



Legislative Fiscal Bureau

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2017

Joint Committee on Finance

Paper #550

Lottery Fund Condition (Revenue -- Lottery Administration)

[LFB 2017-19 Budget Summary: Page 389, #1 and #2, and Page 390, #4 and #5]

CURRENT LAW

Annual lottery sales are estimated in each biennial budget process in order to establish sum sufficient appropriation estimates for lottery retailer compensation and lottery vendor fees and to estimate the lottery proceeds that will be available for property tax relief (the lottery and gaming credit). Two procedures under current law, the annual lottery and gaming credit certification, and the annual lottery sales and prize payout report, affect the issues discussed in this paper:

Annual Lottery and Gaming Credit Certification. Under s. 79.10(11)(b) of the statutes, the Department of Administration (DOA) is required to provide the Joint Committee on Finance with an estimate prior to October 16 of each year of total funds available for distribution under the lottery and gaming credit for property taxes levied in that year. The Department of Revenue (DOR) must be notified of the total amount available for distribution under the lottery and gaming credit by November 1. This estimate provides DOR with the basis for calculating the fair market value (termed the credit base) necessary to distribute the lottery and gaming credit. The credits are calculated by multiplying the credit base by school tax rates. The Committee is authorized to revise the DOA estimate and may do so at a meeting that takes place before November 1. If the Committee chooses to accept the DOA estimate, no further Committee action is required.

Annual Lottery Sales and Prize Payout Report. Under s. 565.02(7) of the statutes, DOR is required to submit a lottery prize payout report to the Joint Committee on Finance, not later than March 1 of each year, that includes: (a) an estimate for that fiscal year and for the subsequent fiscal year of the gross revenues from the sale of lottery tickets; (b) the total amount paid as prizes and the prize payout ratio for each type of lottery game offered; and (c) an evaluation of the effect of prize payout ratios of lottery games on lottery sales, lottery operating costs, and on

maximizing the revenue available for the lottery and gaming tax credit. The report is subject to a 14-day passive review by the Committee.

The total revenue available for tax relief, minus a statutory reserve (2% of gross revenue) and the amount appropriated for the lottery and gaming credit late applications payments, determines the amount available for the lottery and gaming tax credit. Net revenue available for tax relief depends on actual lottery fund revenues and expenditures and will change with any change in revenue or expenditures.

GOVERNOR

Lottery Sales Projections

Project sales of \$629.4 million in 2017-18 and \$632.4 million 2018-19. Projected sales include increased sales (\$12 million in 2017-18 and \$15 million 2018-19) anticipated by Lottery associated with an increase of \$3 million SEG annually for product information funding. Projected lottery sales provide the basis for estimating the lottery and gaming property tax credit in the next biennium. In addition, the projected sales directly affect appropriations for retailer compensation and lottery vendor fees. The following table shows these projections, as well as 2015-16 actual lottery sales and the 2016-17 estimated sales projected in October, 2016, for the purpose of certifying the amount available for the 2016(17) lottery property tax credit. The Governor's 2017-19 projected sales are based on sales projected for the October, 2016, certification.

Governor Lottery Sales Projections (\$ in Millions)

Game Type	Actual	2016-17	2017-18	Percent	2018-19	Percent
	2015-16			Change from		Change from
	2015-16	2016-17	2017-18	2016-17	2018-19	2017-18
Scratch	\$378.8	\$384.4	\$391.6	1.9%	\$393.4	0.5%
Pull-tab	1.1	1.1	1.1	0.0	1.1	0.0
Lotto	<u>247.2</u>	<u>231.9</u>	<u>236.7</u>	2.1	<u>237.9</u>	0.5
Total	\$627.2	\$617.4	\$629.4	1.9%	\$632.4	0.0%

Sum Sufficient Appropriation Reestimates

Provide \$4,587,900 SEG in 2017-18 and \$4,874,200 SEG in 2018-19 to reestimate lottery sum sufficient appropriations for retailer compensation and vendor fees, as follows:

Retailer Compensation. Provide an increase of \$3,249,400 SEG in 2017-18 and \$3,458,300 SEG in 2018-19 to adjust base-level funding for retailer compensation, including payments to retailers under the retailer performance program, to reflect projected lottery sales in the 2017-19 biennium. Projected sales include increased sales anticipated by Lottery associated

with increased product information funding.

Vendor Fees. Provide an increase of \$1,338,500 SEG in 2017-18 and \$1,415,900 SEG in 2018-19 to adjust base-level funding for vendor fees to reflect projected lottery sales in the 2017-19 biennium. Projected sales include increased sales anticipated by Lottery associated with increased product information funding. Base-level funding for vendor fees is \$14,879,700 SEG.

Vendor fees are paid under a major procurement contract for the provision of data processing services relating to both lotto and instant lottery games. The fees are calculated on the basis of a percentage of total ticket sales. Under the bill, vendor fees total 2.58% of lottery ticket sales in both 2017-18 and 2018-19.

State Operations Adjustments

Delete \$3,399,000 SEG and 10.0 SEG positions annually to reflect functions now performed through private vendors. Under a new contract starting May, 2017, with the vendor, the vendor will be responsible for: warehousing tickets as well as packaging and shipping tickets to retailers (-\$161,400 SEG annually and -4.0 SEG positions); telemarketing and some customer service (-\$363,600 SEG annually and -6.0 SEG positions); and a portion of ticket printing (-\$2,874,000 SEG annually).

Lottery Fund Condition Statement

Provide a total of \$167,690,500 SEG in 2017-18 and \$169,347,300 SEG in 2018-19 for the lottery and gaming tax credit. The following fund condition statement provides information on operating revenues, appropriated amounts for expenditures, estimates of interest earnings and gaming-related revenue, and the amounts available for tax relief credits under the bill.

	Projected <u>2017-18</u>	Projected <u>2018-19</u>
Fiscal Year Opening Balance	\$12,350,300	\$12,590,700
OPERATING REVENUES		
Total Ticket Sales*	\$629,452,700	\$632,458,100
Retailer Fees and Miscellaneous	<u>83,200</u>	<u>154,900</u>
Gross Revenues	\$629,535,900	\$632,613,000
EXPENDITURES		
Prizes	\$380,129,500	\$381,932,900
Retailer Compensation	44,060,100	44,269,000
Vendor Fees	16,218,200	16,295,600
General Program Operations*	21,407,500	21,375,300
Gaming Law Enforcement	389,500	389,500
Lottery Credit Administration	267,900	272,700
Program Reserves	<u>264,100</u>	<u>475,800</u>
Total Expenditures	\$462,736,800	\$465,010,800
NET PROCEEDS	\$166,799,200	\$167,602,200
INTEREST EARNINGS	\$1,131,700	\$1,806,700
Total Available for Tax Relief **	\$180,281,200	\$181,999,600
APPROPRIATIONS FOR TAX RELIEF		
Lottery and Gaming Credit	\$167,432,900	\$169,089,700
Late Lottery and Gaming Credit Applications	<u>257,600</u>	<u>257,600</u>
Total Appropriations for Tax Relief	\$167,690,500	\$169,347,300
Gross Closing Balance	\$12,590,700	\$12,652,300
Reserve (2% of Gross Revenues)	\$12,590,700	\$12,652,300
Net Closing Balance	\$0	\$0

*Projected sales and general program operations expenditures include increased sales and expenditures anticipated by Lottery associated with increased product information funding of \$3.0 million annually.

**Opening balance, net proceeds, interest earnings, and gaming-related revenue.

DISCUSSION POINTS

1. The lottery condition statement recommended in the Governor's budget uses the sales estimate from October, 2016, (\$617.4 million) as a base for the recommendation. However, the Governor's condition statement incorporates increased funding for product information (advertising) and additional sales based on additional funding for advertising. Increased funding for advertising and the return on any investment will be discussed in a separate paper. Therefore, advertising funding and its effects are removed from the modified condition statement. This paper will discuss the sales estimate as approved in October, 2016, and used by the Governor as a starting point for the

2017-19 biennium as shown below.

Base Lottery Sales Projections (Governor)
(\$ in Millions)

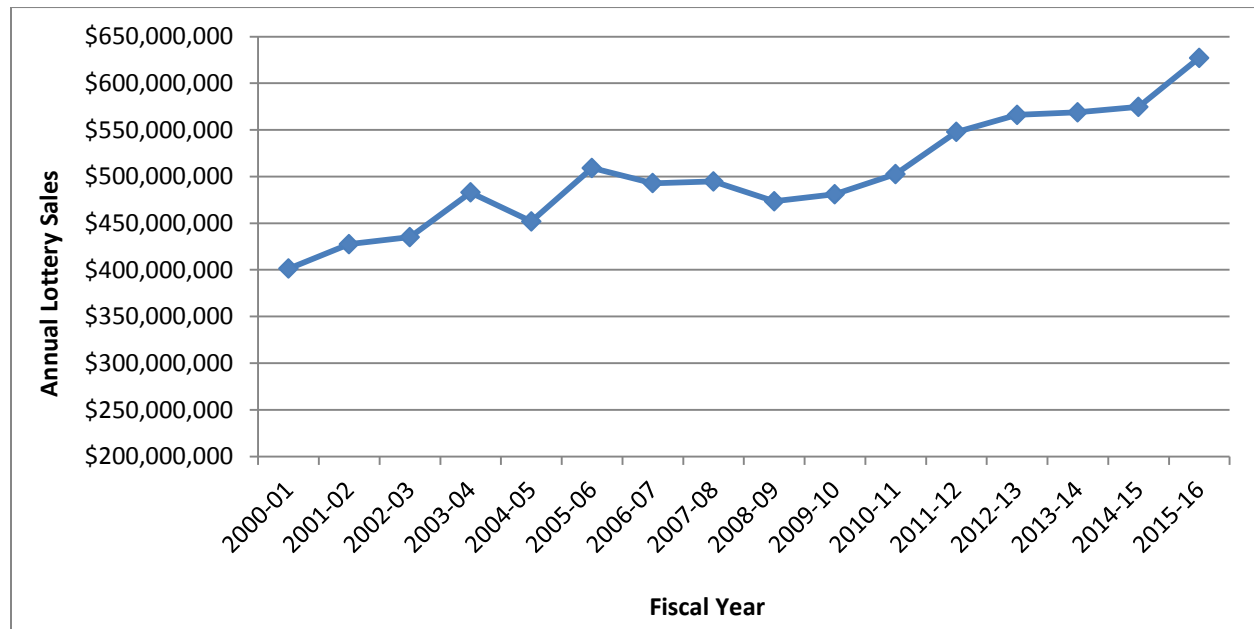
<u>Game Type</u>	<u>Actual</u> <u>2014-15</u>	<u>Actual</u> <u>2015-16</u>	<u>2016-17</u>	<u>2017-18</u>	<u>2018-19</u>
Scratch	\$356.4	\$378.8	\$384.4	\$384.4	\$384.4
Pull-tab	1.1	1.1	1.1	1.1	1.1
Lotto	<u>217.2</u>	<u>247.2</u>	<u>231.9</u>	<u>231.9</u>	<u>231.9</u>
Total	\$574.9	\$627.2	\$617.4	\$617.4	\$617.4

	<u>Projected</u> <u>2017-18</u>	<u>Projected</u> <u>2018-19</u>
Fiscal Year Opening Balance	\$12,350,300	\$12,350,300
OPERATING REVENUES		
Total Ticket Sales*	\$617,431,200	\$617,431,200
Retailer Fees and Miscellaneous	<u>83,200</u>	<u>154,900</u>
GROSS REVENUES	\$617,514,400	\$617,586,100
EXPENDITURES		
Prizes	\$372,915,700	\$372,915,700
Retailer Compensation	43,224,700	43,224,700
Vendor Fees	15,908,400	15,908,400
General Program Operations*	18,407,500	18,375,300
Gaming Law Enforcement	389,500	389,500
Lottery Credit Administration	267,900	272,700
Program Reserves	<u>264,100</u>	<u>475,800</u>
Total Expenditures	\$451,377,800	\$451,562,100
NET PROCEEDS	\$166,136,600	\$166,024,000
INTEREST EARNINGS	\$1,109,900	\$1,763,500
Total Available for Tax Relief **	\$179,596,800	\$180,137,800
APPROPRIATIONS FOR TAX RELIEF		
Lottery and Gaming Credit	\$166,988,900	\$167,528,500
Late Lottery and Gaming Credit Applications	<u>257,600</u>	<u>257,600</u>
Total Appropriations for Tax Relief	\$167,246,500	\$167,786,100
Gross Closing Balance	\$12,350,300	\$12,351,700
Reserve (2% of Gross Revenues)	\$12,350,300	\$12,351,700
Net Closing Balance	\$0	\$0

*Projected sales and general program operations expenditures exclude increased sales and expenditures anticipated by Lottery associated with increased product information funding of \$3.0 million annually.

**Opening balance, net proceeds, interest earnings, and gaming-related revenue.

2. From 2000-01 to 2015-16, the amount available for lottery property tax credits has generally increased over time, reflecting lottery sales growth in most years. As shown below, lottery sales increased from \$401.2 million in 2000-01 to \$509.1 million in 2005-06. Beginning in 2006-07, lottery sales decreased and sales growth was stagnant through 2010-11, reflecting the national economic downturn. As a result, amounts available for the lottery and gaming credit were reduced. In 2011-12, lottery sales recovered and were higher in each successive year, through 2015-16.



Reestimated 2016-17 Lottery Sales

3. The lottery and gaming credit is affected by many factors including lottery sale trends and the opening balance. With total lottery sales of \$574.6 million in 2014-15, the amount available for distribution in 2015-16 for the lottery and gaming credit totaled \$166.4 million. Sales continued to grow, with year-end sales of \$627.2 million in 2015-16. Due to greater than anticipated ticket sales in 2015-16, surplus lottery funds carried over to 2016-17 and were distributed through the lottery and gaming credit in March, 2017. The amount distributed for the lottery and gaming credit in 2016-17 was based on the previous year's estimate, determined through the annual October certification of the lottery and gaming credit, and totaled \$185.6 million.

4. In October, 2015, changes were made to the Powerball matrix to improve the odds of large jackpots. This change resulted in a \$1.6 billion jackpot in 2015-16 and record sales for Powerball ticket sales. The chance of a jackpot over \$1 billion is approximately 4% each year. The impact of this change on future sales each fiscal year is that any year may be relatively normal or may be extraordinary like in 2015-16. Changes to the Powerball matrix made it more difficult to estimate whether years would be normal (as in 2014-15) or extraordinary for Powerball sales (as in 2015-16). The October, 2016, certification estimated an amount that was approximately \$10 million less than the extraordinary year of 2015-16 but approximately \$30 million above 2014-15. As 2016-

17 progressed, sales have trended more toward a more normal year than estimated.

5. On-line game sales appear to be lower in 2016-17 than estimated in October, 2016, primarily because large Powerball jackpots, which can increase sales dramatically, have not been generated in 2016-17 as often as they were in 2015-16. The Powerball game accounted for slightly more than 48.5% of all on-line (lotto) game revenue in 2015-16. In 2015-16, there was an occasion when the Powerball jackpot grew high enough to attract weekly sales of more than \$20.0 million for at least a two-week period. In 2016-17, there have been no weeks in which Powerball sales have exceeded \$5.0 million. Average weekly sales for Powerball tickets in 2015-16 exceeded \$2.15 million per week. By contrast, in 2016-17, average sales through April, 2017, have been about \$1.52 million per week. Total Powerball sales this year are not likely to reach the estimate of sales made in October, 2016. The reestimate of on-line ticket sales in 2016-17 would decrease from \$232 million to approximately \$213.5 million.

6. While lotto sales in 2016-17 have decreased from the high of 2015-16, instant game (scratch ticket) sales have increased. Continuing this trend, instant sales reached a record high in 2015-16 with \$379.9 million in sales. Instant games appear to be setting a new record high in 2016-17 with an estimated \$383.8 million in sales.

7. In Lottery's third quarter report dated May 9, 2017, Lottery indicated that "lottery sales were \$151.8 million for the third quarter of fiscal year 2017, down 21.3% from the same quarter last year. The Wisconsin Lottery experienced unusually high sales in the third quarter of fiscal year 2016 when the estimated annuity jackpot for Powerball exceeded \$1.5 billion."

8. Total ticket sales during the 10-month period, from July, 2016, to April, 2017, have been lower (\$497.2 million) than during a similar period in 2015-16 (\$527.3 million). In comparison, however, ticket sales in 2014-15 for the same period, were \$480.4 million. While total year-to-date sales in 2016-17 are lower than 2015-16, the sales exceed 2014-15 and are more in line with prior experience. For 2016-17, total sales are lower primarily because no large Powerball jackpots have materialized to date in 2016-17 and, as a result, on-line sales have fallen behind projections. Given that there is only one month left in the 2016-17 fiscal year, it is very unlikely their total ticket sales of \$617.4 million for 2016-17 will be realized. As a result of overall sales trends in 2016-17, total sales estimates are reestimated downward to \$597.3 million. This is a 3.2% reduction from the October, 2016, estimate.

9. The 2016-17 reestimate is required to establish more accurately the year-end condition of the lottery fund. The lottery and gaming credits that were paid in 2016-17 were determined in October, 2016, and were paid at the certified level. A reestimate of 2016-17 sales at a lower level will have the effect of reducing the lottery fund's reserve (set each year by statute at 2% of estimated gross revenue) and will result in a lower opening balance in the lottery fund on July 1, 2017.

10. Under the October, 2016, estimate, the opening balance of the lottery fund on July 1, 2017, would be \$12,350,300. The 2016-17 payout certified in October, 2016 was \$185,311,200 and the actual amount paid out in March was \$183,433,000 which produces a balance of \$1,878,600 to add to the opening balance. In addition, reestimating 2016-17 lottery sales to \$597.3 million has the net effect of decreasing the 2017-18 opening balance to \$6,378,000. The net effect of these changes,

also, decreases the amount available for the lottery and gaming credit in the 2017-19 biennium.

Lottery Sales Projections 2017-19

11. In past years, the estimate for the current fiscal year was used to reestimate the next two fiscal years until the next October lottery and gaming certification. As a result of reestimating total lottery sales in 2016-17 from \$617.4 million to \$597.3 million, based on actual year-to-date sales experience relating to all lottery game types, the 2017-18 and 2018-19 sales estimates contained in the bill should also be reestimated. The base projections of sales under the bill for the 2017-19 biennium are identical to those sales estimates developed early in 2016-17 and used in the Department's 2017-19 biennial budget request.

12. Taking the average growth rate over the last nine years, however, and excluding 2015-16 (an extraordinary sales year), average growth in lottery revenue has been about 1.4%. Taking this growth rate into account the reestimated lottery sales figures for 2016-17, 2017-18, and 2018-19 are identified below.

Reestimated Lottery Sales Projections (\$ in Millions)

<u>Game Type</u>	<u>2016-17</u>	<u>2017-18</u>	<u>2018-19</u>
Scratch	\$382.8	\$388.2	\$393.6
Pull-tab	1.0	1.0	1.0
Lotto	<u>213.5</u>	<u>216.5</u>	<u>219.5</u>
Total	\$597.3	\$605.7	\$614.1

*The table does not include potential increased revenue from increased advertising expenditures which is discussed in a subsequent paper.

Sum Sufficient Appropriation Reestimates

13. The recalculations of the retailer compensation and vendor fees associated with the sales reestimate in this paper are identified below. These amounts may change in conjunction with the Committee decisions on the Governor's recommendations for increased advertising funding [discussed in a separate paper]. Any changes in the sum sufficient associated with increased advertising funding will be separately addressed.

14. Basic retailer compensation rates under current law are 5.5% for lotto ticket sales and 6.25% for instant ticket sales. In addition, the retailer performance program provides an amount of up to 1% of for-profit sales as incentive payments to retailers (estimated at \$6.3 million in 2017-18 and 2018-19, under the bill). Base-level funding of \$40,810,700 SEG, established under 2015 Wisconsin Act 55, was based on estimated lottery sales of \$574.0 million in 2014-15. The Department's lottery sales projections of \$629.4 million in 2017-18 and \$632.6 million 2018-19 resulted in the increases to retailer compensation funding. However, based on the sales reestimate, the amounts should be revised.

15. Vendor fees are paid under a major procurement contract for the provision of data processing services relating to both on-line and instant lottery games. The fees are calculated on the basis of a percentage of total ticket sales and some minor fixed costs. Under the bill, vendor fees would total 2.58% of lottery ticket sales in both 2017-18 and 2018-19. Base-level funding for vendor fees is \$14,879,700 SEG.

16. Under the revised sales estimates and not including the effect of increased advertising, the base retailer compensation would be increased from the base by \$1,676,600 SEG in 2017-18 and \$2,268,600 SEG 2018-19. Vendor fees would be increased from the base by \$725,700 SEG in 2017-18 and \$944,100 SEG 2018-19. Compared to the bill, retailer compensation would be decreased from the bill by -\$737,400 SEG in 2017-18 and -\$145,400 SEG 2018-19. Vendor fees would be decreased from the bill by -\$303,000 SEG in 2017-18 and -\$84,600 SEG 2018-19. The reestimated appropriation amounts for retailer compensation and vendor fees are shown in the revised lottery fund condition.

Lottery Fund Condition Statement

17. A revised lottery fund condition is needed to reflect the change in sales estimates and the recalculation of the sum sufficient appropriations for retailer compensation and vendor fees. The change in the sales estimate also requires a reestimate of lottery prizes.

18. Since projecting lottery sales in October, 2016, the Department of Revenue decreased estimated prize payout percentage in its February 22, 2017, prize payout report submitted to the Joint Committee on Finance, pursuant to s. 565.02(7) of the statutes and approved by the Committee on March 15. This had the effect of decreasing expenses by \$303,700 SEG in 2017-18 and \$307,900 SEG 2018-19.

19. Finally, the amounts for the lottery and gaming tax credit are modified as a result of these recalculations. By reestimating sales and lottery prize payouts, recalculating the sum sufficient appropriations for retailer compensation and vendor fees, and modifying gaming-related payments, the lottery and gaming credits would total \$156,497,200 SEG in 2017-18 and \$164,845,600 SEG in 2018-19, as shown in the following fund condition statement. This would be a reduction of \$10,491,700 SEG in 2017-18 and \$2,682,900 SEG in 2018-19.

MODIFICATION

Reestimate 2016-17 lottery sales to \$597.3 million to reflect year-to-date sales experience. Reestimate 2017-18 sales to \$605.8 million and 2018-19 sales to \$614.3 million.

Reestimate the lottery and gaming credit by -\$10,491,700 SEG in 2017-18 and -\$2,682,900 SEG in 2018-19 to reflect 2016-17 sales. [The lottery and gaming credit amount addressed in this paper does not include the portion associated with increased product information funding (\$444,000 SEG in 2017-18 and \$1,561,300 SEG in 2018-19). Any change to the lottery and gaming credit associated with increased advertising are addressed in a separate paper.]

Retailer Compensation. Delete \$737,400 SEG in 2017-18 and \$145,400 SEG in 2018-19 to adjust funding for retailer compensation to reflect projected lottery sales in the 2017-19 biennium.

Vendor Fees. Delete \$303,000 SEG in 2017-18 and \$84,600 SEG in 2018-19 to adjust funding for vendor fees to reflect projected lottery sales in the 2017-19 biennium.

Change to Bill		
	Revenue	Funding
SEG	- \$15,045,600	- \$14,445,000

	Projected <u>2017-18</u>	Projected <u>2018-19</u>
Fiscal Year Opening Balance	\$6,677,500	\$12,115,000
OPERATING REVENUES		
Total Ticket Sales*	\$605,668,700	\$614,148,100
Retailer Fees and Miscellaneous	<u>83,200</u>	<u>154,900</u>
Gross Revenues	\$605,751,900	\$614,303,000
EXPENDITURES		
Prizes	\$367,228,500	\$372,369,700
Retailer Compensation	42,487,300	43,079,300
Vendor Fees	15,605,400	15,823,800
General Program Operations*	18,407,500	18,375,300
Gaming Law Enforcement	389,500	389,500
Lottery Credit Administration	267,900	272,700
Program Reserves	<u>264,100</u>	<u>475,800</u>
Total Expenditures	\$444,650,100	\$450,786,100
NET PROCEEDS	\$161,101,800	\$163,516,800
INTEREST EARNINGS	\$1,090,500	\$1,757,400
Total Available for Tax Relief **	\$168,869,800	\$177,389,300
APPROPRIATIONS FOR TAX RELIEF		
Lottery and Gaming Credit	\$156,497,200	\$164,845,600
Late Lottery and Gaming Credit Applications	<u>257,600</u>	<u>257,600</u>
Total Appropriations for Tax Relief	\$156,754,800	\$165,103,200
Gross Closing Balance	\$12,115,000	\$12,286,100
Reserve (2% of Gross Revenues)	\$12,115,000	\$12,286,100
Net Closing Balance	\$0	\$0

* Projected sales and general program operations expenditures exclude increased sales and expenditures anticipated by Lottery associated with increased product information funding of \$3.0 million annually.

**Opening balance, net proceeds, interest earnings, and gaming-related revenue.

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