


BUDGET NOTES



Office of the New York City Comptroller
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Handicapping the OTB: The Fiscal Health of New York City's Off-Track Betting Corporation

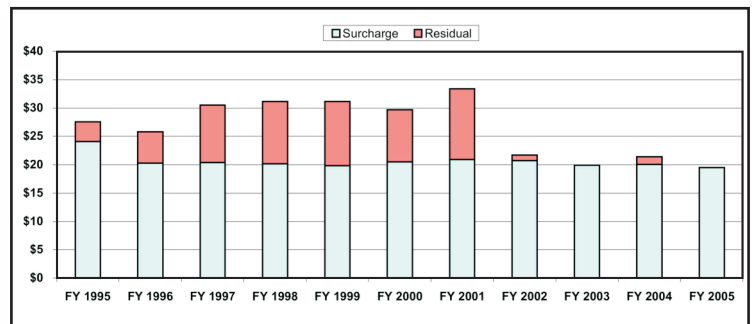
Introduction

New York's system of regionally-based, quasi-public off-track betting corporations was designed to provide benefits to State and local budgets as well as to the racing industry. State-mandated distributions have caused the balance of those benefits to shift away from local governments to the State, race tracks and horse breeders, while jeopardizing the financial health of the off-track betting corporations.

In New York City, the Mayor is pondering whether to sell the New York City Off-Track Betting Corporation (NYCOTB) because it is losing money. The City receives revenues from the NYCOTB based on the amount that NYCOTB takes in from a surcharge levied on winnings from bets placed in OTB parlors and any income (referred to as "residual revenues") that NYCOTB has left over after it has taken care of all its other financial obligations.¹ However, the NYCOTB's other financial obligations, which consist of payments to various entities as required by State law, are absorbing a growing portion of its revenues, driving NYCOTB into the red and leaving no residual revenues for the City.

The decline in City revenues from OTB is depicted in Chart 1. Between FY 1997 and FY 2001 residual revenues to the City averaged \$11 million annually, but plummeted to \$1 million in FY 2002, and the City did not receive any residuals in FY 2003 and FY 2005.

Chart 1. New York City's Revenues from NYCOTB
(\$ in millions)



Source: Comprehensive Annual Financial Report of the Comptroller.

NYCOTB's Financial Condition

In FY 2005, after accounting for operating expenses and statutory distributions to New York State and the State racing industry, NYCOTB revenues available for distribution to the City were \$7.5 million. This was less than the \$17.1 million in surcharges collected by NYCOTB that were due to the City.

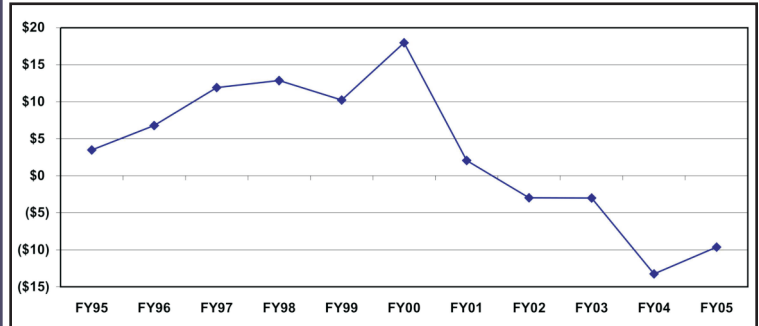
After accounting for the surcharge due to the City, NYCOTB ended FY 2005 with an operating deficit or negative residual revenues of \$9.6 million, as shown in Table 1.

Table 1. NYCOTB Statements of Revenues and Expenses

(\$ in 000's)	2004	2005
Gross Handle	\$1,043,487	\$1,025,734
Operating revenues		
Earned on handle	\$207,206	\$205,168
Surcharge and surcharge breakage	\$20,068	\$19,647
Capital acquisition surcharge	\$3,885	\$3,834
Surcharge received from other OTB communities	\$2,583	\$2,458
Breakage	\$4,800	\$4,694
Uncashed pari-mutuel ticket allocable to New York State	\$3,187	\$2,882
Revenue derived from surcharge	\$9,848	\$9,722
Other	\$1,191	\$2,378
Total operating revenues	\$252,768	\$250,783
Operating Expenses		
Operations	\$108,073	\$104,677
Administrative and selling	\$16,813	\$17,176
Depreciation and amortization	\$4,219	\$3,657
Total operating expenses	\$129,105	\$125,510
Operating income before statutory distributions	\$123,663	\$125,273
Statutory Distributions		
Compensation and other payments to the racing industry	\$95,253	\$94,511
New York State	\$11,272	\$10,925
New York State Racing and Wagering Board Regulatory Fee	\$4,070	\$4,000
Other local governments	\$2,659	\$2,516
Surcharge received from other OTB communities	\$2,583	\$2,458
Total statutory distributions	\$115,837	\$114,410
Operating Income	\$7,826	\$10,863
Non Operating Revenue		
Interest Income	\$222	\$483
Total non-operating revenue	\$222	\$483
Income before distribution to the City of New York	\$8,048	\$11,346
Less Capital acquisition	\$3,885	\$3,834
Revenue available for distribution to the City of New York	\$4,163	\$7,512
Less Surcharge to the City of New York	\$17,409	\$17,131
Residual Revenues	(\$13,246)	(\$9,619)

FY 2005 represents the fourth consecutive year in which NYCOTB has ended the fiscal year with an operating deficit. After a turnaround in FY 1995 when NYCOTB generated residual revenues of \$3.5 million after two consecutive years of operating deficits, NYCOTB residual revenues generally trended upward over the next five years. However, as Chart 2 shows, residual revenues began trending down in FY 2001 and were negative by FY 2002.

Chart 2. NYCOTB Residual Revenues (\$ in millions)



The fiscal picture is not expected to improve anytime soon. The Modified FY 2006 Budget and FYs 2007 through 2010 Financial Plan released in May 2006 projects operating losses of \$8.2 million in FY 2006 growing to \$22.6 million by FY 2010. The expected continuing operating losses of NYCOTB imply that the City is unlikely to receive residual revenues over the term of the financial plan. In addition, from FY 2008 on the fiscal outlook becomes bleaker. Operating losses will exceed the surcharge due to the City. Therefore, NYCOTB may not have the resources to meet all of its statutory distributions to other entities.

Residual revenues have been declining primarily because growth in statutory distributions has far outpaced that of operating revenues. From FY 1995 to FY 2005, operating revenues grew 23.8 percent while statutory distributions grew 32.7 percent. Operating expenses grew at a more moderate pace of 28.2 percent, but faster than operating revenues, nonetheless.

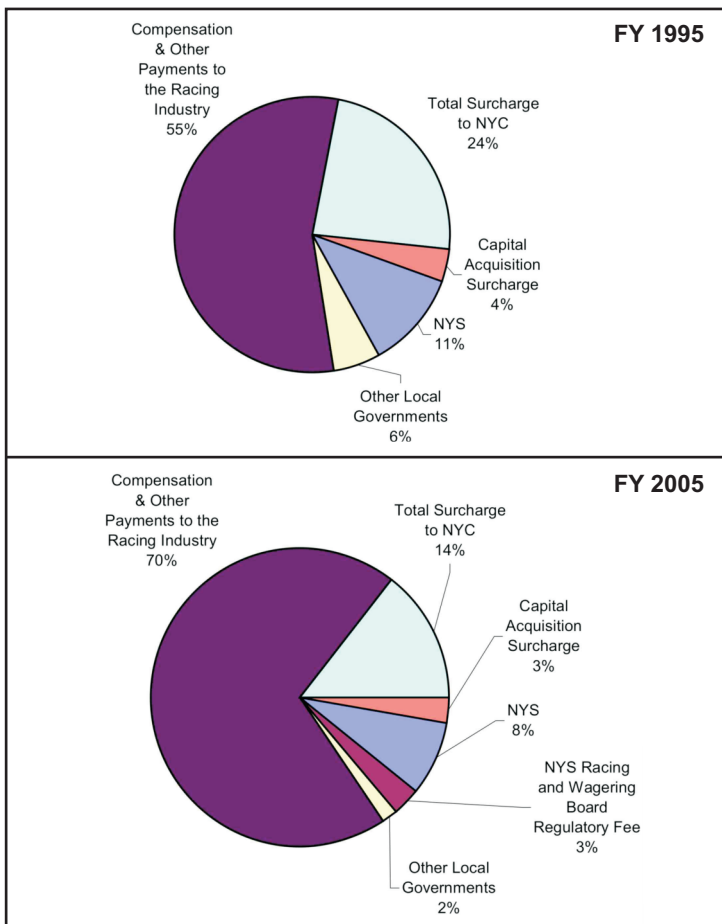
Recent changes to the Racing, Pari-Mutuel Wagering and Breeding Law contributed to the growth in statutory distributions and have an adverse effect on NYCOTB's budget. Chapter 62 of the Laws of 2003 amended the Racing and Wagering Law to impose a "hold harmless" fee that requires OTB to make payments to harness tracks even if no racing is conducted. NYS also imposed a new regulatory fee in 2003 of 0.39 percent of gross wagers, which was later increased in July 2005 to 0.5 percent. This payment of approximately \$4 million for FYs 2004 and 2005 is projected to be \$5.4 million in FY 2006 and to range from \$5.1 million to \$5.3 million in FYs 2007 through 2010.

¹ The City recognizes revenues from NYCOTB on a cash basis while the NYCOTB's financial statements are prepared on an accrual basis. Therefore, the revenues the City receives in a given fiscal year will not match NYCOTB's operating results for that fiscal year because of the difference in accounting as well as the timing of payments to the City.

Chart 3 shows how the composition of statutory distributions has changed since FY 1995. In FY 1995 total surcharges due to the City and to other local governments were 24 percent and 6 percent, respectively, of statutory distribution.² Compensation and other payments to the racing industry comprised 55 percent of statutory distributions. In FY 2005, total surcharges due to the City and to other local governments had diminished to 14 percent and 2 percent of statutory distributions while compensation and other payments to the racing industry had expanded to 70 percent. In addition, the regulatory fee to the NYS Racing and Wagering Board made up another 3 percent of statutory distributions.

Operating expenses grew at a slower pace than statutory distributions from FY 1995 to FY 2005. Over this period, expenditures grew at an annual rate of 2.5 percent, slightly below the average local inflation rate of 2.8 percent, and exceeded revenue growth by less than 0.5 percentage points annually. However, between FY 2001—the last year that NYCOTB reported positive residual revenues—and FY 2005, revenues declined from \$253 million to \$251 million, or 0.7 percent, while operating expenses grew from \$122 million to \$126 million, or 3.2 percent.

Chart 3. Composition of Statutory Distributions

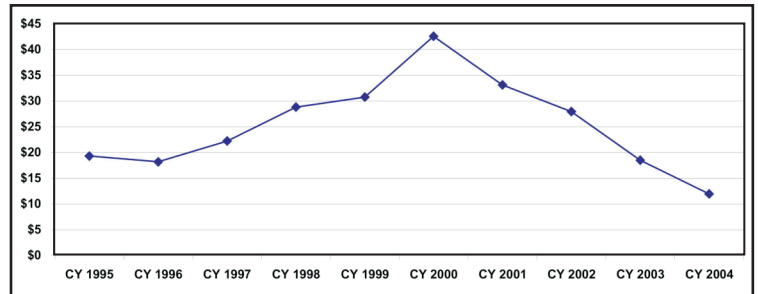


² Total surcharges due to the City include surcharges that NYCOTB receives on behalf of the City from other regional OTBs.

Other Regional Off-Track Betting Corporations (OTB)

NYCOTB’s deteriorating financial condition is not unique. As Chart 4 shows, aggregate residual revenues for all other OTBs in New York State have been trending downwards since calendar year 2000. While the aggregate residual revenues are still in positive territory the trend mirrors that of NYCOTB.

Chart 4. All Other OTBs Aggregate Residual Revenues (\$ in millions)



Similar to NYCOTB, the growth in statutory distributions for all other regional OTBs has significantly outpaced revenue growth over the past ten calendar years. Operating revenues grew 3.8 percent from 1995 to 2004 while statutory distributions increased 25.9 percent over this period.

Conclusions and Recommendations

The financial condition of NYCOTB is deteriorating mainly due to stagnant revenues and escalating statutory distributions. NYCOTB’s handle (the total amount of bets placed) has been flat at about \$1 billion over the past five years and is projected to remain flat through FY 2010. While not discussed in this report, the racing industry has faced increasing competition from other forms of wagering. In New York State, an arm of State government widely promotes the New York State Lottery and the State has entered into a number of agreements to allow casinos on upstate Indian reservations. The proceeds from these gaming venues do not benefit New York City.

In this context, the State Legislature has chosen to increase the statutory expenses of the NYCOTB, increasing revenue to the racing industry but exacting a toll on the fiscal health of NYCOTB and the other regional OTBs. As this report shows, statutory distributions grew at a faster rate than revenues over the past 10 years, and the portion of those distributions going to benefit the racing industry increased significantly.

Furthermore, these actions have been undertaken without compensation to the City of New York or other localities whose OTB revenues have been siphoned away.

Several bills were introduced this year in the State Legislature that were aimed at reducing statutory distributions. It is disappointing that no actions were taken on them. The provisions included reducing the regulatory fee to the Racing and Wagering Board from 0.5 percent to 0.25 percent and ending the hold harmless provision that allows harness tracks to receive compensation even when they are not conducting races.

In addition to reducing statutory distributions, initiatives to address the disparate growth of operating revenues and operating expenses are necessary for the long-term fiscal health of the OTBs and, consequently, for there to be continued benefits to local governments from their operation.

Unfortunately, bills aimed at improving revenues were also not acted upon in the 2006 legislative session. These bills included authorization for OTBs to offer rebate programs to

new or preferred patrons, and requirements for the State to reimburse any county for the loss of revenues from a substantial decrease (more than 5 percent) in revenues at off-track betting corporations.

While there may be room to trim NYCOTB's operating expenses, they would have to be reduced 16 percent by FY 2010 for the Corporation to break even. It is hard to imagine that reductions of that magnitude would not affect OTB's ability to generate revenue, particularly since the 5 percent surcharge is collected only from winning bets placed at OTB parlors.

The State's OTBs are facing structural problems that need to be addressed on a systematic basis. Timely passage of legislation to reduce off-track betting statutory distributions and improve revenues would help address the issues that are posing a serious challenge to the system.

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Structure of NYCOTB Finances

Revenues

NYCOTB derives its revenues mainly from commissions retained on gross wagers. Commissions on wagers range from 15 percent to 31 percent depending on the type of wager and the location of the race.³ Over the past ten years, retained commissions averaged 20 percent of gross wagers and accounted for 80 percent of the corporation's operating revenue.

In addition to commissions retained on gross wagers, NYCOTB also collects a 5 percent surcharge on that part of the pari-mutuel pool to be distributed to winning bets placed at OTB branch offices.⁴ However, NYCOTB serves only as a collection agent for this surcharge on in-state wagers, and must distribute the surcharge to local governments. Fifty percent of this surcharge must be distributed to New York City and the balance to the city or county in which the track conducting the race is located.⁵ For the surcharge on the part of the pari-mutuel pool to be distributed to winning bets on out-of-state races, NYCOTB distributes half of the surcharge to the City and retains the other half for its general purposes. NYCOTB also collects on the City's behalf its share of surcharge from wagers placed at other regional off-track betting corporations on races conducted on tracks located in the City.

An additional 1 percent surcharge is imposed on winning multiple, exotic and super exotic wagers. Revenues from this 1 percent supplemental surcharge are dedicated to finance acquisition, construction or equipping of offices, facilities or premises of NYCOTB. The revenues from this surcharge are held in a Capital Acquisition Fund.

Other sources of revenue include breakage (the rounding down of winning payoffs), that part of the pari-mutuel pool representing uncashed winning tickets and non-wager income such as interest income, admission fees, and concession revenues from teletheaters. Revenues from breakage are distributed to the State, the State's breeding and development funds, and the City. All revenues from uncashed pari-mutuel tickets are distributed to the State.⁶

³ There are four types of wagers—regular, multiple, exotic and super exotic. A regular bet or regular wager is a single bet or wager on one horse. A multiple bet or multiple wager is a single bet or wager on two horses. An exotic bet or exotic wager is a single bet or wager on three to five horses. A super exotic bet or super exotic wager is a single bet or wager on six or more horses.

⁴ Wagers placed at teletheaters and through the telephone are exempt from this surcharge.

⁵ Where the track conducting the race is located in a city with a population of more than 100,000 the entire balance is distributed to the city. Where the track conducting the race is not located in a city with a population of more than 100,000 the entire balance is distributed to the county in which the track is located. Where the track conducting the race is located partially within a city with a population of more than 1,000,000 and partially within a county, 25 percent of the balance will be distributed to the city and the remainder to the county.

⁶ All winning tickets must be presented for payment before April 1st of the year following the year of purchase.

Expenditures

Under the Racing, Pari-Mutuel Wagering and Breeding Law, NYCOTB is required to distribute part of its revenues from wagers to New York State, New York State's breeding and development funds, and track operators. It is also required to distribute the 5 percent surcharge and any residual revenues after statutory distributions and operating expenses to the City.

Statutory distributions consist of:

- *Compensation to racing entities*—depending on the type of wagers, compensation to racing entities range from 4.5 percent to 7.4 percent of total wagers on races at in-state tracks and 3.5 percent to 8.5 percent of total wagers on races at out-of-state tracks.
- *Contributions to breeders' funds*—NYCOTB contributes 0.5 percent of the handle from bets on thoroughbred and steeplechase races to the New York State Thoroughbred Breeding and Development Fund, and 1.0 percent of the handle on harness races to the Agriculture and New York State Horse Breeding Development Fund.
- *Payments to New York State*—New York State imposes a state tax on retained commission ranging from 0.5 percent to 3.5 percent of total handle depending on the type of wager and the location of the race. In addition, NYCOTB is required to remit all uncashed pari-mutuel winnings to the State. A penalty of 5 percent and interest at the rate of 1 percent per month is assessed if payments are not remitted when due.
- *New York State Racing and Wagering Board Regulatory Fee*—NYCOTB is required to pay a regulatory fee of 0.5 percent of gross handle to the New York State Racing and Wagering Board. This is a relatively new fee.
- *Distribution to other local governments*—NYCOTB distributes 50 percent of the 5 percent surcharge on winning bets on in-state races conducted on tracks located outside the City to the local governments in which the tracks are located. NYCOTB retains 50 percent of the surcharge on out-of-state simulcast for its own general purpose.
- *Distributions to the City*—NYCOTB is required by law to distribute the 5 percent surcharge to the City. This includes the City's half of the surcharge due from other regional off-track betting corporations on races conducted on tracks located in the City.

In addition, NYCOTB's residual revenue, after deductions for statutory distributions and operating expenses, is distributed to the City.