CITY OF CHICAGO

COUNCIL OFFICE ON FINANCIAL ANALYSIS (COFA)

August 15, 2019

The Honorable Alderman Pat Dowell
Chairman of the Committee on Budget and Government Operations
121 N LaSalle St
Chicago, IL 60602

Dear Chairman Dowell:

At your request, COFA is hereby presenting its summary and analysis of the *City of Chicago Casino Financial Feasibility Analysis*, prepared by Union Gaming Analytics [hereafter "UGA"], and released on August 13, 2019.

Summary of UGA's Findings

The study examined the financial feasibility and government revenue potential of five proposed Chicago casino sites: Harborside Illinois Port Authority Golf Course (111th St. and Bishop Ford Freeway); former Michael Reese Hospital (31st St. and Cottage Grove Ave.); Pershing Road and State St. (former Robert Taylor Homes); Roosevelt Rd. and Kostner Ave; former U.S. Steel Plant (80th St. and Lake Shore Dr.).

As directed by the City of Chicago, UGA included the following common casino elements: up to 4,000 gaming positions, a modestly sized mid-tier hotel (up to 500 rooms), MICE space, sufficient food and beverage outlets, and some space dedicated to entertainment.

The study estimated that under the current tax structure, as established by Illinois Public Act 101-31, the casinos would generate $500-580 million per year in tax revenues, once they reached full-scale operations by 2024. They also estimate that the casino operator would pay $520-$528 million in one-time fees. The study did not specify how much of this revenue would be received by the City of Chicago, but COFA has determined that the City would receive the $33^{1/3}$% AGR Tax (Adjusted Gross Receipts, i.e., gross receipts less winnings paid out), which would be earmarked for contribution to the police and fire pension funds. The City would also receive the amusement tax and portions of the admissions, hotel, food and beverage taxes[i] for the Corporate Fund. Based on that, and the estimates presented in Figure 36 of the UGA report,[ii] COFA estimates that by 2024, the City's annual revenues would be as follows:

City of Chicago 2024 Annual Tax Revenue by Proposed Casino Location

($ millions)	Harborside	Reese	Pershing	Roosevelt	US Steel
Police & Fire Pensions	230	269	261	233	218
Corporate Fund	9.6	11.3	11.1	9.6	9.4

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However, UGA stated that those revenues would likely never materialize, because the project would never generate enough revenue for debt coverage or return on equity to attract investors, given the tax and fee structure, and their assumption of $750 million in total development costs. They stated that the project could be feasible with a much lower tax burden. They stated that the casino would generate 43-53% greater revenue if located in a more "tourist-centric location." They did not provide financial projections for such a location, as was outside the scope of their contract, but they stated that even that location would likely fail the financial feasibility test, given the tax and fee structure and its much higher development costs.

UGA stated that the proposed locations would be feasible if the casino were owned by the City of Chicago and managed by an outside firm, although this would not be permissible under existing law. There were two reasons why it would be feasible for the City: because the City would keep all of the untaxed revenue plus all of the taxes it would pay to itself; and because the City could borrow the 100% of development cost, and could do so at lower interest rates than the 9-10% UGA estimated for the private developer.

The study stated that none of the proposed locations would require all 4,000 of the authorized gaming positions. They stated that there would be 500 positions available for slot machines deployable to O'Hare and Midway airports. They estimate those slots would generate $37 million/year in AGR, which implies $14 million in revenue for the City.

COFA's Analysis

The most significant assumptions in UGA's study are:

- The revenue forecasts. These rely on UGA's "proprietary gravity model" to estimate how much would be spent on gaming by residents of each zip code within a sixty minute drive to the casino. They use the Huff model to determine how much of that gaming expenditure would go to the Chicago casino, and how much would go to competing casinos. We cannot evaluate the reliability of either model, since they do not disclose the underlying equations. But, from what is contained in their report it seems that the proprietary model categorizes zip codes by whether they are a 15, 30 or 60 minute drive from the casino, and, based on the experience of other metropolitan areas, and they assume that populations will spend 1% of their income on gaming if everyone has convenient access to a casino. The Huff model seems to be primarily based on driving time to the competing casinos, and secondarily on the size and amenities of the competing casino. UGA also estimates how much revenue would be received from visitors who would have come to Chicago whether the casino were there or not, and how much would be received from visitors who come to Chicago specifically to gamble. They state that revenue from visitors would be much lower at the study locations than at a more tourist-centric location. But, even at the most tourist-centric location, they state that the number of visitors coming specifically to gamble would be limited because "gaming has largely grown to be a convenience-based pastime, rather than a destination-based pastime (i.e. Las Vegas) given the proliferation of casinos throughout much of the US"[iii]

- $750 million total development costs for any of the proposed locations. This cost is inclusive of hard construction costs; furniture, fixtures and equipment; land acquisition; project management and pre-opening expenses. UGA states that "While the different sites selected for

> the study by the City of Chicago certainly have varying land values, differences in land valuation were not contemplated herein. We asked for but did not receive land valuation analyses for the five sites… We believe $750 million is reasonable, if not at the low-end of the likely range for a modest casino with the up to 4,000 gaming positions and non-gaming amenities listed."[iv] UGA assumes that the developer would attempt to borrow up to 55% of all start-up costs (the development cost plus one-time government fees of $520-$638 million) at 9-10% interest.

Of the proposed sites, all but the former U.S. Steel location are owned by the City. Selling the land to the developer could be another source of revenue for the City, but that would never be realized if the project itself is not feasible. However, it is possible that the project could become viable if the City were to sell the land for $1. Unfortunately, UGA does not disclose their estimate for development costs without land acquisition. So, for purposes of discussion, COFA is assuming that if the developer could acquire the land for $1 that would reduce development costs to $500 million.

UGA assumes that the maximum loan the developer would be able to obtain would be five times earnings before interest, taxes, depreciation and amortization (EBITDA) projected for the fifth year of operations, which would translate to a maximum loan of $135 million for the highest earning site, the former Michael Reese Hospital.[v] Note that the T is somewhat misleading in the acronym EBITA, because the figures they present for EBITA are *after* the various state and local taxes specific to casinos, but *before* income taxes.[vi] Thus, even with development costs reduced from $750 million to $500 million, the developer would require approximately $1 billion in equity financing. According to UGA, projected fifth-year EBITDA would have to be less than one-ninth of required equity to provide sufficient return to attract investment on the public equity market.[vii] That means that the maximum feasible equity investment for the Michael Reese site would be $270 million, far short of what would be required, even with $1 land.

Potentially, the City could issue bonds and lend the proceeds to the casino developer. The City can borrow relatively cheaply compared to private developers for a number of reasons, including the fact that the interest income earned by municipal bondholders is tax free. In order to shield the City from undue risk, prudence would demand that the bonds be backed by casino revenues but not the City's full faith and credit. Given the maximum equity investment of $270 million for the Michael Reese site, and assuming the City sells the land for $1, the developer would need to borrow $865 million from the City. Assuming a ten year term at 6% interest,[viii] the debt service would be $9.6 million per year. So, under this scenario, the Michael Reese ($27.1 million fifth year EBITA) and Pershing ($21.5 million fifth year EBITA) would become feasible, but the others would not.

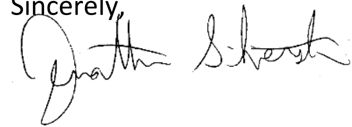
Even if giving the land away could make the project feasible, the City would be wise to consider what revenues it would lose by foregoing the opportunity to sell the land at market prices to another buyer. A deal is reportedly in hand for a development to be anchored by Pete's Fresh Market at the Pershing and State location. The other sites would likely have value to other developers as well, most notably the former Michael Reese hospital.

Finally, we must consider the fact that if people did not spend their money gaming at a Chicago casino, much of that money would be spent elsewhere in Chicago. UGA assumes that by the fifth year the Michael Reese site's AGR would be $545.5 million from local residents, $53.2 million from regional residents, and $170.6 million from its hotel guests and tourists, while the airport slots would earn $36.5 million AGR. Assuming that in the absence of casinos the local residents would have spent 75% of that money elsewhere in Chicago, the regional residents would have spent 20% of that money in Chicago,

and the hotel guests, tourists and airport slot players would have spent 10% of that money in Chicago, that translates to $440.5 in lost retail sales. At the City's current sales tax rate of 2.25%, that would mean $9.9 million in lost sales tax revenue. This is of course, far less than the $269 million in AGR tax revenue the casino would generate for pension contributions.

As for the $13.2 million in Corporate Fund revenues the casino would generate through hotel, restaurant and amusement taxes, COFA believes that in the absence of the casino the great majority of that would be spent and taxed at other Chicago hotels, restaurants and places of amusement, especially in light of UGA's finding that the casino would not draw a significant number of new visitors to Chicago given the widespread availability of gaming opportunities nationwide.

Sincerely,



Jonathan Silverstein
City of Chicago
Council Office of Financial Analysis

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[i] The State imposes a graduated admissions tax according to the number of patrons. UGA estimates the tax would amount to $3 per patron. Under PA 101-31, the State would remit $0.70 per patron to the City. Since 0.70/3=.2333, we estimate that the City would receive 23.3% of admissions tax revenue.

UGA stated that the State hotel tax was 6% and the City's hotel tax is 11.4%, which is not correct. But, UGA was clearly focused on determining whether the casino would be financially viable and not on the fiscal impact of individual taxing bodies, so their numbers work for that purpose. The total of all hotel taxes is 17.39%, very close to their 17.4% total.

The actual breakdown is: State 6.17%, Chicago 5.58%, 2.5% for the Metropolitan Pier and Exposition Authority, 2.14% for the Illinois Sports Facilities Authority (Guaranteed Rate Field and Soldier Field), and 1% for Cook County. Since 5.58/11.4=.489, we assumed that the City would receive 48.9% of the revenue UGA estimated under the category of "Hotel Tax to City 11.4%."

The City's tax on restaurant food and beverage is 2.5%, and the total tax on restaurant food and beverage is 10.5%. Since 2.5/10.5=.238, we estimate that the City would receive 23.8% of all food and beverage tax revenues.

[ii] P. 48

[iii] P. 12

[iv] P. 6

[v] P. 45

[vi] P. 28

[vii] P. 45

[viii] By comparison, the bonds issued by the Sales Tax Securitization Corporation (STSC) in December, 2018 had terms ranging from thirteen to thirty years, and interest rates between 3.82% and 5% (City of Chicago, *2018 Comprehensive Annual Financial Report*, p. 79). However, investors would not consider casino revenue as reliable as the City's dedicated sales tax revenue.