

Arizona State Lottery Commission

	FY 2015 ACTUAL	FY 2016 ESTIMATE	FY 2017 BASELINE
OPERATING BUDGET			
<i>Full Time Equivalent Positions</i>	98.8	98.8	98.8
Personal Services	4,123,400	4,812,000	4,812,000
Employee Related Expenditures	1,870,000	1,732,800	1,732,800
Professional and Outside Services	352,900	386,800	386,800
Travel - In State	204,200	271,600	271,600
Travel - Out of State	14,100	16,800	16,800
Other Operating Expenditures	933,700	1,169,400	1,169,400
Equipment	118,400	0	0
OPERATING SUBTOTAL	7,616,700	8,389,400	8,389,400
SPECIAL LINE ITEMS			
Advertising	13,676,700	15,500,000	15,500,000
Charitable Commissions	443,000	1,105,200	1,215,800
Instant Tickets	10,474,600	22,056,300	23,671,800
On-Line Vendor Fees	7,080,500	7,344,200	8,062,600
Retailer Commissions	22,619,400	53,977,900	56,633,900
AGENCY TOTAL	61,910,900	108,373,000	113,473,500
FUND SOURCES			
<u>Other Appropriated Funds</u>			
State Lottery Fund	61,910,900	108,373,000	113,473,500
SUBTOTAL - Other Appropriated Funds	61,910,900	108,373,000	113,473,500
SUBTOTAL - Appropriated Funds	61,910,900	108,373,000	113,473,500
Other Non-Appropriated Funds	488,728,000	514,176,300	539,989,200
TOTAL - ALL SOURCES	550,638,900	622,549,300	653,462,700

AGENCY DESCRIPTION — The Arizona Lottery is responsible for administering sanctioned games of chance. In addition to Arizona-specific games, the state also participates in multi-state Powerball and Mega-Millions on-line games.

Operating Budget

The Baseline includes \$8,389,400 and 98.8 FTE Positions from the State Lottery Fund in FY 2017 for the operating budget. These amounts are unchanged from FY 2016.

Advertising

The Baseline includes \$15,500,000 from the State Lottery Fund in FY 2017 for Advertising. This amount is unchanged from FY 2016.

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

Charitable Commissions

The Baseline includes \$1,215,800 from the State Lottery Fund in FY 2017 for Charitable Commissions. FY 2017 adjustments would be as follows:

Tab Ticket Increase	OF	FY 2017 \$110,600
The Baseline includes an increase of \$110,600 from the State Lottery Fund in FY 2017 to realign spending with projected revenues. (See Table 1 for more information.)		

Monies in this line item are used to compensate charities for selling lottery 'Tab Tickets.' Tab Tickets are games sold exclusively by charitable organizations, who receive a 20% commission for selling the games. The displayed amount is derived by applying the approved percentage, 20%, to the forecasted Tab Ticket sales. A.R.S. § 5-555 also allows the department to collect up to 35% of total Tab Ticket sales (which includes the 20% commission) for their

operating budget, with the remainder distributed as prizes.

Instant Tickets

The Baseline includes \$23,671,800 from the State Lottery Fund in FY 2017 for Instant Tickets. FY 2017 adjustments would be as follows:

Instant Ticket Sales Increase OF 1,615,500

The Baseline includes an increase of \$1,615,500 from the State Lottery Fund in FY 2017 for Instant Tickets due to higher projected sales. *(See Table 1 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 Baseline includes \$8,062,600 from the State Lottery Fund in FY 2017 for On-Line Vendor Fees. FY 2017 adjustments would be as follows:

On-Line Vendor Fee Rate Increase OF 891,600

The Baseline includes an increase of \$891,600 from the State Lottery Fund in FY 2017 for On-Line Vendor Fees due to a contractual rate increase set to begin in September 2016.

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. This percentage is currently 3.7%. However, the agency has entered into a new contract with another vendor to provide this service. Beginning in September 2016, the rate will increase to 4.256%. The \$891,600 increase in this line item is a result of a blended rate of 4.16% in FY 2017.

On-Line Sales Decrease OF (173,200)

The Baseline includes a decrease of \$(173,200) from the State Lottery Fund in FY 2017 for On-Line Vendor Fees due to lower projected sales. This reflects the decline in on-line vendor fees prior to the adjustment for the fee increase. On-Line sales have experienced a (4.6)% average annual growth rate since FY 2012, which is driven by decreasing revenues in multi-state draw games. *(See Table 1 for more information.)*

Retailer Commissions

The Baseline includes \$56,633,900 from the State Lottery Fund in FY 2017 for Retailer Commissions. FY 2017 adjustments would be as follows:

Retailer Commissions Increase OF 2,656,000

The Baseline includes an increase of \$2,656,000 from the State Lottery Fund in FY 2017 for Retailer Commissions due to higher projected sales. *(See Table 1 for more information.)*

Monies in this line item are used to compensate retailers for selling lottery tickets. A.R.S. § 5-555 specifies that compensation to retailers will be at least 5.5% but not more than 8% of non-Tab Ticket sales. The actual appropriation is equal to 6.5% of these sales. Pursuant to statute, an additional 0.5% of total non-Tab 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.

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FORMAT — Operating Lump Sum with Special Line Items by Agency

FOOTNOTES

Standard Footnotes

An amount equal to 20% of Tab Ticket sales is appropriated for payment of sales commissions to charitable organizations. This amount is currently estimated to be \$1,215,800 in FY 2017.

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 \$23,671,800 in FY 2017.

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 \$8,062,600, or 4.16% of actual on-line ticket sales in FY 2017.

An amount equal to 6.5% of gross lottery game sales, minus Tab Tickets, is appropriated for payment of sales commissions to ticket retailers. 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 currently estimated to be 6.7% of total ticket sales, or \$56,633,900, in FY 2017.

STATUTORY CHANGES

The Baseline would, as session law, require that \$27,227,600 in Lottery ticket sales commissions earned during the second half of FY 2015 be paid from the State Lottery Fund's FY 2015 ending balance. Due to a delay in processing, these amounts were recorded as an FY 2015 administrative adjustment in the state's accounting system.

Other Issues

Lottery Forecast and Distributions

The Baseline assumes an 8.2% increase in overall Lottery ticket sales in FY 2016, followed by a 5.0% increase in FY 2017. For FY 2016 and FY 2017, the Baseline assumes Lottery ticket sales of \$811,167,200 and \$851,361,500, respectively.

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 2015 and the JLBC Staff projected distributions for FY 2016 and FY 2017. A brief description of each beneficiary follows in the order that they receive Lottery-generated revenue in accordance with A.R.S. § 5-534 and § 5-572.

State Lottery Revenue Bond Debt Service Payment Fund

Laws 2010, 6th Special Session, Chapter 4 authorized the Arizona Department of Administration (ADOA) to issue a 20-year, \$450,000,000 Lottery revenue bond by December 31, 2010 to be deposited into the General Fund. The payments are made from Lottery revenues that would have otherwise been deposited into the General Fund. The principal and interest payments in FY 2016 and FY 2017 are expected to be \$37,501,800 and \$37,501,500, respectively. Chapter 4 requires the first Lottery proceeds to be distributed to the State Lottery Revenue Bond Debt Service Payment Fund.

Maricopa County Mass Transit

The projected annual distribution of Powerball proceeds to the Maricopa Public Transportation Fund is \$11,444,400 in each FY 2016 and FY 2017.

Laws 1993, 6th Special Session, Chapter 1 allocated not less than 31.5% of multi-state Powerball revenues to public transportation programs, otherwise known as Local Transportation Assistance Fund (LTAF) II. This allocation was capped at \$18,000,000 and was contingent upon the General Fund receiving \$45,000,000 in Lottery revenues.

Laws 2010, 7th Special Session, Chapter 12 redirected these monies to the General Fund. In September 2011, the U.S. District Court in the case of *Paisley v. Darwin* ruled that the Arizona Legislature must restore the distribution of mass transit monies to Maricopa County because the distribution was part of the state implementation plan to ensure compliance with the Clean Air Act. As a result, the state must calculate Maricopa County's share of 31.5% of statewide Powerball proceeds and distribute those monies to the county.

General Fund - Part 1

The statutory distribution requires the General Fund to receive up to \$84,150,000. The General Fund - Part 2 would receive up to an additional \$15,490,000 (for a total of \$99,640,000) after the statutory funding obligations have been met through the Homeless Shelters distribution. After all other statutory obligations have been met, the General Fund - Part 3 would receive all remaining revenues.

The profit distributions in FY 2016 and FY 2017 are forecasted to fulfill requirements for General Fund - Part 1 and Part 2. The Lottery revenue bond payments of \$37,501,800 in FY 2016 and \$37,501,500 in FY 2017 count towards the \$84,150,000 General Fund - Part 1 requirement.

Heritage Fund

Statute caps annual distributions to the Arizona Game and Fish Commission's Heritage Fund at \$10,000,000. The funds are used to promote wildlife habitat and education programs and to rehabilitate historic buildings. In FY 2016 and FY 2017, the fund is projected to receive its entire allocation.

Health and Welfare Programs

Statute requires annual inflation adjustments for the Health and Welfare distribution. The revised allocation cap is \$20,603,400 in FY 2016 and \$21,087,400 in FY 2017. These amounts are distributed among the following agencies:

- 29.4% to the Department of Child Safety for the Healthy Families program.
- 23.5% to the Arizona Board of Regents (ABOR) for the Arizona Health Education Center program.

- 17.6% to the Department of Health Services (DHS) for teenage pregnancy prevention.
- 11.8% to DHS 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.

General Fund distributions, net of bond payments, are therefore estimated to be \$65,615,300 in FY 2016 and \$73,137,300 in FY 2017.

Health and Welfare Programs are expected to receive their entire allocation in both FY 2016 and FY 2017.

Homeless Shelters

Under the statutory distribution, DES would receive up to \$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. The fund is estimated to receive its full allocation in both FY 2016 and FY 2017.

General Fund - Part 2

As noted above, the General Fund would receive up to an additional \$15,490,000 after all prior allocations have been met. In FY 2016 and FY 2017, the General Fund is estimated to receive its entire allocation of \$15,490,000.

Arizona Competes Fund

Statute caps annual distributions to the Arizona Competes Fund at \$3,500,000. Allotments to this fund are used for administering grants to qualifying businesses for the purpose of attracting, retaining, and expanding business within the state. This fund is estimated to receive its full allocation in both FY 2016 and FY 2017.

University Capital Improvement Fund

This fund serves as the source for up to 80% of the annual debt service associated with \$800,000,000 of University Capital construction lease-purchase agreements. This fund received \$22,273,200 in FY 2015. The UCI Fund is expected to require \$38,653,000 in FY 2016 and \$39,928,200 in FY 2017 to make the expected 80% level of debt service payments. The Universities do not plan to issue any additional lease-purchase agreements in FY 2017 above the \$668,710,000 of lease-purchase agreements that have already been or will be issued by the end of FY 2016. Once the full \$800,000,000 has been issued, debt service payments could total \$41,632,900, depending on assumptions of repayment lengths and interest rates. *(Please see the FY 2017 ABOR Capital Outlay section for more details.)*

General Fund - Part 3

The General Fund receives all remaining revenues after all statutory funding obligations have been met. These payments to the General Fund are estimated to equal \$3,477,100 in FY 2016 and \$10,998,800 in FY 2017. Total

Table 1			
Forecast of Lottery Revenue Distribution			
(\$ in Millions)			
Sales	FY 2015	FY 2016	FY 2017
Instant Sales	\$547.2	\$612.7	\$657.6
On-Line Sales	<u>202.8</u>	<u>198.5</u>	<u>193.8</u>
Total Sales	\$750.0	\$811.2	\$851.4
<i>Less:</i>			
Operating Budget ^{1/}	\$ 61.9	\$ 108.4	\$ 113.5
Delayed Commissions ^{2/}	27.2	0.0	0.0
Gaming Distribution	0.3	0.3	0.3
Prizes ^{3/}	<u>488.7</u>	<u>514.2</u>	<u>540.0</u>
Net Profit ^{4/}	\$171.9	\$188.3	\$197.6
Profit Transfers ^{5/}			
Debt Service Fund	\$ 37.5	\$ 37.5	\$ 37.5
Maricopa County Mass Transit ^{6/}	11.4	11.4	11.4
General Fund - Part 1 ^{7/}	46.6	46.6	46.6
Heritage	10.0	10.0	10.0
Health and Welfare Programs	20.2	20.6	21.1
Homeless Shelters	1.0	1.0	1.0
General Fund - Part 2 ^{7/}	15.5	15.5	15.5
Arizona Commerce Authority	3.5	3.5	3.5
University Capital	22.3	38.7	39.9
General Fund - Part 3 ^{7/}	<u>3.9</u>	<u>3.5</u>	<u>11.1</u>
Total Transfer	\$171.9	\$188.3	\$197.6
^{1/} Of this amount, an estimated \$1,105,200 in FY 2016 and an estimated \$1,215,800 in FY 2017 will be distributed as commissions to charities that sell lottery Tab Tickets.			
^{2/} Due to a delay in processing, \$27,227,600 of Lottery expenditures made in FY 2015 were recorded in FY 2016 in the state's accounting system. This delay in processing did not change the FY 2015 calculations of prizes, net profit, and profit transfers that appear in this table. Any delayed expenditures are assumed to be made from the FY 2015 ending balance and are not included in FY 2016 expenditures.			
^{3/} Prizes are estimated by subtracting net profit, operating budget expenditures, and the Department of Gaming transfer from total Lottery sales.			
^{4/} To derive the profit transfer amounts, the actual FY 2014 and FY 2015 average rate of return for each game was applied to the current budget forecast. The cumulative profit transfer rate is 23.41%.			
^{5/} In addition to these listed transfers, the following monies are distributed:			
- \$900,000 and \$100,000 from vending machine sales in age-restricted areas to the Internet Crimes Against Children Enforcement Fund and the Victims' Rights Enforcement Fund, respectively.			
- 30% of unclaimed prizes to the Court Appointed Special Advocates program.			
- 15% of unclaimed prizes, not to exceed \$160,000 to the Tribal College Dual Enrollment Program Fund.			
^{6/} As a result of a federal court order, Maricopa County's share of Local Transportation Assistance Fund II monies was reinstated starting September 2011. (See <i>Other Issues</i> section for more information.)			
^{7/} Excluding fund transfers, distributions to the General Fund totaled \$66,096,300 in FY 2015 and are estimated to be \$65,615,300 in FY 2016 and \$73,137,300 in FY 2017.			

SUMMARY OF FUNDS	FY 2015 Actual	FY 2016 Estimate
State Lottery Fund (LOA2122/A.R.S. § 5-571)		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 a number of different functions.		
Appropriated Funds Expended	61,910,900	108,373,000
Non-Appropriated Funds Expended	488,728,000	514,176,300
Year-End Fund Balance*	47,093,500	16,496,400

*Expenses for commissions from January – June 2015 are to be funded from the FY 2015 ending balance. They are not included in the FY 2015 and FY 2016 appropriated expenditures listed above.