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FISCAL IMPACT REPORT

ORIGINAL DATE 2/02/17
LAST UPDATED 3/13/17 **HB** 250/HBICS/aHF1#1

SPONSOR HBIC

SHORT TITLE Lottery Employee Bonuses & Unclaimed Prizes **SB** _____

ANALYST Dulany

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY17	FY18	FY19		
\$0.0	\$2,600.0	\$2,600.0	Recurring	Lottery Tuition Fund

(Parenthesis () Indicate Revenue Decreases)

Conflicts with to SB 192/aSFC
 Relates to HB 237

SOURCES OF INFORMATION

LFC Files
 Think New Mexico

Responses Received From

New Mexico Lottery Authority (NMLA)
 Northern New Mexico College (NNMC)
 Higher Education Department (HED)

SUMMARY

Synopsis of House Floor Amendment

The House floor amendment amends the list of prohibited activities concerning NMLA to remove “or is adjacent to” an automated teller machine. NMLA reported in its analysis of HB 250/HBICS that the authority has no control over the placement of automated teller machines by retailers.

Synopsis of Bill

House Bill 250/HBICS amends the New Mexico Lottery Act to tie bonuses or incentive compensation paid to officers, agents, employees, lottery contractors, or lottery vendors to increases in the amount of lottery ticket sales revenue transmitted for deposit in the lottery tuition fund and specifies such bonuses shall not be calculated based on NMLA’s gross revenues or

other factors.

The bill requires money from unclaimed prizes to be paid into the lottery tuition fund for scholarships and requires such money shall not be calculated in the gross revenue requirement under Section 6-24-24 NMSA 1978.

HB 250/HBICS adds new material to the act prohibiting NMLA from offering any style of video lottery game or selling tickets through a self-service device that is part of, shares a display with, or is adjacent to a petroleum dispenser or automated teller machine. The bill defines “video lottery game” as a game that offers the play of casino-style games, including blackjack, craps, keno, dice games, roulette, or poker, on an electronic terminal, through a website, or by any other means or device.

FISCAL IMPLICATIONS

According to NMLA’s FY16 audit, “as of June 30, 2016 the Lottery had unclaimed prizes in the amount of [\$2.6 million] reported as prizes payable but that had not yet been applied against prize expense.” The audit goes on to note, “The [\$2.6 million] in the unclaimed prize fund has already been committed and continues to supplement the prizes on instant games that have been printed and are currently for sale. Any unclaimed prizes will continue to be a portion of the thirty percent return to the Legislative Lottery Scholarship Fund.”

The unclaimed prize pool does not appear separately on NMLA’s consolidated income statement (see Attachment 1).

HB 250/HBICS may add about \$2.6 million to the lottery tuition fund for lottery scholarships. Annual scholarship revenues from lottery ticket sales range from about \$41 million to \$46.3 million. The Legislative Lottery Tuition Scholarship pays 90 percent of average tuition costs in FY17. As Liquor Excise Tax distributions to support scholarships are scheduled to expire at the end of the fiscal year, this amount may drop below 70.6 percent (see Attachment 2). Estimates from HED suggest payouts could be as low as 65 percent.

Based on the agency response, NMLA appears to use unclaimed prize funds for two purposes. First, NMLA indicates it uses unclaimed prizes to enhance payouts for scratcher games. NMLA purports this results in increased sales and thus more funding to support scholarships. NMLA has suggested in recent years surrounding states have higher prize payouts on lottery products, and thus New Mexico loses market share to these states for players in bordering communities. The funds are also used to pay prizes won early before the game has achieved requisite sales to fund prizes and to increase the player base in specialty games.

According to NMLA, the authority currently has nine to twelve months of scratcher ticket inventory available for sale at retailer locations and printed at NMLA’s warehouse for which prizes have been partially funded from unclaimed prizes. NMLA states, “If HB 250 passes, the lottery will have to pull these games from the marketplace and shred millions of tickets.” This, according to NMLA, would result in lost revenue for scholarships.

Second, NMLA reports, the unclaimed prize pool is used to aid cash flow issues at NMLA. In addition to paying early prizes, NMLA states unclaimed prize funds have been used to supplement its 30 percent net revenue transfer obligations to the lottery tuition fund to pay for

scholarships. NMLA reports it had to reduce scratcher prize payouts in spring 2007 to meet its monthly transfer obligation, and the authority attributes this prize payout reduction to a 24 percent slide in scratcher sales between 2007 and 2014.

SIGNIFICANT ISSUES

Unclaimed Prizes

Analysis from Think New Mexico suggests 22 states, as well as the District of Columbia, allocate unclaimed prizes to the lottery fund, general fund, or for other purposes that support lottery beneficiaries. At least three states, according to the analysis, set certain required amounts aside for compulsive gambling disorder and allocate remaining amounts to future prizes and promotions. Think New Mexico reports 12 states, including New Mexico, allocate unclaimed prizes exclusively to future prize or promotion pools. Of these states, one state sends unclaimed prize money to pay sales commissions. Seven states allocate unclaimed prizes to a combination of beneficiaries and future prizes.

Compensation

NMLA states it “does not currently provide monthly bonuses or incentives to officers, agents, employees, contractors, vendors or retailers that are based on gross revenues.” The current compensation agreement for the NMLA chief executive officer (CEO) includes the following in addition to a base salary:

- “Based upon the fiscal year 2017 financial statements for the period of July 1, 2016 through June 30, 2017...incentive pay equal to Four percent (4%) of said Base Salary if those financial statements show that the operating expenses for the Lottery, not including any reserve fund expenses, do not exceed a rate of Four percent (4%) of gross revenues for [FY17].”
- “For the period of July 1, 2015 through June 30, 2017...an additional incentive payment equal to Four percent (4%) of said Base Salary if the Lottery receives an additional five hundred thousand dollars (\$500,000) in added value for its annual media buy.”
- For the period July 1, 2016 – June 30, 2017...additional incentive payment equal to Four percent (4%) of said Base Salary if, the CEO shows that corporate funding in the amount of Ten Thousand Dollars (\$10,000.00) or more has resulted from a lottery contractor expending funds to partner or promote a New Mexico business or enterprise other than the Lottery.”

Although the current compensation agreement for the CEO does not appear to be based on gross revenues, a previous version of the CEO’s compensation agreement from 2014 provided:

- “Based upon the audited financial reports of the NMLA beginning February, 2014 through February, 2015 [the CEO] shall receive a bonus equal to Ten percent (10%) of said Base Salary if those audited financial reports show a minimum increase in the total gross revenues of the NMLA equal to or greater than Ten percent (10%) as compared to the total gross revenues of the period beginning February, 2013 through February, 2014.”

- “Based upon the audited financial reports of the NMLA beginning February, 2014 through February, 2015, [the CEO] shall receive an additional bonus equal to Five percent (5%) of said Base Salary if those audited financial reports show a minimum increase in Instant Ticket total gross revenues equal to or greater than Eight percent (8%) as compared to the total gross revenues of the period beginning February, 2013 through February, 2014.”
- “Based upon the audited financial reports of the NMLA beginning February, 2014 through February, 2015, [the CEO] shall receive an additional bonus equal to Five percent (5%) of said Base Salary if those audited financial reports show a minimum of \$500,000 dollars, which are not attached, received from, or related to the gaming revenues, that the NMLA may utilize in the operational budget for use as enhancement of NMLA’s ability to improve the administrative functions of the NMLA. Such Funds may be sourced from, but are not limited to vendor contract savings, budget adjustments, or other savings measures.”

HB 250/HBICS requires that bonus or incentive compensation committed or paid to a lottery contractor or lottery vendor shall be calculated based on the increase in the amount of lottery ticket sales revenue transmitted for deposit in the lottery tuition fund and shall not be calculated based on the authority’s gross revenues or other factors. These requirements for bonus or incentive compensation do not apply to lottery retailers, as was the case in the previous version of the bill.

Video Lottery Games and “Play at the Pump”

HB 250/HBICS prohibits NMLA from offering any style of video lottery game. The definition of “lottery game” in the New Mexico Lottery Act is defined as “any variation of the following types of games, **but does not include any video lottery game**:

- (1) An instant-win game in which disposable tickets contain certain preprinted winners that are determined by rubbing or scraping an area or areas on the tickets to match numbers, letters, symbols or configurations, or any combination thereof, as provided by the rules of the game, provided an instant-win game may also provide for preliminary and grand prize drawings conducted pursuant to the rules of the game; and
- (2) An on-line lottery game in which a lottery game is hooked up to a central computer via a telecommunications system through which a player selects a specified group of numbers or symbols out of a predetermined range of numbers or symbols and purchases a ticket bearing the player-selected numbers or symbols for eligibility in a drawing regularly scheduled in accordance with game rules” (emphasis added).

NMLA notes it must be innovative in reaching lottery players and has previously discussed the need to use technology to reach younger individuals who tend to use debit cards instead of cash and value convenience. In July 2016, NMLA announced it was testing a pilot program to allow players who purchase gas with a debit card to make lottery purchases at the pump at 13 retailers. The purchases are subject to limitations, including a \$75 weekly limit and a \$20 daily limit per debit card. The initiative also includes third-party age verification. HB 250/HBICS would prohibit NMLA from this practice.

CONFLICT & RELATIONSHIP

Page 7, lines 12 through 16 of HB 250/HBICS require that unclaimed prizes be paid into the lottery tuition fund and shall not be included in the calculation of gross revenues required under Section 6-24-24 NMSA 1978. SB 192/aSFC would replace the gross revenue requirement in 6-24-24 NMSA 1978 with a net revenue requirement.

HB 237 extends the distribution of liquor excise tax revenues to the lottery tuition fund through FY20.

TD/sb/jle

New Mexico Lottery Authority

**FY 16 CONSOLIDATED INCOME STATEMENT
AND FY17 CONSOLIDATED ORIGINAL ANNUAL BUDGET**

	2016 Consolidated Income Statement	2017 Consolidated Original Annual Budget
OPERATING REVENUES		
Instant ticket sales	\$ 83,105,873	\$ 82,987,500
Powerball sales	43,321,879	35,916,500
Mega Millions sales	10,509,262	8,999,500
Roadrunner Cash sales	7,394,565	6,399,500
Pick 3 sales	4,891,153	4,899,500
New Game sales	-	1,999,500
Hot Lotto sales	4,283,277	1,999,500
New Game 2 sales	-	399,500
Quickster sales	691,531	299,500
Lucky Numbers Bingo sales	147,228	99,500
Monopoly Millionaires' Club sales	-	-
Net ticket sales	<u>154,344,768</u>	<u>144,000,000</u>
Retailer fees	14,720	12,000
Bad debts	<u>(21,000)</u>	<u>(24,000)</u>
Total operating revenues	<u>154,338,488</u>	<u>143,988,000</u>
NON-OPERATING REVENUES		
Other income	47,173	-
Interest income	<u>17,141</u>	<u>12,000</u>
Total non-operating revenues	<u>64,314</u>	<u>12,000</u>
GROSS REVENUES	<u>154,402,802</u>	<u>144,000,000</u>
GAME EXPENSES		
Prize expense	84,754,383	77,126,000
Retailer commissions	10,035,060	9,660,000
On-line vendor fees	4,284,035	5,171,000
Advertising	2,053,906	2,300,000
Ticket vendor fees	1,314,494	1,431,000
Shipping and postage	276,853	334,000
Retailer equipment	182,538	370,000
Promotions	116,770	197,000
Responsible gaming	69,999	75,000
Game membership	56,878	116,000
Drawing game	-	-
Total game expenses	<u>103,144,916</u>	<u>96,780,000</u>
OPERATING EXPENSES		
Salaries, wages, and benefits	2,609,094	2,802,000
Utilities and maintenance	313,846	308,000
Professional fees	229,908	260,000
Depreciation and amortization	225,958	220,000
Leases, property taxes, and insurance	145,591	130,000
Other	54,878	98,000
Materials and supplies	48,743	100,000
Travel	24,607	66,000
Operational reserve fund expense	<u>1,241,000</u>	<u>-</u>
Total operating expenses	<u>4,893,625</u>	<u>3,984,000</u>
OPERATING INCOME	<u>46,299,947</u>	<u>43,224,000</u>
NON-OPERATING EXPENSE		
Interest expense	<u>40,104</u>	<u>36,000</u>
Total non-operating expense	<u>40,104</u>	<u>36,000</u>
Net income	<u>46,324,157</u>	<u>43,200,000</u>
Gross Revenue Percentage Return	<u>30.00%</u>	<u>30.00%</u>

Source: NMLA

Legislative Lottery Tuition Scholarship Program: Current Status and Projections
(in thousands)

	FY16	FY17	FY18	
	Actuals	Estimated	LFC Scenario	100 % Tuition Award Scenario
Revenues				
Lottery Revenues	\$45,481.5	\$42,000.0	\$42,000.0	\$42,000.0
Lottery Tuition Fund Beginning Balance	\$3,402.1	\$3,456.8	\$4,126.0	\$4,126.0
Non-reverting and Other Revenues	\$1,619.3	\$18.0	\$18.0	\$18.0
Liquor Excise Tax Distribution	\$14,725.6	\$18,600.0	\$2,925.3	\$2,925.3
Available Revenues	\$65,228.5	\$64,074.8	\$49,069.3	\$49,069.3
Expenditures				
Scholarships - Percent of Tuition Awarded	<i>90% of est. avg. sector tuition</i>	<i>90% of est. avg. sector tuition</i>	<i>70.6% of est. avg. sector tuition</i>	<i>100% of est. avg. sector tuition</i>
<i>Research Awards</i>	\$51,253.2	\$52,432.2	\$40,998.0	\$58,082.8
<i>Comprehensive Awards</i>	\$3,914.7	\$4,425.8	\$3,446.4	\$4,882.7
<i>Two-year Awards</i>	\$3,002.6	\$3,090.8	\$2,624.9	\$3,718.8
<i>FY15 Late Payment</i>	\$3,601.2	\$0.0		
Total Expenditures	\$61,771.7	\$59,948.8	\$47,069.3	\$66,684.3
Est. Year-End Lottery Tuition Fund Balance (Available Revenues - Expenditures)	\$3,456.8	\$4,126.0	\$2,000.0	(\$17,615.0)
Less Statutory Minimum	(\$2,000.0)	(\$2,000.0)	(\$2,000.0)	(\$2,000.0)
Est. Over/Under	\$1,456.8	\$2,126.0	\$0.0	(\$19,615.0)

Source: HED and LFC Files

Notes: FY18 estimates assume 3 percent expenditure increase.