

CITY OF PHILADELPHIA PENNSYLVANIA

OFFICE OF THE CONTROLLER

Promoting honest, efficient, and fully accountable government

ASSESSMENT OF SECOND CITY CASINO OWNERSHIP STRUCTURE

FINANCIAL IMPACT ON THE CITY OF PHILADELPHIA

FEBRUARY 2013



City Controller
ALAN BUTKOVITZ



Assessment of Second City Casino - Ownership Structure

Financial Impact on the City of Philadelphia

EXECUTIVE SUMMARY

Why the Controller's Office Conducted the Assessment

The Controller's Office engaged HLT Advisory to assess elements of a proposal submitted by Penn National Gaming Inc., for the second casino license in the City of Philadelphia. Penn Gaming's proposal consists of an arrangement by which the licensee would make annual distributions through a non-profit organization, which would then distribute the funds to the School District of Philadelphia and the Philadelphia Pension Fund.

What the Controller's Office Found

After assessing the structure of Penn Gaming's proposed concept and its financial impact on the City of Philadelphia, some of the significant findings include the following:

- Adding a second city casino would increase the city's direct local gaming taxes from \$9 million to between \$17 and \$19 million a year.
- Under the Penn Gaming proposal, the casino distribution of fund projections to the non-profit entity over a 15-year period would total \$115 million, which is in addition to the direct local gaming tax revenue. However, for the first eight years, the distribution to the non-profit is projected to be \$2 million a year.
- Critical issues that need to be addressed, include, but are not limited to:
 - Greater clarity with regard to how Penn Gaming intends to transfer the facility to itself, as the licensee and the landowner, including the terms of the transfer,
 - How will the owner operate the casino and can the management contract be structured so that the operator focuses on market share and expenses,
 - To ensure that PCBC will not assume any legal liability by virtue of this transaction
 - To ensure that the \$2 million payment in the first eight years is guaranteed

What the Controller's Office Recommends

While this proposal represents an opportunity for the city to indirectly benefit from casino profits without any injection of capital by the non-profit, the benefits from this arrangement are largely dependent items that need to be addressed. This includes a review of the performance of the casino relative to all other casinos in the local market and whether the non-profit can negotiate a prioritization in surplus cash distributions. These and other recommendations are more fully described at the end of the report.

Honorable Alan Butkovitz
City Controller
City of Philadelphia
1230 Municipal Service Building
1401 John F Kennedy Boulevard
Philadelphia, PA 19102-1679

February 5, 2013

Re: Assessment of Casino Proposal from Penn National Gaming Inc.

Dear Mr. Butkovitz,

1. INTRODUCTION

HLT Advisory Inc ("HLT") has been retained by the Office of the Controller of the City of Philadelphia ("the Controller") to assess elements of a proposal submitted by Penn National Gaming Inc. ("Penn") for the second casino license in the City of Philadelphia (or the "City"). Specifically, the assessment focuses on the structure of Penn's proposed concept and its financial impact on the City.

The remainder of this letter report and attached appendices summarize the results of the assessment.

2. BACKGROUND

The Pennsylvania Race Horse Development and Gaming Act (the "Act") allows for three categories of casino licenses in the State:

- Category 1: allows eligible licensed racetracks to operate up to 5,000 slot machines and up to 250 table games. A total of seven Category 1 licenses are permitted in the State. No Category 1 facility is allowed to be located within a 20 linear miles of another Category 1 facility. Currently, six Category 1 licensed facilities operate in the State.
- Category 2: allows standalone casino facilities to be located in a city of the first class (i.e. cities with a total population of one million or more such as Philadelphia), a city of the second class (i.e. cities with a total population between 250,000 to 999,999 such as Pittsburgh) or a tourism-enhanced location. Similar to Category 1, Category 2 licensed facilities are permitted to operate up to 5,000 slot machines and up to 250 table games. No more than five Category 2 licenses are permitted in the State. Two Category 2 licensed facilities are permitted to be located within a city of the first class and only one within a city of the second class. Currently, four Category 2 licensed facilities operate in the State.
- Category 3: allows casino facilities to be located in "well-established resort hotels having no fewer than 275 guest rooms". Category 3 licensed facilities are

permitted to operate up to 500 slot machines only or up to 600 slot machines and 50 table games if holding a table game operation certificate. No Category 3 licensed facility is permitted to be located within 15 linear miles from any other licensed facility and after July 20, 2017 that restriction will increase to 30 linear miles. Currently, only one Category 3 licensed facility operates in the State.

The Act also created the Pennsylvania Gaming Control Board ("PA Gaming Board"). The PA Gaming Board regulates all casino gaming in the State including the process to award licenses.

In December 2006, two Category 2 licenses were awarded in the City of Philadelphia. One licence was awarded to HSP Gaming, LP which subsequently opened SugarHouse Casino in 2010. The other licence was awarded to Philadelphia Entertainment and Development Partners, LP which proposed the development of the Foxwoods Casino Philadelphia. This latter license was revoked in 2010 due to financing/funding issues and the PA Gaming Board recently initiated a process to re-tender the second license allocated to the City.

A total of six proposals or bids have been submitted to the PA Gaming Board for the second City license. Generally, three proposals (including Penn's) are located in South Philadelphia close to the City's professional sport team facilities. Two proposals are located in the City's downtown area and the remaining proposal is located close to SugarHouse.

The Act prohibits ownership of more than one and one-third interest in casino licenses, as well the State Constitution generally prohibits municipalities from having "financial interest" in private sector companies. As Penn currently owns and operates a racetrack casino in the State, it has proposed a unique ownership structure of the gaming entity which will hold the license to operate the casino. In general, Penn has proposed that two-third ownership would be held by a non-profit corporation. The non-profit corporation would be for the benefit of City related entities (i.e. local school board and City government pension fund). For the purposes of this report, HLT has assumed that Penn's proposed ownership structure does not contravene the Act's or the State Constitution's ownership restrictions.

3. SCOPE OF ASSESSMENT

HLT focussed the impact assessment on two core components. Specific issues imbedded in these components are stated in terms of questions. The two core impact components and associated issues are:

- Market Impact – As Local and County Governments in the State receive 4.0 percent of slot revenues and 2.0 percent of table revenues as direct payment from casinos operating in their community, an additional casino in the City should be able to increase total gaming revenue upon which the 4.0 percent and 2.0 percent tax rates would apply. How does Penn's proposal relative to all other proposals impact the total amount of gaming revenue generated from casinos located in the City?
 - Note: the City also benefits indirectly from State gaming taxes above and beyond Local and County Government's direct allocation. In addition, the casino will generate a host additional City taxes and fees such as property

and parking. The scope of the assessment undertaken did not permit the undertaking of a full impact assessment. Only direct gaming taxes were assessed.

- Ownership Impact – Penn’s proposal concept includes a non-profit corporation participating in casino profits. What is the magnitude of profits the non-profit corporation could expect from participating in Penn’s proposal?

To complete the market impact assessment component, HLT undertook the following work steps:

- Researched the availability and performance of casino gaming activity in the broader and immediate market area surrounding Philadelphia.
- Assessed key market supply and demand performance indicators of the four casinos located in the local Philadelphia market.
- Reviewed publically available information of the six proposals submitted to the PA Gaming Board for the second City casino license.
- Reviewed the third party state wide casino market assessment that was prepared (and is publically available) for the Pennsylvania Treasury.
- Commented on the impact of a second casino license on the City’s direct gaming taxes (i.e., percentage of slot and table allocated to the City for hosting a casino).

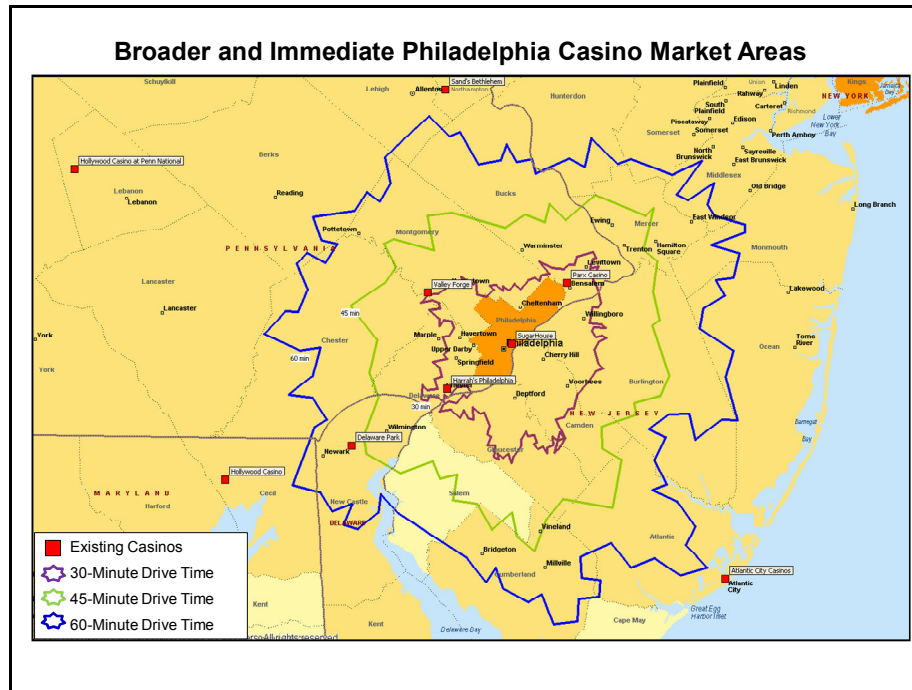
To complete the ownership impact component, HLT undertook the following work steps:

- Reviewed and assessed financial information provided by Penn that detailed their proposed concept. Subsequent discussions with Penn were held to clarify our understanding of the proposed concept.
- Undertook a sensitivity assessment of Penn’s proposed financial arrangement with regard to impacts on profits flowing to the non-profit entity.

4. MARKET IMPACT

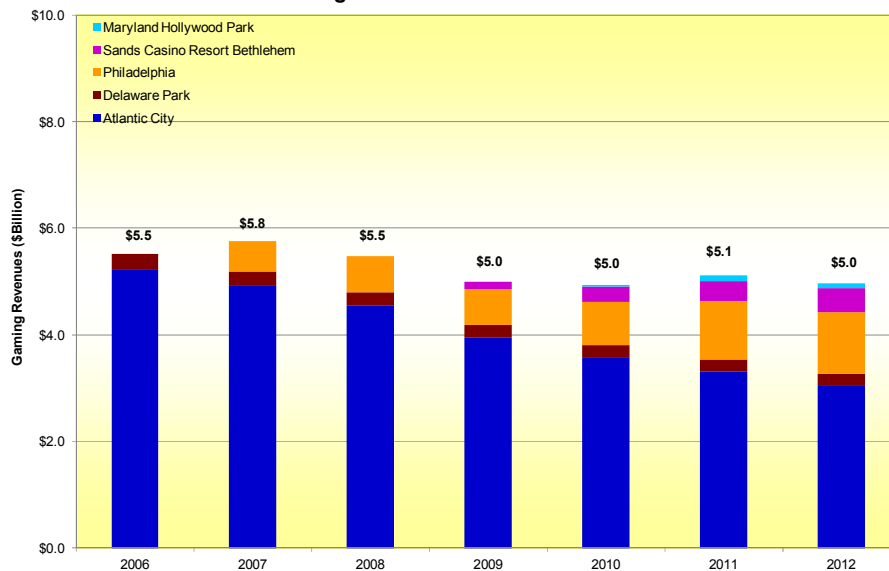
Broader Regional Casino Market Area

While the local or immediate Philadelphia casino market area can be considered to extend outward from the City’s core about 30 minutes (drive time), the broader casino market area can be considered to extend outward about an hour (drive time) (see map following). There are a number of casinos located at and just beyond this broader market area extent including Atlantic City (and its twelve casinos) to the southeast, Delaware (Delaware Park in Wilmington) and Maryland (Hollywood Casino in Perryville) to the southwest and Allentown/Bethlehem (Sands Bethlehem) to the north. Beyond this area, additional casinos/gaming facilities are located in the rest of Pennsylvania and in the States of New York, Delaware, Maryland and West Virginia.



Historically this broader market area was primarily served by Atlantic City. Since 2007 the introduction of casinos in Pennsylvania as well as a major economic recession has impacted this broader gaming market. Total gaming revenue generated in the broader market area has decreased from about \$5.5 billion in the mid 2000's down to \$5.0 billion since 2009. Casinos in the immediate Philadelphia area (and in Allentown/Bethlehem) have increased their market share at the expense of Atlantic City casinos.

**Casino Revenue Performance in the Broader
Regional Casino Market Area**

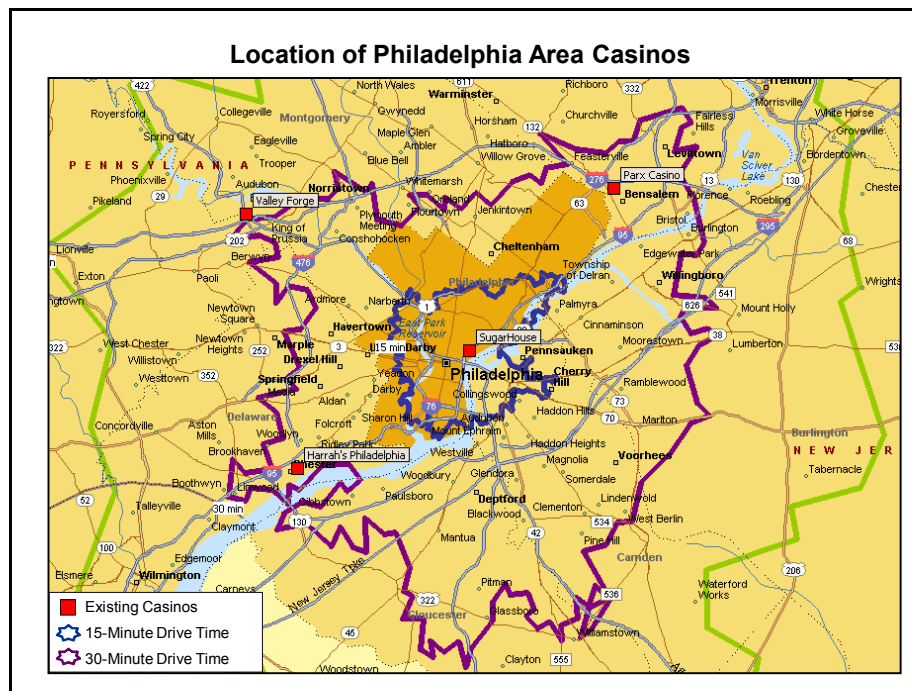


Source: HLT Advisory Inc. based on data available from various State gaming entities.

Given the recent gaming revenue performance, this broader market area can be considered mature. Any additional casinos implemented in or just beyond this market area will likely lead to a further redistribution of gaming revenue market shares. This does not suggest that incremental gaming revenue will not be generated by new facilities but rather, the majority of gaming revenue generated by any new casino will likely be from a redistribution of gaming revenue currently captured by existing casinos.

Local Philadelphia Casino Market Area

The first casino in the immediate Philadelphia area opened in December 2006. Currently, four casinos are located in the area including SugarHouse (opened in December, 2010), the only casino located within the City. The remaining three casinos are located within about a 30-minutes drive time from SugarHouse.



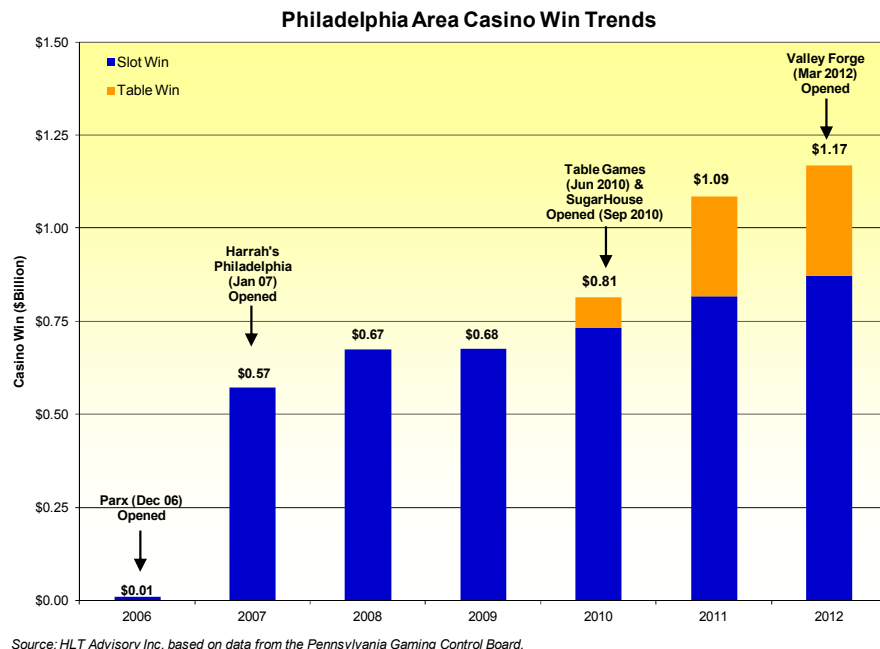
- Parx Casino ("Parx") located in Bensalem Township was the first casino to open (December, 2006) and is a Category 1 casino.
- Harrah's Philadelphia Casino & Racetrack ("Harrah's") located in the City of Chester opened in January, 2007 and is also a Category 1 casino.
- Valley Forge Casino located in Upper Merion opened in March, 2012. Valley Forge is currently the only Category 3 casino in the State.

All of these casinos including SugarHouse but excluding Valley Forge can be considered local serving casinos as they all have a limited scope of ancillary facility offerings beyond multiple food and beverage outlets (see table following). Based on HLT's experience, the majority of casinos in North America outside of Las Vegas generate the majority of their revenue from customers residing in proximity to the casino. This is especially the case for

casino complexes that do not have a significant hotel room inventory attached to the casino.

Characteristics of Existing Philadelphia Area Casinos				
	Parx Casino	Harrah's Philadelphia	SugarHouse Casino	Valley Forge Casino Resort
Gaming Devices				
Slots	3,368	2,799	1,614	600
Tables	163	121	55	50
Initial Capital Cost				
	\$350 Million	\$427 Million	\$395 Million	n/a
Non-Gaming Amenities				
Racetrack	Yes	Yes	No	No
Hotel	No	No	No	486 Rooms
Food & Beverage Outlets	8	3	4	7
Other	1 night club and two additional bars	One bar and one lounge		4 bars/lounges
n/a: not available.				
Source: HLT Advisory Inc. based on information from Casinos' websites and news articles.				

In 2012, the four Philadelphia area casinos combined generated \$1.17 billion in gaming revenue accounting for 37.0 percent of total gaming revenue generated in the State (and about 24.0 percent of the \$5.0 billion in gaming revenue generated by facilities located in the defined broader market area).



All casinos have generally experienced year over year growth since they opened (see table following). Since the opening of SugarHouse in 2010, slot revenue at both Parx and Harrah's has declined; this decline however has been more than offset by increased table game revenue. Table gaming was introduced (permitted) in 2010.

Philadelphia Area Casino Performance (\$Million)							
Casino Name	2007	2008	2009	2010	2011	2012	2012 % Dist.
<u>Slot Revenue</u>							
Parx Casino	\$285.0	\$345.5	\$359.3	\$398.2	\$376.7	\$384.6	44.2%
Harrah's Philadelphia	\$286.0	\$328.4	\$315.9	\$296.5	\$268.1	\$259.8	29.8%
SugarHouse Casino				\$37.1	\$171.0	\$190.2	21.8%
Valley Forge Casino Resort						\$36.5	4.2%
Total Philadelphia	\$571.0	\$673.9	\$675.2	\$731.7	\$815.8	\$871.0	100.0%
<u>Table Revenue</u>							
Parx Casino				\$34.4	\$114.5	\$110.0	37.1%
Harrah's Philadelphia				\$30.0	\$81.0	\$81.0	27.3%
SugarHouse Casino				\$17.1	\$74.2	\$83.9	28.3%
Valley Forge Casino Resort						\$21.4	7.2%
Total Philadelphia	\$0.0	\$0.0	\$0.0	\$81.6	\$269.7	\$296.3	100.0%
<u>Gaming Revenues</u>							
Parx Casino	\$285.0	\$345.5	\$359.3	\$432.6	\$491.2	\$494.5	42.4%
Harrah's Philadelphia	\$286.0	\$328.4	\$315.9	\$326.5	\$349.1	\$340.8	29.2%
SugarHouse Casino				\$54.2	\$245.2	\$274.1	23.5%
Valley Forge Casino Resort						\$57.9	5.0%
Total Philadelphia	\$571.0	\$673.9	\$675.2	\$813.3	\$1,085.4	\$1,167.4	100.0%
Source: HLT Advisory Inc. based on the Pennsylvania Gaming Control Board Gaming Revenue Reports.							

SugarHouse, despite having a large population base residing close to the casino as compared to both Parx and Harrah's,¹ currently has a total market share of 23.5 percent compared to 42.4 percent and 29.2 percent for Parx and Harrah's respectively. SugarHouse does perform better from a market share perspective in table gaming.

Philadelphia Area Casino Performance (Calendar Year 2012)			
	Slots	Tables	Total
<u>Gaming Revenues</u>			
Parx Casino	\$384.6	\$110.0	\$494.5
Harrah's Philadelphia Casino & Racetrack	\$259.8	\$81.0	\$340.8
SugarHouse Casino	\$190.2	\$83.9	\$274.1
Valley Forge Casino Resort	\$36.5	\$21.4	\$57.9
Total	\$871.0	\$296.3	\$1,167.4
<u>Gaming Supply</u>			
Parx Casino	3,368	163	
Harrah's Philadelphia Casino & Racetrack	2,799	121	
SugarHouse Casino	1,614	55	
Valley Forge Casino Resort	600	50	
Total	8,381	389	
<u>Gaming Revenues/Day/Device</u>			
Parx Casino	\$313	\$1,848	
Harrah's Philadelphia Casino & Racetrack	\$254	\$1,834	
SugarHouse Casino	\$323	\$4,181	
Valley Forge Casino Resort	\$221	\$1,558	
Total	\$285	\$2,087	
<u>Market Share</u>			
Parx Casino	44.2%	37.1%	42.4%
Harrah's Philadelphia Casino & Racetrack	29.8%	27.3%	29.2%
SugarHouse Casino	21.8%	28.3%	23.5%
Valley Forge Casino Resort	4.2%	7.2%	5.0%
Total	100.0%	100.0%	100.0%
Source: HLT Advisory Inc. based on the Pennsylvania Gaming Control Board 2011-2012 Annual Report			

¹ About 590,000 adults reside within a 15-minute drive time from SugarHouse compared to 170,000 adults residing within 15-minutes from Parx; 124,000 from Harrah's; and 90,000 adults from Valley Forge (based on Microsoft MapPoint and 2011 population data from the U.S. Census Bureau, 2007-2011 American Community Survey).

The performance of gaming devices (as measured by average daily revenue per device levels) suggests that SugarHouse has capacity constraints. This constraint is more pronounced in table gaming, where SugarHouse performs at a level greater than twice the next highest casino (i.e., the daily revenue per table at SugarHouse is \$4,181 compared to \$1,848 at Parx). The location of the market area population and gaming device performance suggest that if additional slots and especially tables were added to SugarHouse and/or at another casino in the City, combined both casinos would capture additional market share from existing casinos in the immediate market area.

Proposal for Second Casino License in City

Besides Penn's Hollywood Casino Philadelphia bid (located at 700 Packer Avenue), other competing bids include:

- Tower Entertainment, LLC - The Provenance (400 North Broad Street)
- Market East Associates, LP - Casino Philadelphia (8th Street and Market Street)
- Wynn PA Inc. - Wynn Philadelphia (2001 Beach Street)
- PHL Local Gaming, LLC - Casino Revolution (3333 South Front Street)
- Stadium Casino, LLC - Live! Hotel and Casino (900 Packer Avenue)

The following map shows the location of these proposals. Also included on the map is the location of the existing SugarHouse Casino as well as the former proposed Foxwoods' Casino location.



As per information made public by the PA Gaming Board (i.e., economic impact assessments, statements, reports), the following table summarizes key characteristics of the competitive bids.

Characteristics of the Six Proposals Submitted for Philadelphia's Second Casino License						
Casino Name	Hollywood Casino	Casino Philadelphia	The Providence	Casino Revolution	Live! Hotel and Casino	Wynn Philadelphia
Proponent	Penn National Gaming, Inc.	Market East Associates, LP	Tower Entertainment, LLC	PHL Local Gaming, LLC	Stadium Casino, LLC	Wynn PA, Inc.
Location	700 Packer Ave. (South, Philadelphia Sports Complex)	8th & Market Street (Central-Convention Center, Chinatown)	400 North Broad Street (Central, Convention Center, ...)	3333 S Front St. (South, Philadelphia Sports Complex)	900 Packer Ave. (South, Philadelphia Sports Complex)	Richmond and Dyott St. (Delaware River, Sugarhouse)
Gaming Devices						
Slots	2,050	2,630	3,000	2,000	2,013	2,500
Tables	66	106	150	60	125	100
Poker	15	30	n/a	25	n/a	n/a
Development Cost						
Land		\$66.5	\$100.0	n/a	n/a	n/a
Construction/FFE	\$232.9	\$291.7	\$421.1	n/a	n/a	n/a
Gaming licenses	\$74.7	\$74.7	\$74.7	n/a	n/a	n/a
Financing Costs		\$33.1	\$104.2	n/a	n/a	n/a
Total Development Cost	\$307.6	\$466.0	\$700.0	n/a	n/a	n/a
Non-Gaming Amenities						
Hotel Rooms			125	250	240	307
Food & Beverage Outlets	4	4	8		6	
Parking Spaces	3,456	750	1,700		2,600	2,000
Other		Meeting Space	Retail (60,000 sq. ft.), Pool (40,000 sq. ft.), sports venue (30,000 sq. ft.), spa and fitness			Spa, Nightclub, Multi-purpose Entertainment Facility
Gaming Revenue (\$Million)						
Table Revenue	\$62.0	\$175.0	\$116.0	n/a	n/a	n/a
Slot Revenue	\$264.0	\$412.5	\$259.0	n/a	n/a	n/a
Total Gaming Revenue	\$326.0	\$587.5	\$375.0	n/a	n/a	n/a
Gaming Revenue/Device/Day(\$)						
Slots	\$353	\$430	\$237	n/a	n/a	n/a
Tables	\$2,574	\$4,523	\$2,119	n/a	n/a	n/a

n/a: not provided

Source: HLT Advisory Inc. based on the various documents submitted to the Pennsylvania Gaming Control Board.

Three of the six bids including Penn provided casino revenue estimates. Two of these three bids were in the mid \$300.0 million range while the remaining bid was close to \$600.0 million. Based on the performance of existing casinos in the local market, this latter bid seems to be aggressive in terms of daily performance of gaming devices (especially slots).

Impact on City's Gaming Tax

The addition of a second casino in the City should increase the amount of gaming tax (i.e., 4.0 percent of slot revenues and 2.0 percent of table revenues) that is generated for the City. The location of the proposed casino could impact the total amount of gaming revenues generated in the City and annual gaming taxes. The scope of HLT's engagement did not permit the undertaking of a detailed market assessment of each of the competing bid sites. To investigate this market issue, HLT reviewed a publically available third party report that was prepared for the Pennsylvania Treasury.

In September 2011, The Innovation Group completed the "Pennsylvania Gaming Market Assessment and Competitive Analysis" for the Pennsylvania Treasury. The focus of the report was to assess the past and future performance of the Pennsylvania gaming market taking into consideration two undeveloped gaming licenses – Valley View located in the

western part of the State (bordering Ohio) and Foxwoods in the City of Philadelphia.² The following summary of The Innovation Group's report conclusions focuses on the Philadelphia market area.

The Philadelphia market area as defined by The Innovation Group generally extends from Trenton, New Jersey in the north along the Pennsylvania/New Jersey border to Wilmington, Delaware in the South and to the west of Valley Forge in Pennsylvania.



This defined market area was estimated to have a gaming population of 3.17 million adults in 2010, and was expected to increase to 3.21 million adults by 2015. Currently, the City of Philadelphia has a total adult population of 1.1 million, representing about one third of The Innovation Group's total market area. Based on this total adult population and estimated gaming propensity factors, the potential size of the market was estimated at \$1.16 billion (2010). Due to expected population increases, the market was estimated to grow to \$1.22 billion by 2015. These amounts represent estimates of gaming dollars available for casinos to capture.

Using these market area size estimates, The Innovation Group presented several scenarios to assess the impact of various changes to the casino supply in the market area including a Baseline Scenario, which assumed no changes to existing casino supply by 2014. Two casino sites were assumed for the City's second casino - the Foxwoods site and a site known as City Line (located on the western part of the City towards Valley Forge). The results of these assessment scenarios are summarized in the following table. HLT included actual 2012 casino results to compare The Innovation Group's results. Actual 2012 total

² The Innovation Group's assessment was based on a gravitational model where each market area is assigned a unique set of propensity and frequency factors to derive amount of "gamer visits" by zip codes. These gamer visits are then distributed to each gaming facility based on their size, attractiveness and distance from the zip code.

market results are slightly higher than The Innovation Group's 2014 total market estimate. Individual facility estimates are also slightly off 2012 actual results.

Philadelphia Casino Performance -2014 Innovation Group								
	Actual 2012	2014 Scenarios			Impact from Foxwoods		Impact from City Line	
		Base	Foxwoods	City Line	Total	%	Total	%
Parx	\$494.5	\$432.5	\$391.5	\$388.9	-\$41.0	-9.5%	-\$43.6	-10.1%
Harrah's Philadelphia	\$340.8	\$312.5	\$275.8	\$270.9	-\$36.7	-11.8%	-\$41.6	-13.3%
SugarHouse	\$274.1	\$353.0	\$267.0	\$267.2	-\$86.0	-24.4%	-\$85.8	-24.3%
Valley Forge	\$57.9	\$45.0	\$42.0	\$40.0	-\$2.9	-6.5%	-\$5.0	-11.1%
Foxwoods			\$269.1		\$269.1			
City Line				\$291.0			\$291.0	
Total Casino Win	\$1,167.4	\$1,142.9	\$1,245.3	\$1,257.9	\$102.4	9.0%	\$115.0	10.1%

Source: HLT Advisory Inc. based on The Innovation Group, *Pennsylvania Gaming Market Assessment & Competitive Analysis*, September 2011

Key Innovation Group report findings regarding the Philadelphia market area are:

- Philadelphia area casinos have the potential to generate \$1.14 billion in gaming revenues by 2014 without any changes to the existing casino supply. At this potential, SugarHouse was estimated to capture \$353.0 million. SugarHouse currently generates \$274.1 million (2012).
- A new casino in Philadelphia (either at the Foxwoods or at the City Line site) would have the largest impact on SugarHouse – reducing its gaming revenues by about 25.0 percent from \$353.0 million to about \$267.0 million.
- A new casino in the City of Philadelphia has the potential to generate between \$270 and \$290 million in gaming revenues. In total, two casinos in the City Philadelphia could generate between \$540 and \$560 million in gaming revenues combined.

Market Impact Conclusions

Based on the review of the broader and local Philadelphia market area (gaming facility performance) and The Innovation Group's market assessment, HLT puts forward the following comments:

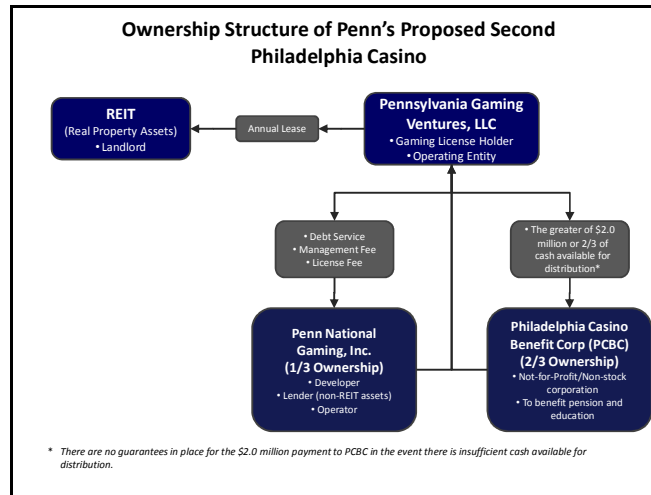
- The introduction of a new casino in the City of Philadelphia will lead to both a redistribution of existing casino market shares as well new market growth. The exact amount of new growth versus redistribution is difficult to predict and can be influenced by a wide range of factors including access/visibility (including distance between facilities), facility capacity, scope of operations and quality of management.
- While the magnitude of win generated by each of the proposed sites will likely not be materially different, those sites located the furthest away from SugarHouse would likely have a better ability to maximize total gaming revenues upon which the City's gaming tax would be applied. The three casino sites located in South Philadelphia area are located the furthest away from SugarHouse.
- Combined, SugarHouse and the second casino (regardless of which site is chosen) would likely be able to capture between \$500.0 and \$550.0 million or between

40.0 percent and 45.0 percent of the total market (\$1.2 billion as estimated by The Innovation Group).

- The City currently generates approximately \$9.0 million from SugarHouse in direct gaming taxes (i.e., 4.0 percent of slot revenue and 2.0 percent of table revenue). This tax amount would likely increase to between \$17.0 and \$19.0 million with two casinos (assuming a 75/25 or 70/30 split in slot/table revenue and total City casino revenues of between \$500.0 and \$550.0 million).

5. OWNERSHIP IMPACT

Based on our review of the material provided by Penn and subsequent clarification discussions with Penn officials, the following chart provides a pictorial representation of Penn's proposed casino ownership structure:



There are four main components to the proposed ownership structure:

- The Pennsylvania Gaming Ventures, LLC ("PGV") – the casino licence holder and casino operating entity:
 - PGV will be owned one-third by Penn and two-thirds by Philadelphia Casino Benefit Corporation ("PCBC").
 - PGV will own all non-real property assets.
- Penn – casino operator and lender of non-real property assets:
 - Penn will be paid a management fee at a rate of 2.0 percent of net revenues and 5.0 percent of EBITDA for the operation of the casino complex.
 - Penn will be also entitled to an annual license fee calculated as 2.0 percent of net revenue. This license fee is for use of Penn's brands as well as participation rights in its loyalty card program.
 - Penn will also receive 1/3 of cash available for distribution.
 - Penn will finance all non-real property assets of PGV and PGV will repay Penn.

- Penn will be responsible for the acquisition of land and facility development. Once the development is complete, these assets would be transferred to the Real Estate Investment Trust (“REIT”) that Penn is establishing to own the real property assets.
- The Real Estate Investment Trust (“REIT”) – landlord of all the real property assets
 - REIT will be established by Penn.
 - REIT will receive an annual lease payment based on a return of invested capital and land.
- Philadelphia Casino Benefit Corporation (“PCBC”) - a not-for-profit non-stock corporation intended to benefit pension and education causes in the City of Philadelphia.
 - PCBC will be entitled to the first \$2.0 million available for distribution (prior to principal repayment of loan to Penn) and 2/3 of available cash greater than \$3.0 million.

Review of Financial Projections Submitted by Penn

HLT received from Penn summarized financial projections attached as Appendix A. This financial data included five year income statement projections (on an Earnings Before Interest, Taxes, Depreciation and Amortization or “EBITDA” basis) and 15 year statement of cash flows and corresponding distributions.

Income Statement Projections

The following table summarizes Penn’s income statement projections for its proposed casino.

Financial Projections for Penn's Proposed Philadelphia Casino									
	Year 1	Year 2	% Change	Year 3	% Change	Year 4	% Change	Year 5	% Change
<u>Gaming Revenues</u>									
Slot Revenue	\$249,792,041	\$262,281,643	5.0%	\$275,395,725	5.0%	\$280,903,639	2.0%	\$286,521,712	2.0%
Less Cashback	-\$47,378,890	-\$49,747,834	5.0%	-\$52,235,226	5.0%	-\$53,279,931	2.0%	-\$54,345,529	2.0%
Net Slot Revenue	\$202,413,151	\$212,533,809	5.0%	\$223,160,499	5.0%	\$227,623,708	2.0%	\$232,176,183	2.0%
Table Game Revenue	\$56,756,980	\$59,594,829	5.0%	\$62,574,571	5.0%	\$63,826,062	2.0%	\$65,102,583	2.0%
Net Gaming Revenue	\$259,170,131	\$272,128,638	5.0%	\$285,735,070	5.0%	\$291,449,770	2.0%	\$297,278,766	2.0%
<u>Non-Gaming Revenue</u>									
Food and Beverage Revenue	\$21,458,431	\$22,531,353	5.0%	\$23,657,921	5.0%	\$24,131,079	2.0%	\$24,613,701	2.0%
Retail Revenue	\$122,620	\$128,751	5.0%	\$135,188	5.0%	\$137,892	2.0%	\$140,650	2.0%
Other Revenue	\$4,598,235	\$4,828,147	5.0%	\$5,069,554	5.0%	\$5,170,946	2.0%	\$5,274,364	2.0%
Promotional Allowances	-\$13,089,643	-\$13,744,125	5.0%	-\$14,431,332	5.0%	-\$14,719,958	2.0%	-\$15,014,357	2.0%
Net Non-Gaming Revenue	\$13,089,643	\$13,744,126	5.0%	\$14,431,331	5.0%	\$14,719,959	2.0%	\$15,014,358	2.0%
Total Net Revenue	\$272,259,774	\$285,872,764	5.0%	\$300,166,401	5.0%	\$306,169,729	2.0%	\$312,293,124	2.0%
<u>Operating Expenses</u>									
Gaming Taxes	\$122,049,727	\$128,152,214	5.0%	\$134,559,824	5.0%	\$137,251,021	2.0%	\$139,996,041	2.0%
Cost of Goods Sold	\$8,632,420	\$9,064,041	5.0%	\$9,517,244	5.0%	\$9,707,588	2.0%	\$9,901,740	2.0%
Labor	\$36,000,000	\$37,000,000	2.8%	\$39,000,000	5.4%	\$39,000,000	0.0%	\$39,000,000	0.0%
Marketing	\$6,130,980	\$6,437,529	5.0%	\$6,759,406	5.0%	\$6,894,594	2.0%	\$7,032,486	2.0%
Other	\$25,855,673	\$26,928,594	4.1%	\$28,055,162	4.2%	\$28,528,320	1.7%	\$29,010,942	1.7%
Total Expenses	\$198,668,800	\$207,582,378	4.5%	\$217,891,636	5.0%	\$221,381,523	1.6%	\$224,941,209	1.6%
Adjusted EBITDA*	\$73,590,974	\$78,290,386	6.4%	\$82,274,765	5.1%	\$84,788,206	3.1%	\$87,351,915	3.0%
Source HLT Advisory Inc. based on financial projections received directly from Penn. *Prior to deductions for Management Fees, License Fees and Rent Expense									

The following are HLT comments based on the above table:

- Net gaming revenue in year one of \$259.2 million is lower than the gaming revenue estimate of \$326.0 million provided in Penn's Local Impact Report that was submitted to the PA Gaming Board. Penn informed HLT that the revenue projections were revised since its Local Impact Report was submitted to the PA Gaming Board.
- Penn has forecasted total cashback of \$47.4 million in year one relating to slot revenue. This represents approximately 23.0 percent of net slot revenue. This is consistent with other casinos in Pennsylvania where the slot cashback rate is 26.0 percent (as per information published by the PA Gaming Board).
- Food and beverage revenue at \$21.5 million represents 8.0 percent of gaming revenue. This amount would be consistent with a casino that positions itself as a local market casino. HLT uses an industry benchmark of 5.0 to 10.0 percent of gaming revenues as indicative of local casino food and beverage expenditure. Comps (non-gaming items provided free of charge to patrons) represent about 50.0 percent of total non-gaming revenue. This is consistent with industry practice of utilizing the non-gaming outlets to incent customer visitation and/or lengthen duration of visit for casino customers.
- Gaming taxes include taxes at a rate of 54.1 percent of slot revenue and 14.0 percent of table game revenue. It also includes regulatory fees of 1.5 percent as charged by the PA Gaming Board.
- EBITDA as a percentage of gaming revenue for year one is 27.0 percent of total net revenue. While Penn does not provide EBITDA level data on a publically available basis for its other properties, Las Vegas Sands Corp. reported an EBITDA margin of 22.7 percent in their 2011 annual report for their Sands Bethlehem property in Pennsylvania. While the EBITDA margins at Penn are forecasted to be better than those earned at Sands Bethlehem, Sands Bethlehem has a hotel and more non-gaming amenities than what is planned for the Penn property which typically lowers profit margins. With that said, Penn's EBITDA margin is reasonably consistent with those earned at Sands indicating Penn has captured all material operating costs in their projections.

Comparison of EBITDA Margins		
	Penn Projections	Sands Bethlehem
Net Revenue	\$272,259,774	\$399,900,000
EBITDA	\$73,590,974	\$90,802,000
EBITDA Margin	27.0%	22.7%
Source: HLT Advisory based on financial projections provided by Penn and Las Vegas Sands Corp. 2011 annual report		

Statement of Cash Distributions

The following table presents the 15 year cash distributions as forecasted by Penn.



City Controller, City of Philadelphia
Assessment of Casino Proposal from Penn National Gaming Inc.
February 5, 2013

Casino Distribution of Funds Projections (Years 1-15)																
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12	Year 13	Year 14	Year 15	Total (Years 1-15)
EBITDA	\$73,590,974	\$78,290,385	\$82,274,766	\$84,788,206	\$87,351,915	\$89,972,472	\$92,671,647	\$95,451,796	\$98,315,350	\$101,264,810	\$104,302,755	\$107,431,837	\$110,654,792	\$113,974,436	\$117,393,669	\$1,437,729,809
<i>Less</i>																
Management Fee	\$9,124,744	\$9,631,974	\$10,117,066	\$10,362,805	\$10,613,458	\$10,931,862	\$11,259,818	\$11,597,612	\$11,945,541	\$12,303,907	\$12,673,024	\$13,053,215	\$13,444,811	\$13,848,156	\$14,263,600	\$175,171,594
License Fee	\$5,445,195	\$5,717,455	\$6,003,328	\$6,123,395	\$6,245,862	\$6,433,238	\$6,626,235	\$6,825,023	\$7,029,773	\$7,240,666	\$7,457,886	\$7,681,623	\$7,912,072	\$8,149,434	\$8,393,917	\$103,285,104
Rent Expense	\$37,068,892	\$37,592,462	\$38,126,503	\$38,671,226	\$39,226,842	\$40,781,614	\$41,359,678	\$41,949,303	\$42,550,720	\$43,164,166	\$44,814,528	\$45,452,757	\$46,103,751	\$46,767,764	\$47,445,058	\$631,075,263
Interest Expense	\$13,879,233	\$14,101,421	\$14,046,051	\$13,752,757	\$13,294,494	\$12,654,120	\$11,931,606	\$11,029,983	\$9,929,676	\$9,929,676	\$9,929,676	\$9,929,676	\$9,929,676	\$9,929,676	\$9,929,676	\$174,197,397
Capital Outlays	\$8,541,667	\$8,541,667	\$8,541,667	\$8,541,667	\$8,541,667	\$8,797,917	\$9,061,854	\$9,333,710	\$9,613,721	\$9,902,133	\$10,199,197	\$10,505,173	\$10,820,328	\$11,144,938	\$11,479,286	\$143,566,588
Free Cash Flow	-\$468,757	\$2,705,405	\$5,440,161	\$7,336,357	\$9,429,591	\$10,373,721	\$12,432,455	\$14,716,166	\$17,245,919	\$18,724,262	\$19,228,443	\$20,809,393	\$22,444,155	\$24,134,469	\$25,882,132	\$1,227,295,947
Distributions																
Priority Payment to PCBC	\$2,000,000	\$2,000,000	\$2,000,000	\$2,000,000	\$2,000,000	\$2,000,000	\$2,000,000	\$2,000,000	\$2,000,000	\$2,000,000	\$2,000,000	\$2,000,000	\$2,000,000	\$2,000,000	\$2,000,000	\$30,000,000
Distribution to PCBC	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$9,497,279	\$10,482,842	\$10,818,962	\$11,872,929	\$12,962,770	\$14,089,646	\$15,254,755	\$94,979,182
Total to PCBC (2/3)	\$2,000,000	\$2,000,000	\$2,000,000	\$2,000,000	\$2,000,000	\$2,000,000	\$2,000,000	\$2,000,000	\$11,497,279	\$12,482,842	\$12,818,962	\$13,872,929	\$14,962,770	\$16,089,646	\$17,254,755	\$114,979,182
Distribution to Penn (1/3)	\$0	\$90,180	\$181,338	\$244,545	\$314,320	\$345,791	\$414,415	\$490,539	\$5,748,640	\$6,241,421	\$6,409,481	\$6,936,464	\$7,481,365	\$8,044,823	\$8,627,377	\$51,570,719
Penn Loan																
Beginning Balance	\$154,213,696	\$156,682,453	\$156,067,228	\$152,808,415	\$147,716,604	\$140,601,332	\$132,573,402	\$122,555,362	\$110,329,735	\$110,329,735	\$110,329,735	\$110,329,735	\$110,329,735	\$110,329,735	\$110,329,735	\$154,213,696
Interest Accrual	\$13,879,233	\$14,101,421	\$14,046,051	\$13,752,757	\$13,294,494	\$12,654,120	\$11,931,606	\$11,029,983	\$9,929,676	\$9,929,676	\$9,929,676	\$9,929,676	\$9,929,676	\$9,929,676	\$9,929,676	\$174,197,397
Loan Payment	-\$11,410,476	-\$14,716,646	-\$17,304,863	-\$18,844,569	-\$20,409,766	-\$20,682,051	-\$21,949,646	-\$23,255,610	-\$9,929,676	-\$9,929,676	-\$9,929,676	-\$9,929,676	-\$9,929,676	-\$9,929,676	-\$9,929,676	-\$218,081,359
Ending Balance	\$156,682,453	\$155,067,228	\$152,808,415	\$147,716,604	\$140,601,332	\$132,573,402	\$122,555,362	\$110,329,735	\$110,329,735	\$110,329,735	\$110,329,735	\$110,329,735	\$110,329,735	\$110,329,735	\$110,329,735	\$110,329,735
Source: HLT Advisory Inc. based on Penn financial projections.																

The following are our comments based on the forecasted cash distributions:

- Management fees are to be paid to Penn for the management of the casino complex, calculated at 2.0 percent of net revenues and 5.0 percent of EBITDA.
- License fees are to be paid to Penn at a rate of 2.0 percent of net revenues. These fees are for intellectual property provided to the casino complex by Penn pertaining to the names of Hollywood Casino, Final Cut Steakhouse and Take Two Lounge, as well as participation in Penn's loyalty card program.
- Interest expense is calculated on the loan provided by Penn for costs incurred prior to opening for assets not included in the REIT. These assets would include license fees payable to securing the gaming license, equipment not categorized as real property, working capital, etc. Penn has estimated the total amount of these assets at \$154.2 million, and has utilized an interest rate of 9.0 percent of the outstanding loan balance each year.
- Rent expense represents the amount to be paid by PGV to the REIT for the assets included in the development phase that form the REIT assets. These amounts will represent the real property of the complex and include land and building costs estimated at \$303.0 million (including a 6.5 percent construction contingency). Of the \$303.0 million, \$28.0 million is the amount that has been included relating to land, while the remaining \$275.0 million relates to facility development costs. Our understanding from Penn officials is that the ultimate purchase price of the land is \$60.0 million; however, this is contingent on the casino achieving certain gaming revenue thresholds beyond the \$259.2 million projected by Penn. Additional land costs would be recorded when and if these thresholds are attained.

The annual rent amount is based on a formula including the following:

- Base rent for the facility costs (projected at \$275.0 million) equal to annual amount to recoup this capital cost, amortized over a 34 year period with an implicit interest rate of 9.0 percent, subject to an annual cost of inflation projected at 2.0 percent, plus
- in respect of the land, 4.0 percent of 50.0 percent of the first full year of the net revenues of the property, plus
- also in respect of the land, 4.0 percent of 50.0 percent of the first full year of the net revenues of the property for the first five years with an increase (decrease) based on a rolling average of the immediately preceding five years thereafter.
- PCBC is to receive a payment in the amount of \$2.0 million each year. In discussions with Penn officials the extent of whether this payment would be "guaranteed" was undecided. In the previous table, Penn provided for the \$2.0 million payment even though there was negative free cash flow in year one, however, we did not receive a clear indication whether this payment would be prioritized above management fees, license fees, rent, interest or capital outlays. Penn stated that the extent which this payment could be prioritized could be negotiated.

- In the Penn loan repayment schedule, Penn has provided that principal on the loan is to be repaid until such time as the debt multiple (loan/EBITDA) is three times or less, then the payments on the loan would be interest only. Penn stated that they would be open to exploring other options should access to funds at a lesser rate of interest be available. In addition, Penn also stated they would work with the City to reach agreeable repayment terms on the loan.
- If the \$2.0 million priority payment is made to PCBC and there were funds available for distribution Penn would receive the first \$1.0 million. If cash available for distribution is \$3.0 or more, it would be distributed proportionally to their ownership interests.
- The total payments that Penn has projected to be paid to PCBC over the first 15 years of operations for the second casino in Philadelphia is \$115.0 million, comprised of \$30.0 million of prioritized distributions and \$85.0 million in excess distributions.

Inherent Risk to PCBC

HLT has assessed the inherent risks that may arise to PCBC as a result of the Penn proposal as follows:

- Given that Penn currently operates another casino in Pennsylvania (within 2 hours from Philadelphia) and one in Maryland (approximately 1 hour from Philadelphia), Penn may redirect business from Philadelphia to either of these casinos. PCBC should ask Penn to clarify operating policies with respect to its other casino interests in the broader Philadelphia market area.
- While HLT has reviewed the basic mechanics of the proposed transaction contemplated by Penn, it is our recommendation that a comprehensive review of the transaction be undertaken ensuring that:
 - The shareholder agreement contains desired language regarding the priority of payments distribution to PCBC.
 - Management and licensing agreements are in place specifying the precise fee structure and conditions of payment.
 - As Penn is acting as developer of the facility, greater clarity should be sought with regard to how Penn intends to transfer the facility once developed to the REIT including the terms of that transfer or transaction.
 - The rent agreement is reviewed by legal parties and is consistent with the proposed transaction and conditions of payment.
 - The loan agreement is reviewed and approved by PCBC, with specific emphasis of whether PCBC would prefer accelerated payments of principal (resulting in decreased distributions in earlier years, yet more distribution in total over the life of the agreement) or a deferral of principal payment (resulting in increased distribution in earlier years yet less distribution in total over the life of agreement).
 - Any and all other agreements are in place that allow for the flow of funds as contemplated by the transaction.

- PCBC would not assume any legal liability by virtue of this transaction.
- While we view the projections provided by Penn as reasonable, in the event revenue targets were not met or expenses increase from those proposed, this would impact what PCBC would receive, especially given the extent of prioritization of the \$2.0 million payment as discussed in the preceding section.

For illustrative purposes only, HLT calculated revised projections using the Penn financial model assuming that EBITDA margins declined by 10.0 percent (a combination of less revenue and higher expenses), and there would be no guarantee of the \$2.0 million paid to PCBC (i.e. the only amounts that would flow to PCBC would be the two thirds of the available cash for distribution ranking behind all operating expenses, management and license fees paid to Penn, rent paid to the REIT, interest expense and capital outlays). This also assumes that any cash shortfall in each year would be added to the Penn loan.

The results of these assumptions for the 15 year period are summarized in the following table labelled "Revised Projection". Penn's projections are also included for comparison purposes (labelled "Penn Projections").

Comparison of Penn Projections to Revised Projections Summary of Year 1 Through Year 15				
	Penn Projections	Revised Projections	Difference	% Change
EBITDA	\$1,437,729,809	\$1,293,723,390	(\$144,006,420)	-10.0%
<i>Less</i>				
Management Fee	\$175,171,594	\$162,807,018	(\$12,364,576)	-7.1%
License Fee	\$103,285,104	\$98,120,849	(\$5,164,255)	-5.0%
Rent Expense	\$631,075,263	\$622,157,287	(\$8,917,977)	-1.4%
Interest Expense	\$174,197,397	\$201,364,340	\$27,166,943	15.6%
Capital Outlays	\$143,566,588	\$143,566,588	\$-	0.0%
Free Cash Flow	\$1,227,295,947	\$65,707,308	(\$1,161,588,638)	-94.6%
<i>Distributions to PCBC</i>				
Priority Payment to PCBC	\$30,000,000	\$-	(\$30,000,000)	-100.0%
Distribution to PCBC	\$84,979,182	\$14,354,360	(\$70,624,822)	-83.1%
Total to PCBC	\$114,979,182	\$14,354,360	(\$100,624,822)	-87.5%
Distribution to Penn	\$51,570,719	\$7,177,180	(\$44,393,539)	-86.1%
<i>Penn Loan</i>				
Beginning Balance	\$154,213,696	\$154,213,696	\$-	0.0%
Interest Accrual	\$174,197,397	\$201,364,340	\$27,166,943	15.6%
Addition (Reduction) to Loan Balance	(\$218,081,359)	(\$245,540,109)	(\$27,458,750)	12.6%
Ending Balance	\$110,329,735	\$110,037,927	(\$291,807)	-0.3%
Source: HLT Advisory Inc., based on Penn projections adjusted for a decline in EBITDA of 10%, and no guarantee of annual distributions				

A slight drop in EBITDA margin can have a material impact on PCBC's profits over a 15 year period (the above example shows that a 10.0 percent drop in EBITDA would result in a \$100.0 million decrease to PCBC's profits over 15 years).

6. CONCLUSIONS

Based on the scope of the market assessment undertaken and summarized in this letter report, SugarHouse and the second City casino (regardless of which casino proposal is selected by the PA Gaming Board) should annually generate combined between \$500.0 and \$550.0 million in gaming revenue. SugarHouse currently generates \$274.1 million (2012). The City currently generates approximately \$9.0 million in direct gaming taxes (from its 4.0 percent of slot revenue and 2.0 percent of table revenue tax) from the operation of SugarHouse. This tax amount should increase to between \$17.0 and \$19.0 million when the second casino is stabilized in the market.

With regard to Penn's proposed ownership structure, this proposal does represent an opportunity for the City to indirectly benefit from casino profits without any injection of capital by PCBC and limited or no legal liability (subject to review by PCBC legal counsel). The extent of and timing when PCBC would benefit from this arrangement is largely dependent on:

- the performance of the casino relative to all other casinos in the local market;
- the financial profitability of the casino;
- the terms of the various rent, management, license and financing agreements that PGV will enter into; and
- whether PCBC can negotiate a prioritization in surplus cash distributions.

* * * * *

Should you have any questions on this letter report, please do not hesitate to contact the undersigned.

Sincerely,

HLT Advisory Inc.



Robert M. Scarpelli
Managing Director

APPENDIX A: PENN'S FINANCIAL INFORMATION

PENN NATIONAL GAMING					
Philadelphia License Facility					
Financial Forecast					
	Year 1	Year 2	Interim	Year 4	Stable
Slot Revenue	249,792,041	262,281,643	275,395,725	280,903,639	286,521,712
Table Revenue	56,756,980	59,594,829	62,574,571	63,826,062	65,102,583
Gross Gaming Revenue	306,549,021	321,876,472	337,970,296	344,729,702	351,624,296
Cash Back	-47,378,890	-49,747,834	-52,235,226	-53,279,931	-54,345,529
Gaming Revenue	259,170,131	272,128,638	285,735,070	291,449,771	297,278,766
F&B Revenue	21,458,431	22,531,353	23,657,921	24,131,079	24,613,701
Retail Revenue	122,620	128,751	135,188	137,892	140,650
Other Revenue	4,598,235	4,828,147	5,069,554	5,170,946	5,274,364
Gross Revenue	285,349,417	299,616,888	314,597,733	320,889,687	327,307,481
Comps	13,089,643	13,744,125	14,431,332	14,719,958	15,014,357
Net Revenue	272,259,774	285,872,763	300,166,401	306,169,729	312,293,124
Gaming Taxes	122,049,727	128,152,214	134,559,824	137,251,021	139,996,041
CGS	8,632,420	9,064,041	9,517,244	9,707,588	9,901,740
Labor	36,000,000	37,000,000	39,000,000	39,000,000	39,000,000
Marketing	6,130,980	6,437,529	6,759,406	6,894,594	7,032,486
Other Expense	25,855,672	26,928,594	28,055,162	28,528,320	29,010,942
EBITDA	73,590,974	78,290,385	82,274,766	84,788,206	87,351,915



City Controller, City of Philadelphia
Assessment of Casino Proposal from Penn National Gaming Inc.
February 5, 2013

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