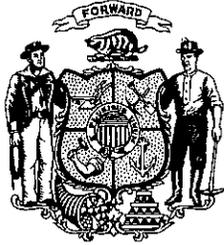


State of Wisconsin

SENATE CHAIR
Alberta Darling

317 East, State Capitol
P.O. Box 7882
Madison, WI 53707-7882
Phone: (608) 266-5830



ASSEMBLY CHAIR
John Nygren

309 East, State Capitol
P.O. Box 8593
Madison, WI 53708-8953
Phone: (608) 266-2343

Joint Committee on Finance

MEMORANDUM

To: Members
Joint Committee on Finance

From: Senator Alberta Darling
Representative John Nygren

Date: February 23, 2016

Re: 14-Day Passive Review Approval – DOR

Pursuant to s. 565.02(7), Stats., attached is a 14-day passive review request from the Department of Revenue, received on February 23, 2016.

Please review the material and notify **Senator Darling** or **Representative Nygren** no later than **Friday, March 11, 2016**, if you have any concerns about the request or if you would like the Committee to meet formally to consider it.

Also, please contact us if you need further information.

Attachments

AD:JN:jm



State of Wisconsin • DEPARTMENT OF REVENUE

2135 RIMROCK ROAD • Mail Stop 624A • P.O. BOX 8933 • MADISON, WISCONSIN 53708-8933 • 608-266-6466 • FAX (608) 266-5718
<http://www.revenue.wi.gov>

Scott Walker
Governor

Richard G. Chandler
Secretary of Revenue

February 23, 2016

The Honorable Alberta Darling, Co-Chair
Member, Joint Committee on Finance
317 East, State Capitol
Madison, WI 53708

RECEIVED
FEB 23 2016

BY: *St. Finance*

The Honorable John Nygren, Co-Chair
Member, Joint Committee on Finance
309 East, State Capitol
Madison, WI 53708

Dear Senator Darling and Representative Nygren:

Section 565.02(7), Wis. Stats., requires a report to the Joint Committee on Finance every March 1, containing the following information:

- A. An estimate of lottery ticket sales and prize payment for the current and subsequent fiscal year;
- B. The prize payout percentages for each type of lottery game offered; and
- C. The Lottery's evaluation of the impact that prize payout ratios are likely to have upon ticket sales and operating costs, and upon the Lottery's constitutionally mandated mission to maximize revenue for property tax relief in Wisconsin.

The report, which is attached, recommends a prize payout of 60.27% for FY 16 and proposes a payout of 60.27% for FY 17.

Please feel free to contact me should you have any questions.

Sincerely,

Richard G. Chandler
Secretary of Revenue

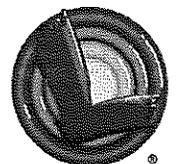
Enclosure

Lottery Sales and Prize Payout

Report to the Joint
Committee on Finance

Wisconsin Department of Revenue
Lottery Division

February 23, 2016



**WISCONSIN
LOTTERY**

EXECUTIVE SUMMARY

The Wisconsin Lottery's mission is to provide property tax relief to Wisconsin homeowners by offering entertaining games while operating with security, integrity, and social responsibility.

Since the sale of the first ticket on September 14, 1988, the Lottery has generated over \$3.87 billion in property tax relief for Wisconsin homeowners, \$766 million in commissions for Wisconsin businesses, and more than \$7.14 billion in prizes for players.

- In FY 15, the Lottery had its fourth record sales year in a row.
- Sales of instant tickets also set a record, and lotto ticket sales were the fifth highest in Wisconsin history.
- Wisconsin's sales outlook and ability to generate funds for property tax relief remain positive with continued historically high levels of ticket sales.

In accordance with sec. 565.02(7), Wis. Stats., the Department of Revenue, Lottery Division, submits this report, detailing the following:

- An estimate of ticket sales and prize payment for the current and subsequent fiscal year.
- The prize payout percentages for each type of lottery game offered.
- An evaluation of the impact that prize payout ratios are likely to have upon ticket sales, operating costs, and maximizing revenue for property tax relief.

Sales Overview

Fiscal Year (FY) 2015 marked the fourth consecutive year of record-breaking sales for the Wisconsin Lottery. FY 15 sales were \$574.6 million, surpassing the previous year's record of \$568.8 million. Sales of instant tickets (scratch and pulltab) were \$357.5 million, yet another record. Sales of lotto tickets (e.g., Powerball and Badger 5) were \$217.2 million, the fifth highest in Wisconsin Lottery history.¹ Net operating income was \$159.3 million.

The Lottery's sales outlook and ability to generate funds for property tax relief remain strong.

Fiscal Year 2016: The Lottery projects that gross revenues from the sale of lottery tickets will be \$580.2 million.²

Fiscal Year 2017: Gross revenues are projected at \$580.2 million.

Lottery sales are difficult to project due to the volatility of jackpot game sales. These sales are largely driven by the size and frequency of the jackpots, which occur randomly. Approximately 25% of all Lottery sales in FY 15 came from such games.³ The Lottery has established a range to forecast future performance based upon past performance, but that range is broad and jackpot game sales from year to year can be tens of millions of dollars different from estimates.

The Lottery continues to enhance its Wisconsin-only lotto games, such as SuperCash!, and Badger 5, through improvements to the games and limited time offers.

¹ FY 15 sales data is from the Wisconsin Lottery's FY 15 Unaudited Financial Statements as of December 17, 2015. These financial statements are preliminary and subject to change.

² Lottery Fund Condition Statement, October 1, 2015, used in certifying the amount of Lottery and Gaming Credit for property taxes levied in 2015.

³ Includes Powerball, Mega Millions, Megabucks, and the daily game Badger 5.



The Lottery is engaged in a long-term growth strategy for instant scratch sales by meeting consumer demand for more games at higher price points, with strong sales continuing to build for tickets priced \$10 and higher. This increase in higher price point sales has driven the significant growth in scratch sales in recent years. In response to consumer demand for higher price point tickets, the Lottery successfully introduced a \$30 scratch ticket into its game portfolio in 2014, and continues to offer innovative \$10, \$15, and \$20 tickets.

Prize Payout

The prize payout percentage is the amount of Lottery revenue that is returned to players in the form of prizes. Each individual game has a unique prize structure that represents the number and value of its prizes and the odds of winning those prizes. In FY 15 the prize payout was 59.59%. In FY 14 the Lottery's prize payout was 59.19%. By comparison, the overall prize payout for U.S. lottery jurisdictions was 62.55%.⁴

Fiscal Year 2016: The Lottery expects to pay \$349.6 million in prizes. Total prize payout for all Lottery games is estimated to be 60.27%.

Fiscal Year 2017: The Lottery expects to pay \$349.6 million in prizes. Total prize payout is estimated to be 60.27%.

Prize Payout Impact

Prize payout increases have contributed to record sales. In FY 05, the prize payout was 58.06%; sales were \$451.9 million. Last year the prize payout was 59.59%; sales were \$574.6 million.⁵

At the same time, operating expenses, as a percentage of gross revenues, have remained low. FY 15 administrative expenses were \$34.1 million, 5.94% of gross operating revenue, well below the 10% limit set by state statute.⁶

The Lottery will achieve its sales goals with only slight adjustments to its current prize payout percentages. The Lottery proposes to maintain the instant scratch game prize payout at 66.26% in FY 16 and FY 17. This marginal increase from FY 15 will allow the Lottery to maintain the successful higher price point strategy. Pulltab prize payout is expected to be 62.95% in FY 16 and FY 17. Total lotto game prize payout is also projected to go from 48.76% in FY 15 to 50.67% in FY 16 and FY 17.

⁴Based on data from reporting lotteries as presented in La Fleur's 2015 World Lottery Almanac, p. 241. FY 14 is the latest year for which national figures for traditional ticket sales and prize payout are available. Does not include Illinois.

⁵Legislative Audit Bureau Report 07-8, June 2007: Financial Audit of the Wisconsin Lottery. (<http://legis.wisconsin.gov/lab/reports/07-8full.pdf>)

⁶Expense and Revenue figures are from the Wisconsin Lottery's FY 15 Unaudited Financial Statements as of December 17, 2015. These financial statements are preliminary and subject to change.

WISCONSIN LOTTERY PRIZE PAYOUT REPORT 2016

LOTTERY SALES

Sales have risen steadily over the last five years, from \$502.7 million in FY 11 to record sales in each of the last four years.⁷ Lottery sales were \$574.6 million in FY 15.

Sales for FY 16 are expected to remain strong at \$580.2 million. Sales by game type for the past three years and projected sales for the next two years are shown on Table 1.

Table 1. Sales by Fiscal Year and Game Type

Game Type	FY 13 Sales Final*	FY 14 Sales Final*	FY 15 Sales Preliminary**	FY 16 Sales Projection***	FY 17 Sales Projection***
Instant Scratch	\$324,035,688	\$337,699,578	\$356,370,186	\$356,191,512	\$356,191,512
Pulltab	\$2,690,059	\$1,261,233	\$1,093,320	\$974,448	\$974,448
Lotto	\$239,376,954	\$229,876,604	\$217,167,877	\$223,006,916	\$223,006,916
Total	\$566,102,701	\$568,837,415	\$574,631,382	\$580,172,876	\$580,172,876

Note: Totals may not equal the exact sum of the figures in each column, due to rounding.

*Source: Legislative Audit Bureau Report 15-9, July 2015: Financial Audit of the Wisconsin Lottery. Figures rounded to the nearest dollar. (<http://legis.wisconsin.gov/lab/reports/15-9full.pdf>)

**Source: Wisconsin Lottery FY 15 Unaudited Financial Statements, rounded to the nearest dollar, as of December 17, 2015. These financial statements are preliminary and subject to change.

***Source: Lottery Fund Condition Statement, October 1, 2015, used in certifying the amount of Lottery and Gaming Credit for property taxes levied in 2015, rounded to the nearest dollar.

TOTAL PRIZE PAYOUT AND PRIZES PAID OR EXPECTED TO BE PAID

Wisconsin law requires that at least 50% of Lottery gross sales be returned to players as prize payments.⁸ In FY 15, 59.59% of Lottery gross sales were returned to players as prize payments. The Lottery estimates that its total prize payout for all products in FY 16 will increase slightly to 60.27%. In FY 17, the Lottery's prize payout for all game categories is projected to remain at 60.27%. The prize payout for Wisconsin Lottery games will continue to be below industry averages.

Scratch Ticket Prize Payout

While the Lottery carefully plans and projects aggregate annual prize payout percentages, the actual percentage of prizes paid for individual scratch games may be more or less than the planned payout. This can occur when sales of a particular game are discontinued before all the tickets are sold, as is done when the last top prize is claimed. Sales of games with drawing prizes may also accrue in one fiscal year, while the prizes are drawn and awarded in the following year. Finally, unclaimed prizes may be credited after the year in which the prize expense was accrued.

In FY 14, the Lottery introduced a \$30 scratch ticket to its game mix. This game continues to generate incremental sales and remains a very significant part of the overall product portfolio. Furthermore, since the launch of the \$30 ticket, sales of \$20 scratch games have increased.

⁷ FY 11 sales data is from Legislative Audit Bureau Report 15-9, July 2015: Financial Audit of the Wisconsin Lottery. (<http://legis.wisconsin.gov/lab/reports/15-9full.pdf>)

⁸ Sec. 25.75(3)(a), Wis. Stats.



Price points at or above \$10 accounted for 41.1% of scratch sales in FY 15, up from 39.7% in FY 14 and 36.0% in FY 13. This increase in higher price point sales has driven overall sales significantly higher in recent years; instant scratch game sales have posted four consecutive record-setting years: \$320.1 million in FY 12, \$324.0 million in FY 13, \$337.7 million in FY 14, and \$356.4 million in FY 15. Sales are expected to decline minimally, but still remain over the \$356 million mark in both FY 16 and FY 17.

The Lottery estimates that continued strong sales of higher price point (higher prize payout) games will result in marginally higher aggregate scratch ticket payout rates over the next two fiscal years. However, these payouts should be accompanied by continued robust sales of over \$356 million per year.

Prize payout for instant scratch tickets was 66.18% in FY 15. The Lottery estimates that aggregate instant scratch game prize payout will be 66.26% in FY 16 and 66.26% in FY 17. This payout percentage will allow the Lottery to continue its strategy of meeting the market demand for higher price point tickets. The success of \$30, \$20, \$15, and \$10 scratch games and four consecutive years of record sales have demonstrated the benefits of such a strategy.

Pulltab Prize Payout

The Lottery continues to offer traditional pulltab tickets without validation barcodes. Prize payout for pulltab tickets was 62.95% in FY 15. Sales and prize payout projections for the next two years assume no reintroduction of validation-coded pulltabs. The expected prize payout for FY 16 is 62.95% and FY 17 is 62.95%.

Lotto Prize Payout

It is difficult to project the prize payout of lotto games because, unlike scratch and pulltab games, they normally do not have a predetermined number of winners. The number of winners and the amount of the prizes won occur randomly. Prize payout for lotto tickets was 48.76% in FY 15. The overall lotto game payout is anticipated to be 50.67% in FY 16 and 50.67% in FY 17.

Total Prize Payout

The average prize payout percentages by game type for the past three fiscal years and the estimated prize payout percentages for the next two fiscal years are shown in Table 2. A weighted average is used to more accurately reflect the performance of games with higher sales.

Table 2. Weighted Average Prize Payout Percentages by Fiscal Year and by Game Type*
(Percentages are rounded)

Game Type	FY 13** Prize Payout	FY 14** Prize Payout	FY 15*** Prize Payout Preliminary	FY 16**** Prize Payout Estimated	FY 17**** Prize Payout Estimated
Instant Scratch	64.67%	65.40%	66.18%	66.26%	66.26%
Pulltab	60.78%	60.57%	62.95%	62.95%	62.95%
Lotto	49.30%	50.05%	48.76%	50.67%	50.67%
Total	58.15%	59.19%	59.59%	60.27%	60.27%

* Data in Tables 1 and 2 have been rounded and may not exactly match data in Table 3.

**Based on data in Legislative Audit Bureau Report 15-9, July 2015: Financial Audit of the Wisconsin Lottery. (<http://legis.wisconsin.gov/lab/reports/15-9full.pdf>)

***Source: Wisconsin Lottery FY 15 Unaudited Financial Statements as of December 17, 2015. The financial statements are preliminary and subject to change.

**** Based on Lottery sales estimates, Lottery Fund Condition Statement, October 1, 2015.

Table 3 shows prizes paid during the past three fiscal years and prizes expected to be paid in the next two fiscal years. Prizes expected to be paid in FY 16 and FY 17 are calculated by multiplying the sales projection for each game by its prize payout percentage.

Table 3. Prizes Paid or Expected to be Paid by Fiscal Year and by Game Type*

Game Type	FY 13** Prize Expense (Final)	FY 14** Prizes Expense (Final)	FY 15*** Prizes Expense (Preliminary)	FY 16**** Projected Prize Expense	FY 17**** Projected Prize Expense
Instant Scratch	\$209,550,537	\$220,871,369	\$235,861,007	\$236,028,379	\$236,028,379
Pulltab	\$1,634,993	\$763,928	\$688,267	\$613,415	\$613,415
Lotto	\$118,016,139	\$115,059,226	\$105,892,045	\$113,002,823	\$113,002,823
Total	\$329,201,669	\$336,694,523	\$342,441,318	\$349,644,617	\$349,644,617

Note: Totals may not equal the exact sum of the figures in each column, due to rounding.

*Rounded to nearest dollar. Amounts shown are based on the accrual method of accounting, consistent with generally accepted accounting principles (GAAP).

**Source: Legislative Audit Bureau Report 15-9, July 2015: Financial Audit of the Wisconsin Lottery. Figures rounded to the nearest dollar. (<http://legis.wisconsin.gov/lab/reports/15-9full.pdf>)

***Source: Wisconsin Lottery FY 15 Unaudited Financial Statements, rounded to the nearest dollar, as of December 17, 2015. These financial statements are preliminary and are subject to change.

**** Based on Lottery sales estimates, Lottery Fund Condition Statement, October 1, 2015.

PRIZE PAYOUT IMPACT ON REVENUES, EXPENSES AND PROPERTY TAX RELIEF

In establishing the proper prize payout, the Lottery seeks to strike a balance between maximizing profits and providing players with the rewards they expect. The Lottery has been very conservative in its use of prize payout to drive sales, with positive results.

In FY 05 the overall prize payout was 58.06%; in FY 15 it was 59.59%.⁹ During the same period, annual sales increased over \$122.7 million, from \$451.9 million to \$574.6 million. Net operating income increased from \$130.1 million to \$159.3 million (preliminary). The Lottery carefully manages payout to maximize funds available for property tax relief.

Instant Scratch Market Trends and Prize Payout

Instant scratch ticket sales have been unprecedented in recent years. FY 15 was a fourth consecutive record-setting year, with \$356.4 million in instant scratch sales, eclipsing the old record of \$337.7 million set the previous year. Much of the growth has come from consumer demand for higher priced tickets which have higher top prizes, better overall odds of winning and higher payouts. Players see increased entertainment value in a higher risk-reward proposition. The Lottery expects that it will be able to maintain instant scratch ticket sales over the \$350 million mark without introducing any new price points. The Lottery projects instant sales in both FY 16 and FY 17 to be nearly \$356.2 million.

Offering higher price point tickets with higher payouts is consistent with the industry strategy of offering more in prizes as a player risks more in the purchase price of a ticket. Table 4 depicts the shift in sales from lower priced tickets to higher priced tickets. In FY 15, 41.1% of scratch sales occurred at \$10 and higher, compared to 34.5% in FY 12.

Table 4. Percentage of Total Net Sales by Price Point

Price Point	FY 12 – % of Total Net Sales	FY 13 – % of Total Net Sales	FY 14 – % of Total Net Sales	FY 15 – % of Total Net Sales	FY 16 YTD – % of Total Net Sales**
\$1	7.5%	7.0%	6.8%	6.0%	5.5%
\$2	18.4%	18.2%	16.8%	15.1%	14.8%
\$3	14.2%	13.6%	12.4%	12.9%	11.6%
\$5	25.5%	25.2%	24.4%	24.9%	25.4%
\$10	14.6%	17.5%	16.2%	15.1%	13.2%
\$15*	---	1.2%	1.2%	1.1%	2.1%
\$20	19.9%	17.3%	16.6%	17.0%	21.1%
\$30	---	---	5.7%	7.9%	6.3%

Note: Percentages may not sum to 100% due to rounding.

*\$15 price point is a seasonal (holiday) game.

**Through October 31, 2015.

Ten years ago, five of the Lottery's 59 instant scratch games were higher price-point games. In FY 16, the Lottery anticipates introducing 74 new games, 17 at the \$10 price point and higher (Table 5). The total number of games launched has declined slightly due to some declines in lower-price-point ticket sales and to higher print runs on select games, leading to longer life on the market.

⁹ FY 05 data is from Legislative Audit Bureau Report 07-8, June 2007: Financial Audit of the Wisconsin Lottery. (<http://legis.wisconsin.gov/lab/reports/07-8full.pdf>)

The prize payout was 66.18% in FY 15, which was 0.68 percentage points higher than the projected payout of 65.50%. The Lottery estimates that the payout will be 66.26% in FY 16 (0.76 percentage points higher than last year's estimate for FY 16) and 66.26% in FY 17. The higher than expected payouts are primarily due to better than expected sales of the new \$30 price point combined with increasing sales of \$20 tickets.

Table 5. Historical Perspective: Number of New Game Launches

Price Point	FY 06 Number of Games	FY 13 Number of Games	FY 14 Number of Games	FY 15 Number of Games	FY 16 Anticipated No. of Games	FY 17 Anticipated No. of Games
\$ 1	19	17	17	15	15	15
\$ 2	17	16	16	12	12	12
\$ 3	8	14	12	14	14	14
\$ 5	10	16	15	16	16	16
\$10	3	11	9	8	8	8
\$15	0	1	1	1	1	1
\$20	2	5	5	6	6	6
\$30	0	0	2	1	2	2
Total Number of Games	59	80	77	73	74	74
Overall Scratch Prize Payout	64.14%	64.67%	65.40%	66.18%	66.26%	66.26%

The Wisconsin Lottery's planned prize payout is lower than the lottery industry's average at all price points (Table 6). The average instant prize payout for U.S. lottery jurisdictions was 67.78% in FY 15, which is 1.60 percentage points higher than Wisconsin. The Wisconsin Lottery payout for FY 16 is anticipated to be 66.26%, which is 1.99 percentage points below the national average of 68.25%.

The trend towards stronger sales of higher price-point (higher prize payout) games will allow the Lottery to continue to generate strong instant scratch sales. To support this strategy, prize payouts will rise modestly in the next two years, but will remain well below industry averages.

Table 6. Average Payout Rate by Price Point

Price Point	U.S. Lotteries' FY 16 Average Payout Rate *	Wisconsin's Designed Payout Rate
\$1	60.6%	59.0%
\$2	64.2%	62.0%
\$3	65.3%	63.0%
\$5	68.4%	64.5%
\$10	72.3%	70.0%
\$15	NA	72.0%
\$20	74.4%	74.0%
\$30	76.6%	75.0%

*Based on data presented in La Fleur's Magazine, July/August, 2015.

Pulltab Market Trends and Prize Payout

Wisconsin Lottery pulltab ticket sales decreased to \$1.09 million in FY 15 due mainly to lower demand from both for-profit and nonprofit retailers. Total sales for all pulltab tickets were \$1.26 million in FY 14 and \$2.69 million in FY 13. This decrease was due in large part to the phasing out of validation-coded pulltab games in late FY 13 and early FY 14. For-profit retailer sales were approximately \$232,465 in FY 14 and \$122,510 in FY 15. Nonprofit sales were \$1.03 million in FY 14 and \$970,810 in FY 15.

At one time when the Lottery was the exclusive vendor of pulltabs in the state, the Lottery had annual pulltab sales of over \$20 million. The Lottery's market share has been eroded by private vendors operating either illegally or under sec.100.16(2), Wis. Stats., a law designed to allow limited-term games of chance by retailers (e.g., McDonald's Monopoly game) and provides few protections for those who purchase these private pulltabs. Moreover, the playing field is uneven. Private vendors can offer retailers a higher commission, whereas the Lottery's commission is set by law.¹⁰

Lotto Game Market Trends and Prize Payout

The prize payout ratio for lotto games was 48.76% in FY 15, ranging from 43.41% (Daily Pick 3) to 60.96% (EZ Match). Table 7 lists the lotto games and associated designed prize payouts that are currently offered in Wisconsin. Actual prizes paid, as a percentage of sales, may be less than the designed prize payout. For example, winners not claiming their prizes will result in lower prize payout. Prizes paid, as a percentage of sales, may also be more than the designed prize payout due to the random nature of game drawings and limited time offers that the Lottery uses to enhance its other Wisconsin-only lotto games, such as SuperCash! and Badger 5.

Table 7

Lotto Games and Corresponding Start Dates and Prize Payout Rates*

Lotto Games	Start Date	Designed Payout*
Powerball	4/19/92	50.00%
Megabucks	6/18/92	53.50%
EZ Match	4/3/11	63.15%
SuperCash!	2/4/91	52.80%
Daily Pick 4	9/15/97	48.40%
Daily Pick 3	9/21/92	48.20%
Badger 5	2/17/03	50.00%
Mega Millions	1/31/10	50.00%
5 Card Cash	4/6/14	60.29%
Special Draw (Raffle)	3/4/07	50.00%

* Reflects anticipated rate based on game design and is approximate.

Traditionally, the prize payout for lotto games has been lower than that for instant scratch games. The primary appeal of most lotto games is the chance to win larger prizes, including large jackpot prizes. The Lottery believes it can manage the lotto product line at this time without a significant change to prize payout in the coming fiscal year.

¹⁰ For a fuller discussion of this issue see the November 2008 audit of the Lottery conducted by the Legislative Audit Bureau, Report 08-13, pp. 22-24. (<http://legis.wisconsin.gov/lab/reports/08-13full.pdf>)

Impact of Prize Payout on Operating Costs

Prize payout has had little effect on administrative costs. Sales increased in FY 15 to \$574.6 million from \$568.8 million in FY 14. Total administrative expenditures as determined in accordance with sec. 25.75(3)(b), Wis. Stats. were \$34.1 million (preliminary). This amount represents 5.94% of gross lottery revenues in FY 15, well within the 10% limitation set by statute.

SUMMARY

Sales will remain strong in FY 16 and FY 17 as the Wisconsin Lottery continues to improve its game mix in all product categories. The Lottery continues to work diligently to maximize funds available for property tax relief. The proposed prize payouts will result in significant revenues for that purpose.

Consistent with national trends, the introduction of higher price points to the instant scratch game mix has proved to be a successful strategy.

For FY 17, the Lottery proposes an overall prize payout of 60.27%, consistent with the projected 60.27% payout in FY 16. The breakdown for FY 17 is as follows:

- Instant scratch prize payout of 66.26%, to meet growing consumer demand for higher price point games.
- Pulltab payout of 62.95%.
- Lotto game payout of 50.67%.

