Providing More Effective and Efficient Casino RFPs

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Abstract

The proliferation of gaming has required governmental entities to become more efficient in the selection of new gaming operators. The Request for Proposal (RFP) process has become the accepted method for selecting operators in new jurisdictions. However, the development of this process has been, and continues to be, evolving; more recent RFPs have learned from the mistakes made in earlier ones.

The authors discuss how to make the RFP process more effective and efficient by analyzing the mistakes made in previous RFPs. They provide recommendations on how to structure the initial RFP and about what information should be contained in all RFPs.

Introduction

The gaming industry and specifically casinos represent one of the fastest growing industries in the U.S. and worldwide. Legalized gambling in the form of casinos or gaming devices such as slot or video poker machines is currently offered in thirteen states. Prior to 1989 gaming was limited to the states of Nevada and New Jersey. In addition to these thirteen states, additional states have limited gaming on oceangoing cruise ships or Indian reservations. Each year, additional states consider some form of gaming legislation.

Growth in the new casino gaming jurisdictions has taken three approaches as defined by state legislators; an unlimited number of licenses for the entire state, an unlimited number of licenses for designated areas within a state, or a limited number of licenses for specified locations.

States allowing an unlimited number of licenses such as South Dakota, Colorado, and Mississippi have found that this approach has produced a boom and bust cycle with many negative effects. For example, both Colorado and South Dakota found that, within a two year period of time, more than 50 percent of the properties faced financial difficulties and either closed down or sold out to another operator. Similarly, Colorado reached a peak of 76 casinos in 1992. At the end of 1994, there were 59 casinos open and within the last 12 months, 10 new casinos opened with offsets by the closure of eight casinos (Smith Barney, 1995, Ernst & Young LLP, 1995). Mississippi is currently finding properties with similar problems. (A good update on the casino industry can be found in current issues of International Gaming & Wagering Business.)

A review of the RFP bidding process and the problems associated with it can go a long way toward understanding the risks and rewards involved in obtaining a limited license in new gaming jurisdictions.

A result of these failures is the loss of projected tax revenues for government entities as well as jobs for the general populace. Casino corporations incur a loss of some, if not all, of their investment and their other properties suffer from negative reputation effects.

More recently new gaming jurisdictions (Louisiana, Indiana, Illinois) have limited licenses to specific locations. That is, a specific location was designated as a casino site and companies were required to bid for the license and the opportunity to open a casino. It was felt that such an approach would do away with the business failures associated with unlimited gaming licenses. An additional argument was that corporations would be willing to pay additional taxes or other incentives if there were no competition. To maximize these incentives, governmental agencies went to the request for proposal (RFP) process. Corporations interested in the limited number of licenses essentially entered into a bidding process. Many of the initial successful bids resulted in earnings in excess of those anticipated.

Recently, even states with limited licenses are finding that new casinos don't always hit the jackpot. For example, the $200 million River City complex in New Orleans, featuring two river boat casinos, closed a month after opening (in 1995). Harrah's New Orleans land based temporary casino was running at 50 percent of estimated revenue projections. Harrah's closed the temporary casino and suspended construction on the permanent casino, when Bankers Trust cut off funds in November, 1995.

Both governmental and business entities are beginning to realize that opening a casino does not automatically produce a wining situation for all parties. While growth has provided numerous opportunities for the traditional gaming companies and opened the door for joint ventures and newly incorporated gaming companies, it also has brought considerable development costs and substantial risks. This does not mean that additional casino opportunities are not available. What it does mean is that both the governmental entities and the gaming companies must do a better job at the outset of a gaming project to prevent another New Orleans experience from occurring.

One of the most important steps in the development of a successful gaming property is the initial selection of the operator. A review of the RFP bidding process and the problems associated with it can go a long way toward understanding the risks and rewards involved in obtaining a limited license in new gaming jurisdictions. This paper examines previous RFPs in terms of the proposal and the evaluation of the submitted bids. Since one of the authors was personally involved in the New Orleans, Windsor, and Rama First Nation RFP process, these provide most of the examples highlighted in this paper. An analysis of the problems that can arise with the RFP process should provide others interested in this process with the tools for developing a more effective and efficient RFP process.

Requests for Proposals

The primary method for selecting the gaming operator(s) in newer jurisdictions is the request for proposal (RFP) process. An RFP provides guidelines used by the respondents in developing a proposal for a specified project or service. For example, various governmental entities, such as the City of New Orleans, Ontario Casino Corporation, and the Rama First Nation, have solicited requests for bids on the development and operation of a casino for a specified location.

Analysis suggests that there are three essential questions that must be addressed by the entities involved in the RFP process for the development of a gaming property.

(1) Does the RFP provide relevant information which allows the bidder to clearly provide an appropriate proposal that addresses the RFP?
(2) What are the criteria used for the selection of a winning proposal and are they clearly defined in the RFP?
(3) Does the RFP provide enough guidance so that the bidder provides relevant information in an understandable format for the selection process?

Defining the Product in the RFP Offering

One of the most important features of an efficient and effective RFP process is the clarity of the RFP. It should clearly define the parameters to which the proposal must conform as well as any limitations of the specified project. The broader the parameters or guidelines, the more diverse the projects will be. The more diverse the projects, the longer and harder the selection process will be. From a bidder's perspective, it could mean that the company is throwing away valuable resources by preparing a proposal which is not what the governmental entity wants. From the government's view point, substantial time is spent evaluating projects which do not fit the needs of that entity.

For example, the New Orleans RFP represents the first use of an RFP. Because the various governmental agencies did not know what they wanted and wanted to see what kind of response they would get, they did not include specific parameters. This approach left the governmental agencies open to speculation of corruption and lawsuits by the unsuccessful bidders. The end result is that the project is still not open.

A review of three different proposals, New Orleans, Windsor, and the Rama Nation, demonstrates the effectiveness of defining the parameters associated with the RFP. The sequence of these proposals reflects the evolutionary nature of the RFP process and the proliferation of gaming; that is, the more recent RFPs learned from the mistakes of earlier proposals.

A clear perception of the criteria used in the selection process aids the bidders in preparing the most effective information.

Each of the three governmental entities had a specific piece of property that was to be used for the casino project. Each also had a study by a reputable consulting group which provided preliminary data on possible revenue projections. Given these variables, each of the governmental agencies could have issued an RFP which provided constraints in terms of the size and type of the casino that would benefit that property.

The city of New Orleans issued its RFP in 1992. This RFP was issued with no direction in terms of the type of property, casino size, total size, or style that should be built. The New Orleans RFP stated that the casino would be developed on the 6.47 acre Rivergate Site in downtown New Orleans. This site already contained a convention center. The RFP suggested that a "respondent may wish to renovate the existing improvements. However, it is envisioned that the selected Developer will remove the Exhibit Center and construct new facilities that would include a casino/gaming facility or a mixed use project" (quote taken from the City of New Orleans RFP).

The resulting submitted proposals included a wide range of designs and sizes. Half the proposals renovated the property while the other half demolished it and built a new structure. Casino size ranged from 120,000 to 250,000 square feet. The entertainment area ranged from zero to 120,000 square feet. The restaurant space went from zero to 55,000 square feet. The total property ranged from 300,000 to 450,000 square feet. Projected costs of the project ranged from $210,000 to $475,000. Such a diversity of amenities, styles, and facilities left little room for objective comparisons among bidders and thus decisions had to be made on more subjective criteria.

While not stated in the RFP, it became apparent that city officials wanted the old structure demolished and a new one built. City officials selected Hemmeter, who proposed building a new facility, as the winning proposal. However, the State of Louisiana argued that it had the authority to issue the license and held it's own

RFP bidding procedure. The state officials selected Harrah's. Harrah's, the State's winning bidder, proposed renovating the old building. Another six months were spent reaching a compromise joint venture between Harrah's and Hemmeter. After further negotiations between Hemmeter, Harrah's and the City, the final acceptable proposal was to demolish the existing property and build an entirely new structure.

Substantial time and effort for all parties could have been saved if the decision about the desired type of facility had been made and included in the initial RFP. The City of New Orleans issued its original RFP on April 22, 1992. Final negotiations over the type of property to be built were not resolved until 1994 with the temporary casino opening in May, 1995, a full three years later.

The Windsor bidding process and RFP provide an excellent contrast to New Orleans. The Ontario Casino Corporation (OCC) worked with the officials from the City of Windsor to select the site of the casino property while making it clear that the OCC would select the winning bid. The OCC also anticipated the possibility of gaming development in nearby jurisdictions such as Detroit and therefore made the decision to build a casino that was substantially smaller than the current market studies suggested. Substantial time and effort were taken to limit the parameters of the proposed property which resulted in substantially more bids while making it easier to compare across the bids. For example, the Windsor proposal specified that the casino complex would include:

- An equipped gaming area of 75,000 square feet,
- An entertainment facility,
- Three restaurants (a coffee shop, a popularly priced restaurant, and an upscale restaurant),
- A hotel with a maximum of 300 rooms,
- Lounges and/or bars,
- A child care facility for children of employees,
- A gift shop, and
- Parking facilities and tour bus drop-off facilities.

Even with these constraints, project costs varied by more than $200 million among the nine proposals. But the governmental advisors were able to isolate the costs by specific areas and evaluate these costs across firms. For example, given the casino square footage of 75,000 square feet, was it realistic for one property to have 300 more machines than another? Or if the expectation was for the installation of 1500 slot machines, why was one proposal's total slot equipment costs so much higher than another's? As a result, the project progressed very smoothly.

The Ontario Casino Project group had a response date of June 30, 1993; selected a short list of four bidders by October 1, 1993; and made the final selection by November 30, 1993. A temporary casino opened on March 1, 1994 with the permanent casino scheduled for May, 1996.

The Rama Nation RFP was issued almost two years after Windsor. While it provided the same detailed descriptions of the casino size and amenities to be offered, it went a step further by specifying the basic architectural designs for the property. The Rama Nation RFP was issued May 1, 1995 with a proposal deadline of July 12, 1995. A short list was developed by August 20, 1995, and final selection occurred in September, 1995.

Criteria for a Successful Bid

Once the governmental entity has clearly defined the parameters of the proposed casino project, the next step is specifying the criteria to be used in the selection process. A clear perception of the criteria used in the selection process aids the bidders in preparing the most effective information.

At the time this paper was written, nine different casino RFPs had been issued. These were collected and reviewed. The casino RFPs ranged from single land-based sites such as New Orleans, Windsor, and Sydney to riverboat sites in Missouri and Louisiana. The Newport News, Virginia RFP was very open ended in terms of defining what was required and was even issued before the vote to legalize casinos in Virginia, which was defeated! A list of the proposals reviewed is provided in Table 1.

Table 1. Cities Submitting Requests for Proposals

- Davenport, Iowa
- Kansas City, Missouri
- New Orleans, Louisiana
- Newport News, Virginia
- Shreveport, Louisiana
- St. Joseph, Missouri
- Sydney, Australia
- Windsor, Ontario

A review of these RFPS found a commonality across the requested information, however, the weighting assigned to the various criteria was not the same. For example, in 1995, the Rama First Nation RFP incorporated all of the commonly requested information. They came up with a nine point generic checklist of evaluation criteria. Specific topical areas included the following: financial, economic development, management expertise, human resources, community relations, strategic and operational business plans, casino complex design, casino complex scheduling, and other criteria including security, etc.

The Ontario Gaming Commission developed the RFP for the Rama First Nation. This group had closely followed the New Orleans proposal when they developed the Windsor RFP. They were therefore able to learn from mistakes made in their previous RFP. For example, gaming experience and financial flexibility received heavier weighing, given the current financial difficulties of many of the new gaming companies.

Successful experience is an essential criterion. For instance, seven of the nine RFPs reviewed listed gaming experience as a top priority. Given the high risk associated with any new venture, firms with prior gaming experience should have a higher rate of success, all other factors being equal. However, governmental entities should realize that gaming is not the golden egg many thought it was. There is a limit to how much can be extracted, in terms of taxes and other social concessions, from any operating entity. New Orleans proved that even successful corporations such as Harrah's have a limit to the burden it can carry.

Governmental officials also put their jobs at risk when a selection goes sour. New Orleans represents such a situation. The shut down of this project put 3000 employees out of work as well as the governmental regulatory agency which oversees the land-based casino. The current bankrupt status of the project has given anti-gaming forces the opportunity to reopen the entire gaming question. They are pushing for a ballot referendum on the various forms of gaming within the State of Louisiana.

Financial stability and flexibility are two other essential criteria that carry substantial weight in the decision process. The operator of a new project should 1) be capable of funding the project through the initial start up phases, 2) have the financial capability to get the project up and running, and 3) have the experience to operate and maintain the property once it opens its doors. While other information is also important in the selection process, the remainder of this paper will concentrate on financial information.

Included Financial Information in a Successful Bid

Given the importance of gaming experience and financial flexibility, a good RFP should clearly spell out the type of financial and managerial information that will lead to the successful completion of the RFP process. A look at prior RFPs shows three common elements of required financial information. These three types of information are 1) company annual report and/or 10-K, 2) sources and methods for project funding, and 3) financial projections for the proposed gaming operation.

Company Annual Report

A company's annual report, or 10-K, is an essential tool for demonstrating a bidder's financial viability. It comprises a variety of audited and unaudited information. The most important section of the annual report is the financial statements and their accompanying notes, which are audited by a certified public accountant. The financial statements provide information on the company's current financial position, operating results, and sources and uses of cash. The notes provide information which support the statements. In addition, the notes are a source of information concerning litigation, joint ventures, merger and acquisition activity, and other activities.

Five-Year Summary

Additional information provided by the annual report is the five-year summary of relevant financial data, which is unaudited. This information is used to develop and analyze trends based on a company's past performance. This type of information allows the bidder to show both its expertise in the gaming industry and its financial viability for funding the project. It clearly demonstrates how the company achieved its current financial position, and its basic cash management philosophy over a period of time. This information is invaluable in assessing a company's past performance and projecting future performance.

Management Discussion and Analysis

Additional relevant information provided by the annual report is the "Management Discussion and Analysis" (MDA). It provides management's view of changes that have taken place over the last three years. Management identifies significant events and uncertainties which have a material impact on the company's operations, capital resources, and liquidity.

The evaluation process should include close scrutiny of the MDA section, not only to understand changes that have occurred over prior years but also to provide an understanding of where the company is headed. For example, this section should include a discussion on current projects. Since many of these projects may still be in the construction stage, they currently do not have an impact on earnings; however they will result in substantial future cash outflows, as well as limit future capital resources and liquidity.

A good RFP should ask the bidder to spell out any current or projected projects being considered as well as indicate the costs and financing associated with that project. A comparison of the RFP information with that presented in the annual report provides the governmental entity with the current status of the projects. Analysis would tell whether the project has been discontinued, has cost overruns, or is completed and running. It will also provide positive or negative information on the future potential funding available.

Controlling Interest

Company annual reports are used to evaluate the viability of the bidders in terms of their ability to provide cash flows until the project generates enough funds to be self-sufficient. But in many cases, the submission of annual reports represents the parent company, not the company actually bidding on the project. For example, the four final bidders for the New Orleans RFP were newly formed corporations. One of those bidders, Hemmeter, entered into a joint venture with Caesars and submitted a $427 million proposal for the New Orleans RFP. Annual reports for both companies were submitted. The combination of both these companies would appear to provide a viable joint effort with considerable financial support. But in reality, Caesars was only contracted to run the casino when it was completed. It was not putting any funding into this project. Hemmeter had 100 percent control of the new Louisiana corporation which meant that funding for the project was dependent on a heavily leveraged company.

The importance of financial viability and control is currently being emphasized in the bankruptcy proceedings in New Orleans. The New Orleans officials are trying to work out a solution with Harrah's. However, it is not Harrah's that has defaulted on the casino project, but Harrah's Jazz. This is a newly incorporated company that was created as a compromise resulting from the dual bidding process. The company is composed of three different groups of investors 1) the Jazz group, composed of ten New Orleans lawyers, 2) the Hemmeter corporation, and 3) the Harrah's group. Each of these groups initially had a one-third interest in the new company but as additional funds were needed, neither Hemmeter nor the Jazz group were able to provide additional funding. This forced Harrah's to come up with the funding and changed the ownership relationship.

The important information for evaluating the proposed entities is information on who controls the new corporation versus who runs or manages it, percentage of ownership of each owner, and guarantees made to provide the necessary funds to keep the project going. It is therefore essential to obtain information on the financial structure of any newly incorporated company and what type of backing it is receiving from its parent corporations. The new corporation has no gaming experience nor has it any credit history or assets beyond what was given to it by the parent corporations.

If a bidder is a newly created joint venture, then annual reports will not exist. It is then the bidder's responsibility to supply both financial and non-financial information concerning the partners of the joint venture. At a minimum, the bidder should supply information on the financial commitments and guarantees of all parties to the joint venture. Documentation should be provided which shows that the financial commitments can and will be met.

The joint venture bidder should provide information on the role each partner will play in the gaming operation. For example, if there are two partners, one of which has gaming experience, then the bidder should indicate that this partner will manage the casino operations. If all the partners have gaming expertise, but different market orientations, it is important for the bidder to disclose what type of property it will develop.

The provision of specific formats to follow would allow for easier comparisons across the different operators.

Funding Sources and Methods

The proliferation of gaming, coupled with the demand that operators in new jurisdictions have gaming experience, has placed a huge demand for financing on the gaming companies. An RFP must therefore require that any submitted proposal clearly define how the proposed project will be financed.

It is essential that a bidder clearly articulate the composition of debt and equity in its financing package. The type of funding can drive the timeliness of starting and completing the project. If a project is to be financed in total with internally generated funds, then a bidder's annual reports are crucial in demonstrating its ability to use this type of financing. However, if funding must be generated externally, the timing of such funding could delay the start of the project.

For example, major delays resulted when Harrah's Jazz had to go to the bond market for $425 million in funding for the New Orleans project. On the other hand, the joint venture of Hilton, Caesars, and Circus Circus provided internal funding for the Windsor project which allowed them to start construction immediately.

A few major casino companies currently have lines of credit that are sufficient to entirely fund a new property. For example, Mirage Resorts has a one billion dollar line of credit from a consortium of banks. Circus Circus just recently obtained a 1.2 billion dollar line of credit. On the other hand, lesser known companies with little in the way of a casino track record have not been able to obtain financing for small gaming projects (Sterns, 1996).

Since very few bidders have enough internally generated funds to completely finance a new project, a financing package has to be developed. A bidder must be able to provide sufficient information to prove to the selection committee that the package can be brought to fruition. A guaranteed line of credit is an example of a secured source of financing. If the bidder's line of credit cannot fund the entire project, it can be used to cover a percentage of the projected costs. Guaranteed commitment from private investors is another reliable source of funding.

Letters of interest from bankers or underwriters, who have an interest in helping to finance the project by taking a debt or equity offering to the market, are not as reliable as lines of credit or guaranteed commitments. The bidder does not have any assurance that these parties will not renege on the financing.

Financial Projections

The third relevant piece of information required is financial projections. This financial information represents the estimation of future incomes statements and balance sheets based on careful analysis of economic data and the anticipated cost of the proposed casino. It is very important that the RFP provide specific guidelines for the submission of this information because a substantial amount of time can be wasted in the evaluation of this material if there is not a consistent format across companies. Prior RFPs provide a good learning experience. The New Orleans project requested firms to provide future income statements, balance sheet and cash flow projections. But there were no additional guidelines. The result was that each bidder used its own terminology and group classifications making it impossible to do any comparison across companies.

Governmental entities can reduce misunderstandings by trying to narrow the assumptions that might be used by the bidders in their preparation of financial projections.

For example, the RFP asked the bidders to provide total cash flows which would go to the City of New Orleans. This information proved to be of little value because some firms used future projections for 10 years while others used 60 year projections. It was rendered even more useless because the bidders used different inflation or growth factors for calculating revenues and expenses but failed to identify these factors. On the other hand, both Windsor's and Rama's RFPs required the bidders to use a specified time frame for their projections. Windsor did not include a specific inflation factor and therefore had to extract this information to do comparisons on cash flows. Rama did require firms to use a specified inflation rate as well as a 10 year cash flow projection.

The information would also be more comparable if the operating financial projections (consisting of revenues and expenses) for a gaming property were identified by departments. These departments should consist of gaming, rooms, food, beverage, and other. A separate general and administrative expenses department should also be provided. This was not provided by the New Orleans bidders. Without providing a standardized format for operators to follow, it is almost impossible to determine whether various general and administrative costs are all inclusive or have been allocated to the various departments. The provision of specific formats to follow would allow for easier comparisons across the different operators. The Rama Nation RFP, learning from the problems associated with the New Orleans and Windsor RFPs, provides a specific income statement format, similar to that used by the Nevada Gaming Control Board. It clearly identifies major revenue and expense components by year and percentage.

Any costs associated with the proposed capital structures and operator fee arrangements should be separated from expenses. Comparison of various expenses can be substantially distorted by the inclusion of various financing or leasing arrangements. For example, if slot machines are purchased, the depreciation costs would be allocated to gaming expenses while interest expenses associated with any loan would show up in administrative expenses. Yet, if the slot machines are leased, the total rental expense shows up as a gaming expense with no interest expense in the administrative section. Without separate disclosure of these items, it would be difficult to determine the reasonableness of expenditures across bidders.

Governmental entities have become more sophisticated in their dealings with corporations and have investigated other ways to tap funds from gaming corporations. One such strategy is taking a percentage of the profits. Evaluation of the different proposals may suggest that one company is providing a higher percentage of the profits but closer analysis of what each proponent means by profits can result in different conclusions. It is therefore important for the RFP to identify which definition of profit to use or, alternatively, require the bidders to clearly identify the assumptions used to calculate these figures.

Governmental entities can reduce misunderstandings by trying to narrow the assumptions that might be used by the bidders in their preparation of financial projections. It is essential that the RFPs clearly articulate any criteria that should be consistent across companies, for example, an inflation rate.

On the other hand, the bidders need to clearly spell out the basic assumptions used in their financial projections. For instance, the impact on revenues and expenses will vary depending on the market that the bidder is aiming for, that is, the high end market versus the grind market. Aiming for the high end market implies higher revenues per customer, higher comp costs, and higher hotel service costs.

Conclusion

The New Orleans experience clearly shows that the RFP process can be full of pitfalls if not carefully thought out. On the other hand, later RFPs such as Windsor and the Rama First Nation show that the process can be effective and efficient if the selection process is clearly defined before issuing an RFP. Table 2 highlights the main points for consideration when developing an RFP. The selection committee (for the governmental entity) must take the time and effort to explicitly define the type of casino desired, the type of financial information it wants presented in the bids, and the necessary financial conditions which the bidders must meet. Table 3 highlights the financial information that should be requested. Because financial data plays such a major role in the selection process, it is vital that the requested financial data is comparable across bidders. Providing a format for the financial information will help in organizing and comparing the bidders' proposals. The net result is a more effective and efficient selection process.

Table 2. Points for More Effective and Efficient Casino RFPS

1. Clearly define the parameters to which the proposal must conform as well as any limitations of the specified project.
2. Specify the criteria to be used in the selection process.
3. Given the importance of gaming experience and financial flexibility, clearly spell out the type of financial and managerial information that will be used for the selection process.

Table 3. Suggested Financial Data for Casino RFPS

1. Annual reports for all associated entities
2. Information on the financial structure of any newly incorporated company as well as backing from its parent corporations. Including:
   a. Controlling percentage interests,
   b. Parties running new casino operation, and
   c. Guarantees from parent corporations.
3. Information on current and projected projects, including:
   a. Costs of project, and
   b. Financing associated with project.
4. Information on financing proposed project, including:
   a. Debt versus equity financing, and
   b. Guarantees.
5. Financial projection information, including:
   a. Specified time period,
   b. Growth and inflation factors,
   c. Discount rate for present value cash flows,
   d. Defined categories for departmental expenses, and
   e. Disclosure of all financing and management fees.

The bidders must conform to the requirements of the RFP and insure that their financing package is in place. If both parties do their parts, the time from the initial issue of the RFP to the generation of revenues by either a temporary or permanent casino should be minimized.

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