

# Legislative Fiscal Office

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## Budget Information Brief / 2020-4

### Lottery Funds Allocation Reductions

Lottery revenues are transferred from the Oregon State Lottery (Lottery) to the Department of Administrative Services (DAS) and deposited in the Administrative Services Economic Development Fund (EDF) each quarter. DAS distributes these funds in accordance with the constitutional distributions (Education Stability Fund, Parks and Natural Resources Fund, and Veterans' Services Fund) and statutory allocations. After transferring the 34.5% of net lottery proceeds that are constitutionally dedicated, DAS distributes net proceeds available in the EDF to recipients of statutorily approved allocations based on a quarterly allocation plan. If net lottery revenues are insufficient pay the quarterly allocation amounts, DAS is required to fund debt service on outstanding lottery revenue bonds, and then reduce remaining statutory allocations proportionately. This authority allows DAS to address lottery revenue shortfalls while maintaining constitutionally dedicated transfers and prioritizing lottery revenue bond debt service payments. DAS is also required to proportionately reduce lottery allocations from the Veterans' Services Fund (VSF) if transfers are insufficient to meet approved allocation amounts. During a revenue shortfall, agencies receiving an allocation of Lottery Funds may make administrative reductions to remain within available revenues. The Legislature can also modify the amount of statutory allocations in a special or regular session to rebalance the overall Lottery Funds budget.

#### **Constitutional and Statutory Lottery Allocations**

The Lottery collects revenues from traditional, sports betting, and video lottery gaming. After payment of prizes and administrative expenses, the Lottery transfers net lottery revenues to the EDF, established under ORS 461.540, each quarter. Article XV, Section 4 of the Oregon Constitution restricts the use of net lottery revenues to the creation of jobs, economic development, public education, state parks, watershed enhancement, and veterans' services. The Constitution also requires that a portion of net lottery revenues be transferred to three restricted funds:

- Education Stability Fund (18%) <sup>1</sup>
- Parks and Natural Resources Fund (15%)
- Veterans' Services Fund (1.5%)

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<sup>1</sup> Transfers to the Education Stability Fund (ESF) are suspended if the ESF balance exceeds 5% of General Fund revenues in the prior biennium. Until the ESF balance is reduced below the 5% threshold, a transfer equal to 15% of net lottery proceeds is deposited in the School Capital Matching Fund to match school district capital expenditures.

Oregon statute establishes the following six additional transfers of net lottery proceeds:

- 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%)
- County fair programs (1%, up to a maximum of \$1.53 million annually adjusted for inflation)
- Match for qualifying employer lump-sum payments to the Public Employees Retirement System Employer Incentive Fund (100% of net proceeds from sports betting games)

In addition to constitutional and statutory dedications of net lottery revenues, the state has issued lottery revenue bonds for both state and local 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.

Each biennium, the Legislature approves allocations of net lottery proceeds from the EDF and VSF in a lottery allocation bill to finance programs approved in the state budget.<sup>2</sup> Lottery transfers established by the Oregon Constitution may not be modified by the Legislature and no allocation is required or approved in the lottery allocation bill. The six existing statutory dedications of net lottery proceeds may be modified by the Legislature and are typically approved as fixed amounts each session in the lottery allocation bill. Other legislative allocations are approved for agencies and programs within authorized public purposes, including education and economic development, as well as for debt service payments on outstanding lottery revenue bonds.<sup>3</sup> Allocation amounts are approved in the odd numbered year session based on the DAS Office of Economic Analysis' (OEA) May revenue forecast of lottery resources for the biennium. Statutory allocations may subsequently be adjusted during even numbered year sessions or in a special session. Historically, the Legislature has retained a projected ending balance in the EDF for additional Lottery Funds expenditures during the biennium (e.g., compensation plan changes) and to protect against allocation reductions due to future lottery revenue declines.

### **Quarterly Lottery Allocation Distribution Plan**

Each quarter, DAS transfers the 34.5% of net lottery revenues that are constitutionally dedicated to the respective funds. Statutory allocations, however, are distributed based on a quarterly allocation plan. The lottery allocation bill includes a provision that requires DAS to establish a process for allocating monies in the EDF and VSF on a quarterly basis to fulfill the biennial allocation amounts.<sup>4</sup> While the budget and approved allocation amounts are based on the projection of lottery revenues for the biennium, only the *actual* net lottery revenues received are transferred each quarter. Therefore, the quarterly allocation plan must consider the timing of expenditures and ensure sufficient cash flow during the biennium. Considering that Lottery Funds expenditures may not be even throughout the biennium, the amount

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<sup>2</sup> The lottery allocation bill also includes allocations from the Criminal Fine Account and Oregon Marijuana Account, which are beyond the scope of this budget brief.

<sup>3</sup> The six dedications of lottery proceeds specified in statute, as well as other allocations approved each biennium by the Legislature, are referred to as statutory allocations.

<sup>4</sup> For the 2019-21 biennium, this provision is established in section 7(1), chapter 670, Oregon Laws 2019 for EDF allocations and section 14(1), chapter 670, Oregon Laws 2019 for VSF allocations.

distributed for each approved allocation is not always even over the eight quarters of the biennium. For example, annual debt service on lottery revenue bonds is required to be deposited into the Debt Service Fund in two equal installments from the transfers made to the EDF in July and October.

In addition to quarterly net lottery revenue transfers, the EDF balance includes interest earned on the fund and reversions of net lottery proceeds. ORS 461.559 requires certain lottery allocations that remain uncommitted and unspent at the end of a biennium to be reverted to the EDF. As noted earlier, the Legislature considers a projected EDF balance when allocating net lottery proceeds; however, the actual balance in the fund may vary due to actual transfers, interest earnings, and reversion amounts. If any funds remain undistributed at the end of a quarter, they remain in the EDF and are available to meet future quarterly allocations. Similarly, the VSF balance also includes interest earned on and reversions of allocations from the VSF.

### **DAS Lottery Allocation Reductions Authority**

The constitutional dedications receive a percentage of actual net revenues transferred from the Lottery and the amounts transferred to these three funds change in direct proportion to revenue changes. Although the constitutionally dedicated transfers adjust automatically, any decrease in the Lottery Funds expenditure limitation included in the legislatively approved budget for expenditures from these funds requires legislative action.

If net lottery revenues and balances are insufficient to pay the quarterly statutory allocation amounts, DAS is required to fund debt service on outstanding lottery revenue bonds, and then reduce remaining statutory allocations proportionately. Allocation reductions must be sufficient to resolve the revenue shortfall and each allocation must be reduced by the same percentage by the end of the biennium. Since allocations are not distributed evenly over the biennium, DAS may reduce the quarterly allocations based on the amount scheduled to be distributed each quarter, provided that by the eighth quarter of the biennium, each allocation has been reduced proportionately. DAS' authority to use available lottery resources to satisfy lottery bond debt service and reduce the remaining statutory allocations is included in the biennial lottery allocation bill.<sup>5</sup> This provision aligns with the priority placed on debt service by the Constitution and provides a mechanism to distribute lottery allocations from the EDF and VSF in quarters when actual net lottery revenues are not sufficient to support the allocation amounts in the legislatively approved budget. The authority for DAS to proportionately reduce lottery allocations in the event of a lottery revenue shortfall may be compared to the Governor's authority to reduce all General Fund appropriations, subject to the allotment authority, by the same percentage to prevent an officially forecasted General Fund biennial budget deficit.<sup>6</sup>

### **Effect of Lottery Allocation Reductions**

Allocation reductions implemented by DAS decrease the actual net lottery proceeds received by lottery allocation recipients. The action does not change the corresponding Lottery Funds expenditure limitation in an agency's legislatively approved budget or propose specific cuts to programs. However, the decrease in net lottery proceeds (i.e., cash) distributed impacts the

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<sup>5</sup> For the 2019-21 biennium, this provision is established in sections 7(2) and 7(3), chapter 670, Oregon Laws 2019 for the EDF and section 14(2), chapter 670, Oregon Laws 2019 for the VSF.

<sup>6</sup> See LFO budget brief #2020-2 "Governor Allotment Reduction Authority" at <https://www.oregonlegislature.gov/lfo/Documents/2020-2%20Governor%20Allotment%20Reduction.pdf>

ability of recipients to operate Lottery funded programs at the level approved in the budget and must be administratively managed by the respective agencies and entities, similar to actions taken to address Other Funds revenue shortfalls. Depending on the level of reduction, reduced allocations may be temporarily managed by utilizing existing balances and other available funding sources but will eventually result in cuts to programs and services. Additionally, while DAS does not have the discretion to reduce allocations disproportionately, the agency does have the authority to modify the quarterly allocation plan. Adjusting the amounts scheduled to be distributed for allocations in each quarter of the biennium provides DAS with a limited ability to manage allocation reductions. However, the modified quarterly allocation plan must still allow DAS to fulfill the biennial allocation amounts, with each allocation proportionately reduced to accommodate the revenue shortfall.

The release of subsequent OEA lottery revenue forecasts throughout the biennium will not change the lottery allocation amounts distributed in prior quarters. However, if actual net lottery revenues transferred to the EDF and VSF are sufficient through the remainder of the biennium, the amounts distributed each quarter will be adjusted to meet the amount of the allocation approved in statute (i.e., future quarter distributions would be increased). If net lottery revenues are not sufficient over the course of the biennium to meet debt service and the full amount of approved allocations, the amounts distributed in future quarters will be reduced to the extent of the actual lottery revenue shortfall for the biennium.

### **DAS Allocation Reductions versus Legislative Reductions**

The Legislature may modify statutory lottery allocation amounts in any manner during a regular or special session to achieve a balanced Lottery Funds budget. The Legislature may consider actual reductions to Lottery funded agencies and programs, including the elimination of positions or full-time equivalents, decreases in agency services and supplies, and reduced levels of special payments for grants and pass-through funding. Approved lottery allocations will be adjusted accordingly. In addition, the Legislature may minimize the impact of reductions through fund-shifts (i.e., shifting the cost of Lottery funded expenditures to another fund source) and the use of reserve funds. While the Legislature must consider the lottery allocations distributed to recipients to date, approved adjustments to statutory allocations essentially negate the proportionate reduction that DAS has previously applied. Future quarterly allocations will be distributed in accordance with the revised allocations amounts that achieve a balanced Lottery Funds budget, provided that actual lottery revenues do not decrease below the level projected at the time of the legislative rebalance. It is important to note that the Emergency Board is not authorized by law to modify lottery allocation amounts, nor reduce corresponding Lottery Funds expenditure limitation, and therefore cannot rebalance the Lottery Funds budget.<sup>7</sup>

### **2019-21 Lottery Allocation Reductions**

The closure of restaurants, bars, and taverns on March 17, 2020 in response to the COVID-19 pandemic and subsequent inactivation of video lottery terminals significantly impacted available lottery revenues for the 2019-21 biennium. This immediate decline in net lottery revenues resulted in the reduction of Lottery Funds allocations under DAS' administrative authority. DAS implemented reductions to the 2019-21 fourth quarter EDF lottery allocations

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<sup>7</sup> See LFO budget brief #2017-2 "Legislative Session and Interim Budget Authorities" at <https://www.oregonlegislature.gov/lfo/Documents/2017-2%20Legislative%20Budget%20Authorities.pdf>

(for the quarter ending March 31) distributed in May 2020. While the fourth quarter Lottery transfer was approximately 86% of the amount originally projected, the fifth quarter transfer was anticipated to be significantly less since video lottery proceeds were originally projected to make up over 85% of expected lottery transfers to the state.

Every statutory allocation (excluding debt service) that received a fourth quarter distribution from the EDF was reduced by 50%. DAS modified the quarterly allocation schedule for the State School Fund (SSF) to minimize the severity of the reductions to the other Lottery funded agencies and programs, delaying the amount of Lottery Funds originally scheduled to be distributed to the SSF in the fourth quarter to later in the biennium. This resulted in a corresponding adjustment to the General Fund allotment schedule for the SSF, with an increase in the General Fund allotted in the fourth quarter by 50% of the originally scheduled fourth quarter lottery allocation to the SSF. These actions were necessary to ensure that there would be sufficient funds available in the EDF to pay debt service owed on the state's lottery revenue bonds in the fifth and sixth quarters, as required by statute and lottery bond covenants.

In its June 2020 quarterly revenue forecast, OEA projects that 2019-21 biennium lottery resources will total \$338.6 million (or 22.1%) less than what was forecasted when the 2019-21 biennium Lottery Funds budget was adopted. The forecast projects that the \$743.6 million of lottery allocations subject to DAS lottery allocation reductions in the 2019-21 biennial budget would need to be reduced by \$202.6 million (or 27.2%) to avoid a deficit in the EDF.