Arizona State Lottery Commission

	FY 2018 ACTUAL	FY 2019 ESTIMATE	FY 2020 BASELINE
OPERATING BUDGET			
Full Time Equivalent Positions	98.8	98.8	98.8
Personal Services	4,266,900	4,812,000	4,812,000
Employee Related Expenditures	1,807,400	1,752,000	1,752,000
Professional and Outside Services	404,500	386,800	386,800
Travel - In State	201,500	271,600	271,600
Travel - Out of State	54,700	16,800	16,800
Other Operating Expenditures	1,195,200	1,963,200	1,963,200
Equipment	56,000	0	0
OPERATING SUBTOTAL	**7,986,200**	**9,202,400**	**9,202,400**
SPECIAL LINE ITEMS			
Advertising	13,779,500	15,500,000	15,500,000
Charitable Commissions[1/]	1,418,900	1,552,300	1,728,200 [2/]
Instant Tickets[1/]	15,135,500	28,367,000	31,060,100 [3/]
On-Line Vendor Fees[1/]	9,533,300	12,310,500	11,009,400 [4/]
Retailer Commissions[1/]	64,420,600	71,654,000	78,287,000 [5/]
AGENCY TOTAL	**112,274,000**	**138,586,200**	**146,787,100** [6/]
FUND SOURCES			
Other Appropriated Funds			
State Lottery Fund	112,274,000	138,586,200	146,787,100
SUBTOTAL - Other Appropriated Funds	112,274,000	138,586,200	146,787,100
SUBTOTAL - Appropriated Funds	**112,274,000**	**138,586,200**	**146,787,100**
Other Non-Appropriated Funds	664,014,500	720,491,500	754,866,200
TOTAL - ALL SOURCES	776,288,500	859,077,700	901,653,300

AGENCY DESCRIPTION — The Arizona Lottery is responsible for administering sanctioned games of chance. In addition to Arizona-specific games, the state also participates in multi-state Powerball and Mega-Millions on-line games.

FOOTNOTES

1/ Charitable Commissions, Instant Tickets, On-Line Vendor Fees, and Retailer Commissions are appropriated as a percentage of sales. Therefore, the amounts shown for those line items are estimates only.

2/ An amount equal to 20% of Tab Ticket sales is appropriated for payment of sales commissions to charitable organizations. This amount is currently estimated to be $1,728,200 in FY 2020. (General Appropriation Act footnote)

3/ An amount equal to 3.6% of actual instant ticket sales is appropriated for the printing of instant tickets or for contractual obligations concerning instant ticket distribution. This amount is currently estimated to be $31,060,100 in FY 2020. (General Appropriation Act footnote)

4/ An amount equal to a percentage of actual on-line game sales as determined by contract is appropriated for payment of on-line vendor fees. This amount is currently estimated to be $11,009,400, or 4.256% of actual on-line ticket sales in FY 2020. (General Appropriation Act footnote)

5/ An amount equal to 6.5% of gross lottery game sales, minus Charitable Tab Tickets, is appropriated for payment of sales commissions to ticket retailers. An additional amount not to exceed 0.5% of gross lottery game sales is appropriated for payment of sales commissions to ticket retailers. The combined amount is currently estimated to be 6.7% of total ticket sales, or $78,287,000 in FY 2020. (General Appropriation Act footnote)

6/ General Appropriation Act funds are appropriated as an Operating Lump Sum with Special Line Items by Agency.

Operating Budget

The Baseline includes $9,202,400 and 98.8 FTE Positions from the State Lottery Fund in FY 2020 for the operating budget. These amounts are unchanged from FY 2019.

Advertising

The Baseline includes $15,500,000 from the State Lottery Fund in FY 2020 for Advertising. This amount is unchanged from FY 2019.

Monies in this line item are used to promote and market Lottery games.

Charitable Commissions

The Baseline includes $1,728,200 from the State Lottery Fund in FY 2020 for Charitable Commissions. FY 2020 adjustments are as follows:

Tab Ticket Increase

The Baseline includes an increase of $175,900 from the State Lottery Fund in FY 2020 to realign spending with projected revenues. *(See Table 1 for more information.)*

Monies in this line item are used to compensate charities for selling lottery 'Tab Tickets.' Tab Tickets are games sold exclusively by charitable organizations, who receive a 20% commission for selling the games. The displayed amount is derived by applying the approved percentage, 20%, to the forecasted Tab Ticket sales. A.R.S. § 5-555 also allows the department to collect up to 35% of total Tab Ticket sales (which includes the 20% commission) for their operating budget, with the remainder distributed as prizes.

Instant Tickets

The Baseline includes $31,060,100 from the State Lottery Fund in FY 2020 for Instant Tickets. FY 2020 adjustments are as follows:

Instant Ticket Sales Increase

The Baseline includes an increase of $2,693,100 from the State Lottery Fund in FY 2020 for Instant Tickets due to higher projected sales. *(See Table 1 for more information.)*

Monies in this line item are used to pay for instant ticket printing and distribution costs. The estimated appropriation was lowered from 3.6% to 3.05% in FY 2018. This figure reflects a blended rate across different services. The appropriation returned to 3.6% in FY 2019. The amount displayed is derived by applying the new approved spending percentage to the forecasted sales total.

On-Line Vendor Fees

The Baseline includes $11,009,400 from the State Lottery Fund in FY 2020 for On-Line Vendor Fees. FY 2020 adjustments are as follows:

On-Line Sales Decrease

The Baseline includes a decrease of (1,301,100) from the State Lottery Fund in FY 2020 for On-Line Vendor Fees due to lower projected sales. *(See Table 1 for more information.)*

Monies in this line item are used to pay the vendor that operates the on-line game computer system. The actual appropriation is equal to a percentage of on-line ticket sales specified in the Lottery's contractual agreement with the vendor, which is 4.256%.

Retailer Commissions

The Baseline includes $78,287,000 from the State Lottery Fund in FY 2020 for Retailer Commissions. FY 2020 adjustments are as follows:

Retailer Commissions Increase

The Baseline includes an increase of $6,633,000 from the State Lottery Fund in FY 2020 for Retailer Commissions due to higher projected sales. *(See Table 1 for more information.)*

Monies in this line item are used to compensate retailers for selling lottery tickets. A.R.S. § 5-555 specifies that compensation to retailers will be at least 5.5% but not more than 8% of non-charitable Tab Ticket sales. The actual appropriation is equal to 6.5% of these sales. Pursuant to statute, an additional 0.5% of total non-charitable Tab Ticket sales may be paid to retailers based on their attainment of specified sales and marketing objectives. Since 40% of retailers are estimated to meet these objectives, this would result in an additional 0.2% in retailer commissions and a total retail commission rate of 6.7%. The displayed amount is derived by applying the approved percentage to the forecasted sales total.

Other Issues

Lottery Forecast and Distributions

The Baseline assumes a 9.8% increase in overall Lottery ticket sales in FY 2019, followed by a 4.1% increase in FY

2020. For FY 2019 and FY 2020, the Baseline assumes Lottery ticket sales of $1,077,223,800 and $1,121,461,900, respectively.

The FY 2019 forecasted sales and Special Line Items expenditures are higher than the amounts included as part of the *FY 2019 Appropriations Report*. This increase is due to a revised FY 2019 sales forecast. These revised amounts are estimates based on the current sales forecast and the special line item percentages included in the FY 2019 General Appropriation Act footnotes. The actual FY 2019 expenditures will be determined by the actual Lottery ticket sales during FY 2019.

Sources and Uses of Lottery Profit Distribution

Table 1 shows the sources of forecasted Lottery profits by revenue stream and illustrates the actual distributions to fund beneficiaries for FY 2018 and the JLBC Staff projected distributions for FY 2019 and FY 2020. A brief description of each beneficiary follows in the order that they receive Lottery-generated revenue in accordance with A.R.S. § 5-534 and 5-572.

State Lottery Revenue Bond Debt Service Fund

Laws 2010, 6th Special Session, Chapter 4 authorized the Arizona Department of Administration (ADOA) to issue a 20-year, $450,000,000 Lottery revenue bond by December 31, 2010 to be deposited into the General Fund. The payments are made from Lottery revenues that would have otherwise been deposited into the General Fund.

In December 2018, the Arizona Department of Administration (ADOA) elected to refinance the 2010 Lottery Revenue Bonds and the refinancing bonds will be issued in October 2019. The refinancing has not extended the original 20-year repayment period. This refinancing will result in annual savings of approximately $3.0 million throughout the term of the bonds for a total savings of $29.9 million. This includes a payment reduction of $(2,988,500) in FY 2020 compared to the previously scheduled FY 2020 payment under the 2010 bonds. These savings will result in additional General Fund revenues since debt service payments count towards the General Fund - Part 1 distribution. These savings were achieved due to lower bond market interest rates, a shorter bond duration than the original 20-year bonds, and a higher bond rating.

As a result of the bond refinancing, the principal and interest payments in FY 2019 and FY 2020 are expected to be $37,502,900 and $34,511,900, respectively. Chapter 4 requires the first Lottery proceeds to be distributed to the State Lottery Revenue Bond Debt Service Fund.

Maricopa County Mass Transit

The projected annual distribution of Powerball proceeds to the Maricopa Public Transportation Fund is $11,529,000 in each FY 2019 and FY 2020.

Laws 1993, 6th Special Session, Chapter 1 allocated not less than 31.5% of multi-state Powerball revenues to public transportation programs, otherwise known as Local Transportation Assistance Fund (LTAF) II. This allocation was capped at $18,000,000 and was contingent upon the General Fund receiving $45,000,000 in Lottery revenues. Laws 2010, 7th Special Session, Chapter 12 redirected these monies to the General Fund. In September 2011, the U.S. District Court in the case of *Paisley v. Darwin* ruled that the Arizona Legislature must restore the distribution of mass transit monies to Maricopa County because the distribution was part of the state implementation plan to ensure compliance with the Clean Air Act. As a result, the state must calculate Maricopa County's share of 31.5% of statewide Powerball proceeds and distribute those monies to the county.

General Fund - Part 1

The statutory distribution requires the General Fund to receive up to $84,150,000. The General Fund - Part 2 would receive up to an additional $15,490,000 (for a total of $99,640,000) after the statutory funding obligations have been met through the Homeless Shelters distribution. After all other statutory obligations have been met, the General Fund - Part 3 would receive all remaining revenues.

The profit distributions in FY 2019 and FY 2020 are forecasted to fulfill requirements for General Fund - Part 1 and Part 2. The Lottery revenue bond payments of $37,502,900 in FY 2019 and $34,511,900 in FY 2020 account towards the $84,150,000 General Fund - Part 1 requirement.

Heritage Fund

Statute caps annual distributions to the Arizona Game and Fish Commission's Heritage Fund at $10,000,000. The funds are used to promote wildlife habitat and education programs and to rehabilitate historic buildings. In FY 2019 and FY 2020, the fund is projected to receive its entire allocation.

Health and Welfare Programs

Statute requires annual inflation adjustments for the Health and Welfare distribution. The revised allocation cap is $21,411,500 in FY 2019 and $21,943,200 in FY 2020. These amounts are distributed among the following agencies:

- 29.4% to the Department of Child Safety for the Healthy Families program.
- 23.5% to the Arizona Board of Regents (ABOR) for the Arizona Health Education Center program.
- 17.6% to the Department of Health Services (DHS) for teenage pregnancy prevention.
- 11.8% to DHS for Disease Control Research.
- 11.8% to DHS for the Health Start program.
- 5.9% to DHS for the Women, Infants and Children food program.

Health and Welfare Programs are expected to receive their entire allocation in both FY 2018 and FY 2019.

Homeless Shelters

Under the statutory distribution, DES would receive up to $1,000,000 for Homeless Shelters. The department shall use the funding to distribute grants to nonprofit organizations, including faith based organizations, for homeless emergency and transitional shelters and related support services. The fund is estimated to receive its full allocation in both FY 2019 and FY 2020.

General Fund - Part 2

As noted above, the General Fund would receive up to an additional $15,490,000 after all prior allocations have been met. In FY 2019 and FY 2020, the General Fund is estimated to receive its entire allocation of $15,490,000.

Arizona Competes Fund

Statute caps annual distributions to the Arizona Competes Fund at $3,500,000. Allotments to this fund are used for administering grants to qualifying businesses for the purpose of attracting, retaining, and expanding business within the state. This fund is estimated to receive its full allocation in both FY 2019 and FY 2020.

University Capital Improvement (UCI) Fund

This fund serves as the source for up to 80% of the annual debt service associated with $800,000,000 of University Capital construction Stimulus Plan for Economic and Educational Development (SPEED) bonds. This fund received $39,610,200 in FY 2018. Based on ABOR data which includes current and planned SPEED bond issuances, the UCI Fund is expected to require $39,889,000 in FY 2019 and 40,924,200 in FY 2020 to make the expected 80% level of debt service payments. *(Please see the FY 2020 Arizona Board of Regents Capital Outlay section for more details.)*

General Fund - Part 3

The General Fund receives all remaining revenues after all statutory funding obligations have been met. These payments to the General Fund are estimated to equal $30,667,200 in FY 2019 and $30,731,300 in FY 2020. Total General Fund distributions, net of bond payments, are therefore estimated to be $92,804,300 in FY 2019 and $95,859,400 in FY 2020.

Table 1

Forecast of Lottery Revenue Distribution
($ in Millions)

Sales	**FY 2018**	**FY 2019**	**FY 2020**
Instant Sales	$719.6	$788.0	$862.8
On-Line Sales	261.8	289.2	258.7
Total Sales	$981.4	$1,077.2	$1,121.5
Less:			
Operating Budget [1/]	$ 112.3	$ 138.6	$ 146.9
Gaming Distribution	0.3	0.3	0.3
ICACF/VREF Sales Transfer [2/]	0.2	0.2	0.2
APF Transfer [3/]	3.5	0.0	0.0
Prizes [4/]	664.0	720.5	754.9
Net Profit [5/]	**$201.1**	**$217.6**	**$219.2**
Profit Transfers [6/]			
Debt Service Fund	$ 37.5	$ 37.5	$ 34.5
Maricopa County Mass Transit [7/]	11.5	11.5	11.5
General Fund - Part 1 [8/9/]	46.7	46.6	49.6
Heritage	10.0	10.0	10.0
Health and Welfare Programs	21.0	21.4	21.9
Homeless Shelters	1.0	1.0	1.0
General Fund - Part 2 [8/9/]	15.5	15.5	15.5
Arizona Commerce Authority	3.5	3.5	3.5
University Capital	39.6	39.9	40.9
General Fund - Part 3 [8/9/]	14.8	30.7	30.8
Total Transfer	**$201.1**	**$217.6**	**$219.2**

1/ Of this amount, an estimated $1,552,300 in FY 2019 and an estimated $1,728,200 in FY 2020 will be distributed as commissions to charities that sell lottery Tab Tickets.

2/ A.R.S. § 5-554H allows the commission to sell tab tickets from vending machine in age-restricted areas. Profits from these sales are distributed to the Internet Crimes Against Children Enforcement Fund (ICACF) and the Victims' Rights Enforcement Fund (VREF), respectively. The ICAC Fund receives up to $900,000 and the VREF receives up to $100,000. If net profits from age-restricted tab tickets are less than $1.0 million, then the difference will be paid to ICACF and VREF from unclaimed prize monies in the State Lottery Fund. In FY 2018, $164,000 was distributed to the ICACF/VREF from the sale of tab tickets. An estimated $209,500 and $240,900 will be distributed in FY 2019 and FY 2020, respectively. *(See Footnote 6.)*

3/ The FY 2018 General Appropriation Act transferred $3,497,400 from the State Lottery Fund to the Automation Projects Fund in FY 2018 for the cost to replace the commission's IT system.

4/ Prizes are estimated by subtracting net profit, operating budget expenditures, the Department of Gaming transfer, and the ICAC/VREF sales transfer from total Lottery sales.

5/ To derive the profit transfer amounts, the historical rate of return for each game was applied to the current budget forecast. The total rate of return on all games in FY 2018 was 20.54%. The estimated total profit margin is 20.25% in FY 2019 and 19.60% in FY 2020.

6/ In addition to these listed transfers, the following monies are distributed:
- 30% of unclaimed prizes to the Court Appointed Special Advocates program.
- 15% of unclaimed prizes, not to exceed $250,000 to the Tribal College Dual Enrollment Program Fund (This distribution was $160,000 in FY 2016, but was increased pursuant to Laws 2016, Chapter 124).
- An estimated $790,500 in FY 2019 and $759,100 in FY 2020 of unclaimed prizes to ICACF and VREF.

7/ As a result of a federal court order, Maricopa County's share of Local Transportation Assistance Fund II monies was reinstated starting September 2011. *(See Other Issues section for more information.)*

8/ Excluding fund transfers, distributions to the General Fund were reported by the Lottery Commission to be $76,975,500 in FY 2018. This amount reflects profits only related to FY 2018 sales. Due to the timing of Lottery profit transfers, however, the actual FY 2018 General Fund distribution amount was only $64,425,400.

9/ Excluding fund transfers, distributions to the General Fund are estimated to be $92,804,300 in FY 2019 and $95,859,400 in FY 2020.

SUMMARY OF FUNDS	FY 2018 Actual	FY 2019 Estimate

State Lottery Fund (LOA2122/A.R.S. § 5-571) **Non-Appropriated**

Source of Revenue: Sales of lottery tickets, retailer license fees, and interest earnings.

Purpose of Fund: A portion of the fund is appropriated to pay for all costs of the Arizona State Lottery Commission. After all expenses are paid including the prize monies displayed below in the Non-Appropriated Funds Expended line, Lottery profits are distributed to a number of different functions.

Appropriated Funds Expended	112,274,000	138,586,200
Non-Appropriated Funds Expended	664,014,500	720,491,500
Year-End Fund Balance	15,381,200	4,905,800