



MARKET ASSESSMENT:

Challenges Facing Indiana's Commercial Gaming Industry, including Planned Indian Casino in South Bend

Prepared for the Casino Association of Indiana
December 9, 2016



1201 New Road, Suite 308
Linwood, NJ 08221 USA
Tel: 609.926.5100
www.spectrumgaming.com

Executive Summary

The Casino Association of Indiana, which represents 11 of the state's 13 casinos,¹ retained Spectrum Gaming Group to independently (a) assess the status of, and outlook for, Indiana's commercial gaming industry; (b) analyze the impact that the planned Four Winds Casino Resort South Bend being developed by the Pokagon Band of Potawatomi Indians would have on the commercial casino industry; and (c) examine what can, or should, be done to ensure that Indiana's commercial casino industry – which has been an important part of the state's economy for more than two decades – thrives and sustains its considerable economic and fiscal benefits to the state.

Two points are foundational to our analysis:

1. Indiana's casinos are no longer in a startup phase. The gaming industry is mature, and mature industries cannot be expected to operate efficiently – nor can they be expected to fully operate in the public interest – with rules that might have made sense for an emerging industry but which are stifling and counter-productive to the goals and needs of today and tomorrow.
2. Rules and requirements that need to be addressed and updated should include all gaming-related taxes, including the tax on promotional spending (i.e., free play), as well as overall gaming taxes.

Key Challenges

Indiana's casino industry is mired in the doldrums, in which the status quo is serving neither the industry nor the State well. For the 12-month period ending September 2016, statewide gross gaming revenue ("GGR") was \$2.227 billion – nearly 21 percent below its peak just seven years earlier. The decline can be attributed to several clear causes. Indiana casinos have been negatively impacted by:

- The legalization of casinos in Ohio
- The 2007 opening of another Pokagon Band casino in New Buffalo, MI, less than four miles from the Indiana border
- The legalization of retail gaming (i.e., video gaming machines in liquor-licensed establishments) in Illinois
- Continued expansion of the gaming industry generally in the Midwest
- An aging patron base that is not being replaced
- Economic conditions generally

Headwinds facing Indiana's commercial casino industry include:

¹ Casino Association of Indiana members are Ameristar, Belterra, Hollywood, Hoosier Park, Horseshoe Hammond, Horseshoe Southern Indiana, Indiana Grand, Rising Star, Tropicana and, as of January 1, 2017, both Majestic Star casinos.

- **New Four Winds South Bend:** As detailed below, the planned Four Winds South Bend would have negative impacts on the commercial industry and the State of Indiana. If Four Winds opens as a Class II casino – as appears to be the case – it will pay zero gaming tax to the State of Indiana, giving it an enormous marketing and pricing advantage, particularly in slot payout rates, over the commercial casinos that pay an average 35 percent GGR tax to the State.
 - The State should seek a compact with the Pokagon Band – if it were to seek Class III status (see Chapter IV) – that would effectively help ensure that the casino’s revenue share with the State would be in line with the gaming tax rates paid by the commercial gaming operators. If the Pokagon Band opts for Class II status, the State’s best option would be to enact policies that encourage capital investment in the commercial casino properties to make them more attractive, and to increase their geographic and demographic reach.
- **Competing Forms of Gambling:** Emerging forms of gambling, such as Internet gaming, daily fantasy sports (“DFS”) and retail gaming (i.e., a limited number of electronic gaming devices in liquor-licensed establishments), as well as next-generation lottery products, vie with casinos for gambling dollars. Internet gaming and DFS (as well as the potential for traditional sports betting) are potential opportunities for casinos. Retail gaming is clearly a threat, as shown in Illinois, where the \$1 billion video gaming machine industry has caused recurring declines in casino revenue, virtually halting capital investment in the properties, thus making them less attractive. New lottery products would represent a threat if the Hoosier Lottery were to offer slot-like video lottery terminals or were to offer online games that resembled slot machines or table games.
 - If supporting growth of the Indiana casino industry is a priority, the State should allow casinos exclusively to offer all forms of online gaming while prohibiting retail gaming and limiting lottery products to those that do not overlap with casino games.
- **Market Saturation:** Although saturation is a major concern among both governments and gaming operators across the country, the issue is minimized *within Indiana* because its casinos are well distributed geographically throughout the state. That would change in Northwest Indiana if the Four Winds South Bend were to open. Some Indiana markets, however, do face issues of market saturation due to border competition, as we discuss below in Regional Competition.
 - The State should not even consider additional commercial casino locations until, on a statewide basis, the industry demonstrates consistent, attractive GGR growth.
- **Regional Competition:** Indiana’s four neighboring states have casinos, with many of them at or near Indiana borders, pulling significant amounts of Indiana gaming dollars across state lines. In total, Michigan, Ohio, Illinois and Kentucky have 50 casinos of varying size and quality, plus thousands of video gaming machines in liquor-licensed establishments in Illinois.

- Indiana can do nothing about another state's industry, but can – and should – provide incentives and encouragement to its own casino operators to make their gaming properties more attractive and competitive.
- **Attracting New Customer Base:** Millennials (ages 18-34 as of 2015) have overtaken Baby Boomers (ages 51-69) as the largest living generation in the country. As Baby Boomer and older gamblers die or stop patronizing casinos, they are not being replaced by younger potential patrons, who find slot machines boring and the casino floor unexciting. Millennials prefer live table games over slot machines because they have a social component and involve decision-making. It should be noted that in many state-tribal gaming compacts across the country table games revenue is not subject to revenue sharing, a situation that if stipulated in Indiana could further put the commercial casinos at a competitive disadvantage and thus lower State tax receipts.
 - Casino operators will need to undertake significant capital investment to change their gaming floors to provide next-generation gaming equipment (such as skill-based games, electronic sports, virtual-reality games, etc.) and create non-gaming areas that offer new experiences that Millennials find engaging.

Impacts of Pokagon Four Winds South Bend

As an Indian casino operating on sovereign land, Four Winds South Bend would pay substantially less in taxes (or revenue sharing) than commercial casinos, thus having a substantial and sustainable competitive advantage over them. The following table summarizes the differences in tax rates between commercial casinos in Michigan and the Pokagon Band's Four Winds Casino in New Buffalo, MI, as well as between commercial casinos in Indiana (actual) and Four Winds South Bend (assumed).

Comparison of tax rates between commercial, Pokagon casinos in Michigan and Indiana

Tax Type	Michigan Commercial - Actual	Four Winds New Buffalo - Actual
Casino revenue tax/revenue share	24% on slots and live table games	8% on slots, 0% on live table games
Corporate income tax	4.95%, plus modified gross receipts tax of 0.8%	None
Sales tax	6.0%	6% for sales to non-tribal members 0% for sales to tribal members
Use tax	6.0%	6% for sales to non-tribal members 0% for sales to tribal members
Motor fuel tax	\$0.19/gallon gasoline \$0.15/gallon diesel	None
Property tax	No exemption	No exemption
Tobacco products tax	\$1.25 per pack of cigarettes	None
Tax Type	Indiana Commercial - Actual	Four Winds South Bend - Assumed
Casino revenue tax/revenue share	Graduated rate on gross gaming revenue (slots and live table games) ranging from 15% to 40%	0% on slots or live table games
Riverboat casino admission tax	\$3 per admission	None
Corporate income tax	6.25%	None
Sales tax	7%	7% for sales to non-tribal members 0% for sales to tribal members
Use tax	7%	7% for sales to non-tribal members 0% for sales to tribal members
Gasoline tax	\$0.18/gallon	None
Property tax	No exemption	2% of net win [actual]
Tobacco products tax	20-pack cigarettes: \$0.995 25-pack cigarettes: \$1.24375 Other tobacco products 24 percent wholesale price of tobacco products other than moist snuff; for moist snuff, 40 cents per ounce	None
Utility service tax	1.4%	None

Source: State gaming commissions, state departments of revenue, Tax Foundations, TaxRates.com, Pokagon-State of Michigan compact, Spectrum research

Spectrum developed two forecasts for Indiana's commercial gaming industry – one with no change in the competitive environment (representing the status quo) and one showing the impacts of Four Winds South Bend. The following table summarizes the results of each scenario; we assume Year 1 is 2018 (fiscal or calendar). It shows that the commercial industry will experience minimal growth in its current state and an average 2 percent annual decline with new competition from Four Winds South Bend. As shown, over the five-year forecast period Indiana's commercial casinos would lose more than \$800 million in GGR and the State would lose more than \$282 million in gaming-tax receipts as a result of competition from the Four Winds South Bend casino.

Projected revenue, gaming-tax impacts of Four Winds South Bend on Indiana's commercial casinos

Commercial Casinos (millions)	Year 1	Year 2	Year 3	Year 4	Year 5	5-year Total	5-year CAGR
Scenario 1 – Status Quo							
Gross gaming revenue	\$2,247	\$2,247	\$2,258	\$2,269	\$2,292		
Dollar change vs. prior year	\$0	\$0	\$11	\$11	\$23	\$45	0.4%
Percent change vs. prior year	0.0%	0.0%	0.5%	0.5%	1.0%		
Gaming tax @ 35%	\$786	\$786	\$790	\$794	\$802		
Dollar change vs. prior year	\$0	\$0	\$4	\$4	\$8	\$16	0.4%
Scenario 2 – with Four Winds South Bend Impact							
Gross gaming revenue	\$2,158	\$2,115	\$2,094	\$2,073	\$2,063		
Dollar change vs. prior year	(\$89)	(\$43)	(\$21)	(\$21)	(\$10)	(\$184)	-2%
Percent change vs. prior year	-4.0%	-2.0%	-1.0%	-1.0%	-0.5%		
Gaming tax @ 35%	\$755	\$740	\$733	\$726	\$722		
Dollar change vs. prior year	(\$31)	(\$15)	(\$7)	(\$7)	(\$4)	(\$64)	-2%
Dollar Differences between Scenario1 and Scenario 2							
Gross gaming revenue	(\$89)	(\$132)	(\$164)	(\$196)	(\$229)	(\$810)	
Gaming tax @ 35%	(\$31)	(\$46)	(\$57)	(\$68)	(\$80)	(\$282)	

Source: Spectrum Gaming Group

The rules of economics and business management make it clear that casino operators will endeavor to reduce costs, including personnel, when business declines and increase jobs and other investments when business is growing. Based on the revenue changes noted above, Spectrum projects the following year-over-year changes in employment (using full-time-equivalent ["FTE"] positions) based on the impacts to the commercial casino industry caused by the opening of Four Winds South Bend. In all, the commercial casinos would shed 732 full-time positions as a result of the Four Winds South Bend operation.

Projected employment impacts of Four Winds South Bend on Indiana's commercial casinos

	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Gaming FTEs	(255.0)	(119.9)	(61.2)	(61.2)	(27.2)	(524.5)
Non-Gaming FTEs	(101.1)	(47.5)	(24.3)	(24.3)	(10.8)	(207.9)
Grand Total FTEs	(356.1)	(167.4)	(85.5)	(85.5)	(38.0)	(732.4)

Source: Spectrum Gaming Group

The changes in revenue and employment will ripple through the economy, having an impact on indirect and induced jobs, gross state output, personal income, and state and local revenue collection. The following table isolates the projected economic and fiscal impacts caused by changes to the commercial casinos resulting from Four Winds South Bend.

It is important to note that Spectrum was tasked with isolating the economic impacts of changes to the Indiana commercial casino industry and the resulting impacts on State of Indiana for the purpose of illustrating the potential effects and using them as a basis for addressing public-policy issues. As such, the following results do not factor in economic benefits of the Four Winds South Bend, which could mitigate some declines experienced by the commercial casino industry, particularly in employment.

As shown below, the state would lose a total of 1,803 jobs (direct, indirect and induced) and hundreds of millions less in Gross State Product, Output and Personal Income, as well as \$73 million less in State tax receipts.

Isolating projected economic, fiscal impacts caused by changes to commercial casinos resulting from Four Winds South Bend

	Year 1	Year 2	Year 3	Year 4	Year 5	5-Year Total
Economic Changes						
Total Private Non-Farm Employment	-856	-449	-233	-203	-89	-1,803
Gross State Product (Fixed millions 2016 \$'s)	-163.5	-82.9	-41.4	-39.2	-19.0	-346.1
Output (Fixed millions 2016 \$'s)	-256.5	-129.9	-65.0	-60.5	-28.0	-539.8
Personal Income (current \$'s)	-70.0	-44.0	-28.0	-27.0	-17.0	-186.0
Fiscal Changes						
State Revenue Collection (Fixed 2016 \$)	-\$34.68	-\$17.09	-\$8.23	-\$8.16	-\$4.60	-72.75
Local Development Agreements	-\$1.80	-\$0.90	-\$0.50	-\$0.50	-\$0.20	-3.90

Source: Spectrum Gaming Group, Regional Economic Models Inc.

Looking Ahead

The Indiana Legislature faces a stark imperative with respect to its casino industry: The policies that served the state well in the past will simply not work in the future. The Indiana casino industry, along with many of its allies and supporters in both the public and private sectors, has been aware of this reality for years, and the imperatives have only grown starker.

Critical questions facing state policymakers – and the commercial casino industry – are these:

- What changes will make gaming operators more competitive?
- What changes will allow operators to develop new, broader business models that do more than target the local gaming-centric adult population?
- What changes will encourage operators – and other, related businesses – to invest more capital in their properties, thus giving operators a broader demographic and geographic reach, while creating more employment?

Capital investment is key to the future of Indiana’s casino industry; its importance cannot be over-emphasized. From the standpoint of gaming operators, the level and quality of capital investment can help determine everything from the type of business model that can be deployed to the geographic and demographic reach of a gaming property to the average length of stay and the spending patterns of visitors.

Without capital investment, the casino industry risks “disinvestment,” in which existing attractions are not maintained, refreshed or replaced, leading to a vicious circle that will negatively impact the industry and the State.

Spectrum recommends that the State undertake the following actions (listed alphabetically):

- **Allow operators, regulators to develop alternatives to admissions tax:** The admissions tax has declined significantly over the past decade, effectively mirroring

the decline in gaming revenue. That tax is regressive – since it is levied the same on all visitors, regardless of how much they spend – and is counter-productive, since operators must take it into account when offering promotions.

- **Change the tax policy on free play:** Providing patrons with free play (i.e., free spins on a slot machine) incentivizes customers to increase their real-money wagering – by a ratio of at least 4:1, based on data in other states. Free play has become a critical part of casino marketing, and other states have recognized this by not taxing free play. Indiana, however, does tax free play after \$7 million, resulting in a substantial cost to operators and thus reducing the effectiveness of this program. Spectrum recommends that Indiana take a graduated approach, easing the free-play tax rate over time to ensure that the desired results are being achieved. As shown in the following table, Indiana ranks as the lowest in the percentage of free play to gaming revenue as compared to the rest of country for states that publicly report free play amounts.

Free play results as percentage of gaming revenue, 2012-2016

State	2012	2013	2014	2015	2016 (6 mos.)
CT	12%	11%	13%	12%	11%
FL	14%	16%	15%	15%	16%
NJ	18%	16%	16%	18%	17%
NY	7%	10%	11%	13%	13%
OH	8%	23%	19%	18%	17%
PA	28%	29%	27%	26%	27%
IN					8%

Source: State gaming commissions, Spectrum research

- **Eliminate the Add-Back Tax:** Indiana does not allow casino operators to deduct the tax on AGR as an expense that could offset taxable income, and we cannot identify any other state that has such a provision in place.
- **Reform AGR tax structure to encourage incremental revenue growth:** Indiana regulators could be granted authority to review and approve petitions for lower incremental tax rates for operators that can demonstrate that such relief will produce tangible benefits that can range from overall market growth to increased employment, or to simply stave off further declines or potential closings.
- **Stimulate capital investment:** If the above above-recommended actions are implemented, and/or other policies are implemented that stimulate capital investment, casino operators can reinvest in their properties.

Spectrum recognizes that such changes cannot be implemented in a vacuum, nor should the State of Indiana make significant regulatory changes in the absence of a quid pro quo from gaming operators. Indiana casino operators have a concomitant obligation to the State that should be met before Indiana lawmakers agree to any material changes to tax rates or regulatory requirements.

In practice, this means that each casino operator seeking relief should present a detailed plan to regulators that, among other things, outlines the specific plans and goals that it would develop in response to regulatory relief. For example, if a casino seeks a reduction in gaming taxes, it should demonstrate:

- Why the current rules limit its ability to market its product, or to optimize revenue and profitability;
- How it would develop a more robust, effective business under new, relaxed rules; and/or
- What the overall impact would be to the state, and to what degree any increased economic activity – including increased employment – would offset the direct loss to the state of revenue from eliminating the admissions tax.

In the absence of such a requirement, Indiana would be undertaking a significant, unnecessary risk that it would lower the operating costs of casinos, simply to have those operators invest elsewhere. That risk would be eliminated by requiring operators to put forth investment plans that would leverage those lower costs.

The overarching goal should be to encourage new investment in Indiana's commercial casinos to make them more competitive and to advance public policy.

Contents

EXECUTIVE SUMMARY	II
INTRODUCTION	1
I. STATUS QUO, OUTLOOK FOR INDIANA COMMERCIAL CASINO INDUSTRY	2
KEY CHALLENGES – PRESENT AND FUTURE	4
New Four Winds South Bend	4
Competing Forms of Gambling	4
Market Saturation	5
Regional Competition	5
Attracting New Customer Base	5
IMPORTANCE OF CAPITAL INVESTMENT	7
Danger of Disinvestment	8
CONCLUSION: STATE MUST INCENTIVIZE CAPITAL INVESTMENT TO SUSTAIN COMMERCIAL CASINO INDUSTRY	9
II. ECONOMIC IMPACTS OF FOUR WINDS CASINO ON INDIANA’S COMMERCIAL CASINOS.	11
PROJECTED COMMERCIAL CASINO REVENUES, TAXES	12
Gross Gaming Revenue	12
Non-Gaming Revenue	13
PROJECTED FOUR WINDS SOUTH BEND RESULTS	14
Gross Gaming Revenue	16
Hotel Revenue	21
ECONOMIC, FISCAL IMPACTS OF POKAGON CASINO ON INDIANA CASINOS	22
Changes in Direct Employment	22
Changes in Wages	23
Impacts to Local Development Agreements	23
Statewide Economic and Fiscal Impacts	24
Description of Economic Indicators	25
Assumptions	25
Economic and Fiscal Impacts	26
III. EXAMINING STATE POLICY TO ASSIST CASINO INDUSTRY	30
STATE GAMING INITIATIVES, 2014 - PRESENT	31
Issue of Add-Back Taxes	32
LOOKING AHEAD	33
Responsibility of Casino Operators	34
MORE FREE PLAY DRIVES GROSS GAMING REVENUE, TAX RECEIPTS	34
New York Example: Free Play Tax Changed, Revenue Increased	36
Relevance to Indiana	38
ROLE FOR INDIANA GAMING COMMISSION	38
IV. INDIAN GAMING: KEY LEGAL, REGULATORY ASPECTS	40
UNDERSTANDING CLASS III TRIBAL-STATE COMPACTS	40
Pokagon-Michigan Compact	43
Pokagon-South Bend Agreement	45
Comparing Tax Treatment between Commercial and Pokagon Casinos in MI, IN	46
CLASS II VS. CLASS III GAMING	48

Differences between Class II and Class III Games	50
Slot Manufacturers Pursue both Class II, Class III Games	52
Conclusion	53
ABOUT THIS REPORT	54
DISCLAIMER	55
APPENDIX I: METHODOLOGY AND ASSUMPTIONS FOR REVENUE PROJECTIONS	56
Population	57
Employment/Wages	59
Additional Economic Factors	60
Regional Populations	62
Gravity Model Interpretations	63
National Figures to Derive Annual Personal Gaming Budget	64
NON-GAMING REVENUE PROJECTIONS	64
APPENDIX II: METHODOLOGY AND ASSUMPTIONS FOR EMPLOYMENT PROJECTIONS	66

Figures

Figure 1: Indiana gaming revenue projections, status quo (or baseline)	3
Figure 2: Change in 2018 Indiana projected commercial casino gaming revenue, by distance traveled, resulting from operation of Four Winds South Bend	12
Figure 3: Indiana gaming revenue projections with operation of Four Winds South Bend	13
Figure 4: Differences in gross gaming revenue, State gaming-tax receipts between the two scenarios... 13	
Figure 5: Sensitivity matrix: +/- 10 percent variation to five-year change in GGR forecast for Indiana commercial casinos.....	13
Figure 6: Projected changes in total revenue at Indiana commercial casinos, by department	14
Figure 7: South Bend total market GGR	15
Figure 8: South Bend 120-minute drive-in market and slot machines by property	17
Figure 9: Casinos with 150 miles of Four Winds South Bend	18
Figure 10: Map showing competition (overlap) from Four Winds South Bend	19
Figure 11: Percent of casinos' GGR and statistics by distance from property	20
Figure 12: Estimated 2018 GGR for Four Winds South Bend	21
Figure 13: GGR from Four Winds South Bend on-site hotel.....	21
Figure 14: Four Winds South Bend projected casino and hotel GGR, 2018-2022	22
Figure 15: Projected changes in Indiana commercial casino gaming positions, jobs resulting from opening of Four Winds South Bend	23
Figure 16: Projected changes in Indiana commercial casino gaming and non-gaming FTE jobs resulting from opening of Four Winds South Bend.....	23
Figure 17: Changes in Indiana commercial casino employee wages, 2018-2022.....	23
Figure 18: Projected statewide changes in commercial casinos' Local Development Agreement funding resulting from operation of Four Winds South Bend	24
Figure 19: Modeling assumptions (changes from baseline resulting from operation of Four Winds South Bend)	26

Figure 20: Changes to Indiana economy – isolating economic impacts from changes to commercial casino industry resulting from operation of Four Winds South Bend	28
Figure 21: Changes to Indiana economy – isolating fiscal impacts from changes to commercial casino industry resulting from operation of Four Winds South Bend	29
Figure 22: Free play results as percentage of gaming revenue, 2012-2016, selected states	35
Figure 23: Typical response rates of casino marketing incentives	35
Figure 24: Timeline and effect of free play experience in New York	37
Figure 25: Comparison of taxes paid by Michigan commercial casinos, Four Winds New Buffalo casino. 47	
Figure 26: Comparison of taxes paid by Indiana commercial casinos, actual/potential taxes to be paid by Four Winds South Bend casino	48
Figure 27: Drive-time bands from Four Winds South Bend.....	57
Figure 28: Population levels and projected growth by state, 2010-2030.....	58
Figure 29: Drive-time bands from Four Winds South Bend and population density	58
Figure 30: National employment trends (non-farm).....	59
Figure 31: Region and national employment, 2010-2015.....	59
Figure 32: National Consumer Price Index growth rates.....	60
Figure 33: Average weekly ages for Indiana, relevant border states and US, 2010-2015	60
Figure 34: Gasoline price trends, 84-month average retail for Indiana, Michigan, US.....	61
Figure 35: Adult population gaming participation based on proximity to property	63
Figure 36: Boulder Strip, Nevada, casinos – percentage of total revenue by department.....	65
Figure 37: Indiana commercial casino industry, salient operating results (LTM June 2016)	67
Figure 38: Indiana commercial casino industry, win per unit per day assumptions, 2017-22.....	67

Introduction

The Casino Association of Indiana (“CAI”), which represents 11 of the state’s 13 casinos,² retained Spectrum Gaming Group (“Spectrum,” “we” or “our”) to assess the state’s commercial casino industry, as follows:

1. The status and outlook for the industry under the current competitive and regulatory environment.
2. The impact that the Four Winds Casino Resort South Bend being developed by the Pokagon Band of Potawatomi Indians would have on the existing commercial casino industry.
3. What can, or should, be done to ensure that Indiana’s commercial casino industry – which has been an important part of the state’s economy for more than two decades – thrives and sustains its considerable economic and fiscal benefits to the state.

In addition, we were tasked with providing an overview of key legal and regulatory aspects of Indian gaming to help stakeholders better understand the potential introduction of a tribal casino in the state.

A primary concern among Indiana’s commercial casino operators is the impact that the planned Four Winds South Bend would have on the state’s commercial gaming industry. However, the industry faces other challenges, including a potentially seismic shift among the gambling preferences of the next generation of casino players, competing forms of gambling, market saturation, and flattening or declining revenues.

This study is a followup to a similar report we prepared for the CAI in 2014,³ although our earlier report did not examine the issue of a potential tribal casino in South Bend.

By way of background, Spectrum has extensive experience working in Indiana and the Midwest, both as economic/market analysts and as regulatory advisors. We have been retained by gaming operators in Indiana, Illinois, Kentucky, Michigan, Missouri and Ohio and we have been retained by state or tribal governments in Iowa, Michigan and Ohio. In addition, we have testified or presented before governmental bodies in five Midwestern states, including the Indiana Gaming Study Commission and the Indiana Horse Racing Commission.

² Casino Association of Indiana members are Ameristar, Belterra, Hollywood, Hoosier Park, Horseshoe Hammond, Horseshoe Southern Indiana, Indiana Grand, Rising Star, Tropicana and, as of January 1, 2017, both Majestic Star casinos.

³ Spectrum Gaming Group, “Responding to Competition, New Challenges: Regulatory, Tax Reform in Indiana,” August 18, 2014, p. 4. http://www.spectrumgaming.com/dl/b78788_dd9f02a2de9e410499d5eec30d8bf46a.pdf

I. Status Quo, Outlook for Indiana Commercial Casino Industry

In assessing Indiana's commercial casino industry, it is critical to note that gross gaming revenue ("GGR," or what is termed "adjusted gross revenue" in Indiana) for the 12-month period ending September 2016 was \$2.227 billion – nearly 21 percent below its peak just seven years earlier. Indiana casinos have been negatively impacted by:

- The legalization of casinos in Ohio
- The 2007 opening of another Pokagon Band casino in New Buffalo, MI, less than four miles from the Indiana border
- The legalization of retail gaming (i.e., video gaming machines in liquor-licensed establishments) in Illinois
- Continued expansion of the gaming industry generally in the Midwest
- An aging patron base that is not being replaced
- Economic conditions generally

Looking ahead – which is the purpose of this report – Spectrum found that the outlook is far from rosy. A recent, ominous report from Fitch Ratings (with emphasis added) encapsulates the forecast for regional gaming operations:

U.S. Regionals Deflating

Low single-digit gaming revenue growth at the start of 2016 has given way to 0% year over year same-store growth in second-quarter 2016 across U.S. regional markets. Continued ramp-up in newer northeast markets has offset *weakness in the increasingly saturated Midwest markets* and oil-dependent Southern markets. Fitch Ratings continues to hold a negative long-term outlook for U.S. regional gaming, which we believe faces a difficult demographic shift and competition from broadened entertainment offerings.

Longer-Term Headwinds

Longer-term headwinds include but are not limited to the younger generation's lower interest in gaming, the proliferation of alternative means of gambling and less-certain retirement prospects for baby boomers. We do find the positive U.S. economic indicators encouraging, which, if sustained, should support the credit profiles of regional gaming issuers given the relatively healthy operator balance sheets and FCFs [free cash flow].⁴

As a basis for our impact modeling and for discussion of assessing the general outlook for the Indiana casino industry, Spectrum developed a five-year, statewide GGR forecast (we assume Year 1 is 2018, which is the anticipated first full year of Four Winds South Bend). We employed a gravity model and certain assumptions in developing the GGR projections in this chapter. (See

⁴ Fitch Ratings, "U.S. Regional Casino Gaming Dashboard – Second Half 2016," October 12, 2016.

the Appendix I for the complete methodology used in our modeling.) As a foundation in all models, we annualized the results from the first six months of 2016.

If there were no new competition in Indiana – i.e., the Four Winds South Bend were not to open – Spectrum projects that statewide GGR will increase by a total of \$45 million over the five-year period (as do the resultant gaming tax receipts), as shown in the following table:

Figure 1: Indiana gaming revenue projections, status quo (or baseline)

Gaming Win (millions)	Year 1	Year 2	Year 3	Year 4	Year 5	5-Year Total	5-Year CAGR
Gross gaming revenue	\$2,247	\$2,247	\$2,258	\$2,269	\$2,292	\$11,313	
Dollar change vs. prior year	\$0	\$0	\$11	\$11	\$23	\$45	0.4%
Percent change vs. prior year	0.0%	0.0%	0.5%	0.5%	1.0%	2.0%	0.4%
Gaming tax receipts @ 35%:	\$786	\$786	\$790	\$794	\$802	\$3,958	
Dollar change vs. prior year	\$0	\$0	\$4	\$4	\$8	\$16	0.4%

Source: Spectrum Gaming Group

The Indiana Legislature faces a stark imperative with respect to its casino industry: The policies that served the state well in the past will simply not work in the future. The Indiana casino industry, along with many of its allies and supporters in both the public and private sectors, has been aware of this reality for years, and the imperatives have only grown starker.

Today, the Indiana casino industry is facing declines caused by aging demographics, growing border competition and, now, the in-state competition from the planned Pokagon Four Winds casino. But even without that potential internal challenge, the external challenges facing Indiana’s commercial operators have been apparent for several years. As noted in our 2014 report for the CAI:

Indiana’s casino industry faces an onslaught of challenges that are both unrelenting and largely unprecedented for the state. The long-term trend is month-over-month declines. ... The core challenge is out-of-state competition that has eaten into Indiana’s revenue and visitor base. The competition from new gaming options in Ohio and Illinois has put virtually all of Indiana’s casinos into a defensive posture, but new competition – with more coming – is not the only challenge. Other challenges include an aging visitor base and a tax and regulatory system that was developed in an earlier era that is no longer relevant.⁵

We were not alone in reaching that conclusion. Ed Feigenbaum, publisher *Indiana Gaming Insight*, noted in 2014: “We’re looking at a new normal that is certainly nothing like we’ve seen before. It has upset the casino apple cart, and it has reordered the hierarchy of casinos within Indiana. And it has proven to be a tremendous negative hit to the state of Indiana’s bottom line.”⁶

⁵ Spectrum 2014 report, p. 4.

⁶ Chris Sikich, “Indiana casinos lose millions to Ohio competitors,” *Indianapolis Star*, June 17, 2014. <http://www.indystar.com/story/money/2014/06/14/casinos-luck/10534623/>

Key Challenges – Present and Future

Following are key challenges that will or could impact Indiana's commercial casino industry; some of these challenges are also national or regional in scope. Spectrum offers practical solutions to each challenge.

New Four Winds South Bend

Northern Indiana casino operators are justifiably concerned about the impact that the planned Four Winds South Bend would have on their revenues, which of course impacts all economic benefits including employment and tax receipts. Chapter II of this report discusses this challenge in detail.

- Both to ensure a level playing field within the entire Indiana gaming industry, the State of Indiana should seek a compact with the Pokagon Band – if it were to seek Class III status (see Chapter IV) – that ensures that the casino's revenue share with the State is in line with the gaming tax rates paid by the commercial gaming operators. If the Pokagon Band opts for Class II status – as appears to be the case presently – the State's best option would be to enact policies – such as financial incentives in exchange for facility enhancements – that incentivize capital investment in the casino properties to make them more diverse and more attractive.

Competing Forms of Gambling

Indiana is far from alone in either considering or embracing emerging or new forms of gambling, such as Internet gaming, daily fantasy sports ("DFS") and retail gaming (i.e., a limited number of electronic gaming devices in liquor-licensed establishments), as well as next-generation lottery products, vie with casinos for patrons' gambling dollars. Some of these represent opportunities to the casino industry and some represent threats.

Internet gaming and DFS (as well as the potential for traditional sports betting, as is being championed by the American Gaming Association) are potential opportunities for casinos, in that the State of Indiana could make casinos the exclusive providers of such games. For instance, only licensed land-based casinos are authorized to conduct Internet gaming in the three states that currently offer this activity – Delaware, Nevada and New Jersey. Regarding DFS, although Indiana earlier this year became one of the few states to formally legalize the activity, casinos can use DFS to attract patrons for sports-related events and, ultimately, become the exclusive providers of sports betting in state.

Retail gaming is clearly a threat, as shown in Illinois, where the video gaming machine industry has surpassed \$1 billion in GGR on an annualized basis (vs. \$1.4 billion for the casino industry) – and the number of machines (24,574 as of October 2016) in operation is the equivalent of adding more than 20 casinos in the state. Illinois casino revenues continue to decline as a result, virtually halting capital investment in the properties, thus making them less attractive over time. New lottery products would represent a threat if the Hoosier Lottery were

to offer video lottery terminals that are effectively slot machines or were to offer online games that resembled slot machines or table games.

- If supporting growth of the Indiana casino industry is a priority, the State of Indiana would allow casinos exclusively to offer all forms of online gaming while prohibiting retail gaming and limiting lottery products to those that do not overlap with casino games.

Market Saturation

Although gaming market saturation is a major concern among both governments and industry operators across the country, the issue is minimized *within Indiana* because its casinos are well distributed geographically throughout the state. That would change in Northwest Indiana were the Four Winds South Bend to open; we discuss the impacts in Chapter II. Some Indiana markets, however, do face issues of market saturation due to border competition, as we discuss below in Regional Competition.

- The State should not even consider additional commercial casino locations until, on a statewide basis, the industry demonstrates consistent, attractive GGR growth (such as 5 percent or more) on a year-over-year basis. Regarding the introduction of the planned tribal casino in state, see the “New Four Winds South Bend” section above.

Regional Competition

Each of Indiana’s four neighboring states has casinos, with many of them at or near Indiana borders, pulling significant amounts of Indiana gaming dollars across state lines. In total, Michigan, Ohio, Illinois and Kentucky⁷ have 50 casinos of varying size and quality, plus numerous video gaming machines in liquor-licensed establishments in Illinois.

- Indiana can do nothing about another state’s industry – but, as noted throughout this report – the State can incentivize its own operators to make its gaming properties more attractive and competitive.

Attracting New Customer Base

Millennials (ages 18-34 as of 2015) have overtaken Baby Boomers (ages 51-69) as the largest living generation in the country.⁸ Baby Boomers – and those older – have been staple casino customers for decades. However, as Baby Boomers die or stop patronizing casinos, they are not being replaced by younger potential patrons, who find slot machines boring when

⁷ Kentucky is traditionally considered a “non-casino” state but, in fact, has three gambling facilities that offer electronic gaming devices that use historical horse races to determine game outcomes. The machines look like slots and play similar to slots and are offered in a casino setting. One such casino – at Ellis Park – is located on the Indiana side of the Ohio River in Henderson, KY, just six miles from Tropicana Evansville.

⁸ Richard Fry, “Millennials overtake Baby Boomers as American’s largest generation,” Pew Research, April 25, 2016. <http://www.pewresearch.org/fact-tank/2016/04/25/millennials-overtake-baby-boomers/>

compared to the video games they have grown up playing. As Spectrum reported in its September 2016 report for the Washington State Gambling Commission:⁹

In general, Millennials are more tech-connected than previous generations. According to research by Zogby Analytics, “90 percent of Millennials say their phones never leave their sides and 78 percent spend more than two hours a day texting, surfing, talking, tweeting and – more importantly for businesses – shopping, banking and more.”¹⁰ Taking into account other forms of accessing the Internet, Millennials “spend on average more than seven hours a day online, on their smartphones or on multiple devices at the same time (PC, laptop, tablet and wearables).”¹¹ Because Millennials have always had technology they are more apt to multi-task. In fact, “those age 16-24 years are three times as likely as those age 55-64 years to ‘second-screen’ on a mobile.”¹² Likewise, “14 percent wouldn’t do business with a company that doesn’t have a mobile site or app.”¹³

At the January 2016 Florida Gaming Congress, keynote speaker Peter Yesawich, Chairman of MMGY Global, noted that Millennials view gaming as an amenity and not the primary purpose of demand.¹⁴

Whereas older generations predominantly play slot machines, gaming executives have found that Millennials are steering away from traditional slots and gravitating to live table games and next-generation electronic games because they have a social element and require decision-making. As Eric Meyerhofer, CEO of skill-based gaming manufacturer Gamblit Gaming, said, “Millennials have grown up in an era of digital media and games. The passive experience of a slot machine does not resonate with them.”¹⁵ Rush Street Gaming CEO Greg Carlin told a trade journal last year that the trend is quantifiable: “It is interesting that the Millennial segment are the only segment we have where table game play actually generates more revenue than slot machines.”¹⁶

It should be noted that in many state-tribal gaming compacts across the country table games revenue is not subject to revenue sharing, a situation that if stipulated in Indiana could

⁹ Spectrum Gaming Group, “Economic Market Study: Casinos, Cardrooms and Other Forms of Gambling in Washington State,” p. 112, completed for the Washington State Gambling Commission, September 28, 2016. <http://www.wsgc.wa.gov/docs/spectrum-report-09-28-16.pdf>

¹⁰ Lisa Kiplinger, “Millennials LOVE Their Smartphones: Deal With It,” *USA Today*, September 27, 2014. <http://www.usatoday.com/story/money/personalfinance/2014/09/27/millennials-love-smartphones-mobile-study/16192777/>

¹¹ World Economic Forum, “Digital Media and Society: Implications in a Hyperconnected Era,” January 2016. <http://reports.weforum.org/human-implications-of-digital-media-2016/section-1-user-behaviour-preferences-and-concerns>

¹² Ibid.

¹³ Kiplinger.

¹⁴ Presentation by Peter Yesawich at Florida Gaming Congress, January 2016.

¹⁵ Laura Parker, “Casinos Look to Video Games as a Draw for Millennials,” *New York Times*, July 6, 2016. http://www.nytimes.com/2016/07/07/technology/personaltech/casinos-look-to-video-games-as-a-draw-for-millennials.html?_r=0

¹⁶ Paul Doocey, “Attracting Millennials to gaming industry,” *Casino Journal*, November 6, 2015. <http://www.casinojournal.com/articles/90152-attracting-millennials-to-gaming-industry>

further put the commercial casinos at a competitive disadvantage and thus negatively impact State tax receipts.

- Indiana casino operators – like their counterparts across the country – will need to undertake significant capital investment to change their gaming floors to provide next-generation gaming equipment (such as skill-based games, electronic sports, virtual-reality games, etc.) and non-gaming areas that offer new experiences that Millennials find engaging.

Importance of Capital Investment

As indicated in the discussion above, capital investment is key to the future of Indiana's casino industry; its importance cannot be over-emphasized. From the standpoint of gaming operators, the level and quality of capital investment can help determine everything from the type of business model that can be deployed to the geographic and demographic reach of a gaming property to the average length of stay and the spending patterns of visitors.

From the standpoint of policymakers and other stakeholders, the level and quality of capital investment will help determine the economic and social impacts of gaming in direct and indirect ways, from the level of employment to the impact on tourism to the level of tax revenue generated.

Clearly, the potential construction and operation of Four Winds South Bend would provide an economic boost to the South Bend region, and such salutary effects would ripple through the Indiana economy. However, from the standpoint of Indiana's commercial casino industry, the effects could be chilling if the State elects to maintain the regulatory status quo.

Gaming operators and their investors can be expected to view capital investment through the mathematical prism of the potential return on investment. If the return – what is left over for the operator or investor after all expenses, including gaming taxes, have been paid – exceeds a pre-determined threshold, or “hurdle rate,” then a capital project is more likely to secure the necessary funding at a reasonable cost of capital. Potential projects that do not meet that hurdle rate must either be scaled back or eliminated. Casino operators at any stage of their operation, irrespective of their business model, require a steady flow of affordable capital, whether or not they seek to expand.

The analytical process that determines whether capital gets invested will involve a determination of the internal rate of return (“IRR”) or the net present value (“NPV”) of a potential project. Such concepts were succinctly explained in a recent *Harvard Business Review* article:

The IRR is the rate at which the project breaks even. (It's) commonly used by financial analysts in conjunction with net present value, or NPV. That's because the two methods are similar but use different variables. With NPV you assume a particular discount rate for your company, then calculate the present value of the investment. But with IRR you calculate the actual return provided by the project's cash flows, then compare that rate

of return with your company's hurdle rate (how much it mandates that investments return). If the IRR is higher, it's a worthwhile investment. ...

Companies generally use both NPV and IRR to evaluate investments, and while NPV tells you more about the return you can expect, financial analysts "often rely on IRR in presentations to nonfinancial folks." That's because IRR is much more intuitive and easy to understand.¹⁷

An Indiana casino operator might have a hurdle rate of 10 percent on capital projects. If a proposed investment is calculated to yield 15 percent, it will be more likely to be approved than a project that would yield, say, 5 percent.

Future capital investment in commercial casino operations would potentially be impacted by a Four Winds South Bend casino, as that in-state competition could have a direct effect on the projected return on such an investment. However, if the State elects to maintain the status quo, that would further complicate such calculations. Four Winds South Bend would not be operating under the same level of taxation and other regulatory costs, and that would add risk to any potential investment in a commercial operation. Greater risk demands a higher cost of capital to compensate for that risk, which translates into a higher hurdle rate.

Danger of Disinvestment

Existing attractions must be refreshed, maintained or replaced if a gaming property seeks to remain profitable and competitive. If such investments are not made, properties can quickly suffer from "disinvestment" – a vicious circle that serves no one well.

Communities that have suffered the effects of disinvestment include Gary, IN,¹⁸ and Atlantic City, NJ. We chronicled this extensively in Atlantic City, as summarized in the following:

The decision to "disinvest" is an arguably rational decision, based on an analysis of economic factors. Essentially, business owners have determined that they cannot realize an acceptable return on any further investment, so they simply elect not to invest. Their capital can be put to better use elsewhere. The decline in investment results in a decline in the quality of the assets that remain, and that further feeds the logic that additional investment is futile, which in turn makes the downward spiral more severe.

Businesses in Atlantic City that were still making a profit were increasingly deciding against reinvesting those profits in the city. Investment by the private sector drew to a virtual standstill. The hotels and motels along Pacific Avenue and the Boardwalk took their profits, and the city's capital stock, out of town.¹⁹

¹⁷ Amy Gallo, "A Refresher on Internal Rate of Return," *Harvard Business Review*, March 17, 2015. <https://hbr.org/2016/03/a-refresher-on-internal-rate-of-return>

¹⁸ Chris Bentley, "How Gary, Indiana Got Serious about Tackling Blight," *citylab.com*, February 26, 2015. <http://www.citylab.com/politics/2015/02/how-gary-indiana-got-serious-about-tackling-blight/386159/>

¹⁹ Michael Pollock, "Cut Casino Tax Rate to Encourage Investment," *The Press of Atlantic City*, February 6, 2014. http://www.pressofatlanticcity.com/opinion/commentary/michael-pollock-cut-casino-tax-rate-to-encourage-investment/article_8373532b-d200-5877-8b60-ee364b1ed920.html

Disinvestment may be a real risk, and its effects are certainly detrimental, but our experience has shown that it is not inevitable for the commercial casino industry in Indiana. Highly visible steps to improve the partnership between the State and its commercial casino industry – particularly in the form of tax or regulatory relief – will encourage capital investment, and send a critically important signal to capital markets that the state is not accepting the status quo, and is seeking to improve the investment climate for commercial operators.

Conclusion: State Must Incentivize Capital Investment to Sustain Commercial Casino Industry

We note that many local communities have much at stake as well. Indiana casinos have Local Development Agreements that contribute a portion of gaming revenue to their cities for various economic development and municipal needs. As discussed in Chapter III, these development agreements are negotiated by the cities with their casinos, and the money received is generally used to improve roads and other infrastructure.

Moreover, as this report makes clear, the State of Indiana will have limited negotiating ability when it comes to structuring a potential Class III compact with the Pokagon Band. As federal law makes clear, the State cannot share in gaming revenue unless it acts in good faith by offering some tangible benefit that would be commensurate with that revenue share. In most instances across the United States, revenue-sharing is based on some level of exclusivity that is offered to tribes. As Indiana already has a well-developed statewide gaming industry, the ability to offer any level of exclusivity is limited.

Just as important, as we discuss in detail later in this report, a tribe does not need State approval – nor would it need to share revenue with the State – to offer Class II gaming, which is also a significant competitive threat to the state’s commercial casino industry. Indeed, an environmental impact study released by BIA characterizes a Class II facility as an element of its “preferred alternative.”²⁰

With that in mind, the State of Indiana is certain to lose direct tax revenue in the face of an in-state casino that has no tax obligations to the State. Based on our extensive experience work with – and in – state government, that may harden legislative resistance to amending the status quo, and could potentially lead to efforts to increase gaming taxes as a means of making up any shortfalls caused by gaming-revenue shifts to the untaxed Pokagon casino.

Spectrum believes that such moves would ultimately prove detrimental to the state’s gaming industry and would undermine gaming policy by making commercial casinos in Indiana less attractive to investors and less able to adjust their business models to address a changing reality. Indeed, one clear truth regarding gaming – as well as any industry that relies on significant

²⁰ Tricia Harte, “Environmental impact of South Bend Casino,” WNDU, June 20, 2016.
<http://www.wndu.com/content/news/Environmental-impact-of-South-Bend-casino-383695871.html>

capital investment – is that negative, costly changes to the rules will clearly make it difficult for operators to attract capital investment.

John Keeler, vice president and general counsel for Centaur Gaming, operator of Indiana's casinos in Anderson and Shelbyville, put the situation in the proper perspective: "We have over a billion dollars invested and we've invested that in reliance on the current system. ... It would be unfair to change the rules of the game midstream."²¹

As our report makes clear, a change that would make the status quo less viable is worse than being simply unfair. Such a change would likely result in less investment, less revenue and a weakening of the gaming industry and its role in the Indiana economy.

²¹ Tony Cook, "A casino in Indianapolis? Bill would allow it," *Indianapolis Star*, January 16, 2015.
<http://www.indystar.com/story/news/politics/2015/01/16/casino-indianapolis-bill-allow/21824103/>

II. Economic Impacts of Four Winds Casino on Indiana's Commercial Casinos

The US Bureau of Indian Affairs ("BIA") in November 2016 approved the application of the Pokagon Band of Potawatomi to take 166 acres of largely undeveloped land in South Bend into trust. As described in its application, the Pokagon Band would build a Four Winds Casino Resort on the site that would employ about 2,000 people²²; the casino property is expected to open in early 2018.²³

The tribe, which operates a successful Four Winds casino in nearby New Buffalo, MI, saw its application take a major step forward in June 2016 when it received a favorable environmental review from BIA, which noted: "The Band intends to develop a tribal village including 44 housing units, a multi-purpose facility, health services and other tribal government facilities. The planned development for the property also includes a Class III gaming facility with a hotel, meeting space and a parking garage to generate revenues required to fund the tribal village and for the capital costs of the land that the Band acquired."²⁴

Earlier this year, the South Bend Common Council voted 8-0 to approve an agreement with the Pokagon Band that would annually commit 2 percent of casino profits to the city, along with a \$5 million donation to community development initiatives.²⁵ South Bend Mayor Pete Buttigieg said at the time: "When the idea of tribal gaming in South Bend first became a possibility, I indicated the city could be supportive of it only if the benefits outweighed the cost, and this agreement is a way to make sure that's the case."²⁶

Based on our observations, the Four Winds South Bend site enjoys significant access to population centers via its location on or near several highways, most notably US Route 31 – which provides direct access to the Indianapolis market – and US Route 20, which provides significant east-west access.

²² Pokagon Band of Potawatomi Indians, Application to Acquire Land in Trust, (South Bend Indiana Consolidation Site), Appendix A, Fee-to-Trust Application, May 14, 2012.

<http://pokagonsouthbendeis.com/content/documents/Draft%20EIS/Appendices/Appendix%20A-%20Tribal%20Documents.pdf>

²³ "Northern Indiana Indian tribe plans to open South Bend casino in 2018," *Chicago Tribune*, December 7, 2016. <http://www.chicagotribune.com/suburbs/post-tribune/news/ct-indian-tribe-casino-south-bend-2018-20161207-story.html>

²⁴ Pokagon Band of Potawatomi Indians, Environmental Impact Statement, June 2016. <http://pokagonsouthbendeis.com/content/documents/Final%20EIS/Executive%20Summary%20and%20Table.pdf>

²⁵ Erin Blasko, "South Bend council approves casino deal," *South Bend Tribune*, April 12, 2016. http://www.southbendtribune.com/news/local/south-bend-council-approves-casino-deal/article_af188ea4-004f-11e6-b5f9-cf98677cd204.html

²⁶ Ibid.

If plans for Four Winds South Bend are fulfilled it would be a major presence within Indiana's gaming industry.

In this chapter, we project the economic and fiscal impacts that the new Pokagon Four Winds South Bend would have on the Indiana commercial casino industry absent any regulatory or other changes.

Projected Commercial Casino Revenues, Taxes

Gross Gaming Revenue

Spectrum used a gravity model and certain assumptions in developing the gross gaming revenue ("GGR") projections in this chapter. *(Please see the Appendix I for the complete methodology used in our modeling.)* Our projections are built upon our baseline projections discussed in Chapter I. We examined Indiana casino database figures obtained from the Casino Association of Indiana and cross-referenced those with driving distances to Indiana casinos from the areas within a reasonable two-hour drive from the Four Winds South Bend site. As a foundation in all models, we annualized the results from the first six months of 2016.

Our process of calculating the projected impact began with utilizing revenue from rated casino patrons (via casino databases) as a percentage of ZIP Codes for Indiana properties. Where we did not have direct rated database information, we discussed the percentages of current revenue from Indiana properties with Indiana senior executives and operating management familiar with that information. Lastly, where we did not have direct information, we assumed that patrons visiting from farther away from South Bend would visit less often.

Our model assumes the Four Winds South Bend opening in Year 1 (which we assume is 2018). The results of our modeling determined that Indiana is at risk of losing \$89 million in 2018 as compared to 2017, as shown in the following table.

Figure 2: Change in 2018 Indiana projected commercial casino gaming revenue, by distance traveled, resulting from operation of Four Winds South Bend

Statewide	GGR Estimate	Distance to Four Winds South Bend			Total	%
		<60 Min	60 - 120 Min	120+		
Indiana Total - 2018E	\$2,246.8	(\$55.9)	(\$20.4)	(\$12.7)	(\$88.9)	-4.0%

Source: Spectrum Gaming Group

The results show a total GGR decline for the five-year period of \$188 million. We assume the 2018-2022 period because this will be the expected time that competition enters the market and a recovery will begin, absent other market shocks. The results of the projections are presented in the following table:

Figure 3: Indiana gaming revenue projections with operation of Four Winds South Bend

Gaming Win (Millions)	Year 1	Year 2	Year 3	Year 4	Year 5	5-Year Total	5-Year CAGR
Gross gaming revenue	\$2,158	\$2,115	\$2,094	\$2,073	\$2,063	\$10,503	
Dollar change vs. prior year	(\$89)	(\$43)	(\$21)	(\$21)	(\$10)	(\$184)	-2%
Percent change vs. prior year	-4.0%	-2.0%	-1.0%	-1.0%	-0.5%	-8.5%	-2%
Gaming tax @ 35%	\$755	\$740	\$733	\$726	\$722	\$3,676	
Gaming tax dollar change vs prior year	(\$31)	(\$15)	(\$7)	(\$7)	(\$4)	(\$64)	-2%

Source: Spectrum Gaming Group

The results above show a 4 percent decline for the Indiana commercial casino industry in Year 1, with GGR losses essentially reducing by half each year, as the initial impact is absorbed rebounding becomes sequentially easier in forward periods.

Next, we illustrate the differences in dollars between our baseline forecast (Scenario 1) and our forecast with the addition of Four Winds South Bend (Scenario 2). As shown in the table below, over the five-year forecast period commercial casinos would lose more than \$800 million in GGR and the State would lose more than \$280 million in gaming-tax receipts.

Figure 4: Differences in gross gaming revenue, State gaming-tax receipts between the two scenarios

	Year 1	Year 2	Year 3	Year 4	Year 5	5-Year Total
Gross gaming revenue	(\$89)	(\$132)	(\$164)	(\$196)	(\$229)	(\$810)
Gaming tax @ 35%	(\$31)	(\$46)	(\$57)	(\$68)	(\$80)	(\$282)

Source: Spectrum Gaming Group

It should be noted that the projections are subject to wide degrees of variation that could be caused by such factors as changes on economy, changes in gasoline prices, marketing activity, seasonal weather issues, etc. For this, we apply a range of outcomes of +10 percent and -10 percent to the base figures. Based on the +/- 10 percent range variation, the outcomes for GGR change for Indiana for gains for the 2018- 2022 period are shown in the following table:

Figure 5: Sensitivity matrix: +/- 10 percent variation to five-year change in GGR forecast for Indiana commercial casinos

(Growth or decline, in millions)	Scenario 1 (Status Quo) 2018-2022	Scenario 2 (w/Four Winds South Bend) 2018-2022
Base:	\$45	(\$184)
+10%	\$50	(\$202)
-10%	\$41	(\$166)

Source: Spectrum Gaming Group

Non-Gaming Revenue

Other revenues would decline in conjunction with GGR, including from hotel, food, beverage, entertainment and other areas. (See Appendix 1, "Non-Gaming Revenue," for methodology in our projections.)

Using each department's revenue contribution as a percentage of GGR from other jurisdictions where non-gaming data are published, we can forecast the impact of a change in GGR on each department's revenue for Indiana casinos. The following table shows that, based on our expected GGR decline in Year 1, Indiana total revenue will likely decline by \$124 million. The total forecasted decline for the five-year is \$257 million, and is depicted by year and by department in the following table.

Figure 6: Projected changes in total revenue at Indiana commercial casinos, by department

	Year 1	Year 2	Year 3	Year 4	Year 5	5-Year Total
Expected GGR decline:	(\$89)	(\$43)	(\$21)	(\$21)	(\$10)	(\$184)
<i>Decline in non-gaming revenue, by department</i>						
Hotel	(\$8)	(\$4)	(\$2)	(\$2)	(\$1)	(\$16)
Food	(\$16)	(\$8)	(\$4)	(\$4)	(\$2)	(\$34)
Bev	(\$6)	(\$3)	(\$1)	(\$1)	(\$1)	(\$12)
Other	(\$5)	(\$3)	(\$1)	(\$1)	(\$1)	(\$11)
Total non-gaming	(\$35)	(\$17)	(\$8)	(\$8)	(\$4)	(\$73)
Total gaming + non-gaming	(\$124)	(\$60)	(\$29)	(\$29)	(\$14)	(\$257)

Source: Spectrum Gaming Group, UNLV Center for Gaming Research

Projected Four Winds South Bend Results

In 2016, the Pokagon Band formally announced an agreement with the city of South Bend to develop a casino on its 164 acres near South Bend.²⁷ According to the announcement, key attributes of the Pokagon casino are:

- 216,000 square feet of gaming space
- 18-story hotel with 500 rooms
- Projected \$620.4 million in annual revenue
- Create 1,400 construction jobs and 2,000 permanent jobs

Spectrum used the published Pokagon assumptions above in our modeling; we did not develop these projections ourselves and make no representations or warranties of any kind, express or implied, about the completeness, accuracy, reliability or suitability of the Pokagon assumptions.

This section examines the total gaming market around South Bend and then determines the GGR available for the Four Winds South Bend casino after adjusting the results of the total market for distance to competition surrounding the planned property.

²⁷ Indiana Department of Administration, "NCIBC Registration: Opportunity Is In The Wind," May 11, 2016. <https://content.govdelivery.com/accounts/INDOIA/bulletins/1461a6e>

Spectrum built a comprehensive, constrained gravity model. We incorporated estimated population data calibrated to 2018 through 2022 covering 650 ZIP Codes in Indiana, Michigan, Ohio and Illinois. These are all within a reasonable two-hour drive of South Bend. The data included population data (both total and gaming-age adults) and median household income (to adjust relative estimated gaming revenue budgets accordingly).

When calculating total -market GGR, many different variables are utilized to determine reasonable estimates. Our projections in determining GGR for the prospective Four Winds South Bend casino are based on estimated drive times. The following maps depict the estimated 30-minute, 60-minute, 90-minute and 120-minute drive times.

In addition to considering aggregate population surrounding the planned location, our model also considers adult population gaming participation rates and potential gaming revenue by location from South Bend based on visitation and spending based on proximity to property.

The estimated total market GGR is calculated using the adult gaming population and per capita income within a 120-minute drive of the Pokagon Casino, which will reach portions of Indiana, Michigan, Illinois and Ohio. Each market area has its own propensity to gamble, household income, and per-person household income rates, all of which we use to derive an estimated gaming budget.

Our forecast of the 2018 adult casino gaming participation rate for the 120-minute range of Four Winds South Bend results in a total gaming age population of approximately 2.7 million adults. For each market, we calculated the gaming-age adult population, estimated annual gaming budgets, and derived a GGR projection for the total market of just over \$2.9 billion.

The average yearly gaming budget for the market area is \$1,110 (see following table), which is above the national average of \$952. The difference may be reflective of numerous items, including but not limited to: higher level of overall population; the region's overall exposure to gaming for many years, which equates to higher propensity; and most importantly higher levels of household income in this region (especially the Chicago region) as compared to the US overall.

Figure 7: South Bend total market GGR

	Driving Minutes from South Bend				Grand Total
	<=30 min	30-60 min	60-90 min	90-120 min	
Total population	505,563	765,388	2,184,164	6,903,517	10,358,632
21+ population	355,067	538,266	1,527,468	4,929,313	7,350,114
Avg HH Income	\$56,515	\$58,884	\$57,126	\$71,657	\$65,309
Share of Adult Gamers*	43%	41%	39%	36%	37%
Gaming Population	152,679	220,689	595,712	1,774,553	2,743,633
% Per Capita Income for Gaming	3.2%	3.2%	3.2%	3.2%	3.2%
Avg Yearly Gaming Budget/pp	\$986	\$1,002	\$986	\$1,209	\$1,110
GGR Estimates (Millions)	\$150.5	\$221.2	\$587.6	\$2,145.4	\$2,954.2

Source: Spectrum Gaming Group, US Census, American Gaming Association, UVA-Weldon Cooper Center Demographics & Workforce Group August 2013, MPMiler Charter Mileage Computation add-in for Maptitude

With the total market established, the next section determines the GGR available for the Pokagon casino after adjusting the results of the total market for distance between competition and the Four Winds South Bend.

Gross Gaming Revenue

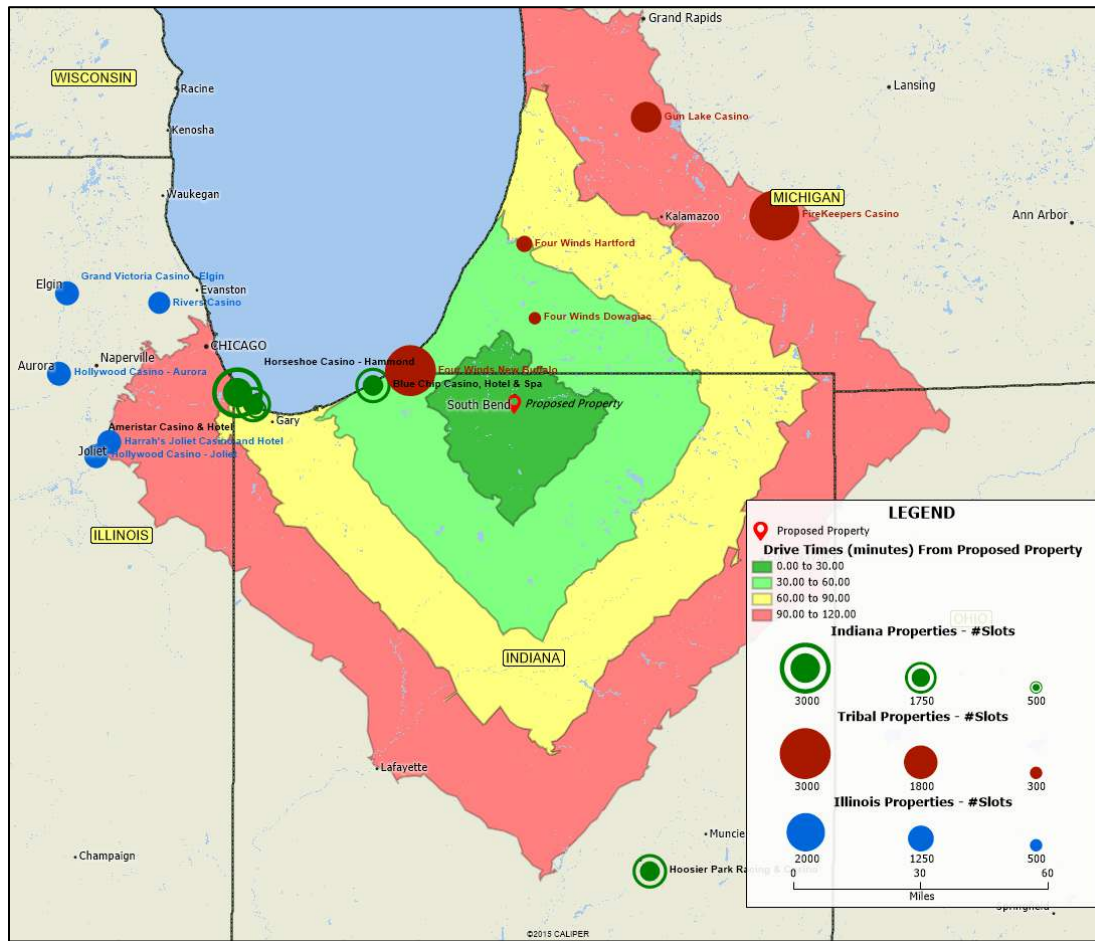
Our gravity model accounts for competition from existing casinos within a two-hour drive time of the Four Winds South Bend site, with a provision for casinos outside the edge of the two-hour drive, as their locations would induce some reasonable competitive infringement on the outer edges of the 90- to 120-minute boundary.

The following map provides a high-level view of the competition represented by total numbers of slot machines. The green circles are for Indiana properties. The red circles are for tribal properties in Michigan. The blue circles are for Illinois properties. All are scaled with smaller to larger circles representing fewer to more slot units and all are overlaid by 30-minute sets of driving bands within two hours of the Four Winds South Bend site.

When viewing the map, it is evident that significant competition is close to the Four Winds South Bend site. The Chicagoland area, while the largest population, is well on the fringe of the two-hour drive market. Chicago also has significant competition in Illinois and on the Indiana border, which will essentially eliminate much of that area from likely being acquired by Four Winds South Bend.

Four Winds South Bend also will be impacted by its own sister properties in southern Michigan: Four Winds Casino in New Buffalo and, to a lesser extent, Four Winds Dowagiac and Four Winds Hartford. Blue Chip is just 14 miles west from Four Winds New Buffalo. Three of the properties that are close (including the two largest) are well within a 60-minute drive while the fourth is just on the edge of a 60-minute drive. The four properties combined have 6,500 gaming positions, more than 900 hotel rooms, 17 food-and-beverage outlets, and entertainment venues.

Figure 8: South Bend 120-minute drive-in market and slot machines by property



Sources: Spectrum Gaming Group, Maptitude 2016

We examine several factors to extrapolate the GGR for Four Winds South Bend. The distance from large populations is of the first order when gravity modeling. Further, the casino must overcome competition with their established brand loyalties and high switching costs, which makes gaining significant levels of market share from these competitors difficult. The competitive market for 150 miles around the Four Winds South Bend site is shown in the following table.

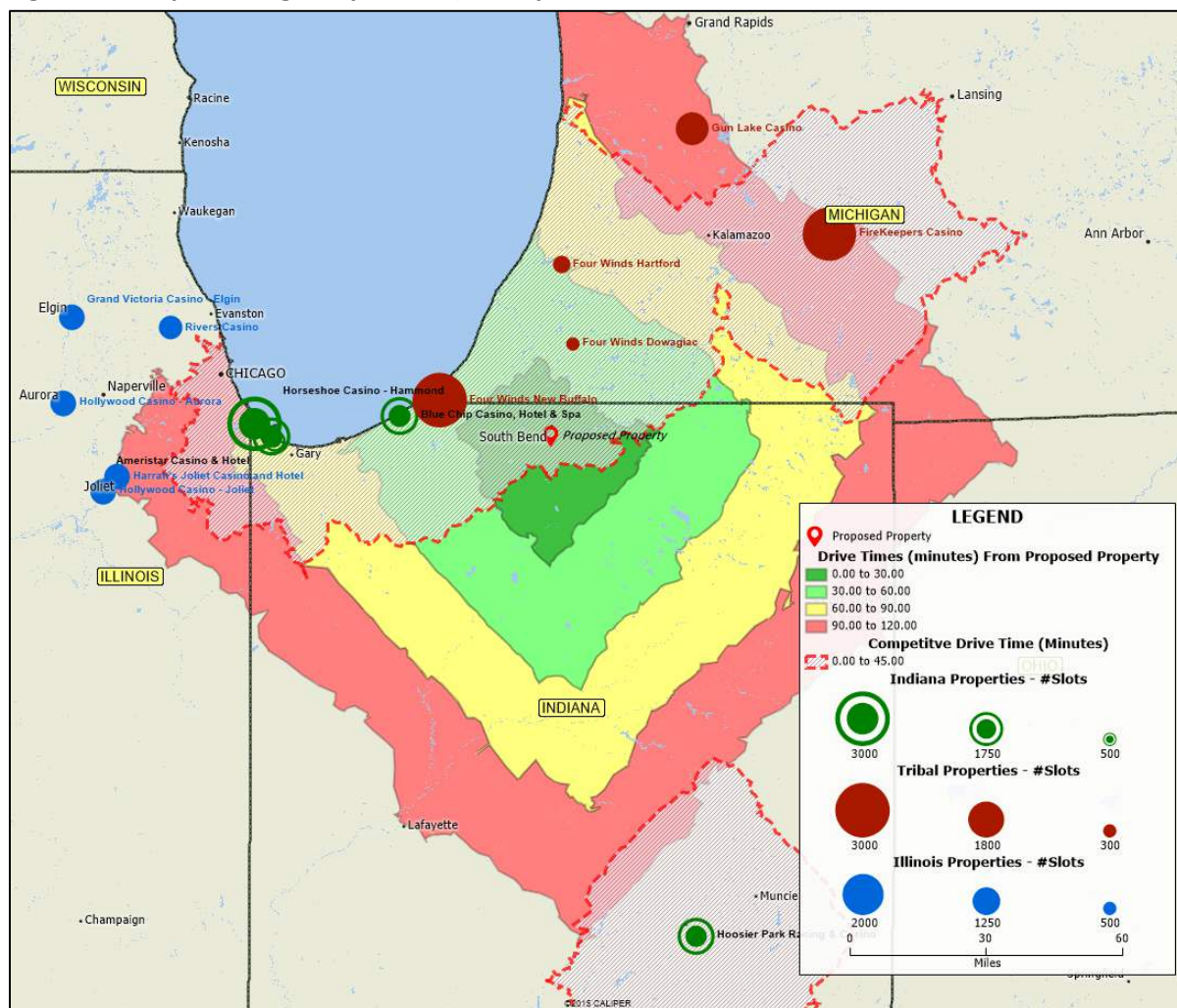
Figure 9: Casinos with 150 miles of Four Winds South Bend

Casino	Miles to South Bend	Slots	Table Games	Other Gaming	Hotel Rooms	F&B	Other
Planned Four Winds South Bend		3,000	66	0	415	9	1
Four Winds New Buffalo	39	3,000	66	0	415	9	1
Blue Chip Casino, Hotel & Spa	43	1,965	48	8	486	6	3
Four Winds Dowagiac	48	330	0	0	0	1	0
Four Winds Hartford	54	550	9	0	0	1	0
Majestic Star Casino	68	994	58	0	299	4	3
Majestic Star II	68	915	11	21	299	6	5
Ameristar Casino & Hotel	70	1,953	41	12	288	6	3
Horseshoe Casino - Hammond	76	3,000	155	34	0	5	1
FireKeepers Casino	92	2,939	68	264	245	8	1
Gun Lake Casino	98	1,570	28	0	0	2	0
Harrah's Joliet Casino and Hotel	104	1,150	30	8	200	4	3
Hollywood Casino - Joliet	105	1,177	23	3	100	4	2
Rivers Casino	114	1,050	48	0	0	5	0
Hollywood Casino - Aurora	137	1,172	21	7	0	3	1
Hollywood Casino - Toledo	141	2,000	60	20	0	4	1
Grand Victoria Casino - Elgin	142	1,150	29	0	201	4	2
Hoosier Park Racing & Casino	145	1,908	0	1	0	8	2
Market Total		29,823	761	378	2,948	89	29
Average (excluding zero)		1,657	48	38	295	5	2

Source: Spectrum Gaming Group, company websites

The competition reaches into the Four Winds South Bend's 30-minute drive band, roughly 15 to 20 minutes from its starting point to areas from the northwest, southwest and northeast. To a lesser extent, Hoosier Park encroaches on the southeast portion of the 90- to 120-minute band, but the distance is so far from Four Winds South Bend and the population from that area is relatively small. To visualize the relationship from the competition, the following map shows graphically the effects of the overlap of a 45-minute drive time from each of the close in competition (red border with red hash lines overlaid on Four Winds South Bend drive times).

Figure 10: Map showing competition (overlap) from Four Winds South Bend



Sources: Maptitude, Spectrum Gaming Group

Our gravity model for Four Winds South Bend accounts for casino competition within a 120-minute drive of the property, as well the effects of other existing casinos located beyond this range. This ensures that we adequately capture and quantify shared visitation throughout the region.

When other factors are equal, the likelihood of a player making a gambling trip to a target location is reduced by the distance that player must travel to reach the target property. To augment our gravity model in determining the expected GGR for Four Winds South Bend, we utilized historical rated-play database information based on the results of nearly 30 casinos nationally from a proprietary data warehouse. We use the data to build a national average set of metrics for regional properties to further segregate the gaming revenues into distance based visitation.

As we consider Four Winds South Bend, Spectrum's experience in analyzing regional gaming markets indicates that 70 percent to 80 percent, and perhaps even more, of the GGR

acquired by the prospective casino will be generated from high-frequency customers who reside within the 0-to-60-minute driving range from the subject property. Additionally, when viewing the 60-to-120-minute drive time, that figure increases to in excess of 92 percent of the total GGR, leaving the remaining 8 percent balance from those customers more than two hours away.

A 2006 *Harrah's Survey*²⁸ estimated the average number of visits annually to a casino was 6:1. Spectrum's research suggests that this estimate remains valid, given the continued proliferation of casino gaming throughout the United States. Additionally, per a 2009 report that Spectrum prepared for the State of Connecticut, a comprehensive survey of 1,427 Connecticut residents found that the average number of casino visits per resident exceeded 12 annually at a time when every Connecticut adult resided within a two-hour drive of a casino and 40 percent resided within a one-hour drive.²⁹ This correlates to our core assumption that those closer in proximity likely visit a casino twice as often as do those farther away.

Utilizing the same data to estimate day-trip visitation patterns, we see parallels between the *Harrah's Survey*, Spectrum's experience and our national database figures. The following table provides gaming patterns by distance. Those closer generate lower win/trip yet take many more trips, yielding their larger annual win production.

Figure 11: Percent of casinos' GGR and statistics by distance from property

Minutes from Property				Cumulative Pct. of Win
	Days/Yr	Win/Day	Annual Win	
<30	14.5	\$71	\$1,028	49%
30-60	8.0	\$96	\$771	73%
60-90	6.3	\$98	\$619	86%
90-120	4.6	\$96	\$439	92%
120-240	3.2	\$76	\$248	95%
240 +	2.9	\$47	\$138	100%
<i>Average</i>	<i>8.4</i>	<i>\$79</i>	<i>\$669</i>	

Source: Spectrum Gaming Group

Based on the previous methodology, the total GGR for the Four Winds South Bend is \$209 million, or approximately a 7 percent share of the total South Bend market and is shown in the following table. Using \$209 million as the center point and inserting a 10 percent deviation around the center generates a low-high range of \$188 million to \$230 million in GGR. The projections yield a total of 2.66 million annual visits at a gaming budget of \$79 per trip.

²⁸ Harrah's Entertainment, *Harrah's Survey: Profile of the American Casino Gambler*, 2006.

²⁹ Spectrum Gaming Group, *Gambling in Connecticut: Analyzing the Economic and Social Impacts*, June 22, 2009. http://www.spectrumgaming.com/dl/june_24_2009_spectrum_final_final_report_to_the_state_of_connecticut.pdf

Figure 12: Estimated 2018 GGR for Four Winds South Bend

	Driving Minutes from Four Winds South Bend				Grand Total
	<=30 min	30-60 min	60-90 min	90-120 min	
Share of Available Gamers	129,670	61,984	24,375	28,300	244,329
Trips/Year	14.5	8.0	6.3	4.6	10.9
Win/Trip	\$71	\$96	\$98	\$96	\$79
Annual Win per Person	\$1,028	\$771	\$619	\$439	\$864
GGR Estimates (Millions)	\$133.3	\$47.8	\$15.1	\$12.4	\$208.6
-10% from estimate					\$187.7
+10% from estimate					\$229.5

Source: Spectrum Gaming Group, US Census, American Gaming Association, UVA-Weldon Cooper Center Demographics & Workforce Group August 2013, MPMileCharter Mileage Computation add-in for Maptitude

Hotel Revenue

With the base-year daytrip GGR established, this section builds incremental GGR projections for prospective hotel guests. Per data publicly disseminated by the Pokagon Band for the planned project, we assumed that a 500-room, on-site hotel will open on the property along with the casino in 2018.

Room occupancy for the casino hotel is estimated at 80 percent, because in addition to non-casino demand, the casino can offer free (comped) rooms to guests in its database. We estimate that 66 percent of available rooms will be allocated to database customers and occupancy from other segments will be 34 percent. Based on benchmarks from other Spectrum projects, we also estimate a total of 1.5 guests per room, an 80 percent gaming capture rate, and an average win per guest of \$99 coming from a blended rate from the existing casino customers and hotel visitors. For the first full year, we would expect \$17 million in additional GGR. Subsequent years would be expected to grow between 2 percent and 3 percent annually due to increases in occupancy and gaming budgets.

Figure 13: GGR from Four Winds South Bend on-site hotel

Hotel Rooms		500
Occupancy		80%
Room Nights		146,000
People per Room		1.5
Gaming Capture		80%
Incremental Visits		175,200
Win/Day: Existing gamer visits GGR	66%	\$119
Win/Day: Non database, hotel visitor GGR	34%	\$59
Win/Day: Total		\$99
Hotel GGR		\$17,301,787

Source: Spectrum Gaming Group

With the components to Four Winds South Bend's GGR tabulated, we next prepare a five-year growth forecast. From Year 1 and based on the population and income data previously presented herein, we estimate combined growth of the population and income levels of 2.5

percent in Year 2 and 2 percent thereafter. Based on our estimates, the combined Four Winds South Bend and hotel revenue will grow from \$226 million in 2018 to \$246 million by 2022.

Figure 14: Four Winds South Bend projected casino and hotel GGR, 2018-2022

GGR Over Five Years (Millions)	Year 1	Year 2	Year 3	Year 4	Year 5	5-Year Total
Casino GGR	\$208.6	\$213.8	\$218.1	\$222.5	\$226.9	\$1,089.8
Hotel GGR	\$17.3	\$17.7	\$18.1	\$18.5	\$18.8	\$90.4
Casino + Hotel GGR	\$225.9	\$231.5	\$236.2	\$240.9	\$245.7	\$1,180.2

Source: Spectrum Gaming Group

Economic, Fiscal Impacts of Pokagon Casino on Indiana Casinos

The projected changes in gaming and non-gaming revenue discussed in earlier in this chapter will have impacts on direct employment and wages as well as a ripple effect through the state economy, including fiscal impacts.

Changes in Direct Employment

Casino operators will reduce employment when business declines and increase hiring when business is growing. Changes in employment are dependent on the existing staffing levels, profitability, strategy and other assessments made by management at each casino property. Thus, the projections in this section are designed to illustrate the potential changes based on the changes in GGR discussed earlier in this chapter.

To determine the potential changes in direct employment to Indiana's commercial casino industry resulting from the operation of Four Winds South Bend, Spectrum developed full-time-equivalent ("FTE") projections on ratios and metrics derived by us from our experience, as well as from a variety of data from other US jurisdictions, as available. *(See Appendix II for methodology and assumptions.)*

We project the potential direct employment, and ultimately FTE, impacts for the Indiana commercial casino industry based on estimated changes in gaming positions (both slots and table games), stemming from changes in GGR, as follows:

- 0.4 gaming employees per slot machine
- 5.0 gaming employees per table game
- 0.15 gaming employees per total gaming position

The following table shows our estimated potential impacts on the existing Indiana commercial casino industry in terms of gaming positions and employment levels due to the operation of Four Winds South Bend.

Figure 15: Projected changes in Indiana commercial casino gaming positions, jobs resulting from opening of Four Winds South Bend

	Year 1	Year 2	Year 3	Year 4	Year 5	Total
# Slots	(709)	(335)	(160)	(157)	(74)	(1,435)
# Table Games	(28)	(13)	(7)	(7)	(3)	(58)
# Gaming Positions	(877)	(413)	(202)	(199)	(92)	(1,783)
# Direct Employees	(300)	(141)	(72)	(72)	(32)	(617)
# FTE Employees	(255.0)	(119.9)	(61.2)	(61.2)	(27.2)	(524.5)

Source: Spectrum Gaming Group

As illustrated, for the first full year of Four Winds South Bend we project the existing Indiana commercial casino industry could shed approximately 877 gaming positions (based on projected decreases to GGR), yielding a reduction of 300 employees, equating to 255 FTEs.

To project the potential changes in non-gaming FTEs, we applied the ratio of non-gaming revenue to gaming revenue to the number of gaming FTEs. Thus, we project the following potential changes in overall FTEs (both gaming and non-gaming related FTEs):

Figure 16: Projected changes in Indiana commercial casino gaming and non-gaming FTE jobs resulting from opening of Four Winds South Bend

	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Gaming FTEs	(255.0)	(119.9)	(61.2)	(61.2)	(27.2)	(524.5)
Non-Gaming FTEs	(101.1)	(47.5)	(24.3)	(24.3)	(10.8)	(207.9)
Grand Total FTEs	(356.1)	(167.4)	(85.5)	(85.5)	(38.0)	(732.4)

Source: Spectrum Gaming Group

Changes in Wages

To estimate the impact on salaries and wages, Spectrum calculated a blended hourly rate for gaming and non-gaming employees by using mean hourly wage rates from the US Bureau of Labor Statistics, via its Standard Occupational Classification for Indiana as of 2015.³⁰ To determine the total impact on salaries and wages, the blended hourly rate was multiplied by the number of FTEs forecasted to be impacted by the changes in gaming and non-gaming revenue. (See *Appendix II for methodology and assumptions.*) The following table shows the total changes in wages for gaming and non-gaming employees combined for the initial five-year period:

Figure 17: Changes in Indiana commercial casino employee wages, 2018-2022

	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Change in wages	(\$10,234,797)	(\$4,926,922)	(\$2,576,608)	(\$2,638,446)	(\$1,200,786)	(\$21,577,559)

Source: Spectrum Gaming Group

Impacts to Local Development Agreements

Indiana casinos and their host municipalities have negotiated Local Development Agreements in which a portion of gaming revenue is dedicated for various economic development and municipal needs.

³⁰ US Bureau of Labor Statistics, May 2015 State Occupational Employment and Wage Estimates, Indiana.
http://www.bls.gov/oes/current/oes_in.htm

Looking at the four Northern Indian casinos that would be impacted by the Four Winds South Bend, Hammond receives 5.2 percent of the adjusted gross receipts from Horseshoe Casino through its agreement, Gary receives 3 percent each from the two Majestic Star riverboats, Ameristar pays 3.8 percent to East Chicago and other entities, and Blue Chip Casino in Michigan City pays 1.6 percent.³¹ According to the Indiana Gaming Commission's 2015 Annual Report, the FY 2015 payments made pursuant to these Local Development Agreements were the following: \$26.5 million to Hammond, \$6 million to Gary, \$7.1 million to East Chicago, \$1.5 million to Michigan City, \$1.1 million to Florence, \$1.9 million to French Lick, \$12.3 million to Lawrenceburg, \$11.4 million to Elizabeth, and \$733 thousand to Rising Sun.³²

If gaming revenues decline, such payments made by commercial casinos to local communities as part of their Local Development Agreements will be reduced. Based on the GGR declines at the four northern Indiana casinos negatively impacted by the Four Winds South Bend opening, we project \$3.8 million in declines in Local Development Agreement funding during the 2018 – 2022 period, as shown in the following table:

Figure 18: Projected statewide changes in commercial casinos' Local Development Agreement funding resulting from operation of Four Winds South Bend

	Millions	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Statewide change in Local Development Agreement funding		\$1.7	\$0.9	\$0.5	\$0.5	\$0.2	\$3.8

Source: Spectrum Gaming Group

Statewide Economic and Fiscal Impacts

Using outputs and assumptions noted throughout this report, we now project macro-level, statewide, net (i.e., incremental) economic impacts of the new Four Winds South Bend casino on the commercial casino industry and the resultant impacts on the State absent any regulatory change. The impacts are measured on a statewide basis, and the study period extends over five years; we assume Year 1 would be 2018, the first full year of operation for Four Winds.

Our analysis is focused on isolating the impacts of changes to the Indiana commercial casino industry and the resulting impacts on the State of Indiana. As such, *the following results do not factor in economic impacts of the Four Winds South Bend casino, which could mitigate some declines experienced by the commercial casino industry, particularly in employment.*

We contracted with Regional Economic Models Inc. ("REMI"), a leading developer of economic modeling and forecasting tools for national, state and local governments, to build an economic model of Indiana for this study. The REMI model is robust and uses variables based on economic, demographic, industry and other data to develop outputs.

³¹ Dan Carden, "Gaming tax changes could have huge effect on region," *The Times of Northwest Indiana*, February 19, 2015. http://www.nwitimes.com/news/local/govt-and-politics/gaming-tax-changes-could-have-huge-effect-on-region/article_4a43ebcf-4ad9-5955-a193-f7bf30665768.html

³² 2015 Indiana Gaming Commission's Annual Report, pages 34-46.

Economic indicators shown in the table below include Employment, Gross State Product (“GSP”), Output, and Personal Income, which are all outputs from the REMI model. The fiscal impacts include the revenue collected by the state and local government. The government revenue is generated from taxes charged directly to the commercial casinos through the GGR tax and sales taxes from hotel, food, and beverage sales, income tax from casino employee wages, and from taxes generated indirectly, from the income and sales that the casinos are projected to induce in the local and state economy.

Description of Economic Indicators

Employment comprises estimates of the number of jobs – full-time plus part-time – by place of work. Full- and part-time jobs are counted at equal weight. Employees, sole proprietors, and active partners are included, but unpaid family workers and volunteers are not included.³³

Gross State Product (“GSP”) as a value-added concept is analogous to the national concept of Gross Domestic Product. It is equal to output, excluding the intermediate inputs, and represents compensation and profits. GSP as a final demand concept is equal to Consumption + Investment + Government + (Exports – Imports).³⁴ GSP is affected by changes in demand and is the concept most often used to represent the net economic impact on a region, in monetary terms, of a change to the economy (in this case the changes that are projected to occur under scenarios 2 and 3). In simplified terms, it can be said to represent the net economic value to an economy.

Output is the gross impact on the economy and is often thought of as total sales. Outputs include GSP + the intermediate inputs (some of which are derived from outside the state). Whereas GSP is considered the net economic value to an economy, Output is considered the gross economic value.

Personal Income is the income that is received by all persons from all sources.³⁵ It is calculated as the sum of wage and salary disbursements, supplements to wages and salaries, proprietors’ income with inventory valuation and capital consumption adjustments, rental income of persons with capital consumption adjustment, personal dividend income, personal interest income, and personal current transfer receipts, less contributions for government social insurance. Personal income is shown by place of residence (in this case the personal income of residents of Indiana).

Assumptions

In calculating the economic impacts that changes to the commercial casino industry caused by Four Winds South Bend would have on the State of Indiana, various data were

³³ As defined by Regional Economic Models Inc., for use in the REMI PI+ Model.

³⁴ Ibid.

³⁵ The model, however, does not include tips that casino dealers may earn.

collected and projections made on how these scenarios would directly impact the State. The assumptions are described below. *Note that all changes in this section are presented on a year-over-year basis.*

Figure 19 below shows the assumptions used to measure the economic and fiscal impacts for the 2018-2022 period. Changes to GGR under Scenario 2 are projected to range from a year-over-year decline of \$89 million in 2018 to a year-over-year decline \$10 million in 2022. Year-over-year changes in total revenues, which include GGR, hotel, food and beverage, and other, are projected to range from a decline of \$124 million in 2018 to a decline \$14 million in 2022. Year-over-year changes in casino FTEs, per our projections, range from a decline of 255 in the first year to a decline of 27 in 2022, and wage declines range from \$10.2 million in 2018 to roughly \$1.2 million in 2022.

It is estimated that the State of Indiana would lose in the range of \$31 million in GGR tax in 2018 to \$4 million in 2022. Additionally, host municipalities are estimated to lose roughly between \$1.8 million in 2018, declining to \$200,000 in 2022 in GGR tax annually (through the Local Development Agreements) over the five-year period. All government revenue – both State and local – is assumed to be general revenue and is modeled accordingly. The fiscal analysis includes only the GGR taxes, and State income and sales taxes; other taxes such as any corporate, business, or other taxes are not included. The state income tax rate used for these projections is 3.3 percent for all workers and the state sales tax is 7.0 percent.

Figure 19: Modeling assumptions (changes from baseline resulting from operation of Four Winds South Bend)

	Year 1	Year 2	Year 3	Year 4	Year 5
Gross Gaming Revenue (\$ in nominal millions)	-89.0	-43.0	-21.0	-21.0	-10.0
Total Revenue (\$ in nominal millions)	-124.0	-60.0	-29.0	-29.0	-14.0
Casino Employment (FTEs)	-255	-120	-61	-61	-27
Casino Wages (\$ in nominal millions)	-10.2	-4.9	-2.6	-2.6	-1.2
State GGR Tax (\$ in nominal millions)	-31.0	-15.0	-7.0	-7.0	-4.0
Local GGR Tax (Local Development Agreements) (\$ in nominal millions)	-1.8	-0.9	-0.5	-0.5	-0.2

Source: Spectrum Gaming Group

Economic and Fiscal Impacts

The follow sections isolate the economic and fiscal impacts caused by changes to Indiana's commercial gaming industry as a result of opening of Four Winds South Bend casino; as noted above, our projections do not consider economic impacts generated by Four Winds South Bend.

Figure 20 below shows the resulting economic impacts. The number of jobs lost annually in the state is projected to range from 856 in the first year to 89 in the fifth year. These jobs include only private-sector employment and exclude any government jobs that might lost. The jobs lost consist of direct commercial-casino jobs (ranging from 255 the first year to 27 in the fifth year) and the additional indirect and induced jobs. Indirect and induced jobs are lost due to a

decrease in consumer spending as a result of the loss of commercial-casino jobs, and consequently wages, and from a decrease in direct commercial-casino spending on goods, services, and equipment, as a result of a decline in GGR.

The employment multiplier for the commercial-casino employment and spending equates to roughly 2.36 additional jobs across Indiana for each direct commercial casino job. This is a fairly high multiplier and may indicate that much of the commercial casino spending is contained within the state. As the commercial casinos decrease spending on goods and services, jobs are lost at Indiana-based firms that supply the commercial casinos with those goods and services. This in combination with the loss in consumer spending, which also impacts Indiana firms, results in a high multiplier. For example, a casino worker earning a relatively high wage – and spending accordingly – can support multiply jobs in the lower-paying retail and service sectors.

Among the industries in the private sector, entertainment experiences the largest loss in annual employment over the study period, ranging from 312 jobs in the first year to 32 in the fifth year; these consist primarily of the direct commercial-casino jobs. The next-largest loss in jobs among private-sector industries is in construction, ranging from 104 jobs lost in the first year to 19 in the fifth year. The construction impact is primarily a result of a decrease in capital investments, a decrease in demand for housing construction, and a decrease in spending in the public sector on public facilities. As jobs are lost and subsequent income is lost, demand for housing, commercial enterprises, and public-sector facilities decreases, thus, the loss in construction jobs.

Other sectors that are projected to be impacted by the changes to the commercial casinos include retail trade, administrative support and waste management services, and professional services. Retail trade jobs are lost due to less demand for retail goods resulting from the loss of wages. Administrative support and waste management services are projected to lose 71 jobs in the first year and seven in the fifth year. Much of this sector is made up of business-support service firms, including waste management and building services. The decrease in employment in administrative support services is primarily the effect of a decrease in non-payroll spending by the commercial casinos on services purchased at local firms, a function of the casinos contracting outside firms to provide support services for its operation. The loss in professional-services jobs is also primarily the effect of a decrease in non-payroll spending by the commercial casinos on support services purchased at local firms.

Gross Regional Product (“GRP”) for Indiana is projected to decline by \$163.5 million in the first year and by \$19 million in the fifth year. All sectors of the economy impacted by the commercial casinos show a drop GRP. The largest drop in GRP, as expected, is in the entertainment sector, the direct impact of the revenue declines at the commercial casinos. Other sectors that show relatively large drops in GRP include construction, professional services, retail trade, and administrative support services. This is result of the indirect and induced spending by

commercial-casino employees and the commercial casinos themselves, as it flows through the state economy.

Total personal income for residents of Indiana is projected to drop by \$70 million in the first year and by \$17 million in the fifth year. The direct wages paid by the commercial casinos to their employees is the largest component of the total personal income. Much of the remaining personal income is represented by wage and salary disbursements for the indirect and induced jobs lost throughout the economy.

Figure 20: Changes to Indiana economy – isolating economic impacts from changes to commercial casino industry resulting from operation of Four Winds South Bend

	2018	2019	2020	2021	2022	5-Year Total
Total Private Non-Farm Employment	-856	-449	-233	-203	-89	-1,830.0
Construction	-104	-82	-53	-39	-19	-297.0
Arts, Entertainment, and Recreation	-312	-146	-73	-72	-32	-635.0
Retail Trade	-75	-39	-22	-19	-10	-165.0
Professional Services	-47	-25	-13	-11	-6	-102.0
Administrative and Waste Services	-71	-35	-17	-15	-7	-145.0
Accommodation and Food Services	-45	-24	-13	-12	-7	-101.0
All other sectors	-202	-98	-42	-35	-8	-385.0
Gross State Product (Fixed millions 2016 \$'s)	-163.5	-82.9	-41.4	-39.2	-19.0	-346.1
Output (Fixed millions 2016 \$'s)	-256.5	-129.9	-65.0	-60.5	-28.0	-539.8
Personal Income (current \$'s)	-70.0	-44.0	-28.0	-27.0	-17.0	-186.0

Source: Spectrum Gaming Group, Regional Economic Models Inc.

The fiscal impacts caused by changes to the commercial casino industry on the State of Indiana includes the changes in revenue collected by the State from the GGR tax and from the changes in income and sales tax (direct, indirect and induced) collected. The fiscal impact at the local level – host local governments – includes only the Local Development Agreement portion of the GGR tax. The GGR tax is based on 35 percent of the commercial casinos' gross gaming revenue. Income tax, derived from the wages earned from direct, indirect, and induced jobs, are calculated at the flat rate of 3.3 percent, Indiana's income tax rate. The State sales tax of 7 percent is applied to the projected change in the sales of taxable goods resulting from the impacts to the commercial casinos. The taxable goods include consumer goods that are subject to sales tax in Indiana in addition to the direct commercial-casino-related sales that are subject to the sales tax, such as food, beverages, and retail goods, hotel room rental and cash sales, complimentary alcohol and cigarettes, and food, beverage, and retail items paid with player points. Other state and local taxes, such as corporate taxes and local tax levies, such as property taxes, are not included in this fiscal analysis.

Figure 21 below show the results of the fiscal impact analysis. It is projected that the annual loss in State government revenue will range from \$34.7 million in the first year to \$4.6

million in the fifth year. By far the largest portion of this is the GGR tax – ranging from \$31 million in the first year to \$4 million in the fifth year.

At the local government level, we project that tax revenue collection will decrease by \$1.8 million in the first year and by \$200,000 in the fifth year; this is entirely from the local-level GGR tax.

Figure 21: Changes to Indiana economy – isolating fiscal impacts from changes to commercial casino industry resulting from operation of Four Winds South Bend

	2018	2019	2020	2021	2022	5-Year Total
State Revenue Collection (Fixed 2016 \$)	-\$34.68	-\$17.09	-\$8.23	-\$8.16	-\$4.60	-\$72.75
<i>Income Tax</i>	-\$1.96	-\$1.16	-\$0.69	-\$0.62	-\$0.29	-\$4.72
<i>Sales Tax</i>	-\$1.72	-\$0.92	-\$0.54	-\$0.54	-\$0.31	-\$4.03
<i>GGR tax</i>	-\$31.00	-\$15.00	-\$7.00	-\$7.00	-\$4.00	-\$64.00
Local Revenue Collection	-\$1.80	-\$0.90	-\$0.50	-\$0.50	-\$0.20	-\$3.90
<i>GGR tax</i>	-\$1.80	-\$0.90	-\$0.50	-\$0.50	-\$0.20	-\$3.90

Source: Spectrum Gaming Group, Regional Economic Models Inc.

III. Examining State Policy to Assist Casino Industry

Indiana's casino industry is mired in the doldrums, in which the status quo is serving it nor the State well. The Indiana Legislature has taken some action in the last three years to assist the casino industry (see section below), but Spectrum believes that maintaining the status quo will lead to further declines in revenue, employment and in the overall quality and ultimate viability of many of the state's gaming operations.

Indiana policymakers face difficult options, including the option of foregoing even more direct tax revenue in exchange for helping its industry remain viable and competitive. This option, at the very least, allows gaming operators to continue as major employers and, to varying degrees, to serve as magnets for tourism and leisure spending. Effectively, this means an increase in various sources of indirect economic benefits to Indiana.

As we did in our 2014 report to the Casino Association of Indiana, Spectrum recommends five core actions (listed alphabetically) to help revitalize the casino industry and, by extension, provide more tax receipts to the State:

- **Allow operators, regulators to develop alternatives to admissions Tax:** The admissions tax has declined significantly over the past decade, effectively mirroring the decline in gaming revenue. That tax is regressive – since it is levied the same on all visitors, regardless of how much they spend – and is counter-productive, since operators must take it into account when offering promotions.
- **Change the tax policy on free play:** Providing patrons with free play (i.e., free spins on a slot machine) incentivizes customers to increase their real-money wagering – by a ratio of at least 4:1, based on data in other states. Free play has become a critical part of casino marketing, and other states have recognized this by not taxing free play. Indiana, however, does tax free play, resulting in a substantial cost to operators and thus reducing the effectiveness of this program. Spectrum recommends that Indiana take a graduated approach, easing the free-play tax rate over time to ensure that the desired results are being achieved.
- **Eliminate the Add-Back Tax:** Indiana does not allow casino operators to deduct the tax on AGR as an expense that could offset taxable income, and we cannot identify any other state that has such a provision in place.
- **Reform AGR tax structure to encourage incremental revenue growth:** Indiana regulators could be granted authority to review and approve petitions for lower incremental tax rates for operators that can demonstrate that such relief will produce tangible benefits that can range from overall market growth to increased employment, or to simply stave off further declines or potential closings.
- **Stimulate capital investment:** If the above above-recommended actions are implemented, and/or other policies are implemented that stimulate capital investment, casino operators can reinvest in their properties.

Additionally, and in light of the challenges facing Indiana's commercial casino industry, the State of Indiana may consider the impact that a potential indoor-smoking ban would have on casino revenue. Currently, Indiana casinos enjoy a competitive advantage over Illinois and Ohio, which prohibit smoking in casinos, and are on a level playing field with Kentucky and Michigan, which allow smoking in casinos (both commercial and tribal casinos in Michigan). Casino smoking bans in other jurisdictions – notably Colorado, Delaware, Illinois and Ontario – were blamed by gaming operators for significant declines in gaming revenue, although smokefree proponents argue that other factors contributed to the declines. It is important to note that tribal sovereignty would preempt any effort by the State of Indiana and local governments to enforce a smoking ban in the Four Winds South Bend casino, thus putting the commercial casinos at a competitive disadvantage. Spectrum raises the issue of smoking in casinos solely from the perspective of considering the impacts on gaming revenue and the resulting impacts on gaming taxes and employment; we recognize the overarching health issues behind enacting indoor smoking bans.

Since our report was issued, the State of Indiana did pass one significant bill regarding its commercial casino industry, as discussed below.

State Gaming Initiatives, 2014 - Present

House Enrolled Act No. 1540, a gaming-related omnibus bill, was approved by the Indiana Legislature (Public Law 255) and became effective on May 12, 2015. This legislation represents the only significant casino bill to be approved by the Indiana Legislature during the past three legislative sessions. The following is a summary of the bill's legislative and fiscal impacts:

- Outlines the process for entering into tribal-state compacts in regard to Indian gaming.
- Authorizes riverboats to move to adjacent inland properties if certain requirements are met.
- Makes numerous changes to the adjusted gross receipts ("AGR") deduction for promotional free play given by a riverboat casino/racino to patrons. It makes the promotional play deduction for riverboats permanent. Under the previous law, the deduction would have expired on June 30, 2016. It increased the promotional play deduction from \$5 million to \$7 million. The bill also provides for the assignability of the deduction starting in FY 2016. According a Fiscal Impact Statement by the Indiana Legislative Services Agency ("ILSA") the promotional free play deduction is estimated to reduce the AGR that is the base for the set-aside payment to horse racing industry as well as to reduce the taxable base for the riverboat wagering tax and the 3 percent county slot machine wagering tax.³⁶ The ILSA concluded that the assignability of free play deduction allowed under the bill could lead to shifting of a small portion of impact

³⁶ Fiscal Impact Statement LS 7218; Legislative Services Agency, Office Of Fiscal And Management Analysis, May 7, 2015. <https://iga.in.gov/legislative/2015/bills/house/1540#document-03b2f222>

between the local units and state General Fund depending on the assignment and claims of the free play deduction.³⁷

- Limits the number of games offered by an operator at the highest number of games offered since January 1, 2007, notwithstanding whether the owner/operator relocates the gaming operations to an inland casino. This provision would not have any short-term impact on the currently operating riverboat casinos.³⁸
- The legislation permits table games at racetrack casinos beginning in 2021, if approved by the Indiana Gaming Commission (“IGC”) and commits the AGR from table games to support the horse racing industry. It provides that a racino owner/operator may not offer more than 2,200 games on the premises of a racetrack after January 1, 2021. It allows racetrack casinos to submit a plan to the IGC between March 1, 2021, and June 30, 2021, to install table games. The ILSA expects that the impact of this provision could begin in FY 2021, with the full impact occurring in FY 2022. Based on the current trend in gaming revenues, the net impact on General Fund is estimated to be over \$10 million based on the estimated impact from displacement of racetrack slot AGR and wagering tax revenue and riverboat casino AGR and wagering tax revenue.³⁹
- Provides that after June 30, 2015, the racetrack casino wagering tax is based on 88 percent of AGR, a decrease from 91.5 percent. This is expected to result in a loss to the state General Fund totaling \$5 million annually beginning in FY 2016.⁴⁰
- Repeals a requirement that the IGC study the use of complimentary promotional credit programs.
- Recommends the Legislative Council form an interim study committee to study numerous significant issues facing the gaming industry in Indiana.

Issue of Add-Back Taxes

One of Indiana’s most noteworthy and long-standing public policy debates concerning the gaming industry is the issue of whether the casino operators should be exempt from adding back wagering taxes when determining their Indiana adjusted gross income for income tax purposes. Our research indicates that the issue of add-back taxes has been percolating in the Indiana Legislature since as far back as 2007. The issue was among the nine topics that Enrolled House Bill (H) 1540 recommended the Legislative Council’s interim study committee study and report on in 2015. The approved legislation recommended the topic be studied by the Legislative Council and explained the issue as follows:

Whether a taxpayer subject to the riverboat wagering tax (IC 4-33-13) or the slot machine wagering tax (IC 4-35-8) should be exempted from adding back wagering

³⁷ Ibid.

³⁸ Ibid.

³⁹ Ibid.

⁴⁰ Ibid.

taxes deducted for federal income tax purposes under Section 63 of the Internal Revenue Code when determining the taxpayer's adjusted gross income for Indiana income tax purposes under IC 6-3-1-3.5.

However, the Legislative Council's 2015 report did not address the add-back taxes topic.

The effort to reform the add-back taxes provision, IC 6-3-1-3.5 Section (22)(b)(3) of Indiana's enabling legislation, is evidenced by the legislative history of House Bill No. 1835, introduced on January 17, 2007. The Senate Committee on Tax and Fiscal Policy amended the bill two months later by adding the following language: "Add an amount equal to any deduction or deductions allowed or allowable pursuant to Section 63 of the Internal Revenue Code for taxes based on or measured by income and levied at the state level by any state of the United States. For taxable years beginning after December 31, 2007, the riverboat wagering tax under IC 4-33-13 is not considered a tax based on or measured by income."

The additional language addressing the add-back taxes provision was subsequently removed from the bill by the House Conference Committee on April 29, 2007, and excluded from the bill signed into law on May 11, 2007 (Public Law 233).

Looking Ahead

The goal in Indiana now should be to stimulate economic activity and to strengthen the commercial casino industry by encouraging capital investment and allowing gaming operators to broaden their demographic and economic appeal. Spectrum believes that operators have a concomitant responsibility to put forth plans as to how they would invest that capital to stimulate their businesses, as well as to help grow the state and local economy.

Key tenets to such a policy should include:

- Gaming operators and regulators should develop a more cohesive, effective partnership. This partnership should center on achieving common goals and should be characterized by a robust dialogue.
- Operators have a responsibility to suggest strategies to achieve those goals, but regulators have a responsibility to examine such strategies, and to suggest improvements.
- When operators suggest strategies, there are no guarantees of achieving the results. Regulators need to assess the soundness of the strategies, but should not penalize operators that act in good faith to achieve the stated goals.

Indiana policymakers can still assist the state's commercial casino industry by encouraging it to tap new markets, including through tax relief in exchange for capital investment, and making greater use of "free play," a powerful marketing tool for casino operators that would make operators more competitive and help grow the overall revenue base.

Responsibility of Casino Operators

The challenges and opportunities examined in this report should not, in any sense, rest solely on the shoulders of Indiana lawmakers. Regulatory or tax relief cannot be implemented in a vacuum, nor should the state make significant regulatory changes in the absence of a quid pro quo from gaming operators. That is an effective recognition of the universal principle that no entity has a right to a gaming license. Rather, a gaming license is granted as a privilege to individuals and entities that agree, in principle and practice, to operate in the public interest while advancing their own business interests.

For purposes of this analysis, Spectrum suggests that Indiana casino operators have a concomitant obligation to Indiana, which should be met before Indiana lawmakers agree to any material changes to tax rates or regulatory requirements. In practice, this means that each casino operator seeking relief should present a detailed plan to regulators that, among other things, outlines the specific plans and goals that it would develop in response to regulatory relief.

For example, if a casino seeks a reduction in gaming taxes, it should demonstrate:

- Why the current rules limit its ability to market its product, or to optimize revenue and profitability;
- How it would develop a more robust, effective business under new, relaxed rules; and/or
- What would the overall impact to the state be, and to what degree will any increased economic activity – including increased employment – offset the direct loss to the state of revenue from eliminating the admissions tax.

In the absence of such a requirement, Indiana would be undertaking a significant – and unnecessary – risk that it would lower the operating costs of casinos, simply to have those operators invest elsewhere. That risk would be eliminated by requiring operators to put forth investment plans that would leverage those lower costs.

More Free Play Drives Gross Gaming Revenue, Tax Receipts

Although the State of Indiana has already improved the tax treatment on free play (as noted above), we believe this particular tax policy should be further improved to drive additional gross gaming revenue.

The new reality is that a Class II operation, such as the planned Four Winds South Bend, will have no such tax burden on free play (or on gaming revenue), and thus we recommend that Indiana eliminate the current tax on free play altogether, which would put it on a par with neighboring Ohio, which does not tax free play; Illinois and the Michigan commercial casinos have no tax exemption for free play but Michigan tribal casinos – which are most proximate to Indiana – are not subject to a tax on free play.

In 2016, Indiana ranks as the lowest in the percentage of free play to revenue as compared to the rest of country for states that publicly report free play. The level of free play in Indiana as of 2016 is approximately 7 percent to 8 percent of overall revenue.⁴¹ At this rate, Indiana is more than 50 percent below neighboring Ohio, which is currently at 17 percent.⁴² This is a distinct disadvantage for Indiana commercial casinos. This also presents an advantage in that Indiana operators can increase their level of free play without endangering hitting any diminishing returns for the use of free play.

Figure 22: Free play results as percentage of gaming revenue, 2012-2016, selected states

State	2012	2013	2014	2015	2016 (6 mos.)
CT	12%	11%	13%	12%	11%
FL	14%	16%	15%	15%	16%
NJ	18%	16%	16%	18%	17%
NY*	7%	10%	11%	13%	13%
OH	8%	23%	19%	18%	17%
PA	28%	29%	27%	26%	27%
IN					8%**

Source: Spectrum Gaming Group, state gaming commissions. * NY statutorily capped at 10 percent through 2014 and 15 percent since; CT statutorily capped at 11 percent. ** Based on data from two Indiana casino operators; not reported by state.

Market research and experience with operations have continually proven that cash incentives provide highest value to casino patrons. These cash offers (also known as free play or promotional credits) generate the highest response compared competing incentives. In gaming markets across the country we have observed the following ranges of response rates to various incentives:

Figure 23: Typical response rates of casino marketing incentives

Incentive	Response %
Cash (free play)	27% - 35%
Hotel room comp	5% - 7%
Food comp	3% - 5%
Beverage comp	1% - 2%

Source: Spectrum Gaming Group

Prior to the technological advances that allow for tracking of free-play incentives to each patron, gaming industry executives had long held the view based on years of experience and research that the return on investment when using free-play incentives is between 3:1 and 4:1. We have prepared numerous tests for clients in multiple gaming jurisdictions, and the tests have been used to prove that the return on investment when using such incentives is indeed within

⁴¹ Information from IN-Casino Association operators

⁴² Free play in Ohio is presently exempt from state gaming taxes, although there have been efforts in recent years to eliminate that exemption.

this range of 3:1 and 4:1. We found several outliers in which the returns on free play reached levels as high as 10:1.

The importance of loyalty marketing – especially to high-frequency, high-annual-worth patrons – cannot be overstated. Once patrons are exposed to cash reinvestment in the form of free play, they quickly become attuned as to how to leverage programs to their most beneficial end. In any competitive environment with essentially similar products, the normal tie-break for purchase is some form of discounting. Grocery stores are one such example. They operate on thin margins and yet they are continually producing coupons to “drive a trip” from their patrons. In this regard, casino properties are no different. Casino direct-marketing departments evaluate patrons and then determine the appropriate level of reinvestment for each patron.

Why does this matter to the casino properties in Indiana? The amount of reinvestment each patron receives is closely monitored by the patron, who knows which casino rewards more and which casino rewards less. Put simply, all else being equal, would a patron choose to drive to a casino for a \$5 coupon or for a \$20 coupon?

As Michigan tribal casinos and Ohio commercial casinos are able to reinvestment more in their players, because their free play is either not taxed at all, or is taxed at a lower level than Indiana, then it stands to reason that Indiana resident patrons will leave Indiana to seek the highest and best gaming offer. Additionally, if patrons known to Indiana casinos receive multiple offers from properties in other states, those patrons will again be more likely to spend their gaming dollars with the provider of the best offer. If Indiana casino properties offers are not competitive, due to the current tax policy that essentially restricts the ability of Indiana casino properties to offer free play, the results will be lower visitation and lower revenue.

New York Example: Free Play Tax Changed, Revenue Increased

While some states have shown gaming win declines as a result of neighboring competition, there is one example of a state that gained revenue: New York. Including the first part of 2016, New York has been gaining revenue in most recent years despite significant competition from neighboring Pennsylvania and Connecticut, as well as from large, well financed Indian casinos within New York.

The following table shows the timeline that New York pursued in the changing of free-play from being taxed as revenue to the current position in which the first 15 percent of any property’s GGR in equivalent free-play redemptions is not be taxed.

Figure 24: Timeline and effect of free play experience in New York

Year	Overall evaluation	Notes
Prior to 2009	Taxes free play as Revenue	<ul style="list-style-type: none"> a) NY racetrack casino operators were not seeing growth while neighboring PA grew dramatically b) Operators would not spend too much free play due to deficits after tax c) NY operators acknowledged that their assets were inferior to the tribal competition and commercial casinos in PA
	PA operators were spending free play in range of 20% to 25% of GTR	PA free play not taxed as Revenue
2009-2011	NY State Lottery (NYSL) conducts two-property, 18-month test program to determine outcome of free play being not taxed as revenue	Test results needed to prove benefit to NYSL by net increase in taxes collected. The expected projection of incremental ROI on free play was 3:1.
2011	NYSL evaluates test	The rate of 3:1 was achieved during the 18 month test. NYSL determined there would be a net benefit to State by allowing for free play to not be taxed, subject to 10% FP to GTR cap
Mid-2011	Based on test results, free play was not taxed, subject to cap, for all properties within State	That is an example of a law providing an incentive to maximize revenue.
May 2011 – April 2012	Change in tax status lead to additional free play spend that fueled revenue growth	<ul style="list-style-type: none"> a) Test property taxes collected grew by 9% b) Test properties grew by 300%+ over competitors in that timeframe
Early 2013	NY Gaming Association (NYGA) requested a raising of 10% cap to 15%	NYSL operators realized while free play was working, the 10% cap was hampering growth as competition (neighboring PA and in-state tribal facilities) had higher levels of free play reinvestment
	NYGA analysis forecasted decline in revenue for 2013/2014	All properties had reached 10% free play cap
Mid-2013	NYSL operator growth slows	As was forecasted by NYGA, growth becomes negative for 7 of 9 properties
1Q 2014	Statewide decline in revenue for all nine properties	First time ever. The request to raise the free play cap to 15% was re-visited.
July 2014	NY legislature passes amendment to 10% free play cap allowing up to 15% not taxed	As NYGA properties ramped up additional incentive spending, growth from 2015 versus 2014 was +3%.
July 2016	NYGA properties continue to reinvest more free play	For first six months of 2016, NY has gained an annualized +5% in GTR versus same time in 2015 while neighboring PA is only up +2% in slot GTR

Source: Spectrum Gaming Group, New York Gaming Association

As shown by the New York results, it is possible for states to encourage the use of free play to stem revenue declines – and potentially grow revenue. It is always preferable to save revenue before it defects across state lines – or, in the looming case in Indiana – to an untaxed competitor.

New York proved that an effectively managed free-play strategy can make a difference. The results clearly impressed New York lawmakers, who instituted a 180-degree turn from the previous policy of taxing free play to allowing free play to be exempt from taxation, up to the current statutory limit of 15 percent of any property's GGR in equivalent free-play redemptions. As a result, the New York gained revenue in what would otherwise have clearly been a declining overall gaming market.

Relevance to Indiana

Prior to New York changing its structure of taxing free play as revenue, both New York and Indiana were similar in nature when viewing as gaming providers:

- Their free play tax structure was causing operators to be disadvantaged to competition
- Both states experienced extreme competition for gaming patrons due to increased border competition and in-state tribal competition
- The amenities of most of the properties are not as new or extravagant as that of the competition or, in the case of Indiana, as the planned Four Winds South Bend
- Gaming markets around the country are showing little true growth
- Indiana has loosened its rules on free play distribution. Whereas originally Indiana taxed free play coupons, in 2013 State law changed to allow the first \$5 million in free play coupons per casino to be untaxed, an amount raised to \$7 million effective June 30, 2016.

As gaming regions, there are also key differences between New York and Indiana:

- The largest population base in country is metro-New York City. Indiana does not have such a population base
- Indiana has full Class III slots and table games, while New York's commercial facilities have VLTs and no live table games.

New York acted aggressively to alter its tax structure on free play two times – first in 2011 and then again in 2014, as it was proven free play can be utilized to preserve market share in a national market that is showing at best slow growth.

Given the heightened competition among Indiana, Illinois, Michigan and Ohio, Spectrum believes that Indiana could learn from the positive results of New York with regard to eliminating the taxes on free play. New York is one example that showed by engaging in property-determined marketing plans, having additional free play to spend generated positive gaming results by targeting database customers with offers that make sense for the patron as well as for the property.

Role for Indiana Gaming Commission

By any measure, the Indiana Gaming Commission ("IGC") is an effective regulatory agency that continuously focuses on meeting its mission: "To license and regulate riverboat gambling in Indiana and ensure compliance with applicable statutes, rules, and regulations in a manner that promotes the integrity of gaming, and the best interest of the State of Indiana and its citizens."⁴³

⁴³ Indiana Gaming Commission, Mission. <http://www.in.gov/igc/2355.htm>

In Spectrum's experience as regulators, a focus on integrity by gaming regulators should be unwavering and unshakeable. That is clearly the view held by the IGC, and that focus should not be tampered with or compromised. Our analysis suggests, however, that changing times require a broader mission, but one that does not dilute or adversely affect that core mission.

As this report notes, Indiana gaming operators need to broaden their business model and invigorate their properties to make them more competitive in an increasingly competitive environment. That requires capital investment that, in turn, requires relief from the current tax rates and related rules.

Spectrum recognizes that simple, across-the-board tax relief could prove detrimental to Indiana, if operators elect to either do nothing or, in the worst case, take the proceeds from that newly found tax relief and invest them in another market, or simply return it to shareholders as a dividend. Rather, we recommend that operators seeking tax relief in order to invest in their properties have an obligation to the State to demonstrate with precision how they intend to invest, and what the projected returns on that investment will be for the State.

Indiana already has a regulatory body in place that possesses the necessary independence to review and measure such plans. Granting operators the ability to petition for tax relief would, however, require that the IGC take on an additional mission: to perform economic reviews of applications for tax relief. The burden in such instances is clearly on the applicant to demonstrate its plans in various areas that would include, but not be limited to:

- The level of new investment
- Planned employment levels, by department
- Expected increases in payroll
- Impact on non-gaming revenues
- Impact on purchases of goods and services, broken down by in-state and out-of-state purchases.
- Total economic impact, regionally and statewide

This report does not suggest how the adoption of a review process would affect the IGC's table of organization, if at all. While it might require some additional position(s) be added, the core requirement – analyzing applications for relief in detail – could be outsourced to third parties. The cost of such outsourcing would be assessed on the applicants for relief. That, in our view, is a fair solution that would advance the essential goal: Revitalizing Indiana's commercial gaming industry to ensure its long-term viability and to enhance its economic benefits.

IV. Indian Gaming: Key Legal, Regulatory Aspects

In this chapter, we provide an overview of key legal and regulatory aspects of tribal gaming, including how tax advantages over commercial operators can lead to operational advantages.

Understanding Class III Tribal-State Compacts

The Pokagon Band of Potawatomi Indians is a federally recognized tribe based in southwestern Michigan and northeastern Indiana. The tribe currently operates three casinos in Michigan and is planning to build a \$480 million casino on its lands in South Bend, IN. As detailed below, in order to operate a casino in Indiana the Pokagon tribe will need to enter into a tribal-state compact pursuant to the Indian Gaming Regulatory Act.⁴⁴

The seminal court case regarding Indian gaming was California v. Cabazon Band of Mission Indians, 480 U.S. 202 (1987). The US Supreme Court ruled that California did not have the right to regulate Indian gaming unless there were criminal prohibitions against gaming in the state. Thereafter, in direct response to the Cabazon decision, Congress passed the Indian Gaming Regulatory Act (“IGRA”)⁴⁵ in 1988.

IGRA was designed to regulate the conduct of gaming on Indian lands in the United States while maintaining tribal sovereignty. The law established the National Indian Gaming Commission (“Commission”) to oversee Indian gaming. The statute designated three classes of gaming. **Class I** includes traditional forms of Indian gaming connected with tribal ceremonies and is regulated solely by the tribes. **Class II** gaming includes bingo and other similar games and is regulated solely by the tribes and the Commission. **Class III** gaming includes casino games and slot machines and is subject to federal, state and tribal regulation.⁴⁶

IGRA permits Class III casino gaming on the lands of federally recognized Indian tribes if certain conditions are satisfied: 1) casino gaming is authorized by a tribal ordinance; 2) it is located in a state that permits casino gaming; and 3) the gaming activity is conducted in accordance with a gaming compact entered into between the tribe and the state and approved by the Department of the Interior.⁴⁷

The tribes request a compact with the state if they desire to have Class III gaming. Following this request, states are required to enter good faith negotiations with the tribe to enter

⁴⁴ Public Law 100-497-Oct. 17, 1988 100th Congress Sec. 2701, 18 U.S.C. Sec 1166 et seq. and 25 U.S.C. Sec 2701 et seq.

⁴⁵ Public Law 100-497-Oct. 17, 1988 100th Congress Sec. 2701, 18 U.S.C. Sec 1166 et seq. and 25 U.S.C. Sec 2701 et seq.

⁴⁶ 25 U.S.C. 2703(6)-(8).

⁴⁷ 25 U.S.C. 2710(d)(1).

into Tribal-State compacts for the conduct of Class III gaming.⁴⁸ IGRA imposes on the state an obligation to negotiate in good faith, but does not specifically identify a particular state actor or entity to negotiate the compacts. That is a matter reserved to state law.⁴⁹ In many instances, state courts have invalidated compacts negotiated by the governor without legislative approval.⁵⁰

The content of these compacts varies from state to state and may vary from tribe to tribe. All such compacts must be approved by the US Department of Interior and they become valid when the US Secretary of Interior has published the compact in the federal registry.⁵¹ The Secretary of Interior may approve or disapprove the compact within 45 days of its submission. If the Secretary does not approve or disapprove the compact within 45 days, the compact is considered to have been approved “but only to the extent the compact is consistent with the provisions of IGRA.”⁵²

Compacts pursuant to IGRA are negotiated business agreements between two entities. IGRA provides detailed instructions and guidelines relating to the content of these compacts and the regulation of such agreements. A compact may include provisions regarding:

- The application of the state’s and the tribe’s criminal and civil laws and regulations that are “directly related to and necessary for the enforcement of such laws and regulations”
- Allocation of criminal and civil jurisdiction between the tribe and the state for enforcement of such laws and regulations
- Payments to the state to cover the state’s costs of regulating the tribe’s Class III gaming
- Tribal taxation of Class III gaming
- Remedies for breach of contract
- Operating and facility maintenance standards, including licensing
- “Any other subjects that are directly related to the operation of gaming activities.”⁵³ Such issues such as minimum standards for the operation of casinos and licensing requirements are usually addressed in a compact. Subjects that are not directly related to the conduct of gaming are outside the purview of these compacts. For example, a compact cannot lawfully impose restrictions on tribal

⁴⁸ 25 U.S.C. 2710(d)(3)(A).

⁴⁹ *Saratoga County Chamber of Commerce v. Pataki*, 798 N.E.2d 1047, 1060 (N.Y. 2003).

⁵⁰ Rand, Kathryn R.L., “Caught In The Middle: How State Politics, State Law, And State Courts Constrain Tribal Influence Over Indian Gaming,” 90 *Marquette Law Review*, 1001-1005 (2007).

⁵¹ 25 U.S.C. 2710(d)(3)(B).

⁵² 25 U.S.C. 2710(d)(8)(C).

⁵³ 25 U.S.C. 2710(d)(3)(C).

hunting and fishing or other treaty rights as they are not subjects directly related to the operation of gaming.⁵⁴

The compacts provide the types of games authorized for play, describe the form of regulatory oversight over Indian casinos and most significantly, set forth any revenue sharing arrangement. Once the compact is negotiated, it is forwarded to the federal government, where it is either approved or disapproved. Once approved, the compact establishes and governs the relationship between the tribe and the state as a matter of contract law.⁵⁵

IGRA imposed on the states a good-faith obligation to negotiate tribal-state compacts.⁵⁶ The original statute also created an enforcement vehicle by providing a cause of action for the tribes to file lawsuits in federal court alleging a failure to negotiate in good faith.⁵⁷ In determining whether the state negotiated in good faith, the court considered the public interest of the state and possible “adverse economic impacts on existing gaming” operations in the state.⁵⁸ The burden was on the states to demonstrate they acted in good faith in the negotiations.⁵⁹

If the court decided that the state acted in good faith, the ruling would favor the state. In the event the court found against the state, the court ordered the parties to reach a compact within 60 days. If these efforts failed, the court appointed a mediator to decide the matter. The state and tribe submitted proposed compacts and the mediator would then choose the proposed compact that best comported with the terms of IGRA.⁶⁰ If the state accepted the mediator’s compact, the compact would be submitted to the Secretary of the Interior for approval. If the state did not accept the mediator’s compact, the Secretary of the Interior would consult with the tribe to draft a compact to regulate Indian gaming in the state.⁶¹ Accordingly, by virtue of this right to sue, the tribes retained considerable leverage in the negotiations.

The Secretary of the Interior has the power to approve or disapprove a tribal-state compact, whether reached through amicable negotiations or following the institution of federal court proceedings.⁶² The Secretary may disapprove a compact for any of three reasons: (1) the compact violates a provision of IGRA; (2) the compact violates federal law; or (3) the compact violates the federal government’s trust responsibility to the tribes.⁶³

⁵⁴ Rand, Kathryn R.L., “Caught In The Middle: How State Politics, State Law, And State Courts Constrain Tribal Influence Over Indian Gaming,” *90 Marquette Law Review*, 971, 978 (2007).

⁵⁵ Indian Gaming Compacts in Oklahoma, Indian Gaming May 2010 at 14.

⁵⁶ 25 U.S.C. 2710(d)(3)(A).

⁵⁷ 25 U.S.C. 2710 (d)(3)(A), (d)(7)(A)(i).

⁵⁸ 25 U.S.C. 2710(d)(7)(B)(i)-(iii).

⁵⁹ 25 U.S.C. 2710(d)(7)(B)(ii).

⁶⁰ 25 U.S.C. 2710(d)(7)(B)(III),(iv).

⁶¹ 25 U.S.C. 2710(d)(7)(B)(vi)-(vii).

⁶² 25 U.S.C. 2710(d)(8)(A).

⁶³ 25 U.S.C. 2710(d)(8)(B).

In 1996, the Supreme Court ruled in Seminole Tribe v. Florida⁶⁴ that the Eleventh Amendment's grant of state sovereign immunity prevented Congress from authorizing lawsuits by tribes against states for failing to negotiate compacts in good faith. Notably, the Court decided that Congress could not abrogate state sovereign immunity and therefore, a state's assertion of sovereign immunity would bar the tribe's action against it for failing to negotiate in good faith under IGRA. Thus, the remedial mechanism for enforcing the good faith clause was effectively abolished. As a result of the Seminole Tribe decision, a tribe can now bring a federal suit only if the state waives its immunity. The substantial leverage once held by the tribes has been abolished entirely.

In an attempt to give tribes an alternative when states assert sovereign immunity, the Department of Interior adopted regulations that would allow the interior secretary to issue gaming procedures without requiring a tribe to sue in federal court.⁶⁵ However, the Fifth Circuit Court of Appeals has held these procedures to be invalid on the grounds that Congress did not explicitly authorize them.⁶⁶ Since the Supreme Court has not ruled on the issue, this holding is binding only in the Fifth Circuit (Louisiana, Mississippi, and Texas). It is not known whether the Department of Interior will attempt to use these procedures in other circuits.

Thus, although states are required by IGRA to negotiate in good faith, following the Seminole Tribe decision the tribes have no remedy to rectify a lack of good faith by the states. In the absence of the right to sue, it is theoretically possible for a state to effectively prevent a tribe from engaging in Class III gaming altogether by refusing to negotiate a tribal-state compact. Alternatively, a state may use its leverage to make harsh demands during the negotiations. State politics become highly relevant in the ultimate resolution of the terms of the compact.

Pokagon-Michigan Compact

As previously noted, the Pokagon Band of Potawatomi Indians currently operates casinos in Michigan. Initially, the tribe paid 8 percent of net gaming revenue from electronic gaming devices to State government and 2 percent of net gaming revenue to local government. The amount was negotiated as part of the compact between the State and the tribe. The compact was amended in 2008 and now the tribe contributes 2 percent of its net gaming win to local governments and another 6 percent to the State. Net win is defined as the total amount wagered on each electronic game of chance minus the total amount paid to players for their winning wagers at such machines. The Pokagon does not share any of its table-games revenue with State or local government. This relatively minimal revenue-sharing rate may be contrasted with the commercial casinos operating in Michigan, which pay a total tax of 24 percent. The breakdown of the casino tax is: 18 percent of net win, with 8.1 percent as the state wagering tax going to the

⁶⁴ 517 U.S. 44, 72(1996).

⁶⁵ 25 CFR pt. 291.

⁶⁶ (*Texas v. United States*, 497 F.3d 491 (5th Cir. 2007)).

state school aid fund and 9.9 percent going to the city where the casino is located, and an additional 6 percent tax levied in 2004, with 1/3 going to the city in which the casino is located, 7/12 to the state general fund, and 1/12 to the Michigan agriculture equine industry development fund.⁶⁷

In Michigan, the first compacts were executed in 1993 with seven federally recognized tribes, prior to the legalization of commercial casinos in the state. The 1993 compacts provided that, for as long as the tribes had the exclusive right to operate casinos in the state, the revenue from slot machines on Indian reservations would be taxed at 10 percent of the net win, with 8 percent earmarked for the state Renaissance Fund, which supports economic development, and 2 percent for improvements to local communities. These compacts stated that, if any non-Indian casinos were subsequently authorized, the tribes would not have to pay any money into the Renaissance Fund. By mid-1999 when the first Detroit casino gaming license was granted, all of these tribes had been released from the state tax obligation.⁶⁸

In 1998, Michigan entered into casino compacts with four additional tribes, including the Pokagon tribe. These compacts provided for a 10 percent state tax obligation, with 8 percent going towards state economic development and 2 percent for local improvements. Unlike the prior compacts, the state tax obligation would continue even if non-Indian casinos were constructed.⁶⁹ Based on this absence of exclusivity, the Secretary of Interior decided that he would not approve nor disapprove the compact. The Secretary took issue with the amount of revenue to be shared with the state. He was concerned with the legality under IGRA of the payments.

In his letter to the Pokagon tribe, the Secretary noted that the Department had approved 196 tribal compacts to date, but in only a few instances were there tribal payments to states other than for direct expenses that the states incur in the regulation of gaming. He further observed that compacts which provided for such payments usually provided for substantial exclusivity of gaming, to completely prohibit commercial gaming or to cease the payments upon the onset of competition with the authorization of commercial gaming. He emphasized that “[t]he Department has sharply limited the circumstances under which Indian tribes can make direct payments to a State. Otherwise, States effectively would be able to leverage very large payments from the tribes, in derogation of Congress’ intent in 25 U.S.C. 2710(d)(4) of IGRA not to permit States “to impose any tax, fee, charge, or other assessment upon an Indian tribe ... to engage in Class III gaming activities.” Finally, he contrasted the compact with the situation for other tribes in Michigan where the state payments ceased upon the onset of commercial gaming competition. Notwithstanding these reservations, the Secretary determined that it was still in the best interests of the tribe in light of the considerable economic benefits at stake for the

⁶⁷ www.ncsl.org at 5.

⁶⁸ www.michiganinbrief.org at 2.

⁶⁹ www.michiganinbrief.org at 2.

compact to proceed and he ruled that the compact could become effective “by operation of law.”⁷⁰

In 2012, the Secretary of Interior disapproved a compact between the Mashpee Wampanoag tribe and the Commonwealth of Massachusetts, saying that the compact unfairly gave the state too much money and unwarranted authority over tribal matters, threatening the tribe’s sovereignty.⁷¹ The compact was found to violate IGRA by imposing an “excessive” 21.5 percent share of its gross gaming revenue. The amount would be reduced to 15 percent if a resort casino opened in southeastern Massachusetts, but made no allowance for a slot parlor in that region. This 21.5 percentage share was thought to be in contravention of the central premise of IGRA that Indian gaming should primarily benefit tribes.

Compacts may only address matters directly related to gaming. In the case involving the Mashpee tribe, the State was found to have impermissibly included provisions relating to the tribe’s hunting and fishing rights in violation of IGRA. The compact also gave the state regulatory authority over several non-gaming activities including entertainment services, non-gaming amenities, and the construction, maintenance and operation of the facility. The Secretary stated that “Congress expressly sought to prevent states from using gaming compacts to leverage power over sovereign tribes about matters unrelated to gaming.”

Subsequently, in 2014, another compact was considered.⁷² The Secretary did not approve or disapprove the revised compact and the new compact became effective to the extent it was consistent with IGRA. The reluctance to approve the compact stemmed from concerns that the compact could be construed as creating a potential for state regulation of Class II gaming, while IGRA specifically reserved such regulation to the exclusive purview of the tribes and the National Indian Gaming Commission. The revised compact provided for reduced casino revenue sharing of 17 percent, which would be further reduced to 15 percent if a slot parlor opened in southeastern Massachusetts. In the event a commercial casino opened in the region, the tribe would not be obligated to share any of its casino revenue with the state.

Pokagon-South Bend Agreement

The Pokagon Tribe has entered into agreements with the City of South Bend for annual payments of 2 percent of net win to the city in lieu of paying property taxes, with 1 percent going to the Redevelopment Commission and 1 percent going to the city’s general fund. This agreement is projected to generate an annual payment of at least \$1 million. By way of comparison,

⁷⁰ Decision of the Department of Interior on Pokagon-Michigan Compact, Federal Register, Vol 64, No.32, February 18, 1999.

⁷¹ Mashpee Wampanoag Tribe Disapproval Letter, Tribal State Gaming Compact, www.indianaffairs.gov October 12, 2012.

⁷² Federal Register, Vol. 79, No. 22, February 3, 2014. [Mashpee Wampanoag Tribe, Feb 3, 2014 Federal Register Notice, Jan 6, 2014 Deemed Approved Letter, Tribal State Gaming Compact](#)

Ameristar Casino in East Chicago paid \$69.8 million in total taxes in 2015, which amounted to approximately 31 percent of its total win of \$226 million.⁷³

The critical concern is that the tribe will not be required to pay the same or substantially similar percentage of its net win to the state as commercial casinos are under state law. As demonstrated in the Michigan and Massachusetts cases, the Secretary of Interior is not inclined to approve any compact that provides for significant revenue sharing.

By virtue of negotiated revenue sharing in a tribal-state compact, a state derives economic benefits from Indian gaming. Since the Seminole Tribe decision, more states have negotiated to include revenue-sharing provisions in Class III gaming compacts.⁷⁴ In some circumstances, exclusivity in gaming was the economic benefit in favor of the tribe agreeing to some percentage of revenue sharing with the state. Once exclusivity ends and competing commercial casinos come into operation, the revenue sharing payments are usually reduced to avoid being construed as a form of unlawful taxation in violation of IGRA. Compacts will not be approved by the Secretary of Interior if the benefit received by the state exceeds the benefit received by the tribe. Under such circumstances, the compact would violate IGRA because it would amount to an unlawful tax.⁷⁵

Comparing Tax Treatment between Commercial and Pokagon Casinos in Michigan, Indiana

Although there is no compact between the State of Indiana and the Pokagon Band regarding the planned Four Winds South Bend, we believe it is useful to examine the December 20, 2002, compact between the State of Michigan and the Pokagon Band for its Four Winds casino in New Buffalo regarding the payment of various taxes. Pursuant to the agreement, and as shown in the following table, the Pokagon Band is exempt from various taxes with respect to many transactions occurring on tribal lands (which includes the casino property), including corporate income tax, sales tax, use tax, motor fuel tax, and tobacco products tax. The effective gross gaming revenue tax (in the form of revenue sharing) paid by the Pokagon Band in Michigan is made pursuant to a negotiated compact and is significantly lower than what is paid by the commercial casinos. We believe it is reasonable to assume that the Pokagon Band would seek to enter into similar arrangements in Indiana.

⁷³ Karen Caffarini, "Pokagon casino deal puts spotlight on gaming agreements, taxes," *Chicago Tribune*, March 25, 2016. <http://www.chicagotribune.com/suburbs/post-tribune/news/ct-ptb-pokagon-casino-deal-st-0326-20160325-story.html>

⁷⁴ Rand, Kathryn R.L., "Caught In The Middle: How State Politics, State Law, And State Courts Constrain Tribal Influence Over Indian Gaming," 90 *Marquette Law Review*, 971, 986 (2007).

⁷⁵ *Id.* at 986.

Figure 25: Comparison of taxes paid by Michigan commercial casinos, Four Winds New Buffalo casino

	Michigan Commercial - Actual	Four Winds New Buffalo - Actual
Casino revenue tax/revenue share	24% - both slots and live tables	8% on slots, 0% on live table games
Corporate income tax	4.95%, plus modified gross receipts tax of 0.8%	None
Sales tax*	6.0%	6% for sales to non-tribal members 0% for sales to tribal members
Use tax**	6.0%	6% for sales to non-tribal members 0% for sales to tribal members
Motor fuel tax	\$0.19/gallon gasoline \$0.15/gallon diesel	None
Property tax	No exemption	No exemption
Tobacco products tax***	\$1.25 per pack of cigarettes	None

Source: Michigan Department of Treasury, Michigan Gaming Control Board, Tax Agreement between the Pokagon Band of Potawatomi Indians and the State of Michigan (December 20, 2002), Spectrum research.

*** Sales Tax:** Individuals or businesses that sell tangible personal property to the final consumer are required to remit a 6 percent sales tax on the total price (including shipping and handling charges) of their taxable retail sales to the State of Michigan. Pursuant to the tax agreement, the Pokagon tribe is exempt from paying sales tax on purchases made on tribal lands for the tribe's exclusive use. In addition, the Tribe does not have to charge sales tax on items sold on tribal lands to tribal members. Sales tax is collected on sales to non-tribal members at the 6 percent rate.

**** Use Tax:** Use tax is a companion tax to sales tax. Use tax of 6 percent must be paid to the State of Michigan on the total price (including shipping and handling charges) of all taxable items brought into Michigan or purchases through the internet, by mail or by phone from out-of-state retailers that do not collect and remit sales or use tax from their customers. Credit is given for tax paid to another state.

***** Tobacco Tax:** The tobacco tax is a tax imposed upon the consumer of tobacco products at the time of purchase. The Pokagon Tribe does not have to charge this tax to its customers.

Now looking at the comparison in Indiana, the following table projects the actual and potential differences in taxes between commercial casinos and the Pokagon Band for its planned Four Winds South Bend casino. If the tribe were to seek Class III status for its Indiana casino, the actual tax rates to be paid by the tribe would be subject to a negotiated compact and negotiated tax agreements, in the same fashion as occurred in Michigan.

Figure 26: Comparison of taxes paid by Indiana commercial casinos, actual/potential taxes to be paid by Four Winds South Bend casino

	Indiana Commercial - Actual	Four Winds South Bend - Assumed
Casino revenue tax/revenue share	Graduated rate on gross gaming revenue (slots and live table games) for riverboat casinos: <ul style="list-style-type: none"> • 15% up to \$25M • 20% on \$25M-\$50M • 25% on \$50M-\$75M • 30% on \$75M-\$150M • 35% on \$150M-\$600M • 40% on over \$600M Graduated rate on gross gaming revenue (slots only; live table games are not permitted) for racetrack casinos: <ul style="list-style-type: none"> • 25% up to \$100M • 30% on \$100M-\$200M • 35% on over \$200M 	0% on slots or live table games
Riverboat casino admission tax	\$3 per admission	None
Corporate income tax	6.25%	None
Sales tax*	7%	7% for sales to non-tribal members 0% for sales to tribal members
Use tax*	7%	7% for sales to non-tribal members 0% for sales to tribal members
Gasoline tax	\$0.18/gallon	None
Property tax	No exemption	2% of net win [actual**]
Tobacco products tax	20-pack cigarettes: \$0.995 25-pack cigarettes: \$1.24375 Other tobacco products: 24 percent wholesale price of tobacco products other than moist snuff; for moist snuff, 40 cents per ounce	None
Utility service tax	1.4%	None

Source: Indiana Gaming Commission, TaxRates.com, Indiana Department of Revenue, Tax Foundation, Spectrum research.

* Both the sales tax and use tax rates are 7%. Use tax is due on property brought into Indiana for use, storage or consumption, unless the Indiana Code (IC 6-2.5-5) contains an applicable exemption for the purchase. If the purchaser paid at least 7% sales tax at the time of purchase there is no use tax due.

** On March 24, 2016, the Pokagon tribe announced two agreements with city of South Bend. The first agreement will enable the city to provide sewer and water services to the Pokagon casino site. Under the agreement, the Pokagon Tribe will pay \$400,000 to help South Bend replace and upgrade the Calvert Street Lift Station. The second agreement stipulates that, in lieu of property taxes, the Pokagon Tribe will pay 2 percent of the casino's annual net win to the city government. The annual payments will not be less than \$1 million if the casino has between 850 and 1,699 games and will not be less than \$2 million if the casino has 1,700 or more games.

Class II vs. Class III Gaming

A central pillar of our report is that Indiana's commercial gaming industry faces a serious threat from either Class II or Class III tribal gaming within the state. Indian gaming has had

significant positive economic benefits for the tribes in other states. However, cost-benefit studies conducted in other states, such as Wisconsin, have shown that Indian casinos can cost the state direct tax revenue.⁷⁶ There is a real potential for the Pokagon Tribe to pay a much smaller percentage of its net win than required for the commercial casinos in the state. In addition, the amount of revenue paid to the state by the commercial casinos will likely be reduced due to a reduction in gaming revenue stemming from this increased competition of Indian gaming.

With that in mind, as Indiana confronts the prospect of tribal gaming within its borders, a full understanding of the different classes of Indian gaming is required. The following definition is provided by the National Indian Gaming Commission:⁷⁷

- **Class I** gaming is defined as traditional and social Indian gaming for minimal prizes. Regulatory authority over Class I gaming is vested exclusively in tribal governments.
- **Class II** gaming is defined as the game of chance commonly known as bingo (whether or not electronic, computer, or other technological aids are used in connection therewith) and, played in the same location as bingo, pull-tabs, punchboards, tip jars, instant bingo and other games similar to bingo. Class II gaming also includes non-banked card games, that is, games that are played exclusively against other players rather than against the house or a player acting as a bank. IGRA specifically excludes slot machines or electronic facsimiles of any game of chance from the definition of Class II games. Tribes retain their authority to conduct, license and regulate Class II gaming so long as the state in which the tribe is located permits such gaming for any purpose and the tribal government adopts a gaming ordinance approved by the National Indian Gaming Commission (NIGC). Tribal governments are responsible for regulating Class II gaming with Commission oversight.
- **Class III** gaming is defined as all forms of gaming that are neither Class I nor II. Games commonly played in casinos, such as slot machines, blackjack, craps, and roulette fall in the Class III category, as well as wagering games and electronic facsimiles of any games of chance. Generally, Class III gaming is often referred to as full-scale casino-style gaming.

The key words “electronic, computer, or other technological aid” with respect to Class II have been instrumental in the growth of Class II gaming, and have led to confusion as well as unintended consequences. This effect was summarized well in commentary by former NIGC Chairman Phil Hogen:

⁷⁶ Id. at 987, citing Wisconsin Policy Research Institute, Gambling.

⁷⁷ “Budget Justifications Fiscal Year 2009,” National Indian Gaming Commission, US Department of the Interior, p. 5.
https://www.doi.gov/sites/doi.gov/files/migrated/budget/appropriations/2009/upload/FY2009_NIGC_Greenbook.pdf

The Indian Gaming Regulatory Act (IGRA) has been a marvelous instrument that much of Indian Country has used to great advantage to bring economic development where it was desperately needed. Some of the genius of the Act lies in its clarity, and some lies in its imprecision. Altogether it has worked better than anything that has preceded it, however, it is not without shortcomings.

Lacking a crystal ball, Congress did not know what technology would bring to the gaming world when it passed IGRA in 1988. It did know, however, that there would be technological advances, and it wanted to assure that tribes could take advantage of those. When you examine the legislative history of IGRA, it becomes clear that Congress envisioned two types of gaming-bingo, which in 1988 tribes were conducting quite successfully, and “casino” gaming, which had not yet come to Indian Country. Casino gaming, Congress said, required a tribal-state compact. Bingo, and the other limited gaming Congress placed in Class II, tribes could offer so long as the state each was in didn’t prohibit such gaming for everyone.

And therein is where imprecise language in IGRA has become most problematic. While compacted Class III gaming was the catch-all category (everything not Class I or II), Congress specifically said that a compact was required for “slot machines of any kind” and for “facsimiles of any game of chance.” Yet Congress also said that Class II games such as bingo could be played with “electronic and technologic aids.” Both terms can be read broadly, and when one does so, they overlap, and drawing a point of distinction is very challenging. While federal courts have addressed a couple of devices they deemed to qualify as permissible Class II technologic aids, in the years since those decisions were made, technology has moved well beyond the rather primitive models those courts considered. It may well be that if it is not already here, the time will come when it will be necessary for Congress to clarify where that line of separation is.⁷⁸

With that level of confusion in mind, this chapter examines differences between Class II and Class III games from a practical perspective. While the research to follow will show the differences in Class II and Class III games, we believe the biggest differentiator will come down to the marketing environment for the planned Four Winds South Bend.

Differences between Class II and Class III Games

The key systemic difference between the two classes of games is that a Class II slot machine is connected to a centralized computer system network that determines the outcome of each wager and the payoff system. Class II game payoffs are a descendant of bingo payouts and are funded by other players, as more than one player must be playing on the network. Class III slot machines are considered traditional slots and are played most major gaming markets around the country. The outcome and payouts are determined by a random number generator in each game. With Class III games, the player’s chances of winning are the same each spin.

⁷⁸ A.J. Naff, “Seeking Clarity: What Exactly is Class II Gaming?” *Indian Gaming Magazine*.
<http://www.indiangaming.com/regulatory/view/?id=43> (accessed August 19, 2016)

Another way to view the differences is that with Class III games patrons are betting against the house; with Class II games patrons are wagering for a share of the money other players are betting.

A key question: Is there an observable difference by players between Class III and Class II slot machines? The answers: “yes” for video poker but “not much” for regular slots. Most Class III video poker players play by their understanding of the pay tables for each machine, which gives them expected payouts for the winning combinations. Class III video poker games are also considered skill games. The players are able to judge their expected payout on a Class III video poker game and use skill to also improve their expected return. On the other hand, Class II video poker games, while behaving as a poker game in some general respects, still are based on the bingo prize platform. This alters basic poker combinations payouts as generated by Class III video poker games. On a Class II video poker game players cannot judge their expected payout because the game is no longer a skill game.

That core question then becomes: Given the different technology used by both systems for payouts, is there an observable difference in the way the Class II and Class III slots are perceived by players? Aside from that difference on video poker games, “when playing either Class II or Class III regular slots, you’re getting a random game, but the route to randomness is different.”⁷⁹

How have Class II and Class III performed in the real world? A few years ago, more manufacturers began to receive performance feedback that noted the win per unit results for Class II games was comparable to that of their Class III offerings. Tribal casinos began responding with new machine orders. As *Global Gaming Business* reported, “At one point, Wisconsin had been 100% Class III games. Numerous Class II games were placed in the Dejope casino (in Madison) and they are performing as good as or higher than the Class III games. That’s causing a lot of attention from the other tribes in the state, who now realize they can get the Class II benefits and still have performance very competitive to Class III.”⁸⁰

Oklahoma provides another good window into the difference between Class II and Class III. The Oklahoma region generates about \$4 billion in gaming revenue annually from 130 properties.⁸¹ Oklahoma opened as a Class II market, and has been open for Class III gaming since 2006. Our research in Oklahoma, including interviews with operators in that market, indicates:

- The majority of high-worth Oklahoma patrons play Class II machines.

⁷⁹ “John Grochowski, “Comparing Class II and Class III Slot Machines at Casinos,” *Casino City Times*, May 21, 2014. <http://grochowski.casinocitytimes.com/article/class-i-ii-and-iii-slot-machines-63245>

⁸⁰ Frank Legato, “Class II Revival,” *Global Gaming Business Magazine*, January 2011. <http://ggbmagazine.com/issue/vol-10-no-1-january-2011/article/class-ii-revival>

⁸¹ National Indian Gaming Commission, 2014 GGR Gaming Revenue by Region.

- Class II games typically occupy 25 percent to 35 percent of the gaming floor footprint in Oklahoma casinos and yet generate more than half of the total play volume.
- Class II slots – which are not subject to tax or revenue-sharing – typically have payout rates of more than 95 percent, whereas Class III slot pay out in the range of 91 percent to 92 percent. The prevalence of Class II games that have a lower “hold” (the inverse of payout percentage) places considerable downward pressure on slot profitability.

Slot Manufacturers Pursue both Class II, Class III Games

In recent years, larger slot manufacturers have made significant inroads into Class II markets. The recent trend among the larger slot providers has been to acquire Class II manufacturers and their titles to deploy more Class II games.

Chris Provence, a senior executive formerly with Cherokee Nation Entertainment and now a consultant operating in Oklahoma as well as other commercial and tribal markets, told Spectrum⁸² that the market is moving rapidly to blur the lines between the two classes of slot machines. A key example of this phenomenon is the number of acquisitions made by larger manufacturers in recent years: the Aristocrat acquisition of VGT in 2014 and the Ainsworth acquisition of Nova Technologies in 2015. In both scenarios, incumbent Class III manufacturers have acquired Class II platforms that allow their titles to be deployed in any jurisdiction. The strategically positioned suppliers will be able to navigate business conditions like those presented by Four Winds South Bend by having the ability to offer either or both Class II or Class III games.

Based on the timing for construction and opening of the Four Winds South Bend in 2018, any gaps between the perceived content quality and game experiences of Class II and Class III should be drastically reduced, and there will be a critical mass of new content available.

In examining the marketing considerations between Class II and Class II, we determined that the differences between the two types of games are grounded more in perception than reality. Class II games should not be considered as some lesser equivalents to Class III games. The marketing environment will be the differentiator for close-in competition, assuming comparable facilities between the competitors. However, as noted throughout this report, the Class II facilities or games will have a significant advantage in free play and payout percentages due to the lack of gaming-tax obligation.

In a discussion with Tony Celona,⁸³ we were able to gain more background from a seasoned operator in both the Class II and Class III environments. Celona has been in slot operations and slot marketing since the inception of gaming in Atlantic City, and he has held

⁸² Discussions/research with Chris Provence, August 18, 2016

⁸³ Interview with Tony Celona, August 8, 2016.

senior positions at gaming properties throughout the Northeast, including having worked in both tribal and commercial properties. Among Celona's key points:

- "When observing the playing of both Class II and Class III machines, they're both vaguely similar in that you stick money in, whack the button, and maybe get some money back. My subjective observations say that Class II behaves quite differently as the number of other players changes; sometimes better, sometimes not."
- Celona notes that the biggest difference is the marketing environment, effectively the ability to send offers: "Assuming that the property of the Class II is similar or equal to the Class III, if players receive offers of better (higher) value and the Class II property is in comfortable travel time as to the Class III property, then the better offer wins."
- Celona offers the following opinion, which is of critical relevance to Indiana: "I would not be discouraged at all to put Class II property in a Class III market especially if my property has a marketing advantage." According to Celona, these marketing advantages include lower effective tax rates, which allow for the added benefit of being able to make more attractive promotional offerings to players, while allowing for lower hold percentages on slots.

Conclusion

A non-compacted, Class II tribal casino in Indiana would not be constrained by the Indiana gaming tax rate, and thus could redirect a considerable portion of those savings toward attracting and retaining players. We believe that the non-compacted property would take that strategic approach. That considered, the question for Indiana casinos is whether or not a compacted Indiana casino would be constrained in its ability to respond with player reinvestment strategies of its own.

The answer to that type of question cannot be provided here, but would be the result of negotiations between the state and the Pokagon tribe, and we note again that the State's leverage in securing concessions from the tribe is limited, in that the state cannot offer the tribe much in return, particularly in the area of exclusivity.

About This Report

This report was prepared by Spectrum Gaming Group, an independent research and professional services firm founded in 1993 that serves private- and public-sector clients worldwide. Our principals have backgrounds in operations, economic analysis, law enforcement, regulation and journalism.

Spectrum holds no beneficial interest in any casino operating companies or gaming equipment manufacturers or suppliers. We employ only senior-level executives and associates who have earned reputations for honesty, integrity and the highest standards of professional conduct. Our work is never influenced by the interests of past or potentially future clients.

Each Spectrum project is customized to our client's specific requirements and developed from the ground up. Our findings, conclusions and recommendations are based solely on our research, analysis and experience. Our mandate is not to tell clients what they want to hear; we tell them what they need to know. We will not accept, and have never accepted, engagements that seek a preferred result.

Our public-sector clients have included state and nation governments, and our private-sector clients have included numerous casino companies, gaming associations, financial institutions, law firms, developers and other gaming-related entities. In addition, our principals have testified before the following government bodies:

- British Columbia Lottery Corporation
- Florida House Select Committee on Gaming
- Florida Senate Gaming Committee
- Georgia Joint Committee on Economic Development and Tourism
- Illinois Gaming Board
- Indiana Gaming Study Commission
- Indiana Horse Racing Commission
- International Tribunal, The Hague
- Iowa Racing and Gaming Commission
- Louisiana House and Senate Joint Criminal Justice Committee
- Massachusetts Gaming Commission
- Massachusetts Joint Committee on Bonding, Capital Expenditures, and State Assets
- National Gambling Impact Study Commission
- New Hampshire Gaming Study Commission
- New Jersey Assembly Tourism and Gaming Committee
- New Jersey Assembly Regulatory Oversight and Gaming Committee
- New Jersey Senate Legislative Oversight Committee
- New Jersey Senate Wagering, Tourism & Historic Preservation Committee
- Ohio House Economic Development Committee
- Ohio Senate Oversight Committee

- Pennsylvania House Gaming Oversight Committee
- Pennsylvania Gaming Control Board
- Puerto Rico Racing Board
- US House Congressional Gaming Caucus
- US Senate Indian Affairs Committee
- US Senate Select Committee on Indian Gaming
- US Senate Subcommittee on Organized Crime
- Washington State Gambling Commission
- World Bank, Washington, DC

Disclaimer

Spectrum Gaming Group (“Spectrum,” “we” or “our”) has made every reasonable effort to ensure that the data and information contained in this study reflect the most accurate and timely information possible. The data are believed to be generally reliable. This study is based on estimates, assumptions, and other information developed by Spectrum from its independent research effort, general knowledge of the gaming industry, and consultations with the Client and its representatives. Spectrum shall not be responsible for any inaccuracies in reporting by the Client or its agents and representatives, or any other data source used in preparing or presenting this study. The data presented in this study were collected through the cover date of this report. Spectrum has not undertaken any effort to update this information since this time.

Some significant factors that are unquantifiable and unpredictable – including, but not limited to, economic, governmental, managerial and regulatory changes; and acts of nature – are qualitative by nature, and cannot be readily used in any quantitative projections.

No warranty or representation is made by Spectrum that any of the projected values or results contained in this study will actually be achieved. We shall not be responsible for any deviations in the project’s actual performance from any predictions, estimates, or conclusions contained in this study.

Possession of this study does not carry with it the right of publication thereof, or the right to use the name of Spectrum in any manner without first obtaining the prior written consent of Spectrum. No abstracting, excerpting, or summarizing of this study may be made without first obtaining the prior written consent of Spectrum.

This study may not be used in conjunction with any public or private offering of securities or other similar purpose where it may be relied upon to any degree by any person other than the Client, without first obtaining the prior written consent of Spectrum. This study may not be used for any purpose other than that for which it is prepared or for which prior written consent has first been obtained from Spectrum.

This study is qualified in its entirety by, and should be considered in light of, these limitations, conditions and considerations.

Appendix I: Methodology and Assumptions for Revenue Projections

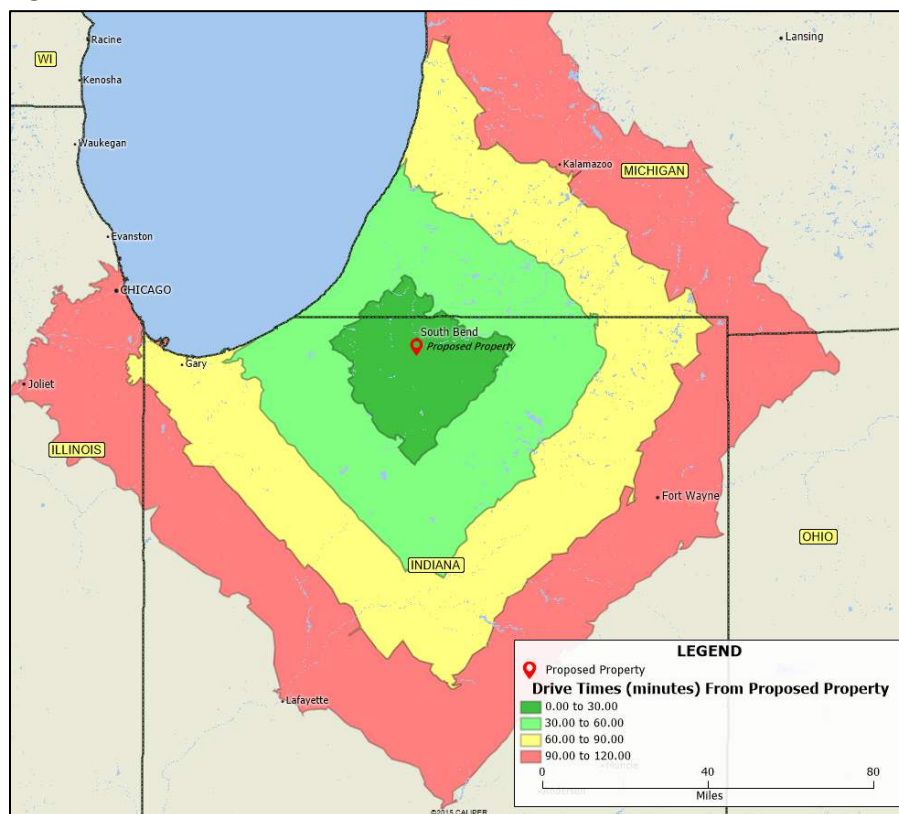
In any forecasting exercise it is critical to understand the methodology, data and assumptions that are the foundation of the analysis.

For this analysis, Spectrum calibrated data beginning in 2018, which assumes an approximate 18- to 24-month build out from our report date of 2016. The data reviewed covers 650 unique ZIP Code areas in four states (Indiana, Michigan, Illinois and Ohio) that are relevant to the assessing the impact of Four Winds South Bend. These areas include all areas within a reasonable two-hour drive of the planned site in South Bend. The data included population data (both total and estimated for gaming-age adults, those aged 21+), wages, and household income (to adjust relative estimated gaming revenue budgets accordingly). We obtained data from the following sources:

- US Census
- US Bureau of Labor Statistics
- Maptitude 2016
- Missouri Census Data Center, a national partner in the US Census Bureau's State Data Center program since 1979
- UVA-Weldon Cooper Center Demographics & Workforce Group
- MPMileCharter Mileage Computation add-in for Maptitude

The following map shows the areas studied based on driving times from the planned Four Winds South Bend:

Figure 27: Drive-time bands from Four Winds South Bend



Sources: Spectrum Analytics, Maptitude 2016

The macro and micro economic environments are important to view in conjunction with a gravity-model analysis. The impact of the economy on consumers ultimately determines their discretionary income and then what is left over for casino gambling.

Population

Through 2020, the US population is expected to grow from 322 million in 2015 at a rate of slightly less than a 1 percent compounded annualized rate to 336 million. The following table shows the population trend for Indiana, for each relevant surrounding state, and nationally. For 2010-2015, Indiana grew at similar rate to US average and faster than surrounding states as the region grew but about half as fast as rest of US average. For the 2015-2020 period, Indiana is expected to grow at less than a 1 percent compounded annualized which is consistent with the US average. The surrounding states are expected to grow but more slowly than Indiana and the rest of US average.

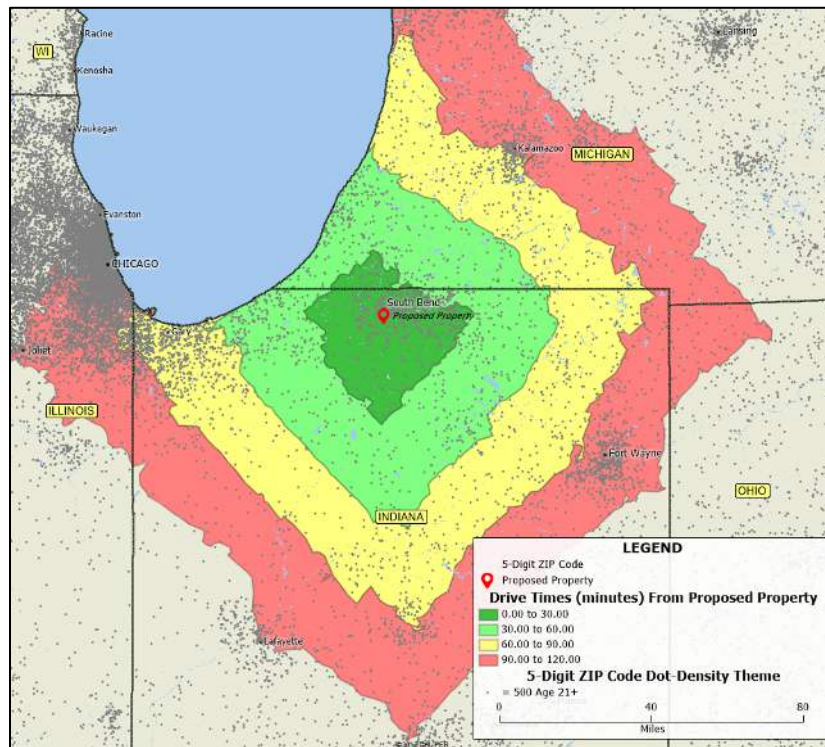
Figure 28: Population levels and projected growth by state, 2010-2030

	Total Population (Millions)				Annual Growth		
	2010	2015	2020	2030	2015 vs 2010	2020 vs 2015	2030 vs 2020
Indiana	6.6	6.8	7.1	7.3	0.5%	0.8%	0.3%
Michigan	9.9	10.0	10.1	10.2	0.2%	0.2%	0.1%
Illinois	12.8	13.1	13.3	13.7	0.3%	0.3%	0.3%
Ohio	11.5	11.6	11.8	11.9	0.2%	0.2%	0.2%
United States	308.7	322.4	335.6	361.0	0.9%	0.8%	0.7%

Source: US Census, UVA-Weldon Cooper Center for Public Service, Demographics/Workforce Group, Spectrum Analytics

The following map takes the previous drive-time chart and adds population density for gaming-age adults (21+). The population is represented by the dot-density symbols in gray (i.e., each dot on the chart represents 500 gaming-age adults). While there is some population base around South Bend and to the east, the larger population clusters are observed in the 90- to 120-minute drive zone in areas of Chicago (northwest of South Bend) and Grand Rapids (northeast of South Bend). These two areas also have significant existing competition and when coupled with the distance factor of being on the outer two-hour band, neither are likely to be significant markets for the Four Winds South Bend.

Figure 29: Drive-time bands from Four Winds South Bend and population density



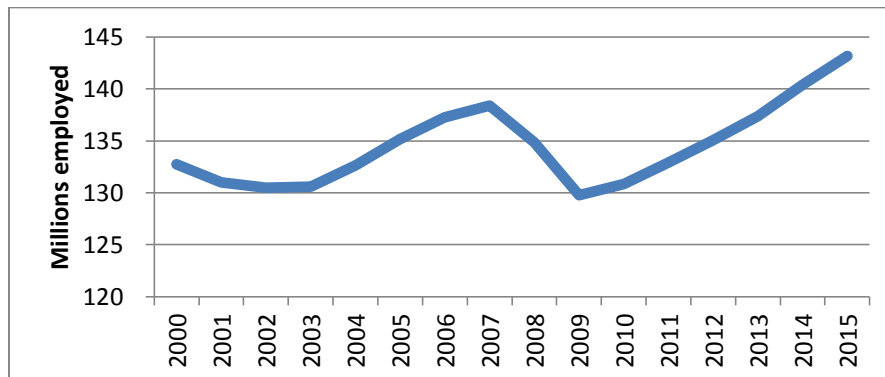
Source: Spectrum Gaming Group, Maptitude 2016

After examining population, the next step is to project reasonable growth rates of employment and wages.

Employment/Wages

In order to gain a better understanding of the region's economy, we analyzed historical employment and wage levels for the area. In the following chart, the national non-farm employment data shows a recovery to levels above those before the 2008 Great Recession.

Figure 30: National employment trends (non-farm)



Source: US Bureau of Labor Statistics

While it is important to note the national trends, the trends closer to home carry greater weight in our modeling. Our regional employment analysis trends back to 2010 as a base, however, we utilize multiple curves of compounded annual growth rates for five-year and three-year periods to understand the more relevant trends in the recent data. Based on the data of employment trends in the four-state region, the three-year compounded growth has declined slightly in the relevant surrounding states. Indiana had second-highest rates of growth in the range only to Michigan. Excluding Michigan, the states that support the Indiana gaming markets exhibit a slower employment growth as the nation as a whole.

Figure 31: Region and national employment, 2010-2015

Year	IN	% Chg	IL	% Chg	MI	% Chg	OH	% Chg	US	% Chg
2010	2.7		5.5		3.8		4.9		127.8	
2011	2.8	2%	5.6	1%	3.9	2%	5.0	1%	129.4	1%
2012	2.8	2%	5.6	1%	3.9	2%	5.0	2%	131.7	2%
2013	2.8	1%	5.7	1%	4.0	2%	5.1	1%	134.0	2%
2014	2.9	1%	5.8	1%	4.1	2%	5.2	1%	136.6	2%
2015	2.9	2%	5.8	2%	4.2	2%	5.3	1%	139.5	2%
5-Year Compound Annual Growth Rate (2010-2015)										
	1.7%		1.2%		2.0%		1.4%		1.8%	
3-Year Compound Annual Growth Rate (2012-2015)										
	1.5%		1.2%		1.9%		1.4%		1.9%	

Source: US Bureau of Labor Statistics

While employment is an important factor to gauge an economy's health, overall wages (and more importantly growth in wages) are also important. The national measure of projecting wages generally uses inflation as a proxy. The US Congressional Budget Office projects that inflationary growth (as measured by the Consumer Price Index) will amount to an annual average growth rate of 2% for 2018 through 2020. Additionally, in their Budget and Economic Outlook 2015-2025, the US Congressional Budget Office projects inflation at 2.0 percent annually.⁸⁴

Figure 32: National Consumer Price Index growth rates

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Change	-0.2%	2.5%	1.3%	1.2%	1.1%	1.3%	1.7%	1.9%	2.0%	2.0%	2.0%	2.0%
Cumulative Change	0.8%	3.3%	4.6%	5.7%	6.9%	8.2%	9.9%	11.8%	13.8%	15.7%	17.7%	19.6%

Source: Bureau of Labor Statistics

Over the past five years workers in Indiana have the lowest wages among the relevant border states. Workers in Indiana have seen their average weekly pay grow by at a rate that is more slowly than the national average and as compared to the relevant border states. St. Joseph County, the closest county to the Four Winds South Bend, has lower wages and slower growth than the state of Indiana and the region as well.

Figure 33: Average weekly wages for Indiana, relevant border states and US, 2010-2015

Year	IN	IL	MI	OH	US	St. Joseph County, IN
2010	\$755	\$952	\$855	\$804	\$899	\$733
2011	\$774	\$978	\$881	\$826	\$924	\$744
2012	\$793	\$1,004	\$898	\$851	\$948	\$763
2013	\$801	\$1,011	\$906	\$859	\$958	\$763
2014	\$818	\$1,040	\$932	\$885	\$988	\$779
2015	\$844	\$1,077	\$963	\$907	\$1,018	\$804
5 Year Compound Annual Growth Rate (2010-2015)						
	2.3%	2.5%	2.4%	2.4%	2.5%	1.9%
3 Year Compound Annual Growth Rate (2012-2015)						
	2.1%	2.4%	2.4%	2.1%	2.4%	1.8%

Source: Bureau of Labor Statistics, Quarterly Census of Employment and Wages

Additional Economic Factors

In addition to population, employment and wages there are other metrics to gauge the ability of consumers to generate discretionary income (which ultimately translates to their casino gaming budget). One of the more relevant data sets relative to discretionary income is the price of gasoline. The majority of gaming markets are dependent upon day-trippers; therefore gas prices are an important factor. A recent publication on the issue stated, "In the short term, lower oil prices are an unambiguous good for the US economy. Each 10-cent decline in gas prices

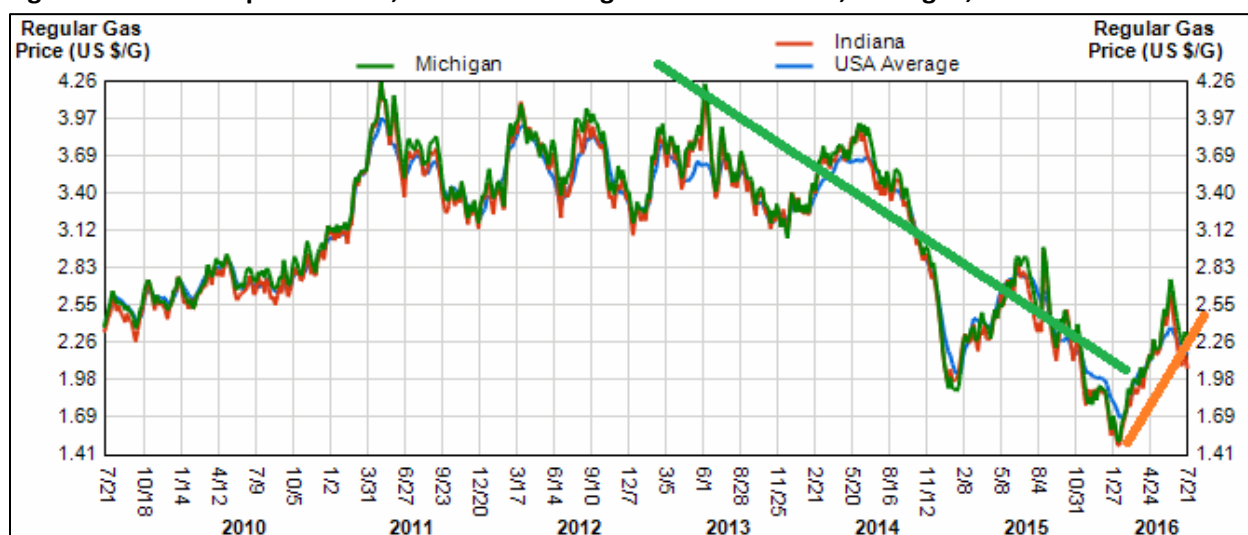
⁸⁴ Congressional Budget Office, Budget and Economic Outlook: 2015-2025.

equates to about an additional \$120 per year in consumers' pockets."⁸⁵ A drop in gas prices is a significant boost to the economy as lower-income households are particularly sensitive to changes in energy prices.⁸⁶

Essentially, lower oil prices in the short-term equate to lower household operating costs and provide a tax-free boost to disposable income, which generally tends to be spent rather than saved. That said, when energy prices remain depressed for long periods, the regional economies built on exploration, production, transport and other industry services become more sensitive to price pressures and economic impact can be adverse.

We track prices of regular gas around the US for our gaming clients to show general trends in gas prices. The data in the following table shows a general decline from 2011 through mid-June 2013. Beginning June 2014, there is a much faster and steeper decline from \$3.40 per gallon to the rate in December 2015 of around \$1.50 per gallon. Since January 2016, gas prices had risen slightly, but most recently, have started a decline, as of July 2016.

Figure 34: Gasoline price trends, 84-month average retail for Indiana, Michigan, US



Source: GasBuddy

Overall, the economic environment presents a combination of a flat to mildly growing population, generally rising employment and wages and the additional benefit of lower gasoline prices. For purposes of our analysis we will project that the South Bend region will see combined

⁸⁵ Brad McMillan, "What Falling Oil Prices Mean for The U.S. Economy," Seeking Alpha, October 15, 2014. <http://seekingalpha.com/article/2564505-what-falling-oil-prices-mean-for-the-u-s-economy>

⁸⁶ Nick Timiraos, "Lower Gas Prices: How Big a Boost for the Economy?" *The Wall Street Journal*, December 1, 2014. <http://blogs.wsj.com/economics/2014/12/01/lower-gas-prices-how-big-a-boost-for-the-economy/>

organic population and income growth of 2.5 percent annually between 2018 and 2019 and trailing to 2 percent in 2020 and beyond.

Regional Populations

In our experience, the gaming participation rate is higher for adults living closer to a casino (or casinos) compared to adults living further away from a casino. According to Harrah's research issued in 2006,⁸⁷ which we have found to be reliable, consistent and still relevant, the largest casino feeder markets all had gaming participation rates as high as 34 percent while the national average gaming participation rate was 25 percent.

This casino participation rate is supported by additional studies. For example, In February 2011, Richard Stockton College of New Jersey (now known as Stockton University), in conjunction with Zogby International, surveyed 3,003 individuals residing in the Northeast US. Of the 16 designated market areas ("DMA") that were surveyed, casino participation for the DMA within locations with gaming close by was between 35 percent and 40 percent and even reached upwards of 50 percent.⁸⁸ We do not believe these percentages would have decreased since either of the studies were performed.

With this in mind, we have a high degree of confidence that, when adjusted for regional tendencies in markets, players who reside near a casino (or multiple casinos) are more likely to gamble than those players who live further away. This leads us to a reasonable conclusion that the participation has increased as the number of casino properties and states providing casino gaming options grew throughout the country.

This leads us to a reasonable conclusion the higher rate (premium) rate of 34 percent in 2006 would increase to 43 percent in 2013 just as the overall participation rate and the number of properties and states providing casino gaming options throughout the country increased.

⁸⁷ Harrah's Entertainment, "Harrah's Survey: Profile of the American Casino Gambler, 2006."
https://www.caesars.com/images/PDFs/Profile_Survey_2006.pdf

⁸⁸ Lloyd D. Levenson Institute for Gaming, Hospitality and Tourism, "2011 Tourism Promotion Survey: Comparing Casino and General Recreational Travel," Richard Stockton College, pg. 5.
https://intraweb.stockton.edu/eyos/business/content/docs/LIGHT/Hosp_tour_surveybroch11.pdf

Figure 35: Adult population gaming participation based on proximity to property

Year	% that gambled in casino	35% premium for those living closer
2013	32%	43%
2012	27%	36%
2011	31%	42%
2010	28%	38%
2009	25%	34%
2008	28%	38%
2007	25%	34%
2006	25%	34%
Recent 5-year average	29%	39%
Recent 3-year average	30%	41%

Source: Spectrum Gaming Group, American Gaming Associations, State of States reports; Harrah's Survey: 2006, Harrah's Entertainment

Based on the national average adult casino gaming participation rates and our research, we project a fair range for the gaming participation rate for adults living near casinos is upward of 40 percent – and in some select cases higher. This rate also likely grows higher as the length of time the population is exposed to gaming increases.

Gravity Model Interpretations

Gravity modeling is the most reliable and commonly used method for estimating the demand and competitive impact of casinos in a specific market area. It is based on a modified version of Newton's Law of Gravitation. As summarized by one author, "In 1931, William J. Reilly was inspired by the law of gravity to create an application of the gravity model to measure retail trade between two cities. Reilly realized that the larger a city the larger a trade area it would have and thus it would draw from a larger hinterland around the city," adding that the boundary between two trade areas is often deemed the breaking point (BP), as that line represents the point at which half the population shops at either of the two cities.⁸⁹

The popularity of gaming gravity models has been growing as more data (the inputs) such as number of gaming machines and tables, hotel rooms, showrooms, food and beverage outlets, retail, spas and others are easily identifiable.

Reilly's Law of Retail Gravitation assumes the geography of a defined area is without impediment. Others economists have since modified this precept and identified factors such as geography and road quality that can materially influence convenience and the subsequent purchase decisions by consumers. This is especially true when the products are similar in size, quality, and product offerings. Numerous modeling academics/scholars have taken Reilly's law and developed many variations, extensions and applications. These include the "Huff" model,

⁸⁹ Matt Rosenberg, "Reilly's Law of Retail Gravitation," Geography.com.
<http://geography.about.com/cs/citiesurbangeo/a/aa041403a.htm> (accessed July 22, 2016)

which allows for multiple attributes such as attractiveness, and Converse's "Breaking Point" formula, which helps measure the distance of competitive pull in overlapping markets.⁹⁰ We use a collection of the above modifications to the basic gravity model to better estimate a casino's ability to attract patrons and spending by the different markets.

National Figures to Derive Annual Personal Gaming Budget

When calculating the annual gaming budget per adult, the basis for the material assumptions are from extensive experience and working knowledge in many domestic gaming markets by Spectrum professionals assigned to this project, supported by public data presented within this report (where applicable).

From earlier sections of this report, the estimated US population in 2015 was approximately 322 million with an adult (>21) population is 73 percent, or 236 million.⁹¹ Based on American Gaming Association⁹² research, 34 percent of adults visited a casino while 32 percent say they actually gambled, which equates to a US Adult Gaming Population of 76 million. When those are all considered relative to an average household income of \$53,482 and a per capita income for gaming aged persons of \$27,749, we estimated average annual personal gaming budget of \$952.

With the annual personal gaming budget established, we next prepare a forecast for the total market surrounding South Bend and then a gravity model which accounts for competition within the market for the planned Four Winds South Bend.

Non-Gaming Revenue Projections

To develop our projections of non-gaming revenue for Indiana commercial casinos in Chapter II, Spectrum looked to other jurisdictions where such data are published. Nevada figures are dominated by the Las Vegas Strip, which is a clear outlier and not particularly relevant to our analysis in this report. However, data from other areas in Nevada are more appropriate to the regional casinos around country and in Indiana.

Figures from the Boulder Strip area of Nevada are more representative of the regional casino revenue mix in that the properties have large gaming floors, relatively small hotel room counts with large complexes of multiple restaurant and beverage outlets. Since 2005 Boulder Strip casinos have attained between 25 percent and 30 percent of their total revenue from non-

⁹⁰ Steven J. Anderson, John X. Volker and Michael D. Phillips, "Converse's Breaking-Point Model Revised," *Journal of Management and Marketing Research*,. <http://www.aabri.com/manuscripts/09219.pdf> (accessed July 22, 2016)

⁹¹ US Census data. <http://www.census.gov/quickfacts/table/PST045214/00> (accessed July 22, 2016)

⁹² American Gaming Association, "2013 State of the States." https://www.americangaming.org/sites/default/files/research_files/aga_sos2013_rev042014.pdf

gaming sources. The following table shows the recent trends and also each department's revenue contribution as a percentage of GGR.

Figure 36: Boulder Strip, Nevada, casinos – percentage of total revenue by department

	GGR	Hotel	Food	Bev	Other	Total Non-Gaming
1986	67%	3%	13%	7%	10%	33%
1990	68%	3%	15%	6%	9%	32%
2000	73%	5%	14%	5%	4%	27%
2005	75%	6%	11%	4%	4%	25%
2010	70%	6%	14%	5%	5%	30%
2015	70%	7%	14%	4%	4%	30%
As percent of GGR* (avg. 2005-2015)		9%	18%	7%	6%	

Source: UNLV Center for Gaming Research

As another source of gaming vs. non-gaming revenue contributions, we used information from the Mississippi Gaming & Hospitality Association. In 2015, Mississippi casinos generated \$2.9 billion in total revenue, with nearly \$800 million or 26 percent, generated from non-gaming departments. Regionally the ratio of gaming versus non-gaming revenue broke down as follows: Gulf Coast 70/30, Central 80/20, North 75/25.⁹³

We used the Nevada and Mississippi non-gaming data to form the basis for our non-gaming revenue projections in Indiana.

⁹³ Mississippi Gaming & Hospitality Association, 2016 Annual Report.
<http://www.msgaming.org/documents/MSGaming2016.pdf>

Appendix II: Methodology and Assumptions for Employment Projections

Our direct employment and FTE (“full-time equivalent”) impact projections are based on ratios and metrics derived by us from our experience, as well as from a variety of data from other US jurisdictions, as available. We project direct-employment, and ultimately FTE, impacts for the Indiana commercial casino industry based on estimated changes in gaming positions, both slots and table games, stemming from changes in GGR as follows:

- 0.4 employees per slot machine
- 5.0 employees per table game
- 0.15 employees per total gaming position

Under this methodology, and as an example, a reduction of 500 gaming positions (e.g., 350 slots and 25 table games) would yield a reduction of 400 direct employees. We further assume total FTEs (or full-time-equivalent positions) are 85 percent of total direct employees – meaning in this illustrative example Indiana’s commercial casino industry would shed 400 direct employees equating to 340 FTEs.⁹⁴

To determine estimated change(s) in gaming positions we take our GGR projections and provide an estimated split according to slot and table games revenue. From the respective split of GGR we then apply benchmarks of respective win/unit/day (“WUD”) to such estimated revenue streams to quantify the impact on the number of slots and table games for the Indiana commercial casino industry. These benchmark assumptions were derived from recent, annual operating results over the last 12-months (“LTM”) ended June 2016 for the Indiana commercial casino industry, as shown in the following.

⁹⁴ We assume 80 percent, which is consistent with our analyses of reported employment counts and derived FTEs for the New Jersey casino industry.

Figure 37: Indiana commercial casino industry, salient operating results (LTM June 2016)

Indiana commercial casino industry results (LTM June 2016)	GGR (\$M)	GGR, Slot %	GGR, Table Games %	Slot WUD	Table Games WUD
Ameristar**	\$229.7	78.8%	21.2%	\$288	\$2,068
Belterra	\$109.9	88.6%	11.4%	\$231	\$834
Blue Chip**	\$162.0	89.1%	10.9%	\$223	\$1,028
French Lick	\$84.4	85.5%	14.5%	\$202	\$904
Hollywood Lawrenceburg	\$175.4	85.4%	14.6%	\$226	\$1,139
Hoosier Park*	\$204.0	100.0%	0.0%	\$292	n/a
Horseshoe (Hammond)**	\$418.5	72.0%	28.0%	\$291	\$2,364
Horseshoe (Southern IN)	\$250.8	78.4%	21.6%	\$325	\$1,910
Indiana Grand*	\$259.2	100.0%	0.0%	\$341	n/a
Majestic Star**	\$90.6	77.0%	23.0%	\$216	\$1,074
Majestic Star II**	\$67.1	97.0%	3.0%	\$212	\$155
Rising Star	\$50.8	87.8%	12.2%	\$127	\$593
Tropicana Evansville	\$126.3	83.7%	16.3%	\$299	\$1,703
Indiana	\$2,228.7	84.9%	15.1%	\$264	\$1,561
<i>Indiana, Net of slots-only*</i>	\$1,765.5	80.9%	19.1%	\$250	n/a
Northern Indiana **	\$967.9	78.7%	21.3%	\$259	\$1,821

Source: Indiana Gaming Commission, Spectrumtrix, Spectrum Gaming Group

As illustrated (and shaded in gray), our primary assumptions to illustrate the impact of Four Winds South Bend on the Indiana commercial casino industry are based on the collective results of the existing five casinos operating in northern Indiana and all within a reasonable two-hour drive of South Bend. While we hold the GGR split constant through all forecast years (i.e., at 78.7 percent slot revenue and 21.3 percent table games revenue), we adjust WUD assumptions according to inflationary growth (corresponding to status-quo GGR projections, illustrated elsewhere in this report). Our WUD assumptions through 2022 are shown in the following table.

Figure 38: Indiana commercial casino industry, win per unit per day assumptions, 2017-22

Indiana commercial casino industry, assumptions	2016-Est	2017(F)	2018(F)	2019(F)	2020(F)	2021(F)	2022(F)
Slot WUD	\$259	\$264	\$271	\$277	\$283	\$289	\$294
Table WUD	\$1,821	\$1,857	\$1,904	\$1,951	\$1,990	\$2,030	\$2,071
Growth/(Decline) rate	0.6%	2.0%	2.5%	2.5%	2.0%	2.0%	2.0%

Source: Indiana Gaming Commission, Spectrumtrix, Spectrum Gaming Group

To estimate the impact on salaries and wages, we calculated a blended hourly rate for gaming and non-gaming employees using mean hourly wage rates from the US Bureau of Labor Statistics (“BLS”), via its Standard Occupational Classification (“SOC”) for Indiana as of 2015.⁹⁵ To determine the total impact on salaries and wages, the blended hourly rate was multiplied by the number of FTEs forecasted to be impacted by the changes in gaming and non-gaming revenue.

⁹⁵ US Bureau of Labor Statistics, May 2015 State Occupational Employment and Wage Estimates, Indiana.
http://www.bls.gov/oes/current/oes_in.htm

The blended hourly rate for gaming positions (\$14.00) was calculated using a weighted average based on the BLS mean hourly rate as of 2015 and the number and types of positions that would typically be impacted by significant changes in gaming revenue. For example, the BLS SOC includes eight gaming job classifications: gaming managers, gaming surveillance officers and investigators, gaming dealers, gaming service workers, gaming supervisors, slot supervisors, gaming change persons and booth cashiers, and gaming cage workers. When revenue changes and staff reductions or staffing increases are necessary, a combination of these jobs will be affected. According the BLS data, in the state of Indiana gaming dealers represent 56 percent of the total gaming workers in the state. So in calculating the blended, weighted average hourly rate, the hourly rate for gaming dealers was assigned a weight of 56 percent. We used the same logic was used for each gaming classification.

The blended hourly rate for non-gaming positions (\$11.47) was also calculated using a weighted average based on the BLS mean hourly rate as of 2015 and the number and types of positions that would typically be impacted by significant revenue changes. The weights assigned to each non-gaming position however were based on standard operating practices of casinos in several gaming jurisdictions and on the experience of Spectrum experts. The blended hourly rate was adjusted for inflation to calculate the total impact of salaries and wages for the five years in the forecast. Rates of inflation used in the forecast were 1.5 percent for 2016, 2.5 percent for 2017, and 2.4 percent for 2018 and each year thereafter.⁹⁶

⁹⁶ David Payne, "Inflation Will Pick Up Next Year," *Kiplinger*, August 18, 2016.
<http://www.kiplinger.com/article/business/T019-C000-S010-inflation-rate-forecast.html>