

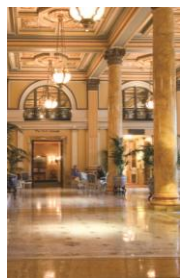
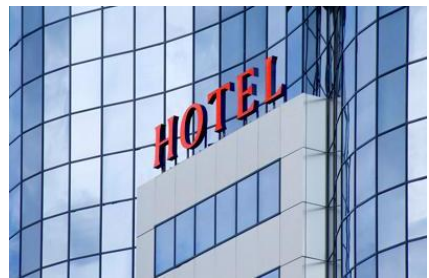


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# ATLANTIC CITY CASINO AND HOTEL MARKET OUTLOOK 2011

**Emily Sze**

*Senior Associate, HVS Las Vegas  
Gaming Division*



Some market pundits have written off Atlantic City, yet 2011 should be a dynamic year for New Jersey's gaming industry. Major changes in Atlantic City are occurring as casinos complete bankruptcy proceedings, regional competitors' table games operations ramp-up, the New Jersey government alters the legislative landscape for the state's gaming industry, and Atlantic City continues to diversify its dining, retail, and entertainment options.

Legislative modifications allow for new additions to New Jersey's casinos, and potentially revamp Atlantic City's marketing, security, and legal rules for operating casinos. These changes have the potential to reverse or moderate Atlantic City's four-year slump in gaming revenues. This article examines Atlantic City's 2010 market-wide gaming revenues, lodging statistics, new and proposed regional competition, and legislation.

## Gaming Demand

Gaming revenue has dropped 31% since its 2006 peak. In the last four years, gaming revenues have slumped but 2010's decline of 9.6% reflects an improvement from 2009's double-digit declines. The following table sets forth historical gaming revenue (win) for Atlantic City.

FIGURE 1 – TOTAL GAMING REVENUE

Year	Total Gaming Revenues	% Change
2004	\$4,806,800,604	—
2005	5,018,276,523	4.4 %
2006	5,217,713,795	4.0
2007	4,920,786,969	(5.7)
2008	4,544,960,791	(7.6)
2009	3,943,171,237	(13.2)
2010	3,565,047,001	(9.6)
Annual Average % Change - 2004 to 2010:		(4.9) %

Source: New Jersey Casino Control Commission

Increased regional competition contributed to Atlantic City's decline. Gaming revenue peaked in 2006, as the economy flourished and the Borgata sparked new interest in Atlantic City. Since 2006, gaming revenue has declined due to increased regional competition in neighboring states including Pennsylvania, New York, and, to a lesser extent, Maryland and Delaware. The year 2006 marked a turning point for Atlantic City's fortunes; the credit crisis and subsequent national recession drove gaming revenue declines in 2008, 2009, and 2010. Revenues in 2010 were further hampered by the opening of table games in Pennsylvania and Delaware. Nevertheless, gaming revenues declined 9.6% in 2010, an improvement over 2009's decline of 13.2%; this moderation of decline is attributed to a strengthening economy.

Table games revenue declined for the third consecutive year in 2010, but shows signs of moderation. The following table sets forth table games win, supply, and win-per-unit-per-day (WPUPD) figures for 2004 to 2010.

**FIGURE 2 – TABLE GAMES REVENUE AND WIN PER UNIT PER DAY (WPUPD)**

Year	Table Games Revenues*	% Change	Units	% Change	WPUPD	% Change
2004	\$1,193,323,068	—	1,197	—	\$2,725	—
2005	1,273,889,333	6.8 %	1,275	6.6 %	2,737	0.5 %
2006	1,334,185,797	4.7	1,322	3.7	2,765	1.0
2007	1,370,357,705	2.7	1,309	(0.9)	2,867	3.7
2008	1,329,693,295	(3.0)	1,299	(0.8)	2,797	(2.5)
2009	1,142,246,550	(14.1)	1,294	(0.4)	2,418	(13.5)
2010	1,020,238,442	(10.7)	1,283	(0.8)	2,178	(9.9)
<b>Average Annual %</b>						
<b>Change - 2004 to 2010:</b>		<b>(2.6) %</b>		<b>1.2 %</b>		<b>(3.7) %</b>

\*Table Games revenue is indicated without poker or keno figures

Source: New Jersey Casino Control Commission

In 2010 revenue fell to a level below that of 2004. Table games revenue declined 10.7% in 2010, indicating some improvement over 2009's decline. A weak national economy

and increased regional competition, particularly with the implementation of Pennsylvania and Delaware table games, suppressed Atlantic City's market-wide table games revenue. In conjunction with table games revenue trends, WPUPD also declined for three consecutive years.

Gaming device revenue declined for the fourth consecutive year, totaling a dramatic 24% drop since 2006. The following table sets forth gaming device revenues, supply, and WPUPD from 2004 to 2010.

**FIGURE 3 – GAMING DEVICE (SLOTS) REVENUE AND WIN PER UNIT PER DAY (WPUPD)**

Year	Gaming Device Revenues	% Change	Units	% Change	WPUPD	% Change
2004	\$3,556,515,052	—	41,948	—	\$232	—
2005	3,673,959,455	3.3 %	41,350	(1.4) %	243	5.1 %
2006	3,803,656,219	3.5	38,288	(7.4)	272	11.8
2007	3,464,470,777	(8.9)	35,931	(6.2)	264	(2.9)
2008	3,132,500,943	(9.6)	34,797	(3.2)	246	(6.9)
2009	2,721,774,076	(13.1)	31,535	(9.4)	236	(3.9)
2010	2,477,350,751	(9.0)	29,072	(7.8)	233	(1.3)
<b>Average Annual %</b>						
<b>Change - 2004 to 2010:</b>		<b>(5.8) %</b>		<b>(5.9) %</b>		<b>0.1 %</b>

Source: New Jersey Casino Control Commission

WPUPD for 2010 is marginally above the levels achieved in 2004. WPUPD has been declining but sustained relative to its 2004/2005 levels because of supply reduction. As operators have seen gaming device revenue shrink, they have reduced slot units in order to sustain WPUPD.

Slot WPUPD is calculated using an average annual count of slot units.

The decline in gaming revenues moderated in 2010, but the city's future is far from certain. Atlantic City's revenues are still recovering from the shock of the national recession, and the ramp-up of expanded regional competition. The year 2011 will be a dynamic one, and an indicator of whether or not Atlantic City can reverse its fortunes through legislative changes, new supply, and ownership changes.

## Lodging Demand

Historically, the Atlantic City lodging market attained occupancy levels consistently above 90% as operators filled rooms to generate gaming demand. The following table presents lodging trends for the Atlantic City market.

Overall, historical occupancy levels for the Atlantic City were strong; casino-hotels typically offer free room nights in order to generate casino play. Occupancy, average rate, and therefore RevPAR declined beginning

TABLE 4– ANALYSIS OF ATLANTIC CITY LODGING STATISTICS

Year	Occupancy	Average Rate	% Change	RevPAR	% Change
2000	92.7 %	\$81.15	---	\$75.23	---
2001	93.3	80.03	(1.4) %	74.65	(0.8) %
2002	94.6	79.87	(0.2)	75.53	1.2
2003	93.0	83.32	4.3	77.49	2.6
2004	90.6	91.41	9.7	82.84	6.9
2005	91.3	94.86	3.8	86.57	4.5
2006	91.7	98.77	4.1	90.55	4.6
2007	91.6	103.20	4.5	94.53	4.4
2008	87.4	97.49	(5.5)	85.18	(9.9)
2009	82.5	95.57	(2.0)	78.89	(7.4)
<b>Average Annual % Change - 2000 to 2009:</b>			<b>1.8 %</b>		<b>0.5 %</b>
Year-to-date Period thru September					
2009	82.2 %	\$96.04	---	\$78.93	---
2010	85.0	94.95	(1.1) %	80.71	2.3 %

Source: New Jersey Casino Control Commission

inventory is closed seasonally midweek. It is uncertain when this excess capacity will be absorbed and occupancy levels will return to the highs achieved in the early 2000s.

## Legislative Changes Ahead

New Jersey Governor Chris Christie has been adamant about Atlantic City's need to change if it is to survive. Governor Christie's key initiatives include creating a tourism district that will be run by the Casino Reinvestment Development Authority (CRDA), improving the safety and cleanliness of the Atlantic City tourism district, cooperating with private casinos to create a marketing plan, shifting power from the New Jersey Casino Control Commission to the Division of Gaming Enforcement, and turning the city into more of a destination market versus a daytrip market. On January 10, 2010, the legislature passed a bill creating a tourism district of Atlantic City and paved the way for Governor Christie's initiatives; the governor is

in 2008. However, occupancy has increased by 2.8 percentage points in the year-to-date period ending September 2010, and rate decline is moderating, indicating the beginnings of a recovery. In the same period, RevPAR grew a modest 2.3%.

In the near term, market occupancy is anticipated to recover. However, a large number of rooms were added late in the last decade including rooms at the Borgata WaterClub, Harrah's Waterfront, and Trump Taj Mahal Chairman tower and some

anticipated to sign it. Despite passage, obstacles remain; city residents and officials previously voiced opposition to the state plan, and implementation of these initiatives will be long-term.

One change already enacted, on January 6, 2011, involves a law allowing two newly built, smaller casino-hotels to be licensed in Atlantic City with only 200 rooms; previously, only casinos with 500+ rooms were allowed. Amid the recent economic recession and Atlantic City's rising competition, the necessary costs to build a 500+room casino-hotel in Atlantic City is well over one billion dollars; this is a significant barrier to entry considering banks' reluctance to lend to gaming companies in the current economic climate. These two licenses allow for two 200+ room casino-hotels, and are not earmarked for any specific project or operator. Of the two licenses, one license will be "staged": one 200+room casino-hotel may be opened on the condition it expands in five years. Hard Rock International in partnership with Och-Ziff is rumored to be interested in developing a 200+room casino-hotel; Och-Ziff already owns a large plot of Boardwalk land suitable for building said 200+ room casino-hotel.

## Regional Competition

In the last year, Atlantic City's gaming revenue and status has continued to decline due to increased competition from Pennsylvania, New York, Connecticut, Maryland, and Delaware. The following bullet points summarize changes to the gaming industry in each respective state.

- **Pennsylvania:** The operation of Pennsylvania's table games has continued to ramp up, and Pennsylvania is one of the few states with growing gaming revenues in 2010. The state now has 10 casinos up and running, out of the 14 original licenses. Table games were implemented in July 2010, further increasing the regional competition for slots and table games in the Northeast and Mid-Atlantic states. The revocation of Foxwoods Philadelphia's casino license in late 2010 has added uncertainty to Pennsylvania's gaming industry. Rumors abound that Caesar's Entertainment or another operator may pick up the license, or the license may be moved outside Philadelphia.
- **New York:** In the past year, several potential projects advanced. After almost a decade of delay, Genting broke ground on the Resorts World New York at the site of the Aqueduct Racetrack in Queens, a borough of New York City, in October 2010; a significant number of VLT (Video Lottery Terminals) are projected to be online within six months, with the entire facility completed in 18 months. Paving the way for a casino in the Hamptons or Long Island, the Shinnecock Indian Nation received federal recognition in October 2010.
- **New Jersey (outside of Atlantic City):** Harness racing at the Meadowlands was saved by a slim margin; the state will fund and keep the Meadowlands open until March 31, 2011, while a lease is negotiated to turn control of the track to a private investor. No plans for slots were announced; Governor Christie commented that slots were not politically viable at this point in time.
- **Delaware:** Table games at Delaware casinos opened in June 2010, adding to the regional competition in the Mid-Atlantic and Northeastern states.
- **Maryland:** The state's second casino opened in early January 2011; a third casino is under construction and two gaming licenses remain available without assigned operators.

New gaming supply, whether slots or table games, has continued to open in neighboring states and legislation paves the way for additional casinos to come. In particular, Pennsylvania's gaming revenue continues to grow with the state's table games in its infancy, several casinos unbuilt, and the industry

continuing to ramp-up. Time will tell if competing regional casinos will match Atlantic City's mix of gaming and non-gaming amenities, but it is clear that Atlantic City will continue to face formidable and increasing competition that will make it challenging to reverse the decline in gaming revenues.

## Sales and Valuation

Several major sales closed in 2010; these include the Resorts Atlantic City, Tropicana Atlantic City, and four ground lease parcels that are used in the Borgata's operations. The following bullet points summarize highlights from the respective sales.

- **Tropicana Atlantic City:** Closed in March 2010, the Tropicana Atlantic City was sold for \$200 million to its debtor, an investment group led by Carl Icahn. In December 2007, the Tropicana's owners were stripped of their casino license. The Tropicana was placed into a trust and put up for sale; the sale was hampered by a deteriorating economy and a series of bankruptcy appeals. In March 2009, a group of investors led by Carl Icahn bid \$200 million for the property. The sale closed in March 2010. According to SEC documents, 2009 EBITDA was \$24.695 million; the estimated EBITDA Multiple is 8.1. This sale was reportedly not an arm's-length transaction, as the price was struck in bankruptcy court.
- **Resorts Atlantic City:** Closed in December 2010, the Resorts Atlantic City was purchased by Dennis Gomes in partnership with real-estate developer Morris Bailey. The closing price was reported at \$31.5 million for the Resorts Atlantic City, which includes the property's Rendezvous hotel tower constructed in 2004 at a cost of \$125 million and its excess land. The Resorts Atlantic City's keys were taken back by the lender last year. Reports released by the New Jersey Casino Control Commission reveal that the property had a net loss from operations between 2008 and the third quarter of 2010; full-year 2010 statements were not available.
- **Borgata:** Closed in November 2010, MGM Resorts International sold four long-term ground leases and respective underlying real property parcels totaling roughly 11.3 acres to Vornado Realty Trust and Geysler Holdings for \$73 million. The sale is part of the settlement reached with New Jersey regulators, who deemed Pansy Ho, MGM Resorts International's Macau partner, unsuitable; MGM Resorts International opted to sell its 50% stake in the Borgata rather than cut ties with its partner in Macau. MGM Resorts International is obligated to sell its 50% stake in the Borgata, and the excess land originally intended for the proposed (but indefinitely suspended) MGM Grand Atlantic City in the Marina district.

Sales of casino-hotels, leases, or land are infrequent in Atlantic City; 2010 marked a dynamic year with multiple sales closed. When MGM Resorts International sells its 50% stake in the Borgata and its excess land in the Marina district, these sales will help establish a benchmark for both EBITDA multiples and land values in Atlantic City.

## Bankruptcies, Restructuring and Stalled Projects

Four Atlantic City casinos are in the midst of bankruptcy proceedings, although none of the bankrupt casinos have closed. Although speculative, it remains a possibility that gaming supply could exit this market with the closure of a bankrupt casino.

- **Atlantic City Hilton:** The Atlantic City Hilton has not paid its mortgage in over a year, and consistently ranks as one of the poorest-performing casinos in the Atlantic City market. Courtroom proceedings are underway as the lenders seek control of the property.
- **Three Trump Casinos (Trump Taj, Trump Plaza, and Trump Marina):** Under a new ownership structure, Marc Lasry of Capital Management in partnership with Donald Trump, took control of Trump Entertainment Resorts Inc., which includes the Trump Plaza, the Trump Marina, and the Trump Taj Mahal. The Trump Marina has been available for sale for approximately two years without any transaction completed.
- **Revel:** Financing continues to be sought to complete the Revel Atlantic City; Morgan Stanley wrote down the \$1.2 billion project to a fraction of its cost in April 2010, with the announcement that it intended to sell its stake. The Revel megaresort and casino was intended to have 1,900 rooms, 150,000 square feet of casino space, and additional convention, retail, and restaurant space.

As these entities emerge out of bankruptcy, definitive ownership changes are likely to occur; new owners are likely to invest more in the asset, and spur growth through capital investments. If the Revel is completed, it has the potential to attract incremental visitation or cannibalize the market. Reinvestment in aging infrastructure is likely to shift market share and may increase visitation, as few regional racinos and casinos can yet match the level of non-gaming amenities available in Atlantic City.

## Conclusion

The year 2011 should be a time of transformation for Atlantic City. An improving economy, business-friendly legislative changes and government policies, reinvestment in aging casino infrastructure, and ownership changes are anticipated to spur economic development directed at increasing visitation and revenues. These signs are positive in slowing Atlantic City's four-year slump, but may not be enough to revive Atlantic City.

Atlantic City is a risky investment: risks include declining revenues, increased regional competition, higher legislative risk compared to other states (MGM's partnership with Ms. Pansy Ho was questioned in New Jersey, but not in Nevada or other states where it operates), and a competitive local market with 11 competing casinos. But with the right asset, Atlantic City's rewards could outstrip its risks. At an investor presentation at the 2010's Global Gaming Expo, Boyd Gaming revealed that its 50% stake in the Borgata, yielded 32% of the company's net revenue, which was the equivalent of its six casinos in the Midwestern and Southern regions of the United States<sup>1</sup>. However, there is only one Borgata and even it has had to close its WaterClub hotel tower seasonally midweek .

Overall, Atlantic City's revenues are anticipated to continue to decline, albeit at a moderated pace, in the near term. In the long term, the city's new legislative policies, marketing initiatives, ownership changes, and reinvestment is anticipated to spur economic development, but the impact of these efforts is uncertain at this time.

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<sup>1</sup> Boyd Gaming Investor Presentation, dated November 2010. Net revenue is for the 12 months ended September 2010.

## About HVS

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## About the Author

**Emily Sze** is a senior associate with HVS's Las Vegas office, specializing in the gaming and hospitality industries. She joined HVS in 2009, after working as a senior financial analyst for Las Vegas Sands, at the Venetian/Palazzo Resort Casino in Las Vegas, NV; a gaming analyst for



Harrah's Entertainment, at Harrah's Chester in Chester, PA; and as a slot manager's associate for Harrah's Entertainment, at Bally's Atlantic City in Atlantic City, NJ. She earned a Bachelor of Science in Hotel Administration at Cornell University, Ithaca, NY.

For further information, Ms. Sze can be contacted at:

HVS Consulting & Valuation - Las Vegas  
8170 W. Sahara Avenue, Suite 201  
Las Vegas, NV 89117  
United States of America  
Tel: +1 (702) 228-8489  
[esze@hvs.com](mailto:esze@hvs.com)