

Legislative Fiscal Office

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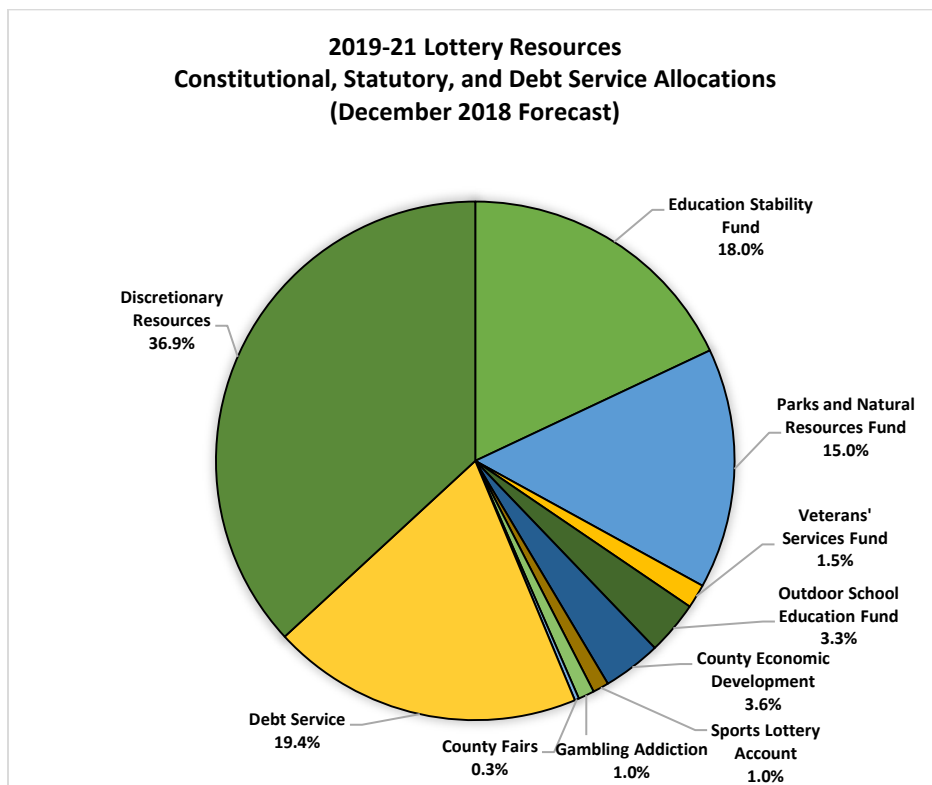


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Budget Information Report

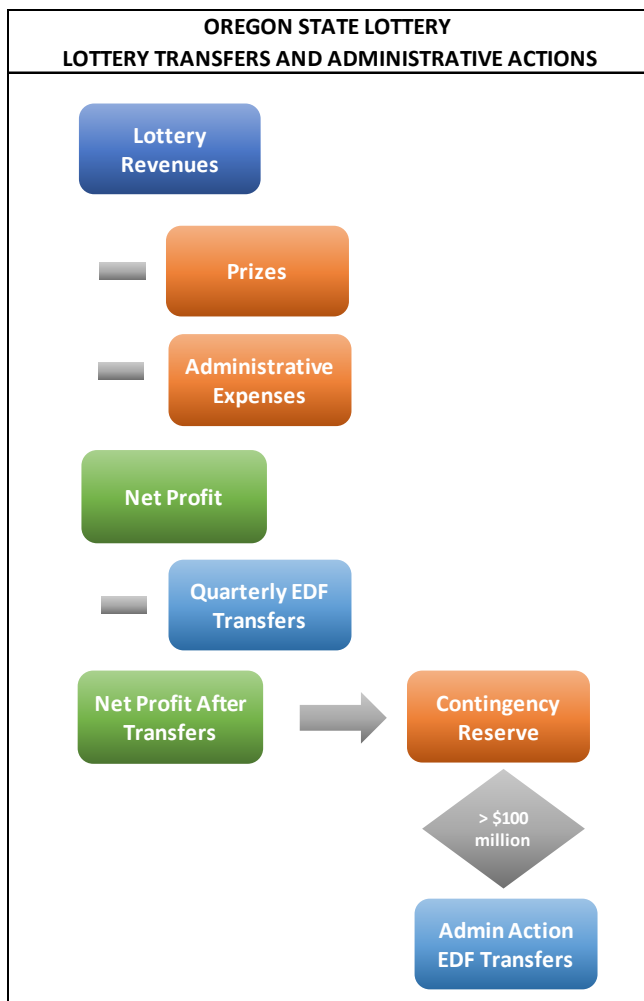
Oregon State Lottery Administrative Costs and Public Purpose Transfer Rate¹

The Oregon State Lottery (Lottery) was created in November 1984 through a voter-approved amendment to the Oregon Constitution (Article XV, Section 4[3]) establishing a State Lottery. Lottery revenues are generated through traditional and video lottery games. Initially, lottery revenues were dedicated to the creation of jobs and economic development. However, voters have approved subsequent ballot measures adding public education, restoration and protection of Oregon's parks, beaches, watersheds, and native fish and wildlife, veterans, and outdoor school as additional required or authorized uses of lottery revenues. The Oregon Constitution provides that 84% of total annual revenues from the sale of all lottery tickets or shares shall be returned to the public in the form of prizes and net revenues benefiting the public purpose, which limits the Lottery's annual operating expenses to 16% of annual revenues.



¹ ORS 173.420(3) requires the Legislative Fiscal Office to "cause a study to be conducted prior to the beginning of each odd-numbered year regular session of the Legislative Assembly that reports the preceding two calendar years' administrative costs and the transfer rate of the Oregon State Lottery Commission, in order to determine if additional funds may be made available for public purposes."

The Lottery transfers net revenues, after deduction for prizes and expenses, to the Administrative Services Economic Development Fund (EDF) established under ORS 461.540 to be distributed for constitutional, statutory, and legislatively approved allocations. The Oregon Constitution includes dedicated transfers to the Education Stability Fund (18%), Parks and Natural Resources Fund (15%), and Veterans’ Services Fund (1.5%). Statutory dedications include outdoor school education programs (4%, up to a maximum of \$5.5 million per quarter adjusted for inflation), county economic development programs (2.5% of net video lottery receipts), gambling addiction treatment programs (1%), public university sports programs and academic scholarships (1%), and county fair programs (1%, up to a maximum of \$1.53 million annually adjusted for inflation). In addition to constitutional and statutory dedications of lottery revenues, the state has issued lottery revenue bonds for projects and programs that benefit the same public purposes as lottery proceeds. Bonds are secured by net lottery revenues, which are constitutionally required to be appropriated to meet lottery bond debt service before being appropriated for any other purpose. The lottery revenue bond master indenture includes a four-times debt service coverage ratio. In order for the state to issue additional lottery revenue bonds, unobligated net lottery proceeds must be at least four times the maximum annual debt service on all outstanding lottery revenue bonds, with the debt service on new proposed lottery revenue bonds treated as part of the debt service ratio calculation. Remaining discretionary lottery resources are allocated by the Legislature and have been used to support the State School Fund, Oregon Business Development Department operations and programs, and the Governor’s Office Regional Solutions program.



The Lottery operates as a self-supporting revenue-raising state agency and does not receive any other state funding to support its operations. Expenses incurred in the operation and administration of the Lottery, including transfers to a contingency reserve, are deducted from lottery revenues, with remaining lottery resources available to transfer to the EDF. The Lottery has the discretion to determine the amount of the contingency reserve and currently targets \$100 million. Net lottery profits after quarterly transfers are deposited into the contingency reserve, until the balance reaches \$100 million, with any excess amounts transferred to the EDF as “administrative actions.” Although Lottery determines the necessary expenditures to develop and market lottery games that will optimize and sustain lottery revenues, while taking into consideration responsible gambling practices, statute requires quarterly and annual reporting on Lottery operations. Reports include lottery revenues, prize disbursements, expenses, net revenues, and all other financial

transactions involving state lottery funds. Pursuant to ORS 461.140, the Lottery submits an annual budget report to the Governor, Legislative Fiscal Office, and Legislative Revenue Office.

The following table includes actual revenue and expenditure data reported by Lottery for fiscal years 2016, 2017, and 2018, as well as the approved budget for 2019.

Oregon State Lottery				
Statement of Profit & Loss - Budgetary (Non-GAAP) Basis				
(\$ in thousands)				
	FY 2016 Actual	FY 2017 Actual	FY 2018 Actual	FY 2019 Approved Budget
Revenue	\$ 11,856,426	\$ 12,114,918	\$ 12,359,850	\$ 12,316,959
Prizes	10,852,550	11,081,228	11,284,939	11,268,404
Net Revenue	\$ 1,003,876	\$ 1,033,690	\$ 1,074,911	\$ 1,048,555
Direct Expenses				
Commissions	234,963	239,552	245,681	243,452
Game Vendor Charges	9,892	8,171	8,440	8,854
Tickets	3,138	3,329	3,043	4,060
Advertising	9,003	10,535	10,814	13,677
Sales Support	634	726	966	1,694
Game Equip / Parts & Maint	1,734	1,572	6,766	19,370
Depreciation	21,030	26,866	31,273	33,852
Total Direct Expenses	280,394	290,751	306,983	324,959
Gross Profit	\$ 723,482	\$ 742,939	\$ 767,928	\$ 723,596
Indirect Revenue	2,675	(5,072)	1,664	5,356
Indirect Expenses				
Public Information	5,759	6,572	6,542	10,766
Market Research	702	536	292	1,788
Salaries & Benefits	56,654	53,763	54,164	61,773
Services & Supplies	15,719	13,564	13,581	33,391
Depreciation	2,834	2,867	2,616	3,125
Interest Expense	-	321	437	376
Total Indirect Expenses	81,668	77,623	77,632	111,219
Net Profit	\$ 644,489	\$ 660,244	\$ 691,960	\$ 617,733
<i>Administrative Expense % (Revenue)</i>	<i>3.1%</i>	<i>3.0%</i>	<i>3.1%</i>	<i>3.5%</i>
<i>Administrative Expense % (Net Revenue)</i>	<i>36.1%</i>	<i>35.6%</i>	<i>35.8%</i>	<i>41.6%</i>

Actual administrative expenses as compared to total lottery revenues have been between 3.0% and 3.1% in each of the last three fiscal years, considerably less than the 16% maximum allowed. However, administrative expenses as compared to net lottery revenues after deduction of prizes has averaged 35.8% over the last three fiscal years.

The contingency reserve is intended to provide funds to cover operating expenses during revenue fluctuations and a balance for capital expenditures. The Lottery Commission approved the current contingency reserve of \$100 million in May 2014, an increase over the previous target reserve of \$85 million, though the amount has varied over time depending on Lottery's operating, equipment, and facility needs. The Lottery reports that it has utilized the reserve balance in previous years to cover administrative expenses at times when sales revenues

decreased, including the Great Recession of 2008 and as a result of the ban on workplace smoking expansion to bars and restaurants in 2009. In addition, Lottery has noted that the contingency has been used to replace gaming systems and equipment. At the close of fiscal year 2018, the \$100 million contingency reserve was fully funded, and Lottery had an additional \$65 million in reserves remaining from the Video Lottery Technology Modernization Program investments that has been committed by the Lottery Commission to new revenue initiatives, including sports and digital gaming. The Video Lottery Technology Modernization Program was completed during 2018 and Lottery’s ongoing plan is to replace 1/6 of video lottery terminals (VLTs) each year. New revenue initiatives are expected to cost \$105 million over the next three to four years. An additional \$10 million of 2018 administrative savings has been also been reserved and committed to revenue initiatives, with the remaining \$30 million anticipated to be funded through annual operating expenditures.

After 2019 budgeted expenditures, the Lottery projects an ending contingency reserve balance of \$85.5 million, with \$53.3 million in additional reserves committed to strategic initiatives. As the contingency balance is expected to be under the \$100 million target, Lottery is not anticipating making additional administrative action transfers in 2020. Administrative actions totaled \$0.9 million in the 2015-17 biennium and are anticipated to total \$47.8 million in the 2017-19 biennium. Actual administrative action transfers in the current and prior four biennia are provided in following table.

Oregon State Lottery Administrative Actions (\$ in thousands)					
	2009-11	2011-13	2013-15	2015-17	2017-19 ¹
Administrative Savings and Contingency Transfers	\$ 29,305	\$ 8,005	\$ -	\$ 918	\$ 47,814

1 - Administrative actions as of December 2018

The Lottery calculates the annual distribution of revenues to prizes, public purposes, and administrative expenses to ensure compliance with the constitutional and statutory provisions that require at least 84% percent of the total annual revenues be returned to the public through prizes and net revenues benefiting public purposes and that at least 50% of the total annual revenues be returned to the public in the form of prizes. Amounts earned and accrued to the EDF during the last quarter of the fiscal year are not transferred until the following fiscal year, which results in a difference between amounts accrued and actual cash transfers of unobligated net lottery proceeds. As reported in the Lottery’s annual financial statements for the last three years, the distribution of revenues has averaged 91.3% to prizes, 5.4% in earnings and unclaimed prizes transferred to the EDF, with the remaining 3.2% being used for administrative expenses and reserves. For purposes of the public transfer rate calculated below, actual cash transfers during the fiscal year have been compared to actual revenues, resulting in an average of 5.5% transferred to the EDF annually. Lottery earnings transfers include any administrative action transfers.

Oregon State Lottery
Public Purpose Transfer Rate
(\$ in thousands)

	FY 2016 Actual	FY 2017 Actual	FY 2018 Actual
Lottery Earnings Transfers	\$ 567,389	\$ 657,297	\$ 720,033
Unclaimed Prizes	5,536	5,128	6,054
Total EDF Transfers	\$ 572,925	\$ 662,425	\$ 726,087
<i>Public Purpose Transfer %</i>	4.8%	5.6%	6.1%

In 1985, the Attorney General issued an opinion that the constitutional provisions approved by voters prohibited the Legislature from limiting the expenditures of the Lottery. Legislative Counsel has concluded that the Constitution does allow the Legislature, within limits, to impose expenditure limitations on the Lottery, to establish terms on Lottery contracts, and to limit the number of Commission employees. However, the establishment of any budgetary limits may not prevent the Lottery from meeting its constitutional obligation to operate. Additionally, as the entity responsible for operations, Lottery’s assessment of what needs to be spent to operate a lottery must be given considerable weight. While the constitutional provision limits the Lottery’s operating expenses to no more than 16% of revenues, Legislative Counsel believes that the Constitution probably does not prohibit the Legislature from enacting statutes that would require the Lottery to spend less than 16% or limit contingency reserve deposits. Currently, under statute, the Lottery functions as a semi-independent agency, with no legislative oversight of budget, expenditures, or staffing. As noted earlier, if the Legislature were to modify such statutes, any restrictions imposed could not impede the ability of the Lottery to operate.