FISCAL NOTE

Bill #:	HB0239	**Title:**	Revise lottery operating expenses
Primary Sponsor:	Facey, T	**Status:**	As Introduced

Sponsor signature Date Chuck Swysgood, Budget Director Date

Fiscal Summary

	FY 2004 Difference	FY 2005 Difference
Expenditures:		
Proprietary	($1,971,238)	($5,894,533)
Revenue:		
General Fund	($77,500)	($517,500)
Proprietary	($1,917,238)	($5,894,533)
Net Impact on General Fund Balance:	($77,500)	($517,500)

- ☐ Significant Local Gov. Impact
- ☐ Included in the Executive Budget
- ☐ Dedicated Revenue Form Attached
- ☐ Technical Concerns
- ☒ Significant Long-Term Impacts
- ☒ Needs to be included in HB 2

Fiscal Analysis

ASSUMPTIONS:

1. HB 239 will establish a statutory amount of revenue from money paid for tickets or chances in which the state lottery may use for operating expenses. This amount equals 20.5 percent in FY 2004 and 19 percent for fiscal years following 2004. Under current law, the state lottery uses approximately 23.9 percent of revenue from money paid for tickets or chances. Under this proposal, the state lottery operating expenses as a percentage of revenue will decrease by 17.1 percent in FY 2004 (beginning October 1, 2003) and 26.3 percent in FY 2005.
2. Section 1 amending 23-7-301, MCA, will decrease the commission rate from 10 percent to 9.5 percent, causing an approximate 5.3 percent decrease in commissions from what would have been under current law beginning October 1, 2003. Retailers earn base commissions of 5 percent and have the opportunity to earn additional commissions by increasing sales on instant (scratch) tickets. To earn the additional commission, a retailer must exceed the previous year's sales by a minimum of 2 percent and for each 2 percent increment a retailer can increase its commission by .5 percent; this equates to an increase in sales of 20 percent over the previous year to earn the maximum 10 percent on instant sales. In FY 2002 some retailers did reach the 10 percent level and received a total of $251,571 in commission. If they were paid at the 9.5 percent level instead, they would have received $226,404, a difference of $25,167 in that year. An estimate for the decrease in sales of only $130,000 at a 20 percent profit margin would offset the

$25,167 saved by the lower commissions. At this level, the provision would result in no change to the general fund transfer. This amount is not listed in the fiscal note.

3. Marketing personnel estimate that in FY 2004 instant sales would be reduced by approximately 5 percent, or $500,000 (10M x .95= 9.5 M in sales) and on-line tickets by 3 percent, or $800,000 (24.8M x 97% = 24M in sales). This amounts to total revenue in FY 2004 of $33.5 million (9.5M + 24.0M). The revenue estimate for these sales in FY 2004 is $35,471,238. The difference or decrease in revenue in FY 2004 is $1,971,238 (35,471,238 – 33,500,000).

   There would be greater decreases in FY 2005 because of the reductions in advertising and other promotional activities. In FY 2005, a 10 percent reduction was forecast for each type of sales, which would amount to total sales of $8.55 million for instant sales (9.5M x 90% = 8.55M in sales) and $21.6 million for on-line gaming (24M x 90% = 21.6M in sales). This amounts to total revenue in FY 2005 of $30.15 million (8.55M + 21.6M). The revenue estimate for these sales in FY 2005 is $36,044,533. The difference or decrease is revenue in FY 2005 is $5,894,533 (36,044,533 – 30,150,000 = 5,894,533).

   The projected percentage decreases in gross revenue is compared to the decreases in revenues in the late 1980s and mid 1990s. From FY 1988 to FY 1989, the Lottery operating expenses were limited to percent of sales. Under this limit, the Lottery could not expand into on-line games and the revenue decreased $10.2M (from $21.8 in FY 1988 to $11.6M in FY 1989), a 46.8 percent decrease. From FY 1994 to FY 1997, expenditures were curtailed through the budget process such that only immediate expenses were covered and no future planning or market place positioning was possible. Sales decreased a total of $9.2 million ($37.5M in FY 1994 to $28.3M in FY 1997), for an average 9 percent decrease each year.

   Therefore, the percentages used to reach the estimates of a total decrease over the biennium of $7.86M in revenues are reasonable (1,971,238 + 5,894,533).
4. Operating expenses are being defined as anything that is not a prize or a commission. Per 23-7-402(3), MCA, "that part of all gross revenue not used for the payment of prizes, commissions, and operating expenses, together with the interest earned on the gross revenue while the gross revenue is in the enterprise fund, is net revenue. Net revenue must be transferred quarterly from the enterprise fund established by 23-7-401 to the state general fund."
5. Section 23-7-402(b) will limit operating expenses. Some operating expenses cannot be reduced, including items such as the Department of Administration pass through costs, loan interest, building costs, audit fees and depreciation on equipment.
6. The Lottery vendor fee represents the largest non-discretionary expenditure that would be affected by a decrease in revenue. The vendor fee is approximately 8 percent, applying that to the decrease in revenue calculates to $157,699 (1,971,238 x .08) in FY 2004 and $471,563 (5,894,533 x .08) in FY 2005.
7. Operating expenses that can possibly be reduced include personnel services, advertising, communications, maintenance, supplies, retailer promotions and point of sale items, travel, and other services. To operate under HB 239, these expenses would need to be reduced by $395,639 in FY 2004 and $575,334 in FY 2005. This eliminates most advertising in FY 2004 and all advertising in FY 2005. In addition, all retailer promotions, all point of sale items, and planned office equipment purchases would be eliminated in both fiscal years, as well as reductions in the other areas.
8. The total available for operating expenses based upon the above revenue figures is $6,867,500 in FY 2004 (33.5M x .205) and $5,728,500 in FY2005 (30.15M x .19). To meet the proposed spending levels, personal services would need to be reduced by $71,400 (from 1,322,744 to 1,251,344) in FY 2004 and $477,136 (from 1,322,125 to 844,989) in FY 2005.
9. The decrease in revenues would decrease the statutory payments of prize money and commissions. The statutory payments use 60 percent for instant ticket prizes, 50 percent for online ticket prizes, and 6 percent for commissions on all prizes. (The following calculations will show .56 and .66, for instant and

online, respectively.)

In FY 2004, instant ticket revenue projections are $10.15M, versus $9.5M under SB 239, for a difference of $650,000. This results in an expense reduction of $429,000 (650,000 x .66). Online ticket revenue projections are $25.5M, versus $24M under SB 239, for a difference of $1.5M. This results in an expense reduction of $840,000 (1.5M x .56). This equates to a reduction of $1,269,000 (429,000 + 840,000) in statutory payments in FY 2004.

In FY 2005, instant ticket revenue projections are $10.4M, versus $8.55M under SB 239, for a difference of $1,85M. This results in an expense reduction of $1,221,000 (1.85M x .66). Online ticket revenue projections are $26.3M, versus $21.6M under SB 239, for a difference of $4.7M. This results in an expense reduction of $2,632,000 (4.7M x .56). This equates to a reduction of $3,853,000 (1,221,000 + 2,632,000) in statutory payments in FY 2005.

10. The following schedule shows the difference in the transfer to the general fund under current revenue projections versus projections under HB 239, for FY 2004 and FY 2005.

	FY 2004	FY 2004 Under SB 239	FY 2005	FY 2005 Under SB 239
Revenue	$35,471,238	$33,500,000	$36,044,533	$30,150,000
Expenses	$7,492,238	$6,867,500	$7,252,533	$5,728,580
Prizes & Commissions	$20,979,000	$19,710,000	$21,592,000	$17,739,000
Transfer to general Fund	$7,000,000	$6,922,500	$7,200,000	$6,682,500
(revenue – expenses – prizes and commissions)				

The difference under SB 239 in the FY 2004 transfer to the general fund is $77,500 (7,000,000 – 6,922,500) less than current projections and in FY 2005 is $517,500 (7,200,000 – 6,682,500) less than current projections.

FISCAL IMPACT:

	FY 2004 Difference	FY 2005 Difference
FTE	(1.50)	(13.50)
Expenditures:		
Personal Services	($71,400)	($477,136)
Operating Expenses		
Vendor fees	(157,699)	(471,563)
Other operating	(395,639)	(575,334)
Transfers	(77,500)	(517,500)
Statutory Expenses	(1,269,000)	(3,853,000)
TOTAL	($1,971,238)	($5,894,533)
Funding of Expenditures:		
Proprietary (06)	($1,971,238)	($5,894,533)
Revenues:		
General Fund (01)	($77,500)	($517,500)
Proprietary (06)	(1,971,238)	(5,894,533)
TOTAL	($2,048,738)	($6,412,033)

<u>Net Impact to Fund Balance (Revenue minus Funding of Expenditures):</u>		
General Fund (01)	($77,500)	($517,500)

LONG-RANGE IMPACTS:

Statutory reduction in support of Lottery retailers would result in reductions to sales and the general fund transfer, which would in turn result in further operating reductions, which would affect sales and the next year's transfer to the general fund, and so on.