

Interim Report on the State of Thoroughbred Racing in Maryland
and Potential Future Operating Models

As Required by House Bill 897

Submitted by:



Submitted to:

Senate Budget and Taxation Committee

Sen. Guy Guzzone, Chair

House Appropriations Committee

Del. Benjamin S. Barnes, Chair

House Ways and Means Committee

Del. Vanessa E. Atterbeary, Chair

September 30, 2022

Introduction

This interim report is presented on behalf of the Maryland Jockey Club (MJC), the Maryland Thoroughbred Horsemen's Association (MTHA), and the Maryland Horse Breeders Association (MHBA) pursuant to the provisions of HB 897. This legislation, which was passed in the 2022 legislative session, included a number of provisions related to the ongoing progress of the Racing and Community Development Act of 2020 (RCDA), including reports by the Maryland Stadium Authority (MSA) on the progress, design and construction of the racing facilities, authorizing the Maryland Economic Development Corporation (MEDCO) to investigate the feasibility, costs and potential benefits of an acquisition of the Laurel Park site by a government or non-profit entity, and as it relates to the Thoroughbred industry stakeholders:

"...On or before September 30, 2022, the mile Thoroughbred licensee, the Maryland Thoroughbred Horsemen's Association, and the Maryland Horse Breeders Association shall report, in accordance with § 2-1257 of the State Government Article, to the Senate Budget and Taxation Committee, the House Appropriations Committee, and the House Ways and Means Committee on the status of the Maryland Thoroughbred racing operations, including models and recommendations regarding future and planning operations of the Maryland Thoroughbred racing industry".

Efforts by MJC, MTHA and MHBA since the adoption of HB 897 have focused on: (i) refinement of the programmatic elements of the Laurel Park training and racing facilities and consultation with MSA directed at cost evaluation and function; (ii) the fundamentals of a potential non-profit operating Laurel Park and evaluation of financial models; and (iii) provision of information to assist MEDCO in its valuation and analysis of future operations.

Background

Thoroughbred racing in the State of Maryland has a luminous and storied history within both the Mid-Atlantic region and the United States. As the home of the Preakness Stakes®, the second jewel of the Triple Crown, the eyes of the racing world and the public turn toward Maryland on the third weekend in May.

The horse industry is steeped in Maryland's history and culture, but it also has a significant economic impact that underlies the need for the RCDA and a new operating model:

- The overall economic impact of the horse industry in Maryland has been estimated at \$2.06 billion.
- Twenty-five percent of Maryland's agricultural land (705,000 acres) is devoted to horses.
- The number of direct and indirect jobs associated with the horse industry is 28,000 and industry participants spend over \$1 billion annually.
- The racing sector has the largest economic impact within the equine industry, estimated at over \$572 million.

Significant challenges to the sport have occurred in recent decades and Thoroughbred racing in Maryland has not been immune. The Great Recession of 2008-09, the rise of alternative wagering opportunities and most recently the COVID-19 pandemic have all impacted the sport. Maryland also faces growing competition from increased purses in Virginia supported by alternative gaming and the recent acquisition of Colonial Downs by Churchill Downs, Inc.

A review of recent, key industry metrics, however, shows a steady recovery from the impact of the COVID-19 pandemic in terms of racing product:

	2019	2020	2021	2022F
# Races	1,691	1,230	1,442	1,472
Handle (\$M)	\$513.0	\$371.1	\$500.6	\$507.4
Preakness Day Handle (\$M)	\$100.7	\$51.5	\$113.4	\$105.5
Purse Levels Paid(\$M)	\$63.1	\$46.6	\$57.6	\$56.2
Purse per Race	\$37,312	\$37,926	\$39,952	\$38,201

Note: Purse levels in 2021 and 2022 were reduced by \$5 million each year to fund RCDA

While still below levels prior to the COVID-19 pandemic, the number of races in Maryland has increased since 2020 despite disruptions to training and racing due to unexpected track repairs at Laurel Park in both 2021 and 2022. The “handle” is the total amount of wagering. As shown, statewide handle has increased following 2020 and has been supported by strong wagering levels on the Preakness Stakes® and that day’s racing card in 2021 and 2022. Purses are the lifeblood of Thoroughbred racing and Maryland sits in the middle of a region where purses are funded by both pari-mutuel wagering and Video Lottery Terminals (VLT), slots and historic horse racing machines. Both the overall level of purses paid and the purses paid per race have improved since 2020.

In addition to the importance of purse money in Thoroughbred racing, breeding is a critical component of the horse racing ecosystem. In order to have a strong racing program, a continuous supply of horses is essential. Horse farms also play a critical role in Maryland’s agricultural and open space network.

The Maryland horse breeding industry has been steady while seeing significant competitive challenges in the region. Maryland ranks in the top seven states in the U.S. for foal production and has seen a 56 percent increase since 2011. Though incentives to encourage breeders to foal, raise and race their horses in Maryland have increased, it is important to note that several other states in the area have significantly more funds dedicated to reward the production of horses. Maryland-bred horses now regularly make up a third of all horses racing in the state and Maryland-bred horses are a critically important part of Maryland’s racing product now and into the future.

According to the Jockey Club 2022 Fact Book, over the past five years the number of:

- mares bred in Maryland annually have been above the national average;
- foals born in Maryland have remained consistent despite lower national numbers; and
- Maryland-bred runners have increased and stabilized.

Despite these improvements, racing revenues have been outpaced by growing operating costs. The fundamental challenge to the longer-term sustainability of the industry is that the operational expenses of two full-time training facilities and racetracks are not supportable from the revenue generated by wagering and non-wagering sources. In addition to challenging operating conditions, Laurel Park and Pimlico are very capital-intensive operations. Given the age and condition of both facilities, significant investment is required to maintain operations.

As racetracks and training facilities, Laurel Park and Pimlico do not receive a share of VLT revenues and, as a result, MJC sought a revenue support agreement with MTHA and MHBA. In 2012, MJC, the MTHA and MHBA entered into a Ten-Year Agreement that provides MJC with annual operational support including the transfer of certain wagering revenue to fund additional racing days and racing operations and offset losses. The agreement, which stabilized Maryland racing and has allowed year-round racing to continue uninterrupted, expires on December 31, 2022. Given the uncertainty surrounding future operations and ownership as the RCDA remains in flux, the stakeholders anticipate extending the agreement through 2023.

The need for funding of significant capital improvements to track facilities, a stable and predictable year-round racing schedule, and preservation of the Preakness Stakes® in Baltimore have become critical issues. In an effort to resolve these broader concerns, representatives of the City of Baltimore, MJC, and MTHA convened a series of negotiating sessions in 2019. The result was the RCDA which included:

- A path for retaining the Preakness Stakes® in Baltimore City, redevelopment of Pimlico and the surrounding land, and consolidation of training and the majority of the racing schedule in a redeveloped facility at Laurel Park. A funding plan based largely on existing racing and community funds was also committed. These concepts became the core of a legislative effort in 2020 and culminated with the General Assembly enacting the RCDA, an integrated program to retain the Preakness Stakes® at Pimlico and sustain a year-round racing and training program at Laurel Park.
- The redevelopment of Pimlico to host the world-famous Preakness Stakes® and other races and events of national interest and provide space and property for community uses during the remainder of the year.
- All Maryland Thoroughbred live racing and training would be consolidated at Laurel Park. In order to accommodate such a consolidation, Laurel Park would be redeveloped to include multiple racing surfaces for racing and training, best in class training/stabling facilities to accommodate approximately 1,600 horses, workforce housing, a new clubhouse facility, and flexibility for future growth.

- The designation of MSA as the entity responsible for the funding, design, and construction of both facilities.

With Pimlico redeveloped for the Preakness meet and other events of national and local interest for the community's benefit and Laurel Park redeveloped as the home of year-round racing and training, the expense base of the industry would be reduced to critical break-even or better financial performance. Additionally, the Preakness Stakes® would enjoy a new home at Pimlico and drive community development for the surrounding neighborhoods.

Current Status

Since enactment of the RCDA, the industry stakeholders have been working with MSA on the needs for both Laurel Park and Pimlico. Laurel Park project improvements now include: (1) re-alignment of the three track surfaces to accommodate the addition of a synthetic racing and training surface, (2) a complete track surface rebuild of the dirt track, including the base; (3) the potential addition of the 58-acre Brock Bridge parcel to provide for additional stabling to safely house up to 1,600 horses and a synthetic gallop track for training; (4) a new, downsized clubhouse to replace the current antiquated facility. MJC has provided MSA with comments regarding the overall programming at Pimlico and is engaged in negotiations with MSA and the City of Baltimore regarding design, construction and management as contemplated by RCDA.

As noted, this is a complex development project including the building of two facilities, minimizing the interruptions to training and racing, and navigating the delays caused by the COVID-19 pandemic and other external factors including the volatility of interest rates and the dramatic rise of materials and labor pricing. Accordingly, as of the end of the 2022 legislative session, a funding deficit of \$175 million was identified. The parties are awaiting further cost analysis from MSA based upon programmatic consultations.

Moreover, a major federal tax consequence has also been identified and evaluated under Section 118 of the Federal Tax Code. Under Section 118, expenditures made by a government unit to construct improvements at a facility owned by a for-profit entity will constitute taxable income to the for-profit entity. This issue affects the improvements at Laurel Park (where MJC will have reversion rights) rather than Pimlico (where MJC will not have reversion rights). RCDA 2020 addressed this potential impact in two ways:

- it eliminated any corresponding state income tax liability; and
- it authorized the creation of a joint venture structure including the local governmental entities or units of same to hold the racing parcels and newly built capital improvements.

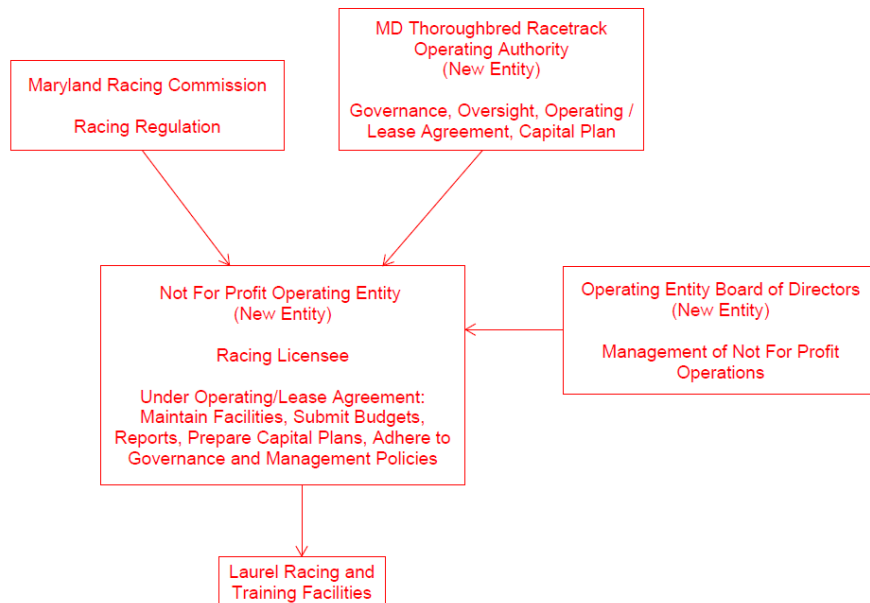
However, given the lack of federal tax precedent, tax advisors have concluded that under the joint venture structure, there is a significant risk that MSA expenditures at Laurel Park may be treated as taxable income to the owner, MJC. The upfront tax liability would be significant and unacceptable.

Accordingly, the only option for continuing the Laurel Park redevelopment is a potential conveyance by MJC of all or a portion of the property to a state or governmental entity or a not-for-profit entity which does not currently exist. HB 897 authorized MEDCO to evaluate the Laurel Park property and the feasibility, costs and potential benefits relating to the state acquiring the property. Furthermore, since a conveyance of the Laurel Park property to a governmental entity or a not-for-profit could impact future operations of Thoroughbred racing, the industry stakeholders were asked to explore possible options for future operations of the industry.

Potential Future Operating Model

As contemplated by HB 897, the future of the RCDA will require conveyance at an agreed upon valuation of all or a portion of the property to the state or a not-for-profit entity. It is critical to emphasize that the Pimlico and Laurel Park projects are interdependent and not independent. The RCDA cannot proceed unless there is a final plan for Laurel Park that accommodates the consolidation of Thoroughbred racing and training operations at Laurel Park.

As directed by HB 897, the stakeholders have explored various options based on similar structures existing today, including the operations of Del Mar, the New York Racing Association, and Monmouth Park in New Jersey. Each involves ownership of the track property by the state with operations conducted by an operating entity created by the state (Del Mar), a franchisee (NYRA), or a lessee (Monmouth). Of the various models, the stakeholders have focused on the Del Mar model as a potential structure for Maryland’s Thoroughbred racing operations as illustrated below.



Open Issues

Given the complexity of this project and the on-going work by MSA to evaluate project costs and financing terms, there are a number of issues that will require further discussion and refinement. These include:

- Overall Project Budget Issues – For various reasons, including necessary programmatic changes, COVID-19 pandemic related delays, interest rate and inflationary pressures, the current capital funding for the Pimlico and Laurel Park redevelopment projects are projected to exceed the dedicated funds available. Funding options for the full project based on updated cost estimates and for future operations must be determined.
- Laurel Park Property Acquisition – MEDCO is appraising the Laurel Park properties and discussions with MEDCO on the terms of any acquisition will follow. To date, those discussions have not commenced.
- Laurel Park and Pimlico Operating Relationship – The structure of a new operating entity will need to be finalized and the terms of any operating model be developed should the state and MJC agree on a conveyance of the Laurel Park property.
- Finalization of Laurel Park Programmatic Concept and Capital Plan – MSA and MTHA/MHBA have been working on concept plans which need to be finalized and cost estimates need to be developed. Reference is made to the MSA report to be filed on September 30 regarding the status of the projects and timing of cost estimates for both Laurel Park and Pimlico.
- Transition Issues – Any final plan must address the importance of maintaining training and racing operations during construction at both facilities.

The Maryland Jockey Club, the Maryland Thoroughbred Horsemen's Association, and the Maryland Horse Breeders Association appreciate the opportunity to present this report to the leaders and members of the Senate Budget and Taxation Committee, the House Appropriations Committee, and the House Ways and Means Committee and look forward to continued dialogue and support for this important industry.