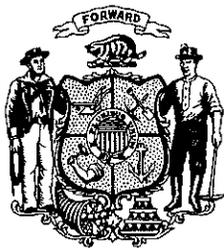


State of Wisconsin

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 24, 2017

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 24, 2017.

Please review the material and notify **Senator Darling** or **Representative Nygren** no later than **Wednesday, March 15, 2017**, 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 22, 2017

FEB 24 2017
St. Finance

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

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 no later than March 1 of each year, 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 60.35% for FY 17 and proposes a payout of 60.35% for FY 18.

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 22, 2017



**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. The Lottery's sales outlook and ability to generate funds for property tax relief remain positive with continued historically high levels of ticket sales.

Since the sale of the first ticket on September 14, 1988, the Lottery has generated more than \$4.0 billion in property tax relief for Wisconsin homeowners, over \$836 million in commissions for Wisconsin businesses, and more than \$7.5 billion in prizes for players.

- In FY 16, the Lottery had its fifth consecutive record sales year.
- Instant scratch tickets and lotto tickets each had their highest annual sales in Wisconsin Lottery history.
- Pull-tab ticket sales, while much smaller than the other two product lines, remained fairly consistent with the previous fiscal year.

Sales will remain strong in FY 17 and FY 18 as the Wisconsin Lottery continues to improve its game mix in all product categories. The projected breakdown for FY 18 is as follows:

- Instant scratch sales: \$384.4 million.
- Pull-tab sales: \$1.1 million.
- Lotto sales: \$231.9 million.
- Total sales: \$617.4 million.

For FY 18, the Lottery proposes an overall prize payout of 60.35%, consistent with the projected 60.35% payout in FY 17. The projected breakdown for FY 18 is as follows:

- Instant scratch prize payout of 66.26%, to meet growing consumer demand for higher price point games.
- Pull-tab payout of 62.89%.
- Lotto game payout of 50.53%.

At the same time, operating expenses, as a percentage of gross revenues, remain low. FY 16 administrative expenses were \$36.6 million, 5.84% of gross operating revenue, well below the 10% cap set by state statute.

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.



WISCONSIN LOTTERY PRIZE PAYOUT REPORT 2017

LOTTERY SALES

Fiscal Year (FY) 2016 marked the fifth consecutive year of record-breaking sales for the Wisconsin Lottery. FY 16 sales were \$627.2 million, surpassing the previous year's record of \$574.6 million. Sales of instant tickets (scratch and pull-tab combined) were \$379.9 million, yet another record. Sales of lotto tickets (e.g., Powerball and Badger 5) were \$247.2 million, the highest in Wisconsin Lottery history.¹

The Lottery's sales outlook and ability to generate funds for property tax relief remain strong. The Lottery projects that gross revenues from the sale of lottery tickets will be \$617.4 million in FY 17.² Gross revenues are also projected at \$617.4 million in FY 18.

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. Approximately 28% of all Lottery sales in FY 16 came from these games.³ The Lottery has established a range to forecast future jackpot game 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 Badger 5 and SuperCash!, through improvements to the games and limited time offers.

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 ticket 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 added a second \$30 scratch ticket to its game portfolio in 2016, and continues to offer innovative \$10, \$15 and \$20 tickets.

Sales by game type for the past three years and projected sales for the next two years are shown on Table 1.

¹ FY 16 sales data is from the Wisconsin Lottery's FY 16 Unaudited Financial Statements as of January 18, 2017. These financial statements are preliminary and subject to change.

² Lottery Fund Condition Statement, September 22, 2016, used in certifying the amount of Lottery and Gaming Credit for property taxes levied in 2016.

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



Table 1. Sales by Fiscal Year and Game Type

Game Type	FY 14 Sales Final*	FY 15 Sales Final*	FY 16 Sales Preliminary**	FY 17 Sales Projection***	FY 18 Sales Projection***
Instant Scratch	\$337,699,578	\$356,370,186	\$378,800,170	\$384,377,573	\$384,377,573
Pull-tab	\$1,261,233	\$1,093,320	\$1,130,803	\$1,130,803	\$1,130,803
Lotto	\$229,876,604	\$217,167,877	\$247,233,964	\$231,922,805	\$231,922,805
Total	\$568,837,415	\$574,631,383	\$627,164,937	\$617,431,181	\$617,431,181

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

* Source: Legislative Audit Bureau Report 16-7, July 2016: Financial Audit of the Wisconsin Lottery. Figures rounded to the nearest dollar. (<https://legis.wisconsin.gov/lab/reports/16-7full.pdf>)

** Source: Wisconsin Lottery FY 16 Unaudited Financial Statements, rounded to the nearest dollar, as of January 18, 2017. These financial statements are preliminary and subject to change.

*** Source: Lottery Fund Condition Statement, September 22, 2016, used in certifying the amount of Lottery and Gaming Credit for property taxes levied in 2016, rounded to the nearest dollar.

PRIZE PAYOUT

Each individual game has a unique prize structure that represents the value of its prizes and the odds of winning those prizes. The prize payout is the percentage of Lottery revenue that is returned to players in the form of prizes.

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 instant scratch 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.

It is also difficult to project the annual prize payout of lotto games because, unlike scratch and pull-tab games, they normally do not have a predetermined number of winners. The number of winners and the amount of the prizes won occur randomly.

That being stated, the Lottery is able to estimate the future aggregate annual prize payout percentages for each of its three main product types, by examining current market trends, evolving consumer preferences, and forecasted sales figures from the Lottery Fund Condition Statement used in certifying the amount of Lottery and Gaming Credit for property taxes.

Scratch Tickets

Much of the growth in instant scratch ticket sales has come from consumer demand for higher priced tickets which have higher top prizes, better overall odds of winning and higher payouts. 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. Players see increased entertainment value in a higher risk-reward proposition.



Price points at or above \$10 accounted for 43.5% of scratch sales in FY 16, compared to 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 five consecutive record-setting years, trending steadily up from \$320.1 million in FY 12 to \$378.8 million in FY 16.⁴ Sales are expected to climb to \$384.4 million in FY 17.

Table 2 depicts the shift in sales from lower priced tickets to higher priced tickets.

Table 2. Percentage of Total Net Sales by Price Point

Price Point	FY 13 – % of Total Net Sales	FY 14 – % of Total Net Sales	FY 15 – % of Total Net Sales	FY 16 – % of Total Net Sales	FY 17 YTD – % of Total Net Sales**
\$1	7.0%	6.8%	6.0%	5.4%	5.8%
\$2	18.2%	16.8%	15.1%	15.1%	14.3%
\$3	13.6%	12.4%	12.9%	11.4%	11.0%
\$5	25.2%	24.4%	24.9%	24.4%	23.5%
\$10	17.5%	16.2%	15.1%	14.9%	15.2%
\$15*	1.2%	1.2%	1.1%	1.2%	2.9%
\$20	17.3%	16.6%	17.0%	20.5%	18.2%
\$30	---	5.7%	7.9%	6.9%	9.1%

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

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

** Through December 31, 2016

⁴ FY 12 data is from Legislative Audit Bureau Report 15-9, July 2015: Financial Audit of the Wisconsin Lottery. (<https://legis.wisconsin.gov/lab/media/1188/15-9full.pdf>)

Ten years ago, six of the Lottery's 67 instant scratch games were higher price-point games. In FY 17, the Lottery anticipates introducing 81 new games, 22 at the \$10 price point and higher (Table 3). The total number of games launched has increased slightly due to the incremental nature of game sales at higher price points.

Table 3. Historical Perspective: Number of New Game Launches

Price Point	FY 07 Number of Games	FY 14 Number of Games	FY 15 Number of Games	FY 16 Number of Games	FY 17 Anticipated Number of Games	FY 18 Anticipated Number of Games
\$1	18	17	15	15	15	15
\$2	17	16	12	14	14	14
\$3	13	12	14	13	13	13
\$5	13	15	16	17	17	17
\$10	4	9	8	10	10	10
\$15	0	1	1	1	1	1
\$20	2	5	6	8	8	8
\$30	0	2	1	2	3	3
Total Number of Games	67	77	73	80	81	81
Overall Scratch Prize Payout	64.52%	65.40%	66.18%	65.81%	66.26%	66.26%

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. These payouts should be accompanied by continued robust sales of \$384.4 million per year.

Prize payout for instant scratch tickets was 65.81% in FY 16. With sales of higher price point games continuing to grow, and sales of low price point games gradually declining, the Lottery estimates that aggregate instant scratch game prize payout will be 66.26% in FY 17 and 66.26% in FY 18; this is the payout level approved in the 2016 Prize Payout Report. This payout percentage will allow the Lottery to continue its strategy of meeting the market demand for higher price point tickets.

The Wisconsin Lottery's planned prize payout is lower than the lottery industry's average at all price points (Table 4). The average instant prize payout for U.S. lottery jurisdictions was 68.55% in FY 16, which is 2.74 percentage points higher than Wisconsin. The Wisconsin Lottery payout for FY 17 is anticipated to be 66.26%, which is 2.19 percentage points below the projected national average of 68.45%.

The trend towards stronger sales of higher price-point 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 to previously-approved levels, but will remain well below industry averages.

Table 4. Average Payout Rate by Price Point

Price Point	U.S. Lotteries' FY 16 Average Payout Rate *	Wisconsin's Designed Payout Rate
\$1	60.4%	59.0%
\$2	64.0%	62.0%
\$3	65.1%	63.0%
\$5	68.4%	64.5%
\$10	72.3%	70.0%
\$15	NA	72.0%
\$20	74.6%	74.0%
\$30	76.9%	75.0%

* Based on data presented in La Fleur's Magazine, Vol. 23 No. 6, July/August, 2016.

Pull-tab Tickets

The Lottery continues to offer traditional pull-tab tickets without validation barcodes. Prize payout for pull-tab tickets was 62.89% in FY 16. Sales and prize payout projections for the next two years assume no reintroduction of validation-coded pull-tabs. A prize payout of 62.89% is expected for FY 17 and FY 18.

Wisconsin Lottery pull-tab ticket sales increased to \$1.13 million in FY 16 due mainly to increased demand from nonprofit retailers. Total sales for all pull-tab tickets were \$1.10 million in FY 15 and \$1.26 million in FY 14. The decrease in FY 15 was due in part to the phasing out of the remaining validation-coded pull-tab games in early FY 14. For-profit retailer sales were approximately \$122,510 in FY 15 and \$120,958 in FY 16. Nonprofit sales were \$970,810 in FY 15 and \$1.01 million in FY 16.

The Lottery had annual pull-tab sales of more than \$20 million when it was the exclusive vendor of pull-tabs in Wisconsin. However, the Lottery's market share has been eroded by private vendors operating either illegally or under sec.100.16(2), Wis. Stats. The law was designed to allow limited-term games of chance by retailers (e.g., McDonald's Monopoly game), but provides few protections for those who purchase these private pull-tabs. Moreover, the playing field is uneven. Private vendors can offer retailers a higher commission, whereas the Lottery's commission is set by law.⁵

Lotto Tickets

The prize payout for lotto games has traditionally been lower than that for instant scratch games. The primary appeal of most lotto games is the chance to win large jackpot prizes.

The prize payout ratio for lotto games was 49.58% in FY 16, ranging from 44.68% (Daily Pick 4) to 60.30% (EZ Match). Table 5 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 several reasons, such as winners not claiming their prizes. 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 Wisconsin-only lotto games, such as SuperCash! and Badger 5.

⁵ 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>)

Table 5
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.

In FY 16, increases in prize payout were driven by more SuperCash! top prize winners (17 vs. 10 the prior year) and two Megabucks jackpot prizes that were won before the jackpot was fully funded (October 21 and 31, 2015).

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. The overall lotto game payout is anticipated to be 50.53% in FY 17 and 50.53% in FY 18.

Total Prize Payout and Prize Expense

Wisconsin law requires that at least 50% of Lottery gross sales be returned to players as prize payments.⁶ In FY 15 the Lottery's prize payout was 59.59%. By comparison, the overall prize payout for U.S. lottery jurisdictions was 62.73%.⁷ In FY 16, 59.40% of Lottery gross sales were returned to players as prize payments. Over the next two fiscal years, the prize payout for Wisconsin Lottery games will continue to be below industry averages.

Fiscal Year 2017: The Lottery expects to pay \$372.6 million in prizes. Total prize payout for all Lottery games is estimated to be 60.35%.

Fiscal Year 2018: The Lottery expects to pay \$372.6 million in prizes. Total prize payout is estimated to be 60.35%.

Prize payout increases have contributed to record sales. In FY 06, the prize payout was 57.74%; sales were \$509.1 million.⁸ Last year the prize payout was 59.40%; sales were \$627.2 million.

⁶ Sec. 25.75(3)(a), Wis. Stats.

⁷ Based on data from reporting lotteries as presented in La Fleur's 2016 World Lottery Almanac, p. 245. FY 15 is the latest year for which national figures for traditional ticket sales and prize payout are available.

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



Going forward, the Lottery should continue to achieve its sales goals with only slight adjustments to its current prize payout percentages. The Lottery proposes the previously-approved instant scratch game prize payout of 66.26% in FY 17 and FY 18. This marginal increase from FY 16 will allow the Lottery to maintain the successful higher price point strategy. Pull-tab prize payout is expected to be 62.89% in FY 17 and FY 18. Total lotto game prize payout is also projected to go from 49.58% in FY 16 to 50.53% in FY 17 and FY 18.

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 6. A weighted average is used to more accurately reflect the performance of games with higher sales.

Table 6. Weighted Average Prize Payout Percentages by Fiscal Year and by Game Type*
(Percentages are rounded)

Game Type	FY 14** Prize Payout	FY 15** Prize Payout	FY 16*** Prize Payout Preliminary	FY 17**** Prize Payout Estimated	FY 18**** Prize Payout Estimated
Instant Scratch	65.40%	66.18%	65.81%	66.26%	66.26%
Pull-tab	60.57%	62.95%	62.89%	62.89%	62.89%
Lotto	50.05%	48.76%	49.58%	50.53%	50.53%
Total	59.19%	59.59%	59.40%	60.35%	60.35%

* Data in Tables 1 and 6 have been rounded and may not exactly match data in Table 7.

** Based on data in Legislative Audit Bureau Report 16-7, July 2016: Financial Audit of the Wisconsin Lottery. (<https://legis.wisconsin.gov/lab/reports/16-7full.pdf>)

*** Source: Wisconsin Lottery FY 16 Unaudited Financial Statements as of January 18, 2017. The financial statements are preliminary and subject to change.

**** Based on Lottery sales estimates, Lottery Fund Condition Statement, September 22, 2016.

Table 7 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 17 and FY 18 are calculated by multiplying the sales projection for each game by its prize payout percentage.

Table 7. Prizes Paid or Expected to be Paid by Fiscal Year and by Game Type*

Game Type	FY 14** Prize Expense (Final)	FY 15** Prizes Expense (Final)	FY 16*** Prizes Expense (Preliminary)	FY 17**** Projected Prize Expense	FY 18**** Projected Prize Expense
Instant Scratch	\$220,871,369	\$235,861,007	\$249,280,244	\$254,688,580	\$254,688,580
Pull-tab	\$763,928	\$688,267	\$711,153	\$711,162	\$711,162
Lotto	\$115,059,226	\$105,892,045	\$122,567,098	\$117,201,237	\$117,201,237
Total	\$336,694,523	\$342,441,319	\$372,558,496	\$372,600,979	\$372,600,979

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 16-7, July 2016: Financial Audit of the Wisconsin Lottery. Figures rounded to the nearest dollar. (<https://legis.wisconsin.gov/lab/reports/16-7full.pdf>)

*** Source: Wisconsin Lottery FY 16 Unaudited Financial Statements, rounded to the nearest dollar, as of January 18, 2017. These financial statements are preliminary and subject to change.

**** Based on Lottery sales estimates, Lottery Fund Condition Statement, September 22, 2016.

PRIZE PAYOUT IMPACT ON OPERATING COSTS

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 06 the overall prize payout was 57.74%; in FY 16 it was 59.40%.⁹ During the same period, annual sales increased \$118.1 million, from \$509.1 million to \$627.2 million. Net operating income increased from \$151.0 million to \$175.4 million (preliminary). The Lottery carefully manages payout to maximize net operating income.

Prize payout has had little effect on administrative costs. Sales increased in FY 16 to \$627.2 million from \$574.6 million in FY 15. Total administrative expenditures as determined in accordance with sec. 25.75(3)(b), Wis. Stats. were \$36.6 million (preliminary). This amount represents 5.84% of gross lottery revenues in FY 16, well within the 10% limitation set by statute.¹⁰

⁹ FY 06 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>)

¹⁰ Expense and Revenue figures are from the Wisconsin Lottery's FY 16 Unaudited Financial Statements as of January 18, 2017. These financial statements are preliminary and subject to change.

