

Prairie Meadows: An analysis of gambling and economic development

by

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CHAPTER 1

INTRODUCTION

The gambling industry has seen enormous growth over the last ten to twenty years due in part to the legalization of various games throughout the nation. The justification for the legalization of gambling, in many cases is economic development. City, county and state officials across the nation cite jobs, new industries sprouting from gambling, such as tourism and renewed growth for blighted urban areas as reasons to legalize gambling.

The state of Iowa is one such state. Iowa has seen a flurry of gambling legalization since the early 1980's. Since that time, the state has legalized various types of lottery games, casino gambling on riverboats, pari-mutuel betting, and has flirted with casino gambling at the state's faltering horse and dog tracks.

Public officials greeted this proliferation of gambling in Iowa with much hope and expectation. In many cases, however, financial capital from private sources was difficult to secure or slow in coming forth. As a result, local governments became involved in guaranteeing the bonds for such things as racing tracks and docking facilities for casino riverboats.

An example of this trend is Prairie Meadows horse track in Altoona, Iowa. The track was built with \$40 million in bonds, which were guaranteed by Polk County. The county guaranteed the bonds by entering into a lease-purchase agreement with a non-profit organization that operated the race track. The track eventually failed to even come close to projections cited by several feasibility

studies. As a result, Polk County was forced to loan large sums of cash to the track so that it was able to meet operating expenses and to make the annual bond payments.

This paper will provide a case study of the Prairie Meadows race track in Altoona. Prairie Meadows is important for several reasons. The most significant is that a local government became an indirect investor in a gambling enterprise. Polk County did not directly finance the construction of Prairie Meadows, but they did enter into a lease-purchase agreement. This lease-purchase agreement called for Polk County to make payments that equaled the amount of the bonds. Thus, it was a means of indirectly guaranteeing the bonds.

It is true that, in the name of jobs and economic growth state and local governments have become involved in financing various businesses that are not normally able to find investors in the private sector. In many cases, this is done through direct assistance, such as grants and loans. However, government involvement in the financing of gambling ventures is a risk, financially and ethically.

As we will see in Chapter 2, the success of gambling ventures is dependent on a number of factors, such as legalization of gambling in other states. A number of states have attempted to duplicate Las Vegas's success, but few are successful. Thus, when governments becomes involved in financing gambling, it assumes a large financial risk.

There is also an ethical risk. When Polk County guaranteed bonds for building a horse track, it had a direct interest in seeing that the project was successful. This put the county in a position of having a vested interest in seeing that the race track was a success, the alternative was assisting the track with

payment of the bonds. On the other hand, the county is responsible for the general social welfare of its citizens. This includes protecting citizens from crime and assisting those that are poverty stricken, both which may be made worse with a horse track that is profitable.

In examining the case study of Prairie Meadows, a short history of gambling in the United States is provided in Chapter 2. Also included is a review of the current status of gambling in the United States and Iowa.

A review of the current literature on gambling and economic development is also found in Chapter 2. As we will see, gambling has presented a means for government to increase revenues to its coffers without substantially increasing direct taxes on citizens. It is also a way to create jobs for regions that are struggling economically. However, a number of researchers have shown that this has come at a cost, in terms of the quality of life for residents. This trend is exemplified by Atlantic City. The legalization of casino gambling has increased jobs and revenues, but it has cost the city in terms of higher crime rates, a continually faltering central business district and an economy predominately based on gambling.

An alternative that is articulated in Chapter 2 is a form of privatization for the future of gambling. Privatization became popular for many local and state governments in the 1980s, as a means of cutting expenses, while still supplying services to the community. Privatization for gambling is viewed as a means of alleviating the conflict of interest that many government's have currently between protecting citizens social welfare and increasing revenues to their treasuries through taxing gambling.

Chapter 3 provides the reader with background as to how Prairie Meadows

was built and financed. The original problem with building a horse track was finding an appropriate location in Polk County. However, the largest hurdle backers faced was financing the track. The financing was slow to come together and remained a question mark at very late stages in the project.

The court cases resulting from the bankruptcy of Prairie Meadows are examined in Chapter 4, specifically Riley v. Maloney and Stanfield v. Polk County. These court cases are studied in view of other Iowa State Supreme Court Cases on economic development, lease purchase agreements, and the bonding power of local governments.

The cases basically revolve around two issues. First, whether the 15 day time period in which to file protests over lease-purchase agreements was past when the protest was filed in court. This is Polk County's position. The plaintiffs contended that the county exceeded its authority to enter into a lease-purchase agreement because Polk County's public notice failed to meet the requirements stipulated by the Iowa Code.

The second major issue addressed by the court cases was whether the lease-purchase agreement that Polk County entered into violated the Iowa Constitution, specifically articles seven and eight.

Chapter 5 examines the final two feasibility studies that were completed in relation to a horse track for central Iowa. There were earlier feasibility studies, but they were not available for this review.

The studies are first examined regarding their accuracy. The actual figures from Prairie Meadows are compared to the projections, specifically in terms of the per capita betting handle and attendance. The reason betting handle and attendance are used is because they play a large role in determining if a track is

profitable, as is illustrated later.

The methodology each study uses to determine attendance and betting handle is also reviewed. This is done in terms of what assumptions each study makes that may have caused projections for attendance and betting handle to be inaccurate. Finally, recommendations are given as to how public managers can review these types of studies for future projects.

Chapter 6 compares two economic impact studies that were completed in association with Prairie Meadows. The Peat, Marwick study projected an economic impact of \$92 million for the county and state, while Arthur Andersen estimated the impact at only \$36.6 million for the county and state.

Chapter 6 seeks to show the reader how such a large contrast can exist between the two studies, the significant assumptions that each study made in the calculations, and how managers and other governmental officials can review economic impact studies in the future.

The case study of Prairie Meadows offers numerous conclusions and lessons for the future of economic development and gambling. These are articulated in chapter 7, the conclusion. First, the future of state and local government involvement in economic development projects is discussed based on this case study and the Iowa Supreme Court ruling on cases associated with the race track.

Second, a review of the significant findings from the review of the feasibility and economic studies is discussed, in hopes that future studies will be examined more closely by public officials before entering into similar types of arrangements.

CHAPTER 2

GAMBLING AS ECONOMIC DEVELOPMENT

Gambling is part of America's culture, and its roots start in the American Colonies. In large part, lotteries were used to finance highways, bridges, dams, fortifications, sewers, schools, colleges, hospitals, and even churches (Abt, Christiansen and Smith 1985, 6). In the years following 1776, private lotteries were used to raise revenues for a variety of public projects well into the century. However, well-publicized scandals and wide-spread cheating led to the demise of such lotteries.

After the Civil War, state-licensed casinos and pari-mutuel betting were popular. As before, widespread scandals spelled the end of legal gambling.

The current popularity of state-sponsored gambling started when Nevada legalized casino gambling and sports betting in 1931 (Abt, Christiansen and Smith 1985, 8). In 1964, New Hampshire, began the first modern day state-sponsored lottery.

Many states, since 1964 have legalized lotteries. Between 1970 and 1990 the number of state lotteries went from three to 33. States that now permit some type of pari-mutuel betting, including off-track betting, thoroughbred, harness racing and greyhound racing, now stands at 43 (Barron 1989, 1, 24).

The number of citizens taking part in some form of gambling is also growing. A New York Times/CBS Poll taken in 1989 shows that 63 percent of Americans placed some type of bet in the last year. This includes buying lottery

tickets, visiting casinos, betting at a track, betting on sports events, playing cards for money, betting in office pools and betting with a bookie (Barron 1989, 1, 24).

However, citizens are beginning to show some skepticism about the renewed gambling spirit in the United States. Only 29 percent believe that state lotteries help keep taxes down, while 50 percent believe that state-sponsored gambling has "helped" crime syndicates (Barron 1989, 1, 24).

In spite of this, gambling attracts millions of dollars in betting. As we can see from Figure 2.1, in 1989, an incredible \$19 billion was spent playing the lottery; contrast this to 1975, when American citizens spent only \$842.7 million on state-sponsored lottery games. The large contrast is due to a number of states legalizing lotteries during this period and the increasing popularity of the lottery with the general public.

Figure 2.1 also illustrates that casinos generate more wagering activity than do lotteries. In 1989, casinos generated nearly \$200 billion dollars of activity, nearly 10 times as much as lotteries. As of 1989, pari-mutuel betting ranks fourth behind lotteries and illegal betting.

Pari-mutuel betting, which includes horse and dog tracks falls in fourth place behind casinos, illegal betting and lotteries. Other types of gambling such as, card games, bingo, legal bookmaking, and wagers from Native American reservations fall far behind (Gelbtuch 1991, 181).

Iowa's position on gambling over the years varied from one extreme position to the other. Before the late 1970s even BINGO was illegal for charitable purposes. In the late 1970s, BINGO was legalized for charitable purposes, and since that time, the state has been in a race to legalize as many forms of gambling as possible.

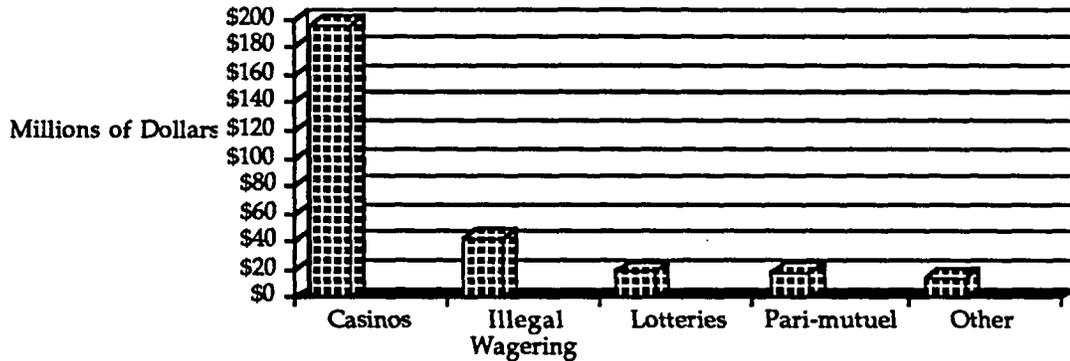


Figure 2.1 United States Wagering Activity 1989
 Source: Gelbtuch, Howard. *The Casino Industry, The Appraisal Journal* (April 1991, 187).

After BINGO was legal, Iowa then legalized pari-mutuel betting in the early 1980s and approved a lottery a few years later. Recently, it has approved casino boat gambling in hopes of spurring economic development in the economically depressed communities along the Missouri and Mississippi Rivers.

The legalization of gambling in Iowa during the 1980's was a partial response to the farm crisis of the 1980's and a response to the changing structure of the nation's economy. Currently, Iowa has more forms of legalized gambling than Nevada (Petroski 1991, 1a, 5a).

Nevada does not allow lotteries, pull tabs, live horse and dog racing, while Iowa permits all of those forms of gambling. The only form of gambling which Nevada allows that Iowa does not is sports betting (Petroski 1991, 1a, 5a).

There are still discussions about further expansion of casino gambling at Iowa's pari-mutuel racing tracks, in an attempt to bolster faltering attendance and diminishing revenues. A further expansion of gambling may also come as

the result of pressure from cities along the Missouri and Mississippi Rivers. These cities want the state to raise the maximum bet limit and daily loss limits on riverboat casino gambling. At this time, state law mandates a \$5 maximum bet, and a maximum daily loss of \$200.

Proponents of raising betting limits claim that such action will make Iowa riverboats more competitive with other states, which either do not impose limits or have limits which are much higher than those in Iowa. Recently, the governor came out in support of raising the betting limits on riverboats, yet, the state legislature failed to pass any changes in gambling laws during the 1992-93 legislative session (Roos 1993, 1m).

Diverse attitudes exist in regard to the effects of gambling. A 17th century English writer referred to gambling as: "an itching disease, that makes some scratch the head, whilst others, as if they were bitten by a tarantula, are laughing themselves to death: or lastly...it renders a man incapable of prosecuting any serious action, and makes him always unsatisfied with his own condition...till he has lost sight of both sense and reason" (Abt, Christiansen and Smith 1985, 4).

Gambling is certainly a part of early American history. It helped to finance the building of the infrastructure of this nation. Public opinion about gambling has shifted over the years, and the latest swing toward acceptance has left many states and regions in direct competition with each other for a limited amount of gambling dollars.

Gambling And Economic Development

There are a number of reasons why states and cities have legalized gambling as a means for economic development. In the last ten years state and local governments experienced extreme fiscal pressures.

Some reasons for this fiscal pressure were property tax relief movements which have curtailed the power of cities and states to raise revenues, the changing structure of the world economy that left many areas without high pay blue collar jobs, and finally continually shrinking financial support from the federal government. As a result, governments are continually seeking new revenue sources and new ways to foster economic development (Levy 1990, 6-7).

Increasing public revenues, whether for property tax relief or helping to meet continually soaring costs of entitlement programs is one of many goals of economic development. Efforts to increase revenues gained momentum as property tax limitation were passed, such as Proposition 13 in California and Proposition 2 1/2 in Massachusetts (Levy 1990, 6-7).

Programs like these limit local government's ability to raise revenues. Thus, local governments have attempted to find alternative revenue sources.

The literature on economic development shows that gambling is very successful at raising revenue for governments. Gambling does not fail to create jobs and new businesses, but governments have to make trade-offs in other areas. Many authors point out that legalization of gambling, especially gaming, leads to other socio-economic problems.

These socio-economic problems are numerous. Many communities have reported increases in crime. Other communities have significant problems diversifying their local economies beyond gambling. In some areas cities and counties that legalize casinos eventually begin to lose their grocery and retail stores, and as a result, local economies begin to have an economy based largely on gambling.

Why gambling as a means of economic development? One argument is

that gambling is inevitable. We are a society of gamblers. People bet in office pools, card games, community numbers games and other forms that are too numerous to mention. Thus, the state may as well regulate gambling and create jobs that increase revenues to local governments (Abt, Christiansen, and Smith 1985, 4-5).

A second reason for the legalization of gambling as a means for economic development is that middle class citizens have become active participants. Gambling is no longer a moral issue for most middle class Americans. They see the activity as "enjoyable" and part of their leisure activities. The net effect is that the middle class is less willing to support groups who want to restrict gambling activities (Rosecrance 1988, 42-51).

A third reason gambling is being used as means of development is that the start-up costs are low. Governments can create new jobs and raise revenues while only incurring a small cost (Dombrink and Thompson 1990, 188).

This is especially the case with lotteries because private companies often will print tickets and assist the state with marketing plans. Casinos and pari-mutuel betting do have higher start-up costs because of the need to monitor tracks and casinos. Yet, states can still legalize casinos and tracks and only incur a small cost.

Revenues

In 1991, the state of Iowa collected \$67 million from gambling through taxes and lottery profits-though this seems like a sizable sum, it is not. When the bigger picture of tax revenues for the state is put in perspective, it is a small amount. In contrast, a 1 cent increase in the state's sales tax will generate almost \$277 million (Petroski 1991, 1a, 12a).

In 1990, revenues to governments across the United States from horse racing totaled \$623 million. Figure 2.2 shows that horse racing revenue has remained constant over the last few years. While, there was a slight drop-off in racing revenues after the peak year of 1976, the industry has rebounded in the last few years.

Revenues generated from gambling however depends upon a number of factors. The amount wagered at tracks, and therefore the amount collected by the state, is affected by weather, income, unemployment, the size of the purses given to winning horses and the takeout rate-which is the amount that is paid to the state (Gulley and Scott 1989, 91-93).

Some researchers refer to this problem as substitution. One study conducted between 1976 and 1980 sought to find the substitution between lotteries and pari-mutuel gambling. The result of the study revealed that each additional dollar bet per capita on the lottery meant an 18 cent reduction on an average bet at horse tracks. Lottery introduction also decreases attendance at tracks by 62,000 for a market area of 1 million (Gulley and Scott 1989, 92).

Authors also point out that a reduction in the average bet does have an adverse effect for the horse racing industry. As the result of lower attendance and a smaller average bet, tracks have to offer smaller purses or, in some cases, it may result in the demise of the track.

Instability at race tracks also affects the horse breeding industry. Breeders have difficulty one year to the next predicting the market value for their product. However, states continue to legalize more forms of gambling because they still can increase total net revenues.

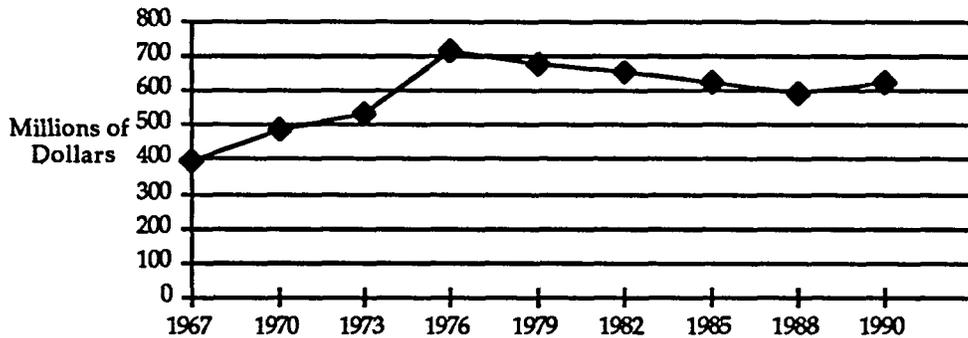


Figure 2.2 Horse Racing Revenue to Governments
 Source: Association of Racing Commissioners
 International Inc., Pari-Mutuel Racing 1990, page 3.

For example, in the case of lotteries and horse tracks it has been estimated that, each additional dollar bet on the lottery means an average of 40 cents for the local government, while racing revenues only fall by about one cent (Gulley and Scott 1989, 92).

Because local governments want to increase revenue, the market for gambling may eventually reach the saturation point. New gambling enterprises expand the pie by attracting new players, but at the same time customers of the old games leave for the new. Gambling can only be expanded so many times until no one industry can survive (Hansen and Seacord 1992, 18).

A second problem with gambling is the lack of proper regulation. In Florida, researchers discovered larger than average profit margins, geographic boundaries that restricted entry, and a lack of standard accounting techniques at racing tracks.

Contributing to these problems was a lack of skilled personnel at the

regulatory agencies. The conclusion of the researchers is that the state might increase their revenues and reduce problems associated with the gaming industry if it would create more effective state regulatory agencies (Berg and Yelton 1976, 197, 198).

In contrast to horse racing, lotteries offer and even greater potential for raising revenues. In 1992, state governments collected almost \$8 billion from lotteries. At the same time, they spent \$400 million on advertising for lotteries (Economist 1992, 23).

Rebuilding Economies

Many states are looking toward varied forms of gambling as means to help rebuild economically stressed areas, especially older communities and areas with deteriorating infrastructure.

Implementation of the lottery by states is closely associated with the age of the housing stock and, specifically, states with a proportion of housing stock built before 1940 (Wohlenberg 1992, 180, 181).

States with older housing stock generally have older roads, sewer systems, bridges and other public infrastructure. The implications is that states are using lotteries as a means to rebuild their aging infrastructure.

Legalization of casino gambling has more to do with the tax burden of the citizens, economic conditions, the level of unemployment and the position of political elites take on gambling. All of these factors help to explain whether a state legalizes casino gambling (Dombrink and Thompson 1990, 94).

Legalization of gambling has led to a new role for states, particularly in the area of lotteries. In most cases, lotteries are administered by a state-run agency, similar to state-owned liquor stores. However, lotteries and liquor stores are

different because, in general, states do not promote liquor sales, while they aggressively promote lottery products (Clotfelter and Cook 1990, 105).

What motivates states is "revenue maximization" and not protection of citizens from the social evils of gambling. Evidence of this is the extremely high taxes imposed on lottery products. The tax rate on lotteries ranges between 40 and 50 percent which is much higher than cigarettes or alcohol. Second, as has been mentioned, states employ various marketing techniques to sell their tickets (Clotfelter and Cook 1990, 117, 118).

The goal of this marketing is not to inform the player of his or her odds, but it is to get current players to purchase more tickets and bring in new players.

In general lotteries are easier to legalize than other forms of gambling. They are characterized by low pay-out rates and high taxation, and are more popular with the general public (Clotfelter and Cook 1989, 43-45).

Casino gambling has also moved toward the forefront of legalization. The exact amount of revenues that casinos generate for states and cities is unclear. States and cities tax casinos operations at varying rates.

Traditionally, Las Vegas exemplifies the effects casino gambling can have on a region. In 1989, Las Vegas had over 18 million visitors-an increase from 1988 of 5.4 percent. As a result, \$11.5 billion in business was done in Las Vegas (Travel Agent Magazine 1990, A8).

Las Vegas gives other regions across the country a powerful image that many have tried to replicate. Thus, when Atlantic City undertook legalization there were grand visions by community leaders.

Atlantic City flirted with casino gambling in 1970, 1973 and 1974; it finally found voter approval in 1976. Political leaders foresaw lower tax rates, new jobs,

a booming tourist trade and increased revenues to the city. At present, most researchers agree that the endeavor is a failure, in terms of totally revitalizing the city.

New Jersey state law imposes a 8 percent tax on gross revenues of casinos. This money is allocated to reduce taxes and to assist elderly citizens with their living expenses. New Jersey law further stipulated a 2 percent reinvestments tax on casinos, which was later lowered to 1.5 percent. This money is to be used for non-gambling projects sponsored by casinos (Ochrym 1983, 592, 593).

One problem is that casinos have avoided paying the reinvestment tax. In general, casinos have done very little in terms of non-gambling development. The casinos are "economic islands" in an economically distressed Atlantic City (Rubenstein 1984, 67).

Casinos in Atlantic City have raised the level of employment and increased revenues to state and local governments (Rosecrance 1988, 47). However, these economic gains need to be examined in light of the current social and economic ills.

Employment in the city, has increased, but many of the employees are hired from outside of the city. An additional problem is that certain sectors of the local economy have declined. On the whole, employment, is less diversified since the opening of casinos (Sternlieb 1983, 84, 86).

Another problem for Atlantic City is land speculation. When casinos were legalized property values doubled and sometimes tripled. Land that was prime for casino development was bought by speculators and developers.

At the same time, Atlantic City did not reassess prime development areas that were bought up by speculators. Instead, the city raised tax rates on other

parts of the city. The result was to drive the elderly and low income residents out of the city (Anastasia 1984, 16-17).

A third problem for Atlantic City is that casinos have had little effect on fostering local businesses. Downtown Atlantic City has not seen an economic recovery. This is because most tourists that come to the city stay in casinos and spend their money there (Rubenstein 1984, 68-69).

A final problem is that of crime. Several researchers have compared crime in post casino years with pre-casinos years in the areas surrounding Atlantic City. The researchers found that the casinos have brought "significantly" more crime to surrounding communities. The large difference came in violent crimes, which were 78 percent higher. In addition, burglaries were 41 percent higher and vehicle thefts rose 30 percent (Friedman 1989, 622).

Similar socio-economic problems are found in other cities that have decided to legalize casino gambling for economic development. Deadwood, South Dakota; saw tax revenue increase by \$6.2 million as a result of gambling, and tourists visiting the city tripled. Further the city was able to renovate historic structures which had become run-down, and expects to pay off \$8.5 million in bonds in the next five years (Hansen and Seacord 1991, 15).

But on the negative side, the city suffered increases in crime, and non-gambling businesses have closed, leaving residents without basic services and a general lack of affordable housing due to the speculation and rapid development (Hansen and Seacord 1991, 15).

Cities in Colorado that legalizing casino gambling face similar problems. Employment has increased in the former mining towns. However, the city has delayed all municipal building maintenance because of the strain gambling has

put on other city services. The cities are also unable to attract any hotel development that may help diversify their economies (Jesitus 1992, 3, 64-65).

To date, the state of Iowa, cities and counties have benefited from the legalization of gambling. Direct employment from the legalization of gambling in Iowa is indeed significant. In 1991, gambling businesses provided over 4,500 jobs; 3,000 on five riverboats, 127 in the Iowa Lottery and 1,400 at four pari-mutuel race tracks.

Critics of gambling argue that these jobs are mostly part-time and only offer low wages (Petroski 1991, 1a, 2a). Further, the jobs are very sensitive to changes in the gambling industry. For instance, riverboat gambling has been legalized in a number of states since Iowa passed its' legislation. These states include Missouri, Illinois, and Mississippi. The result has been the loss of a number of riverboats in Iowa which, in turn, means the loss of jobs for communities.

Few problems have been reported with crime, land speculation and cities unable to cope with the socio-economic pressures from gambling. The reasons for this are varied. First, few researchers have done any studies on the effect of gambling and crime within Iowa.

Second, the population of the state is relatively small and rural. Thus, the gambling industry has a smaller population for marketing its product. This means there are fewer people that take part in gambling. Finally, the state has legalized gambling, lotteries and a number of race tracks.

This means that gamblers are spread out across a number of different market areas that are hundreds of miles apart. As a result, no one community feels extreme socio-economic pressures.

Privatization For Gambling And Economic Development

In spite of gambling producing jobs and raising revenues to state and local governments, many authors are now suggesting varying degrees of privatization for the future of gambling and economic development.

Privatization of gambling has several benefits. First, it removes government from making political decisions about the type of gambling that is legalized in a region. The decision is made solely by the private sector. Second, governments would no longer have a conflict of interest between protecting the public from the evils of gambling and at the very same time promoting gambling as an entertainment alternative.

In general, governments cite their involvement in gambling as a means to control the social evils that result from the general public participating in gaming activities (Stocker 1972, 440-441). As a result of these social problems, governments place high tax rates on gambling. Government also attempts to control increases in crime and poverty that result from gambling.

At the same time the state is supposed to protect the public interest, it is franchising companies, and continually coming up with new ways to increase revenues. This is done by legalizing off-track wagering, raising betting limits and introducing new gambling ventures. Government claims it is protecting the public interest, but in reality it is encouraging citizens to gamble (Abt, Christiansen and Smith 1985, 155-158).

A second reason often cited for state involvement is protection of the public from fraudulent gambling operations. However, by privatizing casinos, track and lotteries, cheating could still be controlled by state law enforcement officials. Companies will compete with each other in the open market for

customers and their entertainment dollars. This alone may serve as a mechanism to protect consumers from fraud (Stocker 1972, 440-441).

An example of where state government's involvement in gambling had a negative results is the near collapse of New York's horse racing industry. The industry was close to failing because of its inability to fund capital improvements on their racing facilities. This inability was attributed to the increasing amount of taxes the horse racing industry was required to pay, and the state's unwillingness to lower the tax rates on wagering. Thus, New York compromised by legalizing off-track wagering, which did increase revenues for the industry and government (Abt, Christiansen and Smith 1985, 93-98).

One way to prevent this type of problem is the privatization of all gambling activity and enterprises. Stocker makes the point that state-sponsored gambling, especially lotteries, is experiencing a curious trend. Governments are actually promoters and marketers, in the case of lotteries. The only other good that governments market on the level of lotteries is education and libraries (Stocker 1972, 439). In some instances governments' become investors by financing docking facilities for riverboat gambling and racing track for horses and dogs.

Stocker suggests that governments legalize all types of gambling and let the private market decide what type of gambling is appropriate for a region. Companies that want to start a casino will do so if they can find financial capital. Then consumers will decide if a gambling enterprises is profitable.

This type of scenario also alleviates many of the current problems, legislators have in determining what type of gambling is to be legalized or expanded.

Stocker does not discuss economic benefits from this type of plan, but it may well foster job development, diversification of local economies and higher revenues for governments through a number of taxes .

Clotfelter and Cook also recommend privatizing the lottery industry. They cite the current conflict of interest that government has when marketing lottery products and, at the same time, protecting the public interest.

A case is made by Clotfelter and Cook that government's administrative costs are high in running lotteries (Clotfelter and Cook 1989, 238). Their recommendation is to remove government from the business of gambling. They suggest that government grant several franchises to private firms for lottery products. The result is to create competition between the companies.

Companies that receive a franchise will cut administrative costs due to the competition. Further, companies that are granted a lottery franchise would increase the amount of money returned to customers in the form of winning tickets. This would mean increased sales and revenues to the state treasury (Clotfelter and Cook 1989, 219-221).

The time may well have come for government to give up its control of gambling enterprises. In the end, it will help to increase revenues and foster job growth that currently exists.

An example where privatization of gambling is working is in the city of Hong Kong. The Royal Hong Kong Jockey Club (RHKJC) is an independent governmental body set up during colony times. The local government has little control over the body.

The board of stewards which run RHKJC are answerable only to the voting members of the club. At present, RHKJC operates a lottery, two horse tracks

within the city and 129 off track betting terminals. Under the direction of RHKJC, the race tracks rank sixth in the world in total per capita season betting (Friedland 1991, 23-25).

During 1990, RHKJC contributed 9 percent of all the taxes that were collected in Hong Kong. Yet, RHKJC does much more than contribute tax revenues to the city. RHKJC paid for many of Hong Kong's schools, hospitals and welfare centers. Recently, they built a \$58 million aquarium and amusement park (Friedland 1991, 23-25).

The club also helped to stabilize the Hong Kong stock market crash of 1987. Some of the projects RHKJC has undertaken, however, were criticized for cost overruns and their large size (Friedland 1991, 23-25).

In the end, RHKJC is deeply committed to community service. It is doubtful whether the projects undertaken by the club would have ever been done if not for the club's financial assistance and direction.

Recently, the club pledged \$221 million to help start the Hong Kong University of Science and Technology (Friedland 1991, 23-25). In short, the club is a respectable corporate citizen and it continually reinvests in the city.

A less radical suggestion than put forward by Stocker and Clotfelter and Cook is the creation of an independent regulatory agency. Agency members will be paid at rates comparable to their counterparts in the private sectors. Appointments to the regulatory commission would have no interest in the gambling industry and should be barred from entering the gambling industry after leaving the agency (Abt, Christens and Smith 1985, 217-221).

This agency would issue "periodic, statutory mandated reviews" of the gambling industry. The belief is that these reviews will make it difficult for

government or gambling to ignore major problems in the industry.

Other benefits of the agency is that it will help to protect gambling from government's continual efforts to extract more revenues. Finally, an independent government agency helps to remove government from its current conflict of interest (Abt, Christiansen and Smith 1985, 217-221).

It is questionable whether this type of regulatory agency can isolate gambling from the pressure of the revenue imperative. However, the suggestion is a step toward privatization of the gambling industry that will yield economic development payoffs.

The time may well have come for government to give up its control of gambling enterprises. In the end, it will help to increase revenues and foster more job growth in the industry than currently exists.

Many authors of gambling address the need for privatization and less involvement by government. However, the current literature lacks much research on government's involvement in financing gambling projects of today.

Prairie Meadows in Altoona is an excellent example of government becoming involved in the financing of a gambling project. Polk County financed the project after several economic development and feasibility studies were completed. It is these studies that help to get the project financed by the county and foster support in the community.

The studies will be examined in terms of critical mistakes made in these reports and the general accuracy of their predications of attendance and betting handle. This paper will also present recommendations on how to effectively review these types of studies for future managers. In sum, this paper seeks to find what can be learned from the experience.

CHAPTER 3

DATA/METHODS: CASE STUDY OF POLK COUNTY HORSE TRACK

The Iowa state legislature flirted with legalizing pari-mutuel betting throughout the 1970s, but only became serious in the early 1980s. In 1982, to the surprise of many legislators and the Des Moines Register, a pari-mutuel betting bill was approved by the Senate Ways and Means Committee. This same committee had bottled up the bill in prior years. The bill died later on the floor, but it started the state's interest in the business of gambling (Graham 1982, 3a).

In the Spring of 1983, the Iowa House approved a pari-mutuel betting bill on a 53 to 44 vote. The debate took six hours and legislators and dealt with 30 amendments. Governor Branstad favored the bill, but the majority of the support for legalization came from the Democrats. The Senate passed the bill, the next day.

The bill set up a five member state racing commission with the power to license dog and horse tracks; approximately \$300,000 was appropriated for the Commission. Presently, the commission is titled the Iowa State Racing and Gaming Commission to reflect its' increased responsibilities since the approval of the riverboat casinos and the Iowa Lottery.

Government officials had high expectations for horse and dog racing, in terms of economic impact. When signing the bill, Governor Branstad said that racing would have an impact on tourism and horse breeding within the state.

He contended that the bill held real economic promise (Knudson 1983, 1a, 2a). The Des Moines Register, in an editorial on August 17, 1983, shared the governor's opinion. They said the bill had great potential for "generating economic growth at the local level."

The first indication a horse track was under consideration in Polk County came quickly. In June of that year various Des Moines business leaders came together to study the possibility of a horse track in Des Moines. They were considering the Iowa State Fair grounds (Caba 1983, 3a).

By early November, 1983, Economics Research Associates of California completed a study for the Iowa State Fair regarding the viability of a track at the grounds. The study concluded that a track was a possibility, but indicated it was "financially risky." The study projected a horse track would not be able to make debt service payments due to the lack of cash flow (Leavitt 1983, 1a).

A second feasibility study was completed by Delaware North in December of the same year. Delaware North was working with investors in the Cedar Rapids area about building a track near Cedar Rapids. Business leaders in Des Moines feared that investors from Cedar Rapids were further along in their plans for building a horse track and convinced Delaware North to study a Des Moines site (Leavitt 1983, 1a).

The Delaware North study was released quickly in December of 1983. Business leaders, included in the discussions were trucking executive John Ruan, real estate developer William Knapp, construction company owner Fred Weitz and Des Moines lawyer William Wimer. Also involved in discussions about the horse track were the Des Moines Chamber of Commerce and lobbyist, lawyer and former chair of the state's democratic party, Ed Campbell (Caba 1983,

1a, 2a).

The study estimated an average daily attendance of 3,413, a total yearly attendance of 352,000, an average daily handle of about \$350,000 in betting and an average per capita betting total of \$103 a day. The study concluded that even if local businesses paid a fee to assist the track with operating expenses, the track would not generate sufficient revenues to justify renovating the Iowa State Fair's Track and grandstand. At that time, business leaders admitted that it was unlikely potential investors could be attracted (Caba 1983, 1a, 2a).

In the end, the study was widely criticized as being flawed and incorrect in a number of areas. Delaware North was accused of having a conflict of interest, as they were also considering building and operating a dog track in Council Bluffs, Iowa. Thus, if the horse track was not built in Des Moines, a dog track in Council Bluffs may have a better chance of succeeding.

A third firm was hired by the Des Moines Chamber of Commerce to review prior studies and make recommendations on how to proceed. Results were reported during April of 1984. The conclusion was that a track was possible in central Iowa.

The firm, Killingsworth, recommended building a new race track. They cited lack of any indoor seating at the state fair grandstand, the difficulty of getting to the fair grounds from the interstate, and costs of renovation of the grandstand at the fair (Caba 1984, 1m).

In the same year, April 1984, Ken Grandquist, a Des Moines businessman and part owner of the Iowa Cubs franchise, expressed an interest in building a horse track. In June, 1984, he proposed a \$39.9 million track near Bondurant, Iowa, a small suburb of Des Moines.

Grandquist

Killingsworth completed its feasibility study in 1985; that study's estimates projected a more optimistic picture concerning attendance and betting handle than was projected in past reports. Killingsworth estimated a daily attendance for the thoroughbred season of 4,480 and a daily betting handle of \$627,648.

The study concluded that, if investors were willing to assist the track in maintaining positive cash flows, the track could be profitable by the year 2,000 (Horse Racing Facility Feasibility Study in Des Moines, Iowa 1985, 71-73).

Grandquist calculated the economic impact of a horse track in Iowa. His calculation estimated, the creation of 2,200 jobs and an economic impact of \$200 million annually for the state.

The track was to be financed by industrial revenue bonds issued by Polk County in the amount of \$35 million. Revenue bonds are issued by city, state or county governments and are paid back from the revenues the project generates. If the project fails, bondholders are not repaid. This is in contrast with general obligation bonds which are issued with a guarantee that, the local government will repay the bonds.

Because of an increase in the cost of construction, the amount of the revenue bonds was raised to \$40 million. The remainder of the funds was to come from private investors. The state racing commission promptly licensed the track. Later, the site moved to its present day location in Altoona, due to the lack of sewer lines at Bondurant.

The track faced possible rejection in Altoona. The planning and zoning board, in a non-binding vote, voted 5 to 2 against re-zoning the site for the track (Kamin 1984, 1a, 6a). A bitter battle ensued between groups who favored the

proposed track and those who were against it.

Citizens' groups against the track cited an influx of crime, clientele a race track would attract and the smell from the horse barns. They contended the quality of life in Altoona was threatened by the possible presence of the horse track.

"Citizens for Progress through Racing," which was organized and run by Altoona city attorney Ed Skinner, cited economic development as the main reason for supporting the track. Skinner stated "we've got sitting at our doorstep the single greatest industry that will have the largest economic impact ever on this state in our generation" (Healey 1984, 1a, 2a). Skinner later resigned his position as city attorney at the request of the mayor, who cited a conflict of interest with his position with the city of Altoona.

In late November of 1984, it appeared questionable if the Altoona City Council would vote in favor of the track. In a series of maneuvers, Grandquist pushed the Altoona City Council for a definitive decision.

First, Grandquist hinted that other sites were being considered for the proposed track, specifically Ankeny. Second, he openly stated that the track's long-awaited financial backing was complete. The Des Moines Register reported that the revenue bonds had been underwritten by Piper, Jaffery and Hopwood Inc. of Minneapolis, Minnesota. Grandquist stated in the Des Moines Register that this meant that Piper, Jaffery and Hopwood would buy the bonds if a buyer was not found.

The announcement came three days before the Altoona City Council was to vote on the proposal to re-zone the area. The goal of Grandquist was to clearly put the decision in the lap of the Altoona City Council.

On December 2, 1984, the Altoona City Council voted 4 to 1 to re-zone the tract of land for the track; central Iowa seemed to be on its way to building the state's first horse track (Kamin 1984, 1a, 12a).

In May of 1985, Grandquist went to the Polk County Board of Supervisors and requested the county to guarantee the \$40 million worth of bonds the Board of Supervisors had previously issued in conjunction with the track. Grandquist retracted his earlier statements and told the supervisors that the bonds had not been sold.

Grandquist informed the board and the media this was the result of a perception across the nation that the Iowa economy was weak. Private financing from the Des Moines business community and across the state was also slow—only \$3 million was raised of the estimated \$5 million that was to come from private investors (Kamin 1985, 1a, 10a).

Grandquist approached Polk County because Altoona was too small to guarantee the bonds and the track was not within the Des Moines city limits. Further, Polk County was expected to benefit the most in terms of economic development. However, the plan did call for extensive legal maneuverings on the part of both parties.

Funds from the sale of the bonds were to be given to Central Iowa Sports Facility Limited Partnership to build the horse track. The county and Central Iowa Sports then planned a series of maneuvers in an attempt to comply with state laws.

Faced with certain defeat, the proposal was withdrawn. There was only one supervisor who publicly supported the financing and he represented the Altoona area.

A second supervisor who took a public stance was Richard Branan, he cited public displeasure about the possible county guarantee. His reason for coming out against the proposal was negative public opinion.

In July of 1985, the state racing commission, in a state of total frustration with Grandquist and the lack of movement toward actually building a track, licensed a horse track for Cedar Rapids, Iowa. The track in Cedar Rapids later failed, due to the lack of potential investors. Almost a year after Grandquist had stated that financing was complete, he announced that a Florida investment firm had been hired to help market the bonds. It planned on selling the bonds at 11 percent interest instead of the intended 7 percent (Shaw 1985, 1m, 5m).

The bonds were pulled from the financial markets in March of 1986, supposedly because large investors were prepared to buy large blocks; this never materialized. Some movement did occur in April when business leader Bill Knapp announced his public support for the track. He pledged a \$100,000 investment.

Knapp was the first from the Des Moines business community to show any public support for the Grandquist horse track. The announcement was made in front of the Iowa State Racing Commission, which was clearly becoming frustrated with the lack of progress toward building.

Finally, in June of 1986, the Iowa State Racing Commission made preliminary moves to pull the Grandquist license. Grandquist withdrew his proposal and a license was promptly granted to a group headed by Richard Wilkey, former Des Moines City Manager.

Wilkey

In a flurry of activity, Wilkey secured control over the \$40 million worth

of bonds that were first issued by Polk County for Grandquist's proposal. He then hired an accounting firm, McGladrey, Hendrickson to update the Killingsworth study. He asked the Polk County Board of Supervisors to name a 24-member commission to study the viability of a horse track. This commission consisted of community, business, and government leaders from Polk County and was referred to as a Who's Who of Polk County.

The group included business leaders Robert Dee, president of Holmes, Murphy and Associates, a local insurance firm; Robert Burnett, president and chief operating officer of Meredith Corporation, a publishing corporation; Thomas Urban, president and chief operating officer of Pioneer Seeds Incorporated; and Carol Baumgarten, executive director of YWCA, in downtown Des Moines.

Eventually, the community-wide board supported the idea of a horse track. The revised Killingsworth study stated that a horse track in central Iowa could be a viable and profitable project. The McGladrey study estimated a daily average attendance of 4,127, a daily betting handle of \$631,844 and an average per capita bet of \$153 (Horse Racing Facility Study 1986, 2). At this point in the process, track financing was still not clear.

Shortly before the McGladrey study that addressed the viability of the track for central Iowa was completed, an economic impact study by Peat Marwick was made public. The economic impact study was heralded by state and local officials as a sign of the economic impact of Prairie Meadows for the county and the state.

Peat Marwick estimated the total economic benefits for the state at \$92 million. The director of state racing believed that the figures were too conservative. Richard Wilkey stated the "track would have an enormous

impact compared with other employers in the state." Polk County Supervisor Jack Bishop was even more optimistic and said "chances are it will turn out a lot better" (Shaw 1986, 1a, 2a).

Clearly, the Peat Marwick economic study gave officials a rallying point, that was tossed out for public consumption, and heralded by the local media. In the end, it helped gain public support. In late 1986, Wilkey went to the Board of Supervisors and asked them to guarantee the bonds under a financing plan similar to Grandquist's. The organization which asked for the guarantee was the Racing Association of Central Iowa (RACI). RACI was a non-profit organization that included a number of significant community leaders. Once again the plan was complicated and consisted of a series of maneuvers designed to comply with Iowa Law. This is most easily visualized in a diagram, Figure 3.1.

First, Polk County issued \$40 million in bonds. The proceeds were then given to RACI to build Prairie Meadows. Once Prairie Meadows was built and generating profits, the track was to move any profits to RACI, this occurs in step 1. Step 2 called for RACI to make payment to Polk County. This payment was anticipated to be at least equal to the annual bond payment. Revenues in excess of the bond payment were to be allocated to local charities. Step 3, would occur when Polk County made its payment as called for under the lease-purchase agreement.

The lease-purchase payment meant that Polk County was in the process of renting the track from RACI and would eventually own the race track at the end of 20 years. Finally, in step 4, RACI was to make the bond payment to the bond holders (Patterson 1993).

The reason for this financing scheme was that under Iowa Law, Polk

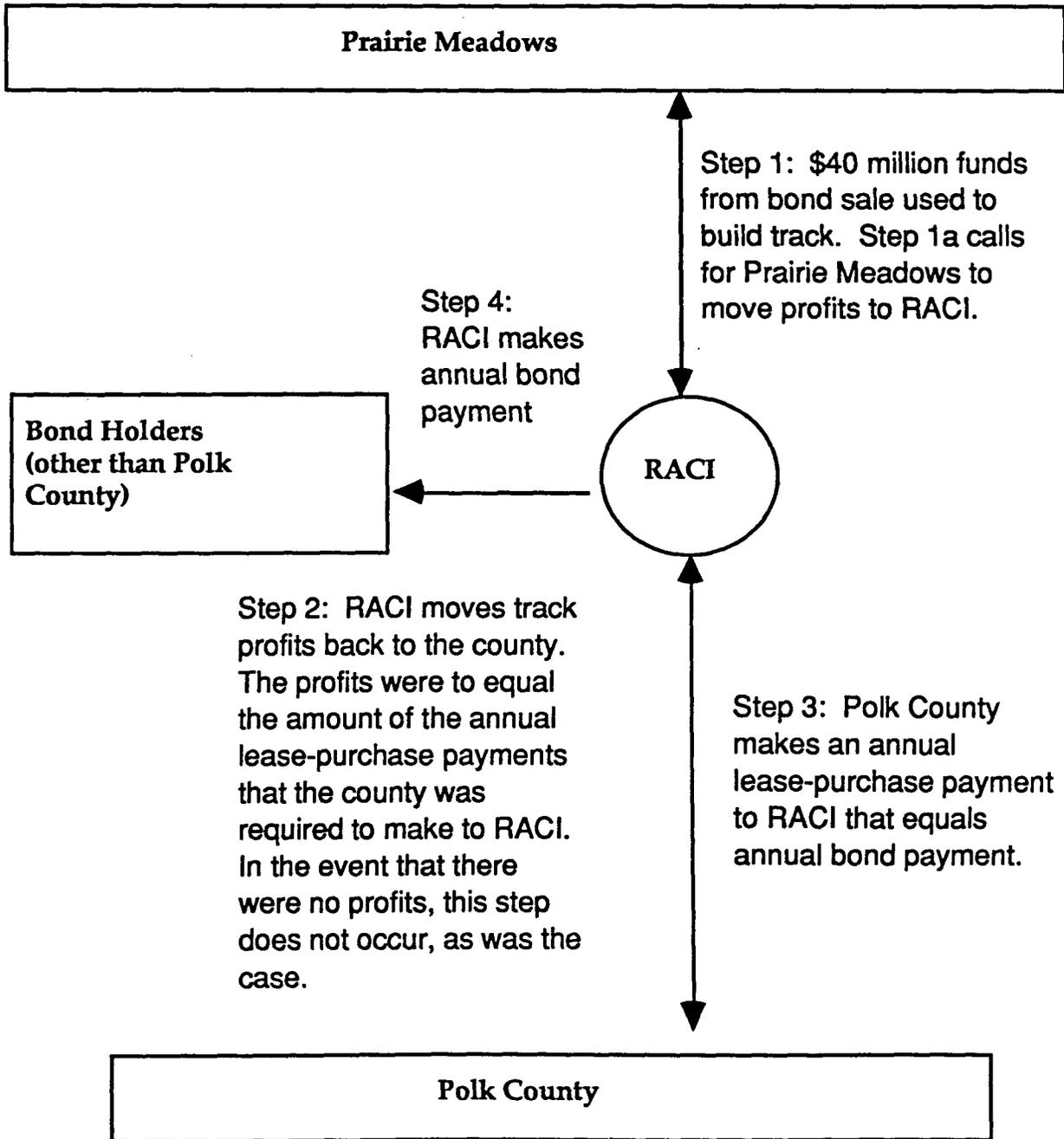


Figure 3.1 Flow of Money

County could not give funds directly to Prairie Meadows, as the result of state laws at the time the track was built. RACI operated as a go-between, an organization whose sole purpose was to oversee operation of the track and funnel money between the county, the race track and the bondholders.

When the board was presented with the plan for the second time, it showed an interest in the plan and was willing to agree to the proposal. Supervisor Richard Branan, who came out against the Grandquist proposal, was a strong proponent of the Wilkey plan.

He stated "the project met three important needs for this community...it will bring economic development, growth, competitiveness with other states in the region and most important of all, it meets the need of job creation" (Beeman 1987, 1a, 5a).

If the track failed to earn a profit, the county would be held liable for \$40 million in bond payments over 28 years. There was no strong public objection raised about Polk County's involvement in the financing scheme. The Des Moines Development Corporation, which is a group of local Des Moines businesses invested a moderate sum of about \$4 million.

A glitch in the financing, however, appeared when a Minnesota firm refused to finance a loan for the equipment. The board refused to take a final vote on the guarantee of the bonds until the issue was resolved by RACI (Beeman 1987, 1m). The Minnesota firm wanted Polk County's guarantee that it would pay back the loan if the track was not profitable.

Finally, Piper Jaffery & Hopwood, who was to sell the bonds and make an estimated \$1 million from the sale, offered to finance the loan at 13 percent interest and a \$200,000 non-refundable up-front fee (Beeman 1987, 2a).

The Board of Supervisors decided to guarantee the bonds on July of 1987, on a 4-1 vote. The county manager stated that he viewed the project as merely another economic development project within the county. The lone dissenter, Supervisor Ray Stephens said, "the whole matter of gambling was not the way to go about stimulating the economy (Beeman 1987, 1a, 5a).

Prairie Meadows

Prairie Meadows horse track opened in the first week of March, 1989. The facility has a seating capacity of 8,000 and barns for 1,000 horses. The track was built at a total cost of \$47.4 million, which was slightly less than projections" (Shaw 1989, 4s).

The first part of the racing season ended with both attendance and the betting handle far below projections. The betting handle is the total amount bet at the track, during the day. This is an important figure, since the more patrons bet, the larger the profits are for the track.

The second part of the 1989 racing season started with harness racing. Harness racing was a financial failure and put the track even further below attendance and betting projections.

Because Prairie Meadows failed to meet projected attendance and betting amounts, the county pumped large sums of money into the track to enable it to meet operating expenses.

The attendance and betting handle reached critically low levels during the summer of 1989. The general manager was widely criticized and resigned. The replacement was Carol Baumgarten, a member of RACI.

Her experience was not extensive in the area of managing a live horse racing operation. Her job experience included head coach of Drake University

women's basketball team and head of the Des Moines YWCA. Upon her arrival at the track, she canceled the faltering harness season and blamed the track's problems on the lack of effective marketing (Benning 1989, 1a, 8a).

In 1991, the final year of live racing at Prairie Meadows until the spring and summer of 1993, there were various discussions about selling the track to two different Native American tribes and another group of investors from Minnesota. Both investors planned to develop the track into a casino with approval of the Iowa State Legislature and a racing facility.

At the start of the 1991 racing season, casino gambling started on the riverboats. Riverboat gambling had only negative effects on the track's betting handle. The betting handle was down 22 percent in May, and continued to stay below projections.

The second major problem for the track in 1991 was a series of lawsuits filed in connection with the financing of Prairie Meadows. The first lawsuit challenged the method of financing that was utilized. The suit contended that the lease-purchase agreement was illegal.

In May, 1991, the suit was thrown out by the district court judge because the citizens should find their "remedy in the polling place," not the courts. The district court stated that the Iowa Supreme Court has ruled that public financing for economic development projects should be given a liberal interpretation to serve the public good (Osher 1991, 1a, 8a).

The Iowa Supreme Court ruled on the case in October of 1992. They ruled in favor of the county based on the fact that the plaintiffs' filed their claim years after the financing scheme was approved by the board of supervisors and statute of limitations on the financing process had expired (Stanfield vs. Polk County

No. 148/91-951, 1992 2-3). The effect of the court case will be addressed later in the paper.

A second lawsuit filed in July of 1991 contended that proper notice was not given to the public regarding the financing of the horse track. The case was decided in March, 1992; the judge ruled in favor of the plaintiff and ruled Polk County can no longer make payments on the bonds or cover any operating expense deficits the track may incur.

The judge said the description of the notice was "inaccurate, confusing and an impossible performance." This was because the Polk County failed to properly notify taxpayers about what actually was occurring (Osher 1992, 1a). The case was appealed by Polk County. The Iowa Supreme Court dismissed the case based on the fact that its earlier ruling was applicable.

In the fall of 1991, another economic impact study was completed by Arthur Anderson. The study estimated the economic development impact of the track in Iowa at approximately \$36.8 million. The study also recommended that the track remain open with some form of live racing.

This recommendation was based on two facts. First, with some form of live racing, the track could possibly be profitable. Second, the report concluded that the economic impact for Polk County and Iowa were considerable, and as a result it was worth keeping the track open (Economic Impact Study, Shutdown Versus Operating Costs Analysis and Operational Suggestions for Prairie Meadows Racetrack 1991, 2-4).

The study was paid for by the Des Moines Development Corporation. The economic development impact study by Arthur Anderson was heralded by state and local governmental officials. The intent of the study was to give the board of

supervisors an indication as to whether the county should continue extending a line of credit to the track taking into account the economic development impact for the county and near by communities.

By the end of October of 1991, growing public outcry about the track during the fall elections meant the replacement of two board members. As a result, the board refused to extend enough credit to Prairie Meadows to permit live racing in 1992. Because of the lack of operating capital, the track filed for bankruptcy.

The board had hoped to refinance the bonds at a lower interest rate throughout the later part of 1992 due to decreasing interest rates. The original bonds were issued at 8.25 percent. The county hoped to reissue bonds at 6.5 percent interest. Refinancing the bonds was expected to save the county approximately \$115 million.

As a result of the bankruptcy of Prairie Meadows and the failure of Polk County to assist the track with operating expenses, Moody's investment became involved with the future of the track.

Moody's assigns rating to cities and counties based on their ability to pay off bonds that are put out in the financial markets. The lower the city or county's rating, the higher the interest rate the governing body must put on the bonds to get investors to buy them and the more money it costs the governmental entity. Their ratings are critical to the viability of future large scale projects that require financing with bonds.

The county's bond rating was first lowered in July of 1991 by Moody's because of the faltering track, and in January of 1992, it was lowered once again. Moody's believed the county knew that not extending the track a line of credit would mean bankruptcy for Prairie Meadows and leave RACI unable to pay

bondholders.

The end of RACI came in March 1992 when it was unable to find liability insurance because of the track's financial problems. Thus, the members of RACI resigned along with several track officials.

Little action was taken on the track during the summer of 1992, but early in the fall of 1992, Des Moines business leaders once again came together to put a referendum on the ballot in Polk County. The ballot asked whether citizens supported casino gambling at Prairie Meadows.

The hope was to use the results as leverage in the Iowa Legislature to legalize casino gambling at Prairie Meadows. Business leaders felt that casino gambling might make the faltering track profitable (Bowers 1992, 13a).

The organization Equity for Polk County Taxpayers was formed. The group was largely comprised of Des Moines business leaders, government officials and other community leaders. The group eventually formed an advertising campaign in favor of casino gambling.

There was some organized opposition to the proposal, but it was largely religious in nature and had limited financial resources and was not able to form an effective organization.

The referendum was approved, with 57% in favor and 43% opposition. The results did not mean a clear victory for casino gambling, but still showed a willingness of citizens to consider it (Bowers 1992, 13a). The 1993 state legislature failed to approve casino gambling for Prairie Meadows or any of the state's tracks.

At the end of November 1992, the Polk County Board of Supervisors placed the annual bond payment for the track into an escrow account. As the result of the district court's ruling that enjoined the county from making further

payments until the Iowa Supreme Court ruled on the case, the \$3.9 million payment was placed in escrow. This assured the financial markets that Polk County had every intention of meeting its obligation to the bond holders (Bowers 1992, 3m).

Clearly, the county was very concerned about the opinion of Moody's and did not want to see its bond rating lowered a third time. Investment rating agencies, like Moody' are solely concerned with bondholders and their ability to get back their investment.

During 1992, Prairie Meadows operated by showing simulcasts of horse racing across the nation. Simulcasting was profitable and Prairie Meadows was able to meet operating expenses for the first time in its history, but the track was not able to make the bond payments.

In 1993, Polk County issued bonds at a lower interest rate than the original bonds and made all lease-purchase payments. As a result, the county now owns the track directly, and eliminates facade RACI. As has been stated earlier RACI established earlier to act as the intermediary between Polk County and the race track, so the county would not be the direct owner of the race track.

Currently, the state legislature is considering legalizing slot machines at all pari-mutuel tracks in the state. This is an attempt to make the state's tracks profitable. There have been three studies completed, in conjunction with slot machines at the horse and dog tracks in the state.

One study completed by Racing Resource Group Inc. was commissioned by the Dubuque Racing Association, the operators of the Dubuque dog track. This study divides patron usage into high, medium and low. Racing Resource Group estimates usage from a low of \$38 million to a high of \$101 million for all of the

state's tracks.

The second study was completed by GTECH Corp. Their estimates are divided into high and low usage at the tracks. GTECH's low estimate for receipts from slot machines is \$54 million to a high of \$91 million for all of the state's tracks. GTECH also offers to pay for putting the machines into the state's four pari-mutuel tracks. As a result GTECH would be given a portion of the profits. Furthermore, the day-to-day operations track would be done by GTECH.

The third study was completed by the fiscal bureau of the Iowa Legislature. Once again they divide their estimates into high, medium and low usage. The Iowa Legislative Fiscal Bureau gives a much more conservative estimate of receipts. Their estimates range from a low of \$14 million to a high of \$32 million.

The Fiscal Bureau's high estimates fall closer to the low estimates of both GTECH and Racing Resource Group. Furthermore, the low estimate of the fiscal bureau is half of the low of GTECH. The large contrast highlights the ease that studies on gambling can arrive at very different results.

In the end, the arrival of slot machines for the state's pari-mutuel tracks is not new. Currently, the state has slot machines operated by Native American at three locations. Thus, critics contentions that this is an expansion of gambling for the state is questionable. However, the soci-economic effects of more slot machines in the state is not known. Yet, given the experiences of other regions legalizing slot machines and casinos, the state begin to find higher rates of petty crimes, land speculation and local economies that become less diverse over time.

CHAPTER 4

COURT CASES ASSOCIATED WITH PRAIRIE MEADOWS

There were two law suits filed against Polk County over the lease-purchase agreement with RACI for Prairie Meadows. The second lawsuit, B.F. Riley v. Maloney , no. 117/92-632, Iowa Supreme Court 1993 did not raise any areas of interest in the field of economic development or lease purchase agreements for local governments. However, Stanfield v. Polk County no. 148/91-951, Iowa Supreme Court 1992, does give local governments several issues to consider when entering into lease-purchase arrangements.

The first court action concerning Prairie Meadows and the lease-purchase agreement was filed by Paul Stanfield on December 23, 1986. They sought to stop the county from making future lease-purchase payments to RACI. The district court dismissed the case, ruling that the county could continue to make payments. The Supreme Court of Iowa accepted an appeal by the plaintiffs and ruled on the case October 21, 1992 in Stanfield v. Polk County.

The second case that challenged the public notice to enter into a lease-purchase agreement was filed on July 12, 1991 by B.F. Riley. In contrast to the first case, the district court judge found that the public notice for the lease-purchase agreement was critically flawed. As a result, Polk County was enjoined from making further payments in March of 1992.

The Iowa Supreme Court also accepted the county's appeal in B.F. Riley v. Maloney. Polk County continued to make payments, but funds were placed in

escrow until the Iowa Supreme Court made a final ruling on the case. The funds were placed in escrow to satisfy Moodys Investments and assure bond holders that they would be paid. The Iowa Supreme Court ruling came on April 1993.

The Iowa Supreme Court reversed the decision of the district court and permitted Polk County to continue making lease-purchase payments. The court ruled that Stanfield v. Polk County barred further lawsuits concerning the lease-purchase agreement (B.F. Riley v. Maloney, no. 117/92-632, p 8, Iowa Supreme Court 1993).

Thus, we need to examine Stanfield v. Polk County for issues relevant to future economic development projects. There are three specific issues that arise from Stanfield v. Polk County. First, does the fifteen day time period to file objections over a lease-purchase apply in the case of Prairie Meadows? Second, was the public notice about the lease purchase agreement in violation of the due process clause of the United States Constitution? Finally, was the lease-purchase agreement in violation of the Iowa Constitution, specifically in violation of articles seven and eight?

Public Notices And Fifteen Day Period

Lease Purchase agreements are addressed in section 331.301 of the Iowa Code. This section grants counties the authority to enter into lease-purchase agreements. The Iowa Code requires that a public notice be published before a local government enters into a lease-purchase arrangement, and articulates several items that the public notice must contain.

The Iowa Code requires that the public notice contain: the amount for the lease-purchase agreement, the purpose of the agreement, the time and place of the public meeting where citizens may voice concerns about the agreement and

where the county board of supervisors will vote on the proposal.

The Iowa Code also states that any citizens wishing to protest the action in court must do so within fifteen days after the county board of supervisors takes action. The code goes on to state that the board's action is final unless the courts find the county has exceeded its authority.

The majority in Stanfield v. Polk County ruled that Polk County complied with the Iowa Code and that the fifteen day time-period in which to file protests was clearly past. Plaintiffs contended that the county did not comply with the requirements of the Iowa Code and therefore exceeded their authority to enter into the lease-purchase agreement.

The public notice Polk County published cited the time, place and date of the public hearing about the lease-purchase agreement. The notice also cites RACI as the organization that the county planned to enter into a lease-purchase agreement (Stanfield v. Polk County, no. 143/91-951, p. 8-9, Iowa Supreme Court 1992).

However, the public notice failed to notify citizens of the exact monetary amount of the lease-purchase agreement under consideration. It also failed to state the exact purpose of the lease-purchase arrangement as required by the Iowa Code (Stanfield v. Polk County, no. 143/91-951, p. 8-9, Iowa Supreme Court 1992)..

In the case of Prairie Meadows, Polk County officials were aware of the original amount of the lease purchase agreement, but the amount was never specifically stated within the public notice. Furthermore, the notice fails to state the actual purpose of the lease-purchase arrangement.

On the surface, it is an arrangement for the county to own a horse track over a period of time. Yet, when the events are examined surrounding the

actual construction of the horse track, it is clear that the lease purchase agreement was merely a means of supplying credit for the bonds.

The revenue bonds to cover construction costs of Prairie Meadows were on the market for months, and little interest in them was shown by potential investors. It was not until the lease purchase agreement was arranged did investors purchase the bonds. Further, the lease-purchase agreement was specifically cited by Moody's when it issued a favorable rating on the bonds. Perhaps, credit support for the revenue bonds was not the publicly stated purpose, but it was the direct result and Polk County intended to use the agreement as a means of making the bonds marketable .

In Grove v. City of Des Moines, 280 Northwestern Reporter, Iowa Supreme Court 1979, the majority wrote that the legislature gave the public the right to appear at public meetings and publicly voice their opinions. However, the majority in Grove v. City of Des Moines goes on to say this right loses all meaning if a council does not provide adequate information to the public. Thus, public notices are important and need to inform the public definitively about proposals (Grove v. City of Des Moines, 280 Northwestern Reporter, p. 386, Iowa Supreme Court 1979).

The majority in Stanfield v. Polk County believed that the notice did state the arrangement as a lease-purchase agreement, and therefore fully explains the lease-purchase arrangement with RACI. However, as we have seen the agreement has the dual purpose of purchasing the track over an extended period of time and providing credit support for the bonds.

The Iowa Supreme Court struck down a similar arrangement in Bachtell v. City of Waterloo, 200 Northwestern Reporter, Iowa Supreme Court 1972. In

this case, a non-profit organization was established to build a civic center. The city entered into a lease-purchase agreement with a non-profit organization for a number of years; the amount of the agreement was exactly equal to the cost of the civic center (*Bachtell v. City of Waterloo*, 200 Northwestern Reporter, Iowa Supreme Court 1972).

The Iowa Supreme Court struck down the arrangement because it believed that the agreement constituted a "transport purchase and sale of the civic center" and therefore a "general obligation" of the city. The case is very similar to *Prairie Meadows*.

However, the majority ruled in *Stanfield v. Polk County* that the fifteen day limitation was still in effect. They point out that the county issued the bonds on December 27, 1984, and the Polk County Board of Supervisors took action on the lease-purchase agreement on December 23, 1986. The law suit was filed nearly three years after this date, July 9, 1990. Thus, the fifteen day time-period, in which to file objections was clearly past (*Stanfield v. Polk County*, no. 143/91-951, p 7,13, Iowa Supreme Court 1992).

The majority also points out that *Bachtell v. City of Waterloo* does not give plaintiffs the authority to avoid the fifteen day time period to file objections. The majority in *Stanfield v. Polk County* cites Iowa Law, which say that the action of the board is "final and conclusive" if no objections are filed and closes the door to all objections. The action of the board of supervisors was deemed final since objections were not filed during the fifteen day time period (*Stanfield v. Polk County*, no. 143/91-951, p 13-14, Iowa Supreme Court 1992).

The result of the court's ruling on this issue is that it makes it easier for counties to enter into lease-purchase agreements since objections have to be

raised within the fifteen day period. It enables counties to engage in lease-purchase which indirectly supported bond payments.

The majority's unwillingness to deviate under any circumstances from the fifteen day limit on challenges refuses to penalize local governments, once the time limit has expired. If the public realizes after fifteen days the actions of their government is questionable, it is too late to take action. However, the majority states in Grove v. City of Des Moines, the public's right to protest loses if the general public is not informed (Grove v. City of Des Moines, 280 Northwestern Reporter, p. 386, Iowa Supreme Court 1979).

An example of a lease-purchase agreement is as follows. A county may enter into a lease-purchase agreement with a non-profit organization for a project such as a riverboat. This gives potential investors assurance that they will receive principal and interest payments on their investment since lease payments are guaranteed. The county may then print a notice that does not explicitly inform citizens of the indirect credit support for a riverboat through the lease arrangement.

This is what occurred with Polk County and Prairie Meadows. First, RACI (a non profit corporations set up to manage the race track) was unable to sell the bonds without the lease-purchase agreement. Second, the county arranged a lease-purchase agreement with RACI for the track, and the terms of the lease-purchase agreement did not mention "credit support." As a result, the county was not required to specifically state this, in the public notice (Stanfield v. Polk County, no. 143/91-951, p 12, Iowa Supreme Court 1992).

Furthermore, once the fifteen day statute of limitations was past, the general public had little recourse. The ruling in Stanfield v. Polk County,

therefore permitted a lease-purchase arrangement to serve as a means of supplying credit support. This was true as long as the agreement did not specifically state that the county was obligated for the debt (*Stanfield v. Polk County*, no. 143/91-951, p 12, Iowa Supreme Court 1992). As a result, counties do not have to directly inform citizens that a lease purchase agreement is indirectly serving as a means of credit support for a project.

The result of the ruling for *Prairie Meadows* permitted the county to continue to make lease-purchase payments to RACI. This enabled RACI to make the annual bond payments. As a result the track was able to stay in business and was not forced to liquidate its assets to pay the bondholders.

United States Constitution And Due Process

The second issue the court addressed was whether due process rights under the United States Constitution were violated. The United States Supreme Court has ruled, that public notices must be reasonably calculated, apprise interested parties of the action, and offer a reasonable amount of time to respond to the action (*Mammel v. M & P Missouri River Levee District*, 326 Northwestern Reporter 2d 299, p. 201, Iowa Supreme Court 1982).

The majority in *Stanfield v. Polk County* rejected the argument by *Stanfield* that taxpayers in Polk County were not given due process. The majority stated that the public notice gave the terms of the agreement, was clear as to the type of arrangement the county was entering, and clearly notified the public where and when they could respond to the impending action.

The majority did state that credit support was the end-result of the lease-purchase agreement. However, the majority pointed out that credit support was not cited in the terms of the lease-purchase agreement and therefore it was not

required to be part of the public notice (*Stanfield v. Polk County*, no. 143/91-951, p 13-14, Iowa Supreme Court 1992).

Thus, the court strongly implied that a public notice needed only to state the specific terms of a lease-purchase agreement. In effect, the court said that the overt intent of a lease-purchase agreement is determined by the pronounced statements of the lease-purchase agreement.

Once again, the question revolves around whether the notice stated the purpose or the actual intent of Polk County; clearly the majority believes the notice performed its required function by stating the terms articulated in the lease.

In contrast, the dissenting opinion contended that notice violated taxpayers' due process rights. The dissenting opinion in *Stanfield v. Polk County* further rejected the public notice because the fifteen day time period in which to file objections is not a reasonable time as required under the due process clause of the United States Constitution.

The majority did not address whether fifteen days was sufficient time for the public to raise objections because the plaintiffs focused upon the issue of clarity and intent of the notice (*Stanfield v. Polk County*, no. 143/91-951, p 13-14, Iowa Supreme Court 1992).

In my personal opinion fifteen days to file objections does not offer a "reasonable" time for taxpayers to absorb what their local government is about to do and then to protest the action in court. However, until the limit is directly overturned in court, it remains intact.

Iowa Constitution

A third issue as the result of *Stanfield* is whether the lease purchase

agreement violates the Iowa Constitution, specifically whether the agreement violates articles seven and eight of the Iowa Constitution.

Article seven, section 1 of the Iowa Constitution states:

The credit of the state shall not in any manner be given or loaned to or in aid of any individual, association, or corporation; and the state shall never assume or become responsible for the debts or liabilities of any individual association, or corporation, unless incurred in time of war for the benefit of the state.

Stanfield also challenged the lease-purchase agreement on the basis of article eight, section 3, which states: "the state shall not become a stockholder in any corporation nor shall it assume or pay the debt or liabilities of any corporation unless incurred in time of war..."

The majority rejected this claim on the basis of Merchants' Union Barb-Wire Co. v. Brown, 20 Northwestern Reporter, Iowa Supreme Court 1884. In this case, the state legislature appropriated the sum of \$5,000 for the Farmers' Protective Association. The money was given to the association to assist them in testing barb-wire patents and to protect them from infringements. The action was protested in court as violating articles seven and eight of the Iowa Constitution (Merchants' Union Barb-Wire Co. v. Brown, 20 Northwestern Reporter, p. 434-435, Iowa Supreme Court 1884).

The majority in Merchants' Union Barb-Wire Co. v. Brown ruled that the legislature appropriating \$5,000 did not "in any manner" loan the credit of the state to the Farmers' Protective Association. Further, the act did not cause the state to become liable to any persons associated with the protective association. Thus, the majority rejected the claim (Merchants' Union Barb-Wire Co. v. Brown, 20 Northwestern Reporter, p. 435, Iowa Supreme Court 1884).

The majority in Stanfield v. Polk County rejected the idea that article eight and seven were violated on the basis that the fifteen day period was past (Stanfield v. Polk County, no. 143/91-951, p 13-14, Iowa Supreme Court 1992).

However, the lease-purchase agreement that Polk County entered into called for payments that equaled the amount of the bond payment. The agreement called for this to occur until the year 2014, the same year that bond payments were to cease. The agreement specifically states that Polk County's obligation to make these payments was "absolute and unconditional in all events (Cranberg 1991, 9a).

At the same time, the agreement between RACI and Polk County also did not constitute a moral or general obligation to pay back the bonds. Polk county officials insisted in Stanfield v. Polk County that the lease-purchase payments were rent and not bond payments (Cranberg 1990, 17a). Bond lawyers who reviewed the agreement for potential investors stated that the lease-purchase agreement was not enforceable, in cases of bankruptcy or moratorium. However, when governmental rental payments equal the cost of the bond payments, the plan can be perceived to be nothing more than a method to guarantee investors payment on the bonds.

The majority in Merchants' Union does not seem to elaborate on instances in which local governments indirectly loan their credit to a private entity. The dissent in Stanfield v. Polk County cites Grout v. Kendall, 192 Northwestern Reporter, Iowa Supreme Court 1923, as a case in which the court is clear on how to handle state governments indirectly assuming the debts of a private organization (Stanfield v. Polk County, no. 143/91-951, p 13-9, Iowa Supreme Court 1992).

In Grout v. Kendall and Merchants' Union Barb-Wire Co. V. Brown, the court applied articles seven and eight to the state government. Stanfield v. Polk County is the first time, the Iowa Supreme Court examined whether articles seven and eight apply to local governments.

In Grout v. Kendall, the majority points out that Article seven of the Iowa Constitution was directly borrowed from the New York State Constitution. New York and many other states adopted this phrase in reference to cities, states and counties that issued large amounts of bonds to assist with the expansion of the railroads in mid to late 1800's. Loaning credit was done with the belief that the primary debtor (railroads) would pay the debt. However, because of over expansion and rampant speculation, many railroads went bankrupt. As a result, states that held the secondary liability on these debts became the primary debtor upon the failure of the railroads and suffered severe financial problems (Grout v. Kendall, 192 Northwestern, Reporter, p 531 Iowa Supreme Court 1923).

The court stated in Grout v. Kendall that the state "shall not be beguiled into indirect liability by the promise and hope that a primary debtor will perform the obligation." This clause seems to clearly indicate that states cannot become indirectly liable for debts of private organizations (Grout v. Kendall, 192 Northwestern, Reporter, p 531 Iowa Supreme Court 1923).

The lease-purchase agreement was not only a means of supplying credit support for the bonds, but it also made Polk County indirectly, liable to the bondholders. Once Prairie Meadows failed financially, RACI was unable to make payments to Polk County. Yet, Polk County continued make lease payments.

The reasons for this are not entirely clear. However, this paper offers two reasons as to why Polk County continued to make lease-purchase payments.

First, Moody's investment may have lowered Polk County's bond rating if the county refused to make payments. Second, the county may have feared further court action by the bondholders. In short, the taxpayers of Polk County became indirectly liable through the lease payments for the debts of RACI upon the failure of the track to meet expectations.

In the end, the lease-purchase agreement permitted the bondholders to assume little or no risk. The result of the Iowa Supreme Court's ruling on the issue of lease-purchase agreements gives counties somewhat greater latitude in the field of economic development. In essence the ruling suggest that unless protests are filed within fifteen days local governments can become secondary or indirect risk holders for private companies and associations through the means of lease-purchase agreements.

CHAPTER 5

ANALYSIS OF FEASIBILITY STUDIES DONE IN CONJUNCTION WITH PRAIRIE MEADOWS

The studies that were completed pertaining to a horse track in central Iowa are important because they generated interest and, at times, slowed potential investors from coming forward. More importantly, the public statements made about these feasibility studies by community leaders and public officials were a significant reason that the general public believed the project was viable.

Because of the importance of these studies this section of the paper will compare and contrast two of these feasibility studies. The goal is to find where the feasibility studies failed in their reasoning. Second, the conclusion will give recommendations about how public managers can more effectively review these types of studies.

There were four major studies done on the viability of a horse track for central Iowa. The first was completed by Economic Research Associates from California. It considered the Iowa State Fair Grounds as a potential location. Their conclusion was that a track at the fair grounds was a possibility, but it was financially risky in the early years of operation (Leavitt 1983, 2m).

In the second study, Delaware North also examined building a track at the Iowa State Fair Grounds. This study concluded that a track was possibility, but would not generate sufficient revenues to finance improvements to the Iowa State Fair Grandstand (Caba 1983, 1a).

The Delaware North and Economic Research Associates studies were

unavailable to this author, except for information about the attendance and total betting handle.

The third major study that was completed about the feasibility of a horse track in the Des Moines area examined Altoona, Iowa as the site for the track. In February 1985, the Killingsworth study was completed for Central Iowa Sports Facility Limited Partnership, which was organized by Ken Grandquist, a local Des Moines business person.

Killingsworth And McGladrey

The Killingsworth study found that the track would have negative net operating cash flows in the first year of expected operation (1986) through 1996. As a result, Central Iowa Sports Facility Limited Partnership would need to assist with the operating expenses. Central Iowa Sports Facility, which has to make the bond payments, showed negative cash flows in every year of projection when depreciation was taken into account. Because of this, the depreciation expense was credited back into the projections, and even when this was done the bond payments were at times to come from cash reserves. (Killingsworth 1985, 34-45).

The Killingsworth study was updated by McGladrey, Hendrickson & Pullen in 1986. The McGladrey study concluded that a horse track was a viable project for central Iowa and estimated a higher betting handle and attendance than did the Killingsworth review. The final conclusion of the McGladrey report was that the horse track would have no negative cash flows (McGladrey 1986, section III).

The McGladrey shows positive "net cash flows" by making different assumptions than the Killingsworth study. First, McGladrey estimates a higher betting handle: \$153 versus \$140 in the Killingsworth study. Second, they

estimate higher concessions revenues than the Killingsworth report. Third, as a result of the higher betting handle, they also estimate a higher debt service credit.

The debt service credit is funds that get returned to the track to assist in paying off the bond debt of the race track. The debt service credit was 5 percent of the betting handle at the time of the report. However, the debt service credit was later raised by the state legislature to 6 percent when the track began to have financial difficulties. The result of a higher betting handle meant more funds for the debt service credit.

The estimates for attendance by Delaware North are the most accurate when compared to the actual attendance and per capital betting handle. The contrast between projected and actual attendance is shown in Table 5.1. Table 5.1 shows that both the Killingsworth and McGladrey projections were far from accurate. The estimates were off by anywhere from 617 to 1,871 people a day. The Delaware North study, which estimated figures for the Iowa State Fair Grounds, was the closest of any of the studies, but by 1991 its estimate was off by 791 patrons a day.

The biggest problem is that the actual attendance falls in the second and third years of operation. At the same time the projected attendance is held constant from the opening year except in the McGladrey study, which drops its expected attendance in the third year of operation. The reason McGladrey attendance figures drop in the third year is because a horse and dog track was to open in Kansas City.

Clearly, the attendance figures were inaccurate, there was a drop between 18 to 49 percent from the projected attendance to the actual daily attendance.

Table 5.1 Actual Average Daily Attendance Versus Projected Daily Attendance

	1989	% Drop	1990	% Drop	1991	% Drop
Delaware North	3,400	18	3,400	33	3,400	23
Killingsworth	4,480	38	4,480	49	4,480	42
McGladrey	3,748	26	3,748	40	3,470	25
Actual	2,783	—	2,269	—	2,609	—

Source: Prairie Meadows Attendance and Betting Handle Figures 1993. McGladrey, Hendrickson & Pullen 1986, 2 and Caba 1983, 1A.

Further difficulties are found when one looks at the disparities between the per capita daily wager and the actual per capita daily wager. This is easily shown in Table 5.2.

As is shown in Table 5.2, in the first year of operation, Prairie Meadows did not even come close to generating a per capita daily wager that reflected the projections of the three studies. The Delaware North study was closest, yet their projections are still 18 to 33 percent too high. The McGladrey study, which was the last completed and viewed by community leaders as the final word about a horse track in central Iowa, was off by 33 to 42 percent compared to actual daily wagering. The McGladrey study estimates were \$64 higher than the actual per capita wager in the final year of live thoroughbred racing. As we will see later, this difference resulted in severe cash flow problems for Prairie Meadows.

Methodology

The methodology both studies use to estimate the total betting handle, per capita wager and attendance is generally the same. The two studies are different only the standpoint of their final results. The studies use a comparative analysis to determine the betting handle and the attendance for Prairie Meadows.

Table 5.2 Actual Per-Capita Daily Wager Versus Projected

	1989	% Drop	1990	% Drop	1991	% Drop
Delaware North	\$103	25	\$103	7	\$103	14
Killingsworth	\$126	39	\$144	34	\$149	40
McGladrey	\$129	40	\$142	33	\$153	42
Actual	\$77	—	\$95	—	\$89	—

Source: Prairie Meadows Attendance and Betting Handle Figures 1993. McGladrey, Hendrickson & Pullen 1986, 2 and Caba 1983, 1A.

The studies begin their calculations with a term entitled fan spending. Fan spending is the amount spent by patrons, and not returned to them in the form of winnings. In the case of Prairie Meadows, if a patron wagers \$1.00, 19.5 cents is not returned to the bettor and goes to pay various expenses. Thus, 19.5 cents is the total fan spending for this example, Figure 5.1 (Arthur Andersen & Co. 1991, 59).

Fan spending is contrasted with the betting handle. The betting handle is the total amount bet by patrons while at the track. In the above example, the betting handle for that one individual is \$1.00 (see Figure 5.1).

In each study, fan spending is used as the basis of determining the total betting handle. First, fan spending is compared with other states as a percentage of per capita income for that particular state. The fan spending percentage is compared on a state-by-state basis and an average fan spending is established for Iowa based on the other states. The fan spending percentage is then applied to the total income for Prairie Meadows' nine market areas, after the fan spending

percentage is discounted based on distance from Prairie Meadows and other factors (McGladrey 1986, 8 and Killingsworth 1985, 18).

The per capita daily wager for Iowa is based on the per capita wager for selected states as a percentage of their per capita income. This percentage is then applied to Prairie Meadows' market areas per capita income (McGladrey Hendrickson & Pullen 1986, 2-17).

The total handle or total amount wagered is calculated by dividing the total fan spending for each market area by the takeout percentage. The takeout percentage is the amount not returned to bettors and taken out for taxes, purses and track operations. The next step for both studies is to calculate the attendance. This is done by dividing the projected total handle by the expected per capita wager (Figure 5.1) (McGladrey 1986, 2-17).

Analysis

The states that both reports use to estimate an average fan spending and per capita wager for Iowa are suspect. In the earlier Killingsworth study, South Dakota, Nebraska, Arkansas, Louisiana, Ohio and Illinois were selected to calculate fan spending. The average fan spending for these states is .122 percent (Killingsworth 1985, 16, 18).

The McGladrey study uses Illinois, Michigan, Nebraska, New Mexico, Ohio and Washington to calculate an average fan spending. The average fan spending for these six states is .113 percent.

The 12 states used to determine the average fan spending are similar. First, they have a tradition in the tourism industry. Second, they also have a much longer tradition of pari-mutuel racing in their respective states.

For example, Ohio and Illinois are in the top six destinations for domestic

$$\text{Fan Spending} = \text{Total Handle} - \text{Winnings Returned to Bettors}$$

$$\text{Expenses} = \text{Operating Costs} + \text{Taxes} + \text{Purses} + \text{Other Track Expenses}$$

$$\text{Total Handle} = \frac{\text{Total Fan Spending}}{\text{Takeout Percentage}}$$

$$\text{Attendance} = \frac{\text{Total Handle}}{\text{Per Capita Wager}}$$

Figure 5.1 Equations Utilized in Feasibility Studies

Source: Arthur Andersen & Co. 1991, 59, 18 and McGladrey 1986, 2-17.

travelers (The New Book of American Rankings 1984, 196). On a yearly basis, thousands of tourists travel to these states. This is not to say Iowa does not have a tourist trade. It is simply not as strong as the majority of the selected states.

This is further highlighted by examining domestic travel expenditures by individual states. All of the states selected by the two studies have higher expenditures by travelers than does Iowa, with the exception of Nebraska, New Mexico and Arkansas (State and Metropolitan Area Data Book 1991, 240).

Because the states selected have a heavier tourist trade than Iowa. The per capita wager and fan spending percentages for citizens in these states is higher. Thus, the averages projected for Iowa may be much higher than they are in actuality. An example of this trend is the amount spent on eating and drinking by cities and counties in the U.S. The areas that rank high in total expenditures are traditional tourist destinations (Sales & Marketing Management 1991, 3).

The large difference between Iowa's total betting handle and that of the states used in the studies is significant (please see Figure 5.2). In Figure 5.2, the majority of the states used by both studies were from the high end of the scale.

For instance, two of the states used to calculate the per capita wager percentage had a total betting handle 100 times more than Iowa's. In contrast to the states shown in Figure 5.2, we can look at states from the low end of the scale. For instance, the total betting handle in 1990 for Kansas was \$3.9 million, Minnesota \$7.9 million and Alabama \$3.44 million. Clearly, the states used as a comparison were not reflective of Iowa's racing potential or local economy. Any of the above states are more reflective of Iowa in terms of the establishment of the racing industry and tourism.

It is important that the states which are selected to determine an average, are as reflective of the state or region, as possible. Isserman and Merrifield use statistical analysis to find control regions to compare to their experimental region and take extensive care to assure that the regions are as similar as possible (Isserman and Merrifield 1981, 44).

The average fan spending percentage is discounted for special circumstance in both reports. Killingsworth's fan spending is discounted because the track's racing season was not in the traditional horse racing season, thus, drawing lower attendance and wagering than other markets. A second discount is given depending on how far away the market area is from Des Moines and the number of pari-mutuel racing facilities available to that market area. Prairie Meadows' final spending percentage for Killingsworth is discounted to .087 percent from an original .122 percent (Killingsworth 1985, 16-21).

McGladrey's fan spending average begins at .113 and is discounted to the same number as Killingsworth .087 percent. This is also because of the non-prime racing season. However, McGladrey's original average fan spending percentage

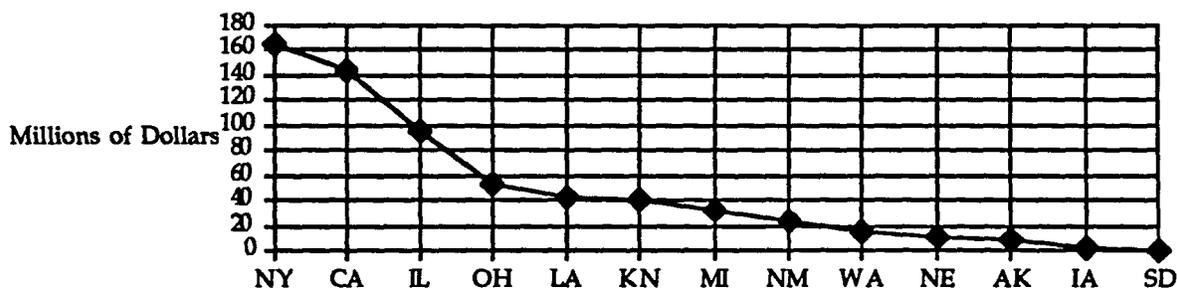


Figure 5.2 Total Betting Handle 1990

Source: A Statistical Summary Prepared by: Association of Racing Commissioners International, Inc. 1990, 10-13.

was lower than Killingsworth's, yet McGladrey's final percentage for fan spending is the same. Thus, McGladrey began with a lower fan spending average than does Killingsworth, but after McGladrey discounts their average it is still the same as Killingsworth.

This is after McGladrey was fully aware of the continued expansion of the gambling in Iowa and the Midwest, such as a dog track in Waterloo and a horse and dog track in Kansas City. The McGladrey report does not address the difference. In the end, using a smaller discount and higher income projections (as we will see later) assists the McGladrey report in projecting a higher total betting handle and attendance (McGladrey 1986, 8-13).

Another difference between the two reports is that McGladrey uses updated data for per capita income in the nine market areas. The total per capita

income for Des Moines in the Killingsworth study was \$70 million for the first year the track was to operate, 1986. The updated McGladrey study estimates a higher total per capita income, \$88 million for 1988, the first year the track was to operate under the McGladrey report. Thus, the total per capita income figures for McGladrey are almost \$18 million higher (McGladrey 1986, 9).

In calculating the per capita wagering percentage, Killingsworth utilizes California, Florida, Illinois, Kentucky, Louisiana, Nebraska, New Mexico and New York. McGladrey uses Illinois, Nebraska, New Mexico, Ohio and Washington to figure its per capita average wager. They give special weight to the state of Nebraska, because of its similarity to the state of Iowa (McGladrey 1986, 2-17).

As is easily seen in Figure 5.3, the states used to derive an estimated per capita wager for Iowa were far above the actual per capita wager in Iowa. Three of the states utilized, New York, Louisiana and Florida, are nearly double that of Iowa's per capita daily wager. Clearly, the states utilized to determine the per capita wager have a much greater potential for racing and are not reflective of a race track in Iowa.

An example of how skewed the data which was utilized is highlighted by examining the average per capita wager of the states used in both reports. As Figure 5.3 illustrates, the per capita wager, excluding Iowa, is \$129.9. This is in stark contrast to Iowa, who's actual per capita wager in 1990 was only \$81.

There was only one state that was used by both Killingsworth and McGladrey studies that had a lower per capita wager than Iowa, that being Nebraska. It is easy to see that the states used to derive the estimated per capita

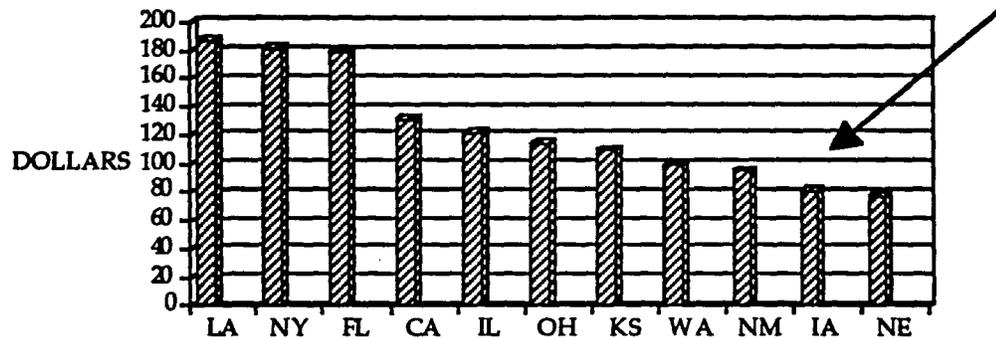


Figure 5.3 1990 Per Capita Daily Wager of States Used in Studies for Iowa's Per Capita Daily Wager
 Source: A Statistical Summary Prepared by Association of Racing Commissioners International, Inc. 1990, 10.

wager for Iowa are far above its racing potential. In reality, the states utilized were taken from the high end of the scale.

The results from these studies may have been strikingly different if different states' per capita daily wagers were utilized to arrive at an estimated Iowa figure.

An example of the stark differences between states taken from the low end of the scale versus the high end of the scale is found in Figure 5.4. In the case of states taken from the low end of the scale, the average per capita wager, excluding Iowa, is only \$70.

For fan spending and the per capita wager the states that were chosen by both Killingsworth and McGladrey were on the high or middle part of the range. It is curious that both studies used states from the high end or middle part of the scale. The net result of this action was to drive up the average projected

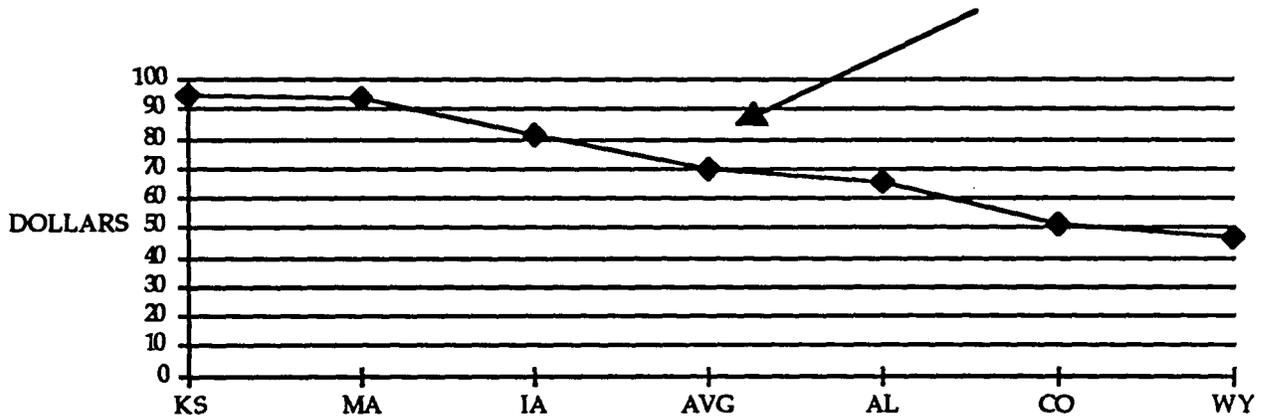


Figure 5.4 Selected States Per Capita Wager

Source: A Statistical Summary Prepared by Association of Racing Commissioners International, Inc. 1990, 10.

per capita wager.

When evaluating studies of this nature, it is important to make sure that the states being used to arrive at the average are actually representative of all pari-mutuel states and not a select few. Public managers need to ask tough questions about whether the sample is representative of all racing states. \

The second problem that the comparative analysis presents is the two different sets of states utilized. A specific set states were utilized to calculate the per capita wager percentage and then a different set for the fan spending percentage. If the first group of states matched Iowa, because of their socio-economic similarity to Iowa, then why not utilize the same set for the calculation of per capita wager?

What McGladrey and Killingsworth attempt to do is create a model of the track's financial picture based on attendance and wagering. However, the problem in this case is that the data calculated to create the model is not reflective of the project. As is pointed out by Bowen, Krosnick and Weisberg, the sample needs to correspond as closely as possible with the whole model (Bowen, Krosnick, and Weisberg 1989, 23-60).

Market Areas

The McGladrey and Killingsworth studies establish nine market areas for Prairie Meadows. They are the primary area around the track, secondary ring, Waterloo, southeast Iowa, Northeast Iowa, third ring, Sioux City, Omaha and Kansas City.

The early Killingsworth study reports discounts for a number of these market areas. The discounts try to take into account the availability of other pari-mutuel racing facilities that are available for patrons in these market areas.

The Waterloo market area is given an additional discount from the Killingsworth study because McGladrey was aware of the opening of a dog track in Waterloo. In spite of the additional discount, McGladrey still projects almost 19,000 patrons coming from Waterloo to Prairie Meadows. This figure is only 6,000 patrons less than the original Killingsworth study. (McGladrey 1986, 7-15).

McGladrey also assumes that Waterloo per capita wager for Prairie Meadows will only drop by 4%. A track in Waterloo would have devastating effects for Prairie Meadows. This is because a pari-mutuel facility would be readily available in their community. It is true a percentage of the patrons will continue to come to Des Moines. However, the drop in projected attendance should be more than 6,000. The McGladrey report gives no reasons as to "why" it

expects a major portion of Waterloo's patrons continue to attend Prairie Meadows (McGladrey 1986, 7-15).

The opening of the Waterloo facility should also have negative effects for other market areas. Possible patrons from Cedar Rapids and Iowa City, the secondary market for Prairie Meadows, are only minutes away from the Waterloo track, via Interstate 380. Yet, no additional discount is given to the secondary market areas of Prairie Meadows. Further, the Waterloo dog track is only an hour and half from Des Moines, and in all probability would have a negative affect on the primary market area around Des Moines. The original Killingsworth study states a dog track in Waterloo may have substantial effects for Des Moines (Killingsworth 1985, 10 and McGladrey 1986, 15).

Fan spending for the Omaha, Council Bluffs area is only discounted by 20 percent. Fan spending for all market areas is calculated from the original fan spending average. At this point, the fan spending is discounted for distance from Prairie Meadows and the urban/rural mix of the market area. A second discount is given based on the availability of pari-mutuel gambling to patrons within that particular market area.

On the surface a 20 percent discount makes sense. However, the Omaha, Council Bluffs area has six pari-mutuel facilities in close proximity. There are horse tracks in South Sioux City, Nebraska; Lincoln, Nebraska; Kansas City; Omaha; and the dog track in Council Bluffs and North Sioux City, South Dakota. McGladrey does not offer the reader any documentation as to how they determine what type of discount is in order for each market area. The McGladrey report does state why an area is given a discount, but it does not show the reader how a 20 percent discount is calculated.

A further problem is that the McGladrey report does not give an additional discount to the Omaha, Council Bluffs market area because of the opening of a track in Kansas City. This is highly suspect because patrons have easy access to Kansas City on Interstate 29 (McGladrey 1986, 7-9).

This same problem is found in the market areas along the Iowa, Missouri border. The report fails to give any additional discount to this area because of the opening of the Kansas City track. This is questionable because for many of these patrons, Kansas City is as close as Des Moines. Further, Kansas City is a larger city offering a variety of services and entertainment, thus having a stronger pull than Des Moines (McGladrey 1986, 9).

The southeast Iowa market and the Quad Cities area also are in question. Both studies fail to consider two major horse tracks in Chicago and a harness racing facility in the Quad Cities, on the western edge of Illinois. For citizens in this area, Chicago is nearly as close as Des Moines, and once again Chicago has a stronger retail and entertainment mix than does Des Moines. Thus, some discount is in order for the southeast Iowa market area.

The failure in both studies in the area of attendance is that they continually assume that customers outside of the Des Moines market area and secondary markets have a need and are willing to come to Des Moines to view horse racing merely because it is in the same state.

In sum, customers in these market areas may not be attracted to Des Moines. They may go to another track that is of equal distance from their residence or has a variety of entertainment choices. Citizens care little that they are patronizing a different state's facility. They look at the product, its quality, price and availability, they do not know borders. This is seen in today's society

when citizens cross state borders to purchase firecrackers, alcohol and cigarettes that are not legally available or are highly taxed in their home state.

Evaluators of these studies need to take into consideration what else is occurring in the surrounding areas, such as is the product readily available at another market location? One should not think that people from Iowa are attracted to a track in Altoona merely because they are citizens of Iowa. There are a multitude of reasons patrons attend one race track over another, similar to a restaurant or department store. These reasons include quality of horses and size of the betting handle. However, when establishing market areas, other matters such as personnel satisfaction, amenities of facility, size of the city, travel time and cost, all need to be taken into consideration (Shaffer 1989, 150).

Other Factors

The next step in the McGladrey study is a discussion of other factors and their possible impact. McGladrey speaks about the availability of horses in the Midwest for racing. They do conclude that enough horses exist for the racing meet, as long as Prairie Meadows is able to offer comparable purses with other tracks.

It also addresses Iowa's regulations regarding medication of horses, regulations which are stricter than most other states. It concludes that these rules may have a negative effect on the availability of quality horses.

This is important because quality horses usually means higher attendance and a higher betting handle. Killingsworth, however does not address any problems about the availability of horses as a result Iowa's medication rules or the size of Prairie Meadows' purses (McGladrey 1986, section II 1-2).

Cash Flow

Each study shows projected cash flow statements which estimate revenues and expenses. The major difference comes in the earlier Killingsworth study, which shows occasional negative cash flows (Killingsworth 1985, section 2, 45). McGladrey does not project negative cash flows. Its projected profits range from \$937,052 to \$14,447,876 (McGladrey 1986, section III, 1-4).

There are several reasons for this difference. As a result of the higher per capita wager, McGladrey estimates higher revenues from the betting handle. Killingsworth estimates \$3.9 million from the betting handle. In contrast, McGladrey shows revenues from the handle at \$9.8 million. There is a \$6 million difference between the two revenue estimates, which is related to the higher per capita wager.

Another significant difference is that McGladrey shows a higher debt service credit; this is the result of the higher betting handle. The debt service credit is 5 percent of the total handle and is retained by the track for payment toward the bonds. Thus, the higher the total per capita bet, the higher the debt service credit. The debt service credit is the amount returned to the track to make bond payments.

The track gets a significant portion of its revenues from the betting handle. In both cases, a significant portion of the track's revenues come from the betting handle. The result is that the track is extremely sensitive to changes in attendance and the betting handle.

A second difference between the two financial statements is that McGladrey shows a number of "other" revenues that Killingsworth does not include. McGladrey estimates \$45,000 from "special events" held at the track.

There is little discussion about what these are; the study only states that these revenues are from events held on an annual basis during the off-season (McGladrey 1986, section III, 1, 7).

The other revenue that appears in the McGladrey study that does not appear in the Killingsworth study is advertising revenue. Estimated at \$104,000, these funds are to come from ads placed in the track's programs and other events associated with the track. (McGladrey 1986, section III, 1, 7).

The expenses for each study are similar and no significant differences are found except one: the way each study handles depreciation within their cash flow statements.

Killingsworth shows a depreciation expense based on \$38.9 million in depreciable assets, the majority of this being buildings and other structures, based on an 18-year depreciation. The remainder, \$6.9 million in equipment, is based on a five-year depreciation (Killingsworth 1985, Summary of Significant Assumptions, 51).

In contrast, McGladrey shows depreciation expenses that are significantly lower than Killingsworth. They do state that Prairie Meadow's assets are approximately \$39.68 million in buildings and equipment. However, McGladrey only considers equipment in its depreciation schedule (McGladrey 1986, section III, 1-2, 10).

However, when we simply look at the depreciation expenses which Killingsworth lists as "equipment," there is still a sizable difference between the two projections. The Killingsworth report shows a depreciation expense for equipment between \$.4 million in the first year to \$1.9 million in the last year. This is in contrast to the McGladrey report that only shows depreciation expenses

for equipment at \$.104 million in the first year and \$.375 million in the final year (McGladrey 1986, section III, 1-2 and Killingsworth 1985, 36-40).

This large contrast in the two reports' depreciation expense is highlighted in Figure 5.5. The largest bar of the three in Figure 5.5 shows Killingsworth's depreciation expenses for the first eight years of operation. This figure includes equipment and buildings. Their estimates range from \$1 million to \$3.9 million. The second largest bar is Killingsworth's depreciation expense, strictly for equipment.

The final bar shows McGladrey's total depreciation expense from its cash flow statements. As we can see from Figure 5.5, McGladrey's depreciation expenses are significantly less than the Killingsworth report. This is also the case when we only consider depreciation from equipment. The reason can only be that McGladrey fails to depreciate the track and other buildings on the grounds and also a portion of the facilities equipment. Obviously, this permits McGladrey to show positive net cash flows instead of only marginal or negative flows.

Significant Assumptions

A "summary of significant assumptions" is the next section of both reports. This section is divided into several sections: racing statistics, which include per capita handle and total attendance, revenues, expenses, debt financing and assets.

There are two major differences of interest. First, Killingsworth estimates a working capital of \$1.5 million for the track, while McGladrey only estimates \$1 million. This is not a large difference, but it is interesting that McGladrey does not address the reason for this difference. A manager reviewing this report would want to ask the reason for the lower working capital and its affects for the

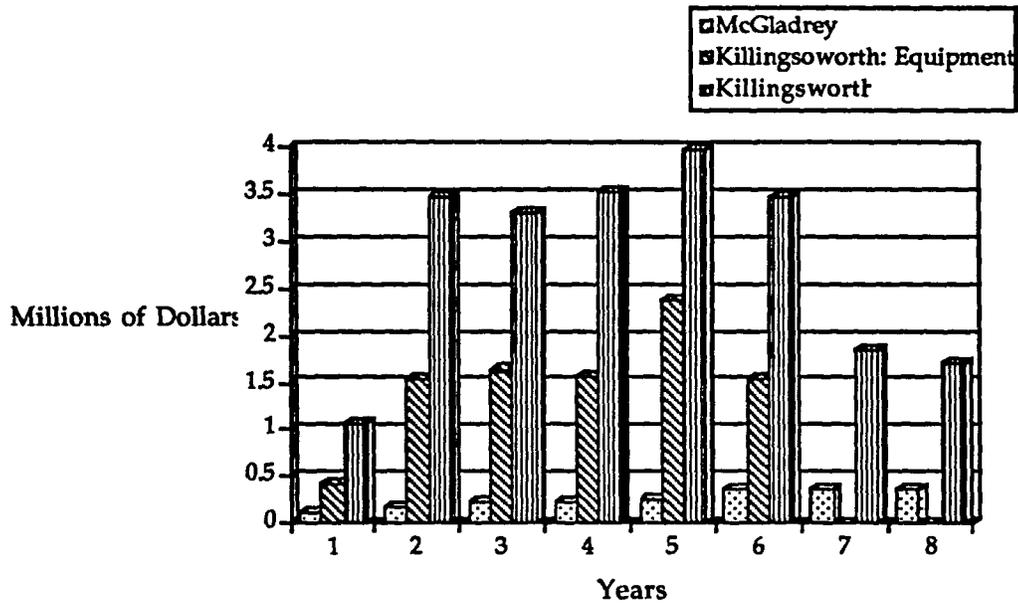


Figure 5.5 Comparison of Depreciation Expenses
 Source: Killingsworth 1985, 36-38 and McGladrey 1986, section III, 1-2.

track (Killingsworth 1985, 51 and McGladrey 1986, section IV 10).

A second difference is that Killingsworth estimates an interest rate of 6 percent on the \$40 million in bonds, while McGladrey estimates a bond rate of 7.5 percent. This represents a difference in the financial markets at the time each review was completed.

The last section of each study presents what it is entitled a "sensitivity analysis" of the projections. A sensitivity analysis is a recalculation of the projections taking into account problems that may arise or were not considered in the final projections.

Killingsworth only presents one sensitivity analysis; it examines the projected cash flows as a result of a 10 percent drop in attendance. McGladrey presents the same scenario to the reader. The effects of a 10 percent drop in attendance is devastating to profit projections for the track (Table 5.3).

The McGladrey study shows that with a 10 percent drop in attendance, the track may well run deficits four out of the next five years. The Killingsworth report offers a similar scenario with the track running deficits for all of the five years (McGladrey 1986, section IV, 10 and Killingsworth 1985, 51).

Table 5.3 McGladrey Sensitivity Analysis of Attendance

	1988	1989	1990	1991	1992
Cash Flow Projections	\$937,052	\$1,386,041	\$943,598	\$1,068,178	\$1,208,378
Cash Flow with 10% drop in Attend.	(\$321,294)	\$370,152	(\$184,980)	(\$42,836)	(\$22,666)
Percent decrease	(134%)	(73%)	(120%)	(104%)	(102%)

Source: McGladrey, Hendrickson & Pullen 1986, section IV, 10 and Killingsworth 1985, 51.

This shows us that the track revenues are very sensitive to changes in attendance because the betting handle makes up such a significant portion of the total revenues. A second sensitivity analysis in the McGladrey study examines a drop in the per capita wagering. The track's projected profits decreased by 50 to 98 percent (McGladrey 1986, section IV, 3).

The third "sensitivity analysis" in the McGladrey study presents a scenario based on a drop in the betting handle of 10 percent and a 10 percent drop in attendance. The McGladrey study cites a number of potential reasons for this change: smaller than expected population growth for the market areas, Prairie Meadows not attracting the average pari-mutuel wager, changes in the amount of income spent on wagering by the general public, the effectiveness of track management and any other changes in competition (McGladrey 1986, 4).

This analysis offers the most frightening scenario. The track shows total deficits exceeding \$1 million in four of five years. The study shows a deficit of \$1.16 million in the first year, \$647,691 in the second, \$1.3 million in the third, \$1.28 million in the fourth and \$1.27 million in the fifth (McGladrey 1986, 4).

McGladrey also performs a sensitivity analysis on the interest rates the county may have to pay on the bonds. This McGladrey study assumes a 7.5 percent interest rate for the bonds. Here the "sensitivity analysis" calculates a 1 percent increase in the interest rate for the bonds. The study finds that a 1 percent increase in the interest rate of the bonds would not result in negative profits. However, it did show that profits would be cut as a result of the increased interest rates (McGladrey 1986, section IV, 5).

As was discussed earlier, the bonds for the track were sold at 8.25 percent. Though this is not the 1 percent that is discussed in the analysis, it is still .75 percent higher than the assumed 7.5 percent in the McGladrey feasibility study. This may have further stressed the cash flow for Prairie Meadows.

CHAPTER 6

ANALYSIS OF ECONOMIC DEVELOPMENT REPORTS DONE IN ASSOCIATION WITH PRAIRIE MEADOWS

As we saw earlier, the economic impact studies that were completed in association with Prairie Meadows assisted in securing public support for the horse track. In short, they were an integral part in the process.

This was also the case in the city of Detroit, where advocates of casino gambling used economic development studies to promote gambling as a revenue generator for the city and state and, most importantly to bring new jobs to the city (Rich 1990, 283).

An economic development and feasibility study was done for the city of Denver in 1985, that helped to garner support for the building of a second airport. The study over-estimated the economic development impact of the airport and minimized the long term costs to Denver (Des Moines Register 1993, 8s).

As a result, it is important to examine the differences and similarities between the two economic studies that are available on Prairie Meadows, so that future economic impact studies that are done on large scale economic development projects can be more effectively evaluated.

There were a total of three economic development impact studies done in conjunction with a horse track in central Iowa. An economic development study was completed by Grandquist when he was involved with the plan to build a horse track.

As was stated earlier, the Grandquist study estimated an impact of \$200

million annually and 2,200 jobs created within the state. This study was unavailable to the author and is not used to make any comparisons.

The second study was done with the information and assumptions within the McGladrey feasibility study. It was completed by Peat, Marwick, Mitchell & Co. on September 25, 1986, before the track was opened. Peat, Marwick estimated the total employment from the construction of the track and other operations at 1,457 full-time equivalent jobs. The total economic impact for the state and the county was projected at \$92 million, excluding the construction.

The final and most recent economic impact study was completed September 3, 1991, by Arthur Andersen & Co. At that time, the track had been operating approximately three years. The report was done at the request of the Polk County Board of Supervisors and the Des Moines Development Corporation to examine the "economic contributions" of the race track for Iowa and Polk County. Arthur Andersen projected the total full-time equivalent jobs at 697 and a total economic contribution at \$36.8 million.

The two reports are similar in their format and methodology. The studies differ in some of their final results and assumptions. The most striking similarity is that both reports fail to show reader how important calculations were done, and many times when ratios and estimates are utilized, there is no source cited.

A second difference is that Peat, Marwick tries to put a number on the indirect impact of the study and Arthur Andersen restricts itself to the direct impact.

Arthur Andersen divides its report into four areas, Figure 6.1. They are track operations, horse breeding, the horse industry and tourism. In a similar

fashion, Peat, Marwick divides its report into the areas of track operations, horse breeding industry, horsemen, tourism and construction. The areas of "horsemen" and "horse industry" are effectively the same. The dollar amounts that each report applies to the areas are similar. In Figure 6.1, it shows easily that both reports come close in their final numbers.

As we can see the tourism in both studies is very similar, Arthur Andersen estimates tourism at \$5.2 million and Peat, Marwick estimates \$5.5 million. Track operations is where the studies begin to differ, with Arthur Andersen showing \$9.4 million and Peat, Marwick \$11.4 million. The area of horse industry also differs with Peat, Marwick calculating \$15.5 million and Arthur Anderson at \$9.6 million. The last area constitutes the biggest difference, with Arthur Andersen calculating \$16.9 million and Peat Marwick \$13.7 million (Arthur, Andersen 1991, 2 and Peat, Marwick 1986, I-5).

The one area that Peat, Marwick includes that is not included by Arthur Andersen is the initial construction of Prairie Meadows. This is as a result of Arthur Andersen's report being done after the track was built.

Although the construction is treated separately from the other four areas of the report and not included in their final figures, Peat, Marwick does include a section of the economic impact of the construction. They estimate that 788 full-time equivalent (FTE) jobs were created by the construction. The direct financial impact within the state was calculated at \$35.8 million. This figure includes salaries, purchases of equipment, supplies and land, and finally, sales tax for these purchases (Peat, Marwick 1986, I-5).Track Operations

The first area of comparison for both reports is track operations. The one difference that is readily apparent is the number of estimated jobs: Peat, Marwick

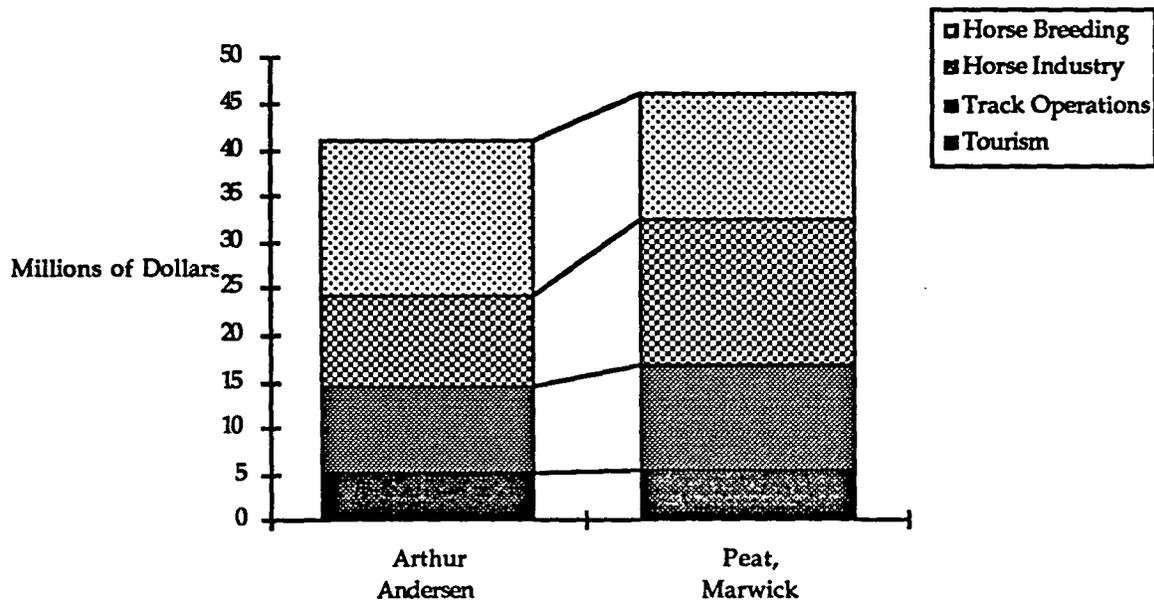


Figure 6.1 Economic Development Impact Studies: Arthur Andersen versus Peat Marwick

Source: Arthur, Andersen 1991, 1 and Pear, Marwick 1986, I-5

estimated 274 FTE, while Arthur Andersen estimated 235 FTE (Peat, Marwick 1986, 2 and Arthur Andersen 1991, 2).

Peat, Marwick clearly shows the reader how their numbers are derived and in what area of the track these employees are working, while Arthur Andersen only tells the reader the number. This difference is not addressed, but it can be reasonably assumed that it is the result of the difference in attendance and betting handle. The result of the lower betting handle and attendance meant the number of people employed at the track is smaller than the projected numbers.

Payments for goods and services to other business by the track are also calculated, with Peat, Marwick at \$2 million higher than Arthur Andersen. This difference is most likely accounted for by using estimated betting handle and

attendance figures.

However, neither of the reports address how the numbers were concluded. They do discuss the types of goods and services the track purchases. However, they do not show how their final estimates are derived. There are no formulas or estimates, only the final dollar amounts (Peat Marwick 1986, II-4, Arthur Andersen 1991, 22).

The two studies are clear about how the amount of taxes and fees are calculated. Arthur Andersen uses admissions tax on patrons, state sales tax, income and unemployment insurance taxes, state licensees and uncashed winning tickets. In contrast, Peat Marwick does not use unemployment insurance and income taxes in its report. Thus, Arthur Andersen figures for taxes and fees are double that of Peat, Marwick (Peat Marwick 1986, II-4, Arthur Andersen 1991, 22).

This difference is accounted for by taking into consideration that Peat, Marwick most likely counted these type of effects as indirect rather than direct effects.

HORSE BREEDING

The next section of both reports is the economic impact of the horse breeding industry to Iowa. Both reports try to estimate the number of race horses in Iowa. The Peat, Marwick study, which was done before the track opened, uses numbers from Minnesota before its horse track opened and after. The report also uses information from the Iowa Thoroughbred Breeders and Owners Association, the Iowa Department of Agriculture and "industry experts." Its final figure is 3,360 horses in the state (Peat, Marwick 1986, III-2, III-3).

The problem once again is that Peat, Marwick does not tell the reader how

this number is calculated. The report only states the final figure and the sources that were utilized.

The Arthur Andersen report uses actual numbers from the Iowa Thoroughbred and Standardbred Owners and Breeders Association. This accounts for its lower number of 2,820 horses in the state (Arthur Andersen, 1991, 30).

The second difference in this section is the number of jobs created. Arthur Andersen believes it takes one person to feed, exercise and groom 10 horses. Thus, the number of jobs created is 282 FTE for the state. Arthur Andersen then discounts this number to 240 FTE, because not all breeding activity can be attributed to Prairie Meadows. Surprisingly, the same ratio of 10 to 1 is used by Peat, Marwick (Peat, Marwick 1986, III-3).

This figure is supplied by the Iowa Thoroughbred Breeders and Owners Association and is taken for granted by both reports. In neither case do they address the number 10 to 1, and why the number is not higher or lower.

This calculation is suspect because the number is supplied by an organization that may directly benefit by the use of a higher number. A more reliable ratio may have been used by surveying the breeders in Iowa. Both breeders and the breeders association have similar interests. However, by surveying the breeders we may gain a more accurate picture of what the facts are and not what the breeders association believes to be the truth.

Another difference in this section is the amount of purchases accounted for by the breeding industry each report uses. Peat, Marwick estimates only \$13.7 million to cover feeding, bedding and the general maintenance of breeding horses. A much higher number of \$16.9 million is arrived at by the Arthur

Andersen study. The reason for the difference is \$4 million for purchases of "new capital." This includes new investments in equipment, fencing and barns for breeding horses (Arthur Andersen 1991, 29).

The capital expenses are justified, to a degree. Many investors getting involved in horse breeding for the first time would incur a significant amount of start-up costs. Yet, many people in the state may have already been involved in horse breeding due to the availability of horse racing in Illinois and Nebraska. Thus, those people would have little or no new capital expenses; as a result, some type of discount is in order.

Horse Racing Industry

The third section of both reports is the economic impact of the horse racing industry. That is the economic impact that trainers, veterinarians, jockeys and other staff who take care of the horses at the race track have on the area.

A major difference between the two reports is the number of jobs they project to be created. Arthur Andersen estimates only 167 FTE jobs, while Peat, Marwick arrives at 650 FTE jobs. Arthur Andersen does tell the reader how its FTE was arrived at and gives the reader the ratio they use to figure jobs. Arthur Andersen also cites that its information is from a survey of horse owners and trainers (Peat, Marwick 1986, IV-3 and Arthur Andersen 1991, 34).

The reason Peat, Marwick's report gives a higher employment number is because the ratio used is much higher. The ratio used is from the Iowa Thoroughbred and Breeders Association. Also the Peat, Marwick numbers count employment from race horses after they end of the race season. For example, once the race season is over, horses are moved to farms until the next racing season (Peat Marwick 1986, IV-3 and Arthur Andersen 1991, 34).

Peat, Marwick takes into account the jobs as a result of race horses that stay in Iowa awaiting the next season. The problem with this is that some horses may move to a track out of state and continue to race. A second problem is that not all horses that race at Prairie Meadows would stay in Iowa after the racing season, because not all horses at the track are from Iowa and may leave the state to await the next racing season.

Another problem with this section concerns salaries and wages. Arthur Andersen does not clearly tell the reader how wages and salaries are totaled. The reader does not know the assumptions that are the basis for arriving at the final numbers.

For instance, how much are these workers expected to earn in a year? Peat, Marwick does tell the reader approximately how they calculate salaries and wages, but they are not clear as to how wages for employees off-track are figured.

The other area of difference in this section concerns purchases of goods and services by horsemen. There is very little discussion in either report about the final numbers; in neither case do the reports cite surveys of horsemen or figures supplied by the Iowa Thoroughbred and Breeders Association.

Thus, it is difficult to find out why the Peat, Marwick report is \$2.5 million higher than Arthur Andersen. The one difference that is apparent is that Peat, Marwick does not include expenditures on lodging, meals and drinks by horsemen, while Arthur Andersen includes an estimate for this type of activity (Peat, Marwick 1986, IV-1-4 and Arthur Andersen 1991, 33-37).

Tourism

The fourth and final part of each report is the economic benefits from tourism that the horse track would generate for the state's economy. Again, the

reports are amazingly similar in their outcomes. This seems unusual when we recall that Peat, Marwick used estimated attendance figures that were much higher than the actual numbers. In contrast, Arthur Andersen has the benefit of being able to use actual attendance numbers.

The first major difference in this section is that Peat, Marwick believes that 197 FTE jobs would be created as a result of the race track and tourism. They use numbers supplied by an Iowa legislature committee on tourism that uses a sales-per-employee ratio to estimate FTE jobs. However, they do not inform the reader of sales-per-employee ratio or how they estimate the number of visitors coming to the track will spend in retail establishments (Peat, Marwick 1986, V-5, V-7).

In contrast to Peat, Marwick, Arthur Andersen estimates 55 FTE jobs from tourism. Arthur Andersen's ratio is from the Iowa Department Economic Development and is also a sales-per-employee ratio, but it is provided to the reader with little explanation. As in the Peat, Marwick study, the reader does not know how Arthur Andersen calculated the number of visitors from each area and the amount they would spend at retail businesses (Arthur Andersen 1991, 40-47).

The two studies are also comparable in the economic impact from transportation to and from the track. They only differ by \$.5 million. The estimates of the number of patrons coming to Prairie Meadows from outside of the Des Moines market are fairly close. Arthur Andersen is slightly higher at 60,000 patrons a year, while Peat, Marwick's is only 51,000 (Peat, Marwick 1986, V-2 and Arthur Andersen 1991, 40).

The difference is slight, but this is most likely because Arthur Andersen

uses survey results from Prairie Meadows, while Peat, Marwick uses estimated attendance figures from the McGladrey feasibility report.

The area of lodging has two interesting differences. First, both studies use estimated lodging costs per day, \$33 for Arthur Andersen and \$59 in Peat, Marwick. The numbers are used from economic development studies done in Iowa and Nebraska (Peat, Marwick 1986, V-3 and Arthur Andersen 1991, 43-44).

A second difference is found in that Arthur Andersen expects almost all patrons outside the central Iowa area to stay in hotels. Peat, Marwick takes a different approach and discount patrons attending from areas closer to Prairie Meadows. This is a reasonable way to approach this problem. It is clear that patrons living closer to the track are less likely to stay in a hotel while at Prairie Meadows.

Both reports approach the section on restaurants in the same fashion. In both cases, the reports cite the amount a party would spend on food and drink. Peat, Marwick does use a higher number of \$20 per person, while Arthur Andersen only figures \$10 per person (Peat, Marwick 1986, V-4, Arthur Andersen 1991, 44).

The problem here is that Arthur Andersen does not show how its final number was derived as; they only state that "considering the origin of the patron, the average party size and the likelihood that the racetrack is the primary destination" they estimate the effect. It would assist the reader to actually see how this was done, as in the Peat, Marwick report.

The same problem exists in retail expenditures for Arthur Andersen. Peat, Marwick lets the reader see how its numbers were derived, this adds to the validity of the data.

Conclusion

The two economic development impact reports are similar in the fashion in which the reports are divided for the reader. They are also the same because both reports neglect to state from where particular figures came, as was pointed out in the examples. A further problem exists because both reports fail to show how particular ratios or formulas were utilized and derived. The Peat, Marwick study does do a better job of this, but is still lacking.

A major difference between the two reports is that Arthur Andersen, in all sections, estimates the percentage of economic impact that belongs to Polk County. This is not done in the Peat, Marwick study. A second major difference is that Peat, Marwick tries to estimate the indirect economic impact from the track in the form of a multiplier.

The multiplier is an attempt to estimate the indirect impact of Prairie Meadows instead of only the direct impact. An example of how the track may have an indirect impact on the Iowa economy is easily created.

A local hotel may have higher residence rates with the opening of the hotel. As a result, it may have to hire more staff than it normally would have in the past. Thus, the money from patrons going to the track enters the central Iowa economy and is "multiplied."

The multiplier Peat, Marwick uses is 1.0. Thus, the total indirect and direct economic impact of the track is \$92.0 million. This includes salaries and wages, payments to other business, payments to governments from racetrack operations, horse breeders, horsemen and tourism (Peat, Marwick 1986, 2-3).

The 1.0 multiplier leads to a number of questions. For instance, how did Peat, Marwick arrive at 1.0? The study quotes no source for its figure or any

research on a 1.0 multiplier. Thus, we cannot recreate the studies findings.

Another oversight is the report fails to give the reader any discussion of multipliers and how they work in the local economy. There is no discussion of important variables that affect multipliers. The size of the geographic region, population of the area and type of workers employed can all affect the size for the multiplier (Shaffer 1989, 243-244, 249).

Further, the multiplier effect does not occur immediately; it may take several years for the multiplier to actually make an effect in the local economy (Shaffer 1989, 245-249). The hotel owner in the above example may not hire a second maid immediately. He may wait to assure himself that the increases in business will continue. Further, the hotel may not be running at full capacity and be able to absorb an increase in business.

In sum, both reports have small similarities and differences in the manner that economic impact of the track is assessed. As was stated in the opening of this chapter, there are two striking similarities: continual neglect of citing sources and not clearly showing the reader how certain numbers were derived. As a result, any manager reviewing the report needs to examine the numbers with suspicion until substantive changes are made.

CHAPTER 7

CONCLUSIONS

Gambling has spread across the nation and Iowa at an amazing rate. State and local governments have fostered this growth through the legalization of various types of gambling. Their justification is nearly always economic development, be it new revenues for governmental treasuries or the creation of new jobs, as is the case with Prairie Meadows.

Prairie Meadows offers an excellent example of legalized gambling that was financed by local government. However, the track failed financially. The track was unable to meet operating expenses from its opening. Thus, Polk County not only had to make the annual bond payments, but also assists the track with operating. What have we learned from Prairie Meadows and local governments involvement in gambling enterprises?

In chapter 3, we find that Prairie Meadows was pushed through and financed under the guise of an economic development project for the state and Polk County. Business leaders and governmental officials felt the track would have a major economic impact. Because of the lack of any strong organized voice against the financing scheme for Prairie Meadows, local business leaders were successful in pushing through their agenda.

In light of the present circumstances business leaders would contest this assertion. However, the idea of a horse track in the Polk County area was continually pushed by the business community.

Business leaders were not at the forefront of the effort to build a track after Grandquist's efforts failed. Yet, they worked behind the scenes by paying for many of the studies. This helped to keep the idea in the public eye. Once the concept of a horse track was developed, the idea had a life of its own and it kept coming back under new leadership and new studies to justify building the facility.

Business leaders stood to gain from the building of a horse track in a number of ways. If Prairie Meadows was successful, it would mean more economic growth for Polk County. There would be more business for the hotels, restaurants and other entertainment attractions in the area. Thus, none of the local business leaders questioned the wisdom of Polk County financially backing the track through the lease-purchase agreement. Logan and Molotch point out that business leaders rarely question growth and often try to encourage more within a community, as we have found with Polk County (Logan and Molotch 1992, 431).

As a result of the county's financial involvement, and the fashion in which this was done, two lawsuits were filed against the county.

The first Stanfield v. Polk County raises several important issues. The Iowa Constitution strictly forbids state and local government from loaning their credit to a private entity. The majority in Stanfield v. Polk County felt the arrangement between RACI and Polk County was legal, since no challenges were made within the required fifteen day period. The lease-purchase agreement serves as indirect credit by pledging continued lease-purchase payments, upon the failure of the track financially.

The Iowa Supreme Court also ruled on the validity of the public notice

that Polk County published before entering into the lease purchase agreement. The public notice that was published did not need notify the public that the agreement was serving as credit support. This was because the lease-purchase agreement did state specifically that this was the intent of the lease-purchase agreement. Thus, it was not required to be mentioned in the public notice.

The reasons for this type of financing scheme is not clear. If the county would have directly guaranteed the bonds and directly owned the track, a public vote would have been required. The chance that a public vote would have passed was not good, given the general mood of the public toward bond issues across the country. Thus, the county was able to avoid a public vote by arranging a lease-purchase agreement with RACI and still financing the bonds.

Two feasibility studies were conducted by McGladrey Hendrickson & Pullen and Killingsworth. These studies were similar in many ways. The same basic methodology and formulas were used to calculate the total betting handle, per capita handle, and attendance for each market area of the track. These figures were arrived at by comparing other states' total betting handle, per capita handle and attendance, then calculating average figures for Prairie Meadows and its market areas. The averages for each market area are discounted to take into account distance from Prairie Meadows and at times also consider the availability of pari-mutuel betting for that market area.

The significant differences in the two reports is that McGladrey estimates a higher per capita wager and therefore a higher total betting handle, than Killingsworth.

McGladrey fails to discount fan spending percentages to take into account other pari-mutuel facilities and new gambling enterprises opening since the

Killingsworth study. The effect of new gambling enterprises on Prairie Meadow's market areas could only result in less money and potentially less patrons for the track.

A further reason why the McGladrey study showed positive cash flows is that they used higher total per capita incomes for their market areas than does Killingsworth. This has the effect of driving up the final per capita wager. As a result of these differences McGladrey is able to show positive cash flows in all projected years. Killingsworth, shows occasional negative cash flows in their report.

The manager reviewing this type of feasibility report needs to keep in mind a number of potential problems. A manager needs to consider what is happening outside of their state that may affect the final results. Polk County and the state of Iowa do not operate in a bubble. They are affected by the decisions of surrounding states concerning economic development, taxes and in this case gambling. When reviewing feasibility reports, one must consider the type of events that occur in surrounding states and the nation. In the example of Prairie Meadows, this was not done and the end result was building a track that can not meet expectations.

Second, when a comparative analysis is used, close attention needs to be paid to the regions or states that are being used to determine averages for the projected region. As Isserman and Merrifield point in their article on control regions and economic policy, it is important that states are as similar to projected regions as possible (Isserman and Merrifield 1982, 43-56). By taking states merely from the high end of the scale results are skewed or less than accurate. Further, each of the studies use two different groups of states to calculate the fan spending

percentage and per capita wager percentage. This leads the reader to wonder about the validity of the results.

Third, managers need to consider how realistic the estimates are within the report. The rise in total per capita income was estimated at \$18 million. Though these figures are estimates from a Department of Commerce survey, a question remains as to how "rosy" of a scenario were the per capita income projections in the McGladrey report.

Fourth, public managers may benefit by having experts at other horse racing tracks review the report and give their opinions about the feasibility of the track. A possible Delphi exercise would bring together experts from outside the community, in the field of horse racing, and business to discuss the reports and the horse track. This committee would discuss the feasibility report's findings and formulate their own (Morgan 1989, 110-112).

Fifth, the McGladrey and Killingsworth reports tries to present a model or simulation of what the actual attendance and wagers will be in the future. Ethridge points out that when evaluating models, two questions need to be asked. What are the assumptions inherent in the model and are they appropriate for this project? Second, does the model over simplify to the point where there is a measurable distortion of the actual project or event (Ethridge 1990, 223, 224).

Sixth, failure to sell bonds in the market place should send a signal to the public sector, such as the Polk County Board of Supervisors. That signal is that a horse track is not a viable operation.

Finally, public managers should read the report closely and seriously consider the downside projections and derive a plan of attack. The feasibility

studies that were completed in association with Prairie Meadows show a multitude of possible financial difficulties. These financial difficulties may occur because of a 10 percent drop in attendance or per capita wager, or higher interest rates on the bonds.

The Killingsworth feasibility study states that if there is a 10 percent drop in attendance, the lease purchase payments are effectively reversed. Thus, the body who is controlling the track would have to subsidize any negative cash flows (Killingsworth 1985, 55-56).

In the case of the Killingsworth study the controlling body was Central Iowa Sports Facility Limited Partnership, which was the organization put together by Grandquist. An interesting point to raise is that no discussion is made in the McGladrey study about the affect of negative cash flows and their end result.

It seems clear that a close reading of the report reveals the track was very "sensitive" to attendance and the betting handle. It is also clear that a 10 percent drop in attendance or the betting handle would surely mean negative cash flows and an increase in the interest rate for the bonds could only put further stress on Prairie Meadows.

Any manager reading this report, and viewing the results from merely a 10 percent change in attendance, betting handle and any number of other factors should discuss with his supervising body a course of action or a contingency plan. A contingency plan was informally discussed by the board of supervisors and county officers, but no plan of attack was agreed upon (Patterson, 1993)

This decision to push forward with a contingency plan may not be popular, but the project very well run a deficit, formal discussions on a plan of

action is instrumental. A contingency plan would not alleviate all of the headaches related to the horse track, but would give the county an alternative plan in place. County and city managers were the result of the reform movement which sought: elimination of corruption, greater efficiency and more democracy for citizens. In cases like Prairie Meadows it is important that they stick to these traditions (Morgan 1989, 44).

The list of possible options are numerous. The county may raise property taxes to supplement operating expenses, use a portion of the hotel motel taxes to supplement the track, use a one cent county sales taxes to assist the track, simulcast horse and dog races from other race tracks to boost appeal and finally request the state legislature for a broadening of the state's gambling laws, such as casino gambling or sports gambling.

The economic development reports that were done in conjunction with a race track in central Iowa were a vital part of receiving financial support from Polk County. However, both the reports are inconsistent.

In general, I believe both the reports lack credibility. This is because they consistently fail to show the attentive reader how particular calculations were made and how certain ratios were derived. The credibility of the reports would be more effective, if the reader could recreate the findings through data given in the reports. Presently, this is not possible.

The economic development reports do offer the reader an idea about the economic development impact of the horse track for Iowa and Polk County. However, the inconsistencies in both reports leave many questions.

The legalization of gambling and state-sponsorship of gambling will undoubtedly continue to grow across America. What role should state and local

governments have in the future of gambling?

Currently, the role of government is varied. In the case of lotteries, government is responsible for marketing, regulating, taxing and at the same time protecting the public from the social evils of gambling. Government's role in pari-mutuel wagering is similar.

Clotfelter and Cook (1989, 43-45) and Abt, Christiansen and Smith (1985, 155-158) tells us that the motivation of government in nearly all cases, where gambling is legalized is "revenue maximization." Governments are not motivated by protecting the public from fraudulent games, or social evils. Rather their intent is to increase revenues (Clotfelter and Cook 1989, 43-45 and Abt, Christiansen and Smith 1985, 155-158). This puts governments in an unique situation of claiming to protect the public's interest, while at the same time encouraging citizens to gamble by legalizing new games or assisting in the marketing of current games. As Stocker points out governments have a clear conflict of interest (Stocker 1972, 440-441).

As was stated in chapter 2, one way to avoid this clear conflict of interest is to privatize gambling. There are a variety of plans put forward by researchers. However, most agree that government's role should be limited to that of regulation. Thus, the private markets decide if an area has a casino or horse track, based on the ability to raise financial capital, and not the involvement of the legislature or local governments.

This alleviates the conflict of interest that currently exists. It would also solve the problem of reasonably assessing feasibility studies associated with gambling projects. Chapter 5 and 6, indicates that a close reading of the feasibility studies found that the track may have negative cash flows. Yet, the track was still

built and the county indirectly financed the bonds through the lease-purchase agreement.

The problem is that governments' motivations are often different than the private sector. In the case of Prairie Meadows, the county's motivation was to create jobs for the state's economy. This may not work as planned since gambling enterprises are very sensitive to legalization of gambling in surrounding states and areas (Seacord and Gulley 1989, 89-93).

Polk County officials failed to consider the continued expansion of gambling across the nation and they failed to effectively review the feasibility studies. This may have been attributed to the political pressure brought to bear on county officials by the general public and the business community. The failure to consider these problems came at a cost of \$40 million.

For this reason, I believe that state and local governments involvement in gambling projects should be limited to a regulatory role. If a horse track or casino is under consideration for a region, the private sector is the one that should finance, build and operate the facility.

The reason for this view is that the private sector primary goal is profit (Pack 1987, 290-292). The motivation of the private sector is profit and when the feasibility reports showed that the track may operate with negative cash flows, the track would not have been able to raise the financial capital.

A further reason for privatization of gambling projects is that the private sector can better operate a business than the public sector. As Clotfelter and Cook point out the administrative costs of lotteries are high. They estimate that the administrative cost would be lower if operated by the private sector (Clotfelter and Cook 1989, 238).

Prairie Meadows was nearly never built because the private sector was unable to raise the financial capital. Polk County stepped in and indirectly financed the bonds. However, the track never lived up to its financial expectations.

Clearly, Polk County was unable to effectively review these feasibility studies. This may have occurred due to political pressures. Because of these pressures and the conflict of interest between financing gambling projects, collecting revenues and protecting the public interest; I believe that state and local governments should not be involved in the direct or indirect financing of gambling project, or the operation, of any type of gambling projects.

State and local governments role in gambling should be that of regulation, making sure that games are operated in a fair and honest manner. Because of the private sector's role as a risk taker in exchange for profit they should be the ones that decide if a horse track is built in central Iowa. In the end, the private sector needs to be the one responsible for reviewing feasibility and economic development reports and for the \$40 million in bonds. Thus, if a venture is unable to meet financial expectations it is the risk takers or investors, who should become liable and not average citizens of the state.

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