

Arizona State Lottery Commission

JLBC: Juan Beltran
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DESCRIPTION	FY 2008 ACTUAL	FY 2009 ESTIMATE	FY 2010 JLBC
OPERATING BUDGET			
<i>Full Time Equivalent Positions</i>	110.0	110.0	110.0
Personal Services	4,383,800	4,972,100	4,972,100
Employee Related Expenditures	1,652,400	1,724,900	1,724,900
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
OPERATING SUBTOTAL	7,506,000	8,815,700	7,996,600
SPECIAL LINE ITEMS			
Advertising	10,690,700	20,162,700	11,000,000
Instant Tickets	7,424,500	9,088,100	9,209,800
On-Line Vendor Fees	8,890,500	8,890,600	9,129,300
Retailer Commissions	31,673,700	31,686,800	32,310,100
Sales Incentive Program	45,200	50,000	50,000
Telecommunications	376,500	629,400	629,400
AGENCY TOTAL	66,607,100	79,323,300	70,325,200

FUND SOURCES

Other Appropriated Funds

State Lottery Fund	66,607,100	79,323,300	70,325,200
SUBTOTAL - Other Appropriated Funds	66,607,100	79,323,300	70,325,200
SUBTOTAL - Appropriated Funds	66,607,100	79,323,300	70,325,200

Other Non-Appropriated Funds	264,741,500	252,073,800	267,460,600
TOTAL - ALL SOURCES	331,348,600	331,397,100	337,785,800

CHANGE IN FUNDING SUMMARY

	FY 2009 to FY 2010 JLBC	
	\$ Change	% Change
Other Appropriated Funds	(8,998,100)	(11.3%)
Total Appropriated Funds	(8,998,100)	(11.3%)
Non-Appropriated Funds	15,386,800	6.1%
Total - All Sources	6,388,700	1.9%

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.

PERFORMANCE MEASURES	FY 2006 Actual	FY 2007 Actual	FY 2008 Actual	FY 2010 JLBC
• 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 JLBC includes \$7,996,600 and 110 FTE Positions from the State Lottery Fund for the operating budget in FY 2010. The FY 2010 adjustments would be as follows:

Eliminate Computer Replacement OF \$(69,100)

This adjustment would decrease computer replacement funding by \$(69,100) from the State Lottery Fund in FY 2010. This adjustment would eliminate funding associated with the Lottery's computer technology replacement schedule.

Eliminate Performance Pay OF (750,000)

This adjustment would decrease agencywide performance based compensation funding by \$(750,000) from the State Lottery Fund in FY 2010. This adjustment would eliminate funding associated with the Lottery's sales performance incentive plan.

Advertising

The JLBC includes \$11,000,000 from the State Lottery Fund for Advertising in FY 2010. The FY 2010 adjustment would be as follows:

Advertising Decrease OF (9,162,700)

This adjustment would decrease Advertising funding by \$(9,162,700) from the State Lottery Fund in FY 2010. Laws 2008, Chapter 287 permanently eliminated the 4% of annual gross revenues 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 JLBC would cap funding for advertising expenses at \$11,000,000. (See "Statutory Changes" for more information.)

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

Instant Tickets

The JLBC includes \$9,209,800 from the State Lottery Fund for Instant Tickets in FY 2010. The FY 2010 adjustments would be as follows:

Instant Ticket Sales Increase OF 121,700

This adjustment would increase Instant Tickets funding by \$121,700 from the State Lottery Fund in FY 2010 due to higher projected sales. (See "Other Issues for Legislative Consideration – Lottery Forecast" for more information.)

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 JLBC includes \$9,129,300 from the State Lottery Fund for On-line Vendor Fees in FY 2010. The FY 2010 adjustments would be as follows:

On-line Vendor Fees Increase OF 238,700

This adjustment would increase On-line Vendor Fees funding by \$238,700 from the State Lottery Fund in FY 2010 due to higher projected sales. (See "Other Issues for Legislative Consideration – Lottery Forecast" for more information.)

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 JLBC includes \$32,310,100 from the State Lottery Fund for Retailer Commissions in FY 2010. The FY 2010 adjustments would be as follows:

Retailer Commission Increase OF 623,300

This adjustment would increase Retailer Commissions funding by \$623,300 from the State Lottery Fund in FY 2010 due to higher projected sales. (See "Other Issues for Legislative Consideration – Lottery Forecast" for more information.)

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.

Sales Incentive Program

The JLBC 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 JLBC 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.

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FORMAT — Operating Lump Sum with Special Line Items by Agency

FOOTNOTES

Standard Footnotes

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.

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.

An amount equal to 6.5% of gross lottery game sales is appropriated for payment of sales commissions to ticket retailers. In accordance with Laws 1997, Chapter 214, an additional amount not to exceed 0.5% of gross lottery game sales is appropriated for payment of sales commissions to ticket retailers. The combined amount is estimated to be 6.7% of total ticket sales, or \$32,310,100 in FY 2010.

New Footnotes

An amount equal to \$11,000,000 is appropriated for advertising expenses in FY 2010. (*The advertising cap prior to FY 2009 was \$11,000,000.*)

STATUTORY CHANGES

The JLBC would:

- As permanent law, repeal the State Land Department's Community Protection Initiative Fund and the Department of Environmental Quality's Water Supply Development Fund Special Line Item from the list of recipients of State Lottery Fund monies.
- As permanent law, repeal the use of Lottery revenues for the debt service payments pursuant to the Arizona Board of Regents' \$1,000,000,000 bonding authority.
- As permanent law, require that the General Fund receive at least \$57,000,000 from Lottery proceeds.

OTHER ISSUES FOR LEGISLATIVE CONSIDERATION

Lottery Forecast

The FY 2009 Education Budget Reconciliation Bill (BRB) (Laws 2008, Chapter 287), which was effective September 26, 2008, made several changes to Lottery operations in order to generate additional sales. These additional sales are to be primarily used to pay for 80% of the debt service associated with a new \$1,000,000,000 university capital construction lease-purchase issuance. (*See "Sources and Uses of Lottery Profit Distribution - University Capital Improvement Fund" for more information.*)

To generate additional sales, Chapter 287:

- Permanently removed the cap on Lottery advertising. (*See the Advertising Special Line Item" for more information.*)
- Appropriated \$750,000 in FY 2009 to allow Lottery staff to receive performance incentives, directly tied to sales objectives and agency sales goals.

Beyond statutory revisions, the Lottery is implementing several other administrative changes to increase sales:

- Offer higher prizes and increase aggregate game payouts from 60% to 70%.
- Increase Utilization of "Lottery Express" machines, where customers are able to purchase all Lottery products. These machines were first integrated into the traditional network of instant ticket vending machines in FY 2007.

Prior to Chapter 287, the JLBC Staff had forecast FY 2009 sales of \$481,859,400, or a 2% increase above FY 2008. With the Chapter 287 revisions and due to current economic conditions, the JLBC Staff forecasts no growth in overall Lottery ticket sales for FY 2009, followed by a 2% increase in FY 2010. For FY 2009 and FY 2010, the JLBC Staff forecasts Lottery sales of \$472,937,300 and \$482,239,800, respectively.

The JLBC Staff forecasts no growth in instant tickets in FY 2009, followed by a modest 1% increase in FY 2010. The Instant Scratchers game remains the largest contributor to both FY 2009 and FY 2010 forecasts with estimated sales of \$206,511,500 and \$208,576,600, respectively.

In regards to state-only on-line ticket sales (excluding Powerball), the JLBC Staff forecasts no growth in FY 2009, followed by a 5% increase in FY 2010. Due to the uncertainty of when large Powerball jackpots will occur, the JLBC Staff forecasts no growth in Powerball ticket sales in FY 2009, followed by a modest 1% increase in FY 2010.

With the Chapter 287 revisions, the Lottery estimates FY 2009 sales of \$576,077,600, or an increase of 22%, and FY 2010 sales of \$638,446,100, or an increase of 11%.

Chapter 287 also modified the distribution formula of Lottery proceeds to add the new university construction debt service contributions along with new payments to the Water Supply Development and Community Protection Initiative Funds. Except for the Commerce and Economic Development (CEDC) Fund, which still receives its funds from the sales of 2 Arizona Lottery Scratchers games, every beneficiary now receives funding from all ticket sources. The CEDC Fund is administered by the Arizona Department of Commerce and used to support the state's community and economic development goals, initiatives, and strategic plans as defined and developed by the CEDC. (Please see Table 1 for revised distribution formula.)

The General Fund's share of Lottery profits includes \$31,000,000 prior to all other distributions, followed by an additional \$15,490,000 (for a total of \$46,490,000) after the statutory obligations have been met through the Homeless Shelters distribution. In FY 2009 only, the General Fund can receive up to an additional \$26,000,000 above the \$31,000,000 requirement. JLBC estimates that the General Fund would have received \$55,004,500 in FY 2009; however, due to how Lottery is implementing its FY 2009 fund transfers of \$4,628,500, JLBC estimates the General Fund will only receive \$50,376,000 in FY 2009.

After all statutory fund distributions have been made, the General Fund receives any remaining revenues.

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 the JLBC projected distributions for FY 2009 and FY 2010. A brief description of each beneficiary follows in the order that they receive Lottery-generated revenue.

General Fund – Part 1

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

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 10% every year until total revenues reach a maximum of \$18,000,000. In FY 2009 only, 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.

Sales	FY 2008 ^{1/}	FY 2009	FY 2010
Instant Sales	\$252.4	\$252.4	\$255.8
On-Line Sales	220.5	220.5	226.4
Total Sales	\$472.9	\$472.9	\$482.2
<i>Less:</i>			
Operating Budget	\$ 66.6	\$ 79.3	\$ 70.3
Fund Transfer ^{2/}	6.1	4.6	0.0
Prizes ^{3/}	264.7	252.1	267.5
Net Profit ^{4/}	\$135.5	\$136.9	\$144.5
Profit Transfers			
General Fund ^{5/}	\$ 31.0	\$ 31.0	\$ 31.0
LTAF II	11.5	9.5	9.9
LTAF	23.0	23.0	23.0
CAF	7.7	7.7	7.7
Heritage	20.0	20.0	20.0
Health and Welfare Programs	21.3	21.6	22.1
Homeless Shelters	1.0	1.0	1.0
General Fund ^{6/}	16.4	19.4	15.5
University Capital ^{6/}	NA	0.0	3.0 ^{7/}
Water Supply Development ^{8/}	NA	NA	7.4 ^{7/}
Community Protection ^{8/}	NA	NA	0.0 ^{7/}
General Fund ^{9/}	NA	0.0	0.0
Economic Development ^{9/}	3.6	3.8	4.0
Total Transfer^{10/}	\$135.5	\$136.9	\$144.5

1/ Lottery used a different distribution formula in FY 2008. This year has 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 to the General Fund and \$84,900 due to a hiring freeze.
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 2008 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 are estimated to total \$50,376,000 in FY 2009 and \$46,490,000 in FY 2010.
6/ The FY 2010 amount represents the debt service for the \$64,600,000 in fire, life, and safety building renewal projects favorably reviewed by the Joint Committee on Capital Review.
7/ Does not account for statutory changes. (See "Statutory Changes" section.) If these changes were enacted, it is estimated the General Fund would receive an additional \$10,384,700 in FY 2010.
8/ Effective beginning in FY 2010.
9/ Dedicated funding from 2 instant ticket games.
10/ Total Transfers might not add due to rounding.

Local Transportation Assistance Fund (LTAF)

LTAF receives a maximum of \$23,000,000 annually. Funds are distributed to counties, cities, and towns. The uses include road building, traffic signals, sidewalk and alley repair, general maintenance, and Dial-a-Ride operating expenses.

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.

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.

Health and Welfare Programs

Statute requires annual inflation adjustments for the Health and Welfare distribution. The FY 2010 allocation is projected to be \$22,059,200. 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.

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.

General Fund – Part 2

As noted above, the General Fund receives an additional \$15,490,000 after all prior allocations have been met.

University Capital Improvement Fund

Chapter 287, as session law, requires that after all Lottery revenue beneficiaries have received their statutory distributions, up to \$20,000,000 shall be deposited into the University Capital Improvement Fund.

This fund serves as the source for 80% of the debt service associated with \$1,000,000,000 University Capital construction lease purchase. (See the FY 2010 Arizona Board of Regents – Capital Outlay Section for more information.)

Water Supply Development Funding

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.

Community Protection Initiative Funding

Chapter 287 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.

General Fund – Part 3

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

SUMMARY OF FUNDS	FY 2008 Actual	FY 2009 Estimate
State Lottery Fund (LOA2122/A.R.S. § 5-521)		Partially-Appropriated
Source of Revenue: Sales of lottery tickets, retailer license fees, and interest earnings.		
Purpose of Fund: A portion of the fund is appropriated to pay for all costs of the Arizona State Lottery Commission. After all expenses are paid including the prize monies displayed below in the Non-Appropriated Funds Expended line, Lottery profits are distributed to the General Fund, Local Transportation Assistance Fund II (Mass Transit), Local Transportation Assistance Fund, County Assistance Fund, Heritage Fund, Health and Welfare programs, Homeless Shelters, University Capital Improvement Lease-to-Own and Bond Fund, and the Economic Development Commission, revenues permitting.		
Appropriated Funds Expended	66,607,100	79,323,300
Non-Appropriated Funds Expended	264,741,500	252,073,800
Year-End Fund Balance	14,474,600	9,796,900