

Executive Director: Jeff Hatch-Miller

JLBC Analyst: Juan Beltran

	FY 2008 ACTUAL	FY 2009 ESTIMATE	FY 2010 APPROVED
<b>OPERATING BUDGET</b>			
<i>Full Time Equivalent Positions</i>	110.0	110.0	104.0
Personal Services	4,383,800	4,972,100	4,972,100
Employee Related Expenditures	1,652,400	1,724,900	1,773,900
Professional and Outside Services	337,500	383,400	383,400
Travel - In State	306,700	269,800	269,800
Travel - Out of State	14,200	16,700	16,700
Other Operating Expenditures	566,800	1,379,700	629,700
Equipment	244,600	69,100	0
<b>OPERATING SUBTOTAL</b>	<b>7,506,000</b>	<b>8,815,700</b>	<b>8,045,600</b>
<b>SPECIAL LINE ITEMS</b>			
Advertising	10,690,700	20,162,700	16,000,000
Instant Tickets <sup>1/</sup>	7,424,500	9,088,100	9,209,800 <sup>2/</sup>
On-Line Vendor Fees <sup>1/</sup>	8,890,500	8,890,600	9,129,300 <sup>3/</sup>
Retailer Commissions <sup>1/</sup>	31,673,700	31,686,800	32,310,100 <sup>4/</sup>
Sales Incentive Program	45,200	50,000	50,000
Telecommunications	376,500	629,400	629,400
Lump Sum Reduction	0	(690,600)	(1,000,000)
<b>AGENCY TOTAL</b>	<b>66,607,100</b>	<b>78,632,700</b>	<b>74,374,200<sup>5/</sup></b>
<b>FUND SOURCES</b>			
<u>Other Appropriated Funds</u>			
State Lottery Fund	66,607,100	78,632,700	74,374,200
SUBTOTAL - Other Appropriated Funds	66,607,100	78,632,700	74,374,200
<b>SUBTOTAL - Appropriated Funds</b>	<b>66,607,100</b>	<b>78,632,700</b>	<b>74,374,200</b>
Other Non-Appropriated Funds	264,741,500	283,146,800	280,542,800
<b>TOTAL - ALL SOURCES</b>	<b>331,348,600</b>	<b>361,779,500</b>	<b>354,917,000</b>

**AGENCY DESCRIPTION** — The Arizona Lottery is responsible for administering sanctioned games of chance. Arizona-specific games include instant tickets, the Pick, Pick 3, and Pick 5 on-line games. Arizona also participates in the multi-state Powerball on-line game.

- <sup>1/</sup> Instant Tickets, On-line Vendor Fees, and Retailer Commissions are appropriated as a percentage of sales. Therefore, the amounts shown for those line items are estimates only.
- <sup>2/</sup> An amount equal to 3.6% of actual instant ticket sales is appropriated for the printing of instant tickets or for contractual obligations concerning instant ticket distribution. This amount is currently estimated to be \$9,209,800 in FY 2010. (General Appropriation Act footnote.)
- <sup>3/</sup> An amount equal to a percentage of actual on-line game sales as determined by contract is appropriated for payment of on-line vendor fees. This amount is currently estimated to be \$9,129,300, or 4.0322% of actual on-line ticket sales in FY 2010. (General Appropriation Act footnote.)
- <sup>4/</sup> An amount equal to 6.5% of gross lottery game sales is appropriated for payment of sales commissions to ticket retailers. An additional amount of not to exceed 0.5% of gross lottery game sales is appropriated for payment of sales commissions to ticket retailers. The combined amount is currently estimated to be 6.7% of total ticket sales, or \$32,310,100 in FY 2010. (General Appropriation Act footnote.)
- <sup>5/</sup> General Appropriation Act funds are appropriated as an Operating Lump Sum with Special Line Items by Agency. As appropriated by Laws 2009, 1<sup>st</sup> Regular Session, Chapter 12.

<b>PERFORMANCE MEASURES</b>	FY 2006 Actual	FY 2007 Actual	FY 2008 Actual	FY 2010 Approved
• Increase in on-line sales from prior year (\$ in millions)	41.0	(17.7)	19.3	5.9
• Increase in instant ticket sales from prior year (\$ in millions)	30.1	11.2	(8.6)	3.4
• Customer satisfaction rating for retailers (Scale 1-8)	7.8	7.4	7.5	7.5

### **Operating Budget**

The budget includes \$8,045,600 and 110 FTE Positions from the State Lottery Fund for the operating budget in FY 2010. These amounts fund the following adjustments:

#### **Eliminate Computer Replacement**

The budget includes a decrease of \$(69,100) from the State Lottery Fund in FY 2010 to eliminate funding associated with the Lottery's computer technology replacement schedule.

#### **Eliminate Performance Pay**

The budget includes a decrease of \$(750,000) from the State Lottery Fund in FY 2010 to eliminate funding associated with the Lottery's sales performance incentive plan.

#### **Statewide Health Insurance Adjustments**

The budget includes an increase of \$49,000 from the State Lottery Fund in FY 2010 for state employee health insurance statewide adjustments. *(Please see the General Provisions section.)*

### **Advertising**

The budget includes \$16,000,000 from the State Lottery Fund for Advertising in FY 2010. This amount funds the following adjustments:

#### **Advertising Decrease**

The budget includes a decrease of \$(4,162,700) from the State Lottery Fund for advertising in FY 2010. Laws 2008, Chapter 287 permanently eliminated the \$11,000,000 advertising cap. As a result, there is no longer any specific limitation on advertising expenses. The Lottery's overall administrative expenses, however, are capped at 18.5% of total annual revenues. The \$(4,162,700) is transferred from the State Lottery Fund to the General Fund.

Monies in this line item are used to promote and market Lottery games.

### **Instant Tickets**

The budget includes \$9,209,800 from the State Lottery Fund for Instant Tickets in FY 2010. This amount funds the following adjustments:

#### **Instant Ticket Sales Increase**

The budget includes an increase of \$121,700 from the State Lottery Fund in FY 2010 for Instant Tickets due to higher projected sales.

Monies in this line item are used to pay for instant ticket printing and distribution costs. The actual appropriation is for 3.6% of instant ticket sales. The amount displayed is derived by applying the approved spending percentage to the forecasted sales total.

### **On-Line Vendor Fees**

The budget includes \$9,129,300 from the State Lottery Fund for On-line Vendor Fees in FY 2010. This amount funds the following adjustments:

#### **On-line Vendor Fees Increase**

The budget includes an increase of \$238,700 from the State Lottery Fund in FY 2010 for On-line Vendor Fees due to higher projected sales.

Monies in this line item are used to pay the vendor that operates the on-line game computer system. The actual appropriation is equal to a percentage of on-line ticket sales specified in the Lottery's contractual agreement with the vendor. The displayed amount is derived by applying the approved percentage of 4.0322% to the forecasted sales total.

### **Retailer Commissions**

The budget includes \$32,310,100 from the State Lottery Fund for Retailer Commissions in FY 2010. This amount funds the following adjustments:

#### **Retailer Commission Increase**

The budget includes an increase of \$623,300 from the State Lottery Fund in FY 2010 for Retailer Commissions due to higher projected sales.

Monies in this line item are used to compensate retailers for selling lottery tickets. The actual appropriation is equal to 6.5% of total ticket sales. Pursuant to statute, an additional 0.5% of total ticket sales may be paid to retailers based on their attainment of specified sales and marketing objectives. Since 40% of retailers are estimated to meet these objectives, this would result in an additional 0.2% in retailer commissions and a total retail commission rate of 6.7%. The displayed amount is derived by applying the approved percentage to the forecasted sales total.

	<u>FY 2009</u>	<u>FY 2010</u>
State Lottery - Advertising	\$ 0	\$(4,162,700)
Transfer		
State Lottery - EBT	(4,898,500)	0
State Lottery - FRAT	(440,800)	(799,700)
State Lottery - Salary	(249,800)	(200,300)
State Lottery - Unclaimed Prizes*	0	(1,398,400)

\* These transfers are from non-appropriated funds.

### **Sales Incentive Program**

The budget includes \$50,000 from the State Lottery Fund for the Sales Incentive Program in FY 2010. This amount is unchanged from FY 2009.

Monies in this line item are used to provide monetary incentives to employees in the Lottery's Marketing Division for working with retailers to increase sales.

### **Telecommunications**

The budget includes \$629,400 from the State Lottery Fund for Telecommunications in FY 2010. This amount is unchanged from FY 2009.

Monies in this line item are used to pay for all costs related to the Lottery's telecommunications network. The Lottery provides telecommunications services to retailers who sell on-line game tickets through a contract with private vendors.

### **Lump Sum Reduction**

The budget includes an agencywide lump sum reduction of \$(690,600) for the midyear FY 2009 revisions and \$(1,000,000) for FY 2010. The latter reduction reflects the adjustment to the originally enacted FY 2009 appropriation.

	<u>FY 2009</u>	<u>FY 2010</u>
<b>Fund Reduction and Transfer</b>		
State Lottery Fund	\$(440,800)	\$(799,700)
<b>Personnel Expense Reduction</b>		
State Lottery Fund	(249,800)	(200,300)

### **FTE Position Reduction**

The budget includes a decrease of (6) FTE Positions for a lump sum FTE Position reduction. *(Please see the General Provisions section.)*

### **Fund Transfers**

The budget includes the following midyear FY 2009 revisions and FY 2010 transfers to the General Fund from the funds listed below:

### **Revised Lottery Forecast and Distributions**

The JLBC Staff forecast for overall ticket sales of \$482,239,800 for FY 2010 represents a 2% increase from forecasted FY 2009 ticket sales of \$472,937,300. Actual ticket sales of \$484,486,100 for FY 2009 were above the forecast. The FY 2010 estimate of \$482,239,800 represents a (0.5)% decline from FY 2009 actual sales.

The JLBC Staff forecast for instant ticket sales of \$255,828,900 for FY 2010 represents a 1% increase from forecasted FY 2009 instant ticket sales of \$252,448,400. Actual instant sales of \$278,924,400 for FY 2009 were above the forecast. The FY 2010 estimate of \$255,828,900 represents a (8.3)% decline from FY 2009 actual sales. The Instant Scratchers game remains the largest contributor to the FY 2010 forecast with estimated sales of \$208,576,600.

In regards to state-only on-line ticket sales (excluding Powerball), the forecast for on-line ticket sales of \$94,682,600 for FY 2010 represents a 5% increase from forecasted FY 2009 on-line ticket sales of \$90,064,800. Actual on-line sales of \$88,323,300 for FY 2009 were below the forecast. The FY 2010 estimate of \$94,682,600 represents a 7.2% increase from FY 2009 actual sales. Due to the uncertainty of when large Powerball jackpots will occur, the forecast includes a 1% increase in Powerball ticket sales in FY 2010 from forecasted FY 2009 ticket sales of \$130,424,100.

Lottery estimates FY 2010 total ticket sales of \$510,000,000.

As a result of offering higher prizes as well as increasing aggregate game payouts, the percentage of ticket sales that is used for distribution to beneficiaries dropped from 30% in FY 2008 to 26% in FY 2009. Therefore, despite total ticket sales increasing by \$11,548,800 in FY 2009 as compared to the prior year, actual monies available for distribution to beneficiaries, excluding fund transfers, dropped by \$(21,675,800) in FY 2009 as compared to the prior year. A.R.S. § 5-505B requires the Lottery to deposit at least 50% of total ticket sales in the non-appropriated portion of the State Lottery Fund, which is used for prize payouts. If the Lottery chooses to deposit more than 50%

of total ticket sales for prize payouts, then the remaining amount for beneficiary distribution decreases.

**Sources and Uses of Lottery Profit Distribution**

Table 1 shows the sources of forecasted Lottery profits by revenue stream and illustrates the actual distributions to fund beneficiaries for FY 2008 and FY 2009 and the JLBC projected distribution for FY 2010. A brief description of each beneficiary follows in the order that they receive Lottery-generated revenue in accordance with A.R.S. § 5-522.

<b>Sales</b>	<b>FY 2008</b> <sup>1/</sup>	<b>FY 2009</b>	<b>FY 2010</b>
Instant Sales	\$252.4	\$278.9	\$255.8
On-Line Sales	220.5	205.6	226.4
Total Sales	\$472.9	\$484.5	\$482.2
<i>Less:</i>			
Operating Budget	\$ 66.6	\$ 75.3	\$74.3
Fund Transfer <sup>2/</sup>	6.1	12.2	5.1
Prizes <sup>3/</sup>	264.7	283.2	280.6
Net Profit <sup>4/</sup>	\$135.5	\$113.8	\$122.2
<b>Profit Transfers</b>			
General Fund <sup>5/</sup>	\$ 31.0	\$ 31.0	\$ 31.0
LTAf II <sup>6/</sup>	11.5	9.0	9.9
LTAf <sup>6/</sup>	23.0	21.9	23.0
CAF <sup>6/</sup>	7.7	7.3	7.7
Heritage	20.0	20.0	20.0
Health and Welfare Programs	21.3	20.9	22.2
Homeless Shelters	1.0	0.0	1.0
General Fund <sup>5/</sup>	16.4	0.0	3.9
University Capital	NA	0.0	0.0
Water Supply Development <sup>7/</sup>	NA	NA	0.0
Community Protection <sup>7/</sup>	NA	NA	0.0
General Fund <sup>5/</sup>	NA	0.0	0.0
Economic Development <sup>8/</sup>	3.6	3.8	3.5
<b>Total Transfer<sup>9/</sup></b>	\$135.5	\$113.8	\$122.2

1/ Lottery used a different distribution formula in FY 2008. FY 2009 and FY 2010 have been restated using the new distribution formula.

2/ Transfers in FY 2008 include \$5,996,400 mandated fund transfer to the General Fund and \$84,400 due to a hiring freeze. In FY 2009, this amount includes a \$4,543,600 mandated fund transfer and \$84,900 due to a hiring freeze, as originally approved in the FY 2009 General Appropriation Act. This amount also includes the following transfers approved in the midyear FY 2009 revisions; a \$4,898,500 mandated fund transfer, \$690,600 due to a combined Fund Reduction and Transfer (FRAT) and a personnel expense reduction, and \$2,007,500 due to a 5% county proceeds transfer. The FY 2010 amount represents an advertising fund transfer of \$4,162,700 and \$1,000,000 due to a combined FRAT and personnel expense reduction.

3/ Prizes are estimated by subtracting net profit and operating budget expenditures from total Lottery sales.

4/ To derive the profit transfer amounts, the actual FY 2009 rate of return for each game was applied to the current forecast.

5/ Total distributions to the General Fund totaled \$47,420,000 in FY 2008 and \$31,000,000 in FY 2009 and are estimated to be \$34,877,100 in FY 2010.

6/ Distribution cumulatively reduced by \$(2,007,500) in FY 2009. (Please see Additional Legislation for additional information)

7/ The FY 2010 budget presumed the passage of legislation to repeal both the Water Supply Development Fund and the Community Protection Initiative Fund (SB 1025, 3<sup>rd</sup> Special Session). The Governor vetoed this bill.

8/ Dedicated funding from 2 instant ticket games.

9/ Total Transfers might not add due to rounding.

General Fund – Part 1

The General Fund receives up to \$31,000,000 prior to other distributions. In FY 2009 only, the General Fund could have received up to an additional \$26,000,000 above the \$31,000,000 requirement (for a total of \$57,000,000). In FY 2009, the General Fund received \$31,000,000.

Beginning in FY 2010, the General Fund could receive an additional \$15,490,000 (for a total of \$46,490,000) after the statutory funding obligations have been met through the Homeless Shelters distribution. The General Fund is estimated to receive \$31,000,000 in FY 2010 from this distribution plus \$3,877,100 from the possible secondary distribution of \$15,490,000.

Mass Transit Fund

The Mass Transit Fund (otherwise known as LTAF II) receives its monies after the \$31,000,000 distribution to the General Fund is met. Starting in FY 2009, it receives a maximum of \$9,000,000 increasing by up to 10% every year until total revenues reach a maximum of \$18,000,000. In FY 2009 only, Laws 2008, Chapter 287 allocated \$9,499,300 from the State Lottery Fund to the LTAF II Fund. The funds are used by the counties to enhance existing public transportation systems. In FY 2009, LTAF II received \$9,024,300 and is estimated to receive \$9,900,000 in FY 2010. (Please see Additional Legislation for additional information.)

Local Transportation Assistance Fund (LTAF)

LTAF receives a maximum of \$23,000,000 annually. Funds are distributed to cities and towns. The uses include road building, traffic signals, sidewalk and alley repair, general maintenance, and Dial-a-Ride operating expenses. In FY 2009, LTAF received \$21,850,000 and is estimated to receive \$23,000,000 in FY 2010. (Please see Additional Legislation for additional information.)

County Assistance Fund (CAF)

CAF receives a maximum of \$7,650,000 each fiscal year. The monies are distributed to the General Funds of each of the counties to be used at their discretion. In FY 2009, CAF received \$7,267,500 and is estimated to receive \$7,650,000 in FY 2010. (Please see Additional Legislation for additional information.)

Heritage Fund

The Heritage Fund receives up to a maximum of \$20,000,000. Monies are divided equally between the Game and Fish Commission Heritage Fund and the State Parks Board Heritage Fund. The funds are used to promote wildlife habitat and education programs, rehabilitate historic buildings, acquire and develop park land, and renovate trail systems, among other purposes. The Heritage Fund received \$20,000,000 in FY 2009 and is estimated to receive \$20,000,000 in FY 2010.

### Health and Welfare Programs

Statute requires annual inflation adjustments for the Health and Welfare distribution. The current allocation cap is \$22,234,800 in FY 2010. The amount is distributed among the following agencies:

- 29.4% to the Department of Economic Security for the Healthy Families program.
- 23.5% to the Board of Regents for the Arizona Health Education Center program.
- 17.6% to the Department of Health Services (DHS) for teenage pregnancy prevention.
- 11.8% to the Arizona Biomedical Research Commission for Disease Control Research.
- 11.8% to DHS for the Health Start program.
- 5.9% to DHS for the Women, Infants and Children food program.

Due to insufficient Lottery proceeds in FY 2009, Health and Welfare programs received \$20,897,400, which is less than their full statutory allocation. They are estimated to receive \$22,234,800 in FY 2010.

### Homeless Shelters

The Department of Economic Security receives \$1,000,000 for Homeless Shelters. The department shall use the funding to distribute grants to nonprofit organizations, including faith based organizations, for homeless emergency and transitional shelters and related support services. Due to insufficient Lottery proceeds, the Homeless Shelters are not expected to receive any monies in FY 2009. They are estimated to receive \$1,000,000 in FY 2010.

### General Fund – Part 2

As noted above, the General Fund could receive an additional \$15,490,000 after all prior allocations have been met. The General Fund did not receive any additional monies in FY 2009 and is estimated to receive an additional \$3,877,100 in FY 2010.

### University Capital Improvement Fund

The FY 2009 Education Budget Reconciliation Bill (BRB) (Laws 2008, Chapter 287) required that after all Lottery revenue beneficiaries have received their statutory distributions, up to a maximum of \$20,000,000 shall be deposited into the University Capital Improvement (UCI) Fund in FY 2009. However, this new fund received no monies in FY 2009 and is expected to receive no monies in FY 2010.

This fund will serve as the source for 80% of the debt service associated with \$800,000,000 University Capital construction lease-purchase. *(Please see the FY 2010 Arizona Board of Regents Capital Outlay section for more details.)*

The FY 2010 Higher Education BRB (Laws 2009, 3<sup>rd</sup> Special Session, Chapter 9) restricts Lottery distributions in FY 2010 and FY 2011 into the UCI Fund by not allowing Lottery revenues to exceed 80% of the required annual debt service for \$167,671,200 of debt in both years.

### Water Supply Development Funding

Laws 2008, Chapter 287 added the Department of Environmental Quality's Water Supply Development Fund as a new recipient starting in FY 2010. The purpose of this \$10,000,000 distribution is to provide financial assistance to water suppliers for planning and design of water supply systems; purchasing or refinancing debt obligations for water providers; purchasing insurance for local bond obligations; and paying costs to administer the fund. *(Please see below.)*

### Community Protection Initiative Funding

Laws 2008, Chapter 287 also added the State Land Department's Community Protection Initiative Fund as a new recipient starting in FY 2010. The purpose of this \$3,000,000 distribution is to assist local governments and private land owners in reducing the volume of hazardous fuels on nonfederal forested land in the state.

The FY 2010 budget presumed the passage of legislation to permanently repeal both the Water Supply Development Fund and the Community Protection Initiative Fund from the list of recipients of Lottery monies (SB 1025, 3<sup>rd</sup> Special Session.) The Governor vetoed this bill.

### General Fund – Part 3

The General Fund receives all remaining revenues after all statutory funding obligations have been met.

## **Additional Legislation**

### ***County Proceeds Transfer***

Laws 2009, 1<sup>st</sup> Special Session, Chapter 3 reduced FY 2009 State Lottery Fund distributions to the County Assistance Fund by \$(382,500), LTAF by \$(1,150,000), LTAF II (Mass Transit) by \$(475,000) and transferred these monies to the General Fund.

The FY 2010 budget presumed the passage of legislation to reduce FY 2010 Lottery distributions to the County Assistance Fund by \$(765,000), LTAF by \$(2,300,000), and LTAF II (Mass Transit) by \$(990,000) and transfer these monies to the General Fund (SB 1025, 3<sup>rd</sup> Special Session.) The Governor vetoed this bill.