



M E M O R A N D U M

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**Date:** April 14, 2010

**To:** California State Lottery Commission

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Director

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**Subject:** Item 9(a) - Revised FY 2009-10 Budget Reflecting  
Passage of Assembly Bill 142

**ISSUE**

Should the California State Lottery Commission (Commission) approve the proposed revisions to the Fiscal Year 2009-10 sales goals and the budget which includes the affects of passage of Assembly Bill (AB) 142?

**RECOMMENDATION**

California State Lottery (Lottery) staff recommends that the Commission approve the proposed revisions to the Fiscal Year 2009-10 sales goals and budget as presented. The revised budget reflects an additional \$15 million to public education above what was expected in the original budget adopted by the Commission.

**BACKGROUND**

At the June 26, 2009 meeting, the Commission approved the Lottery's Fiscal Year 2009-10 budget. At that time, sales were budgeted at \$2.96 billion with an additional \$50 million expected from proceeds resulting from restructuring of the Lottery's investment portfolio. The approved budget anticipated a total of \$1.054 billion being transferred to public education for Fiscal Year 2009-10.

Lottery Staff is proposing a revised budget that reflects \$1.069 billion being transferred to public education, an increase of \$15 million above what was expected in the original budget adopted by the Commission. The \$15 million increase is a net amount resulting from higher than expected sales of Lottery products combined with lower than expected funds from areas especially sensitive to current economic conditions.

## **DISCUSSION**

### **Introduction**

During Fiscal Year 2009-10, the Lottery has experienced groundbreaking changes that will result in increased contributions to public education. The efforts of the RENEW project are beginning to achieve tangible dividends. Several of the project team initiatives have been implemented and are already beginning to stem the declining sales trends of the past three years. This is significant considering the State continues to grapple with the impacts of the worst recession in over a quarter of a century.

And on April 9, 2010, the Governor signed Assembly Bill (AB) 142 that amends the Lottery Act by providing the Commission with the flexibility to determine the amount of annual revenues that are returned to the public in the form of prizes. The added flexibility to the Lottery's prize payout structure will maximize total revenues for public education by allowing California to implement best practices of other state lotteries. AB 142 takes effect immediately.

Presented below are the key elements of the revised Fiscal Year 2009-10 budget being presented to the Commission for approval.

### **Revenues**

The development of the Lottery's budget begins by projecting sales performance by game and determining prize funding levels by game. Sales goals for the Fiscal Year 2009-10 budget were projected by using sophisticated modeling as well as recent sales trend data. However, sales of Lottery products are affected by many variables. Some of these variables are influenced by strategic decisions such as prize payout levels, marketing efforts, and introduction of new games. These variables have fiscal constraints directly tied to the budget.

Sales are also heavily influenced by unpredictable factors, most notably jackpot levels, and uncontrollable factors such as the economy. As a result, the Lottery has relied on modeling that incorporates key assumptions to develop sales projections.

Earlier in the fiscal year, staff reported that sales for Scratchers® games were projecting to be below the \$1.7 billion amount expected in the Fiscal Year 2009-10 budget. However, staff also indicated that implementation of the RENEW project's "quick win" initiatives were expected to lift sales back up to the original budget level by the end of the fiscal year. This proposed budget reflects that the "quick win" initiatives have been successful in returning Scratchers game sales to the \$1.7 billion goal which is a reversal of the downward trend in Scratchers game sales over the past three years.

The passage of AB 142 has a tremendous affect on one of the key variables that impacts sales; prize payout levels. The added flexibility afforded the Commission for setting prize payout levels enables the Lottery to offer games that will result in more winners and more prizes and ultimately, more revenues for public education. Lottery staff is finalizing a strategy for implementing higher prize payout flexibility to present to the Commission. This strategy will focus on sustainable growth in sales of Lottery products and sustainable increases in revenues to public education.

The passage of AB 142 this month provides perfect timing for Commission review and approval of the sustainable growth strategy and to incorporate that strategy in development of the Fiscal Year 2010-11 business plan and budget. For the current year, passage of AB 142 will allow the Lottery to propose launching an additional \$5 Scratchers game that would otherwise have been cost-prohibitive under pre-AB 142 Lottery Act requirements. The revised budget being proposed includes an additional \$18 million of sales from this game.

Sales for SuperLOTTO Plus® and MEGA Millions® jackpot games are heavily influenced by jackpot levels. As a result of several large MEGA Millions jackpots earlier this fiscal year, sales have been boosted for this product and total projected sales are expected to be \$409 million, or \$94 million above the budgeted level. However, staff projects that SuperLOTTO Plus sales will be \$472 million which is \$18 million below the budgeted level.

Daily Games and Hot Spot® sales are projected to be \$428 million which is \$27 million below the amounts expected in the Fiscal Year 2009-10 budget.

In summary, total sales for the revised Fiscal Year 2009-10 budget are projected to be \$3.027 billion. This is an increase of \$67 million above the total sales amount in the original Fiscal Year 2009-10 budget. A comparison of sales figures from the budget adopted by the Commission last June and projected sales in the proposed revised budget are presented in the table below.

**COMPARISON OF SALES AND OTHER RESOURCES  
 FY 2009-10 BUDGET and REVISED FY 2009-10 BUDGET  
 (\$ in Thousands)**

	<b>ORIGINAL BUDGET FY 2009-10</b>	<b>CHANGE</b>	<b>REVISED BUDGET FY 2009-10</b>
<b>Sales</b>			
Scratchers	\$1,700,000	\$18,000	\$1,718,000
SuperLotto Plus	\$490,000	(\$18,000)	\$472,000
MEGA Millions	\$315,000	\$94,000	\$409,000
Daily Games	\$335,000	(\$24,000)	\$311,000
Hot Spot	\$120,000	(\$3,000)	\$117,000
Total Sales	\$2,960,000	\$67,000	\$3,027,000
<b>Other Resources</b>	\$50,000	(\$5,000)	\$45,000
<b>Total Resources</b>	<b>\$3,010,000</b>	<b>\$62,000</b>	<b>\$3,072,000</b>

The Fiscal Year 2009-10 budget also anticipated \$50 million from the Lottery's continued efforts to restructure its investment portfolio. This effort, which began in the latter portion of Fiscal Year 2008-09, involves taking advantage of financial market conditions to leverage the Lottery's currently held U.S. Treasury bonds by replacing them with other high-credit higher yielding investment instruments. This market condition created an opportunity to reduce the Lottery's investment costs while generating funds for public education as well as for reinvestment in the Lottery's business.

As of April 6, 2010, the Lottery has been successful in achieving \$39 million of proceeds from restructuring of the Lottery's investment portfolio. However, there has been a combination of recent changes in financial market conditions that are prompting staff to recommend reducing expected proceeds from investment portfolio restructuring from \$50 million to \$45 million.

The new sales projection of \$3.027 billion plus the \$45 million augmentation from restructuring of the Lottery's investment portfolio results in total proposed resources of \$3.072 billion for the revised Fiscal Year 2009-10 budget. This represents an increase of \$62 million above the resource level in the original budget adopted by the Commission.

**Expenses**

The revised budget that incorporates the higher sales projection also includes a corresponding increase in prize expenses. Prize expenses are projected to increase

\$38 million from \$1.583 billion to \$1.621 billion. Included in this figure are the prize expenses accompanying the proposed \$5 Scratchers game that will be launched with a 64% prize payout structure. The passage of AB 142 is what allows the Lottery to offer this higher prize Scratchers game.

Administrative expenses in the revised budget remain unchanged with the exception of incrementally higher retailer compensation and game operations costs that accompany the increased sales projections.

The increased sales reflected in this revised budget generates the authority for additional administrative expenses, however, staff recommends keeping those funds in reserve. Thus, the Administrative Reserve will increase from \$2 million to \$4 million. If this reserve is unneeded, these funds will be included in the transfer to public education at the conclusion of the fiscal year.

### **Contribution to Public Education**

The revised sales projections in this proposed budget will result in a \$20 million increase to public education over the original budget adopted by the Commission last June.

This increase in funding for public education from revised sales projections is partially offset due to by current economic conditions. The Lottery Act mandates that interest earned on Lottery funds held in the State Treasury be transferred to public education. The original Fiscal Year 2009-10 budget expected interest earnings of \$10 million. However, interest rates for the State's Surplus Money Investment Fund have plummeted lower than anticipated and interest earnings are now expected to be \$5 million for the fiscal year.

### **Summary**

With this revised budget, profits to California public schools in Fiscal Year 2009-10 are anticipated to be nearly \$1.07 billion marking the tenth consecutive year that the Lottery has surpassed the billion dollar mark in contributions to public education. This reflects a \$15 million increase above what was anticipated in the Fiscal Year 2009-10 budget approved by the Commission.

When that budget was presented to the Commission last June, staff stated that should the Legislature approve actions to modernize Lottery operations by lifting prize payout restrictions, the Lottery would submit a revised budget for Commission approval. The passage of AB 142 has provided that prize payout flexibility and the Lottery is poised to take immediate action that is reflected in this revised budget.

AB 142 combined with the Lottery's RENEW initiatives have positioned the Lottery for greater contributions to public education in the upcoming fiscal year. More importantly, they provide the foundation for sustainable growth in revenues and further enable the Lottery to carry out the commitment to enhancing education and supporting local communities.

Attachment