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FISCAL IMPACT REPORT

ORIGINAL DATE 2/13/15

SPONSOR Sanchez, M LAST UPDATED _____ HB _____

SHORT TITLE Forfeited Lottery Prizes to Tuition Fund SB 286

ANALYST van Moorsel

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	FY16	FY17	FY18	FY19		
Potentially negative in long run – see “Fiscal Implications.”					Recurring	Lottery Tuition Fund

(Parenthesis () indicate revenue decreases)

Conflicts with SB 355 – Purchase of Lottery Tickets with Card

SOURCES OF INFORMATION

LFC Files

Responses Received From

New Mexico Lottery Authority (NMLA)

Higher Education Department (HED)

SUMMARY

Synopsis of Bill

Senate Bill 286 amends the New Mexico Lottery Act to require forfeited prizes to be transferred to the lottery tuition fund.

There is no effective date of this bill. It is assumed that the new effective date is 90 days after this session ends.

FISCAL IMPLICATIONS

The fiscal impact of this bill is difficult to determine. Initially, transferring unclaimed prize money to the lottery tuition fund could increase transfers to the fund. Assuming the lottery is transferring 30 percent of gross revenue under current law, in the short run, this bill could increase the transfer percentage to marginally above 30 percent.

However, the long term impact will likely be negative. The lottery currently uses unclaimed

prizes to supplement prize payouts in active games. The lottery reports the prize payout percentage is an integral factor in driving sales. As such, a reduction in the prize payout percentage could contribute to lower sales and therefore lower gross revenues. Lower revenues, in turn, would mean the 30 percent transfer to the lottery tuition fund would be lower as well.

Another potential outcome is that the bill could have no impact on the transfer to the lottery tuition fund. Current law requires the lottery to transfer 30 percent of gross revenues to the lottery tuition fund, and gross revenues are calculated as operating and non-operating revenues. Game expenses and operating expenses may total 70 percent of gross revenues. Unclaimed prizes are unpaid game expenses and therefore do not increase or decrease gross revenues. As a result, the required transfer (defined as a percentage of gross revenues) could potentially be unchanged. However, it is unclear whether the transfer of unclaimed prize money is to be transferred to the lottery tuition fund in addition to the 30 percent of gross revenue pursuant to 6-24-24 (C) NMSA 1978.

According to NMLA, redirecting unclaimed lottery prizes to the lottery tuition fund will have a negative impact on instant Scratchers sales, resulting in a decline in instant Scratchers sales and a reduction in the total funds transferred to the tuition fund to award as scholarships. NMLA cautions that if sales decline, the revenue generated from the unclaimed prize fund will also decline and become an unstable source of revenue.

Further, NMLA states it uses the unclaimed prize fund to pay prizes won early in a game before the game has achieved requisite sales to fund prizes. The fund is also used for specialty games to increase our player base, which results in increased revenues.

SIGNIFICANT ISSUES

According to NMLA:

- As of Dec. 31, 2014 there is approximately \$1.451 million in the New Mexico Lottery's unclaimed prize pool.
- The annual average of unclaimed prizes over the past five years has been \$3 million.
- 80 percent of the time since FY07, the lottery has had to use unclaimed prize money to supplement net revenues in order to meet its monthly transfer requirement.
- Without unclaimed prizes, the lottery's cash flow will decrease and the authority will have to borrow money to pay expenses, such as prizes to winners, retailer commissions, vendors and supplier costs, and operating expenses.
- In FY14, the lottery implemented a strategic plan to use unclaimed prizes to enhance prizes in Scratchers games. Scratchers sales between April 2014 and January 2015 have increased 14 percent or approximately \$5.5 million year-to-date. Scratchers sales have been vital to the authority's ability to meet monthly transfers to the Legislative Lottery Scholarship program.
- Without unclaimed prizes to enhance the prize payout, the Instant Scratchers prize payout in New Mexico would be approximately 55 percent, compared to approximately 68 percent in Arizona, Colorado, and Texas, border states to whom New Mexico could lose market share.

Along with its agency analysis, NMLA submitted the attached sales projections.

The New Mexico Lottery Act requires NMLA to transmit monthly at least 30 percent of the gross revenue of the previous month to the State Treasury to be deposited in the lottery tuition

fund. A 2007 amendment to the act increased this share from 27 percent starting January 1, 2009. NMLA reports this increased transfer requirement strained its ability to operate effectively and meet its statutory requirements. Since 2009, NMLA has eliminated retailer and employee sales incentives, reduced staffing from 68 to 54 FTE, reduced its advertising budget by \$1 million (33 percent), and reduced the prize payout percentage. The FY07 prize payout for instant games was 63 percent; and NMLA reports it was reduced to 59 percent by FY13. Since decreasing the payout percentage, instant game sales decreased from \$91.4 million in FY07 to under \$70 million in FY13. NMLA has taken steps to bring back lapsed players, bring in new players, and increase sales by increasing its FY15 advertising budget to by \$200 thousand to \$2.5 million and prize payout percentage to just over 60 percent.

NMLA recommends the Legislature reconsider the requirement that 30 percent of gross revenue be transferred to the lottery tuition fund. The requirement may have resulted in fewer sales and reduced revenues for education. Any reduction in the required return percentage may reduce lottery revenues in the short term, because players may not immediately respond to higher payouts and increase sales. However, the added flexibility may enable the authority to operate more efficiently. The authority has already implemented significant cost reductions to meet the 30 percent return requirement, such as staff reductions, but it should continue to seek cost savings. Further, the authority's marketing division may be able to spur increased lottery sales by targeting areas of the state with less-than-optimal sales, or through other creative approaches.

Reconsidering the 30 percent revenue transfer requirement, attaining further cost savings, and investigating different marketing approaches would be timely because the lottery scholarship, as currently structured, is successful but not sustainable. Expenses from the lottery tuition fund have risen rapidly due to rising tuition costs and an increasing number of recipients. Between FY08 and FY14, tuition payments from the fund to institutions of higher education have increased by 72 percent, or nearly \$28 million, with nearly \$24 million of this growth occurring at the research institutions. During this period, the number of students receiving the lottery scholarship increased by 19 percent, with nonresearch institutions experiencing 57 percent growth in scholarships received.

While scholarship expenditures have been increasing, revenue transfers from the lottery have been relatively flat, averaging \$42.2 million in FY10-FY14, with a peak of \$43.7 million in FY13 thanks to a large run-up in the Powerball jackpot. FY14 revenue transfers were \$40.9 million.

Legislative action has provided temporary support for the lottery tuition fund through a nonrecurring appropriation and by channeling liquor excise tax revenue to the fund for several years. A statute change also attempted to reduce lottery scholarship expenditures by reducing the number of scholarship semesters from eight to seven, requiring incoming recipients to enroll in 15 credit hours, and requiring a 2.5 GPA to qualify. Finally, in the event of insufficient scholarship funds, the awards are reduced by the percentage of the funding shortfall. These additional revenue solutions are only temporary, however, and increased lottery revenue to the fund would benefit the scholarship program.