

Legislative Fiscal Office

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Budget Information Report

Oregon State Lottery Administrative Costs and Public Purpose Transfer Rate

Oregon State Lottery revenues are utilized to fund expenditures in the legislatively approved budget that support the public purposes of lottery proceeds specified in the Oregon Constitution. Constitutional provisions also limit the State Lottery's operating expenses to 16% of annual revenues and require that 84% of total lottery revenues be returned to the public as either prizes or net proceeds that benefit allowable public purposes, including economic development, public education, and parks and natural resources. Prior to the beginning of each odd-numbered year regular session of the Legislative Assembly, the Legislative Fiscal Office (LFO) is required to conduct a study that reports the preceding two year's administrative costs and the transfer rate of the Oregon State Lottery, in order to determine if additional funds may be made available for public purposes. Lottery's administrative costs as a percentage of revenues for fiscal years 2019 and 2020 were 3.1% and 3.4%, respectively, and actual public purpose transfers averaged 5.9% of direct revenues in the prior two years.

Lottery Revenues

Lottery revenues are generated through traditional, sports betting, 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 State 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 the following dedicated transfers:

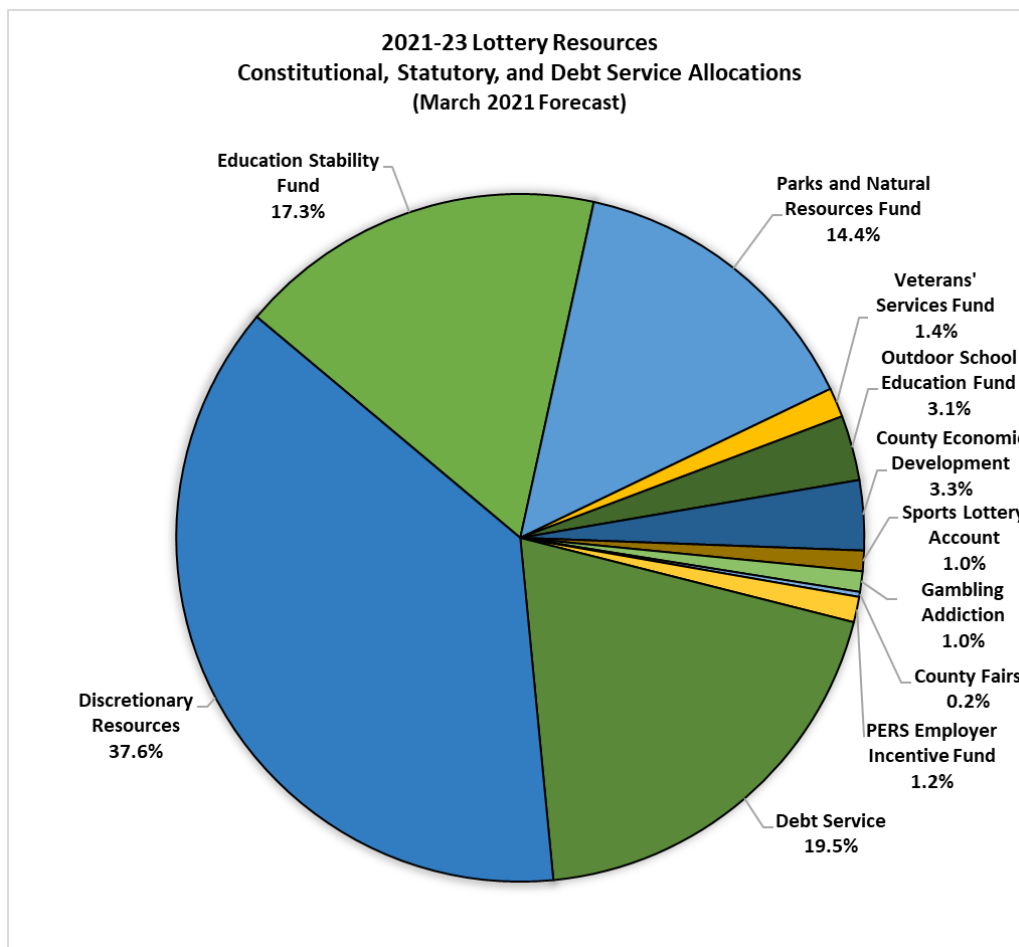
- Education Stability Fund (18%)¹
- Parks and Natural Resources Fund (15%)
- Veterans' Services Fund (1.5%)

¹ Transfers to the ESF are suspended if the ESF balance exceeds 5% of General Fund revenues in the prior biennium. Instead, 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 dedications 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), and
- match for qualifying employer lump-sum payments to the Public Employees Retirement System Employer Incentive Fund (net proceeds of sports betting games).

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. Lottery revenue bonds have a four-times coverage ratio requirement; in order for the state to issue additional lottery revenue bonds, annual debt service payments may not exceed 25% of net lottery revenues. 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 following chart reflects the constitutional and statutory allocations of total 2021-23 lottery resources based on the Office of Economic Analysis March 2021 revenue forecast:



Administrative Costs

The following table includes actual revenue and expenditure data reported by the Lottery for fiscal years 2018, 2019, and 2020², as well as the approved budget for 2021:

Oregon State Lottery				
Statement of Profit & Loss - Budgetary (Non-GAAP) Basis				
(\$ in thousands)				
	FY 2018 Actual	FY 2019 Actual	FY 2020 Actual	FY 2021 Approved Budget
Revenue	\$ 12,359,850	\$ 12,995,202	\$ 10,904,148	\$ 9,718,891
Prizes	11,284,939	11,883,643	9,980,613	8,890,220
Net Revenue	\$ 1,074,911	\$ 1,111,558	\$ 923,535	\$ 828,671
Direct Expenses				
Commissions	245,681	254,277	217,920	189,777
Game Vendor Charges	8,440	8,558	12,496	19,786
Tickets	3,043	2,923	3,399	3,317
Advertising	10,814	7,448	7,678	7,901
Sales Support	966	1,221	606	689
Game Equip / Parts & Maint	6,766	5,912	8,384	8,631
Depreciation	31,273	32,237	21,905	21,209
Total Direct Expenses	306,983	312,577	272,389	251,311
Gross Profit	\$ 767,928	\$ 798,981	\$ 651,146	\$ 577,360
Indirect Revenue	1,664	17,229	21,628	9,000
Indirect Expenses				
Public Information	6,542	9,026	4,369	1,998
Market Research	292	903	374	503
Salaries & Benefits	54,164	64,192	65,613	58,334
Services & Supplies	13,581	17,540	27,117	18,906
Depreciation	2,616	2,526	3,062	3,431
Interest Expense	437	376	311	300
Total Indirect Expenses	77,632	94,563	100,846	83,472
Net Profit	\$ 691,960	\$ 721,647	\$ 571,928	\$ 502,888
<i>Administrative Expense % (Revenue)</i>	3.1%	3.1%	3.4%	3.4%
<i>Administrative Expense % (Net Revenue)</i>	35.8%	36.6%	40.4%	40.4%

Actual administrative expenses as compared to total lottery revenues were 3.1% in fiscal years 2018 and 2019 and increased to 3.4% in fiscal year 2020. Operating expenses as a percentage of revenue increased due to the pandemic-related decline in lottery revenues in fiscal year 2020. Fourth quarter lottery sales were significantly impacted by the COVID-19 pandemic and resulting restrictions that led to the closure of lottery retailers. Lottery implemented expenditure reductions to ensure that administration costs remained below the 16% constitutional limit. Additionally, the fiscal year 2021 budget was adopted based on the June 2020 revenue forecast and continued the lower level of operations spending. As restrictions have been lifted, lottery revenues have recovered more quickly than projected, and despite

²Actual FY18, FY19, and FY20 financial statement data from the Oregon State Lottery's annual audited Comprehensive Annual Financial Reports.

additional pandemic-related retailer closures beginning in November 2020, forecasted 2021 lottery sales have increased 34% since the budget was adopted.

Lottery maintains a contingency reserve to provide funds to cover operating expenses during revenue fluctuations and a balance for necessary investments in infrastructure to generate revenue and support operations. The Lottery Commission approved the current target 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. 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 independently 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, LFO, and Legislative Revenue Office (LRO).

At the close of fiscal year 2020, the contingency reserve balance was \$73.1 million, a decrease of \$24.2 million from the balance at June 30, 2019. Lottery utilized the reserve balance during the year to sustain operations as sales revenues decreased. An additional \$60.5 million is also maintained in an investment fund reserve to support modernization projects and strategic initiatives. The fiscal year 2021 budget includes a total of \$27.2 million in spending from the investment fund for modernization projects. As the contingency balance is under the \$100 million target, and uncertainty stemming from the ongoing pandemic remains, Lottery is not anticipating making any administrative action transfers to the EDF in 2021. Administrative actions totaled \$0.9 million in the 2015-17 biennium and \$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)					
	<u>2011-13</u>	<u>2013-15</u>	<u>2015-17</u>	<u>2017-19</u>	<u>2019-21</u>
Administrative Savings and Contingency Transfers	\$ 8,005	\$ -	\$ 918	\$ 47,814	\$ -

Public Purpose Transfer Rate

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, 5.5% 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 direct revenues, resulting in an average of 5.9% transferred to the EDF annually. Lottery earnings transfers include any administrative action transfers.

Oregon State Lottery			
Public Purpose Transfer Rate			
(\$ in thousands)			
	FY 2018	FY 2019	FY 2020
	<u>Actual</u>	<u>Actual</u>	<u>Actual</u>
Lottery Earnings Transfers	\$ 720,033	\$ 723,187	\$ 692,286
Unclaimed Prizes	<u>6,054</u>	<u>6,956</u>	<u>6,558</u>
Total EDF Transfers	<u>\$ 726,087</u>	<u>\$ 730,143</u>	<u>\$ 698,844</u>
<i>Public Purpose Transfer %</i>	<i>5.9%</i>	<i>5.6%</i>	<i>6.4%</i>