



Legislative Fiscal Bureau

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Joint Committee on Finance

Paper #695

Minor Policy and Technical Changes -- Lottery Sales Projections, Retailer Compensation and Vendor Fees Reestimates, and Reestimate of Certain Lottery Fund Revenues and Reserves (DOR -- Lottery Administration)

Bill Agency

[LFB 2007-09 Budget Summary: Page 493, #1, Page 494, #3, and Page 496, #7]

INTRODUCTION

Lottery sales are a key component in determining certain lottery expenses and the amounts that will be available for the lottery and gaming credit for property tax relief. This paper reestimates lottery sales projections under the Governor's budget bill, reestimates sum sufficient appropriations for retailer compensation and lottery vendor fees, makes certain technical adjustments to elements in the lottery fund condition statement, and reestimates the amounts available for the lottery and gaming credit in 2007-08 and 2008-09. These adjustments are accomplished through a modification to the bill described at the end of the paper.

GOVERNOR

Lottery Sales Projections

Project lottery sales of \$504,690,200 in 2007-08 and \$518,990,200 in 2008-09. Projected lottery sales provide the basis for estimating the lottery 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 2005-06 actual lottery sales and 2006-07 estimated sales projected in October, 2006, for the purposes of certifying the amount available for the 2006(07) lottery property tax credit. The Governor's 2007-09 projected sales reflect increased funding for lottery advertising and a new instant ticket inventory system provided under the bill.

Lottery Sales Projections
(\$ in Millions)

<u>Game Type</u>	<u>Actual</u> <u>2005-06</u>	<u>2006-07</u>	<u>2007-08</u>	<u>Percent Change</u> <u>from 2006-07</u>	<u>2008-09</u>	<u>Percent Change</u> <u>from 2007-08</u>
Scratch	\$280.3	\$277.8	\$277.8	0.0%	\$292.1	5.1%
Pull-tab	5.3	5.3	5.3	0.0	5.3	0.0
On-line	<u>223.3</u>	<u>206.6</u>	<u>221.6</u>	7.3	<u>221.6</u>	0.0
Total	\$508.9	\$489.7	\$504.7	3.1%	\$519.0	2.8%

Sum Sufficient Appropriation Reestimates

Provide \$1,649,700 SEG in 2007-08 and \$3,049,700 SEG in 2008-09 to reestimate lottery sum sufficient appropriations for retailer compensation and vendor fees, as follows:

Retailer Compensation. \$1,192,500 SEG in 2007-08 and \$2,229,200 SEG in 2008-09 to adjust base level funding for retailer compensation, including payments to retailers under the retailer performance program, to reflect projected lottery sales in the 2007-09 biennium.

Vendor Fees. \$457,200 SEG in 2007-08 and \$820,500 SEG in 2008-09 to adjust funding for vendor fees to reflect projected lottery sales in the 2007-09 biennium.

Lottery Fund Condition Statement

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 2007 Senate Bill 40 (SB 40).

The bill would appropriate \$125,746,700 in 2007-08 and \$125,421,200 in 2008-09 for the lottery and gaming tax credit. However, the revenues and expenditures budgeted under the bill would support credits of \$127,265,400 in 2007-08 and \$131,073,300 in 2008-09. These lottery and gaming credit amounts are reflected in the fund condition statement below.

Lottery Fund Condition Statement Governor

	<u>2007-08</u>	<u>2008-09</u>
Fiscal Year Opening Balance	\$9,796,700	\$10,095,700
Operating Revenues		
Ticket Sales	\$504,690,200	\$518,990,200
Retailer Fees and Miscellaneous	<u>96,600</u>	<u>96,600</u>
Gross Revenues	\$504,786,800	\$519,086,800
Expenditures		
Prizes	\$293,637,200	\$302,879,300
Retailer Compensation	35,780,700	36,817,400
Vendor Payments	12,928,200	13,291,500
General Program Operations	22,318,500	21,862,700
Appropriation to DOJ	348,000	348,000
Appropriation to DOR	282,600	282,600
Program Reserves	<u>355,000</u>	<u>673,800</u>
Total Expenditures	\$365,650,200	\$376,155,300
Net Proceeds	\$139,136,600	\$142,931,500
Interest Earnings	\$3,668,500	\$3,668,500
Gaming-Related Revenue	\$0	\$0
Total Available for Tax Relief*	\$152,601,800	\$156,695,700
Appropriations for Tax Relief		
Lottery and Gaming Tax Credit	\$127,265,400	\$131,073,300
Farmland Tax Relief Credit	15,000,000	15,000,000
Lottery and Gaming Credit: Late Applications	<u>240,700</u>	<u>240,700</u>
Total Appropriations for Tax Relief	\$142,506,100	\$146,314,000
Gross Closing Balance	\$10,095,700	\$10,381,700
Reserve (2% of Gross Revenues)	\$10,095,700	\$10,381,700
Net Closing Balance	\$0	\$0

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

DISCUSSION POINTS

Lottery Sales Projections

1. Lottery sales began in Wisconsin in 1988-89. The table below shows the sales history of lottery sales through 2005-06. As is typical of state lotteries, sales totals in Wisconsin steadily increased in the initial years of operation, rising to a high of \$518.9 million in 1994-95. In subsequent years, sales declined to \$401.2 million in 2000-01, before again increasing. Sales reached nearly \$509.0 million in 2005-06.

Wisconsin Lottery Ticket Sales History

<u>Fiscal Year</u>	<u>Instant Games</u>	<u>On-Line Games</u>	<u>Totals</u>
1988-89	\$230,365,300	\$0	\$230,365,300
1989-90	182,674,800	126,923,100	309,597,900
1990-91	230,724,800	160,672,200	391,397,000
1991-92	289,685,900	159,370,500	449,056,400
1992-93	310,951,800	184,180,100	495,131,900
1993-94	285,317,800	210,203,500	495,521,300
1994-95	320,356,100	198,558,900	518,915,000
1995-96	310,401,700	171,722,300	482,124,000
1996-97	273,413,600	157,677,500	431,091,100
1997-98	252,915,500	165,724,800	418,640,300
1998-99	230,817,600	197,378,500	428,196,100
1999-00	241,040,900	165,629,300	406,670,200
2000-01	237,944,200	163,244,400	401,188,600
2001-02	238,214,000	189,336,300	427,550,300
2002-03	249,467,400	185,570,400	435,037,800
2003-04	270,286,700	212,633,600	482,920,300
2004-05	269,904,800	181,967,200	451,872,000
2005-06	285,609,900	223,293,700	508,963,600

2. The 2006-07 estimated sales projection of \$489.7 million, made in October, 2006, for the purposes of certifying the amount available for the 2006(07) lottery property tax credit, still appears to be accurate. An updated estimate of total lottery sales for 2006-07, based on a straight-line projection, shows that sales would fall within 1% of the October, 2006, estimate. Therefore, there is no need to modify the 2006-07 sales estimate at this time.

3. In the agency budget request, DOR estimated that sales in 2007-08 and 2008-09 would continue at the same levels as the estimated sales in 2006-07. Given the overall stability in sales at this point in time, the budget request estimates would appear reasonable. The DOR budget request did not include funding for advertising or inventory control initiatives.

4. However, in the Department's 10% budget reduction plan, DOR projected potential additional lottery revenues of \$15.0 million annually in the 2007-09 biennium by increasing the advertising budget by \$2,900,000 SEG annually. In addition, an additional \$14.3 million in sales revenue in 2008-09 was projected for a new instant ticket inventory control system. This system would require \$350,000 SEG in one-time funding in 2007-08, offset by deleting \$106,200 SEG and 2.25 SEG positions in 2007-08, and \$212,000 SEG and 4.5 SEG positions in 2008-09.

5. The Governor adopted the advertising and inventory system proposals made in the

DOR 10% budget reduction plan and included the Department's sales increase estimates in the revenue projections for the lottery under SB 40.

6. The additional sales estimates under the bill relating to advertising (\$15.0 million annually) would represent a 3% increase to projected 2006-07 sales. The Department arrived at this estimate after examining data from other states relating to advertising. For example, a 2003 Pennsylvania study of advertising concluded that a \$1 increase per adult in the state would produce about a 7% increase in lottery sales. Similarly, the additional sales estimate under the bill relating to the inventory management initiative (\$14.3 million in 2008-09, an increase of 5% to projected 2006-07 scratch ticket sales) is based on review of other states operating this type of inventory control. According to Department officials, the State of Washington, which is fairly comparable to Wisconsin in its lottery operations, achieved this level of increase.

7. These types of add-on sales projections are difficult to make. Lottery sales are simultaneously affected by a variety of factors, and attributing an increase to one or another factor is somewhat arbitrary. However, the sales projections appear fairly conservative and, on the whole, reasonable. [Separate issue papers on the advertising increase and the proposed inventory system have been prepared for the Committee, in which these sales estimates could change as a result of Committee action on these proposals.]

8. In summary, if the advertising and inventory control initiatives are approved, the sales estimates under the bill appear to be reasonable (\$504.7 million in 2007-08 and \$519.0 million in 2008-09). If the proposed funding or implementation of either the advertising or the inventory control initiative is modified by the Committee, the estimated sales increases would be adjusted accordingly. Finally, if the advertising and inventory initiatives are not approved, the sales estimate of \$489.7 million (the same amount as the 2006-07 estimate) could be continued unchanged in 2007-08 and 2008-09, as estimated in the Department's 2007-09 budget request.

9. However, a correction needs to be made to the sales estimate relating to the additional advertising funding in the bill. Under SB 40, the entire \$15.0 million in projected sales associated with the advertising expansion is attributed to on-line sales. This would clearly not occur because increased advertising would affect both scratch and on-line sales. The additional revenue needs to be correctly attributed to both scratch and on-line sales because the sales of each game type affect the calculation of the appropriations for retailer compensation and lottery vendor fees.

10. In its March 1, 2007, prize payout report, DOR included the projected sales increase of \$15 million in 2007-08 associated with the proposed advertising funding. This annual report, required under s. 565.02(7) of the statutes, provides the Joint Committee on Finance with the following: (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.

11. In assuming the \$2.9 million in advertising funding would be approved, the March 1, 2007, report projected: (a) a sales increases of approximately \$6.5 million in scratch ticket sales in 2007-08 (an estimated 2.4% increase in scratch game sales compared to 2006-07); and (b) \$8.5 million in on-line sales in 2007-08 (an estimated 4.1% increase in on-line game sales compared to 2006-07). The March 1, report is not required to, and does not, project 2008-09 sales; however, in other lottery materials, DOR officials indicate that these same increases would be projected in both 2007-08 and 2008-09.

12. If the additional amounts attributed to scratch ticket sales (\$6.4 million) and on-line ticket sales (\$8.6 million) are applied to both 2007-08 and 2008-09, the projected sales under the bill should be corrected to the amounts shown in the following table. While total sales remain the same as under the bill, the corrected sales amounts for scratch and on-line games require new calculations for prizes, retailer compensation, vendor fees, and the appropriation for the lottery and gaming property tax credit.

**Revised Lottery Sales Projections 2007-08 and 2008-09
(\$ in Millions)**

<u>Game Type</u>	<u>2006-07</u>	<u>2007-08</u>	<u>Percent Change from 2006-07</u>	<u>2008-09</u>	<u>Percent Change from 2007-08</u>
Scratch	\$277.8	\$284.3	2.4%	\$298.6	5.0%
Pull-tab	5.3	5.3	0.0	5.3	0.0
On-line	<u>206.6</u>	<u>215.1</u>	<u>4.1</u>	<u>215.1</u>	0.0
Total	\$489.7	\$504.7	3.1%	\$519.0	2.8%

Sum Sufficient Appropriation Reestimates

13. Basic retailer compensation rates under current law are 5.5% for online 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 \$5.0 million in 2007-08 and \$5.2 million in 2008-09, under the bill). Base level funding of \$34,588,200, established under 2005 Wisconsin Act 25, was based on estimated lottery sales of \$490.4 million in 2006-07. The appropriations for retailer compensation under the bill total approximately 7% of projected sales in 2007-08 and 2008-09.

14. 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 2.56% of lottery ticket sales in both 2007-08 and 2008-09. Base level funding for vendor fees is \$12,471,000.

15. The appropriated amounts under the bill for retailer compensation and vendor fees are incorrect, based on the sales projections made in SB 40. DOA officials indicate that errors

occurred when the Chapter 20 appropriations schedule was being created for SB 40. While the errors are quite small (less than 1% of the total appropriation in both cases), they should be corrected.

16. Under the revised sales estimates, and correcting the appropriations schedule, retailer compensation would be reduced by \$249,000 SEG in 2007-08 and \$248,900 SEG in 2008-09. Vendor fees would be reduced by \$109,100 SEG annually. The corrections can be made by the Committee by adopting the modification at the conclusion of this paper. The corrected appropriation amounts for retailer compensation and vendor fees are shown in the revised lottery fund condition. If the Committee deletes or modifies the Governor's recommendations for advertising funding or a new instant ticket inventory control system, further recalculations of the retailer compensation and vendor fees would be required.

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. Another factor requiring correction is gaming-related revenue under the bill. Under the Wisconsin Constitution, gaming-related revenues (state receipts of racing and charitable bingo revenue remaining after regulatory and enforcement costs are paid and interest earnings on these monies) must be deposited in the lottery fund. The amounts of gaming-related revenue transferred to the lottery fund have declined in recent years. In 2004-05, this revenue totaled \$1,031,000 and declined to \$660,900 in 2005-06, primarily due to the closing of one of two remaining pari-mutuel racetracks. In 2006-07, gaming-related revenue was reestimated to total \$333,100 to reflect the decline in pari-mutuel racing and charitable bingo revenue. It is likely that gaming-related transfers to the lottery fund will continue at about this level. However, in SB 40, the estimate for gaming-related revenue is \$0 in both 2007-08 and 2008-09. The fund condition statement below restores the annual estimate at \$333,100.

19. The program reserves for the lottery fund under the bill (reserves for anticipated compensation increases, additional employee health insurance coverage costs, and space costs) were estimated at \$355,000 in 2007-08 and \$673,800 in 2008-09. These amounts reflect an error in the compensation reserve calculation. These estimates have been corrected to total \$248,000 in 2007-08 and \$462,300 in 2008-09. These revised reserve amounts are shown in the following fund condition statement.

20. 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 \$128,555,600 in 2007-08 and \$132,467,900 in 2008-09, as shown in the following fund condition statement.

**Lottery Fund Condition Statement
Reestimate**

	<u>2007-08</u>	<u>2008-09</u>
Fiscal Year Opening Balance	\$9,796,700	\$10,095,700
Operating Revenues		
Ticket Sales	\$504,690,200	\$518,990,200
Retailer Fees and Miscellaneous	<u>96,600</u>	<u>96,600</u>
Gross Revenues	\$504,786,800	\$519,086,800
Expenditures		
Prizes	\$293,145,200	\$302,387,300
Retailer Compensation	35,531,700	36,568,500
Vendor Payments	12,819,100	13,182,400
General Program Operations	22,318,500	21,862,700
Appropriation to DOJ	348,000	348,000
Appropriation to DOR	282,600	282,600
Program Reserves	<u>248,000</u>	<u>462,300</u>
Total Expenditures	\$364,693,100	\$375,093,800
Net Proceeds	\$140,093,700	\$143,993,000
Interest Earnings	\$3,668,500	\$3,668,500
Gaming-Related Revenue	\$333,100	\$333,100
Total Available for Tax Relief*	\$153,892,000	\$158,090,300
Appropriations for Tax Relief		
Lottery and Gaming Tax Credit	\$128,555,600	\$132,467,900
Farmland Tax Relief Credit	15,000,000	15,000,000
Lottery and Gaming Credit: Late Applications	<u>240,700</u>	<u>240,700</u>
Total Appropriations for Tax Relief	\$143,796,300	\$147,708,600
Gross Closing Balance	\$10,095,700	\$10,381,700
Reserve (2% of Gross Revenues)	\$10,095,700	\$10,381,700
Net Closing Balance	\$0	\$0

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

MODIFICATION

Reestimate scratch ticket sales to \$284.3 million in 2007-08 and \$298.6 million in 2008-09 and on-line ticket sales to \$215.1 million annually. Delete \$358,100 SEG in 2007-08 and \$358,000 SEG in 2008-09 to reestimate lottery sum sufficient appropriations for retailer compensation and vendor fees, as follows:

Retailer Compensation. Delete \$249,000 SEG in 2007-08 and \$248,900 SEG in 2008-09 to adjust funding for retailer compensation to reflect projected lottery sales in the 2007-09 biennium.

Vendor Fees. Delete \$109,100 SEG annually to adjust funding for vendor fees to reflect projected lottery sales in the 2007-09 biennium.

Explanation: The lottery sum sufficient appropriations for retailer compensation and vendor fees are based on estimated sales. Under the bill, the appropriated amounts are not correct due to a miscalculation when the Chapter 20 appropriations schedule for SB 40 was created. Total sales estimates under the bill are reasonable, and include sales increases associated the proposed initiatives for additional advertising (\$15.0 million annually in new revenue) and a new instant ticket inventory system (\$14.3 million in new revenue in 2008-09). However, the bill attributes the entire \$15.0 in sales relating to the advertising initiative to increased on-line sales. This requires a correction because the increased advertising would affect both scratch and on-line ticket sales. Lottery sales estimates are corrected by attributing increased lottery sales to both scratch ticket games (an increase of \$6.5 million annually) and on-line ticket games (an increase of \$8.5 million annually). Under these revised sales amounts, the modification corrects the Chapter 20 appropriations schedule and provides the correct amounts for retailer compensation and vendor fees based on the reestimated scratch and on-line sales.

	Change to Bill Funding	Change to Base Funding
SEG	- \$716,100	\$3,983,300

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