beginning in FY 2006 due to decreased lottery sales; future year losses increase with increased VLT implementation, totaling \$69 million in FY 2009. General fund expenditures increase in FY 2005 and beyond due to Attorney General and State Police expenses. General fund expenditures decrease in FY 2006 and beyond due to the availability of revenues from the ETF. Special fund revenues and expenditures increase for lottery agency administrative expenses, local aid, purse dedication, bred funds, and gambling addiction treatment expenditures, beginning in FY 2006, except lottery and GCEI expenditures which begin in FY 2005. **Appendix 1** shows the revenues and expenditures by fund in greater detail.

(\$ in millions)	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
GF Revenue	\$0	(\$3.8)	(\$50.3)	(\$68.7)	(\$69.7)
SF Revenue	60.0	67.1	802.3	1,078.5	1,078.5
GF Expenditure	.9	22.6	(523.7)	(723.8)	(705.0)
SF Expenditure	62.2	67.1	802.3	1,078.5	1,078.5
Net Effect	(\$3.1)	(\$26.4)	\$473.4	\$655.0	\$635.3

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 \$4.9 million in FY 2006, increasing to \$80.6 million at VLT full implementation in FY 2008 and 2009. Future year revenues represent increased VLT operation and efficiency and revenues distributed from nontrack VLT facilities. Distribution of these revenues would depend on the sites selected. Local expenditures increase significantly for local governments with VLT facilities.

Small Business Effect: The Administration has determined that the bill has a meaningful impact on small business (attached). Legislative Services concurs with the assessment that the bill will have a meaningful impact. (The attached assessment does not reflect amendments to the bill.)

Analysis

Bill Summary: The major provisions of the bill are as follows:

Video Lottery Terminals and Locations

The bill authorizes a total of 15,500 VLTs in the State – a maximum of 9,000 VLTs at up to three race tracks and a total of 6,500 VLTs at three nontrack locations. The VLT facility locations are to be determined by a committee created by this bill.

The bill reiterates the current prohibition on additional forms of gambling, other than those currently authorized under State law (lottery, horse racing, and charitable gambling). The State Lottery Commission will provide regulation and oversight of the VLT program.

Distribution of Video Lottery Terminal Proceeds

The Comptroller is required to distribute the proceeds of VLT operations, which must be transferred electronically on a daily basis to the State Lottery Fund.

For the race track locations, from the gross proceeds of VLTs, after payout to players, proceeds are distributed as follows:

- 5% to the State Lottery Agency for administrative costs (after the first year, the distribution is 4.3%);
- 5% to the local governments in which video lottery facilities are operating;

- 9.3% to the Purse Dedication Account (PDA) to enhance horse racing purses and to provide funds for the horse breeding industry (after the first year, the distribution increases to 10.0%);
- the operators will receive the amount stated on the bid proposals selected by the State Video Lottery Facility Commission, not to exceed 36% to VLT operation licensees; and
- the remainder of the proceeds will be distributed to the ETF established under the bill (a minimum of 44.7%).

For the nontrack locations, from the gross proceeds of VLTs, after payout to players, proceeds are distributed as follows:

- 5% to the State Lottery Agency for administrative costs (after the first year, the distribution is 4.3%);
- 5% to the county(s) in which the video lottery facilities operate;
- the operators will receive the amount stated on the bid proposals selected by the State Video Lottery Facility Commission, not to exceed 30%; and
- the remainder of the proceeds will be distributed to the ETF (a minimum of 60% in the first year of operations and 60.7% thereafter).

Video Lottery Facility Location Commission

This bill creates a Video Lottery Facility Location Commission that will determine the distribution of the 15,500 VLTs among the six potential licensees and the percentage of operator VLT gross proceeds. A VLT facility may not be located within four miles of another facility. Eligible applicants for VLT licenses must submit an application and a \$10 million application fee by October 1, 2004.

Race track locations

The commission is authorized to award of maximum of 9,000 VLTs to three horse tracks. Each race track can receive up to 3,000 VLTs initially. Three race track licenses can be awarded from among Laurel Park, Pimlico Race Course, Rosecroft, and Allegany of which one license must be awarded to a horse track to be built in a rural area, which is presumed to be in Allegany County. If all 9,000 VLTs are not initially awarded, the State Lottery Commission can distribute the unawarded VLTs based on a competitive process. Race track locations are authorized to operate in temporary facilities provided the facilities conform to minimum standards as specified by State Lottery Commission regulations.

Nontrack locations

The commission is authorized to award a maximum of 6,500 VLTs to nontrack locations. Each nontrack location can receive up to 2,500 VLTs initially. The nontrack locations must be selected from among the following eligible locations: Prince George's and Cecil counties, and Baltimore City.

When considering all facility applications, the commission must consider an application: (1) 70% based on business and market factors; (2) 15% economic development factors; and (3) 15% siting factors. No applicant may own or have interest in more than one VLT license.

The commission is composed of nine members, of whom three are appointed by the Governor, three by the Speaker of the House, and three by the President of the Senate. These appointments are subject to the approval of the Legislative Policy Committee. The Governor selects a chairman from among the members. The Department of Budget and Management (DBM) is required to contract with an independent analyst with at least 10 years' experience in gaming industry consulting that will provide advice on bids to the location committee.

Lottery Commission Authority and Duties

VLTs will be owned or leased by the State Lottery Commission and under the control of the commission. The membership of the State Lottery Commission increases from five to nine. One member will serve as a liaison to the State Racing Commission and one member of the State Racing Commission will serve as a liaison to the lottery commission.

The commission has authority to issue subpoenas and conduct investigations and hearings and is required to adopt regulations requiring a bond for faithful performance of the requirements of the bill. Commission employees must be present at VLT facilities during all hours of VLT operation for the purpose of certifying revenue from VLTs and receiving complaints from the public.

VLT Licenses

Licenses must be obtained by VLT operators, VLT manufacturers, VLT employees, and anyone hired by a VLT operator to manage a VLT facility. In addition, the commission may require others to be licensed.

All applicants for VLT-related licenses are subject to an application process that involves a State and national criminal history records check. All applicants for VLT-related

licenses must establish their qualifications including financial stability and background of the applicant and all individuals and business entities associated with the applicant; integrity of financial backers and investors; good character and honesty; and sufficient business ability and experience.

A VLT operation license applicant must provide additional information that includes the financial structure of the entity and names, personal history, and criminal history of all officers, partners, and principal employees; the names of all holding companies, subsidiaries, or other business entities of the applicant; and the names of all persons who own or control the business entity as well as a description of all bonus and profit-sharing agreements. It is a misdemeanor offense punishable by up to three years in jail and/or a \$5,000 fine for any person that requires licensure under the bill and knowingly provides false information to the commission.

The term of a VLT operation license is 15 years. At the end of the 15-year term, the licensee may reapply for a license renewal of 10 years, with the fee to be determined by future statute. Within one year of the expiration of the license, the licensee must inform the State Lottery Commission that it intends to reapply for the license. The bill provides that a VLT-related license is a revocable privilege and that it is the intent of the bill to prohibit the creation of a property right in a license granted under the bill.

Any VLT license issued under the bill may not be transferred, sold, or pledged as collateral. A licensee may not sell or transfer more than 5% of the legal or beneficial ownership in the licensee without the approval of the commission.

VLT licensees must meet the State's minority business participation requirements for facility construction and procurement, and meet the county's minority business participation requirements, to the extent practicable, if they are higher than the State's. VLT licensees must provide health insurance coverage to its employees and have a preference for hiring individuals that live within 10 miles of the VLT facility. From the time of being issued a license, a VLT licensee is required to commence operations within 18 months (the State Lottery Commission is authorized to extend this deadline for up to one year). VLT licensees must propose capital construction expenditures of at least \$35 million for each 1,000 VLTs.

Additional Requirements for Horse Track VLT Operation Licensees

None of the requirements in this section apply to the nontrack VLT facilities.

As a condition of licensure, a track licensee must maintain the number of live racing days conducted in 2004. If either the Preakness Stakes or Woodlawn Vase is transferred out of the State, the VLT operation license for Pimlico and Laurel Park will be revoked. In

addition, the Maryland Million must be conducted annually at Laurel Park. Race track VLT operations must be “fully operational” at a permanent facility within two years of being issued a license.

Each track licensee must develop a racing improvement plan to improve the quality and marketing of horse racing at the track. The plan must include \$1.5 million of annual capital maintenance and improvements of the horse racing facilities (the Allegany track is required to make \$750,000 in improvements annually). The capital improvements must include the improvements necessary to make residential areas of the tracks conform to minimum county housing and sanitation standards. In addition, part of the capital improvements at Pimlico must include the creation of a premier classic race track and museum.

Other Regulation of Video Lottery Operations and Consumer Protections

The bill prohibits a VLT operation licensee from offering food (except finger food and the like) and beverages, including alcoholic beverages, for free or for a price that is lower than the prices in the county where the VLT facility is located.

The commission must adopt regulations to reduce or mitigate the effects of problem gambling, including provisions that provide for mandatory exclusion of career offenders from VLT facilities; procedures that permit self-exclusion from VLT facilities for individuals with gambling problems; limits on the dollar amount that VLT machines will accept; payouts of winnings above a certain amount by check; limits on the number, location, and maximum withdrawal amounts for ATMs; conspicuous disclosures related to VLT payouts and odds; and giving consumers a record of spending levels to the extent that marketing measures that track customer spending are used.

Purse Dedication Account

The bill creates a Purse Dedication Account to which 9.3% of gross proceeds from the track facilities will be distributed in the first year and 10% in the following years. Funds from the account are to be distributed between standardbred and thoroughbred racing based on the percentage of total live wagering in the State each type of racing had in the previous year.

- from the proceeds allocated to thoroughbred racing: 89% to mile thoroughbred purses at Pimlico, Laurel Park, Allegany, and Timonium; 11% to the Maryland-bred Race Fund; and
- from the proceeds allocated to standardbred racing: 89% to standardbred purses at Rosecroft, Ocean Downs, and Allegany; 11% to the Standardbred Race Fund.

Education Trust Fund

The bill creates an ETF as a special, nonlapsing fund that will receive an indeterminate share from the VLT facilities to fund the Bridge to Excellence in Public Schools Act of 2002 (Chapter 288 of 2002). In addition, the initial application fees will be credited to the fund in order to fund the fiscal 2005 cost of implementing GCEI established by the bill. Funds provided to Baltimore City may be used to offset that public school system's deficit.

Local Development Councils and Transportation

From the local development grants provided to the areas where VLT facilities are located, the proceeds are intended to be used for infrastructure improvements, public safety, and other needs in the communities in the immediate proximity of the facility. A Local Development Council would be created in each area where a VLT facility is located to advise, comment, and make recommendations on a plan developed by the county providing for the use of the Local Development Grant funds. The bill also provides that the State may pay for the reasonable transportation costs necessary to mitigate the impact on the communities in immediate proximity to the VLT facilities and to make VLT facilities accessible to the public. Counties must allocate at least 10% of their local development grant to provide grants to minority business enterprise (MBE) small businesses in the county. These grants are to be focused on communities that are economically distressed or in close proximity to a VLT facility.

Compulsive Gambling Fund

The bill assesses a \$390 fee per VLT terminal to be paid by VLT operation licensees that will be placed into a Compulsive 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 and other support services for compulsive gamblers, and establish problem gambling prevention programs.

Other Provisions

The bill also requires the Maryland Department of Transportation to review, coordinate, and approve county transportation studies. The Governor's Office of Minority Affairs must monitor compliance with applicable minority participation requirements in equity sales and facility construction.

DHMH is required to provide grants to public agencies and nonprofits in order to establish regional centers providing treatment and other services to compulsive gamblers and their immediate family members. These grants may be funded with federal or State

monies, including the Compulsive Gambling Fund established by the bill. The bill also requires DHMH to contract with an independent researcher to conduct a pathological and problem gambling prevalence study every five years. The first study is to be completed by September 30, 2005.

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 tourist destinations in the State. Numerous states have authorized VLT gambling. For more information on prior year introductions and other state VLT regimes, consult the *Legislators' Guide to Video Lottery Terminal Gaming*.

One of the recommendations of the Commission on Education Finance, Equity, and Excellence (Thornton Commission) was to adjust State aid to reflect regional differences in the cost of education that are outside the control of local jurisdictions. The Thornton Commission defined adequate funding as revenues sufficient to acquire the resources needed to reasonably expect that students can meet the State's academic performance standards. Because these resources cost different amounts in different places, the Thornton Commission recommended that State aid be adjusted to account for the variations. However, the commission did not believe that an acceptable index existed at the time it was completing its work. The commission recommended that the Maryland State Department of Education (MSDE) contract with a private entity to develop a Maryland-specific index to be used to adjust State aid beginning in fiscal 2005. This recommendation was codified in the Bridge to Excellence in Public Schools Act of 2002.

The consultants hired by MSDE submitted a final report entitled *Adjusting for Regional Differences in the Cost of Educational Provision in Maryland* on December 31, 2003. The report includes a GCEI with index values that range from 0.948 in Garrett County to 1.048 in Prince George's County. The bill codifies the index recommended by the consultants except that no adjustment in aid is made for counties that leave an index value below one.

State Revenues:

Application Fee Revenues

The bill requires VLT licensees to pay an application fee of at least \$10 million. Application fees must be paid by October 1, 2004. These fees are to be distributed to the ETF in order to fund the increase in education aid in fiscal 2005 resulting from the application of GCEI established by the bill. Assuming that all the applicants opt to participate and pay their license fees by the required deadlines, special fund revenues would increase by \$60 million in fiscal 2005.

VLT Revenues

Six locations in the State may be licensed to operate a total of 15,500 VLTs; 9,000 VLTs must be located at three horse racing tracks; 6,500 VLTs must be located at three nontrack locations. Each horse track is authorized to operate up to 3,000 VLTs, and each nontrack facility is authorized to operate up to 2,500 VLTs.

As a result, total revenues generated – after payouts to winning players, but **before** any other distributions are made – could total approximately \$98.6 million in fiscal 2006, \$1.2 billion in fiscal 2007, \$1.61 billion in fiscal 2008, and approximately \$1.61 billion in fiscal 2009 and later.

These estimates assume that: (1) three licenses will be awarded to race tracks and three licenses will be awarded to nontrack facilities; (2) each VLT facility will average \$285 win-per-day; (3) facilities will initially operate at 50% capacity and reach full capacity one year later; and (4) all 15,500 VLTs are awarded within two years of the beginning of VLT operations. It is assumed that the nontrack locations begin operations July 2006, one horse track begins operations in January 2006, and two horse tracks begin operations in May 2006. To the extent that race track operators receive approval to operate temporary facilities, revenues will be potentially higher than estimated in fiscal 2006 and 2007.

The Department of Legislative Services (DLS) advises that the final location of VLT facilities may substantially alter both the total revenue and distribution thereof generated by the six VLT facilities. These estimates have taken into consideration some degree of competition between the central Maryland facilities. To the extent that a VLT facility is located in close proximity to another VLT facility, total gross proceeds could be substantially less.

Win-per-day estimates for the three central Maryland facilities are based on a gravity model utilized last year by the Innovation Group, under contract with Magna

Entertainment, Corp., and are adjusted by DLS to reflect the effects of the additional machines as compared to last year's proposal. To the extent that win-per-days are higher at nontrack facilities, annual revenues to the ETF will be greater, and purse dedication amounts will be less.

It is assumed that race track VLT operators will receive 36% of gross proceeds and nontrack VLT operators will receive 30%. As a result, it is assumed that 44.7% of the gross proceeds from race track facilities will go to the ETF and 60% from the nontrack facilities in the first year of operations (60.7% thereafter). To the extent that VLT facilities accept less than these respective operator shares, then the ETF revenues could be higher. For each 1% that the nontrack facilities accept under 30%, the ETF revenues (at full implementation) would increase by approximately \$6.8 million annually. For each 1% that the track facilities accept under 36%, the ETF revenues (at full implementation) would increase by approximately \$9.4 million annually.

Other Assumptions

- VLTs will operate 365 days a year, once operational.
- Pennsylvania, Washington, DC, and Virginia 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.
- The Innovation Group's gravity model estimated that 13,500 machines is the optimal number for central Maryland and that increasing the number of machines beyond that level results in diminishing win-per-days. To the extent that there is unmet demand beyond what was estimated by the Innovation Group, then win-per-days could be higher at all facilities, resulting in greater total gross proceeds.

Distribution of Revenues

Exhibit 1 details the revenue distribution resulting from VLTs for fiscal 2005 through 2009.

Exhibit 1
Distribution of VLT Revenues
(\$ in millions)

	<u>FY 2005</u>	<u>FY 2006</u>	<u>FY 2007</u>	<u>FY 2008</u>	<u>FY 2009</u>
Total Annual Gross		\$98.60	\$1,200.60	\$1,612.40	\$1,612.40
ETF		44.08	607.80	828.92	828.92
Licensees		35.50	404.33	539.89	539.89
PDA		9.17	69.76	93.62	93.62
Local		4.93	60.03	80.62	80.62
Lottery Operations		4.93	58.70	69.33	69.33
Application Fees-to ETF	\$60.00	\$0	\$0	\$0	\$0

Effect on Lottery Sales

The bill prohibits lottery sales at VLT facilities.

DLS estimates that VLTs, when fully implemented, will cause a permanent reduction in lottery revenues of 15% 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 2** details the estimated decline in the 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 2
Estimated Loss in General Fund Revenue
Due to Decreased State Lottery Sales
(\$ in millions)

<u>FY 2006</u>	<u>FY 2007</u>	<u>FY 2008</u>	<u>FY 2009</u>
\$3.8	\$50.3	\$68.7	\$69.7

The Lottery Agency estimates that lottery revenues would decline by 1% in fiscal 2005, 5% in fiscal 2006, 3% in fiscal 2007, and 1% in fiscal 2008 before rebounding in fiscal 2009 and beyond.

Compulsive Gambling Fund

Approximately \$6.0 million annually, based on \$390 per VLT at full implementation, will be credited to the Compulsive Gambling Fund administered by DHMH. The fund must be used to establish a 24-hour hotline, provide counseling and other support services for compulsive gamblers, and establish problem gambling prevention programs. Funds may also be used to establish regional compulsive gambling treatment centers.

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, VLT facilities must undertake \$35 million in one-time capital improvements for each 1,000 VLTs. In addition, race track facilities must spend \$3.8 million annually for capital improvements to the horse racing track facilities.

The construction jobs associated with track improvements could bring dollars into the areas surrounding the tracks, providing an economic boost to the local economy. 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. For

comparison purposes, Lincoln Park, a 2,000 VLT dog-racing facility in Rhode Island, employs 800 persons (at both the VLT and dog-track operations) with an average wage of \$18,750.

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 3**.

Exhibit 3
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 to the movies which generate liquor and admissions and amusement taxes respectively.

Estimates vary as to the share of total VLT revenues that Marylanders will contribute. *For illustrative purposes only*, if it is assumed that 25% of VLT revenue will come from Marylanders who do not currently play VLTs, VLTs at full implementation could lead to the reallocation of approximately \$397 million annually in Marylanders' consumption to VLTs and away from other forms of entertainment and spending. Some of this reallocated spending was subject to State taxation while other consumption such as services and Internet purchases are not. *For illustrative purposes only*, if half of this reallocated spending was subject to the sales tax, sales tax revenues could decline by approximately \$10 million annually at VLT full implementation.

State Expenditures:

Administrative Expenditures

Lottery Agency

The Lottery Agency states that it will need 50 additional employees. The agency estimates a supplemental request of approximately \$13 million will be needed for fiscal 2005 to pay for start-up costs associated with VLT operations. Administrative costs for the State Lottery to operate video terminals would be approximately \$4.9 million in fiscal 2006. This estimate assumes that the cost of leasing and maintaining VLT terminals and central computer system as well as providing for additional staff will be equal to approximately 5% of gross revenues in the first year and 4.3% of gross revenues in the following years. Lottery Agency administration expenses are assumed to be consistent with the percent of gross proceeds allocated to it, so no net effect is assumed. To the extent that expenses are higher or lower than estimated, the net effect could change accordingly. If administration expenses are less than the amount allocated in each year under the bill, the additional gross proceeds from horse track VLT facilities would be split equally between the PDA and the ETF. Additional gross proceeds as a result of lower than estimated agency administrative costs at nontrack VLT facilities would be distributed to the ETF.

Attorney General

The Office of the Attorney General would incur increased general fund expenditures of approximately \$182,762 in fiscal 2006 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

The Department of State Police would incur increased general fund expenditures of approximately \$391,335 in fiscal 2005 as a result of equipment costs and hiring three full-time troopers and one office secretary to handle the anticipated volume of background checks.

Education Expenditures

State VLT revenues after operating costs are dedicated to the ETF to be used for public education programs associated with the Bridge to Excellence in Public Schools Act of 2002 (Chapter 288). Under that legislation there are significant increases in education aid beginning with fiscal 2004. It is assumed that the availability of the ETF revenues from VLT operations to fund these increases will result in an equivalent decrease in general fund expenditures beginning in fiscal 2006.

The bill also increases education aid beginning in fiscal 2005 by applying a GCEI to the foundation program to recognize required differences in the cost of education. The bill uses the simple average GCEI and makes upwards adjustments to the full foundation program amount for jurisdictions with index values above 1.0. Jurisdictions with index values below 1.0 would receive no adjustments. The bill phases in the adjustments from fiscal 2005 to 2009. In fiscal 2005, 50% of the additional funding calculated in the approach would be provided, and the percentage would increase each year until it reaches 100% in fiscal 2009.

With the proposed phase-in, this method would increase expenditures by \$49.2 million in fiscal 2005. The bill requires that the initial license fees paid by VLT facilities accrue to the ETF to pay the fiscal 2005 costs of applying the GCEI. The impact of the proposal on each local school system in fiscal 2005 is shown in **Appendix 2**. It is estimated that State aid will increase by \$123 million by fiscal 2009 when the GCEI is fully phased in.

Infrastructure Costs

The State and local governments could also incur significant costs associated with infrastructure upgrades at each of the race tracks. The actual costs are site specific and could range from adding more traffic signs and lights 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 the locations of the facilities are determined.

Purse Dedication Account

9.3% of race track VLT facilities are to be distributed to the PDA in the first year and 10% thereafter. The PDA is to be distributed between the thoroughbred and standardbred industries based on the percentage of total wagering on live racing each industry had in the prior year. According to the State Racing Commission, approximately \$86 million was wagered on live racing at State tracks in 2003, of which approximately 89% was from thoroughbred tracks and 11% was from standardbred tracks. The distribution in any year will depend on the prior year's split, which will also depend on what type(s) of racing the Allegany track will conduct.

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. Due to substantial estimation and methodological difficulties, the negative costs cannot be quantified and attempting to do so is subject to substantial error and is misleading. 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*.

DHMH advises that beginning in the year when all VLTs are awarded, the money credited to the compulsive gambling fund will be distributed as follows:

Statewide hotlines	\$200,000
Gambling prevention effort	500,000
Outpatient treatment services	3,741,500
Residential treatment services	<u>1,603,500</u>
Total	\$6,045,000

DHMH estimates that a prevalence study will cost up to approximately \$1.2 million. This estimate is based on conducting a four-month study that samples 38,000 Marylanders or approximately 1% of the State adult population. DLS estimates that the preliminary study would cost approximately \$50,000 to conduct. Administrative costs at DHMH, as a result of the provisions of this bill, could be absorbed within the agency's existing budget.

Local Revenues: The bill provides local impact aid for jurisdictions in which VLT operations are located. This aid is to be used for infrastructure, facilities, services, and other improvements and grants to MBE businesses. For all facilities except Laurel Park, 5% of gross proceeds will be distributed to the county in which they are located. Of the 5% of VLT gross proceeds generated by Laurel (if it receives a license), Anne Arundel County is to receive 73%, Howard County 17%, and Laurel 10%. Based on the assumed VLT-implementation schedule, local aid will total \$4.9 million in fiscal 2006, \$60.0 million in fiscal 2007, \$80.6 million in fiscal 2008, and \$80.6 million in fiscal 2009. **Exhibit 4** shows the local aid that would be distributed at full implement for different sized VLT facilities.

Exhibit 5
Local Aid Distributed at VLT Full Implementation

<u>VLTs</u>	<u>5% Local Distribution</u>
1,000	\$5,201,250
1,500	7,801,875
2,000	10,402,500
2,500	13,003,125
3,000	15,603,750
3,500	18,204,375

Indirect Local Revenues

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. For example, Dover Downs and Delaware Park each attracted over 2 million visitors in 2003. These facilities have approximately 2,000 VLTs, substantially less than the 9,000 total VLTs proposed at the three Maryland horse tracks.

Baltimore City estimates that if Pimlico is granted a license the annual operating costs for public safety, sanitation, and transportation approximate \$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 \$65 million in

transportation-related capital improvements would be necessary to accommodate the expected influx of activity in and around the impacted area. These improvements include intersection improvements, signal system installations, and street widening and rehabilitation.

The City of Laurel estimates that if Laurel Park is granted a license expenditures would increase by approximately \$1.2 million annually as a result of the bill. This reflects hiring additional police and public works personnel as well as other operating costs. Howard County stated that as a result of VLT operations at Laurel, the county would need to hire additional police personnel and widen access roads to Laurel Park. Allegany County, in its submitted fiscal estimate, did not address the possibility of additional local expenditures as a result of the new Allegany VLT facility. *Anne Arundel County did not respond to a request to estimate local expenditures required as a result of this bill.*

Prince George's County advises that if a VLT facility is located in the county it would incur initial expenditures of up to \$20 million and \$4.2 million annually as a result of infrastructure improvements and expanded public services.

In addition, the nontrack VLT facilities will likely require substantial local expenditures in the county(s) in which they are located, which could include Cecil and Prince George's counties and Baltimore City.

Small Business Effect: The Administration has determined the bill will have the following small business impact:

- horse trainers, owners, and breeders would benefit from increased purses. This benefit would be offset to the extent that increased purses result in more out-of-state horse racing in Maryland;
- tourism-related businesses would benefit;
- small businesses that sell construction materials and supplies to VLT facilities would benefit; and
- to the extent that VLT wagering replaces other types of entertainment expenditures, revenues of those businesses would decline.

DLS 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.

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: None.

Cross File: HB 293 (The Speaker and the Minority Leader) (By Request – Administration) – Ways and Means.

Information Source(s): City of Laurel, Allegany County, Howard County, Maryland Department of Transportation, Innovation Group, State Lottery Agency, Office of the Attorney General, State Department of Assessments and Taxation, Baltimore City, Department of Legislative Services

Fiscal Note History: First Reader - February 10, 2004
ncs/mdr Revised - Clarification - February 12, 2004
Revised - Senate Third Reader - March 29, 2004

Analysis by: Robert J. Rehrmann

Direct Inquiries to:
(410) 946-5510
(301) 970-5510

Appendix 1 Summary of Fiscal Impact

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
Gross VLT Revenues		\$98,607,031	\$1,200,621,875	\$1,612,387,500	\$1,612,387,500
Licenseses		\$35,498,531	\$404,332,172	\$539,889,750	\$539,889,750
Special Fund Revenues					
Application Fees	\$60,000,000	\$0	\$0	\$0	\$0
Education Trust Fund	\$0	\$44,077,343	\$607,801,821	\$828,923,213	828,923,213
Purse Dedication Account	0	9,170,454	69,760,682	93,622,500	93,622,500
Compulsive Gambling	0	4,021,680	6,045,000	6,045,000	6,045,000
Local Distributions	0	4,930,352	60,031,094	80,619,375	80,619,375
Lottery VLT Administrative	0	4,930,352	58,696,106	69,332,663	69,332,663
Total Special Fund Revenues	\$60,000,000	\$67,130,181	\$802,334,703	\$1,078,542,751	\$1,078,542,751
General Fund Revenues					
Lost Lottery Revenue	0	(3,774,188)	(50,327,448)	(68,716,326)	(69,747,071)
Special Fund Expenditures					
Education Trust Fund	\$0	\$44,077,343	\$607,801,821	\$828,923,213	\$828,923,213
Purse Dedication Account	0	9,170,454	69,760,682	93,622,500	93,622,500
Compulsive Gambling	0	4,021,680	6,045,000	6,045,000	6,045,000
Local Distributions	0	4,930,352	60,031,094	80,619,375	80,619,375
Lottery VLT Administrative	\$13,000,000	4,930,352	58,696,106	69,332,663	69,332,663
GCEI	\$49,240,014				
Total SF Expenditures	\$62,240,014	\$67,130,181	\$802,334,703	\$1,078,542,751	\$1,078,542,751
GF Expenditures					
State Police	\$391,335	\$286,742	\$292,760	\$369,088	\$304,989
Attorney General	0	182,762	249,119	262,677	292,488
Education – from ETF	0	(44,077,343)	(607,801,821)	(828,923,213)	(828,923,213)
GCEI		66,234,762	83,558,371	104,530,783	123,284,555
DHMH-prevalence Study	500,000				
Total GF Expenditures	\$891,335	\$22,626,923	(\$523,701,571)	(\$723,760,665)	(\$705,041,181)
Net Effect	(\$3,131,349)	(\$26,401,111)	\$473,374,123	\$655,044,339	635,294,110

**Appendix 2
GCEI Expenditures
Fiscal 2005**

<u>County</u>	<u>Total</u>	<u>Per Pupil</u>
Allegany	\$0	\$0
Anne Arundel	3,254,348	45
Baltimore City	9,336,950	105
Baltimore	2,073,952	20
Calvert	884,214	51
Caroline	0	0
Carroll	986,612	34
Cecil	0	0
Charles	1,228,376	49
Dorchester	0	0
Frederick	2,259,327	58
Garrett	0	0
Harford	0	0
Howard	1,745,464	37
Kent	60,298	25
Montgomery	11,420,168	83
Prince George's	15,718,832	117
Queen Anne's	194,847	27
St. Mary's	76,629	5
Somerset	0	0
Talbot	0	0
Washington	0	0
Wicomico	0	0
Worcester	0	0
Total	\$49,240,014	\$58