

**The Competitive Implications of Mississippi as an Open License
Jurisdiction**

Biloxi, Mississippi

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Because Mississippi is an open license gaming jurisdiction there is a popular misconception that the State will allow casinos in unlimited numbers and in unlimited locations. Nothing could be further from the truth. In reality, Mississippi represents some of the best in casino gaming: political support of the industry, open (i.e., non political) access to licenses for those who qualify and low (12.5%) gaming tax. What it doesn't provide for, as is discussed in this report, is wide open access to possible casino sites for anyone with an inclination to build a casino in the State.

The Competitive Implications of Mississippi as an Open License Jurisdiction

Mississippi is an open license jurisdiction which means in essence that any person found suitable may apply for a license to operate a casino in the three proscribed casino jurisdictions (certain northern Mississippi River counties, certain mid-river counties and the southern coastal counties) within the State. The three counties which comprise the Mississippi Gulf region are generally included in the permitted regions. These counties are (west to east) Hancock, Harrison and Jackson.

A broad interpretation of that statement might lead one to conclude that as a result casinos might be situated almost anywhere within the approved zones which in turn would suggest that competition could appear just about anywhere at just about any time. ***In all practicality nothing could be further from the truth.***

The fact that Mississippi is an open license state does provide some protection from the typical political melee which ensues whenever there are a limited number of licenses to be awarded (recently Massachusetts, New York and Philadelphia). Having said that, as will be discussed below, legal restrictions on actual site eligibility, local casino/no casino preferences and, as of 1/1/14, substantial new investment criteria for new casinos, combine to define what can be built on the Gulf and where those prospective new casinos can actually be located.

Additional complications flow from the fact of land ownership in Biloxi: much, if not most of the available land (including much of the land under the existing casinos) is not for sale, hence must be leased adding thus considerable financial drag to any new venture which cannot negotiate an outright purchase of the land needed for project development.

Taken as a whole, Mississippi actually represents some of the best in casino gaming: political support of the industry, open (i.e., non political) access to licenses for those who qualify and low (12.5%) gaming tax. What it doesn't provide for, as is discussed below in detail, is wide open access to possible casino sites for anyone with an inclination to build a casino in the State. That distinction—and the fact that Biloxi has a long history of being one of the major southern US coastal destinations of choice—actually makes the Mississippi Gulf region, for those fortunate enough to find a legal site and which can finance the cost of building to the new standards of investment, one of the best and perhaps one of the last clearly advantageous places to develop a casino property.

Eligible Areas In the Gulf Region

Rule 2.2 of the Mississippi Gaming Regulations defines the parameters for eligible Gulf locations as generally the waters of the three Gulf counties. The Regulations, however, further limit potential sites to those sitting directly on the ocean (i.e., no inland

waterways). Appendix I summarizes the pertinent sections of the MGR that apply to locations, additional site restrictions, and the numerous qualifiers that the Executive Director can use to further refine the definition of eligible sites. The latter prerogative is important for it allows the Executive Director of the Commission latitude to exclude certain sites because of their proximity to sensitive areas, for example schools, churches, wetlands and the like. In summary, Mississippi permits gaming in the Gulf Region only along the coast and in major costal waterways. However those permitted areas are further refined to include only those locations within 800' of the mean high tide line and then only in areas that in the discretion of the Commission would not impact adjacent sensitive areas. The takeaway is that the actual locations which a casino could be sited are in fact relatively few and very specific as to physical location as will be discussed below in more detail. The perception of Southern Mississippi as a potential host of a free-for-all of new casino development is simply not true.

Geographic Limitations on New Casino Development—the Macro

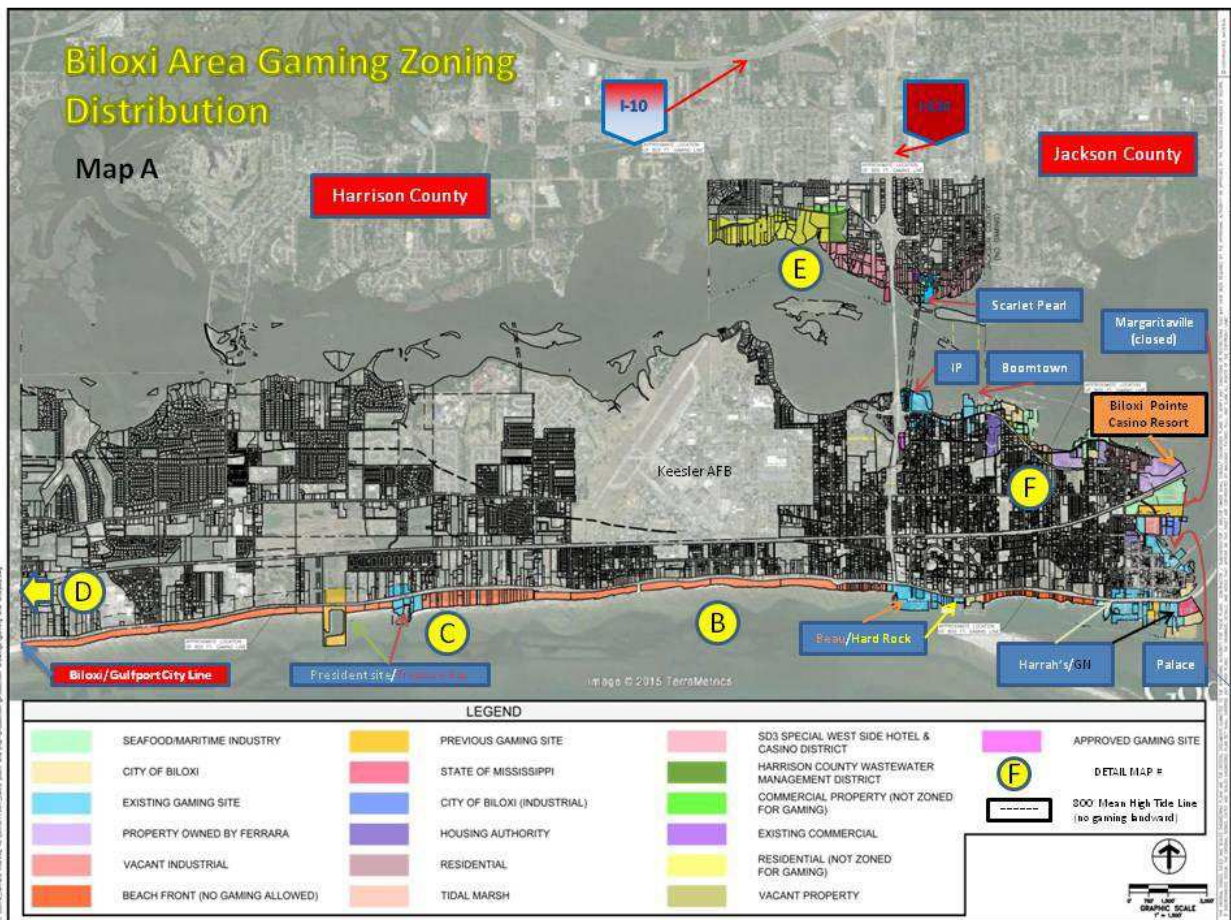
The Mississippi regulations noted above make clear that at the outset the State intended for casinos to exist only in certain geographic areas which in the case of the Gulf included the three most southern counties that lay on the Gulf of Mexico. These counties are Hancock (LA state line to roughly Bay St. Louis), Harrison (Bay St Louis to Biloxi) and Jackson (east of Biloxi to the AL state line).

At first blush one might conclude that the regulations would permit casinos virtually the entire length of the State's coastline. This is far from the case however as Jackson County (to the east of Biloxi) voted down casinos in that county by local referendum virtually as soon as was possible to do so. As a result casinos are limited to certain towns and cities in Harrison and Hancock Counties only.

Moreover, as is seen in the coastal detail of Map A below, casinos are not permitted along the beach which in fact runs substantially the length of the coast line from Bay St Louis to Biloxi. Certain exceptions exist, for example around the site of the former *President Casino Broadwater Resort*, but those are rare. In fact, from the I-110 off ramp (west of the *Beau Rivage*) to Gulfport (and including Gulfport) only four casino locations/development sites exist: The *Treasure Bay* (operating), the *President* (closed), *Island View* (operating) and *Rotate Black* (proposed). The latter two are the only legal gaming sites in Gulfport.

Geographic Limitations on New Casino Development—the Micro

By using detailed aerial photos color coded by zoning, all provided courtesy of the Mississippi Gulf's top engineering/surveying firm of Machado/Patano (www.mpeng.us), one can determine with greater precision the eligible gaming sites in the greater Biloxi market.



Source: Machado/Patano

What becomes clear very quickly is that no casinos are indeed legal to the east in Jackson County and in fact, other than the two existing locations (the operating *Treasure Bay*, and the vacant *President* site), to the west before one comes to the two Gulfport sites. If one continued westward from Gulfport the map would look similar, that is no legal sites until Bay St. Louis. West of Bay St. Louis is Louisiana and the Mississippi River Delta. There are no Louisiana casinos heading westward until *Harrah's* in Downtown New Orleans. Louisiana is a limited license state with no additional licenses available for future expansion so there is virtually no likelihood of Louisiana “backfilling” to the Mississippi state line.

The five detailed site maps (maps B-F) are included in Appendix II.

The high level conclusion that one comes to by looking carefully at the detail maps is that there are really only **three viable sites remaining in the Biloxi/Gulfport market**: *Biloxi Pointe Resort Casino*, the western most of the two D’Iberville sites (west of I-110) which is controlled by a Las Vegas investor group and *Rotate Black* in Gulfport.

Looking at each map individually provides ample evidence of the lack of legal gaming sites. In fact, taken in the broadest interpretation of the legal description of acceptable gaming sites there are only approximately eight Biloxi/Gulfport sites *in total* legally zoned for gaming which include, as noted, the *Biloxi Pointe Resort Casino site*, the western most D'Iberville site and *Rotate Black*.

The five other theoretically legal sites have so much baggage attached that it's very difficult to ever conceive of them as legitimate development locations. These other locations include the existing *Margaritaville* site, the old *President* site on Highway 90, the former *Casino Magic* site adjacent to the *Golden Nugget* (the hotel tower is being refurbished as a stand-alone hotel), a very small (<3 acres) site on Caillavet Street along I-110 to the south of the *Imperial Palace* (the "*Bacaran Bay*" project of old) and the eastern most of the two locations in D'Iberville (Map E) to the west of I-110. This site has serious, costly and likely fatal, wetlands issues, hence of dubious value as a gaming site.

Upon analysis of the legal and practical realities of the coastal region, a conclusion can readily be reached that other than the *Biloxi Pointe Resort Casino* site and possibly the more western portion of the D'Iberville site west of I-110, there are really no additional truly viable sites for casinos of any size—certainly of a size that would qualify under the State's new investment criteria (see below) in Biloxi and only one more additional site in the expended region, that being in Gulfport.

Moreover the restrictions noted above as to locations within the immediate vicinity of residential areas, churches, schools and children's public playgrounds eliminate a substantial additional portion of the coast line. In fact, a substantial section of the coast line in D'Iberville east of I-110 and on the north side of Biloxi (Maps E and F) are residential. Much of the coast line is also State and City owned as well—especially on the eastern and south eastern tip of Biloxi peninsula itself—and therefore out of consideration for gaming.

Leasing the Land: the Impact Of Not Owning the Dirt

It's a not well understood fact that most of the casinos in Biloxi sit on leased land—and those leases are an expensive drag on earnings. The impact of leased land is significant: in the case of *Margaritaville*, for example, the cost of the lease was 6% of gaming revenues. Coupled in that case (but not unique to *Margaritaville* as *Hard Rock* shares a similar issue) was the cost of the license to use the *Margaritaville* name—also 6%. These "hidden" costs, notably the land lease, are one of the reasons that EBITDA margins in the market seem so low. While leased land not entirely universal to all land under all properties, the fact is that most of the land is leased and leasing the land has a significant impact on cash flow generation that is not appreciated by most investors. Investors who look at the market and comment on what they perceive as weak margin performance are in most cases observing the impact of land leases (and in several cases, franchise license fees as well). Obviously, any operator who can own the

dirt—as *Biloxi Pointe Resort Casino* does--will be at an advantage over the Operator who doesn't. Equally true is that much of the available, theoretically gaming-legal sites are owned by entities (City, State or individuals) that cannot or will not sell outright thereby impacting potential future ownership and development opportunities.

One other observation on leased land of note—much of the leased land is owned not by one or two landlords but is typically controlled by numerous individuals and negotiations with them can be difficult. *Margaritaville's* landlord group, for example, included an estimated six and management's inability to reach successful negotiations with "the landlord" over a possible hotel expansion is one reason cited for that property's eventual closure (source: GulfCoastNews.com 7-21-14). The *Golden Nugget* also sits on leased land and has three landlords: The City of Biloxi, the IHL (state college board), and the Secretary of State. Clearly having a lease is problematic, both in so far as it represents a large, cash draining expenditure as well as making any conversation with a landlord—or more likely a group of landlords--about the lease potentially problematic in a stress situation.

Investment Criteria: The Hammer Comes Down

Prior to January 1, 2014, Mississippi did not hold casino projects to any particular defined minimum standard of project finishes nor did it require that a specific dollar amount be expended on the asset itself. Following Katrina in 2005, regulators did permit Gulf casinos to move onto land so long as the casino itself was within 800 feet of the mean high tide line (as determined by an Army Corp of Engineers survey of the mean high tide line: see the dashed line on our maps). Because most of the Biloxi casinos were wiped out by Katrina, nearly all of them took advantage of the new rules in one form or another. The impact of moving the casinos into existing public space has reduced the meeting and exhibit space for many Operators as that space was converted into gaming space (the old gaming floor being on the then destroyed floating barges). The advantage to these operators of moving the casino into the former meeting/exhibit space was a more secure casino; the disadvantage was the loss of all or most all of their meeting/exhibit space. Their loss is our gain, however, as the *Biloxi Pointe Resort Casino* will offer approximately 71,000 square feet of meeting and exhibit space, making it the second largest meeting facility on the Gulf Coast and the largest with an attached hotel and entertainment nexus.

However despite the newly relaxed location rules, no entirely new build casinos were attempted until a consortium of local investors launched the *Margaritaville* project on the east end of Biloxi peninsula in 2010. *Margaritaville*, with an estimated budget of only \$65MM was a mismanaged mess from the start (see our case study: "Why Margaritaville Failed") and after less than two tortured years of operations closed in September 2014.

Around this time, another collection of investors proposed a new build casino for Gulfport to be called *Rotate Black*. Although *Rotate Black* was better conceived and theoretically funded

(both debt and equity), it too failed for lack of *actual* committed funding after a series of deadlines set by the Mississippi Commission for commencement of the project were serially missed by the developers.

Embarrassed by this pair of spectacular duds, the Commission decided that it needed to impose stricter controls over new projects. *Rule 1.5 established minimum standards of investments which set, along with a requirement for a “unique” amenity, other minimum standards for finishes and attractions.*

The unique amenity is in its own right an interesting control mechanism for the Commission. The “unique amenity” is a loosely defined requirement which gives the Commission a great deal of leeway in its affirmation of “uniqueness”...kind of like Justice Stewart’s comment on how he knew something was pornography: “I know it when I see it”. *Scarlet Pearl*, which was approved before 1-1-14 but did not commence construction until well after that date, argued that it was grandfathered under the old rules, hence did not require a “unique amenity”. Fortunately for *Pearl*, the rest of the program did meet the new minimums (by sheer luck in most cases) so *Pearl* management was able to successfully argue that its new miniature golf course, at 42,000 square feet and 36 holes, should qualify as “unique”. The Commission begrudgingly agreed.

The new requirements for projects include the following standards from Section 1.5 (a) of the MGC Regulations:

- *Commission approval requires that the project include a 500-car, or larger parking facility in close proximity to the casino complex*
- *Infrastructure facilities shall include a 300-room, or larger hotel of at least a three diamond rating as defined by an acceptable travel publication to be determined by the Commission*
- *In addition, infrastructure facilities must include a restaurant capable of seating at least 200 people and*
- *A fine dining facility capable of seating at least 75 people, and*
- *The casino floor must be at least 40,000 square feet.*
- *The project will also have or support an amenity that will be unique to the market and will encourage economic development and promote tourism. The Commission will have authority in determining the quality of the amenity and the ultimate approval of the amenity, and may in its discretion reduce the requirements above should it determine that there is a justification to do so in certain markets. The Commission will further determine, in its discretion, if the prerequisite hotel and dining facilities may be supplanted by an amenity of high value to the overall tourism market in that the amenity will likely encourage economic development and promote tourism.*

While laudable in its effort to establish minimum quality standards for new build casinos, the de facto result of these regulations is to set a practical minimum standard of financial commitment

to a new project which is in all likelihood substantially higher than the \$65MM for *Margaritaville* and estimated \$105MM budget for *Rotate Black*.

As a way of benchmarking what 300 rooms, a 500 car parking facility, a 200 seat restaurant, a 75 seat fine dining facility, a 40,000 square foot casino and a somewhat nebulous new “amenity” would likely cost to construct consider the now under-construction *Scarlet Pearl* ‘s budget for example. For its 300 rooms, 60,000+ square foot casino, 250 seat buffet, 114 seat café, small (470 seat) event center, retail space, outdoor pool area, all-surface-lot parking lot (for 1,700 cars) and its 36 hole putt-putt golf course (its “amenity”) ***Scarlet Pearl’s budget is over \$260MM.***

From a practical perspective then, it’s reasonable to conclude that in order to build an asset to the Gaming Commission’s new standards an investor would likely have to spend over \$250MM excluding land costs (+/- depending on financing, legal and related costs not directly part of the building program). This represents a substantial financial commitment which is clearly beyond the reasonable grasp of smaller developers and casino operators. By establishing minimum build-out requirements Mississippi not only determines what gets built but in effect indirectly controls who can build there as well.

While for the larger gaming companies such as Wynn, Las Vegas Sands, MGM and Penn, \$250MM is a rounding error, it is also true that each of these companies is either already in the market (MGM and Penn) or as “big box” operators would find the market too small to justify the time and energy needed to develop a multi-billion dollar asset there (Wynn and Sands). In so far as that is true for most other operators of size, the practical implication is that the cadre of companies for which a Biloxi project would be a flick of the pen there is no real strategic imperative for entering the market (or going deeper in it). That means by default that the only other likely players who could develop in the market will be the smaller guys for whom the \$250MM price to play will be a substantial—and for some insurmountable—financial commitment. ***Competition for new licenses is thereby impeded by a substantial financial barrier to entry.***

The Mississippi market is a solidly middle-market region which, through its new investment criteria, The Mississippi Gaming Commission seeks to expand carefully by ensuring that new development is consistent with the strategy of preserving the character of the market as a regional destination of choice for (principally) Southern US patrons. This direction represents a challenge for some but for others--such as *Biloxi Pointe Resort Casino* which has the assets and resources necessary to build to the new standard--represents a tremendous opportunity to expand into a rationally managed and resurgent gaming market.

Conclusion

The new Commission guidelines act as a clear impediment to de minimis new build investment which is almost as insurmountable as the geographic limitations discussed above. The cost to construct to the new standards is at least \$250MM for an asset of any size and reasonable (but not five—even four—star) quality. The cost might be less than \$250MM were the land leased—which almost all of the land under the casinos in Biloxi is—but the offset to not having to buy the land is the high lease expense associated with the lease itself which will impact the Operators EBITDA margins. Couple the economics of building to the new paradigm with the lack of available sites both in the Gulf region generally and in the Biloxi market specifically makes the likelihood of a rush of new projects highly unlikely, if not actually impossible. So, despite Mississippi being an open license jurisdiction, the practical reality is that not everyone who has inkling to build a casino on the Gulf can afford and/or could find a place to do so. So whereas the popular misconception is that Mississippi’s open license policy means anyone can build virtually anywhere making for competitive chaos, the reality is that is not the case; however, **Mississippi does promote a business friendly, low tax environment where the politics typically associated with new license procurement are almost non-existent. For those developers lucky enough to secure one of the very few practical sites and who have the financial resources needed to invest \$250MM or so to ensure that the product will meet the MGC’s new standards of investment, the Mississippi Gulf market represents a “win/win” proposition that those who have studied the market in detail can readily appreciate.**

APPENDIX I

Summary of Key Mississippi Gaming Regulations relating to geographic and site criteria; Summary of Executive Director's prerogatives regarding site suitability

Geographic locations for gaming along Mississippi's Gulf Coast:

"Waters within the State of Mississippi which lie adjacent to the three (3) most southern counties of the State. In addition to the Mississippi Sound, this would include St. Louis Bay, Biloxi Bay and Pascagoula Bay. However, the rivers, bayous, lakes and back bays leading into these bays, including but not limited to the Jourdan River, Wolf River, Bernard Bayou, Tchoutacabouffa River, Pascagoula River and Escatawpa River, Biloxi River, Big Lake and Back Bay of Biloxi are not within the authorized area. In determining where the river ends and the bay begins, an imaginary line shall be drawn from the foremost land mass at the intersection of the river and bay, straight across the river to the foremost land mass of the intersection on the other side. In determining where Back Bay of Biloxi ends and Biloxi Bay begins, an imaginary line shall be drawn beginning at a point 1200 feet west of the center line of Interstate 110 on the northern shore to a point on the center line of Interstate 110 on the southern shore."

Further site restrictions apply and are described as:

"The part of the structure in which licensed gaming activities are conducted is located entirely in an area which is located no more than eight hundred (800) feet from the mean high-water line (as defined in Section 29-15-1) of the waters within the State of Mississippi, which lie adjacent to the State of Mississippi south of the three (3) most southern counties in the State of Mississippi, including the Mississippi Sound, St. Louis Bay, Biloxi Bay and Pascagoula Bay, or, with regard to Harrison County only, no farther north than the southern boundary of the right-of-way for U.S. Highway 90, whichever is greater; and In the case of a structure that is located in whole or part on shore, the part of the structure in which licensed gaming activities are conducted shall lie adjacent to state waters south of the three (3) most southern counties in the State of Mississippi, including the Mississippi Sound, St. Louis Bay, Biloxi Bay and Pascagoula Bay. When the site upon which the structure is located consists of a parcel of real property, easements and rights-of-way for public streets and highways shall not be construed to interrupt the contiguous nature of the parcel, nor shall the footage contained within the easements and rights-of-way be counted in the calculation of the distances specified in the above paragraph."

In addition to physical site restrictions, there are numerous qualifiers due to the unsuitability of certain locations. Those are defined as:

"The Executive Director may recommend that an application for a license be denied if the Executive Director believes that the place or location for which the license is sought is unsuitable for the conduct of gaming operations. The Commission may deny an application for a state gaming license if it deems that the place or location for which the license is sought is unsuitable for the conduct of gaming operations. Without limiting the generality of the foregoing, the following places or locations may be deemed unsuitable:

(a.) Premises located within the immediate vicinity of residential areas, churches, schools and children's public playgrounds.

(b.) Premises where gaming is contrary to any county or city, ordinance, including, but not limited to, zoning ordinances restricting the permissible locations for gaming facilities, so long as such ordinances do not have the effect of absolutely excluding or prohibiting legal gaming;

(c.) Premises which fail to meet federal, state or local health and safety standards, and any other applicable laws or regulations including, but not limited to Coast Guard regulations.

(d.) Premises frequented by minors. The Executive Director may recommend and the Commission may determine that premises frequented by minors are nevertheless suitable if the applicant demonstrates that it has taken sufficient precautions to separate areas of the premises frequented by minors from the gaming operation.

(e.) Premises lacking adequate supervision or surveillance.

(f.) Premises difficult to police, or where adequate fire protection may be difficult.

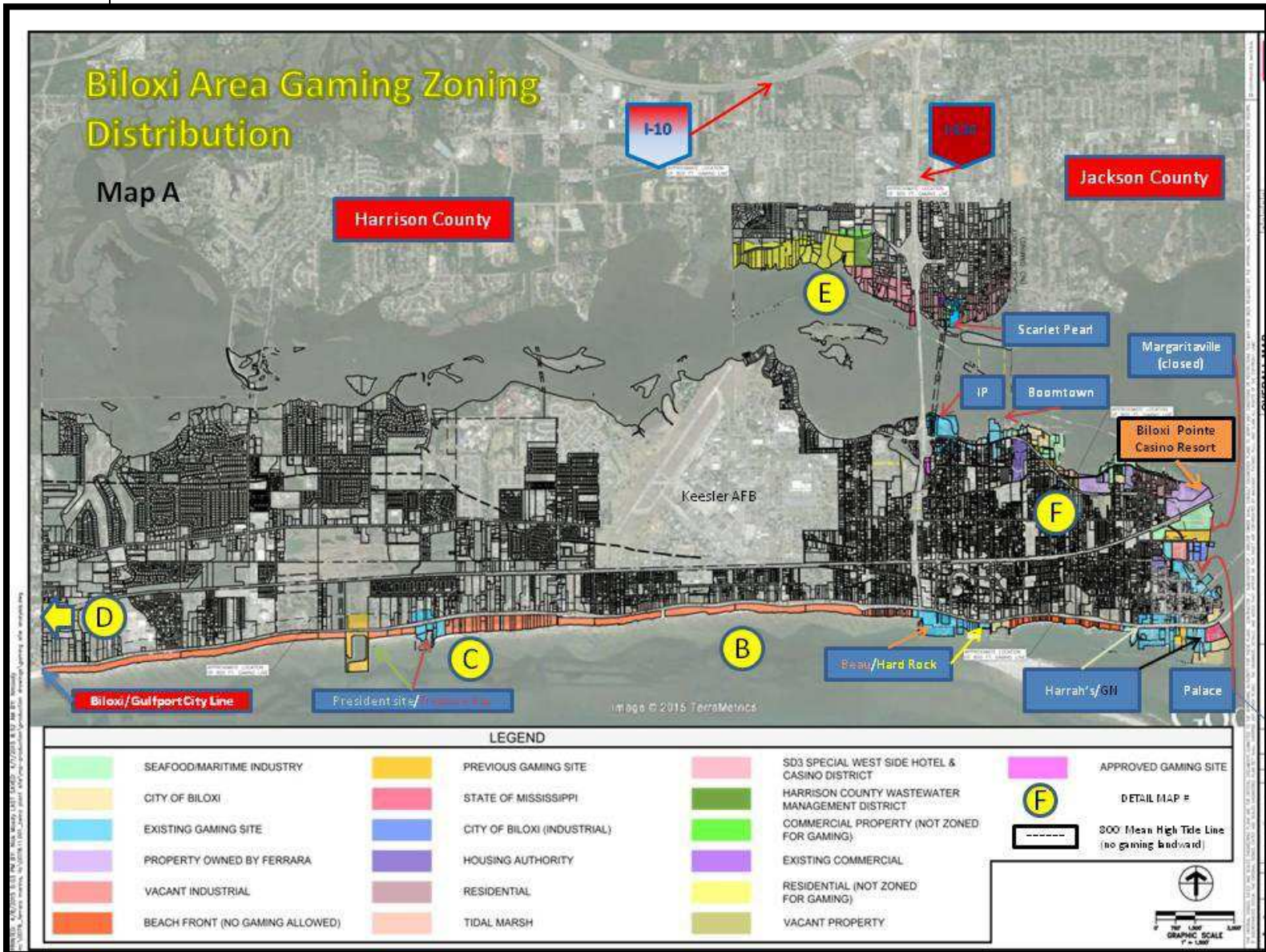
(g.) Any other premises where the conduct of gaming would be inconsistent with the public policy of the State of Mississippi."

APPENDIX II

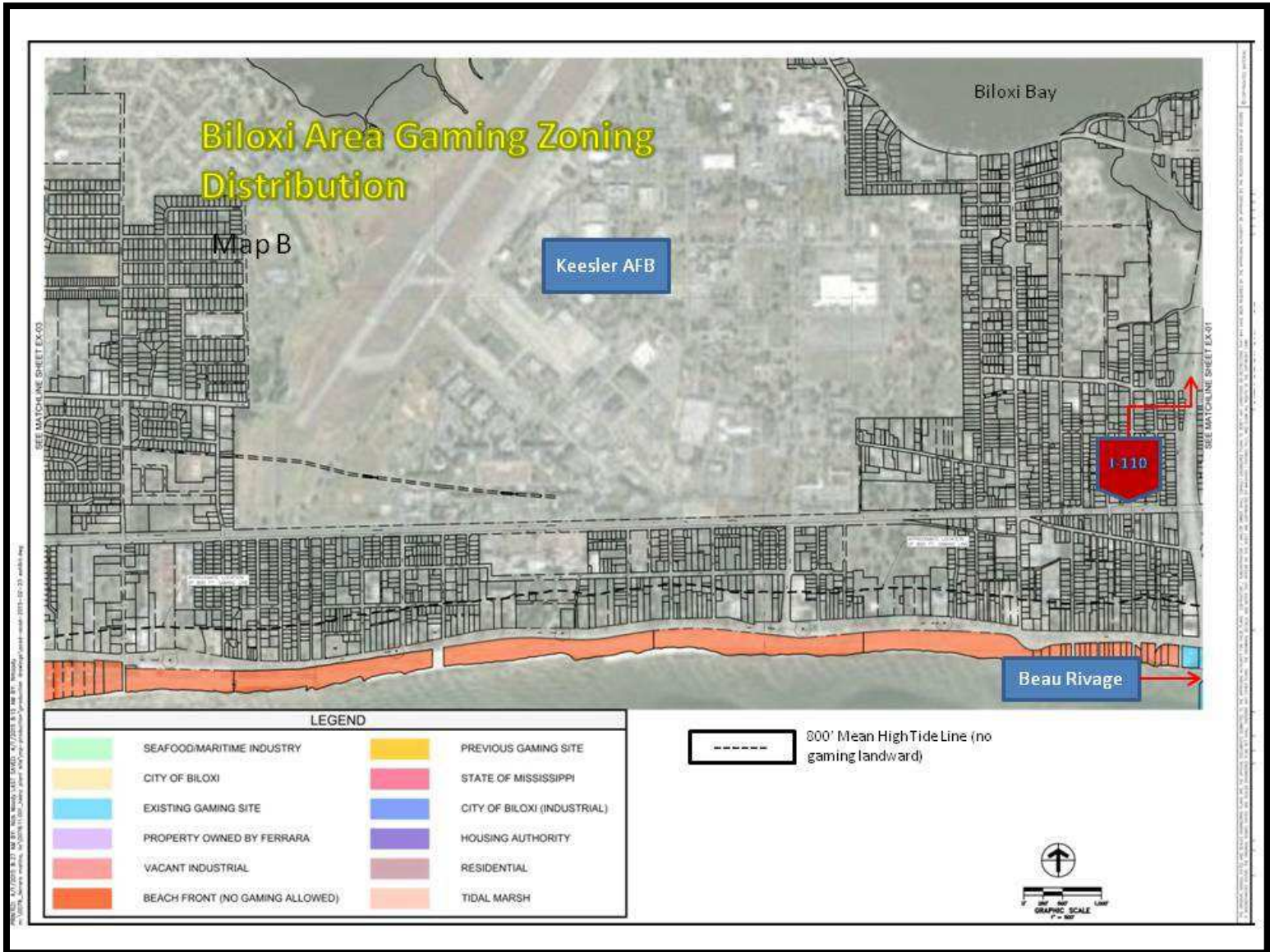


All maps courtesy of Machado/Patano (www.mpeng.us)

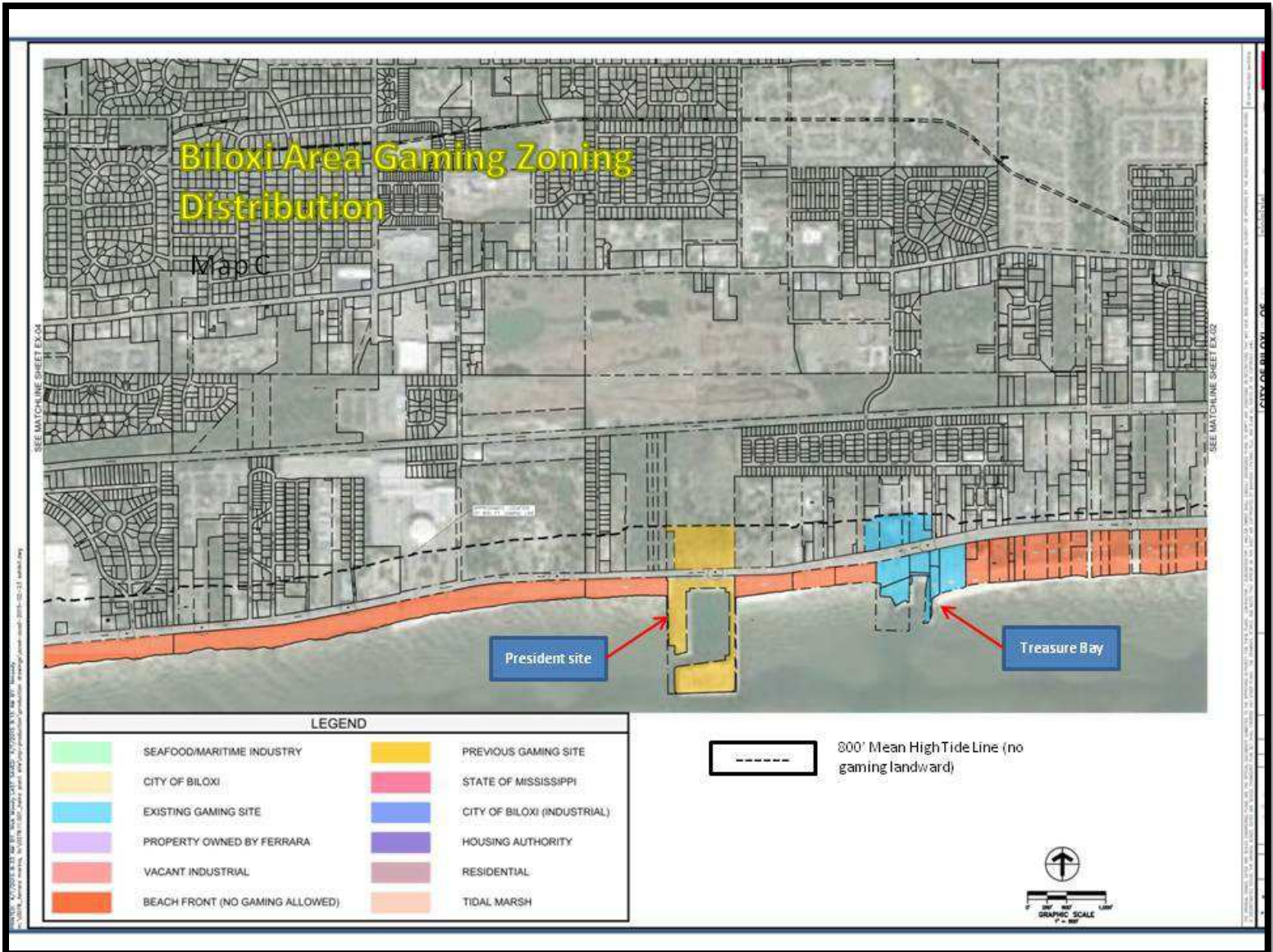
MAP A



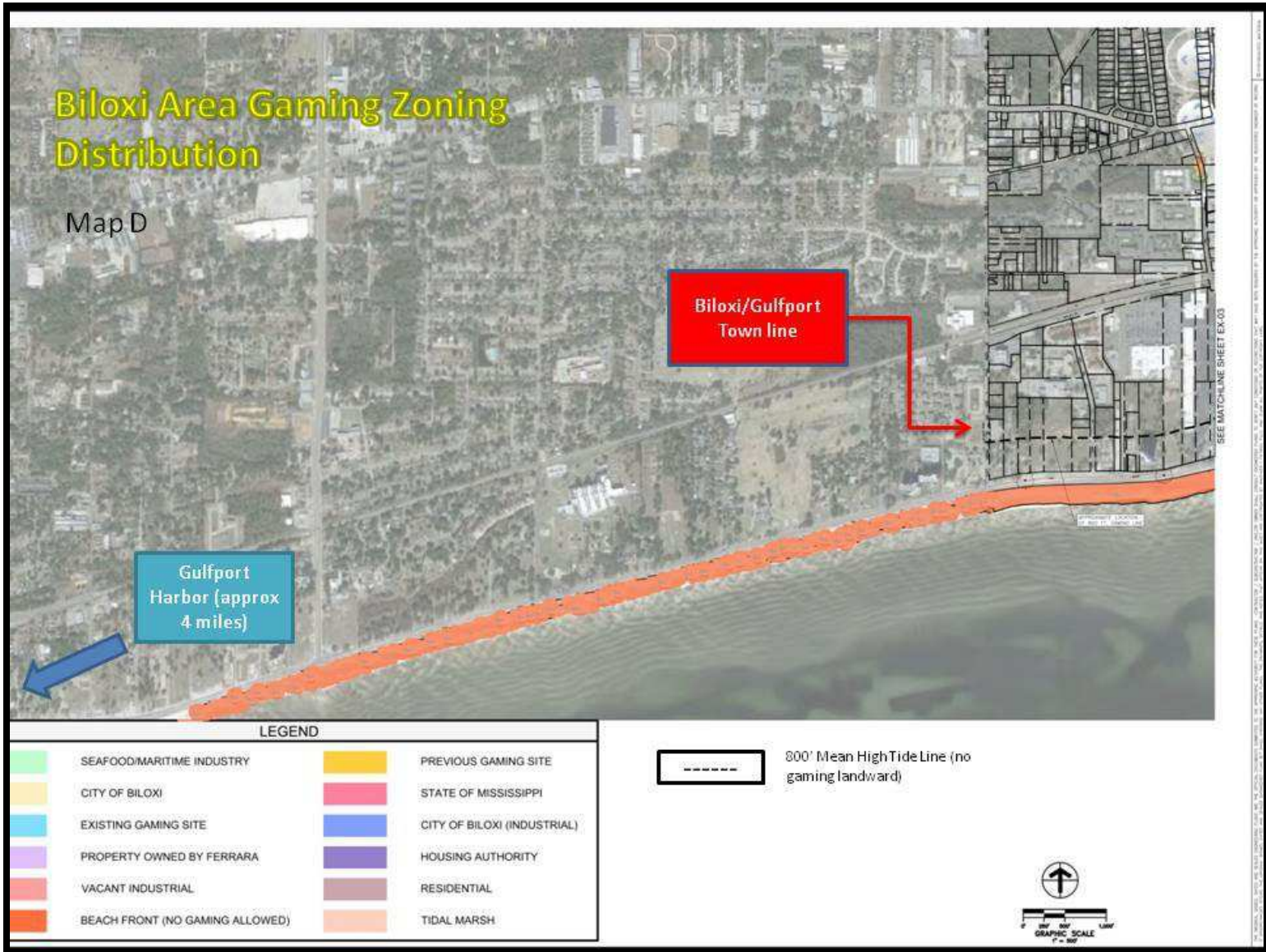
MAP B



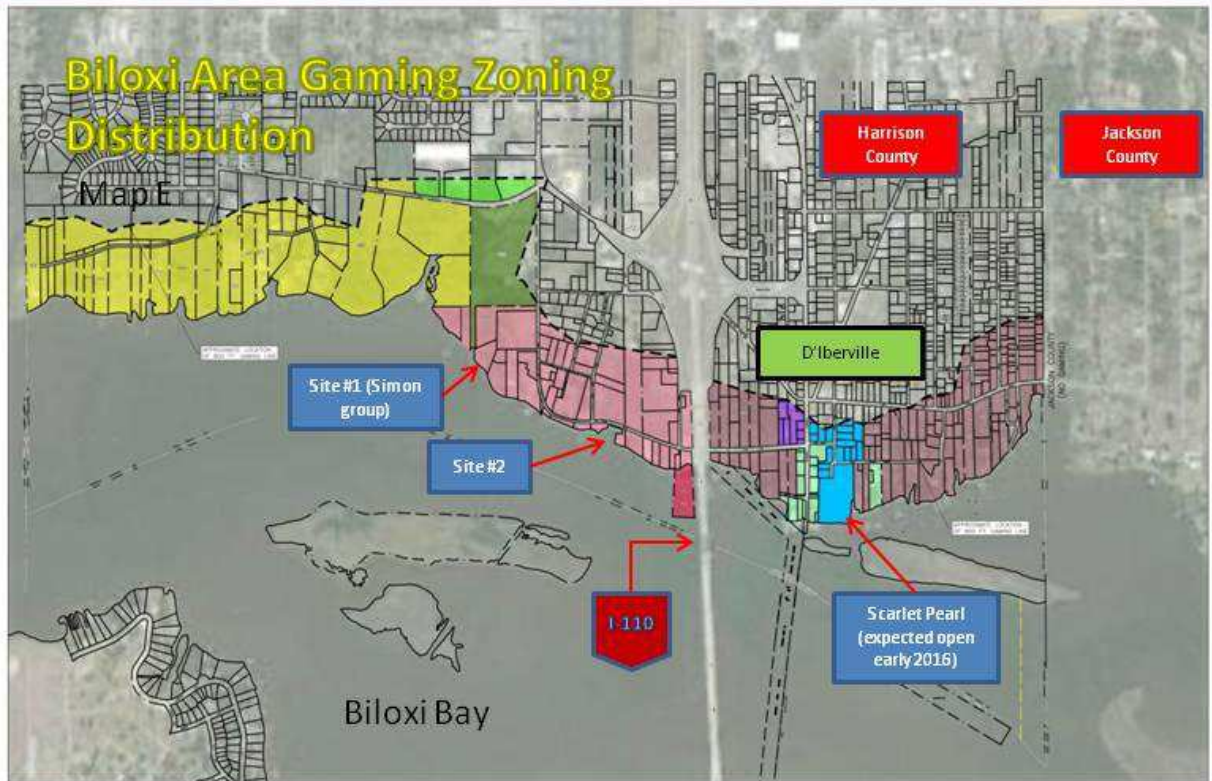
MAP C



MAP D



MAP E



LEGEND			
	SEAFOOD/MARITIME INDUSTRY		RESIDENTIAL
	STATE OF MISSISSIPPI		EXISTING COMMERCIAL
	EXISTING GAMING SITE		RESIDENTIAL (NOT ZONED FOR GAMING)
	SD3 SPECIAL WEST SIDE HOTEL & CASINO DISTRICT		300' Mean High Tide Line (no gaming backward)
	HARRISON COUNTY WASTEWATER MANAGEMENT DISTRICT		
	COMMERCIAL PROPERTY (NOT ZONED FOR GAMING)		



MAP F

