

NEW YORK State of Mind

WHAT HAPPENED TO THE STATE'S CASINOS?

BY ANDREW KLEBANOW

For decades, casino operators viewed the potential for casinos in the Catskills region of New York as the mother lode of gaming development.

The region's proximity to the New York City metropolitan area and its history as a vacation destination made it a near ideal location for casino development. State legislators also saw casinos in upstate New York, a region that has had difficulty recovering from the loss of a host of manufacturing industries, not only as a tool for economic development, but tax revenue.

In 2013, the New York state legislature passed the Upstate New York Economic Development Act, which provided the legal framework for commercial casinos in the state. The act went into effect on January 1, 2014. When signing the bill, Governor Andrew Cuomo stated, "This new law will bring the state one step closer to establishing world-class destination gaming resorts that will attract tourists to upstate New York and support thousands of good-paying jobs as well as new revenue for local businesses. For too many years, gaming revenue has left New York for our neighboring states."

The act authorized the issuance of up to four casino licenses. Destination gaming resorts were authorized in three regions of the state: the Hudson Valley-Catskill region, the Capital District-Saratoga region, and the Central-Southern Tier region. The act further specified that one region could have up to two casinos, if determined by the State Siting Board.

It was initially believed that the Hudson Valley-Catskills region, given its proximity to the New York City metropolitan area, could support two casino resorts. The act further precluded the development of destination gaming resorts in Westchester, Rockland and Putnam counties, New York City or Long Island, and included a seven-year exclusivity period during which time no further destination gaming resorts would be licensed by the state.



Empire Resorts' Resorts World Catskills exterior and the Empire Lounge

Subsequent to passage of the act, the board issued a "Request for Application" and in turn received 17 applications. The board selected the developers of Del Lago Casino Resort for the Central-Southern Tier region, the developers of the Rivers Casino in Schenectady for the Capital District-Saratoga region, and Empire Resorts, owner of Monticello Raceway, to build what was to become Resorts World Catskills for the Hudson Valley-Catskills region.

The State Siting Board took great care in selecting sites that would be best suited to fulfill the governor's mandate, protect racetracks and New York Indian casinos from undue cannibalization, and prevent oversaturation. The board further made a decision to limit the Hudson Valley-Catskills region to one license, despite the region's proximity to the New York City metropolitan area. State legislators subsequently awarded that license to another candidate in the Central-Southern Tier region.

In 2017, the first commercial casinos opened. Today, there are four casinos in operation and all are performing well below their anticipated levels. So, what happened?

The easy answer is oversaturation. Casinos in Pennsylvania, Massachusetts, Atlantic City and Connecticut are all proving to be far more formidable competitors than originally anticipated, as are the Indian casinos in upstate New York. In addition, as far back as 2012, there was already a suffi-



cient supply of electronic gaming devices at the state's racetracks to satisfy existing demand for slot machine gambling in the state. Yet, these were known factors in 2014.

Why were these particular sites selected when others offered greater chances for success? Were expectations realistic? Did New York state regulations conspire to limit casinos' success? The answer is that other factors may have played a role. An explanation for what happened is far more nuanced.

The Hudson Valley-Catskills Region

The Hudson Valley-Catskills region, referred to in the act as Region 2, attracted the most applications. Beginning approximately 30 miles north of the west side of the Mario Cuomo Bridge, the region serves as a primary transportation corridor to Albany via the New York State Thruway and west to Scranton via I-84. It is also the closest region to the burgeoning and wealthy populations in northern New Jersey and the Hudson Valley.

Empire Resorts was awarded the license for the Hudson Valley-Catskills region at what was to be called the Montreign Resort Casino. A subsequent licensing agreement brought the Resorts World brand to the property.

Empire Resorts had a long history in the region, having owned and operated Monticello Raceway, and had the rights to redevelop Grossinger's Hotel, which was once considered the finest resort in the Catskills. Other applicants with sites closer to both major population centers and the interstate highways were rejected.

While projected gaming revenues would probably have been higher at locations closer to the New York State Thruway, those locations were not as isolated and had not suffered the same long-term economic decline as the area around Monticello. In addition, in an effort to assure the success of this site, the Site Selection Committee prudently decided that the market could only support one casino. That decision proved brilliant in hindsight.

Unfortunately, neither the Site Selection Committee nor the developer foresaw how difficult it would be to attract gamers that had developed relationships with other casinos in the region.

Mohegan Sun and Foxwoods, two of the largest casino resorts in the United States, had spent nearly two decades developing their properties into fully integrated casino resorts. Mohegan Sun boasts over 5,000 slot machines, over 300 table games, 45 food and beverage outlets, 1,600 hotel keys, 100,000 square feet of meeting space, a 12,000-seat arena and a shopping mall. Foxwoods has 4,800 slot machines, over 340 tables, 42 food and beverage outlets, 2,220 hotel keys, and a premium outlet mall. Both of these integrated casino resorts are essentially "category killers" in that they offer a wealth of amenities that no new competitor could match without putting at

risk billions of dollars in capital.

Atlantic City, with nine properties, continues to offer a wealth of gaming and recreational options that make it difficult for Resorts World to pull loyal customers north to the Catskills. It too is a category killer among regional casino markets. Even Sands Bethlehem, with its expansive casino, hotel and shopping mall, has also proven to be a very formidable competitor, owing in part to its location closest to New York City, its wealth of amenities, and generous marketing programs.

What the Site Selection Committee may have underestimated was the power that these mega-properties had, not only in their product offerings but in customer loyalty. Customers loyal to a particular casino, who have demonstrated their gaming worth, are the recipients of countless marketing offers. Suites, show tickets, fine dining, invitations to special events, free slot play, access to personal hosts, are all part of the benefits they currently receive, and moving their loyalty to another property puts those benefits at risk.

Getting customers to switch to a casino that offers fewer amenities than what their current casino provides is difficult. This is not to say that Resorts World Catskills is not beautiful. It certainly is. It just does not offer players enough amenities and benefits to switch loyalties.

Casinos often entice players to return to their properties with the offer of free slot play. Free slot play is game credits that players receive as members of a casino's rewards program. As customers wager those game credits, they may win more game credits that can be redeemed for cash, or lose those game credits. At that point, the customer will put his own money at risk. In some states, casinos are allowed to deduct free slot play from gross slot revenue to determine net slot revenue that is taxable.

Some states cap that amount while others simply do not allow the deduction. New York caps the amount of free slot play that a casino can deduct from gross slot revenue at 19 percent. New York racetracks are capped at 15 percent. Casinos in Pennsylvania have no such cap and are free to give out as much free slot play as they feel is warranted. That means Resorts World cannot afford free slot play offers that are more generous than what Pennsylvania casinos offer. That may not have been considered when original projections were made back in 2014.

Another issue is that of cigarette smoking. All commercial casinos and racinos in New York state prohibit indoor smoking. Approximately 16 percent of adults in the United States smoke. Assuming that casino customers are representative of the U.S. population, then 16 percent of the gaming public would not patronize a non-smoking casino if an alternative was available.

Now assume that an additional 10 percent of the gaming population are spouses or gaming partners of smoking patrons, and they too would not go to a non-smoking casino because of their friends that smoke. Atlantic City, Sands Bethlehem and the casinos in Connecticut all offer smoking sections in their casinos. So, that one codicil of the act effectively reduced the potential market of gaming customers by over 25 percent.

Another issue is perception. Residents of New York City have long per-

ceived the Catskills to be “in the country.” Of course, this perception dates back to a time when millions of New Yorkers ventured into the Catskills for summer vacations or ski holidays and drove along two-lane highways to get to their favorite resort or bungalow colony. Highways have improved since then. Unfortunately, the perception of the Catskills as “the country” remains. Would another location adjacent to the New York State Thruway have overcome that perception? Perhaps, but the fact remains that going to Resorts World Catskills feels like a drive to the country.

The Central-Southern Tier Site

Del Lago Casino Resort near the village of Tyre was selected as the licensee in the Central-Southern Tier, referred to as Region 4. It is a very attractive property with 1,980 slot machines, 100 table games, eight restaurants, a spa, and 205 hotel keys. The resort is located along Interstate 90 in a rural area between Rochester and Syracuse.

Once again, this is a region that was already well served by two regional casino resorts that also could be considered category killers, as well as a number of racinos.

Turning Stone, 66 miles east of Del Lago, offers 2,000 slot machines, 100 table games, four hotels with a total of 567 keys, three golf courses, 100,000 square feet of meeting space, and 14 food and beverage outlets. Seneca Niagara, 128 miles to the west, contains 4,500 slot machines, 100 table games, and more than 600 lodging keys. Also, both properties offer smoking sections within their casinos. In fact, in 2013, the total gaming supply along the Interstate 90 corridor from Verona, New York to Hamburg, New York was comprised of seven casinos with over 10,000 electronic gaming devices and 200 table games, enough to meet demand.

NEW YORK STATE COMMERCIAL GAMING TAXES

Facility	% of Slot Revenue	% of Table Revenue
Tioga Downs	37%	10%
Del Lago	37%	10%
Rivers Casino	45%	10%
RW Catskills	39%	10%

Source: New York State Gaming Commission, GMA

Again, the challenges of moving market share from well-established competitors remain for the operators of Del Lago. Customers are loyal to their properties, not only because of their past experiences, but the benefits that they stand to lose if they start devoting their gaming play to a new resort, albeit a beautiful one, that offers fewer amenities or is farther than their favored casino. They can smoke at the Indian casinos to the east and west. Also, there is the issue of the cap on free slot play that precludes Del Lago from buying market share.

The fourth casino license, originally not awarded by the Site Selection Committee, was eventually assigned to Tioga Downs, a racino west of Binghamton, New York. To meet the requirements for the license, the property was expanded with a hotel component, meeting space, an additional dining outlet and a parking garage. It is certainly an improved property, but it is not nearly as attractive as Del Lago to the north, Mohegan Sun Pocono to the south, or Seneca Allegheny to the west. It remains a rural casino with a limited catchment area and a small population from which to draw.

The Capital District-Saratoga Region

The Rivers Casino in Schenectady opened in February 2017. In its first year, it generated approximately \$116 million compared to an original forecast of \$181 million to \$222 million. Built for a cost of \$330 million, it is a thoughtfully designed, attractive casino with an entertaining mix of dining along with an attractive hotel.

Its nearest competitor, Saratoga Raceway, is at a competitive disadvantage in that it does not offer the wealth of amenities that the Rivers offers. It is also the most perplexing one to figure out what went wrong. Part of the problem might be attributed to its location in a former industrial zone that has not yet reached a point of gentrification or urban renewal. Part of it may be that smokers are venturing 100 miles to Turning Stone to play. Regardless, it is also the casino with the highest tax rate at 45 percent for slot machine revenue.

What's Next?

All four casinos now face their unique challenges to meet their financial projections. An underestimation of the power of the competition, the difficulty in changing player behavior, the inability to offer smoking areas within their casinos and limits on how much casinos can spend on free play all played a role in the industry's disappointing first-year results.

These casinos did succeed in other ways. They have collectively created thousands of jobs in regions that were economically depressed. They brought needed investment capital. They created compelling entertainment destinations in areas of the state that were devoid of things to do. They just did not do enough in terms of generating gaming revenue.

What has yet to be discussed are the high tax rates that these properties are obligated to pay.

GAMING SUPPLY ALONG I-90 CORRIDOR 2013

(excludes Poker)

Property	Slots/VLTs	Table Games
Seneca Buffalo Creek	808	18
Seneca Niagara	4,000	100
Batavia Downs	647	
Finger Lakes Gaming	1,500	
Hamburg Gaming	940	
Turning Stone	2,162	83
Vernon Downs	700	
Total	10,757	201

Excludes casinos in Niagara Falls, Canada

Taxes on slot revenue vary by region, from 37 percent to 45 percent. These taxes are paid from net slot revenues, before any operating expenses are paid including wages, salaries, utilities and other costs of doing business. At some point New York state legislators will have to consider some reduction of these rates in order to keep these facilities viable so they can compete with more superior, integrated casino resorts in the surrounding region.

Too much has been invested in these projects and the communities that they reside in to allow them to fail because of high tax rates and onerous regulations that limit their ability to compete.

Andrew Klebanow is a senior partner at Global Market Advisors, a leading hospitality, gaming and tourism consulting firm.