Impact on the State of Proposed Increase in the Wagering Tax to 36%

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The purpose of the proposed wagering tax increase is to raise $195 million in new tax receipts to offset a reduction in the top marginal brackets of Iowa's corporate income tax. Those who proposed this tax increase apparently assumed that the proposal would not have an impact on casino operations in terms of employment, purchases, customers and mix of gaming activities. They must have assumed that tracks and casinos 1) would have the resources to pay the higher tax rate and 2) would not be forced to adopt severe changes. Both assumptions were wrong.

On the day when Governor Branstad announced this tax plan, the Iowa Gaming Association commissioned Strategic Economics Group (SEG) to analyze the facts, determine how the gaming industry would most likely respond to this threat and determine the likely impact on the state and on the communities where tracks and casinos are located.

In order to anticipate the survival strategy of Iowa's casino managers, SEG analyzed eight years of audited financial statements for each of Iowa's gaming facilities, examined whitepapers and surveys provided by their managers and interviewed a substantial number of those managers.

We examined the current financial status of the Iowa gaming industry following two years of recession. Notwithstanding the widely-held perception that the industry is awash in cash, we found that one facility currently shows negative net income (earnings before interest, taxes, depreciation and amortization). Another five had income on their books of less than $10 million – often committed in support of a loan. Four additional facilities had negative equity levels in 2010 and another had equity levels below $10 million.

The managers of two facilities indicated that any increase in the current wagering tax rate would require closing down – in one case it would be immediate. The other manager indicated that his facility would close in early 2012 because inadequate collateral to support refinancing of their note.

Our conversations with facility managers indicated that if confronted with the proposed tax increase, their first strategy would be to reduce payrolls, amenities, purchases and advertising – in other words, downscaling. Next they would draw from that portion of net income that was not otherwise committed as collateral for their loans. If those two sources were not sufficient to cover the tax cost, they would then commit up to half of

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their equity – for those who had positive equity. After that, any additional tax balance would mean closing their facility.

With this framework and using the most recent financial statements, here is what we believe will happen if the wagering tax is increased to 36%:

1. Six of the 17 facilities will close; the two mentioned above and four that will not have sufficient resources to pay the tax increase (even if they reduce their payroll expenses by 50% and other expenses by 25%).

2. In addition to the 2,800 workers who will be displaced by the six closed facilities, the remaining 11 facilities will reduce their payrolls by as little as 25% or as much as 50%, laying off another 1,700 to 3,100 workers. In total, the payrolls will drop between $136 and $181 million per year.

3. The jobless benefits that will be necessary to cover those displaced workers will cost up to between $36 and $48 million.

4. The state income tax which those displaced workers previously paid another amounted to another $3 to $4 million a year.

5. The six facilities that will close will no longer pay their local communities the $9 million in annual property taxes, nor will the community and the state receive the $1.3 to $1.5 million in hotel/motel tax from the downsized facilities.

6. Iowa vendors of food, supplies and services will lose between $113 and $122 million in yearly sales to the casinos and tracks that have been forced to downsize.

7. Adjusted Gross Receipts (AGR) will decline from $1.37 billion in 2010 to between $690 and $732 million as a result of the downsizing. As a result, the state wagering tax collection will fall from the $298 million in 2010 to between $249 and $264 million.

8. As a result of the drop in AGR, the wagering tax will <u>decline</u> by between $34 and $49 million – rather than the $195 million <u>gain</u> which the Governor intended to use to buy down the corporate income tax.

9. For the local communities, they will receive between $5 and $6 million less in their share of the wagering tax, they will receive $26 million less in civic and charitable contributions because of the closures, and more importantly they will have lost a substantial tourism partner or seen that partner substantially downsized.

10. The impact of the proposed tax increase is not limited to casinos, their employees, vendors and communities. It will also affect all Iowans through the reduced paychecks, and the lower level of goods and services purchased.

Plugging the above numbers into the Iowa IMPLAN[2] model tells us that from 7,500 to 9,500 employees in the state will have their jobs jeopardized, about $1 billion in consumer spending in Iowa will be impacted and the total personal income of Iowans will be diminished by $220-$270 million as a result of this proposal.

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[2] Strategic Economics Group applied the IMPLAN statewide regional economic input-output model to determine the magnitude of secondary economic impacts. MIG, Inc. is the corporation that is responsible for the production of IMPLAN (IMpact analysis for PLANning) data and software.