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FISCAL IMPACT REPORT

SPONSOR Candelaria/Smith **ORIGINAL DATE** 2/14/19
LAST UPDATED 3/01/19 **HB** _____
SHORT TITLE Limit Lottery Operational Expenses **SB** 283/aSEC/aSFC/aSFI#1
ANALYST Valenzuela

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21		
	See Fiscal Implications		Recurring	Lottery Tuition Fund

(Parenthesis () Indicate Revenue Decreases)

Relates to Senate Bill 80, Unclaimed Prize Funds to Lottery Tuition Fund

SOURCES OF INFORMATION

LFC Files and Audits for the New Mexico Lottery Authority
 FY20 LFC Appropriation Recommendation, Volume II

Responses Received From

New Mexico Lottery Authority (NMLA)
 NM Independent Community Colleges (NMICC)

SUMMARY

Synopsis of Senate Floor #1 Amendment

The Senate Floor #1 amendment to Senate Bill 283 makes several technical amendments to ensure the bill is properly constructed and aligned with the existing set of statutes that govern the administration of the Lottery.

1. Strikes the SFC amendment number 2, but replaces with the same language and a technical correction that clarifies the transfer of unclaimed prizes will be start in FY23 and continue through subsequent years.
2. Inserts technical revisions to Section 6-24-21 to ensure the Lottery Authority transfers unclaimed prize fund balances to the lottery tuition fund, which aligns with the changes discussed in item 1.
3. Makes technical corrections to identify the internal auditor designee.

According to existing statute, the Lottery Authority may promulgate rules to define administration of the unclaimed prize fund, and in context of this bill, rules that would define the

expiration time before the unclaimed prizes are swept and transferred to the lottery tuition fund. Current rules define the expiration of prizes at 90 days after the lottery award.

Synopsis of SFC Amendment

The Senate Finance Committee amendment to Senate Bill 283 strikes the Senate Education Committee (SEC) amendment number 2 and replaces it with the same language — requiring a minimum distribution to the lottery tuition fund of \$40 million in FY20, \$40.5 million in FY21, and \$41 million or 30 percent of gross revenues in FY22 and subsequent years—with one additional section. The new section requires the New Mexico Lottery Authority, starting in FY23, to transfer balances in the unclaimed prize fund to the lottery tuition fund on a monthly basis.

Enactment would increase revenue into the lottery tuition fund by the amount of fund balance in the unclaimed prize fund, which changes each year depending on sales activity. According to its audit, the Lottery Authority held \$1.3 million in this fund at the end of FY17 and \$1.7 million in FY18. The New Mexico Lottery Authority reports that since 2008, the lottery tuition fund has benefited from more than \$40 million of unclaimed prize fund dollars.

Synopsis of SEC Amendment

The Senate Education Committee amendment to Senate Bill 283 requires a specific minimum annual distribution to the lottery tuition fund in FY20 of \$40 million, in FY21 of \$40.5 million, and FY22 and subsequent years of \$41 million. In FY22 and subsequent years, the amendment requires that the distribution to the lottery tuition, if not equal to \$41 million, shall be equal to 30 percent of gross revenues.

Attachment 1 simulates the impact. Using a 3-year average as the base (FY16 to FY18 Actual Financials from the Lottery Authority), the scenarios include (1) a no growth scenario, (2) a growth in instant tickets sale of 25 percent from the 3-year average, and (3) a decrease in instant ticket sales of 25 percent from the 3-year average.

The attachment provides the annual changes in minimum distribution and the annual cap on operating expenses. The assumption is prize expense would match the amount, 54.3 percent, of the 3-year average. Given these assumptions, the scenario analysis follows:

- Scenario 1, no growth with SB283a changes: the percent of revenue distribution to the lottery tuition fund equals 28.9 percent (\$40 million), 29.7 percent (\$41 million) and 30.7 percent (\$42.4 million) for FY20, FY21 and FY22, respectively.
 - In the first two years, the lottery tuition fund would lose funding under SB283a compared to the current process, but would in subsequent years benefit with payback in two years if variables remain constant.
- Scenario 2, 25 percent growth in ticket sales with SB283a changes: the percent of revenue distribution to the lottery tuition fund equals 28.7 percent (\$45.1 million), 29.7 percent (\$46.7 million) and 30.7 percent (\$48.2 million) for FY20, FY21 and FY22, respectively.
 - In the first two years, the lottery tuition fund would lose funding under SB283a compared to the current process, but would in subsequent years benefit with

payback in almost three years, if variables remain constant.

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- Scenario 3, 25 percent reduction in ticket sales with SB283a changes: the percent of revenue distribution to the lottery tuition fund equals 33.6 percent (\$40 million), 34 percent (\$40.5 million) and 34.4 percent (\$41 million) for FY20, FY21 and FY22, respectively. After FY22, the 30 percent gross revenue would be invoked in this decreasing revenue scenario, where the distribution would drop to \$36.6 million.
 - The SB283a hedge provides value in the first three years. However, after the lottery tuition fund would continue to lose funding, if variables remain constant.

The Senate Education Committee amendment creates a hedge for three years. After three years, the minimum floor would not be in place where revenues decline relative to the 3-year average. Scenario 3 demonstrates the impact after year three, where distributions to the Lottery Tuition Fund drop to \$36 million.

The simple analysis is intended to provide a perspective on the impact of the cap on operational expenses and the impact of the minimum floor. A more thorough multivariate analysis would be required to assess the impacts in fluctuating years of revenue declines or revenue increases.

The key assumption in this analysis is the use of Net Revenue. The analysis holds the prize expense steady at 54.3 percent of total sales for all scenarios, providing for positive net revenue in some cases, which according to SB283a, would be distributed to the lottery tuition fund in addition to the minimum floor.

Synopsis of Original Bill

Senate Bill 283 amends the enabling act for the New Mexico Lottery Authority in two important ways: (1) amends the requirement for the Lottery Authority to transfer 30 percent of **gross** revenues and rather transfer **net** revenues to the lottery tuition fund every month and (2) sets up a schedule restricting operating costs to no more than 17 percent of revenues in FY20, 16 percent of revenues in FY21, and 15 percent of revenues thereafter.

FISCAL IMPLICATIONS

The New Mexico Lottery Authority (NMLA) struggles to manage its monthly cash flow because of the requirement to transfer 30 percent of gross revenues to the Lottery Tuition Fund.

SB283 seeks to remedy cash flow problems at the New Mexico Lottery Authority (NMLA). The cash flow problems arise from the statutory constraints placed on NMLA: (1) lottery prizes should be at least 50 percent of **annual** revenues and (2) **monthly** distributions to the Lottery Tuition Fund must be equal to 30 percent of **gross** revenues. When operating expenses are higher than these constraints, the Lottery Authority has difficulty managing its finances.

In one way, NMLA has managed through these constraints by using fund balance from the unclaimed prize fund to offset those months when operational expenses exceed the projected annual 50 percent prize requirement and 30 percent gross revenue distribution. In another way, NMLA reports it has had to limit its game offerings to reduce operating costs.

In SB283, by changing to net revenue, the monthly cash flow problem should be solved, given that NMLA will transfer net (after operating expenses) revenues each month. The bill restricts the amount of operating expenses the lottery may incur to ensure the net revenue transfer does not reduce the amount of revenue into the Lottery Tuition Fund.

SIGNIFICANT ISSUES

NMLA asserts that its ability to earn additional revenue through increased ticket sales is constrained by these cash flow issues, and particularly by the requirement to transfer 30 percent of gross revenues to the lottery tuition fund monthly. According to the Lottery Authority, having flexibility to manage cash will allow them to grow revenue.

NMLA states:

“Mathematically, the Lottery must maintain a low prize payout because after meeting the monthly 30% return mandate and paying expenses such as retailer commissions and product costs, there only remains a small (by lottery industry standards) percentage of revenue for prizes. In FY18, total prizes were 54.6% of revenue. Scratcher prize payout was approximately 60.01%.”

The FY20 LFC appropriation recommendation, Volume II, provides a detailed itemization of revenues and expenses for the NMLA, which is included as an attachment.

The information below provides a historical overview of gross sales at the Lottery Authority, which includes the amount of revenue transferred to the Lottery Tuition Fund when the distribution was 27 percent prior to FY09 and after when the distribution was changed to 30 percent.

New Mexico Lottery Revenue History (dollars in millions)				
Fiscal Year	Gross Revenues	Net Transfers for Education	Operating and Game Expenses	Percent Transferred for Education Initiatives
FY96 (Partial Year)	\$28.5	\$6.3	\$22.2	22.1%
FY97	\$82.4	\$21.9	\$60.5	26.6%
FY98	\$85.4	\$20.1	\$65.3	23.5%
FY99	\$89.7	\$19.6	\$70.1	21.9%
FY00	\$111.2	\$24.5	\$86.7	22.0%
FY01	\$113.7	\$25.9	\$87.8	22.8%
FY02	\$129.5	\$29.7	\$99.8	22.9%
FY03	\$133.6	\$33.1	\$100.5	24.8%
FY04	\$142.6	\$35.9	\$106.7	25.2%
FY05	\$134.7	\$32.2	\$102.5	23.9%
FY06	\$150.6	\$36.9	\$113.7	24.5%
FY07	\$148.8	\$34.8	\$114.0	23.4%
FY08	\$147.8	\$40.8	\$107.0	27.6%
FY09	\$142.6	\$40.8	\$101.8	28.6%
FY10	\$143.6	\$43.6	\$100.0	30.4%
FY11	\$135.6	\$41.3	\$94.3	30.5%
FY12	\$133.9	\$41.3	\$92.6	30.8%
FY13	\$141.8	\$43.7	\$98.1	30.8%
FY14	\$136.1	\$40.9	\$95.2	30.1%
FY15	\$137.1	\$41.1	\$96.0	30.0%
FY16	\$154.4	\$46.3	\$108.1	30.0%
FY17	\$126.1	\$37.8	\$88.3	30.0%
FY18	\$134.1	\$40.2	\$93.8	30.0%

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Scenarios for Senate Bill 283a	Base	3-year Average, No growth			Growth in Instant Tickets Sales: 25 percent			Decrease in Instant Tickets Sales: 25 percent					
	3-year Average (actuals FY16 to FY18)	FY2020	FY2021	FY2022	FY2020	FY2021	FY2022	FY2020	FY2021	FY2022	FY2023	FY2024	FY2025
Revenues													
National Draw Games - Revenue	\$ 62,206,420	\$ 62,206,420	\$ 62,206,420	\$ 62,206,420	\$ 62,206,420	\$ 62,206,420	\$ 62,206,420	\$ 62,206,420	\$ 62,206,420	\$ 62,206,420	\$ 62,206,420	\$ 62,206,420	\$ 62,206,420
Instant Ticket Sales	75,931,960	75,931,960	75,931,960	75,931,960	94,914,950	94,914,950	94,914,950	56,948,970	56,948,970	56,948,970	56,948,970	56,948,970	56,948,970
Miscellaneous	49,855	49,855	49,855	49,855	49,855	49,855	49,855	49,855	49,855	49,855	49,855	49,855	49,855
Total Revenue	138,188,235	138,188,235	138,188,235	138,188,235	157,171,225	157,171,225	157,171,225	119,205,245	119,205,245	119,205,245	119,205,245	119,205,245	119,205,245
Expenditures													
Prize Expense	75,027,004	75,036,212	75,036,212	75,036,212	85,343,975	85,328,693	85,328,693	64,728,448	64,728,448	64,728,448	64,728,448	64,728,448	64,728,448
Lottery Tuition Fund (SB283a) - minimum floor	41,459,533	40,000,000	40,500,000	41,000,000	40,000,000	40,500,000	41,000,000	40,000,000	40,500,000	41,000,000	35,761,574	35,761,574	35,761,574
Operating Expenses	15.7%	17%	16%	15%	17%	16%	15%	17%	16%	15%	15%	15%	15%
Retailer Commission & Other Game Related Expenses	17,440,262	18,905,098	17,793,033	16,680,969	21,502,101	20,237,272	18,972,442	16,308,095	15,348,795	14,389,495	14,389,495	14,389,495	14,389,495
NMLA Operating Expenses	3,340,825	3,621,427	3,408,402	3,195,377	4,118,904	3,876,616	3,634,327	3,123,949	2,940,188	2,756,426	2,756,426	2,756,426	2,756,426
NMLA Operating Reserve	890,667	965,475	908,683	851,890	1,098,103	1,033,509	968,914	832,847	783,856	734,865	734,865	734,865	734,865
Total Operating Expenses	21,671,754	23,492,000	22,110,118	20,728,235	26,719,108	25,147,396	23,575,684	20,264,892	19,072,839	17,880,787	17,880,787	17,880,787	17,880,787
Total Expenditures	138,158,291	138,528,212	137,646,329	136,764,447	152,063,084	150,976,089	149,904,377	124,993,340	124,301,287	123,609,235	118,370,809	118,370,809	118,370,809
Net Revenue: Add to Transfer to Lottery Tuition Fund	\$ 29,945	\$ (339,976)	\$ 541,906	\$ 1,423,788	\$ 5,108,142	\$ 6,195,136	\$ 7,266,848	\$ (5,788,095)	\$ (5,096,042)	\$ (4,403,990)	\$ 834,437	\$ 834,437	\$ 834,437
Total Distribution to Lottery Tuition Fund		\$ 40,000,000	\$ 41,041,906	\$ 42,423,788	\$ 45,108,142	\$ 46,695,136	\$ 48,266,848	\$ 40,000,000	\$ 40,500,000	\$ 41,000,000	\$ 36,596,010	\$ 36,596,010	\$ 36,596,010
Prize Expense as percent of gross sales	54.3%	54.3%	54.3%	54.3%	54.3%	54.3%	54.3%	54.3%	54.3%	54.3%	54.3%	54.3%	54.3%
Lottery Tuition Fund Receipts as percent of gross sales	30.0%	28.9%	29.7%	30.7%	28.7%	29.7%	30.7%	33.6%	34.0%	34.4%	30.7%	30.7%	30.7%
Current process: 30 percent of gross sales		\$41,459,533	\$41,459,533	\$41,459,533	\$47,154,851	\$47,154,851	\$47,154,851	\$35,764,215	\$35,764,215	\$35,764,215	\$35,764,215	\$35,764,215	\$35,764,215
Comparison Current Process over/(under) SB283a		(1,459,533)	(417,627)	964,255	(2,046,709)	(459,715)	1,111,998	4,235,785	4,735,785	5,235,785	831,795	831,795	831,795

Source: LFC Files