

Department of Legislative Services
Maryland General Assembly
2012 Session

FISCAL AND POLICY NOTE

House Bill 1348
Ways and Means

(Delegate McComas, *et al.*)

Slot Machines - Ownership and Operation by War Veterans' Organizations -
Allocation of Proceeds

This bill authorizes for counties where nonprofit organizations are not currently authorized to operate slot machines, a bona fide war veterans' organization that has been located in the State for at least five years to own and operate up to five slot machines at its principal meeting hall. The bill specifies the distribution of proceeds from slot machines that are authorized by the bill, which includes 15% to the State general fund and 15% to the local jurisdiction(s).

The bill takes effect July 1, 2012.

Fiscal Summary

State Effect: General fund revenues increase due to distribution of proceeds from slot machines authorized by the bill beginning in FY 2013. Potential decrease in special fund revenues and expenditures from the Video Lottery Terminal (VLT) Program beginning in FY 2013. Under one set of assumptions, general fund revenues increase by \$2.1 million annually while special fund revenues decrease by \$1.4 million annually, with approximately half of the revenue loss needing to be replaced with general funds to support mandated expenses, resulting in a net gain of approximately \$1.4 million to the general fund. Comptroller's Office special fund revenues and expenditures each increase annually beginning in FY 2013 by approximately \$30,000 due to regulation of slot machines.

Local Effect: County and municipal revenues increase due to distribution of proceeds from slot machines authorized by the bill. Potential minimal decrease in local impact grants distributed to certain counties from the VLT program beginning in FY 2013.

Small Business Effect: None.

Analysis

Bill Summary: In a county where slot machine operations by bona fide veterans' organizations are authorized by the bill (*i.e.*, other than an Eastern Shore county where certain nonprofits, including war veterans' organizations, are authorized to operate slot machines), net after payout proceeds from slot machines must be distributed as follows:

- 50% to further the purposes of the organization;
- 20% to one or more charitable organizations in the county;
- 15% to the State general fund; and
- 15% to the county or 7.5% each to the county and municipality.

If the war veterans' organization is located in a municipality, 7.5% of proceeds go to the county and 7.5% of proceeds go to the municipality. Slot machine operations authorized by the bill will be subject to the same regulatory authority of the Comptroller's Office that applies to currently authorized slot machines in Eastern Shore counties.

The bill also clarifies that at least one-half of net after payout proceeds, instead of gross proceeds, from currently authorized slot machines operated by nonprofit organizations in Eastern Shore counties be used as the base amount from which specified distributions must be made.

Current Law: Certain nonprofit organizations are authorized to operate slot machines in nine Eastern Shore counties: Caroline, Cecil, Dorchester, Kent, Queen Anne's, Somerset, Talbot, Wicomico, and Worcester. Chapter 315 (House Bill 39) of 2011 altered the provision requiring at least one-half of proceeds to go to charity and the remainder to further the organizations' purposes, such that at least half of "gross" proceeds must go to charity. Pursuant to Chapter 315, the Comptroller's Office must regulate the specified slot machines and charge a license fee to cover the costs of regulating the machines.

Background: An April 2011 bill review letter from the Attorney General to the Governor notes that House Bill 39 does not define "gross proceeds" and advises that the term "should be construed to mean the gross proceeds after payouts to gambling winners."

In fiscal 2011, 60 nonprofit organizations on the Eastern Shore operated slot machines. Unaudited reports with complete data were available for 56 of the organizations.

The total amount bet at these 56 organizations was approximately \$42.3 million, 88% of which was returned to gamblers. Of the approximately \$5.2 million in proceeds after payouts, \$2.6 million (50%) was disbursed to charity. The Department of Legislative Services (DLS) notes that in reviewing the fiscal 2011 data, it appeared that several organizations were not in compliance with the 50% charity requirement or misclassified some contributions as charitable. Several organizations submitted returns that were incomplete or mathematically incorrect. **Exhibit 1** shows the slot machine “handle” (or amount bet) by county for 57 organizations (one of which did not submit a complete set of data). Generally, the practice has been consistent with applying the 50% requirement to proceeds after payout.

Exhibit 1
Slot Machine Handle for Eastern Shore Counties
Fiscal 2011
(\$ in Millions)

<u>County</u>	<u>Slot Machines</u>	<u>Handle</u>
Caroline	20	\$1.8
Cecil	45	13.7
Dorchester	25	3.4
Kent	25	1.6
Queen Anne’s	35	7.2
Somerset	35	1.8
Talbot	25	2.7
Wicomico	60	11.4
Worcester	10	0.2
Total	280	\$43.8

Source: Department of Legislative Services

The Maryland State Lottery Agency conducted a study of local gaming in Maryland required by Chapter 474 of 2008. The report indicates (similar to DLS findings for fiscal 2008) that in fiscal 2008, 273 slot machines on the Eastern Shore generated \$54.8 million in total handle.

State Lottery Ticket Sales

In fiscal 2011, the State Lottery generated \$1.7 billion from ticket sales. Payments to lottery winners were \$1.0 billion, while operating costs and payments to agents totaled \$166.0 million. Approximately \$499.4 million was deposited in the general fund after

payments were made to the Maryland Stadium Facilities Fund (\$20.0 million). **Exhibit 2** shows lottery sales by jurisdiction in fiscal 2011.

Exhibit 2
State Lottery Sales by County
Fiscal 2011

County	Total Sales	Percent of Sales
Allegany	\$11,240,905	0.66%
Anne Arundel	176,010,692	10.27%
Baltimore City	292,271,222	17.05%
Baltimore	278,196,840	16.23%
Calvert	24,328,024	1.42%
Caroline	6,761,520	0.39%
Carroll	34,465,435	2.01%
Cecil	19,786,084	1.15%
Charles	57,571,067	3.36%
Dorchester	8,649,659	0.50%
Frederick	36,423,372	2.12%
Garrett	3,426,916	0.20%
Harford	58,365,876	3.40%
Howard	47,761,493	2.79%
Kent	4,245,306	0.25%
Montgomery	169,445,933	9.88%
Prince George's	352,964,544	20.59%
Queen Anne's	11,636,346	0.68%
St. Mary's	35,318,712	2.06%
Somerset	5,906,556	0.34%
Talbot	8,269,194	0.48%
Washington	25,900,199	1.51%
Wicomico	21,971,165	1.28%
Worcester	23,485,566	1.37%
Total	\$1,714,402,620	100.00%

Note: Numbers do not sum to the total due to rounding.

Source: Maryland State Lottery Agency

Video Lottery Terminal Program

Two VLT gambling bills passed during the 2007 special session – House Bill 4 (Chapter 5) and Senate Bill 3 (Chapter 4). Chapter 5 was a constitutional amendment approved by Maryland voters at the November 2008 general election authorizing 15,000 VLTs at

five locations in the State. Chapter 4, which was contingent on ratification of Chapter 5, established the operational and regulatory framework for the authorized VLT program.

Under Chapter 4, VLT facility operation licenses are awarded by the Video Lottery Facility Location Commission. The State Lottery Commission oversees VLT operations and owns/leases VLTs and the central monitor and control system. A maximum of 15,000 VLTs are allowed, distributed as follows: 4,750 VLTs in Anne Arundel County; 3,750 VLTs in Baltimore City; 2,500 VLTs in Worcester County; 2,500 VLTs in Cecil County; and 1,000 VLTs in Allegany County. In addition, geographic parameters for each jurisdiction within which a VLT facility may be located are provided.

Under current law, except for the Allegany County location, gross VLT proceeds are distributed as follows:

- Business Investment – 1.5% to a small, minority, and woman-owned business investment account;
- Lottery Operations – 2% to the State lottery for administrative costs, with other costs provided for in the State budget;
- Local Impact Grants – 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 \$1 million annually to Prince George’s County for the community surrounding Rosecroft;
- Purse Dedication Account – 7% to enhance horse racing purses and funds for the horse breeding industry, not to exceed \$100 million annually;
- Racetrack Facility Renewal Account – 2.5% for an eight-year period to RFRA, not to exceed \$40 million annually;
- Licensee (Operator) – no more than 33% to video lottery operation licensees; and
- Education Trust Fund (ETF) – remainder to ETF (48.5%-51.0%).

The Education Trust Fund is a nonlapsing, special fund that is used for continued funding of the Bridge to Excellence formulas and programs. The fund may also be used to support capital projects for public schools, public colleges and universities, and community colleges.

Exhibit 3 shows the estimated VLT revenues for fiscal 2013 through 2017 and the various fund distributions, including revenues distributed to the Education Trust Fund.

Exhibit 3
Distribution of Estimated VLT Revenues in Maryland
(\$ in Millions)

	<u>FY 2013</u>	<u>FY 2014</u>	<u>FY 2015</u>	<u>FY 2016</u>	<u>FY 2017</u>
Education Trust Fund	\$254.4	\$386.2	\$483.4	\$513.3	\$523.6
Licensees	173.1	265.0	333.5	353.9	361.0
Local Impact Grants	28.9	43.6	54.4	57.8	58.9
Business Investment	7.9	11.9	14.8	15.8	16.1
Purse Dedication Account	36.7	55.4	69.0	73.3	74.8
Racetrack Renewal	13.1	19.7	24.5	26.0	26.5
Lottery Operations	10.5	16.0	20.0	21.2	21.7
Total Annual Gross	\$524.6	\$797.8	\$999.6	\$1,061.3	\$1,082.6

Note: Assumes Allegany County and Baltimore City facilities open by December 2013.
Source: Department of Legislative Services

State Fiscal Effect:

Impact on the State VLT Program

State special fund revenues and expenditures may be reduced, depending on the degree to which additional eligible war veterans' organizations are licensed to operate and implement slot machines. These machines may serve as a substitute for gambling at VLT facilities in the State.

Gambling at the newly eligible war veterans' organizations would represent a shift of spending from other activities, a portion of which are taxable by the State. Numerous studies have examined the relationship between expanded VLT gambling and the substitution effect this expansion has on existing VLT revenues or other State revenues such as the lottery and sales tax. Most of these studies conclude that although total revenues might increase from expanded gambling, there is a negative impact on existing revenue streams that partially offsets the revenue from expanded gambling. For example, DLS estimates that VLTs, when fully implemented, will cause a permanent 10% reduction in annual revenues from lottery.

The average annual revenue generated from existing gambling at eligible nonprofits is approximately \$94,700 (*i.e.*, total handle minus total amount returned to players) per organization. The bill will add an estimated 150 war veterans' organizations (an average of 10 per county, excluding counties where slot machines at eligible nonprofits

are currently authorized) offering slots play; assuming 5 machines at each results in 750 slot machines generating approximately \$14.2 million in revenue annually. A small portion of this would likely have otherwise been spent at State VLT facilities. If that portion is 10%, the result is an annual loss of \$1.4 million in special fund revenues. The impact to the State includes a \$688,950 reduction in Education Trust Fund revenues and a \$28,400 loss in revenues for State lottery administration of the VLT program. These lost revenues will likely need to be replaced with general funds to cover mandated K-12 education aid and VLT lease costs. **Exhibit 4** shows the reduction in special fund distributions from the total reduction of \$1.4 million illustrated above and based on the distribution of VLT revenues from facilities other than Rocky Gap.

Exhibit 4
Illustration of Reduced VLT Program Distribution

Education Trust Fund (48.5%)	\$688,950
Licensees (33%)	468,775
Purse Dedication Account (7%)	99,450
Local Impact Grants (5.5%)	78,125
Racetrack Renewal (2.5%)	35,500
Lottery Operations (2%)	28,400
Minority Business Investment (1.5%)	21,300
Total Reduction	\$1,420,500

Regulation by the Comptroller's Office

Given the addition of approximately 750 slot machines and a license fee of \$50 per machine, special fund revenues increase by approximately \$37,500 annually beginning in fiscal 2013. Special fund expenditures increase by an equivalent amount at the Comptroller's Office beginning in fiscal 2013 due to increased administrative costs for regulating slot machines operated by eligible organizations.

Net Impact on the General Fund

The general fund receives 15% of proceeds from additional slot machines authorized by the bill. Under the assumptions stated above, the result is 15% of \$14.2 million annually, or \$2.1 million in increased general fund revenues. However, under these same assumptions, general fund expenditures increase by \$717,350 to cover mandated K-12 education aid and VLT lease costs. The net effect on the general fund under these assumptions will be a gain of \$1.4 million annually. However, the impact on the general fund will depend on the number of war veterans' organizations that operate authorized

slot machines, their location with respect to VLT facility locations, and the degree to which slot machines authorized by the bill constitute a substitute for VLT gambling in the State.

Local Fiscal Effect: County and municipal revenues increase within the counties where eligible veterans' organizations are newly authorized to operate slot machines. In total, revenues to these local governments increase by approximately \$2.1 million annually; an average of \$142,050 for each of 15 counties, with larger than average increases generally going to more populous counties. However, local impact grant funds distributed to counties where VLT facilities are located will decrease by a total of approximately \$78,125 annually.

The provision of the bill altering the portion of proceeds from authorized slot machines operated by nonprofit organizations in Eastern Shore counties that must be used for the benefit of charity clarifies current practice, and has no impact on local finances.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Cecil, Kent, Talbot, and Worcester counties; Comptroller's Office; Maryland State Lottery Agency; Department of Veterans Affairs; Department of Legislative Services

Fiscal Note History: First Reader - March 19, 2012
ncs/rhh

Analysis by: Scott P. Gates

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