F I S C A L I M P A C T R E P O R T

SPONSOR Campos **ORIGINAL DATE** 2/22/19 **LAST UPDATED** **HB**

SHORT TITLE Lottery Scholarship Fund Changes **SB** 598

ANALYST Gaussoin

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY19	**FY20**	**FY21**		
	Indeterminate but substantial	Indeterminate but substantial	Recurring	Lottery Tuition Fund

Relates to House Bills 146, 350, 363, and 441 and Senate Bills 397, 407 and 179.
Conflicts in Senate Bill 283.

SOURCES OF INFORMATION
LFC Files

Responses Received From
New Mexico Lottery Authority (NMLA)

No Responses Received From
State Treasurer (STO)
Higher Education Department (HED)

SUMMARY

Synopsis of Bill

Senate Bill 598 strikes language in the New Mexico Lottery Act requiring the monthly transfer of 30 percent of gross sales to the lottery tuition fund and replaces it with a requirement that the Lottery Authority transfer all net revenue to the fund each month.

The effective date is July 1, 2019.

FISCAL IMPLICATIONS

Before the Lottery Authority was mandated to deposit a certain percentage of the gross to the tuition fund – starting with 27 percent in 2007 and then moving to 30 percent in 2009 – net income transferred to the tuition fund varied between about 21.9 percent and 25.2 percent of the gross and averaged 23.7 percent. If that average is applied to the $134 million in gross revenues from 2018, the deposit to the tuition fund would have been $31.8 million, compared with the $40.2 million transferred under the mandate.

However, the Lottery Authority argues gross income will increase if the mandate is lifted because it will allow the authority to increase payouts for instant tickets, known as scratchers, which will attract more buyers. The authority says scratcher sales dropped after the mandate because the mandate cut into scratcher payouts; sales will increase when payouts increase.

But higher instant ticket scratcher sales do not always translate to higher distributions to the tuition fund. In 2006, instant ticket sales totaled $84.8 million and tuition fund transfers totaled $36.9 million. A year later, the total for instant ticket sales was up $6.5 million but the total transferred to the tuition fund was down $2 million – $91.4 million in instant ticket sales resulted in $34.8 million in transfers.

In addition, scratcher sales figures did not consistently decline after the mandate was imposed. While total sales dropped year-over-year from 2008 to 2012, landing at a low of $68.7 million, sales were at $80 million in 2015 and $83 million in 2016, although a large Powerball prize that year likely contributed to stronger scratcher sales as well. Since then, scratcher sales have settled at about $72.3 million a year, the same amount estimated for 2019.

Assuming the elimination of the mandate has no immediate impact on sales, gross sales are the same as the $137.6 million average for FY14 through FY18, and the share of the gross transferred is the same as the average in the years before the mandate, the FY20 deposit to the tuition fund would be $32.6 million without the mandate. With the mandate, the minimum 30 percent transfer would be $41.3 million, meaning the removal of the mandate could result in an $8.7 million loss to the fund.

Estimating sales in following years is difficult given the lack of a consistent pattern in instant ticket sales. Nevertheless, if gross revenues increase an astounding 22 percent in FY21 – a figure larger than the five-year loss in either scratcher sales or gross sales between 2008 and 2012 – the transfer to the tuition fund in FY21 would be $39.8 million, based on the transfer average before the mandate. That would represent a $1.5 million loss to the tuition fund.

This analysis does not look beyond the next two fiscal years; the loss could possibly disappear over time.

SIGNIFICANT ISSUES

The New Mexico Lottery Authority (NMLA) argues it struggles to manage its monthly cash flow because of the 30 percent monthly transfer requirement coupled with the statutory mandate to award at least 50 percent of annual revenues in lottery prizes. NMLA contends it has managed, despite the constraints, by using fund balances from the unclaimed prize fund and limiting game offerings to reduce operating costs.

NMLA says removing the mandate would address cash flow problems by allowing the authority to cover its operating expenses each month before transferring the remaining revenue to the tuition fund. In addition, greater flexibility would allow them to grow revenue. NMLA states:

> To meet the monthly mandate, the Lottery cut operational costs but also had to reduce Scratcher (often called instant game) prizes to players. Prior to the mandate, the Lottery was maintaining prize payouts (meaning the percentage of revenue going to players as prizes) consistent with best practices in the lottery industry. Since the return mandate was introduced, New Mexico has dropped to one of the lowest Scratcher prize payouts in the country.

NMLA says the reduction in prize payouts caused by the return mandate triggered a drop in scratcher sales during a period when scratcher sales nationally were growing. In FY18, total prizes were 54.6 percent of revenue, while scratcher prize payout were approximately 60 percent, low "by lottery industry standards," the authority says. The authority estimates the lottery tuition fund has lost more than $49 million in the 11 years since the mandate was enacted.

The authority says scratchers should be the foundation for year-over-year sales growth, because sales on draw games are driven by jackpot sizes and are unpredictable. The agency claims it has been forced to remove popular $20 scratchers from the market because players are reluctant to spend $20 for a relatively low payout. NMLA contends:

- New Mexico's 60 percent scratcher prize payout is significantly lower than in bordering states – payouts in border states range from 70 percent in Texas to 66.7 percent Oklahoma, incentivizing players near the border to buy tickets out of state.

- The authority receives negative player feedback, both from direct communications and from lack of play.

The authority points to smaller states with larger gross revenues as evidence the mandate is hurting New Mexico sales, but given differences in state economies and demographics, it is hard to attribute lower sales solely to the mandate. However, NMLA says a test of the impact on scratcher payouts conducted in 2013 and 2014 indicates bigger payouts lead to larger contributions to the tuition fund.

> The Lottery decided to test increasing Scratcher prize payouts beginning with $1 and $2 games in 2013 and continuing with $5 and $10 games in 2014. This effort was funded through agency-wide budget cuts and by using funds from unclaimed prizes. … During the pilot, increased prizes for players resulted in a 16 percent increase in Scratcher sales and an 8 percent increase in tuition scholarship dollars ($3.4 million more) from Scratchers in FY16 over FY15. FY16 saw the highest-ever annual transfers to the tuition fund – more than $46 million. … After the pilot program of increased prize payouts ended, prize payouts reverted and an immediate decrease in scholarship funding followed as revenues declined.

It is important to note, however, that a 25 percent increase in draw-game revenues in 2016, driven by a large Powerball prize, was a greater contributor to the high FY16 transfers to the tuition fund than the increase in scratcher revenues. Further, while gross revenues dropped $28.3 million between FY16 and FY17, more than 60 percent of that is attributable to a drop in draw-game revenue.

Nationally, lottery sales have declined steadily since the Great Recession in 2009, with 2016 being an outlier because of Powerball. The National Conference of State Legislatures attributes the decline to consumer fatigue and consumers delaying participation until jackpots reach high levels.

PERFORMANCE IMPLICATIONS

From NMLA: "Eliminating the 30 percent mandate would lead to increased prizes for players, which would increase lottery sales. Increased sales would lead to more dollars for the tuition fund."

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Relates to HB146 and HB561 which would add financial need as a qualification for receiving a lottery scholarship.

Relates to HB350 and SB397 which would make the names, addresses and other personal identifying information of lottery winners confidential on the winner's request.

Relates to HB363 and SB407 which would add students who attend tribal colleges to those eligible for receiving lottery scholarships.

Relates to HB441 which would allocate unclaimed lottery prizes to the tuition fund and provide for semiannual deposits to the tuition fund instead of monthly.

Relates to SB80 which would allocate unclaimed lottery prizes to the tuition fund.

SB179, already signed into law, allows disabled students to leave New Mexico for high school and retain eligibility for a lottery scholarship.

Conflicts with SB283, as amended by the Senate Finance and Education committees, which would replace the 30 percent mandate on transfers with minimum dollar amounts, require the authority to transfer unclaimed prizes to the tuition fund, and set limits on the percent of gross revenue that could be spent on operations.

OTHER SUBSTANTIVE ISSUES

From its creation in 1996 to 2018, the authority transferred $740 million to the legislative lottery scholarship fund. During that time, nearly 117 thousand New Mexico students received 450 thousand awards, and about 56 percent of students receiving awards earned a postsecondary credential.

Demand for the program, rising tuition costs, and the volatility of lottery income forced the Legislature over the last decade to boost the program with nonlottery revenue, tighten eligibility, and reduce awards. Once equal to 100 percent of tuition costs, the value of the award is now based on where the student attends school: The award is a minimum of $1,500 a semester at a four-year research university, $1,050 a semester at a four-year comprehensive university, or $380 a semester at a two-year community college or branch campus of a four-year school. Award amounts can increase if money is available in the scholarship fund.

HFG/al