Fiscal Note

BILL # HB 2772 **TITLE:** fantasy sports betting; event wagering

SPONSOR: Weninger **STATUS:** As Amended by House COM

PREPARED BY: Jack Brown, Henry Furtick,
Jeremy Gunderson, Benjamin Newcomb

Description

The amended version of HB 2772 would authorize entities other than Indian tribes to operate keno, mobile draw, fantasy sports betting, and event wagering in this state. In addition, the bill would authorize Indian tribes to operate fantasy sports betting and event wagering through mobile platforms available for off-reservation use.

The Arizona Department of Gaming (ADG) is authorized to establish the state's operating fees for fantasy sports betting and event wagering, subject to the restriction that the operating fee rate be set at a minimum level of the "highest percentage of revenue share that an Indian tribe pays to this state pursuant to the Tribal-State Gaming Compacts". Based on the current Tribal-State compacts, the minimum fee rate would be 8.0%. ADG is also allowed to set the level of fantasy sports betting and event wagering licensing fees. In addition, the Lottery Commission is given authority to design the keno and mobile draw games.

The bill provides this expansion of gaming is enacted upon the following condition being met: "each Indian tribe with a gaming facility in Pima County and in the Phoenix Metropolitan area, as defined in the 2021 Compact amendment, has entered into a 2021 Gaming Compact amendment" and that relevant federal approval has occurred. Any change or expansion in on-reservation gaming activity would be subject to the provisions in a revised Tribal-State Gaming Compact. Because the legislation does not directly impact on-reservation gaming, the fiscal impact of any revised Tribal-State Gaming Compact is excluded from the analysis below.

Please see below for more information on the bill's provisions.

Estimated Impact

Since the bill grants ADG the discretion to design the financial structure of fantasy sports betting and event wagering gaming, the fiscal impact will depend on how ADG implements these programs. As of publication, the Executive Branch has not yet provided an estimate of the fiscal impact of the proposed gaming activity regulated by ADG. As a result, our analysis attempts to provide a cost estimate if ADG uses the minimum 8.0% operating fee rate and sets licensing fees at a level comparable to other states.

The bill also grants the Lottery Commission discretion in establishing keno and mobile draw games. Any fiscal impact of these games will depend on the Lottery Commission's decisions regarding marketing activity, game design, game frequency, and prize payouts. As of publication, the Executive Branch has not yet provided an estimate of the fiscal impact of the proposed gaming activity regulated by the Lottery Commission. As a result, this analysis uses the broad details outlined in the bill and estimates the fiscal impact of keno and mobile draw games based on the keno experiences of other states and Arizona's recent experience with other draw games.

Under these assumptions, we estimate the legislation will generate the following amounts of General Fund Revenue (See *Table 1).*

The bill is expected to generate $34.2 million in annual General Fund revenue after the markets for the authorized games become more fully operational in the next several fiscal years. We project the state would reach this level of revenue collections by FY 2024.

(Continued)

Table 1

General Fund Revenue Impact [$ Millions]

Description of Provision	License Revenue	Fee/Game Revenue	Total Revenue
1) Authorize Lottery Commission to operate keno and mobile draw games on a statewide mobile platform and keno games at certain physical locations.	N/A	17.8	17.8
2) Authorize ADG to license fantasy sports betting operators for statewide mobile use and at certain physical locations	0.1	1.1	1.2
3) Authorize ADG to license event wagering operators for statewide mobile use and at certain physical locations	4.1	11.1	15.2
Total Impact	**$4.2**	**$30.0**	**$34.2**

The introduction of new gaming activity in the state may cause players to shift a portion of their existing gaming expenditures, which could impact General Fund revenues. This impact could occur if activity is shifted away from existing Lottery games, as those games are usually the most beneficial for the General Fund – due to their above-average profit margins and revenue structure where 100% of profits are retained by the state. According to a 2018 study published in the *Journal of Gambling Issues* by Marionneau and Nikkinen, new gambling products tend to partially substitute for existing ones. The sector with the strongest evidence of "cannibalization" was the casino industry, where newer casino would divert business from older casinos. However, in their systematic review of the gambling industry at the time, no instance of total substitution took place and gambling markets tended to expand overall with the addition of new products. This study was done prior to the mid-2018 relaxation of federal gambling restrictions. If a significant substitution effect impacts existing games, then our estimate of net new overall revenue from expanding gaming would be overstated.

Our analysis does not attempt to address any indirect fiscal impacts from the gaming activities authorized by the bill, such as whether any potential increase in gambling addiction would occur.

Analysis

There are 3 main components of the fiscal impact: keno and mobile draw games, fantasy sports contests, and sports event wagering.

Keno and Mobile Draw Games

The bill would allow the State Lottery Commission the ability to offer keno and mobile draw games. Keno is a game in which players choose up to 20 numbers between 1 and 80 and the game operator randomly selects 20 numbers. Players win based on matching their chosen numbers to the randomly selected numbers.

Licensing Process

- The bill requires the Lottery director to grant licenses to authorized keno locations using the same process the Lottery uses for all other Lottery retail licenses. Lottery retail licenses currently do not require an annual fee, and this analysis assumes no annual fee will be charged for licensing of keno locations.
- Mobile draw games would be operated centrally by the Lottery Commission and would require no further licensing.

Permittable locations

- Keno will be available only at fraternal organizations, veterans' organizations and horse racing tracks/off-track betting sites that receive a Lottery license. Electronic keno formats are allowed but must be geographically restricted (through "geofencing") to the authorized locations.
- The number of authorized keno locations is capped at the number of Class 14 (Private Club) liquor licenses issued to fraternal organizations and veterans' organizations, plus the number of horse racing tracks/off-track betting sites in the state. This location limit number is then increased by 2.0% every 2 years. Based on available data, we estimate Keno would be available at approximately 250 locations,
- The mobile draw game can be played statewide on mobile devices.

(Continued)

State Revenue Collections
Revenue generated from the sale of keno and mobile draw tickets would be treated the same as all other Lottery sales. As such, ticket sales net of prizes and administrative costs will be distributed according to the standard Lottery profit distribution. Lottery profits are distributed according to a statutory priority where each item receives its statutory distribution amount before funds can be allocated to the next beneficiary. Given the current level of Lottery sales, all other beneficiaries receive their complete allocation and the General Fund receives any additional growth in Lottery profits. As such, all net proceeds from the new sale of keno and mobile draw tickets will be distributed to the General Fund.

We estimate that this portion of the bill would generate $17.8 million in General Fund revenue, of which $16.0 million would come from keno and $1.8 million would come from the mobile draw game. *(See below for details.)*

Fiscal Impact – Keno
Currently, 21 state Lotteries offer keno or a keno-style game. Total keno ticket sales vary widely from state to state, ranging from $978 million in Massachusetts to $0.1 million in New Mexico, and make up varying portions of total state lottery sales, ranging from 18.3% to only 0.1%. Because of the wide array of keno sales in other states, and the difficulty in comparing prospective Arizona keno sales against the varying state rules and games, we estimate keno sales will amount to 5.3% of total Lottery sales, which is the median share found in other states. We estimate FY 2022 Lottery ticket sales will total $1.2 billion. Using the 5.3% median share of keno sales as a percentage of total sales, the bill would generate $63.9 million in keno sales.

The profit margin of existing lottery games net of prizes and other administrative costs range from 17.0% on instant win Scratcher tickets to 33.0% for some draw games. We estimate the net keno profit transfers at the midpoint, or 25.0%. As such, the bill would generate $16.0 million in new profit transfers. As noted above, since the General Fund currently receives all net new Lottery profits, we estimate the bill would generate $16.0 million in General Fund revenue resulting from keno sales. In comparison, as part of a study commissioned in 2018, the Lottery has previously estimated that a new keno game would generate annual profits ranging from $17 million - $24 million after allowing for several fiscal years of implementation.

Fiscal Impact – Mobile Draw Games
Currently, no other state offers an hourly Lottery draw game that would serve as a comparison to the new mobile draw game created by the bill. Because of this lack of comparable data, we have used existing Lottery draw games as the basis for developing a fiscal estimate.

Since 2009, the Lottery has introduced 6 new draw games. On average, these games have generated $8.9 million in ticket sales during their first 12 months of operation, with an average net profit distribution of $1.8 million. Several factors affect draw game ticket sales, including game design, prizes offered, and marketing resources allocated. The bill does not specify these factors and leaves them to the discretion of the Lottery Commission.

Based on these recent draw games, we estimate that the mobile draw game created by the legislation would generate the same average sales and profit distributions, resulting in a $1.8 million increase in General Fund revenues.

Fantasy Sports Contests

The bill would authorize ADG to license and regulate operators who offer Fantasy Sports Contests for professional, collegiate, and other recognized sporting events. Fantasy sports involves participants who pay an entry fee to create virtual teams by selecting proxies of actual players on teams. Prizes are then awarded to participants according to how many "points" the virtual player selections earn based on their performance in the actual sporting event.

Permittable locations

- Fantasy Sports Contests will be available statewide on online platforms administrated by licensed operators. The bill prohibits the use of a physical kiosk/machine for Fantasy Sports Contests at retail stores, bars, restaurants, and other commercial establishments. However, the use of fantasy sports contest kiosks/machines is permitted at fraternal organizations, veterans' organizations, and horse racing tracks.

(Continued)

State Revenue Collections
ADG will have authority to issue licenses to fantasy sports contest operators. The bill does not specify licensing fee amounts and those amounts will be determined by ADG. A license would be valid for 2 years.

The bill also requires ADG to establish a fee (tax rate) for the privilege of operating fantasy sports contests. This fee rate would be applied to net revenue from the fantasy sports contests, which is generally calculated as the operator's entry fee receipts minus prizes paid, adjusted for the percentage of tournament participants from Arizona. This fee authority is subject only to the restriction that the fee rate be set a minimum level of the "highest percentage of revenue share that an Indian tribe pays to this state pursuant to the Tribal-State Gaming Compacts". Based on the current Tribal-State compacts, the minimum fee rate would be 8.0%. We have used the minimum level of 8.0% to develop our revenue projection.

The Fantasy Sports Contest Fund is established to receive licensing and fee revenue collected by ADG in relation to the regulation of fantasy sports contests, with ADG being permitted to use up to 10.0% of the monies in the fund for administrative purposes. Any remaining monies annually revert to the General Fund.

Fiscal Impact – Fantasy Sports Contests
Currently, 42 states and Washington D.C. authorize and regulate fantasy sports contests. However, there is a general lack of specific fantasy sports revenue data across many states. Given this data limitation, we use Pennsylvania's fantasy sports contest revenue as the basis for our estimate. Pennsylvania is one of the few states with a robust amount of publicly available data on legal fantasy sports contest revenues.

Given that fantasy sports began to be regulated by Pennsylvania in mid-2018, revenues trends suggest that the market had not fully matured through calendar year (CY) 2019 and the COVID-19 pandemic heavily affected revenues in the first half of CY 2020. In order to approximate a fully mature market, this analysis first used taxable fantasy sports contest revenue from the last six months of CY 2020, which corresponds to the first six months of FY 2021. This revenue amount represents the applicable base for which the state's fee rate is applied, known as "Fantasy Contest Adjusted Revenue".

In order to extrapolate those 6 months of data into a full year, we reviewed several years of historical data from sports wagering in Nevada to determine the general pattern of revenues during a given year. The Nevada data indicated that within a given year, 60.0% of sports wagering revenue is earned during July – December and 40.0% of sports wagering revenue is earned during January – June. Based on these proportions, 6 months of Pennsylvania data was extrapolated into a full year of revenue data. With this full year of revenue data, we then estimated that the per capita fantasy sports contest revenue for Pennsylvania was $2.02 per resident.

Multiplying this per capita estimate by Arizona's population, we estimate that taxable fantasy sports contest revenue will be $15.0 million once the market becomes fully operational. Assuming a fee rate of 8.0% is levied on fantasy sports contest revenue, we estimate $1.2 million of annual fantasy sports fee revenue will be deposited into the Fantasy Sports Contest Fund. After 10.0% is deducted for allowable administration costs, the remaining $1.1 million of annual fee revenue will be deposited into the General Fund.

Data on licensing fees in other states is more broadly available, therefore using the median fantasy sports contest license fees from all other states (and controlling for license duration), we estimate Arizona operators will pay $10,000 for each year of licensure. Because the bill does not limit the number of licensed fantasy sports operators, we have used Pennsylvania as the basis for the number of licensees, with that state currently having 8 fantasy sports operators. Assuming that 8 operators will be licensed in Arizona, we estimate $80,000 per year in licensing revenue will be deposited into the Fantasy Sports Contest Fund. After 10.0% is deducted for allowable administration costs, the remaining $72,000 of annual license revenue will be deposited into the General Fund.

When combining revenue from the operating and license fees, we estimate the total annual General Fund impact of legal fantasy sports contests to be $1.2 million.

(Continued)

Event Wagering

The bill would authorize ADG to license and regulate operators who offer Event Wagering (also known as sports betting). Event wagering would be permitted on professional and collegiate athletic events, motor racing events, Olympic events and E-Sport events (competitive video games competitions).

<u>Licensing Process</u>

ADG would be authorized to issue 20 operator licenses (10 tribal and 10 non-tribal) and 10 limited operator licenses for racetracks/off-tracking betting sites along with management service provider and supplier licenses.

<u>Permittable locations</u>

- Sports betting will be available statewide on mobile platforms from all operator licensees. In addition, in-person event wagering will be available at the locations of the 10 non-tribal operators and their associated 10 limited operator licensees.

<u>Permittable forms</u>

The bill establishes 2 tiers by which to classify and regulate sports betting.

- Tier 1 consists of wagers place exclusively on the outcome or point spread of an event.
- Tier 2 is defined as wagers not fitting the definition for Tier 1, which effectively means "proposition wagers" which are placed on any measurable aspect of the event other than the outcome or point spread of the event.
- The bill prohibits proposition wagers on collegiate sports.
- An individual licensee, sports team, sports league, or institution of Higher Education may petition ADG to prohibit a certain type or form of wagering if the activity is deemed to be unfair to consumers or impact the integrity of a game.

<u>State Revenue Collections</u>

ADG will have authority to issue licenses to event wagering operators and other licensees listed above. The bill does not specify licensing fee amounts and those amounts will be determined by ADG.

The bill also requires ADG to establish a fee (tax rate) for the privilege of operating event wagering. This fee rate would be applied to net gaming revenue from event wagering, which is generally calculated as the operator's gross receipts minus prizes paid. This fee authority is subject only to the restriction that the rate be set a minimum level of the "highest percentage of revenue share that an Indian tribe pays to this state pursuant to the Tribal-State Gaming Compacts". Based on the current Tribal-State compacts, the minimum fee rate would be 8.0%. We have used the minimum level of 8.0% to develop our revenue projection.

The Event Wagering Fund is established to receive licensing and fee revenue collected by ADG in relation to the regulation of event wagering, with ADG being permitted to use up to 10.0% of the monies in the fund for administrative purposes. Any remaining monies annually revert to the General Fund.

<u>Fiscal Impact – Sports Betting</u>

Currently, 25 different states and Washington D.C. authorize and regulate event wagering. However, many of these states do not serve as useful comparison points for the following reasons: 1) A lack of mobile betting options (mobile betting would be authorized in Arizona under the bill); 2) A limited number of operators, which may impact overall market activity and dampen in-person betting activity; and 3) Limited market development due to recent legalization, which would not serve as a good proxy for estimating a mature market size.

In addition, while states such as New Jersey and Nevada have robust event wagering markets, they also pose challenges for comparison purposes. When analyzing data on a per capita basis, these 2 states have revenue totals that are significantly impacted by tourism, which distorts any calculation of event wagering revenue per resident population.

(Continued)

For the purpose of this analysis, the JLBC Staff used 4 states for comparison under the assumption that the event wagering markets in these states are closer to the potential Arizona market – the selected comparison states are Iowa, Indiana, Pennsylvania, and West Virginia.

Similar to the above fantasy sports revenue analysis, we used the final 6 months of CY 2020 data for these states as the basis for our revenue estimate. Based on the historical Nevada data (60.0% of sports wagering revenue is earned during July – December and 40.0% of sports wagering revenue is earned during January – June), we extrapolated the Iowa, Indiana, Pennsylvania, and West Virginia data to represent a full year of FY 2021 revenue collections.

Using the extrapolated FY 2021 annual revenues, we estimated the per-capita event wagering revenue for each of the 4 states. Those per capita amounts were then averaged, with this $20.80 average serving as the basis for our projection of the bill's impact. *(See Table 2 below)*.

Table 2

Estimated Event Wagering Revenue Base

State	July 20 – Dec. 20 Revenue	Extrapolated FY 21 Revenue	2020 Population	Per Capita Revenue
Iowa	$35,177,800	$58,629,700	3,163,561	$18.53
Indiana	$101,514,300	$169,190,500	6,754,953	$25.05
Pennsylvania	$140,878,100	$234,796,800	12,783,254	$18.37
West Virginia	$22,770,200	$37,950,300	1,784,787	$21.26
		Average Per Capita Revenue		**$20.80**

Multiplying this estimated per capita revenue by Arizona's population, we estimate taxable event wagering revenue to be $154.4 million once the market becomes more fully operational. Assuming a fee rate of 8.0% is levied on event wagering revenue, we estimate $12.3 million of annual event wagering fee revenue will be deposited into the Event Wagering Fund. After 10.0% is deducted for allowable administration costs, the remaining $11.1 million of annual fee revenue will be deposited into the General Fund.

In terms of license revenue, based on the median event wagering license fee from all other states (and controlling for license duration), we estimate Arizona operators will pay $150,000 for each year of licensure. Based on the 30 event wagering operators authorized in the bill (20 Operator Licenses and 10 Limited Operator Licenses) we estimate $4.5 million per year in licensing revenue will be deposited into the Event Wagering Fund. After 10.0% is deducted for allowable administration costs, the remaining $4.1 million of annual license revenue will be deposited into the General Fund.

When combining the revenue from operating and license fees, we estimate the total annual General Fund impact of legal event wagering to be $15.2 million.

Under the legislation and the state's overall framework for gaming, any event wagering that occurred in-person at a tribal gaming facility would not be subject to the 8.0% fee rate assumed for the bill. Instead, those in-person wagers placed at tribal facilities would be subject to tribal contributions under any revised Tribal-State Gaming Compact. The above event wagering analysis is based on estimating the entire fully operational market in the state. To the extent that event wagering occurs at tribal facilities, the above estimates would be overstated. However, based on the experiences of other states, we would expect that a substantial portion of event wagering activity will take place through mobile platforms in non-tribal settings.

2/22/21