Charitable Gambling Impact Study

A brief review of the fiscal impact of a statewide smoking ban on lawful gambling

Presented by the Gambling Control Board
(in cooperation with the Commissioner of Revenue)

March 28, 2008

Minneapolis Lawful Charitable Gambling Gross Receipts
2003-2007

Millions Per Month

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<tr>
<td>December</td>
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Statewide Smoking Ban Begins

March 28, 2008
March 28, 2008

Honorable Tim Pawlenty, Governor
Honorable Margaret Anderson Kelliher, Speaker of the House
Honorable James Metzen, President of the Senate
Legislative Committee Members
Senate Research
House Research

The Freedom to Breathe Act of 2007 (Minnesota Session Laws, Regular Session, Chapter 82) included a provision for the Gambling Control Board, in cooperation with the Commissioner of Revenue, to study the impact of a statewide smoking ban on lawful (charitable) gambling and to provide a report with recommendations to the Governor and the appropriate legislative committees. The effective date of the statewide ban was October 1, 2007.

While the report covers only 3 months of actual lawful gambling activity since the ban was effective (October 2007 – December 2007), the data clearly shows a correlation that the statewide smoking ban has impacted charitable gaming receipts. The study also took into account other factors such as unemployment, gas prices, and proximity to other areas with no smoking ban (such as tribal casinos and cities bordering other states).

The Gambling Control Board remains neutral on the policy of the smoking ban but the findings and recommendations focus on the expected impact on non-profit organizations and their mission to raise funds for charitable purposes.

The report is based on the monthly tax filings by the licensed charitable organizations and the data analysis was provided by the Tax Research Division of the Department of Revenue.

Sincerely,


Tom Barrett
Executive Director
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Summary

Major Findings

- Prior to the statewide smoking ban, annual gross receipts from lawful (charitable) gambling were down an average of 2.5 percent per year for the last five years.

- For the fourth quarter 2007 (October through December), gross receipts from lawful (charitable) gambling were down 12.8 percent from the same period a year earlier. This represents the largest drop in receipts since lawful gambling was first regulated by the state in 1985.

  - Chart 1 shows that gross receipts fell slightly in 2004, with larger changes in 2005 and 2006 (partly due to local smoking bans). Gross receipts in 2007 remained close to those for 2006 until the state-wide smoking ban took effect in October.

  ![Chart 1](chart1.png)

- Actual gross receipts for lawful gambling for the fourth quarter 2007 decreased by over $40 million when compared to the same period a year earlier.
Beginning in October 2007, there is a clear delineation from the monthly gross receipts “pattern” from the previous 5 years, indicating that the smoking ban appears to be a major factor in the decrease.

As shown in Chart 2, monthly gross receipts from lawful gambling have declined at a progressive rate in the months following the state-wide smoking ban: October (9.7%); November (11.7%); December (16.8%).

For areas that did not already have a local ban on smoking, gross receipts for the fourth quarter 2007 dropped by 13.9 percent from the same period a year earlier.

Areas that already had a smoking ban also showed a significant drop in gross receipts (down 6.3 percent). It is difficult to understand how this could be related to the smoking ban.

Analysis of the historical data suggests that the state-wide smoking ban itself caused state-wide gross receipts to fall by 7.5 to 8 percent more than they otherwise would have fallen.
Annualized, a 7.5 to 8 percent decrease would equate to a loss of $95 to $105 million in gross receipts from lawful (charitable) gambling.

The smoking ban’s impact on net receipts available for charitable purposes will exceed its impact on gross receipts, because allowable expenses are unlikely to fall by as much.

State and local gambling taxes and fees will decrease roughly in proportion to the decrease in gross receipts. Although the shift in consumer expenditures may increase revenues from other taxes (such as the sales tax), that shift will not offset the drop in lawful gambling tax revenue.

Other factors such as the business cycle and the price of gasoline are also correlated with gross receipts, but they cannot explain a decline as drastic as occurred in the fourth quarter of 2007.

Lawful gambling sites in the immediate proximity to areas without a smoking ban have experienced a larger decrease in gross receipts.

Licensed organizations will have a difficult time meeting expense limitations.

**Recommendations**

- The Gambling Control Board should continue to monitor the fiscal impact of decreasing gross receipts from lawful (charitable) gambling and provide quarterly updates to legislative leadership.

- Licensed organizations should review their current operations including proposed expenditures and charitable contributions and adjust accordingly.

- The Gambling Control Board should conduct a comprehensive study of current operations involving the conduct of lawful gambling, focusing on cost saving opportunities for licensed organizations.

- The legislature should consider either raising the expense limits imposed on licensed gambling organizations or allowing a temporary increase of the limits while charitable organizations evaluate their operations and fund raising capabilities.

- The legislature could consider additional forms of lawful (charitable) gaming.
Charitable Gambling Impact Study

Estimated Impact on Gross Receipts

Gross receipts from lawful gambling have been declining in recent years, both in areas with and without local bans on smoking in bars. As a result, some of the decline in gross receipts following the state-wide smoking ban would likely have occurred even in the absence of that ban. Data from the first three months of the smoking ban (October through December 2007) shows clear evidence, however, that the state-wide ban has reduced gross receipts. Gross receipts state-wide are down by 12.8 percent compared to the fourth quarter of 2006.

How much of that 12.8 percent state-wide decline was due to the state-wide smoking ban?

Answering this question is complicated by the introduction of local smoking bans in 2005, 2006, and 2007. Strong local smoking bans – those that ban all smoking in bars, not just restaurants – were introduced in Minneapolis, Bloomington, and Golden Valley in April 2005 and in St. Paul in April 2006. Hennepin County also enacted a strong ban in April 2005, but the ban was weakened starting January 2006, when exceptions were permitted for most bars. Those exemptions continued through the end of July 2007. Strong bans also took effect in Mankato (July 2006) and Meeker County (August 2007).

Chart 3 compares the fourth-quarter year-over-year change in gross receipts in each of four distinct areas:

- Areas that allowed smoking in bars prior to the state-wide ban.
- Areas with a ban on all smoking in bars by the fourth quarter of 2006.
- The rest of Hennepin County – other than Minneapolis, Bloomington, and Golden Valley. This area had a strong ban in 2005 but a weak ban in 2006, which explains the unusual pattern in the chart (decrease in 2005, increase in 2006, decrease in 2007).
- The state as a whole.

In areas with no local ban (or a weak ban), fourth quarter 2007 gross receipts fell by 13.9 percent. By comparison, gross receipts fell by only 6.3 percent in areas with a strong local ban in effect a year earlier. That 6.3 percent reduction is presumably independent of the smoking ban, because the state-wide ban is no stronger than the pre-existing local ban.
Not all of the 13.9 percent reduction in areas with no prior ban on smoking in bars is due to the state ban. Three downward adjustments are needed.

- First, past history suggests that a 3 percent decline would probably have occurred in the absence of a ban. Gross receipts in no-ban areas fell by 3.0 percent in 2004 and 3.3 percent in 2006. The smaller decrease in 2005 was probably the result of some shifting into these areas from areas with newly enacted smoking bans. It is likely that about 3 percent of the 13.9 percent drop in gross receipts would have occurred anyway, leaving a net change of about 11 percent.

- Second, there may be other reasons – including a weak economy and high gasoline prices – that account for part of that 11 percent larger-than-expected decline. The 6.3 percent reduction in areas that already had a strong smoking ban for bars is higher than what would be expected based on recent history. Local bans first effective in 2005 and 2006 make those years useless for comparison, but the declines in earlier years were all below the 6.3 percent in 2007. That 6.3 percent decrease exceeds the reductions in 2003 and 2004 by about 2 percent. It exceeds the average for 2002 through 2004 by about 1.5 percent. Whatever is causing the unusually large reduction in areas that already had strong smoking bans is probably affecting the no-ban areas as well. Assuming that economic conditions or other factors are responsible for 1.5 to 2.0 percentage points of the 2007 decline, this reduces the estimated impact of the smoking ban (in areas with no prior ban) by 1.5 to 2 percent – down from 11 percent to between 9 and 9.5 percent.
Third, this 9 to 9.5 percent reduction which appears to be due to the state-wide smoking ban would apply to only the portion of the state not already subject to a strong ban. About one-sixth of total gross receipts in 2006 were in areas that already had a strong local ban, so the state-wide impact of the 9 to 9.5 percent reduction in five-sixths of the state would reduce state-wide gross receipts by between 7.5 and 8.0 percent.

**Conclusion:** The state-wide ban accounts for 7.5 to 8.0 percentage points of the 12.8 percent state-wide reduction in the fourth quarter of 2007.

This conclusion is based on only three months of data, so the estimate is somewhat tentative. Preliminary data for January 2008 shows a larger year-over-year state-wide percentage reduction. If the preliminary January data were added to the fourth quarter data to estimate the percent decline in the first four months after the ban, though, the estimated impact of the state-wide ban would remain the same. The January reduction in gross receipts is larger throughout the state – in areas that had a prior smoking ban as well as in areas with no prior ban. As a result, despite the larger overall state-wide reduction, the full four months of data would yield the same estimate – that the state-wide ban has reduced state-wide receipts by 7.5 to 8.0 percent.

**Estimated Impact on the Net Profit Available for Distribution**

The estimated 7.5 to 8.0 percent reduction in gross receipts may reduce the net profit available for distribution by a larger amount. As shown in Chart 4, net profits equal gross receipts minus prizes, allowable expenses, taxes, and fees. A drop in gross receipts unmatched by a drop in expenses will squeeze net profits, pushing them down by a larger percentage.
If gross receipts, prizes, taxes and fees, and allowable expenses all fell by 7.5 to 8 percent, then net profit available for distribution would also fall by 7.5 to 8.0 percent. There is little likelihood, however, that reductions in allowable expenses will keep up with the drop in gross receipts. If gross receipts, prizes, taxes, and fees all fall by 7.5 to 8 percent but allowable expenses remain unchanged, net profits available for distribution would fall 3.3 times as much – by 25 percent. In areas with no local smoking ban, the estimated 9 to 9.5 percent reduction in gross receipts due to the smoking ban would reduce net proceeds by roughly 30 percent if expenses did not fall.

In the fourth quarter of 2007, gambling sites did reduce expenses – but they fell only four-tenths as fast as gross receipts fell. If allowable expenses are reduced four-tenths as fast as gross receipts, net profits available for distribution will fall 2.4 times as much as gross receipts fall. In that case, the state-wide smoking ban’s estimated 7.5 to 8 percent reduction in state-wide gross receipts would reduce net profits by 18 to 19 percent. In areas with no local smoking ban, the estimated 9 to 9.5 percent reduction in gross receipts due to the smoking ban would reduce net proceeds by 22 or 23 percent.

Conclusion: If allowable expenses decline more slowly than gross receipts (in percentage terms), the percentage reduction in net profits available for distribution will be significantly larger than the percentage drop in gross receipts.

What Explains Historical Changes in Lawful Gambling Gross Receipts?

Chart 5 shows seasonally adjusted monthly gross receipts since 1990, both in current-year dollars and in 2007 (inflation-adjusted) dollars. In 2007 dollars, gross receipts remained fairly steady between 1992 and early 2000, but then declined by about one-third between 2000 and the end of 2007. This section of the report examines several possible explanations for that historical pattern. It also helps identify how economic variables may help explain a small part of the reduction in gross receipts following the local and state-wide smoking bans.
To consider potential causes for the pattern shown in Chart 1, each of several suggested explanatory variables was first examined individually to see if it was correlated with gross receipts. Correlation between two variables – by itself – does not prove that one of the two causes the observed changes in the other, nor does it suggest anything about the magnitude of the potential impact. Nevertheless, a lack of correlation generally eliminates the possibility that one variable caused changes in the other.

Analyzing one possible causal relationship at a time ignores possible interaction among the alternatives. Regression analysis can measure the separate and independent impact of each of several potential causes. Some suggestive results from regression analysis are reported below.

**The Business Cycle:** Chart 6 plots real seasonally-adjusted gross receipts against the unemployment rate. The simple correlation of -0.11 suggests that lawful gambling moves with the business cycle (that is, gross receipts fall as unemployment rises). The period of steady real gross receipts (1992-2000) was a period of economic expansion and falling unemployment. The decline after 2000 occurred as unemployment rose.

![Chart 6: Real Monthly Gross Receipts (2007 Dollars) Plotted Against Unemployment Rate](chart6.png)
**Gasoline Prices:** Chart 7 plots real seasonally-adjusted gross receipts against the price of gasoline (adjusted for inflation). The simple correlation of -0.83 suggests that lawful gambling falls when real gas prices rise. This correlation results largely from the period starting in 2002, when gasoline price increases occurred at the same time lawful gambling was declining.

**Lottery Gross Receipts:** The correlation between total lottery gross receipts and lawful gambling gross receipts (+0.27) shows that they tend to move together, even when adjusted for inflation. This is probably because they are both affected by the business cycle and gasoline prices. Gross receipts from Power Ball alone are negatively correlated with lawful gambling receipts (-0.04), however, though the correlation is low.

It is also possible, as some have suggested, that lawful gambling receipts fall in months when the Power Ball prize is unusually high, pulling gambling dollars away from lawful gambling. This hypothesis is discussed further on page 12.
Regression Analysis

A regression model was used to test the hypothesis that real lawful gambling gross receipts depends on each of the variables listed below. (In each case, gross receipts were expected to fall when the value of the variable increased.)

- Minnesota unemployment rate
- Real gasoline prices (cents per gallon in 2007 dollars)
- Local smoking bans in bars effective starting April 2005 (Bloomington, Golden Valley, and Minneapolis)
- Local smoking bans in bars effective April and July 2006 (St. Paul and Mankato)
- Time trend (to account for increased gambling options, etc.)

Because only three months of data are available following the state-wide smoking ban, the regression model uses only data for months prior to the state ban (through September 2007).

The regression results suggest the following:

- Lawful gambling is strongly affected by the business cycle. Each percentage point increase in the unemployment rate was associated with a $3.8 million drop in monthly gross receipts.
- Lawful gambling also appears to be affected by gasoline prices. Each one-dollar increase in the retail price of gasoline was associated with a $2.5 million reduction in monthly gross receipts.
- Smoking bans appear to have had large independent impacts:
  - April 2005 bans reduced state gross receipts by over $12 million per month (an ongoing impact).
  - April and July 2006 bans reduced state gross receipts by an additional $6 million per month (an ongoing impact).
- Even after accounting for all of the above, the time trend – unexplained by other variables – accounted for a $1.8 million per-year drop in monthly gross receipts. This may be due to increasing access to substitutes for legalized gambling, demographic changes, or other causes not included separately in the regression equation.

Each of the variables included in the regression model was significant, with an independent impact even after taking account of the effects of the other variables. The preferred regression equation had a very high adjusted R-square (0.92). This means that the variables included in the equation can “explain” 92 percent of the month-to-month variation in the seasonally-adjusted totals. Alternative regression equations showed similar results.

Conclusion: Although the business cycle and gasoline prices each have large and significant impacts on legalized gambling, smoking bans have a strong independent impact. The unusually large decline in gross receipts following the local smoking bans (where they affected bars) was not just a result of simultaneous changes in other economic variables.
The Insignificance of Lottery Variables

Lottery-related variables were not successful in helping explain the variation in lawful gambling gross receipts. The following alternative lottery variables were tested:

- Lottery gross receipts
- Power Ball gross receipts
- Months with very high Power Ball gross receipts

In each case, adding the lottery variable to the equation failed to show statistically significant results. In each case, an increase in the lottery variable appeared to increase (rather than reduce) lawful gambling receipts. This is likely due to both being determined simultaneously by the other variables, such as unemployment and gasoline prices.

Proximity to a State Border

To study the impact of the smoking ban on lawful gambling receipts near state borders and casinos, all lawful gambling sites were geo-coded. This made it possible to map the distance from each site to the nearest bridge on a state border.

Distance to the nearest bridge on a state border was used because a large percentage of the state’s population near a border must cross a river to reach the neighboring state. In this study, we further narrowed the scope to sites in 5 border counties: Dakota and Washington counties (in the Twin Cities metro); St. Louis County (Duluth); Clay County (Fargo/Moorhead) and Polk County (Grand Forks/East Grand Forks). None of these counties were affected by strong local smoking bans prior to the implementation of the statewide smoking ban on October 1, 2007. All five counties have a major population center on one or both sides of the state border.

Historical data (prior to October 2007) for lawful gambling sites in these five counties near a state border show no clear pattern of behavior.

Chart 8 compares fourth quarter 2007 changes in these five counties to previous years. It shows the following:

- In the last quarter of 2007 – the first three months after the state-wide smoking ban – gross receipts were down by **20.0 percent** for sites within 5 miles of a border.
  - This contrasts with earlier years. Fourth-quarter receipts in 2002 through 2006 show changes ranging from an increase of 2.9 percent over the previous year to a decrease of 3.0 percent over the previous year.

- In the last quarter of 2007 – the first three months after the state-wide smoking ban – gross receipts were down by **17.7 percent** for sites within 10 miles of a border.
  - Fourth quarter receipts in 2002 through 2006 show changes ranging from an increase of 2.1 percent over the previous year to a decrease of 7.3 percent over the previous year.
In the last quarter of 2007 – the first three months after the state-wide smoking ban – gross receipts were down by 16.7 percent for sites in the 5 selected counties that are more than 20 miles from a border/bridge.

- Fourth quarter receipts in 2002 through 2006 show changes ranging from an increase of 1.6 percent over the previous year to a decrease of 4.2 percent over the previous year.
- For all sites, the five counties saw a 15.9 percent decrease over the previous year.
- Statewide in areas without a local smoking ban, gross receipts for the fourth quarter of 2007 were down 14.0 percent from the previous year. We have no information to suggest that the 1.9 percent difference in growth between these five counties and the non-local ban areas statewide is anything other than a statistical anomaly.

Sites within 5 miles of a border/bridge were down 3.3 percent more than sites in the same county that were more than 20 miles from a border. These counties on the whole were down 2 percent more than the statewide totals for non-local ban areas.

Conclusion: *Given the volatility of changes in gross receipts in previous years, it is difficult to quantify the magnitude of the differential impact of the smoking ban on sites near a state border. However, it does appear that sites less than 10 miles from a state border are seeing larger decreases in gross receipts since the implementation of the statewide smoking ban.*

Chart 8
4th Quarter Gross Receipts: 5 County Proximity to a Bridge
(Clay, Dakota, Polk, St. Louis and Washington Counties)
Proximity to a Casino

Geo-coding also identified each site’s distance from a casino. For several years, gross receipts at sites within close proximity to a casino have been decreasing at rates greater than the statewide average. Given the larger declines at sites near casinos in 2004 and 2005, the data does not suggest that the difference between sites within 5 to 10 miles of a casino and the statewide average during the first three months after the smoking ban can be attributed to the smoking ban. It appears to be part of a trend that began in earlier years as shown in Chart 9.

- In 2004, decline for sites within 5 miles of a casino were 16.2 percentage points greater than the decline statewide (19.4% compared to 3.2%). The declines for sites within 10 miles of a casino were 5.3 percentage points greater than the decline statewide.
- In 2005, decline for sites within 5 miles of a casino were 6.0 percentage points greater than the decline statewide. The declines for sites within 10 miles of a casino were 4.4 percentage points greater than the decline statewide.
- In 2006, decline for sites within 5 miles of a casino were 2.2 percentage points greater than the decline statewide. The declines for sites within 10 miles of a casino were 2.5 percentage points less than the decline statewide.
- In 2007, decline for sites within 5 miles of a casino were 4.8 percentage points greater than the decline statewide. The declines for sites within 10 miles of a casino were 6.1 percentage points greater than the decline statewide.

Conclusion: While there does appear to be an unknown factor causing a larger decrease in gross receipts for sites near a casino, this impact can be seen going back to 2004. As a result, it cannot be attributed to the implementation of the statewide smoking ban.
Temporary Decline?

If all conditions remain constant, it is doubtful that there will be a return of lawful gambling activity to the levels experienced prior to the statewide smoking ban.

The City of St Paul was one of the first local units of government to initiate a smoking ban. A partial ban was effective January 31, 2005 but it exempted bar locations. Effective March 31, 2006, a complete ban was enacted. Chart 10 below shows the dramatic impact on lawful (charitable) gambling receipts at the time the full ban went into effect. The chart also shows the progression of monthly gross receipts continuing through the implementation of the statewide ban. Based on this data, there does not appear to be any rebound in gross receipts other than the seasonal increases that also characterized previous years.

Conclusion: Smoking bans appear to cause a permanent drop in lawful gambling. The lack of a rebound in gross receipts in St. Paul is similar to what has been seen in other cities with smoking bans in bars.
Appendix A: Recent Gross Receipts History

Charts A-1, A-2, and A-3 show the history of gross receipts since 2001. Because there is substantial seasonality in lawful gambling gross receipts, the historical patterns are easier to see when the data is seasonally adjusted.¹

Chart A-1 shows state-wide trends. Gross receipts were essentially flat between 2001 and July 2004, then fell by 12.5 percent (seasonably adjusted) between July 2004 and July 2007. Local smoking bans accounted for a portion of this decline. The striking reduction in gross receipts during the first three months after the state-wide smoking ban is shown by the last three data points on the graph.

¹ Seasonal adjustment used the X12-ARIMA program used by the US Census.
Chart A-2 shows the trend limited to areas without local bans on smoking in bars. Gross receipts were essentially flat between 2001 and July 2004, then fell by 8.5 percent (seasonally adjusted) between July 2004 and July 2007. The striking reduction in gross receipts during the first three months after the state-wide smoking ban is shown by the last three data points on the graph.
Chart A-3 shows the trend for areas that had local bans on smoking in bars prior to 2007. Following a slow decline totaling 2 percent between January 2001 and October 2003, the chart shows a fairly steady downward trend starting October 2003 (well before the local bans became effective in April 2005). This steady downward trend is interrupted by a large one-time drop immediately following the local bans. Gross receipts fell by a total of 34 percent between October 2003 and October 2007; only about half of that occurred at the time the local bans were enacted.

Areas with local bans prior to 2007 show no noticeable drop from trend in October or November of 2007, the two months following the state-wide smoking ban. There is a noticeable drop in December (when seasonally adjusted), but it is not yet clear whether this represents a one-month aberration.
## Appendix B: Fiscal Year 2007 Summary

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<th>Activity</th>
<th>Gross Receipts (sales) FY 2007</th>
<th>% Change from FY 06</th>
<th>Prizes Paid FY 2007</th>
<th>% Change from FY 06</th>
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### Lawful Gambling Activity

- **Pull-tabs**: $1,172,358,000 (92.7%)
- **Bingo**: $64,778,000 (5.1%)
- **Raffles**: $6,357,000 (0.5%)
- **Paddlewheels**: $16,528,000 (1.3%)
- **Tipboards**: $5,352,000 (0.4%)

### Ten-Year Comparison of Receipts and Prizes Paid

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