# DRAFT TRANSITION REPORT

## NEW JERSEY GAMING/SPORTS AND ENTERTAINMENT COMMITTEE

JANUARY 5, 2010

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## A. Mission Statement

The purpose of this sub committee transition report is to address the significant issues and financial needs of New Jersey Gaming, Professional/Sports and Entertainment Industries. Inherently, the overriding objective(s) of this analysis is to harness, distill and focus upon a series of key issues that must be thoroughly examined and integrated into a master plan for the "Global Good" of New Jersey. This plan will provide an outline of a roadmap.

Additionally, the plan will provide solid strategic options upon which to move forward.

## B. Keys to Success

1. Create meaningful bridges to all parts of the New Jersey Community for the "Global Good".

2. Inventory, account for and integrate core assets and liabilities to force financial accountability for the benefit of the New Jersey taxpayer.

3. Eliminate entities that are based on deficit spending and no longer relevant to the healthy future of New Jersey.

4. Act decisively and immediately.

## C. Executive Summary

Our sub-committee deals with activities that cross over 3 major entities: NJSEA, Lottery Commission and the Atlantic City Gaming and Casinos (Since the Authority's sub-committee addresses the structure of these entities our report excludes this information).

1. **Casino Industry:** The historic business model has failed. However, a united front in a Public/Private venture to create Atlantic City as a Destination Resort may save Atlantic City and the Casinos. A review of State initiatives to improve Atlantic City must be undertaken immediately.

2. **NJSEA and Horseracing:** As budgeted for 2010, horseracing on track is projected to lose $22 million; the business model is broken. The agreements with the various Horsemen Associations will ensure continued losses; during 2010 these agreements need to be reopened and renegotiated. It is time to review options for racing in New Jersey. THE STATUS QUO IS NOT SUSTAINABLE. We encourage consideration of all the options to make horseracing self-sustaining, including consolidation of racing state-wide. The ultimate goal is to continue to have live racing at a venue where the Sports Authority and its OTW system can operate without a subsidy. (NJSEA budgeted total deficit for 2010 is $38 million). Another option to be considered is a feasibility study for the commercial redevelopment of the Meadowlands, including examining other potential uses such as NASCAR.

3. **IZOD Center**: The Corzine Administration attempted to negotiate an agreement that permits the Nets to play the 2010-2011 and 2011-2012 seasons at the Prudential Center. We suggest that the December 31, 2009 deadline that gives the Nets an

opportunity to opt-out be extended to February 28, 2010, and any changes to the Nets Licensing Agreement be held until the Christie Administration is in office. The Christie Administration can then resolve the 2 Arena question. Regarding concerts; the State directly or indirectly controls 4 venues where concerts can be held (IZOD, PNC, AC Convention Center and Rutgers); an integrated policy should be developed for these facilities; if possible, include Giants/Jets Stadium and PRU Center. The possibility of including the Pru Center through an integrated program administered by NJSEA should be pursued.

4. Xanadu: This project appears to be a failed business model. The NJSEA needs to engage the owners (NJSEA owns the land, not the buildings) to open or surrender the property.

5. Lottery: The latest numbers available show a net of $883 million with potential to increase. Considerations should be given to privatize (package with Racing) in an RFP on a 20 year license. The potential price is in excess of $10 billion.

6. New Jersey Professional Sports Franchise Report: New Giants/Jets Stadium appears on schedule, it will not be a financial contributor for the NJSEA; over time it will be a drain. Need to apply Sec 6.10 Giants/Jets ground lease, which provides 50% of $34 million annually, and starts April 2010. There are no imminent issues with the franchises other than as stated in this report.

## I. CASINO INDUSTRY:

New Jersey's Gaming Industry, a key economic engine for New Jersey with over 38,000 jobs is at a crossroads – and both directions are painful. Either we maintain a (i) "business as usual" approach with an accelerated economic collision between out-of-state competition and in-State mismanagement; or (ii) adopt substantial governmental and economic reform creating a re-engineered and enhanced industry for the "Global Good" of New Jersey. We strongly recommend the immediate selection of the latter alternative, as evidenced in the following report.

In 2009 alone, New Jersey Gaming will have delivered close to $1 billion in State and local taxes – with more than $400 million dedicated to seniors and disabled (PAAD). Furthermore, an additional $2.2 billion of goods and services will have been purchased from New Jersey businesses throughout the State generating another 20,000 jobs. However, the present gaming model and its focus on the day trip market is broken, as evidenced by 6 of the 11 casinos in Atlantic City being either in bankruptcy, or in the midst of major debt restructuring. Additionally, the Revel Casino currently under construction lacks necessary funding to finish construction and to open. These current capital restructurings and industry difficulties are due to several factors, including the economy. An over reliance in the past on an east coast gaming monopoly which, in turn, had New Jersey casinos focused solely on a gaming product and not diversifying its offerings has exacerbated the situation. This business model will no longer work with the new "convenience gaming" day-trip competition in PA, NY, DE, and with more competition on the horizon. While there has been some movement and capital investment by various casinos to an alternative model -- a Tourism, Entertainment and

Destination model like Las Vegas -- there must be stronger government and casino industry leadership and a greater collective effort to generate new customers and revenues and position NJ gaming more competitively to the new "convenience gaming" on our borders. This effort also needs to be coupled with streamlining the current regulatory structure and the related disproportionate astronomical regulatory costs and operational burdens in NJ in comparison to other U.S. Gaming destinations.

For historical perspective, there has been over $17 billion invested into New Jersey Gaming since 1978. A consistent pattern of revenue growth, both industry-wise and in governmental receipts was enjoyed for 29 years. This investment and continuous growth was driven by a combination of non-competitive market demand, plus a tax model designed to incentivize large scale capital investment. In fact, over $7 billion of capital has been invested since 2003, largely to begin the conversion of Atlantic City from a solely Gaming centric day-trip market with mostly gaming product, to a more compelling and competitive Destination Resort with many non-gaming offerings. Unfortunately, between the "Great Recession", increased mid-Atlantic Gaming competition and related frozen Gaming capital markets, there has been an epic contraction in New Jersey Gaming with revenues shrinking over 20% from $5 billion to $4 billion annually since 2007. Inherently, jobs have seen a draconian decline going from nearly 50,000 to less than 38,000 in this same 2 year period.

Essentially, this historically significant downturn is primarily due to 4 factors:

1) Increased competition in "Convenience Gaming" in the 5 State mid-Atlantic region. From 1990 to 2009, Atlantic City has gone from a "monopoly", to a scattered competitive marketplace of 26 existing alternatives of VLT/Slots with close to a doubling of the supply of gaming product in recent years. Atlantic City remains the only alternative in New Jersey, but has been surrounded by a "picket fence" of competitive interests in surrounding states; the vast majority of which are principally stand alone warehouses of slot machines with little non-gaming product (no hotels and little in the way of night life, retail and food offerings). The newest generation of increased Atlantic City competition through convenience gaming is New York's Aqueduct Racetrack pending 4,500 VLT facility. This needs to be monitored.

2) Impact of the "Great Recession" on customer's spending.

3) Partial Smoking Ban has material revenue impact (est. 10% decline).

4) Perception of Atlantic City as unsafe and unclean arising from a failure to invest in the areas surrounding the casinos, and local government's inability to manage this current reality, in spite of unparalleled tax revenue per capita on a statewide peer basis.

The above 4 fundamental business conditions are further detrimental to New Jersey Gaming due to both an industry paradigm shift in marketing, and a failure to marshal a coordinated effort amongst "Stakeholders"; – State, Casinos and Atlantic City. The original Atlantic City business model based upon nearly 90% gaming revenue (now 75% gaming) is inappropriate to create success in today's highly competitive mid-Atlantic region gaming marketplace. With convenience gaming competition now surrounding

New Jersey, Atlantic City must appeal to a broader array of customers that stay longer (convention market, younger demographic) and, in doing so, derive a greater increase from non-gaming activities. This necessary objective requires immediate and full scale change through supporting a "Tourism and Entertainment Destination Resort" brand and culture and the private capital investment to achieve this transformation. This must and can be done through the development and implementation of an industry, State and Local agencies master marketing campaign. Presently, Atlantic City Convention and Visitors Bureau ("ACCVB") spends less than $4 million on marketing, compared to over $100 million for Las Vegas.

Unfortunately the city government in Atlantic City suffers from a combination of fiscal imprudence and very inefficient (at best) governmental guidance. A comparable peer analysis of Atlantic City demonstrates that they are from 70% to more than 100% more expensive than other New Jersey cities on a per capita basis. Consequently, less is performed for more money. For example, while much is spent on public safety, there is little return to show on this investment (or lack thereof) with perceptions of Atlantic City being at a low (a recent study reflected that 51% felt the city was not a safe place to visit, but 76% stated that a cleaner and safer environment would be a key factor in whether they would come more often). There is <u>no</u> revenue problem in Atlantic City, there is a significant and unparalleled expense and utilization problem. This is best evidenced by the fact that in spite of their "outlier" revenue per capita through largely casino real estate taxes, the City is now anticipating a potential ($34 million) budget deficit in fiscal year 2010. It is imperative that an independent State review of Atlantic City is done, on a forensic accounting basis, to ascertain the greatest public benefit from existing revenue.

Like revitalization efforts in other key tourism markets throughout the US, there is a critical need for all Stakeholders to engage in a coordinated Public-Private Partnership to stabilize the Gaming Industry, and develop a comprehensive plan to take it to the next level as a Tourism and Entertainment Destination Resort. Creating an environment of fiscal accountability is vital to such an accomplishment in Atlantic City. In order to do this, a State presence will be required within the local governmental structure to achieve best in practice and most efficient financial benefits.

A summary of core revitalization and strategic goals are identified for the immediate, medium and long term:

1) **<u>Immediate Goals</u>:**

   A) Develop the necessary Clean & Safe initiatives, especially on the Boardwalk to encourage family traffic (a combination of police and cleaning up blight).

   B) Improve existing regulatory model consistent with competitive markets (i.e., Las Vegas), without sacrificing integrity. Derive substantial savings (potentially in excess of $30 million annually) and mandate to industry a rededication of savings to reinvestment in new business revenue generating marketing.

C) Implement Private-Public Partnership – an urban revitalization program managed and executed by State and Local agencies with experts with proven results – not political appointees - overseeing the effort.

D) Marketing Strategy – develop a more focused and funded (see later source recommendation) concentration on branding and event marketing activities never before implemented in AC.

E) Meetings and Conventions – re-establish Atlantic City as a significant Northeast hub for meetings and conventions with business complimenting the existing weekend market.

2) **<u>Medium Term Goals</u>**:

- Adopt and implement a master plan for Atlantic City, Boardwalk, Marina District and Atlantic City Entryways.

3) **<u>Long Term Goals</u>**:

A) Master plan for the inlet.

B) Bader Field plan that supports existing Atlantic City investment and overall positioning of Atlantic City.

Most importantly, the key implementation goals for the Governor-elect to consider are to endorse the above goals with the following bold actions:

1) A challenge to Casinos to match "seed capital" of New Jersey for Atlantic City Partnership (ACP) (possibly up to $5 million), in order to "prime the pump".
   A) Establish the Atlantic City Partnership (ACP), a new entity funded by Private and Public dollars, responsible for visitor marketing, redevelopment strategy and project management of the new brand and integrate ACP with CRDA and ACCVA to ensure coordinated industry/state agency efforts.
   B) State and Local focus to prioritize Clean & Safe efforts

2) Streamline Casino Control Act: For years there has been discussion of regulatory reform that could create savings of between $20 and $30 million annually which could be rededicated to Atlantic City marketing and redevelopment efforts without sacrificing integrity. New Jersey's costs compared to Nevada's are astronomical. The regulatory cost per slot machine is $1,596 in New Jersey compared to $170 in Nevada. Cost per employee is $1,769 in New Jersey compared to $196 in Nevada and cost as a percentage of gross gaming revenue is 1.47% in New Jersey compared to 0.33% in Nevada. Much of the cost is in redundancy between the CCC and DGE; especially with respect to staffing. One model is to turn the CCC into a purely administrative judicial function over licensee activity (reducing staffing with the DGE focused on day to day regulatory functions and enforcement and instituting actions before the CCC) similar to other models in other jurisdictions. Bringing the Act up-to-date could save more funds and create more operating efficiencies as many requirements are antiquated and serve no legitimate function. In addition to external cost of the

agencies, there is also an undefined, yet significant cost to comply with unnecessary regulations.

3) CRDA: Casinos pay 1 1/4% of GGR (about $30M per year) towards "Atlantic City" "South Jersey" and "North Jersey" statutory funds. Subject to accounting for funds that are already bonded or committed, these funds could be an available source.

4) Fiscal Responsibility: Greater efficiencies at all government levels, particularly in Atlantic City where the industry pays $180 million per year in Real Estate taxes. Create a State role of overseer to immediately delve into financial operations of Atlantic City to constructively reform current spending. The objective is to bring Atlantic City into a closer conformance to other New Jersey peer cities, and to use a portion of savings to support marketing and branding of Atlantic City. Also, better utilization of the police department could assist in the Clean and safe initiatives which are critical to making Atlantic City a destination.

5) Evaluate with current Stakeholders (State and Casinos) how to expand New Jersey Gaming with a goal of collective investor future growth.

6) Do not waste State money to pursue intra-state internet wagering, or sports betting until Federal laws change.

## 2. NJSEA AND HORSERACING:

The New Jersey Sports & Exposition Authority operates The Meadowlands Sports Complex. It is home to the world's most popular harness race track, a thoroughbred race meet, the #1 ranked stadium in the world (2009) and the #4 ranked large arena in the United States (2008). Unfortunately, the current financial structure can no longer support the financial, operating, capital and contractual requirements of the Authority. Without outside financial resources the Authority will be forced to discontinue its racing operations in 2010. In 33 years of successfully managing racing, sports and entertainment industries to the enormous financial benefit of the State, the NJSEA's 1970's financing structure was not addressed nor updated to meet current market conditions. This occurred even as State revenues from Authority activities grew. In short, while the new operating structure was increasing State revenues, the Authority's revenue streams were being reduced or even eliminated.

In 2006, solutions were presented to the Corzine Administration. As part of the solutions presented, the Authority's revenue streams would be linked to the fiscal benefits from the operations of the Stadium Project (See Section 6.10 attached). In 2008, the NJSEA pressed for the implementation of this prior commitment. Unfortunately, to date, it has not been adopted.

In light of the above, the 2010 financial and contractual obligations of the NJSEA must legally be met. This overview will present the problem and identify solutions and their ramifications. It is imperative that a solution be put in place for 2010 to allow for the implementation of a long-term plan. If not, chaos will ensue in the racing, sports and entertainment businesses in the State with legal and financial ramifications should the NJSEA cease operations from lack of funds.

**Racing's Financial Impact on NJSEA**

1) The Meadowlands Racetrack and Monmouth Park will sustain projected losses of $22 million in 2010 in their respective live on-track businesses. Both facilities additionally require major capital investments. The losses have been underwritten in recent years by the advance lease payments made by Xanadu. Those funds are exhausted. That project is now stalled and the capital structure has failed.

2) Off track wagering at Woodbridge and internet account wagering are profit centers that offset the on-track loss by some $9 million. Legislative mandates however require that the NJSEA conduct a specific number of on-track days in order to operate OTW's and account wagering. This is a restrictive legislative mandate that does not allow for a change in New Jersey's racing business model.

3) The addition of gaming at New York, Pennsylvania and Delaware racetracks drove New Jerseys on-track live racing from profitable to unprofitable in the past five years. In 2000, there were just 3 racinos on our borders competing with New Jersey. Today there are 12.

4) In addition to legislative mandates, prior legal agreements with horsemen require a certain number of specific racing days to continue until 2016.
5) The New Stadium agreement negotiated by the State with the Giants and Jets gave the teams the right to sponsorship and advertising at the Meadowlands Racetrack (a potential revenue source of approximately $500,000 annually)

6) Suspending racing eliminates over 5,000 on-track full, part-time and seasonal jobs between The Meadowlands and Monmouth Park. Another 7,000 jobs statewide are dependent upon racetrack operations according to a recent Rutgers University study.

7) East Rutherford's PILOT is approximately $6 million. Monmouth Park provides nearly $2 million in property taxes to the Borough of Oceanport as its largest payer. Ending racing puts much of this at risk.

8) The NJSEA has currently issued the first contracts for a $20 million project at Monmouth Park funded by a low interest loan from the New Jersey Environmental Infrastructure Trust to provide a long-term solution to the stormwater run-off problems in the CAFO area at the facility. This project is mandated under an Administrative Consent Order with the NJDEP. An immediate decision regarding this investment is needed as it is a prerequisite for continued horseracing at the track. The Borough of Oceanport has guaranteed the loan.

**Additional Factors**

The New Meadowlands Stadium agreement took a net revenue stream of $20 million from the Authority and reduced it to $6.3 million. Revenue was given to the new entity as they were given control of the new building and its revenues sources such as sponsorship, concerts, and naming rights to the new Stadium, the Sports Complex and the Racetrack. The NJSEA will provide substantial services to the new Stadium under a 5 year contract.

Additionally the NJSEA is contractually obligated to provide site, security, fire, environmental remediation and EMS service going forward on the Complex.

**NJSEA Transition Team Suggested Options to Resolve Losses/Create New Revenue**

The solution to the NJSEA Financial Problems is, by necessity multi-dimensional. There is no single solution that will singularly address the industries competitive position within the regional gaming industry. As a result, we are recommending a number of solutions, when taken as a whole, will begin to address the short and long-term needs of the industry and will go along way toward increasing New Jersey's tax revenues and jobs.

1) Implementing Section 6.10 (Application of Fiscal Benefits) of the Stadium Project Ground Lease and Development Agreement dated December 21, 2006, approved by the NJSEA Board of Commissioners and approved by the Governor's Office.

    a. This section provides that 50% of the fiscal benefit of the new stadium (estimated in 2006 to be $17.1 million/year) be directed back to the NJSEA for maintenance, repair and replacements to the Sports Complex. This provision was to begin after the initial commencement Date (April 2010). This provision would continue throughout the term of the new stadium ground lease (39 yr initial term & three 14.5 yr options).

2) Consolidate racing industry statewide and allow the NJSEA to develop all OTW facilities in-state if the private track owners continue to choose not to develop their allotted franchises.

3) In order to be more competitive with neighboring states, modify existing statutes to provide more management flexibility in staging live racing, i.e., existing purse agreements.

4) Reduce Monmouth Park to a 50 day summer meet with high purses assuming the elimination of the Meadowlands thoroughbred meet and more flexibility for standard-bred scheduling.

5) Amend legislation making siting and development of OTW's go more quickly. Rescind allocations not used by Freehold and Atlantic City Race Course.

6) Allow NJSEA to manage and coordinate the non-casino concert and entertainment industry in the State at IZOD, Prudential Center, PNC, Atlantic City Convention Center and Rutgers. Consolidate these facilities as much as possible. Study defeasance issue regarding IZOD Center.

7) PILOT payments saving $8.1 million from Meadowlands and Monmouth (Madison Square Garden, Prudential Center, PAC, and Atlantic City Convention Centers pay none.) Needs to be addressed.

8) The Nets issue must be addressed. They cannot leave the Meadowlands without paying the waiver amount. The impact upon suites and sponsorship dollars has to be a part of the negotiations.

9) Explore content relating to sports and entertainment with the idea of building a cable or internet based network.

The above options are a stop-gap measure.

We need to explore restructuring the entire operations of the Sports Complex to make the Authority at least revenue neutral to the taxpayers. This may include discontinuing racing at the Meadowlands and restructuring the industry in NJ. See comments in Executive Summary.

## 3. IZOD CENTER:

### Historical Perspective for Two Arenas

**Concert/Family Show Industry in New Jersey: Two Arenas**

In the competitive marketplace it is important to point out that the IZOD Center ranked 3rd and 4th nationally respectively in 2007 and 2008 for concert and family show gross sales and 4th for the decade as tracked independently by BILLBOARD Magazine

**Concerts**

The two-year concert industry statistics are testament to the positive impact two arenas have had on New Jersey's entertainment marketplace: 46 for the IZOD Center, 36 for the Prudential.

For perspective, The IZOD Center has averaged 25 concerts per year since 2000. Therefore, as a result of the opening of the Prudential Center, New Jersey added over 30 concert dates for metro area consumers, which were more dates for the people working in the buildings, and more event-days worth of revenues generated for the State while the IZOD Center maintained its historic level.

**Family Shows**

For Feld Entertainment (Ringling Bros. Barnum & Bailey Circus, Disney on Ice, etc.), the IZOD Center has and continues to be one of the highest grossing venues in the country. As a result, we are contracted with them through 2012. In 2009 there were 54 family shows at the IZOD and 39 at the Prudential Center.

A number of concerts in the past year would not have played New Jersey without two Arenas available because a conflict at IZOD meant an opportunity for the Prudential Center and vice versa.

In 2009 the IZOD has been used for rehearsals and movie shoots, and for example, in 2008, Madonna used the IZOD as the rehearsal hall for her world tour. In 2007, both Bruce Springsteen and Marc Anthony/Jennifer Lopez used the building in the same way. Additionally the IZOD has become the venue of choice for its convenience for the many major college and university graduations, performing quite a community service.

## Current Situation

Much has been written about a cooperative arrangement between the IZOD Center and the Prudential Center to maximize the sports and entertainment industry impact for New Jersey. Unfortunately much of it has been ill-informed.

First, the premise that there are bidding wars for concerts between the two buildings belies a lack of understanding of the industry. One major promoter AEG has been involved in the Prudential Center. They bring their concerts to the Pru not the IZOD. Many other promoters vastly prefer the IZOD because of logistics and operations, i.e. many more seats in the lower bowl, parking, single concourse.

In the past 26 months two major Arenas operating in the State have driven an increase of 222 events (58%) for New Jersey over what would have been the historic norm. This substantial increase in events supported hundreds of jobs, increased the entertainment options for our people, and increased State sales and income tax revenue as well as increasing overall economic activity within the State. From the State's perspective, two arenas has been a huge success.

From the opening of the Prudential Center on October 25th, 2007 through December of 2009, the IZOD Center has booked 305 events and the Prudential Center has booked 297, for a total of 602 events. Given the current entertainment marketplace and our projections for the next few years it would be an exceptional year for a single Arena to host approximately 180 events. Because of the inherent date conflicts with professional teams, including the fact that a building manager is contractually required to keep two months of spring dates clear for potential playoff games, and compounded by the seasonality of family show and concert business, scheduling logistics limit the number of days a year any venue can be "lit".

One Arena in the time frame of October 27 2007 through December 2009 would have hosted a maximum of somewhere in the neighborhood of 380 events.

### New Jersey Nets

A deal was proposed at the end of the Corzine Administration to allow the Nets to move to the Prudential Center commencing with 2010-11 for the seasons until the Barclays Center opened in Brooklyn. Additionally the plan called for a three-way "booking arrangement" with representatives of Devils Sports and Entertainment, the NJSEA and the Governors Office. The Prudential Center would apparently be the "sports" building, the IZOD the concert and family show arena.

Details are sketchy but we are unaware of any fiscal analysis of what the impact such an arrangement would be for 2010 or would have been for 2009 for that matter.

If the New Jersey Nets were interested in leaving the IZOD Center for the 2010-2011 season, they were contractually obligated to inform the NJSEA by January 1, 2009. Similarly should they wish to play elsewhere for the 2011-12 season notice needs to be given by December 31, 2009. There are substantial early termination provisions for the Nets as well, currently approximately $7.5 million.

While discussions concerning the aforementioned joint arrangement were going on there was no contact from the Nets to the NJSEA about possible termination and departure.

Additionally, it is unknown how many concerts and family shows that would have gone to the IZOD Center in 2010 under the new "arrangement" would have been re-directed to the Prudential Center, despite their being the "sports" arena.

One entity booking both buildings, as well as for that matter the PNC Arts Center, Atlantic City Convention Center and any concerts on the Rutgers main campus makes sound sense and should absolutely be studied as a way to maximize the entertainment industry in the State. But without further substantial analysis, the three-way arrangement seems untenable.

Early in 2010, given the heated political rhetoric and more importantly the economic importance of the entertainment industry to the State's economy, some person(s) should be assigned immediately to study and analyze the best conceivable mechanism for maximizing the benefit of the two Arenas. Joint management of the two facilities should be analyzed. A recommendation is hereby made to immediately complete such an evaluation during the "opt out" extension from December 31, 2009 to February 28, 2010. The Christie Administration can then resolve the two New Jersey arena questions.

## 4. XANADU:

### Current Status

Presently, this 2.3 million square foot complex looms as an abandoned project at the "front door" of New Jersey's historical sports and entertainment headquarters, the Meadowlands. There are very legitimate questions of viability to this incomplete project, and its apparently failed leasing plan. In addition, the original capital structure of nearly $2 billion has been "frozen" by construction lenders.

Essentially, Mills Corporation, the original owner of Xanadu, has had their nearly $500 million equity investment subordinated to Colony Capital and Dune LLC's additional equity investment of over $400 million. Mills has retained a minority interest of approximately 5%.

The construction loan of $1,015,000,000 was made to an entity known as ERC 16W Limited Partnership. The Note holders have suspended further debt fundings, with nearly $400 million still not yet funded in the original commitment. Capmark is agent for the funding group and servicer. An agreement has apparently been reached by the original construction lending group to subordinate their nearly $600 million loan to a new lender (tbd) for up to $500 million. Therefore, the original construction lenders would rather risk $500 million of their already funded loan to someone "new", than to continue funding.

Essentially, there is no leasing plan making material on-site progress. The physical activities of construction are at a stand-still, if not abandonment. The construction loan is out of balance. There are no monies readily available to finish construction of public areas, nor tenant improvements. Further complications exist due to Capmark Finance being in bankruptcy (a $250 million note holder and a $105 million participating note holder).

Most, if not all, of announced major tenants have an "escape clause", solely dependent on leasing – or lack thereof.

In conclusion, the Xanadu project needs both cash and tenants to complete their obligations to NJSEA. Both are missing. Hence, the original business model appears to have failed. The NJSEA needs to engage the owners (NJSEA owns the land, not the improvements) to either complete and open, or surrender the property.

## Historical Background

The approximately 90 acres surrounding the IZOD Center has been subdivided into five (5) lots and use restricted for the development, construction and operation of an Entertainment Retail Center ("ERC"), Office A-B, Office C-D, Hotel and Baseball Stadium. Each of the five (5) subdivided lots has been leased to a separate entity (each, a "Project Ground Tenant") pursuant to the terms of a ground lease (each a "Project Ground Lease"). The IZOD Center and pedestrian skirt is a sixth, separate subdivided parcel. The ERC and related roads and infrastructure improvements are the first components of the project to be constructed. The Meadowlands Xanadu Project is to be operated in accordance with a Project Operating Plan approved by the NJSEA as part of the Master Plan for the Project, which details parking operations, common-area maintenance, security and other matters.

### Rent

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| Prepaid Ground Rent: | $160.0 million |
| Less WMB Payment: | $26.8 million - Payment is consideration paid by the NJSEA to The Mills Corporation to purchase the rights of The Mills Corporation to operate a wetlands mitigation bank using the Empire Tract. |
| Less Bond Defeasance: | $37.2 million |
| Total to NJSEA | $96.0 million |

The initial $160 million dollar payment was characterized as the "Development Rights Fee" under the project documents. The Development Rights Fee was allocated among the five (5) Project Ground Tenants and characterized as prepaid rent for the period Effective Date (June 30, 2005) through the last day of the 15$^{th}$ Lease Year under each of the Project Ground Leases.

Ground Rent Payments with respect to the entertainment/retail component commence on the first day of January in the year following the 15$^{th}$ anniversary of the earlier to occur of (a) ERC Grand Opening or (b) 3$^{rd}$ anniversary of Effective Date (June 30, 2005).

### Pilot

The NJSEA has agreed to make PILOT payments to the Borough of East Rutherford in connection with the Project commencing on the ERC Grand Opening Date.

The total amount of the first year additional PILOT payment is $1,850,000, increasing to $9,850,000 in Years 6-20. After Year 20, the additional PILOT Payment increases in accordance with CPI increases. The entire PILOT payment has been allocated amongst the Project Ground Tenants under each of the Project Ground Leases.

**Arena Right of First Refusal** (On all uses except those excluded.)
Currently held by Meadowlands Developer Limited Partnership Colony Xanadu LLP, Managing GP.

Triggering Events Change in Use Event: The Arena is no longer used, operated, managed or controlled for Arena Component Uses (i.e. uses permitted under the NJSEA Enabling Legislation) in effect as of December 3, 2003.

Third-Party Event: NJSEA determines to accept a bona fide offer from a third party for the ownership, long-term lease, exclusive use and/or redevelopment of the arena tract by a third party.

Excluded Events:

A) any lease to a present or future sports complex tenant;
B) conduct of any particular category of events with greater frequency; and
C) any delegation of Arena Management responsibility to a third party contractor.

**Racetrack Right of First Refusal** (Limited to Hotel uses connected to Gaming.)
Currently held by Meadowlands Developer Limited Partnership Colony Xanadu LLP, Managing GP

Triggering Events
Video Lottery Terminals or any other form of legalized gaming is approved or otherwise permitted in accordance with the applicable laws in connection with the operation of a portion of the racetrack site; and

NJSEA (or third party designated by NJSEA to have control over the racetrack) shall have received and determined to accept a bona fide written offer from a third party for one or more racetrack hotel developments.

The developers of the Xanadu project have invested approximately $2 billion in the project and are currently looking for approximately $500 million to complete the project.

While the developers have represented that the ERC portion of the project is approximately 70% rented, there is great uncertainty as to the firmness of these commitments.

Neither the ERC Ground Lease nor the other Meadowlands Xanadu project documents provide a deadline for opening or a continuous operation covenant. The prevailing business conclusion at the time of the negotiation of the Meadowlands Xanadu project documents was that once constructed, the developer's investment return and debt service requirements would compel the prompt opening and continuous operation of the ERC. Unbelievable!

## 5. LOTTERY:

In spite of its value as a huge cash source to state education uses, $887 million in 2009 alone, the Lottery has flat to declining sales, is run by 130 demoralized state employees, has only short term Executive Directors for years, has adopted no strategic plan for generating higher sales, struggles to make even marginal improvements to its systems, old computers etc., has all its operating cash swept by the New Jersey Treasury in addition to the normal distributions for higher education leaving the management with little decision making authority.

The Sub-committee met with key personnel of the New Jersey Lottery and GTECH, the provider of its online gaming and instant ticket distribution services. The Sub-committee toured the Lottery headquarters located in Lawrenceville, the attached GTECH site and the backup data and distribution center in Cranbury. The Lottery and GTECH facilities are both physically and economically satisfactory for efficient current operations and future growth.

The committee makes the following major recommendation:

- **Privatization of the Lottery** – The Lottery would benefit from privatization with operations conducted by private management contracted by the State to manage, staff, and operate the administration of the Lottery. We are advised that the State of Georgia has privatized their lottery. The contract should include incentives to increase sales and net revenues to the State. The committee believes a significant increase in gross and net revenues to the State will result from privatization.

  In the absence of a full privatization of Lottery Operations, or during the time privatization is implemented, the committee recommends the following **immediate** changes:

- **New Chief Executive** – We recommend that a qualified chief executive with Lottery and contract management experience be appointed. He or she should be charged with the responsibility of making a full analysis of Lottery operations, staffing and budget needs, contract status, sales and marketing plans, infrastructure needs and all aspects of Lottery operations in order to do what is required to increase sales and grow net revenues.

- **Put the Lottery off budget** – Putting the administration expenses "off budget" would enable the Lottery to operate without being subject to budget cuts or restrictions each fiscal year that have had a negative impact on its ability to make long-term (3-5 years) sales and marketing plans. This would enhance the ability of the professional staff to grow sales and net revenue to the state.

- **Develop a Strategic Plan** - The New Jersey Lottery lags far behind neighboring states in marketing resources and the player survey showed that New Jersey players are spending money in other jurisdictions with larger marketing budgets.

- **Enhanced Security** – Conduct a top down review of standards, procedures and personnel to insure the integrity of operations and play.
- **New Information Management and Technology** – Complete a review, bid and implement a complete upgrade of the Lottery's information technology. The last significant upgrade was done in 1998.

**Background**
The Lottery operates as a Division within the Treasury Department. The FY10 budget is approximately $21.6 million of which $8.7 million is allocated to salaries. The Lottery operates with 131 full-time staff and more than 6,100 agents throughout the state in retail locations. In addition to the allocated budget, the Lottery pays contracted vendor and network costs of approximately $55 million and approximately $1.1 million to NJN for broadcast fees. The contracted vendor costs for the online gaming system and network will be reduced by approximately $18 million per year when the new contract is fully implemented.

By law, the Lottery must contribute a minimum of 30% of gross ticket sales to the Treasury for state aid for education and state institutions. Results in FY09 were gross sales in excess of $2.5 billion and contribution to the state of $887 million or 35% of total revenues. Their goal for FY10 is to generate $2.5 billion in gross ticket sales and contribute $893 million to the Treasury. Through November 2009, the Lottery is on budget to meet these goals due mainly to larger than expected increases in sales from Pick 6 and Mega Millions both of which were driven by large jackpots.

The current patronage based management has little or no authority to grow the business or make strategic decisions having virtually all authority removed by the prior administrations and the New Jersey Treasury Department. The current practice of viewing the Lottery as a division of the State Treasury, similar to the Office of Information Technology (OIT) or the Division of Taxation for example, results in budget decisions based on the State's overall revenue and expense situation rather than on sound business practices needed to market and sell Lottery tickets.

The Lottery currently faces two major challenges: 1. the completion of the implementation of its new online gaming contract, and 2. the launch of Powerball by January 31, 2010. The contract implementation is behind schedule and costs the Lottery approximately $50,000 per day in excess costs over the new contract. Completion is not expected until early October 2010. The launch of Powerball on January 31, 2010 is in jeopardy due to a lag in negotiations between the Mega Millions consortium and MUSL, the Powerball consortium. Management hopes to resolve the outstanding issues by December 31 in order to meet the January 31 deadline for launch. Powerball is expected to increase gross revenues by an additional $69 million and contribution to the State of $25 million for FY10 if launched on time.

- **Management** – The Lottery has been operating without a full-time Chief Executive for several years. Various Acting Executive Directors who are state employees with little or no business experience have filled the position. This practice has resulted in management's loss of authority as the Treasurer depended on his personnel to make strategic decisions especially in the area of contract specifications. The absence of qualified Lottery upper management and the lack of confidence placed in them created mistrust and frustration among employees, lack of focus on the sales nature of the business, and delays in the awarding and implementation of vendor contracts that have proved costly and inefficient.

The new Chief Executive should be given full authority to hire qualified persons to fill the upper management level positions. He or she should have the authority to hire those persons in whom he/she has confidence and remove those who have lost that confidence. The Chief Executive should interview employees currently in management positions and assess their qualifications, competence and ability to do their jobs effectively.

A major challenge facing the new Executive Director is the immediate completion of the online contract currently being implemented. It is behind schedule and is not projected to be complete until early October 2010. Further, the delays have resulted in unnecessary costs by remaining bound by the terms of the old contract. The new contract terms are approximately half the current costs.

In addition, the Lottery expects a significant increase in sales from the launch of PowerBall on January 31, 2010. Not all systems are in place, however, and work remains to be done in order to meet this deadline. A delayed startup will result in lost revenues.

- **Marketing & Sales** - GTECH produced an Integrated Marketing Strategic Business Plan that contains survey information about player attitude and usage. The key findings indicate opportunities in several areas that the Lottery can use to identify future growth potential. The plan contains a number of suggestions including the need for a greater investment in marketing communications. The New Jersey Lottery lags far behind neighboring states in marketing resources and the player survey showed that New Jersey players are spending money in other jurisdictions with larger marketing budgets.

  Among its peers (New York, Pennsylvania, Ohio, Michigan and Massachusetts), the New Jersey Lottery has an average annual marketing budget of $4 to $6 million compared to $12 million for the peer group. Marketing resources should be increased by at least $10 million to support a variety of promotional efforts.

  This department currently has a Marketing Manager with more than 20 years experience who is well respected in the industry for his knowledge and expertise. The department has insufficient staff; however, to enable him to manage the advertising budget while also developing and implementing an overall marketing plan along with the development of new game launches. The Lottery should review the GTECH plan and incorporate those initiatives that it deems most productive to increasing sales and State revenue.

  The Deputy Director of Sales heads the Sales department and manages a field staff of approximately 30 Sales Representatives along with a small in-house agent support staff. The Sales Reps do not have modern technology (laptops) or the ability to access retailer information while at an agent location. The GTECH Integrated Marketing Strategic Business Plan recommended enhancing the relationship between the Lottery's Sales Reps and the agent retailer network in order to foster greater agent cooperation in promoting Lottery sales.

- **Finance** – The finance manager is currently the Acting Executive Director. He should be relieved of this extra duty and returned to his role as Chief Financial Officer as soon as possible. The new Chief Executive should make an assessment of staffing levels to assure they are sufficient to adequately report and collect revenues.
- **Validations/Claims** – Headed by a Supervisor, this unit validates and pays winning tickets of $600 and more. The process is slow and paper intensive. The processes should be analyzed and automated to the greatest extent possible.
- **Information Management and Technology** – The online vendor supplied the current back office hardware/software and support when the current contract was implemented in 1998. Most of the equipment and systems date from that time with only periodic updates and improvements. The new online contract currently being implemented does not contain this provision due to a decision made by the NJ Treasury Department to exclude the requirement that the vendor supply the back office infrastructure and software/support. This leaves the Lottery in the position of having to compete with other State divisions for scarce technology resources at a time when it needs modern and up to date technology due to the aging equipment with which it now operates. This will present a challenge to the incoming Executive Director as the aging equipment will hamper the Lottery's ability to quickly gather data and take advantage of tools the new contract will provide.
- **Security** – The Deputy Director of Security was recently hired. He is a 30-year veteran of the NJ State Police assigned for 22 years to the Casino Gaming Bureau conducting licensing and criminal investigations of persons and companies doing business with casinos. The department is responsible for the licensing of retail agents and key agent personnel. The department also conducts investigations when complaints of wrongdoing are received from the public. The department is understaffed and lacks modern technology. Additional investigators should be hired to both clear and avoid a backlog in investigations. The new online contract will contain tools that Security can use to access a variety of retailer information that can be used to aid the department in its work. These tools will not be useful without updated hardware and technology.

  The new Chief Executive should interview the Security Director and assess his qualifications and effectiveness in managing the Department.

In summary, the New Jersey Lottery faces challenges in the following areas:

**Ineffective Leadership & Management**
**Outdated Technology Infrastructure**
**Inadequate Staffing Levels**
**Inadequate Advertising & Marketing Support**
**Lack of Autonomy & Decision Making Power**

To overcome these challenges an effective leader must be hired who can take control of what is essentially a $2 billion sales business, restore confidence and morale among staff, develop and implement sales and marketing plans, interact with its online vendor and sales partner, convince the Treasury Department of the benefit of fully supporting the Lottery mission with human, economic and technological resources and operate within the borders of its mission to raise money for education and State institutions.

**Other Suggestions**

- **Sale of the Lottery** – Some investigation should be made into the merits of selling the Lottery and retiring outstanding State indebtedness. If a 20 year "operating lease" of the Lottery could be sold for $10-12 billion and the funds used to retire debt, the State should review the possibility. We have been advised that this is a reasonable market value for a sale.

## 6. NEW JERSEY PROFESSIONAL SPORTS FRANCHISE REPORT:

The franchises reported no serious issues at the present time but identified several items they wanted resolution on:

**New Jersey Devils**

The Devils want the two arena issues resolved preferably with the Nets moving to Newark and the IZOD Center becoming a concert venue. They reported no pending deals or outstanding issues with the Corzine Administration.

**New York Giants**

Concerned about the lack of speed on the roadwork around the Complex, specifically the 16W Turnpike exit. They are also concerned about an agreement coordinating parking with Xanadu. They are pleased with the relationship with NJSEA and their agreement moving forward. Would like the law preventing the offering of presale tickets for events changed. They are preparing a bid for the 2014 Super Bowl and we assume they would need state assistance if they get the bid.

**New Jersey Nets**

Their issues have been partially addressed in the proceeding sections of the report. They would like to get to Newark on a short-term lease. They have an issue with what their split of the IZOD naming rights are.

**New York Jets**

Woody Johnson would like a conversation with us to discuss his ideas and suggestions about the NJSEA and the complex itself.

**New Jersey Red Bulls**

Planning to open their new stadium 3/17/10 in Harrison. Harrison committed to build roads and parking lots with DEP Brownfields Funds. DEP doesn't have any money, so no roads or parking lots were built. Trying to resolve the issues with Harrison.