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GOVERNOR

STATE OF MICHIGAN
MICHIGAN GAMING CONTROL BOARD
DETROIT

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Date: September 1, 2010

To: State Budget Office Director
Senate and House Appropriation Subcommittees on Agriculture
Senate and House Appropriation Subcommittees on General Government
Senate and House Fiscal Agencies

From: Richard S. Kalm, Executive Director

Re: Status of the Office of Racing Commissioner Transfer to MGCB

In accordance with Section 251 of Public Act 66 of 2010, I am reporting on the status of the transfer of the function of the Office of the Racing Commissioner (ORC) to the Michigan Gaming Control Board (MGCB) pursuant to Executive Order Nos. 2009-45 and 2009-54. Section 251 requires reporting in three specific areas, as follows:

1. Efforts to utilize the most efficient and effective methods of regulating and promoting the horse racing industry.
2. Efforts to promote and support the horse racing industry with the goal of increasing employment and expanded economic activity associated with the horse racing industry.
3. A comparison of Michigan with other states regarding both regulation and promotion of the horse racing industry.

<u>Efforts to Utilize the Most Efficient and Effective Methods of Regulating the Industry</u>

Executive Order 45-2009, dated April 4, 2009, transferred the functions of the Office of Racing Commissioner (ORC) to the Michigan Gaming Control Board (MGCB) effective January 17, 2010. The ORC had already undergone very significant budget and staff reductions prior to that transfer. For FY 2009, the original ORC budget was approximately $3.8 million, funded from the State Services Fee Fund.

On May 5, 2009, Executive Order 22-2009 cut the ORC budget by $1.4 million and eliminated all funding from State Services Fees. For FY 09/10, the Governor's recommended budget was $2.5 million. That amount was reduced to $1.785 million in the final appropriation, with the funding source shifted to the Agriculture Equine Industry Development Fund (AEIDF). The AEIDF is funded through horse racing simulcast revenues and is also the funding source for horse racing purses and a variety of other line items (such as breeders awards and county fair grants) related to the equine industry. The projected continuing reduction in AEIDF revenues during 2010 prompted another budget reduction to $1.4 million for racing regulatory operations.

Prior to the transfer of ORC to MGCB, staffing had already been reduced by 17 full and part time positions in 2009 due to previous budgetary reductions, leaving only five full time positions in what is now the MGCB Racing Section office to provide support and administrative oversight to the regulatory functions. The remainder of the positions now employed by MGCB are all part-time veterinarians, stewards, licensing clerks and equine testing technicians who perform the regulatory activities at the race tracks required by statute, but only when live racing is scheduled. The severity of the budget cuts has even eliminated the entire investigative function, which previously consisted of three positions.

Because the majority of MGCB Racing employees do not work unless live racing is being conducted, the cost of horse racing regulatory operations is largely a function of the number of race days allotted to race tracks each year. MGCB is working with the industry to further increase the cost effectiveness of racing regulatory operations through the following initiatives:

1. Detailed Analysis of Regulatory Costs: For the first time, MGCB has assigned index codes and created a financial management structure that will allow for the analysis of regulatory costs by race track to better understand the variables that drive costs at each type of race track and report those expenses back to the industry more systematically and transparently.
2. Comprehensive Job Task Analysis: MGCB is conducting a detailed job task analysis of each regulatory position at the race track to determine what tasks are essential to the regulatory function and whether those tasks can be performed more efficiently in another way.

Efforts to Promote and Support the Horse Racing Industry

Horse racing in Michigan has been in economic decline for the past two decades, primarily due to increased competition for wagering from casinos, the lottery and other forms of gambling, such as internet wagering and charitable gaming. The number of live racing days in Michigan has declined by approximately 77% from 918 days in 1992 to 217 in 2010. The reduction of live race days is driven by a 55% loss of wagering revenues which equates to a 70% loss of tax revenues since 1992. An equally important factor in the industry’s decline has been the unavailability of the alternative forms of funding for the Michigan horse racing purse structure that many other states are now using successfully to revitalize their horse racing industries. Almost every other state with a significant horse racing industry is now using race track slot machines and/or casinos, off-track betting (OTB), account wagering, internet wagering on horse races, or other alternative funding mechanisms to turn around struggling industries and transform them into job-creating, economic development engines.

In the horse racing industry, the purse structure—the size of the purses that horse owners, trainers, jockeys and drivers have the opportunity to compete for—drives every other aspect of the industry. Larger purses attract higher quality horses, drivers and jockeys. Larger purses also create fuller fields, allow more race dates and make the races more competitive. That competition, in turn, attracts more bettors wagering on the races, both live at the track and, more importantly for the industry, through simulcast wagering from around the country. Approximately 90% of the industry's revenues come from simulcast wagering. Increased simulcast wagering also continues to increase the size of the purses, continuing the upward cycle. In the process, new jobs and small businesses are created that drive economic development and increased tax revenues. This has been the model in other states where alternative funding mechanisms for purses have been implemented.

Michigan's horse racing industry, on the other hand, has been caught in a downward spiral of declining simulcast wagering revenues, resulting in smaller purse pools and fewer race dates, which in turn generate ever smaller simulcast revenues. The problem was compounded when funding for ORC regulatory operations from the State Services Fee Fund was discontinued and the costs shifted to the Agriculture Equine Industry Development Fund (AEIDF), further reducing both the money available to fund purses and the cost of regulatory operations at the race tracks. As a result, race dates and the opportunity for horsemen to race and to generate simulcast wagering revenue for the AEIDF is further diminished and the cycle of attrition continues.

The impact of the trend toward alternative funding for horse racing purse structures in surrounding states has also been devastating to the Michigan horse racing industry. Michigan horsemen have been leaving the state in droves over the past several years in order to compete in surrounding states for purses that are often five to ten times the average purse value in Michigan. Michigan's departing horsemen take with them entire horse breeding farm operations, training centers, racing operations and the dozens of direct and indirect jobs associated with every one of those small businesses. It is worth noting that the hemorrhage of Michigan horsemen to other states also deprives the Michigan economy of the tax revenues generated by dozens and dozens of small businesses and hundreds of employees who are now either unemployed or working in other states.

There have been at least two barriers to the implementation of some form of alternative funding for Michigan's horse racing purse structure. The first is Proposal One of 2004, a ballot initiative that limited the expansion of gaming and effectively prevented the horse racing industry (as well as any other gaming entities) from implementing slot machines and other forms of gaming at the race tracks, as many other jurisdictions have done to fund purse structures. The second barrier has been the lack of any legislative initiative that would provide the tools that the horse racing industry needs to compete on a level playing field with the other forms of gaming and ultimately survive as an industry.

In earlier years, the ORC—now MGCB Racing Section—was appropriated funding intended specifically to help promote and expand the industry. In 2001 and 2002, for example, the ORC expended $96,876 and $92,754, respectively, for promotional activities intended to encourage growth in the horse racing industry by generating increased public participation and interest. Much of that promotional activity took the form of matching grants to race tracks for advertising and other promotional activities. More recently, no legislative appropriation has been provided for promotional activities. Furthermore, successive budgetary and staffing reductions have eliminated the part-time staff position that facilitated even any limited promotional activities with the industry. Any promotional activities currently being conducted are planned and funded by individual race tracks, without any support from MGCB.

One of the most important ways that MGCB can "promote" the horse racing industry in Michigan is to ensure its integrity. Nothing damages the ability of a race track's ability to compete for simulcast wagering dollars from bettors around the country more than the perception that the integrity of the races is somehow corrupted. As an example, in March 2010, the simulcast wagering revenues at Northville Downs dropped 40 percent on the weekend following media attention surrounding three search warrants and subsequent license suspensions related to a joint Michigan State Police-MGCB investigation into race fixing at Michigan harness tracks. That phenomenon occurs because simulcast bettors around the country have many choices as to where to invest their wagering dollars and they will not risk them where there is a perceived lack of integrity. More recently, as the investigation has progressed with the full cooperation of the industry, a total of nine co-conspirators have been suspended from Michigan racing thus far and criminal prosecutions are pending. Anecdotal reports from horsemen indicate that the races are now much more competitive and that attendance and wagering activity is on the upswing. In light of the importance of integrity to the continued survival of the industry, it is essential that MGCB be appropriated adequate funding to provide an investigative capability sufficient to ensure a high level of integrity.

Comparison of Michigan with Other States Regarding Regulation and Promotion

Over the months since the Office of Racing Commissioner transitioned into the Michigan Gaming Control Board, the MGCB has been working with the industry to analyze and report in more detail the costs associated with regulating the horse racing industry in Michigan. As mentioned earlier, MGCB has developed a financial reporting structure that has the capability to identify and break out the various costs *by breed*, for regulatory operations at the race tracks. The financial analysis reveals that the cost of regulation on a given race day is different for each breed because of the different mix of regulatory staff required, differences in travel costs and other variables. The cost figures produced by the MGCB analysis include only the "at-track" costs of regulatory staff salaries and benefits, travel, unemployment, etc., and do not include all costs incurred, including the five positions in the Lansing office that provide administrative oversight and support for the regulatory functions. The average FY 2010 "at-track" regulatory costs per race day for the three breeds are contained in the table below.

Breed/Track(s)	**"At-Track" Regulatory Costs***
Mixed Breed (Mount Pleasant Meadows)	$4,415
Standard Bred (Hazel Park, Northville Downs, Sports Creek)	$5,587
Thoroughbred (Pinnacle Race Course)	$7,042

*Average "at-track" race day regulatory costs, as of pay period ending 8/7/10

As indicated earlier, the “at-track” costs above include only those direct regulatory costs associated with staffing the regulatory effort at the race tracks. They do not reflect the total cost associated with regulating the horse racing industry in Michigan because they do not take into account the additional expense of providing administrative oversight of the various regulatory processes, including licensing, investigations, appeals, human and equine drug testing, etc. The Legislature appropriated $2,067,684 for horse racing regulatory operations in FY 2010 in order to fund 217 days of live racing in the fiscal year ending September 30, 2010. The table below compares the total regulatory cost of horse racing regulatory operations across a number of other racing jurisdictions.

State/Province	Annual Race Dates*	Regulatory Budget*	Regulatory Cost Per Race Day
Illinois	493	$7.3 million	$14,807
Ontario	1654	$11.4 million	$6,892
Indiana	286	$2,359,716	$8,308
Pennsylvania	936	$11,936,155	$12,752
California	810	$11,067,000	$13,662
New Jersey	387	$9,647,489	$24,929
Michigan	217 (FY 2010)	$2,067,684	$9,528

* Utilizes most current figures available

Many states have been much more proactive in the *promotion* of their horse racing industries than Michigan has been over the past decade. As mentioned earlier, assistance with the promotion of the industry in Michigan has been limited to some grant funding provided for advertising and related activities in 2001 and 2002. Even that level of promotional assistance is no longer available in the current fiscal environment.

A number of other states have been in the same situation that Michigan finds itself in currently; with a horse racing industry that is dying a slow death of attrition, shedding jobs and generating continually declining tax revenues. Confronted with that reality, some of those states took decisive action that turned their dying horse racing industries into dynamic, job-creating economic development engines. In particular, there are a number of states successfully using slot machines at race tracks in order to grow their horse racing industries and generate additional general fund tax revenues, including West Virginia, Pennsylvania, Delaware, Iowa, Louisiana, Maine, New Mexico, New York, Oklahoma and Rhode Island. Some examples follow:

Pennsylvania

Pennsylvania’s horse racing industry was dying in 2006 when lawmakers voted to utilize a percentage of slot machine tax revenues to fund horse racing purses. Purses at the six Pennsylvania race tracks have increased from $55 million in 2006 to $201 million in

2008. In turn, that increase has driven the construction of two additional race tracks, created an additional 5,000 direct jobs at the race tracks and an estimated thousands more additional indirect jobs for veterinarians, farmers, construction and maintenance workers, service workers, etc. Dozens of breeding farms have sprung up and/or moved in from other states and horsemen from other states (including many from Michigan) have moved to Pennsylvania to compete for the higher purses. Pennsylvania's horse racing industry, once one of the worst in the country, has become one of the best.

Ontario

Approximately a decade ago, Ontario introduced slot machines at Ontario race tracks and utilizes a portion of the revenues to fund horse racing purses. Ontario's horse racing industry generates an estimated 65,000 full and part-time jobs in Ontario and an estimated $2.6 billion for the Ontario economy (up from $1.6 billion in 2000). Every dollar invested in the industry is estimated to produce a $1.22 net impact on the economy. The horse racing industry is the second largest agricultural program in Ontario. Ontario is a sought-after racing destination, especially for Michigan horsemen, many of whom now race and contribute to the local economy in Ontario because of the more attractive purses available there.

Indiana

Indiana has also revitalized its horse racing industry with tax revenues from slot machines at Indiana race tracks. Greatly increased purses have attracted a large number of horsemen from other states—including Michigan—many of whom have moved their entire breeding, training and racing farm operations to Indiana. One measure of the industry's vitality, the number of registered breeding mares, doubled from 2007 to 2009. The added financial incentives provided by the industry for "Indiana bred" horses has increased the "draw" for horsemen from other states to move their operations to Indiana.

Illinois

Illinois recently approved legislation that would allow online wagering on horse races and video gambling machines at certain business establishments, as part of an effort to fund a $32 billion public works program. The revenue package also includes a three percent "impact fee" on Illinois casinos designed to preserve the thousands of jobs and estimated $1.5 billion in economic impact provided by the Illinois horse racing industry. The addition of online wagering on horse races is intended to generate significant tax revenues from the estimated $100 million in previously illegal online wagering occurring on Illinois races. Part of the revenue generated will fund regulatory operations at Illinois race tracks.

Delaware

Delaware's horse racing industry was floundering in 1995, when that state first introduced slot machines to race tracks in an effort to boost a declining purse structure. That decision is credited with moving Delaware's horse racing industry from mediocrity to national prominence, because the larger purses attracted horsemen—and then simulcast wagering—from all over the country. A 2004 study concluded that nearly 24,000 acres of farmland valued at nearly $500 million was used for horse racing related purposes. At one point in 2007, the proceeds from the three casino race tracks made up approximately 7% of Delaware's $3.1 billion annual budget.

Conclusion

With the prospect of Ohio introducing video-based gaming at Ohio race tracks in the near future, Michigan will be one of the last remaining states without some form of alternative funding for horse racing purses. Without some legislative intervention to level the playing field for the industry, the exodus of Michigan's horse owners, breeding and training operations and horse racing families will continue at an accelerated pace. As other states have demonstrated, a dying horse racing industry can be transformed into a vibrant, job creating, revenue-producing industry, but legislative action is required to provide alternative sources of funding that will expand the purse structure to grow the industry, attract increased simulcast wagering and make Michigan a preferred horse racing industry destination.