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FISCAL IMPACT REPORT

ORIGINAL DATE 1/29/07
SPONSOR Sanchez, M. **LAST UPDATED** 3/6/07 **HB** _____
SHORT TITLE Lottery Board & Fund Distribution **SB** 364/aSFC/aSFL#1/aSFL#2
ANALYST Francis

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY07	FY08	FY09		
	\$4,438.0	\$6,680.0	Recurring	Lottery Scholarship Success Fund

(Parenthesis () Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY07	FY08	FY09	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
Total		(\$4,438.0)	(\$6,680.0)	(\$11,118.0)	Recurring	NM Lottery Authority

(Parenthesis () Indicate Expenditure Decreases)

Relates to HB 87

SOURCES OF INFORMATION

LFC Files
US Census

Responses Received From

NM Lottery Authority (NMLA)
Think New Mexico
Higher Education Department (HED)
Department of Finance and Administration (DFA)

SUMMARY

Synopsis of Senate Floor Amendments

Senate Bill 364 was amended twice on the Senate Floor. Senate Floor Amendment #1 removed the changes to the NM Lottery Authority Board, restoring the board to current law. Senate Floor amendment #2 changes the title to reflect the change made by the first floor amendment.

Synopsis of SFC Amendment

The Senate Finance Committee amended Senate Bill 364 in the following ways:

- Changes the title to include “NAMING THE TUITION SCHOLARSHIP THE “LEGISLATIVE LOTTERY SCHOLARSHIP.”
- Changes the political party membership of the board to no more than five can be from the same political party.
- Adds a new responsibility of the NM Lottery board to support problem gambling and provide information to players.
- Phases-in the minimum distribution to the scholarship fund to 27 percent until December 31, 2008 and then 30 percent thereafter.
- Changes the date for distributing revenue to the last day of the month following the receipt of revenues to the scholarship fund.
- Changes references to conform to new title. (See Technical Issues for more information)

Synopsis of Original Bill

Senate Bill 364 amends the New Mexico Lottery Act in the following ways:

- Requires the New Mexico Lottery Authority (NMLA) to obtain board approval for procurements greater than \$75 thousand.
- Places NMLA under the state procurement code
- Adds two members to the NMLA board to represent four-year and two-year higher education institutions
- Requires NMLA to transmit 30 percent of gross revenue for the month to the state treasurer for deposit into the Lottery Scholarship Fund (“Fund”)
- Eliminates the reserve fund
- Requires that a copy of the annual audit be delivered to the legislative council service library

The effective date of SB364 is July 1, 2007.

FISCAL IMPLICATIONS

Senate Bill 364 as amended would change the distribution to the Fund from net revenue—revenue after expenses—to a flat 27 percent of gross revenues until 12/31/2008 and 30 percent thereafter. This would add approximately \$4.4 million in FY08 and \$6.7 million in FY09. Half of FY09 is at the 27 percent rate and the other half is at the 30 percent rate. The estimate is based on the difference between the DFA/LFC consensus estimate of lottery revenue and that estimate modified to incorporate the increased distribution. Over the last six years, the share of revenues distributed to the Fund has average 24 percent.

Table 1: Fiscal Impact

	FY07	FY08	FY09	FY10	FY11	FY12
	Estimate	Estimate	Estimate	Estimate	Estimate	Estimate
Total Revenue	\$143.75	\$146.14	\$148.36	\$151.17	\$154.20	\$157.30
Net Revenue - Current Forecast	\$34.50	\$35.07	\$35.61	\$36.28	\$37.01	\$37.75
Net Revenue - SB 364 as Amended		\$39.46	\$42.28	\$45.35	\$46.26	\$47.19
Fiscal Impact		\$4.38	\$6.68	\$9.07	\$9.25	\$9.44
Share - Current Law	24%	24%	24%	24%	24%	24%
Share - SB364		27%	29%	30%	30%	30%

NMLA reports that this revenue would come out of their operating costs first but that lowering prize payouts and cutting advertising expenditures may be necessary. Total operating expenses are approximately \$5.6 million so there is not much room for \$4.4 million in cuts required. Prize payouts, as a share of revenues, average approximately 55 percent, 5 percent above the statutory minimum.

NMLA has identified options facing it to meet the 30 percent target:

- **Prize Percentage Payout:**

The Lottery’s prize percentage payout, which determines the amount of dollars that players receive as prizes, may be reduced by approximately 3% (or \$4.7 million.) In other lotteries, reducing the prize percentage payout has resulted in lost sales. However, we are unable to predict with any degree of certainty what the impact on sales in New Mexico might be.

In order to reduce the prize percentage payout effective July 1, 2007, all of the Lottery’s instant tickets will need to be removed from 1,100 retail locations and be replaced with tickets with a lower prize percentage payout prior to July 1, 2007. This has resulted in litigation by players in other states.

- **Advertising**

The advertising budget would be cut by approximately 50% (or \$1.5 million), reducing or eliminating the promotion of new and existing lottery games, current jackpot amounts and the Lottery Success Scholarship program.

- **Promotions:**

The sponsorship of statewide and university events and promotions would be reduced or eliminated; as would retailer equipment such as instant ticket vending machines, electronic store signage, computer equipment and lottery information centers.

- **Retailer Commissions & Incentives:**

Retailer sales commissions, which are currently at 6%, may be reduced to 5% and sales incentives eliminated. Cutting retailers’ commissions may negatively impact retailer support and decrease the number of distribution points for Lottery products, resulting in a significant loss of revenue. One NM-owned retailer chain has 118

stores and accounted for more than \$17 million in lottery sales in FY 06 and approximately \$4 million in revenues. Decreasing the sales commission would result in a reduction of approximately \$170,000 in commissions for this retailer chain.

- **Staffing:**
Salaries and benefits would be reduced by approximately \$500,000, requiring the elimination of certain positions and a reduction in benefits.

According to NMLA, eliminating the reserve would have little impact as the money in the reserve is used for promotions, bonuses and incentives for retailers and those expenditures would still be made, only out of a different line item.

SIGNIFICANT ISSUES

Mandating 30 percent distribution to Fund. Current assumptions are that lottery revenues grow by inflation as measured by the consumer price index. The table below shows the current Fund revenue estimates. Even though the average rate over the history of the lottery is higher than currently forecast, many other states are forecasting slow, flat or negative growth in their lottery revenues. Montana is projecting less 0.5 percent growth, for example, and Maryland has been worried about their revenue growth. According to the US Census Survey of Government Finances, the compound annual growth rate for revenues (defined as ticket sales less commissions) is 3.9 percent from 1997 to 2004, the latest data available. During that time, the amount available for states or net revenue only grew 2.5 percent.

Lottery Net Revenues Forecast

	Year	Net Income (000s)	% Change
	FY97	21,253	
	FY98	19,267	-9.34%
	FY99	20,010	3.85%
	FY00	25,680	28.33%
	FY01	25,914	0.91%
	FY02	29,604	14.24%
	FY03	33,093	11.79%
	FY04	35,939	8.60%
	FY05	32,231	-10.32%
	FY06	36,856	14.35%
Forecast	<i>FY07</i>	<i>34,500</i>	<i>-6.39%</i>
	<i>FY08</i>	<i>35,074</i>	<i>1.67%</i>
	<i>FY09</i>	<i>35,607</i>	<i>1.52%</i>
	<i>FY10</i>	<i>36,288</i>	<i>1.91%</i>
	<i>FY11</i>	<i>37,009</i>	<i>1.99%</i>

Source: DFA/LFC Consensus Forecast, September 2006

Net Revenue is the amount that is distributed to the Lottery Scholarship Fund

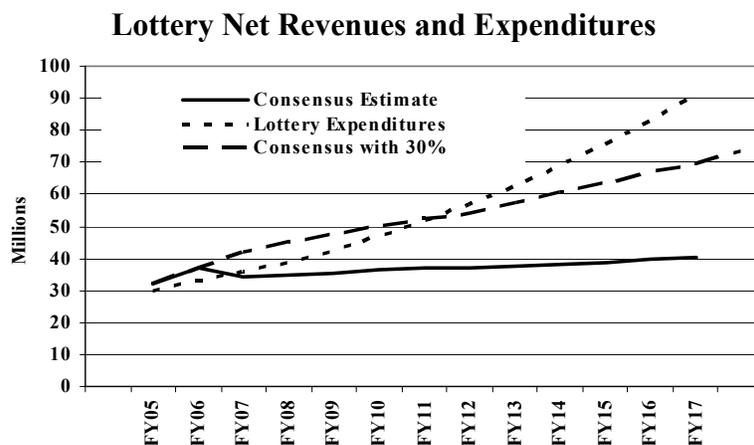
The Fund promises to pay the instate tuition of any New Mexico high school graduate who maintains satisfactory progress. The scholarship begins in the second semester of a student's first year and can be renewed if student maintains satisfactory progress and full time status. The latest projections available from the Higher Education Department (HED), from September

2006, show both the number of eligible students and the costs of tuition increasing. Together, the amount required to fund all scholarships has surpassed the amount of revenue the lottery provides. The chart shows the scholarship expenditures exceeding revenues beginning in FY07 under current assumptions. Under SB 364, revenues would continue to outpace expenditures until FY11, building the Fund for a few more years. HED could continue to draw upon the fund to maintain current levels of expenditure until FY12 under current law and FY17 under SB364.

When the Fund balance is exhausted, additional funding will have to be secured to maintain the current projections of scholarships or scholarship eligibility will have to be tightened to fit the revenues provided by the lottery. The Higher Education Department forecast for lottery scholarship expenditures is between eight and nine percent due to increases in tuition and enrollment. Even if lottery revenues are higher than currently forecast, the Fund will run out of money under current the current policy governing the lottery scholarship level.

DFA:

Setting a minimum distribution of 30% of gross Lottery revenues would increase the amount of revenue available for Lottery Success Scholarships and likely extend the number of years for which the Scholarship program would be able to pay full tuition. Currently, Lottery Scholarships pay 100% of tuition costs, though this is not required in statute. However, growth in the scholarship program is projected to be greater than the corresponding growth in available revenue. For the next few years, growth in the program can be supported through use of fund balances in the Lottery Tuition Fund and the program could continue to pay 100% of tuition. However, as the fund balance is depleted -- under current law estimated to occur around FY12/FY13 -- the program would no longer be able to pay 100% of tuition. The Higher Education Department (HED) has statutory authority to adjust the scholarship amount to a certain percentage of tuition, based on available revenue (Section 21-1-4.4 NMSA 1978).



It is important to note that the amount of the scholarships is not codified by statute although the eligibility is. Under current law,

“Prior to June 1 of each year, the Higher Education Department shall determine the amount of money available for tuition scholarships at state public post-secondary educational institutions. Based on the amount appropriated by the legislature from the lottery tuition fund and on the projected enrollment at all public post-secondary educational institutions, the commission on higher education shall establish the percentage of tuition that shall be

awarded for qualified resident students attending New Mexico public post-secondary educational institutions. The percentage of tuition awarded shall be the same for each institution, regardless of the actual cost of tuition at each institution.” Section 21-1-4.4 1978 NMSA

In other words, when the Fund runs out, the scholarships do not end but the amount of each scholarship will have to be adjusted to match the expected revenues.

Criticisms about NMLA’s expenses. New Mexico’s lottery has been criticized for having high costs relative to the revenues and as a consequence a lower distribution to the lottery scholarship fund. Think New Mexico, a Santa Fe non profit organization, using data from La Fleur’s 2006 World Lottery Almanac, published a report in September 2006, that indicated the NM lottery’s share of revenues that went to operating costs and administration, 19.6 cents per one dollar, was too high compared to the national average. They came to the following conclusions:

- NM is 5th highest of 41 state lotteries in operating costs per dollar of revenue
- Among states with low populations, NM still is among the highest cost lotteries
- Among states with large rural populations, NM is among the highest cost lotteries
- Among states with low total sales, NM is among the highest cost lotteries

The main causes, according to the report, of the high costs include no statutory level of beneficiary distribution, high vendor commissions, and an expensive contract with GTech, a vendor for NMLA’s online games whose contract was extended in 2001 without the solicitation of new bids. GTech has the online vendor contract with NMLA and receives a commission of 8.52 percent on all online sales. Think NM reports that this is far above what other comparable states pay. Idaho, Nebraska, and New Hampshire pay less than 3 percent. Idaho is also a GTech client. NMLA receives less than half of its revenue from on-line games. Renegotiating the contract with GTech to 5 percent, for example, would add about \$3 million to the lottery scholarships. NMLA reports that they have issued a request for proposal (RFP) for the online contract. They disagree with Think NM’s methodology comparing NM to other states since other states have contracted with GTech for all of their lottery business and so have received a lower rate. The NM contract only includes online games and so there is a higher rate which had been negotiated down in 2001. The contract with GTech ends in November 2008.

PERFORMANCE IMPLICATIONS

Think NM reports that eleven other states have statutory minimums for beneficiary distribution, similar to the one proposed by SB364, ranging from 30 percent to 35 percent. The latest distribution percentage for NM is 24.9 percent and has never been above 26.7 percent reached in FY97. NMLA reports that even though the percentage is lower than it was in FY97, the revenues have increased and so the total amount of the distribution has gone up significantly. They also note that four of the eleven states did not meet their statutory required distribution.

TECHNICAL ISSUES

DFA has reported technical issues with the SFC amendment changing the title:

The Senate Finance Committee amended the bill to rename the Lottery Scholarship to be the “Legislative Lottery Scholarship.” However, they only amended one section of the authorizing statute for the lottery scholarship – there are several sections of the statute that authorize the Lottery Scholarship program.

SFC amended Section 21-1-4.3 – which authorizes Lottery Scholarships at 4-year institutions and their branch campuses.

However, SFC did not amend the following sections to rename the scholarship:

- Section 21-13-10 – which authorizes Lottery Scholarships at community colleges (Santa Fe CC, San Juan College, etc.)
- Section 21-16-10.1 – which authorizes Lottery Scholarships at technical-vocational institutions (CNM, Mesa lands, etc.)
- Section 21-1-4.4 – which authorizes the Higher Education Department to determine the level of Lottery Scholarship funding available
- Section 6-24-23 – which creates the Lottery Tuition Fund

For consistency, all of these sections should probably be amended with the new name.

ADMINISTRATIVE IMPLICATIONS

NMLA reports that the effective date of July 1, 2007, places an incredible burden on their operations. To comply by this date, they will have to curtail or eliminate promotions and advertising, lower retailer commissions and prize payouts and reduce salaries and benefits.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

House Bill 87 raises the eligible age to 21 from 18 to play and to sell lottery tickets.

ALTERNATIVES

Changing the eligibility requirements for the Lottery scholarship program or capping the amount of the scholarship is more likely to result in long term solvency for the Fund.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

NMLA reports that they recognize problems with the operating costs and have been working to resolve these issues, particularly with the Gtech contract which they have put out for bid. Its focus is on increasing total revenues rather than concentrating on the net revenues and that has resulted in higher distributions to the Fund but not increases in the percentage share.

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