

LOTTERY AND GAMING

A Financial Analysis of the OLG's Gaming Expansion and Sale
of the Greater Toronto Area Gaming Bundle

Spring 2018

About this Document

Established by the *Financial Accountability Officer Act, 2013*, the Financial Accountability Office (FAO) provides independent analysis on the state of the Province's finances, trends in the provincial economy and related matters important to the Legislative Assembly of Ontario.

The FAO produces independent analysis on the initiative of the Financial Accountability Officer. Upon request from a member or committee of the Assembly, the Officer may also direct the FAO to undertake research to estimate the financial costs or financial benefits to the Province of any bill or proposal under the jurisdiction of the legislature.

This report was prepared at the direction of the Officer in response to a request from a member of the Assembly. In keeping with the FAO's mandate to provide the Legislative Assembly of Ontario with independent economic and financial analysis, this report makes no policy recommendations.

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Table of Abbreviations

| Abbreviation | Long Form |
|--------------|--------------------------------------------|
| COSA | Casino Operating and Services Agreement |
| DCF | Discounted cash flow |
| FAO | Financial Accountability Office |
| GBH | Great Blue Heron |
| GTA | Greater Toronto Area |
| MSIFN | Mississaugas of Scugog Island First Nation |
| NPP | Net Profit to the Province |
| NPV | Net present value |
| OFNLP | Ontario First Nations Limited Partnership |
| OGGLP | Ontario Gaming GTA LP |
| OLG | Ontario Lottery and Gaming Corporation |
| RFP | Request for proposal |

1 | Essential Points

Starting in 2010, the Ontario Lottery and Gaming Corporation (OLG) undertook a review of its gaming and lottery operations in order to generate more revenue for the Government of Ontario (the Province). As part of OLG's gaming review, OLG divided its gaming assets into eight different regional "bundles" and began a process to identify private sector service providers to operate each bundle.

This report reviews the Greater Toronto Area (GTA) Gaming Bundle, which was transitioned to a service provider in January of 2018. The report highlights key aspects of the agreement between OLG and the service provider, estimates the financial benefit to the Province of the sale and proposed gaming expansion of the GTA Gaming Bundle, and identifies key financial risks.

Deal Structure

- The GTA Gaming Bundle includes the OLG Slots at Woodbine, the OLG Slots at Ajax Downs, and Great Blue Heron Casino. Overall, the GTA Gaming Bundle generates about \$600 million in revenue for the Province¹ from over 4,000 slot machines and 60 table games.
- In August of 2017, Ontario Gaming GTA LP (OGGLP) was announced as the successful bidder to operate the GTA Gaming Bundle assets for an initial 22-year term. Under the deal, OLG retains the gaming revenue from the assets in the GTA Gaming Bundle and will no longer be responsible for capital and operating costs. OLG also received a one-time \$170 million payment from OGGLP. In return, OLG will make payments to OGGLP to operate the assets. OGGLP will also retain all non-gaming revenue.
- The GTA Gaming Bundle deal includes approval for OGGLP to expand the number of games at each existing gaming location and also to build a new casino in the region.² In total, once expansion is completed, the GTA Gaming Bundle could have up to 11,100 slot machines and 570 table games.³

Financial Benefit to the Province

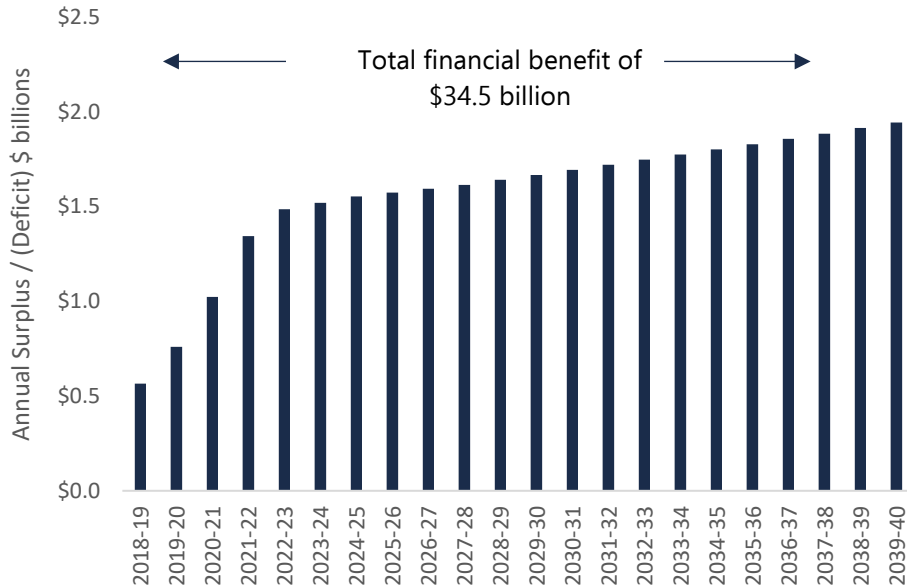
- The FAO estimates that the GTA Gaming Bundle will contribute a total financial benefit to the Province of \$34.5 billion over the next 22 years.

¹ Revenue to the Province is OLG's net income plus a Win Contribution of 20 per cent of OLG's gaming revenue from its resort casinos and Great Blue Heron Casino.

² OGGLP may also relocate an existing casino in the same area. OGGLP announced on April 3, 2018 that it intends to relocate Casino Ajax to a new development in the City of Pickering. Ontario Gaming GTA L.P. "WORLD CLASS RESORT IN DURHAM REGION SET TO PROCEED". 3 April. 2018. Web. 15 April. 2018.

³ See appendix A for more details.

Estimated Contribution to the Annual Surplus / (Deficit), billions of dollars



Source: FAO analysis of Provincial information.

- The FAO’s \$34.5 billion financial benefit estimate is in nominal dollars. The financial benefit to the Province is estimated to be \$13.1 billion on a net present value (NPV) basis, which accounts for inflation and investment risk.
- OLG has targeted an incremental annual revenue increase to the Province of \$211 million by 2021-22 from the planned expansion of gaming in the GTA Gaming Bundle region.⁴ Based on the FAO’s review, the incremental revenue increase to the Province is expected to be \$398 million by 2021-22.⁵ This forecast assumes that 90 per cent of planned gaming expansion will be completed by 2021-22. The FAO estimates that OLG will miss its \$211 million Provincial revenue expansion target should planned gaming expansion be less than 50 per cent complete by that time.

Key Assumptions and Risks

The FAO’s estimate of a \$34.5 billion financial benefit to the Province over 22 years is based on a number of key assumptions and risks, including the following:

⁴ The Province has targeted an incremental revenue increase of \$889 million by 2021-22 from province-wide expanded gaming and lottery initiatives. Of the \$889 million target, \$211 million is expected from planned gaming expansion in the GTA Gaming Bundle region.

⁵ Total GTA Gaming Bundle revenue to the Province in 2021-22 is forecast to be \$1.3 billion, of which \$398 million would result from the planned expansion of gaming.

- The financial benefit calculation assumes that OGGLP will expand gaming at each location to the maximum-approved levels and open a new casino in the GTA. Planned gaming expansion is expected to be 50 per cent complete by 2019-20 and 100 per cent complete by 2022-23.⁶ If the gaming expansion timelines are not achieved, then the FAO's estimate of a \$34.5 billion financial benefit to the Province over 22 years will be overstated.
- The FAO assumes that all necessary provincial and municipal approvals are obtained by OGGLP. The delay or rejection of planned gaming expansion would reduce the FAO's estimated financial benefit to the Province.
- The FAO's analysis includes an assumption that gaming expansion will reduce the overall revenue per electronic game and table game due to market saturation.⁷ Any deviation from the assumption will impact the financial benefit calculation.

Revenue Sharing Agreements

- OLG makes payments to various parties, such as First Nations and municipalities, which are calculated based on revenue specifically defined in various agreements. As OLG will continue to receive all gaming revenue from the GTA Gaming Bundle, the process to make the payments to these parties is not expected to change.⁸
- The FAO estimates that OLG will pay a total of \$3.1 billion to First Nations and municipalities from GTA Gaming Bundle revenue over the next 22 years, or \$1.1 billion on a net present value basis.
- The FAO estimates that a total of \$775 million from GTA Gaming Bundle revenue will be directed to problem gambling funding over the next 22 years, or \$303 million on a net present value basis.

⁶ See appendix A for more details.

⁷ See chapter 4 for more details.

⁸ However, non-gaming revenue will be affected. See chapter 5 for more details.

2 | Introduction

The Ontario Lottery and Gaming Corporation (OLG) sells lottery games and conducts and manages gaming facilities in Ontario. Lottery games include tickets such as LOTTO 6/49 and instant games such as Cash FOR LIFE. Gaming facilities include resort casinos with hotels, such as Niagara Fallsview, and other casinos which are limited to slot machines, such as Casino Woodbine.

OLG is responsible for conducting and managing gaming at four resort casinos, 13 slot machine casino facilities at racetracks and seven other casinos in Ontario.⁹ OLG also sells lottery games to approximately 9,800 independent retailers across the province.¹⁰

OLG is wholly-owned by the Province. For the fiscal year 2016-17, OLG generated over \$2 billion in revenue for the Province.¹¹ The revenue reported by the Province from OLG includes OLG's net income plus a Win Contribution,¹² and is characterized by OLG as Net Profit to the Province (NPP). About half of OLG's revenue is from the lottery business and half is from gaming facilities.¹³

In 2010, the Province directed OLG to undertake a review of its gaming and lottery operations in order to generate more revenue for the Province.¹⁴ As a result of OLG's review, the Province expected annual revenue from gaming and lottery to increase by \$1.0 billion by 2017-18.¹⁵ However, the Province has since revised this target to a revenue increase of \$889 million by 2021-22.¹⁶

As part of OLG's gaming review, OLG recommended the expansion of regulated private sector delivery.¹⁷ Consequently, OLG divided its gaming assets into eight different "bundles", each representing a geographic region.¹⁸ To date, OLG has identified service providers to operate seven of the eight regional gaming bundles. The operating agreement between OLG and the service provider for the East Gaming Bundle was the first to be finalized in January of 2016.

⁹ The four resort casinos are operated under contract by private operating companies. As of April 9, 2018, day-to-day operations of 16 of the 20 slot machine casino facilities at racetracks and other casinos have transitioned to private sector service providers, with the remainder expected by summer 2018.

¹⁰ Ontario Lottery and Gaming Corporation. "2016-17 Annual Report." 31 Mar. 2017.

¹¹ Treasury Board Secretariat. "Annual Report and Consolidated Financial Statements, 2016-17." 31 Mar. 2017: 115.

¹² Win Contribution is a payment made by OLG to the Province as prescribed by Ontario Regulation 81/12 and the *Ontario Lottery and Gaming Corporation Act, 1999*. Win Contribution is calculated as 20 per cent of OLG's gaming revenue from its resort casinos and Great Blue Heron Casino.

¹³ Ontario Lottery and Gaming Corporation. "2016-17 Annual Report." 31 Mar. 2017.

¹⁴ Ontario Lottery and Gaming Corporation. "Modernizing Lottery and Gaming in Ontario." 12 Mar. 2012.

¹⁵ Ibid.

¹⁶ Information provided to the FAO by the Province. This projection was prepared by OLG for its Business Plan Fiscal 2017-18 in the fall of 2016.

¹⁷ Ontario Lottery and Gaming Corporation. "Modernizing Lottery and Gaming in Ontario." 12 Mar. 2012.

¹⁸ Additionally, OLG's review proposed changes to its lottery terminals and sports betting, and to build a new entertainment centre in Niagara Falls. Ontario Lottery and Gaming Corporation. "OLG's Modernization Project Status." Web. 25 Mar. 2018.

This report reviews the GTA Gaming Bundle, which was transitioned to a service provider in January of 2018. The report highlights key considerations of the agreement between OLG and the service provider, estimates the financial benefit to the Province of the sale and proposed gaming expansion of the GTA Gaming Bundle, and identifies key financial risks.

Appendix B provides more information on the development of this report.

3 | Deal Structure

Gaming Bundle

The GTA Gaming Bundle includes the OLG Slots at Woodbine, the OLG Slots at Ajax Downs,¹⁹ and Great Blue Heron Casino. Overall, the GTA Gaming Bundle generates about \$0.6 billion in revenue for the Province from over 4,000 slot machines and 60 table games.²⁰ The Woodbine and Ajax facilities include live horse racing and betting, but these activities are owned and operated by private companies. OLG does not generate revenue from horse betting.²¹

In addition to the existing gaming facilities, the GTA Gaming Bundle includes approval for an expansion of the number of games at each location and also the potential for a new casino to be built in the GTA.²² In total, once expansion is completed, the GTA Gaming Bundle could have up to 11,100 electronic games (i.e. slot machines) and 4,560 table positions (or about 570 table games).²³

Request for Proposal

OLG issued a request for proposal (RFP) for the GTA Gaming Bundle in February of 2016, in which pre-qualified proponents could make bids to purchase and operate the GTA Gaming Bundle assets.²⁴ Under the proposed RFP, OLG would receive an initial up-front payment from the successful service provider from the sale of the GTA Gaming Bundle, but then OLG would make future payments to the successful service provider as compensation for operating the GTA Gaming Bundle's assets. As a result, the RFP invited prospective service providers to bid on both the sale price and the amount of future compensation payments from OLG.

OLG announced in August of 2017 that Ontario Gaming GTA LP (OGGLP) was the successful bidder, purchasing the GTA Gaming Bundle assets for \$170 million.²⁵ The final agreement between OLG and OGGLP, known as the Casino Operating and Services Agreement (COSA), was executed in January of 2018.

¹⁹ The OLG Slots at Ajax Downs is expected to relocate to the proposed Durham Live complex in the City of Pickering in late 2019. Please see appendix A for further details.

²⁰ Information provided to the FAO by the Province.

²¹ In addition, the GTA Gaming Bundle does not include any aspects of the lottery business.

²² OLG and the Minister of Finance must approve the expansion of gaming in the GTA Gaming Bundle, as prescribed under Ontario Regulation 81/12 and the *Ontario Lottery and Gaming Corporation Act, 1999*. OLG and the Minister of Finance have already approved the expansion of the number of games at existing locations in the GTA Gaming Bundle and the number of games for a new casino in the GTA. However, the introduction of table games at an existing site where there currently are none or the establishment of a new gaming site is still subject to final approval by OLG and the Minister of Finance. In addition, any gaming expansion at an existing site or the establishment of a new gaming site may be subject to municipal approvals.

²³ Appendix A provides further detail on the gaming expansion limits. The FAO's analysis assumes no further gaming expansion in the GTA Gaming Bundle beyond the approved limits of 11,100 slot machines and 570 table games.

²⁴ Prior to the RFP, OLG issued a Request for Pre-Qualification (RFPQ) for the GTA Gaming Bundle in December of 2013. Ontario Lottery and Gaming Corporation. "RFPQ# 1314-045 Modernizing Land Based Gaming in Ontario, Gaming Bundle 5 (GTA)." 12 Dec. 2013.

²⁵ Great Canadian Gaming Corporation. "GREAT CANADIAN GAMING AND BROOKFIELD COMPLETE ACQUISITION OF THE GTA BUNDLE IN ONTARIO GAMING MODERNIZATION PROCESS". 23 Jan. 2018. Web. 25 Mar. 2018.

OGGLP is a partnership among three companies.²⁶ Great Canadian Gaming Corporation,²⁷ which holds a 49 per cent interest in the partnership, will operate the assets, while the other partners will provide financial support.

GTA Gaming Bundle Deal Terms

Under the terms of the COSA with OGGLP, OLG retains the gaming revenue from the assets in the GTA Gaming Bundle but forgoes the capital and operating costs. OLG is also required to make a payment to OGGLP as compensation for operating the assets.²⁸ OGGLP retains all non-gaming revenue from the GTA Gaming Bundle, such as from dining or hotels. The initial term of the operating agreement (COSA) between OLG and OGGLP is 22 years, plus an automatic additional 10 years if a new development at Woodbine is completed, with further options to extend the term by increments of 10 years thereafter.

OLG makes payments to various parties, such as First Nations and municipalities, which are calculated based on revenue specifically defined within various agreements.²⁹ As OLG receives all gaming revenue from the GTA Gaming Bundle, the process to make the payments to these parties is not expected to change.³⁰

OGGLP is allowed to expand gaming in the GTA Gaming Bundle but cannot exceed the limits on the number of slots and table games positions.³¹ OLG is not responsible for any debt incurred by OGGLP as part of the expansion of gaming. There are no investment limits and only limited OLG constraints imposed on non-gaming initiatives. However, both gaming expansion and non-gaming initiatives may be subject to municipal approvals where applicable.

OLG will continue to conduct and manage gaming for the GTA Gaming Bundle on behalf of the Crown in accordance with the Criminal Code. OLG will continue to establish rules of play and impose standards for responsible gaming to maintain compliance with Alcohol and Gaming Commission regulations. OLG will also review and approve OGGLP's business plan, additions of material non-gaming amenities and amendments to lease agreements.³²

²⁶ Great Canadian Gaming Corporation (49 per cent), Brookfield Business Partners L.P. (49 per cent), and Clarivest Group Inc. (2 per cent).

²⁷ Great Canadian Gaming Corporation operates 21 gaming facilities, three theatres and two hotels. It operates in British Columbia, Ontario, Nova Scotia, New Brunswick and Washington State.

²⁸ The FAO cannot disclose the amount of the compensation payment due to disclosure restrictions under s. 13 of the *Financial Accountability Officer Act, 2013*.

²⁹ Chapter 5 reviews these parties and the respective payments in further detail.

³⁰ However, non-gaming revenue will be affected. See chapter 5 for more details.

³¹ See appendix A for more details.

³² Part 4 of OLG's RFP on the GTA Gaming Bundle includes a comprehensive list of the roles and responsibilities of both OLG and the service provider.

4 | Financial Analysis

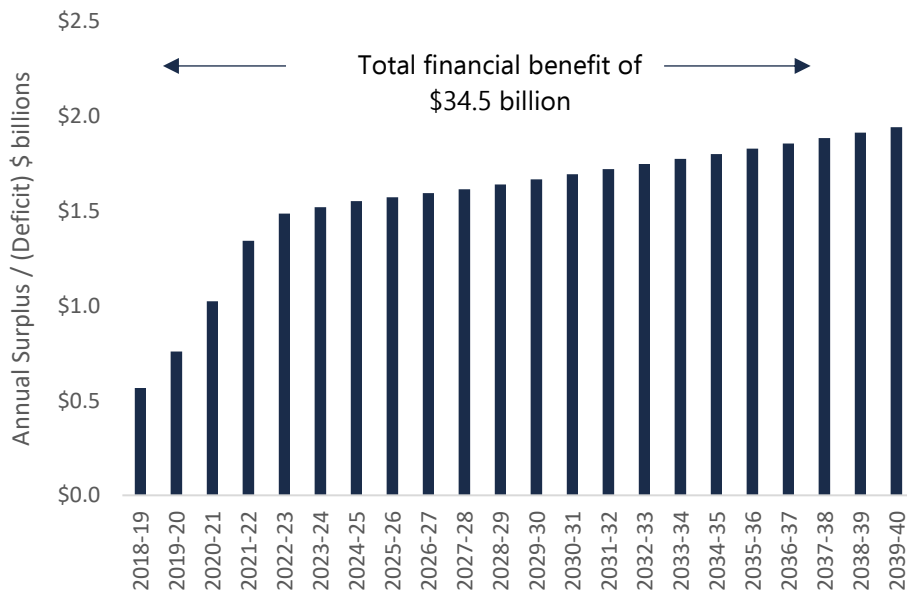
This chapter reviews the FAO’s estimated financial benefit to the Province of the sale and expansion of the GTA Gaming Bundle. The FAO’s key assumptions and estimation uncertainties are reviewed throughout.

Financial Benefit to the Province

The GTA Gaming Bundle contributed \$0.6 billion in revenue to the Province in 2016-17. The FAO estimates that the sale of the GTA Gaming Bundle and planned expansion of gaming in the region will result in revenue to the Province rising to \$1.3 billion by 2021-22.³³

Over the initial 22-year term of the Casino and Operating Services Agreement (COSA), the FAO estimates that the GTA Gaming Bundle will contribute a total financial benefit to the Province of about \$34.5 billion.

Estimated Contribution to the Annual Surplus / (Deficit), billions of dollars



Source: FAO analysis of Provincial information.

The \$34.5 billion estimate of the financial benefit to the Province consists of direct revenue from OLG of about \$33.4 billion. The remaining \$1.1 billion is the FAO’s estimate of the Province’s gain from sales and corporate tax revenue derived from the operation of GTA Gaming Bundle assets over the 22-year period.

³³ The FAO has selected this year because it coincides with OLG’s updated revenue expansion target of a province-wide increase in revenue to the Province of \$889 million by 2021-22.

The expected \$34.5 billion financial benefit to the Province over 22 years includes forecasted revenue from both the existing assets in the GTA Gaming Bundle and anticipated revenue from the planned expansion of gaming. Overall, about \$18.3 billion of the financial benefit is expected to come from existing GTA Gaming Bundle assets, with the remaining \$16.2 billion from the planned expansion of gaming within the GTA Gaming Bundle.

Estimated Nominal Financial Benefits of the GTA Gaming Bundle, billions of dollars

| Location | Existing Assets | Planned Expansion | Total |
|------------------|-----------------|-------------------|-------------|
| Woodbine | 15.8 | 6.8 | 22.6 |
| Ajax / Durham | 2.0 | 2.6 | 4.6 |
| Great Blue Heron | 0.5 | 3.1 | 3.6 |
| Other | 0.0 | 3.7 | 3.7 |
| Total | 18.3 | 16.2 | 34.5 |

Source: FAO analysis of Provincial information.

Notes: This table shows the FAO’s estimate of the nominal financial benefits to the Province of the GTA Gaming Bundle. The figures are not from the perspective of OLG or OGGLP. The other location accounts for OGGLP’s option to open a new casino in the GTA. Numbers may not add due to rounding.

The FAO estimates that Casino Woodbine is the most valuable asset in the GTA Gaming Bundle; contributing total nominal financial benefits of \$22.6 billion to the Province over the next 22 years. Most of the benefits from Woodbine are from existing assets, whereas most of the benefits for the other assets in the GTA Gaming Bundle are from planned gaming expansion.

Net Present Value

Although the FAO estimates that the GTA Gaming Bundle will contribute a financial benefit to the Province of \$34.5 billion, this amount is in nominal terms which does not account for inflation and investment risk. Consequently, the FAO estimated the financial benefit to the Province on a discounted cash flow (DCF) basis. DCF analysis is useful because it accounts for both the timing and risk of future benefits. The summation of discounted future cash flows is known as the net present value (NPV).

The FAO estimates the NPV of the financial benefit to the Province of the GTA Gaming Bundle at \$13.1 billion.³⁴ The existing assets account for \$8.9 billion of this estimate, and the planned gaming expansion accounts for \$4.3 billion. Overall, the FAO estimates that Casino Woodbine is the most valuable asset in the GTA Gaming Bundle, with an estimated NPV of about \$9.3 billion.

³⁴ The FAO discounted 22 years of future cash flows, which is the length of the initial operating agreement (COSA).

Estimated NPV of the GTA Gaming Bundle, billions of dollars

| Location | Existing Assets | Planned Expansion | Total |
|------------------|-----------------|-------------------|-------------|
| Woodbine | 7.6 | 1.7 | 9.3 |
| Ajax / Durham | 1.0 | 0.4 | 1.5 |
| Great Blue Heron | 0.2 | 0.9 | 1.2 |
| Other | 0.0 | 1.1 | 1.1 |
| Total | 8.9 | 4.3 | 13.1 |

Source: FAO analysis of Provincial information.

Notes: This table shows the FAO's estimate of the NPV of the financial benefit to the Province of the GTA Gaming Bundle. The NPV figures are not from the perspective of OLG or OGGLP. The other location accounts for OGGLP's option to open a new casino in the GTA. Numbers may not add due to rounding.

The FAO estimates that planned gaming expansion accounts for close to 50 per cent of the nominal benefits, but only 33 per cent of the discounted (NPV) benefits. This is because the benefits from gaming expansion are riskier and expected to occur later in the 22-year term. The FAO assumed a 7 per cent discount rate on the estimated financial benefits derived from the existing GTA Gaming Bundle assets, but a 12 per cent discount rate on the estimated financial benefits derived from planned gaming expansion.³⁵

Revenue Expansion Target

As noted previously, OLG has targeted incremental annual revenue to the Province³⁶ of \$889 million by 2021-22 from lottery and gaming expansion initiatives. Based on information provided to the FAO, \$211 million of the \$889 million target is expected to come from the planned expansion of gaming in the GTA Gaming Bundle region.³⁷

Based on the FAO's review, the FAO forecasts incremental Provincial revenue of \$398 million by 2021-22 from the planned expansion of gaming within the GTA Gaming Bundle.³⁸ However, there is uncertainty with this estimate, as the FAO assumes that 90 per cent of planned gaming expansion will be completed by 2021-22. OLG will miss its modernization revenue expansion target should planned gaming expansion be less than 50 per cent complete by that time.

³⁵ The FAO solved for the discount rate that would set the NPV of the FAO's estimate of future cash flows to Great Canadian Gaming Corporation from the GTA Gaming Bundle equal to the movement in the company's share price following the announcement that it was awarded the RFP on the GTA Gaming Bundle. The FAO estimates a 12 per cent discount rate using this method. The FAO also estimated the discount rate for existing GTA Gaming Bundle assets using the capital asset pricing model (CAPM) for Great Canadian Gaming Corporation's current operations. The FAO estimates a 7 per cent discount rate using this method.

³⁶ Provincial revenues from OLG are defined as OLG's net income plus a Win Contribution, which is a payment made by OLG to the Province as prescribed by Ontario Regulation 81/12 and the *Ontario Lottery and Gaming Corporation Act, 1999*. Win Contribution is calculated as 20 per cent of OLG's gaming revenue from its resort casinos and Great Blue Heron Casino.

³⁷ Information provided by the Province to the FAO. This projection was prepared by OLG for its Business Plan Fiscal 2017-18 in the fall of 2016.

³⁸ The FAO estimates that total Provincial revenue from the GTA Gaming Bundle in 2021-22 will be approximately \$900 million from existing assets plus \$398 million from the planned expansion of gaming for a total of \$1.3 billion.

Key Assumptions and Risks

The FAO's estimate of a \$34.5 billion financial benefit to the Province over 22 years is based on a number of key assumptions and risks, including the following:

Achieving Planned Gaming Expansion Timelines

The FAO assumes that OGGLP will expand gaming positions at each location to the maximum-approved levels and open a new casino in the GTA. The FAO assumes this planned gaming expansion will be 50 per cent complete by 2019-20 and 100 per cent complete by 2022-23.³⁹ If the gaming expansion timelines are not achieved, then the FAO's estimate of a \$34.5 billion financial benefit to the Province over 22 years will be overstated.

Obtaining Required Approvals

The FAO assumes that all necessary provincial and municipal approvals are obtained by OGGLP. OLG and the Minister of Finance have approved the maximum number of gaming positions for electronic games (slots) and table games for each geographic area (gaming zone) in the GTA Gaming Bundle. However, the introduction of table games at an existing site where there currently are none or the establishment of a new gaming site is still subject to final provincial and municipal approvals. The delay or rejection of planned gaming expansion would reduce the FAO's estimated financial benefit to the Province.

Profitability of Gaming Assets

The GTA Gaming Bundle region currently has 4,000 slot machines and 60 table games, with approval to expand to 11,100 electronic games and 570 table games. The FAO's financial benefit calculation assumes that gaming expansion will reduce the revenue per electronic game and table game due to market saturation. Additionally, there is a risk of sales cannibalization⁴⁰ among casinos because there may not be sufficient demand for gaming in the GTA region and existing customers could switch to the new casino.⁴¹ For electronic games, the FAO assumes a 3 per cent decline in revenue per slot machine due to new slot machines at existing locations. The FAO assumes an additional 15 per cent reduction in revenue per slot machine due to the new casino opening in the GTA. For table games, the FAO assumes a relatively small drop in revenue per table, as there are currently only 60 table games in the GTA Gaming Bundle region, all of which are located at Great Blue Heron Casino.

³⁹ See appendix A for more details.

⁴⁰ Marionneau, V., & Nikkinen, J. (2018). "Market Cannibalization Within and Between Gambling Industries: A Systematic Review." *Journal of Gambling Issues*.

⁴¹ However, one study found that although customers may switch, overall spending on gambling rises following the introduction of new casinos: Gallagher, R. (2014). "An examination of cannibalization effects within the riverboat gaming industry: The case of Illinois-area casinos." *Growth and Change*.

Finally, OGGLP may introduce material non-gaming amenities at existing locations.⁴² The FAO assumes that the addition of material non-gaming amenities will not increase the profitability of gaming revenue at existing locations. However, if the addition of non-gaming amenities does lead to an increase in the profitability of gaming assets, then the FAO's estimated financial benefit would improve.

Capital Investment Risk

Significant capital investment is required to expand gaming, which may increase financial risks for OGGLP and could impact the FAO's estimate of the financial benefit to the Province. However, the parent companies in OGGLP have a combined value of over \$8 billion,⁴³ so the capital investment risk may be absorbed and shared among the partners. OLG is not responsible for any debt incurred by OGGLP or costs incurred by the service provider.

The FAO estimates that the magnitude of the financial risks for OLG are relatively smaller than for the OGGLP partnership because of the deal structure. For example, the FAO estimates that in the absence of achieving the planned gaming expansion, OLG would likely retain the baseline net income growth from existing GTA Gaming Bundle assets.⁴⁴ However, the FAO estimates that OGGLP would report net losses in this scenario.⁴⁵

⁴² For example, OGGLP announced in April of 2018 that it intends to relocate Casino Ajax to a new development site in the City of Pickering. The casino will be hosted at the Durham Live complex, which is expected to include more than 600 hotel rooms, an amphitheater for live concerts, significant retail space and more amenities. Ontario Gaming GTA L.P. "WORLD CLASS RESORT IN DURHAM REGION SET TO PROCEED". 3 April. 2018. Web. 15 April. 2018.

⁴³ As of April 13, 2018, the combined market capitalizations of Great Canadian Gaming Corporation and Brookfield Business Partners was over \$8 billion.

⁴⁴ However, OLG may be liable to compensate OGGLP in the event of failed gaming expansion, should OGGLP provide sufficient evidence to OLG that reasonable attempts were made to expand.

⁴⁵ As such, gaming expansion will likely be pursued by OGGLP.

5 | Revenue Sharing

OLG makes payments to various parties based on the amount of gaming revenue that is generated. For example, OLG makes payments to municipalities that host OLG's gaming facilities, as defined by contribution agreements. The Mississaugas of Scugog Island First Nation (MSIFN), which hosts Great Blue Heron (GBH) Casino, is subject to the same contribution structure as municipalities. MSIFN also receives payments from OLG equal to 4 per cent of gaming revenue that is generated from GBH Casino.⁴⁶ Finally, Ontario First Nations Limited Partnership (OFNLP) receives payments from OLG equal to 1.7 per cent of Gross Revenue (which includes gaming and non-gaming revenue), as defined in the agreement with OFNLP.⁴⁷

Overall, the FAO estimates that OLG will pay a total of \$3.1 billion to third parties from GTA Gaming Bundle revenue over the next 22 years. The FAO estimates the net present value (NPV) of these payments at \$1.1 billion.⁴⁸

Estimate of OLG Payments to Third Parties, 2018-19 to 2039-40, millions of dollars

| Party | Existing Assets | Planned Expansion | Total | Discounted (NPV) |
|-----------------------------------|-----------------|-------------------|--------------|------------------|
| Municipalities | 525 | 906 | 1,431 | 525 |
| MSIFN | 163 | 591 | 755 | 250 |
| OFNLP | 374 | 571 | 945 | 344 |
| Total Third-Party Payments | 1,063 | 2,069 | 3,131 | 1,119 |

Source: FAO analysis of Provincial information.

Notes: The existing assets column accounts for the FAO's estimate of total nominal third-party payments from revenue from existing GTA Gaming Bundle assets over the next 22 years. The planned expansion column accounts for third-party payments from revenue from planned gaming expansion.

In addition, Provincial policy is to direct 2 per cent of OLG slot machine gross revenue, excluding OLG's resort casinos and Great Blue Heron Casino, to problem gambling funding. The FAO estimates that a total of \$775 million from GTA Gaming Bundle revenue will be directed to problem gambling funding over the next 22 years, or \$303 million on an NPV basis.

⁴⁶ MSIFN previously received 5 per cent of gross slot revenue from the GBH Casino. However, the previous revenue-sharing agreement between OLG and MSIFN was terminated and a new revenue-sharing agreement was negotiated on September 8, 2016. OLG provided \$7.4 million to MSIFN in compensation for the contract termination. The new agreement stipulates that OLG is to provide MSIFN with 4 per cent of Gaming Revenue, as defined, from Electronic Games and the Live Table Games from the GBH Casino. In addition, the new agreement transferred the ownership of table games from MSIFN to OLG which were included in the GTA Gaming Bundle sale.

⁴⁷ As noted in chapter 3, the COSA transfers all non-gaming revenue to OGGLP. This will affect OLG's agreement with OFNLP. In May of 2017, OFNLP initiated arbitration proceedings against the Province and OLG regarding the matter. At the time this report was finalized, the arbitration proceedings had not yet concluded.

⁴⁸ The FAO discounted the future payments from revenue from existing GTA Gaming Bundle assets at 7 per cent, and future payments from planned gaming expansion at 12 per cent.

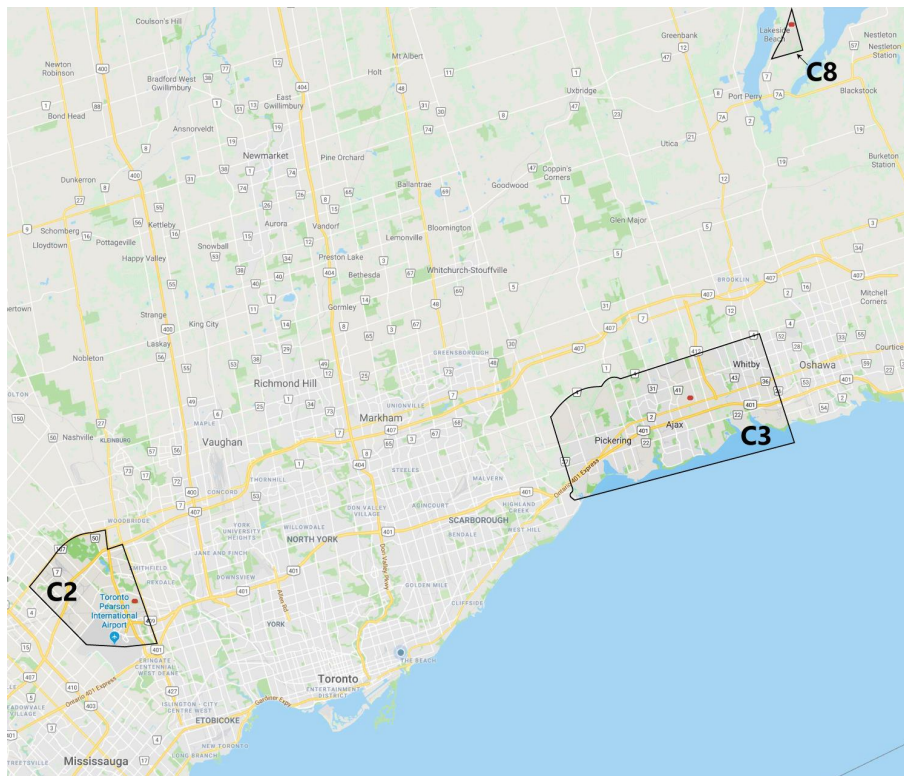
Appendices

Appendix A: GTA Gaming Bundle Gaming Zones

The GTA Gaming Bundle has already been approved for a total of 11,100 electronic games (such as slot machines) and 4,560 table positions (or about 570 table games).⁴⁹ However, OLG and the Minister of Finance must review and provide final approval for the introduction of table games to an existing gaming site where there currently are none or the establishment of a new gaming site. In addition, OLG must approve a casino closure or the expansion of gaming positions above the maximum limits set out in the COSA.⁵⁰

OLG also determines the geographical boundaries for gaming zones within a bundle region. There are three gaming zones in the GTA Gaming Bundle, and only one casino can operate within each zone.⁵¹

Gaming Zones and Boundaries for the GTA Gaming Bundle



Source: FAO, Google.

⁴⁹ The FAO assumes that the average table game includes 8 seats, or table positions.

⁵⁰ As prescribed by Ontario Regulation 81/12 and the *Ontario Lottery and Gaming Corporation Act, 1999*.

⁵¹ Page 4 of Part 1 of OLG's RFP on the GTA Gaming Bundle provides a map of the gaming zones.

Further, OLG imposes maximum electronic and table game positions for each gaming zone, as well as maximum limits relative to other zones within the GTA Gaming Bundle. For example, if the gaming position limit is maximized at Casino Woodbine and 5,000 electronic games are established, then only 3,000 electronic games would be available for the new GTA casino.

GTA Gaming Bundle Limits by Gaming Zone

| Gaming Zone | Electronic Games | | Table Positions | |
|-----------------------|------------------|-----------------|-----------------|-----------------|
| | Existing | Expansion Total | Existing | Expansion Total |
| C2 (Woodbine) | 3,010 | 5,000 | 0 | 2,400 |
| New Zone (GTA) | 0 | 5,000 | 0 | 2,400 |
| Total | 3,010 | 8,000 | 0 | 3,000 |
| C3 (Ajax / Durham) | 800 | 2,500 | 0 | 1,200 |
| C8 (Great Blue Heron) | 535 | 2,500 | 480 | 1,200 |
| Total | 1,335 | 3,100 | 480 | 1,560 |
| Grand Total | 4,345 | 11,100 | 480 | 4,560 |

Source: FAO analysis of Provincial information.

Notes: The existing column accounts for the number of electronic games and table positions that are currently in the GTA Gaming Bundle, i.e. before any gaming expansion activities. The expansion total column accounts for the total number of approved electronic games and table positions in the GTA Gaming Bundle. Numbers are not additive due to gaming zone constraints. For example, if the gaming zone constraint is maximized in gaming zone C2 (Casino Woodbine) and 5,000 electronic games are established, then only 3,000 electronic games would be available for the new GTA casino.

OLG may establish a new gaming zone in the GTA and OGGLP has the right of first opportunity to build a new casino in the area. Also, OGGLP has the option to close a casino,⁵² and then build a new casino, so long as it remains within the original gaming zone, subject to provincial and municipal approvals.

OGGLP announced in April of 2018 that it intends to relocate Casino Ajax to a new development site in the City of Pickering.⁵³ The casino will be hosted at the Durham Live complex and is expected to be operational by late 2019.⁵⁴ The FAO includes both Casino Ajax and Durham Live in its presentation because the FAO estimates financial benefits from Casino Ajax until its relocation.

⁵² However, OGGLP does not have the option to close the GBH Casino.

⁵³ The relocated casino is within the gaming zone C3 boundary.

⁵⁴ Ontario Gaming GTA L.P. "WORLD CLASS RESORT IN DURHAM REGION SET TO PROCEED". 3 April. 2018. Web. 15 April. 2018.

Appendix B: Development of this Report

Authority

The Financial Accountability Officer accepted a request from a member of the Legislative Assembly to undertake the analysis presented in this report under paragraph 10(1)(b) of the *Financial Accountability Officer Act, 2013*.

Key Questions

The following key questions were used by the FAO as an initial guide while undertaking research for this report:

- How is the agreement between the winning bidder and OLG structured?
 - What aspects of the business will OLG or the Province maintain control over?
 - What impact will the sale have on any revenue-sharing agreements between municipalities and First Nations?
 - Is there a limit to new capital investment for the winning bidder?
 - Is OLG responsible for any debt incurred by the winning bidder in the event of bankruptcy or contract termination?
- What is the estimated fiscal impact of the sale of the GTA Gaming Bundle?
 - What is the estimated impact on the Province's annual surplus / (deficit)?
 - What is the estimated impact on Provincial net debt?
 - What are the key financial risks as a result of the sale?
 - How will the sale of the GTA Gaming Bundle help OLG reach its stated objective of remitting an additional \$900 million annually to the Province by 2021?
- What is an estimated fair selling price for the GTA Gaming Bundle?
 - What are the key uncertainties and considerations with this estimate?

Scope

This report does not seek to assess:

- the merits of the decision to sell the GTA Gaming Bundle;
- the impact on jobs and economic development; and
- the impact on profitability of other OLG assets.

Methodology

This report has been prepared with the benefit of information provided by, and meetings with staff from, the Ontario Lottery and Gaming Corporation and the Ministry of Finance, and a review of relevant literature and other publicly available information. Specific sources are referenced throughout.

The FAO's estimate of the profitability of the GTA Gaming Bundle is subject to various assumptions and uncertainties as detailed in the report.

All dollar amounts are in Canadian, current dollars (i.e. not adjusted for inflation) unless otherwise noted.