

**House Gaming Oversight Committee  
Hearing on House Bill 1010 - Video Gaming Terminals  
Pennsylvania Department of Revenue  
May 1, 2017**

Chairman Petri, Chairman Harkins, and members of the committee, thank you for the opportunity to provide information regarding House Bill 1010, Printer's Number 1169, which calls for the establishment of video gaming terminals at licensed businesses. The Department of Revenue has several concerns with this legislation, which we'll break down into various categories for your consideration. However, it is equally as important to understand the financial status of the Lottery Fund, as well as the programs it funds, the constituencies it serves, and further possible impacts to the General Fund budget.

**The Importance of the Lottery Fund**

The Lottery Fund is a special revenue fund generated by lottery ticket sales, that supports programs for older Pennsylvanians including property tax and rent rebate assistance, community care programs, mass transit fare subsidies and prescription drug assistance. Specifically, expenditures are made in the following areas:

<b>Subcategory/Appropriation</b>	<b>2015-16 Lottery \$ Actual</b>	<b>2016-17 Lottery \$ Actual</b>	<b>2017-18 Lottery \$ Budget</b>
<b><u>Medical Assistance and Healthcare Delivery</u></b>			
<i>MATP</i>	\$4,900	\$3,300	\$3,500
<i>Pharmaceutical Assistance Fund</i>	175,000	185,000	125,000
<b><i>Medical Assistance and Healthcare Delivery</i></b>	<b>\$179,900</b>	<b>\$188,300</b>	<b>\$128,500</b>
<b><u>Aging and Adult Community Living</u></b>			
<i>General Government Operations</i>	\$9,058	\$9,272	\$8,949
<i>Long Term Care Services</i>	184,081	184,081	184,081
<i>Home and Comm. Based Services</i>	120,668	120,668	120,668
<i>PENNCARE</i>	314,282	325,246	329,537
<i>Pre-Admission Assessment</i>	18,000	19,916	19,916
<i>Caregiver Support</i>	12,103	12,103	12,103
<i>Alzheimer's Outreach</i>	250	250	250
<i>Grants to Senior Centers</i>	2,000	2,000	2,000
<b><i>Aging and Adult Community Living</i></b>	<b>\$660,442</b>	<b>\$673,536</b>	<b>\$677,504</b>
<b>TOTAL LOTTERY FUNDS</b>	<b>\$840,342</b>	<b>\$861,836</b>	<b>\$806,004</b>

**Lottery Fund Impact**

With any gaming expansion proposal, the first question that must be asked is how will this impact the future financial health of the Lottery Fund and the programs it supports and people it serves. VGT implementation under HB 1010 is no different.

If VGTs are implemented in the next fiscal year, ticket sales will decline by \$63.8 million, or 1.5 percent, and profits will decline by \$14.4 million, or 1.29 percent. In year five, Lottery sales would

be reduced by about \$432 million, or 9.8 percent, and profits reduced by \$96.3 million or 8.44 percent.

**Casino Revenue Stream Impacts**

The establishment of VGTs under House Bill 1010 would have a negative impact on existing revenue streams that come from casino-based gaming activities. House Bill 1010 authorizes a five-percent reduction in the daily gross terminal revenue tax for slot machine licensees, from 34 percent to 29 percent. This reduction in the tax rate will also reduce revenues to the State Gaming Fund by \$123 million annually. Additionally, implementing VGTs would decrease Commonwealth collections from slot machines by \$5 million next year and \$77.2 million the year after.

**Total State Impacts of House Bill 1010**

As outlined below, coupling the casino related losses with the anticipated impact to the Lottery Fund would keep the Commonwealth from experiencing a net gain in revenue until fiscal year 2021-2022 under this legislation. Additionally, in the first three years of implementation, the Commonwealth would experience a \$100 million net negative impact because of this legislation. Finally, this legislation would cause the Lottery Fund to experience a loss of \$445 million over the first six years of implementation.

# HB 1010 PN 1169

## Video Gaming Terminal Revenue Estimate

Effective Date July 1, 2017. First remittance of tax due January, 2018.

Assumes the same participation rate as Illinois; Accounts for Illinois municipalities opting out

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Net revenue per machine year 1	\$37,925	
Net revenue per machine year 2	\$36,264	
Net revenue per machine year 3	\$42,068	
Net revenue per machine at full phase in	\$46,755	4/

At Full Participation		
Number of active retail licenses (restaurant, tavern, bar, etc.)	11,450	
Percent participating	40.6%	5/
Number of private clubs	3,123	
Percent participating	40.6%	5/
Number of truck stops	191	5/
Percent participating	40.6%	
Number of nonprimary locations	15	5/
Percent participating	100.0%	
Total venues	6,002	
Commonwealth Share - Video Gaming Fund	34%	
Annual Revenue at Full Participation	\$387,972,727	

### Cash Flow (in \$ millions)

	2/	5/	6/	7/	8/	
Video Gaming Fund	Application, Licensing, and Annual Fees	Estimated Decline in State Share of Slots Gaming Revenue	Slots Rate Adjustment from 34% to 29%	Impact on PA Lottery Profits	Total State Impact	
2016-17	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
2017-18	\$ 19.4	\$ 2.7	\$ (8.2)	\$ -	\$ (14.4)	\$ (0.5)
2018-19	\$ 161.7	\$ 5.9	\$ (61.8)	\$ (123.5)	\$ (59.5)	\$ (77.2)
2019-20	\$ 283.7	\$ 6.0	\$ (109.6)	\$ (123.8)	\$ (84.1)	\$ (27.7)
2020-21	\$ 366.1	\$ 6.6	\$ (120.4)	\$ (123.5)	\$ (94.2)	\$ 34.6
2021-22	\$ 386.4	\$ 6.7	\$ (127.1)	\$ (123.5)	\$ (96.3)	\$ 46.2
2022-23	\$ 388.0	\$ 6.7	\$ (127.1)	\$ (123.5)	\$ (96.3)	\$ 47.8

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### Funds Impacted

	General Fund	Lottery Fund	10/ Property Tax Relief Fund	Economic Development and Tourism Fund	Race Horse Development Fund	Compulsive and Problem Gambling Treatment Fund	Fire Company and Emergency Responder Grant Fund	Department of Drug and Alcohol Programs
2017-18	\$ 9.1	\$ (14.4)	\$ -	\$ (0.8)	\$ (1.9)	\$ 2.5	\$ 2.5	\$ 2.5
2018-19	\$ 5.9	\$ (59.5)	\$ (0.7)	\$ (6.7)	\$ (16.1)	\$ -	\$ -	\$ -
2019-20	\$ 89.4	\$ (84.1)	\$ -	\$ (11.9)	\$ (28.6)	\$ 2.5	\$ 2.5	\$ 2.5
2020-21	\$ 165.8	\$ (94.2)	\$ -	\$ (13.1)	\$ (31.4)	\$ 2.5	\$ 2.5	\$ 2.5
2021-22	\$ 182.0	\$ (96.3)	\$ -	\$ (13.8)	\$ (33.2)	\$ 2.5	\$ 2.5	\$ 2.5
2022-23	\$ 183.6	\$ (96.3)	\$ -	\$ (13.8)	\$ (33.2)	\$ 2.5	\$ 2.5	\$ 2.5

Notes:

1/ HB 1010 PN 1169 provides for video gaming in the commonwealth at licensed liquor establishments, licensed nonprimary locations, and licensed truck stop establishments. The bill provides video gaming terminals located on the premises of the establishment licensee shall be placed and operated by a terminal operator licensee pursuant to a terminal placement agreement; and no terminal operator licensee may give an establishment licensee a percentage of gross terminal revenue that is more than 25% of the gross terminal revenue of the video gaming terminals operating in the establishment licensee's premises. Each licensed liquor establishment may operate up to 5 video gaming terminals. Each licensed nonprimary location and each licensed truck stop establishment may operate up to 10 video gaming terminals.

The bill provides the department shall determine and each terminal operator licensee shall pay, on a bimonthly basis, a tax of 34% of its gross terminal revenue from all video gaming terminals operated within the Commonwealth and a 4% local share assessment from its gross terminal revenue. The tax shall be deposited into the Video Gaming Account, a separate account to be established in the State Treasury. The local share assessment shall be distributed to the municipality, or in some instances the county, in which video gaming terminals are operated. Gross terminal revenue is defined as "the total of cash or cash equivalents received by a video gaming terminal minus the total cash or cash equivalents paid out to players as a result of playing a video gaming terminal. "

The bill provides the department shall determine and each terminal operator licensee shall pay, on a bimonthly basis, a regulatory assessment, from its weekly gross terminal revenue, in an amount necessary to recover the costs or expenses incurred by the board, the department, the Pennsylvania State Police, and the Office of the Attorney General to administer Video Gaming. These assessments shall be deposited into accounts within the State Treasury for each terminal operator.

2/ The bill provides for the following transfers from Video Gaming Fund to be made on June 30, 2018, and the last day of each fiscal year thereafter. Estimate reflects the estimated remaining balance to be transferred to the General Fund.

--To Property Tax Relief Fund, prior to any of the other transfers, an amount equal to:

the balance in the Property Tax Relief Fund on the last day of the prior fiscal year, adjusted for inflation, minus  
the balance in the Property Tax Relief Fund on the last day of the current fiscal year.

\*Estimate assumes the balance of the prior fiscal year includes any transfer from this calculation for a shortfall that year.

--\$2.5 million, or 0.002 multiplied by the total gross terminal revenue of all terminal operators, whichever is greater, to the Compulsive and Problem Gambling Treatment Fund.

--\$2.5 million to the Fire Company and Emergency Responder Grant Fund.

--\$2.5 million to the Department of Drug and Alcohol Programs.

--The remaining balance to the General Fund.

3/ The bill provides for initial funding, in fiscal year 2017-2018, of \$5 million from the General Fund to the Board, \$3 million from the General Fund to the Department, and \$2 million from the General Fund to the Pennsylvania State Police for costs associated with implementing video gaming. These funds shall be repaid from the Video Gaming Account to the General Fund by June 30, 2022. The impact of this funding and repayment is not reflected in the estimate.

4/ Estimate is based on Illinois, which appears to be similar to Pennsylvania's video gaming legislation. Participation is assumed to be the same as Illinois. Net revenue per machine based on the initial four years for Illinois' net taxable income with no growth thereafter. A summary of Illinois' Video Gaming Act may be found at <http://www.icmoa.org/Data/Sites/3/videogamingpublicfiles/ilvideogamingsummary.pdf>.

5/ Estimate assumes an effective date of July 1, 2017, with first bimonthly remittances of tax due in January, 2018. Time to implement and phase-in are assumed to match Illinois' experience. However, the initial 3-year delay is not considered as this appears to be related to issues Pennsylvania is not anticipated to experience. The bill also provides for alternative license standards for terminal operators, manufacturers, and suppliers licensed in another jurisdiction or under existing Gaming and provides for conditional licensing for establishments, terminal operators, manufacturers, suppliers, and other licenses. FY 2017-18 is adjusted to reflect video gaming in Pennsylvania beginning in December, 2017. Estimate assumes the net revenue per machine growth rate will be zero after full implementation. FY 2012-13 represents a partial year; based on Illinois video gaming which began in September, 2012. Estimate is overstated to the extent the effective date and actual implementation do not meet this timeframe.

Assumed Participation

Illinois Participation Rates in Video Gaming, enacted July 13, 2009 (accounts for Chicago opting out of video gaming)

Participation	
FY	Rate
2009-10	0.0%
2010-11	0.0%
2011-12	0.0%
2012-13	5.8%
2013-14	24.8%
2014-15	35.2%
2015-16 Estimated	39.6%
6/30/2016 (Assumed to be full participation)	40.6%

#### Estimated PA Participation

Assumes July 1, 2017 effective date

*Number of active retail licenses (restaurant, tavern, bar, etc.)	11,450	191	Number of truck stops**
*Number of private clubs	3,123	15	Nonprimary locations (see Potential Participation)
Total without truck stops	14,573		

\*Source: PA Liquor Control Board.

\*\*Source: [http://www.truckstopguide.com/Search\\_State.aspx](http://www.truckstopguide.com/Search_State.aspx).

	Participating			Number of Terminals	Number of Venues
	Liquor Licenses	Truck Stops	Non-primary locations		
2016-17	-	-	-		
2017-18	842	11	15	3,606	868
2018-19	3,615	47	15	14,986	3,677
2019-20	5,134	67	15	21,222	5,216
2020-21	5,764	76	15	23,814	5,855
2021-22 (Assumed to be full participation)	5,910	77	15	24,406	6,002

6/ Details on Cannibalization Sheet.

7/ The bill provides, beginning July 1, 2018, the tax on gross terminal revenue from slot machines is reduced from 34% to 29%. This impacts the State Gaming Fund.

8/ VGT impact on PA Lottery Profits provided by the Pennsylvania Lottery.

9/ See Fund allocations in footnote 2. It is assumed that if not enough money is generated to offset the Property Tax Relief Fund losses that the other Funds receive no transfers.

10/ Estimate assumes the impact to the State Gaming Fund, resulting from the decline in slots gaming revenue and the slots rate adjustment, is completely absorbed by the Property Tax Relief Fund as a result of a reduction in the remaining balance transfer to that fund for property tax relief, to the extent it is not offset by the transfers explained in Note 2/ above.

#### **Implementation and Regulatory Costs**

Additionally, numerous, costly technological challenges would be necessary for the implementation of VGTs as required by HB 1010. The legislation assigns the Department responsibility for connecting VGTs to the central control computer system, and sharing access to that system with the Pennsylvania Gaming Control Board.

Connecting VGTs to the central control computer system will require up to a year (or more) of contract amendments and intensive development work. The cost of implementation could be higher than the \$3 million allocated by the legislation for this purpose.

Physically connecting VGTs to the system will require infrastructure work to accommodate the different types of communication connections available at the locations that will be licensed to offer these games. This also means having built-in redundancies to ensure continuous data connections and related safeguards.

Further, capping the administrative assessment for gaming at 1.5 percent could increase costs to the General Fund for monitoring the industry, thereby forcing taxpayers to pay for regulatory costs that the casinos have traditionally covered. The assessment reimburses the Pennsylvania State Police, Pennsylvania Attorney General, Pennsylvania Gaming Control Board and Department of Revenue for the cost of regulating the industry. The assessment rate of 1.7 percent this year and the anticipated rate of 1.9 percent next year is less than the cost to the

four agencies. Funds held over from prior years are closing the gap, however this temporary relief to the Commonwealth will be exhausted.

As the chart below indicates, capping the rate at 1.5 percent is insufficient to cover the agencies' costs and the additional expense for regulating the industry may be borne by the General Fund.

#### Gaming - Administrative Assessment

Projection as of April 10, 2017

(in thousands)

				Current Estimated	HB 1010
	Actual 2014-15	Actual 2015-16	Available 2016-17	Budgeted 2017-18	Budget 2017-18
Gross Slots Terminal Revenue (GTR) plus Promo	\$ 3,007,735.17	\$ 3,017,394.20	\$ 2,942,478.17	\$ 3,013,411.11	\$ 3,013,411.11
Gross Table Game Revenue (GTGR)	770,530.50	833,403.47	849,062.32	912,761.88	912,761.88
Total Gross Gaming Revenue <sup>1</sup>	\$ 3,778,265.67	\$ 3,850,797.67	\$ 3,791,540.49	\$ 3,926,172.99	\$ 3,926,172.99
<b>Revenue</b>					
Slots Admin Assessment	\$ 45,116.03	\$ 45,260.91	\$ 49,547.01	\$ 56,755.60	\$ 45,201.17
Tables Admin Assessment	11,557.96	12,501.05	14,147.11	17,055.29	13,691.43
Subtotal Administrative Assessment	\$ 56,673.99	\$ 57,761.97	\$ 63,694.12	\$ 73,810.89	\$ 58,892.59
Collected In Advance From Prior Year	24,645.61	18,491.70	8,785.38	7,850.69	7,850.69
Actual Year Lapse (Unused Funds From Prior Year)	1,811.11	3,836.71	6,459.19		
Total Revenue	\$ 83,130.70	\$ 80,090.38	\$ 78,938.69	\$ 81,661.58	\$ 66,743.28
<b>Expenditures <sup>2</sup></b>					
PGCB - Administration (1401 Accounts)	\$ (30,990.00)	\$ (32,900.00)	\$ (34,414.00)	\$ (35,910.00)	\$ (35,910.00)
Attorney General	(1,141.00)	(1,192.00)	(1,223.00)	(1,300.00)	(1,300.00)
State Police	(22,995.00)	(27,700.00)	(28,485.00)	(30,699.00)	(30,699.00)
Revenue	(9,513.00)	(9,513.00)	(6,966.00)	(6,512.00)	(6,512.00)
Total Expenditures	\$ (64,639.00)	\$ (71,305.00)	\$ (71,088.00)	\$ (74,421.00)	\$ (74,421.00)
Balance (Ending Collected In Advance)	\$ 18,491.70	\$ 8,785.38	\$ 7,850.69	\$ 7,240.58	\$ (7,677.72)
Administrative Assessment Rate	1.50%	1.50%	1.7% - Aug 2016	1.9% - Aug 2017	1.5% - Aug 2017

<sup>1</sup> Gross Terminal Revenue (GTR) and Gross Table Game Revenue (GTGR) based on Actuals through March 2017 and DOR Projections thereafter.

<sup>2</sup> Assumes enacted appropriations for 2014-15, 2015-16 and 2016-17. Expenditures for 2017-18 based on GBO budget recommendation.

Under HB 1010, the staffing required to monitor new venues with 5-10 VGTs would double the current workload for the tax receipts and reconciliation function and it would impact the audit caseload. Currently, the department has a total of 19 filled positions dedicated to monitoring the 12 existing casinos across collections, compliance, audits and information technology. To provide monitoring to VGTs and casinos a significant increase in staffing would be required.



**12 Venues**

Slot Machines	26,503
Tournament Slot Machines	104
Fully Automated Electronic Gaming Terminals (Table Games)	36
Electric Wagering Terminals (Table Games)	262
<b>Total</b>	<b>26,905</b>

**Complement Levels**

	<b>Filled</b>	<b>Vacant</b>	<b>Total</b>
Bureau of Fiscal Management, Gaming Division	5	2	7
Compliance	5	2	7
BIS	4	2	6
Audits	5	0	5
	19	6	25

**Ensuring the Solvency of the Lottery Fund through iLottery and Other Proposals**

The governor's proposed budget proposed several initiatives to maintain the solvency of the Lottery Fund, ensuring that programs for older Pennsylvanians funded by these dollars can continue at their current funding and service levels. Specifically, the 2017-18 budget proposal assumes Lottery Fund revenue growth through the implementation of iLottery (\$19 million) to ensure the system remains competitive in an increasingly online marketplace. Current law does not permit the Lottery to sell its games on the Internet, a restriction that prevents the Lottery from growing its business and will eventually translate into reduced funding for senior benefit programs.

The budget plan also presumes revenue growth from the Lottery by expanding points of distribution, optimizing the retailer network, and continuing the growth of instant games. Growth in terminal-based games is generated by increasing play value, launching lottery sales on the internet and mobile devices, and implementing a number of modernization initiatives. Realizing the projected revenue growth through iLottery will also require the enactment of Lottery Fund margin relief.

In addition to these revenue enhancements, the proposed budget relies upon significant programmatic savings by consolidating commonwealth programs that purchase and dispense prescription drugs. These savings are estimated to total \$45 million in 2017-18. This will allow for uniformity of program services, rules, and fees related to pharmaceutical services in the Pharmaceutical Assistance Contract for the Elderly (PACE), Children's Health Insurance Program (CHIP), and Medical Assistance programs. This coordination could lay the groundwork for further integration of pharmacy functions throughout other commonwealth programs.

Maintaining a solvent Lottery Fund will rely on adopting both the new revenue proposals, as well as realizing savings from the program consolidations discussed above.

Our Lottery Fund no longer has any reserve fund or other financial protection to maintain solvency. As gaming conversations continue in the General Assembly, it is critical to protect current and future Lottery receipts and maintain funds to pay for essential programs for older Pennsylvanians. Regardless of whether that conversation focuses on internet gaming, VGTs, or

**other “games of skill” becoming more popular in venues across Pennsylvania, it is incumbent upon all of us to ensure we take appropriate steps to protect our Lottery Fund.**