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MEMORANDUM

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February 8, 2007

TO: Interested Persons

FROM: Ron Kirk, Research Associate, 303-866-4785

SUBJECT: Colorado Lottery Distributions, Revenues, and Expenditures

This memorandum responds to your request for information on Colorado Lottery distributions, ticket sales, prize money, operating expenses, and the specific use of Powerball revenue for capital construction purposes.

Summary

Colorado is one of 42 states and the District of Columbia that has established a lottery and one of 31 states having Powerball. The Colorado Lottery is entering its 24th year of operation and since its inception in 1983 has distributed \$1.6 billion in proceeds to beneficiaries.

State law requires that total disbursements for lottery prizes be no less than 50 percent of lottery ticket sales revenue. During FY 2005-06, ticket sales revenue was \$468.8 million, of which lottery prizes for all games amounted to \$281.6 million or about 60 percent of revenue. All remaining proceeds *after prizes and expenses* are constitutionally allocated as follows: 40 percent to the Conservation Trust Fund; 50 percent to the Great Outdoors Colorado Trust Fund (GOCO); and 10 percent to the Colorado Division of Parks and Recreation. Distributions to GOCO are capped at \$35 million (adjusted for inflation). The remaining portion of this share is earmarked for school district capital construction. Proceeds to beneficiaries for FY 2005-06 were \$125.6 million or about 27 percent of total lottery ticket sales.

The remaining 13 percent of revenue was spent on operating expenses such as retailer commissions and bonuses, ticket costs and vendor fees, marketing and communications functions, wages, benefits, and other expenses to run and administer the lottery.

Summary (continued)

The lottery revenue earmarked for school district capital construction, \$12.6 million in FY 2005-06, must be used to remedy health and safety issues in public schools. No other lottery money is currently distributed for capital construction, however, \$439.8 million was distributed for capital construction between FY 1982-83 and FY 1998-99. Amendment 8 in 1992, the Great Outdoors Colorado (GOCO) Amendment to the Colorado Constitution (Article XXVII), eliminated the distribution for capital construction.

Colorado Lottery

Forty-two states including Colorado and the District of Columbia have established state lotteries. Although there is no national lottery in the United States, 31 of the states having lotteries have Powerball lotteries.

The Colorado Lottery Commission within the Department of Revenue was created to promulgate the rules that govern the operation of the Colorado Lottery (Section 25-35-207, C.R.S.). Data from the Department of Revenue indicates that since the lottery's inaugural year in 1983, total net proceeds to beneficiaries amounted to \$1.6 billion. After commission expenses, which include prize money, distributions are primarily used for state and local parks, recreation, and open space purposes.

History of distributions. The original distribution formula in FY 1982-83 allocated 50 percent of the Lottery Fund (less prizes and expenses) to the Capital Construction Fund. In November 1992, the passage of the Great Outdoors Colorado (GOCO) Amendment phased out the distribution to the Capital Construction Fund. In November of 1999, the fund received its last payment of \$11.1 million. Between FY 1982-83 and FY 1998-99, distributions from lottery proceeds to the Capital Construction Fund amounted to \$439.8 million.

Prior to 1992, the General Assembly determined the distribution of Lottery Fund moneys. In November 1992, Colorado's voters approved the Great Outdoors Colorado (GOCO) Amendment to the Colorado Constitution (Article XXVII). The amendment mandated the distribution of net proceeds (less prizes and expenses) as follows: 40 percent to the Conservation Trust Fund; 10 percent to the Division of Parks and Outdoor Recreation; and 50 percent to the Great Outdoors Colorado (GOCO) Trust Fund. The amendment limits the annual distribution to the GOCO fund to \$35 million, adjusted for inflation using 1992 as the base year. Prior to 2000, money that exceeded the GOCO cap was transferred to the General Fund.

In November 2000, voters approved Referendum E, which allows the lottery to participate in multi-state games such as Powerball. The passage of this measure earmarked lottery moneys that were initially distributed to the General Fund (GOCO spillover money) for health and safety issues in public schools. Graph 1 shows how lottery proceeds were distributed from the first year of operation to the present. Over the course of 24 years, the lottery distributed over \$1.6 billion to

beneficiaries. The Conservation Trust Fund received the largest amount of revenue at \$605.2 million which made up about 37 percent of all benefits paid out.

Graph 1: Lottery Distributions (\$1.6 billion)
FY 1982-83 through FY 2005-06

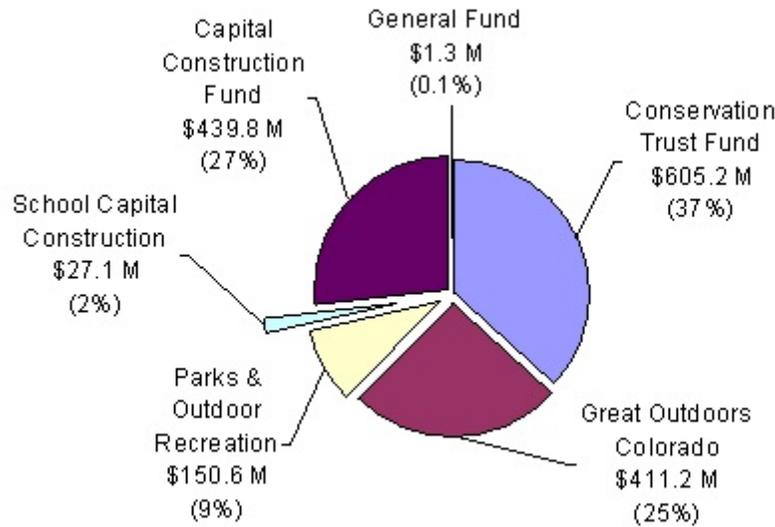


Table 1 provides three-years worth of data for distributions from FY 2003-04 through FY 2005-06. Total distributions were \$333.3 million over this period. The distribution to GOCO over this period is about 45.0 percent of total distributions rather than the 50 percent requirement in the amendment. This results from the Referendum E spillover provision that directs GOCO spillover revenue to school district capital construction after the GOCO cap (\$35 million adjusted for inflation from 1992) is exceeded.

Table 1: Lottery Distributions (\$333.3 million)
FY 2003-04 through FY 2005-06
(in millions)

Distribution	FY 2003-04	FY 2004-05	FY 2005-06	3-year Total	3-year % of Total
Conservation Trust Fund	\$41.6	\$41.5	\$50.2	\$133.3	40.0%
GOCO	49.6	50.1	50.2	149.9	45.0%
Parks and Outdoor Recreation	10.4	10.4	12.6	33.4	10.0%
School Capital Issues	2.6	1.7	12.6	16.7	5.0%
Totals	\$104.0	\$103.7	\$125.6	\$333.3	100.00%

Source: Colorado Department of Revenue.

Lottery ticket sales. The lottery sells scratch game tickets and three online games — Cash 5, Lotto, and Powerball. The scratch game was the only game offered from 1983 through 1988. In 1988, the first online game, Lotto, was authorized by Senate Bill 97 and ticket sales began in 1989.

Other online games were introduced beginning with Keno in 1991. Cash 5 was added in 1996 and Powerball in 2001. Keno was discontinued in 1998.

Financial highlights and Powerball. Lottery ticket sales totaled \$468.8 million for FY 2005-06, which is the largest amount of revenue generated from ticket sales in the lottery's 24-year operating history. Fiscal Year 2005-06 ticket sales were up 12.4 percent or \$51.8 million over the prior year's sales of \$417.0 million. Despite the fact that scratch ticket sales hit a record high for the third year in a row, Powerball sales growth for FY 2005-06 soared to \$119.8 million from \$80.9 million (48.1 percent increase) in the prior year. A programming change made in August 2005 allowed the Powerball jackpot to reach record highs of \$340 and \$365, million which contributed to the growth in Powerball sales.

Powerball and funding for capital construction. As was previously noted, lottery revenue was used to fund capital construction through FY 1998-99. A total of \$439.8 million was distributed for capital construction. Currently, only money earmarked for school capital purposes is used for capital construction. Powerball revenue was first collected and distributed in FY 2001-02 and amounted to \$79.9 million. Powerball revenue is distributed in the same manner that all other game revenue is distributed. As an example, in FY 2001-02, or the first year that Powerball contributed to total distributions, \$8.5 million of \$110 million of total distributions went to school capital construction to remedy health and safety issues in public schools. Total revenue distributed for school capital construction since the initial transfer was made in FY 2001-02 is \$27.1 million.

Sales and distributions. From FY 2003-04 through FY 2005-06, distributions to the Conservation Trust Fund, Great Outdoors Colorado, Parks and Recreation, and school district capital construction ranged from \$104.7 million in FY 2003-04 to \$125.6 million in FY 2005-06. In FY 2005-06, lottery distributions of \$125.6 million were 26.8 percent of total lottery sales, growing by 21.1 percent over the prior year's distributions of \$103.7 million. Table 2 summarizes recent data for lottery ticket sales and distributions.

Table 2: Lottery Ticket Sales and Distributions
FY 2002-03 through FY 2004-05
(in millions)

Game	FY 2003-04	FY 2004-05	FY 2005-06	% Change (FY 2005-06 over FY 2004-05)
Cash 5	\$14.5	\$15.1	\$16.9	11.9%
Lotto	40.8	38.3	38.3	0.0%
Powerball	85.0	80.9	119.8	48.1%
Scratch	260.9	282.7	293.0	3.9%
Total Ticket Sales	\$401.2	\$417.0	\$468.0	12.4%
Distributions	\$104.7	\$103.7	\$125.6	21.1%
Distributions as % of Ticket Sales	25.9%	24.9%	26.8%	N/A

Source: Colorado Department of Revenue.

Prize money. State law requires that total disbursements for lottery prizes shall be *no less than 50 percent* of the total revenue accruing from the sale of lottery tickets or shares (Section 24-35-210 (9), C.R.S.). According to the Colorado State Auditor, prize money is the largest category of expenses and has grown steadily over the years. For FY 2005-06, lottery prizes for all games amounted to over 60 percent of total lottery revenue. Lottery prize money as a percentage of lottery ticket sales differ by game. Table 3 compares prize money to ticket sales for FY 2005-06. Scratch games have the largest sales volume and payback in terms of prize money (65.9 percent).

Table 3: Prize Money and Ticket Sales
FY 2005-06

Game	Cash 5	Lotto	Powerball	Scratch	Total
Prize Money	\$8,783,953	\$22,875,469	\$56,215,803	\$193,719,020	\$281,594,245
Ticket Sales	\$16,858,542	\$38,332,996	\$119,757,642	\$293,812,628	\$468,761,808
Prize Money as % of Ticket Sales	52.1%	59.7%	46.9%	65.9%	60.1%

Source: Colorado Lottery

Direct and other operating expenses. Direct operating expenses consist of prize money and game-related expenses that directly support lottery games. Aside from prize money, which is the lottery's largest direct operating expense, there are other game-related expenses such as retailer commissions and bonuses. Retailer commissions are based on the individual retailer's sales, the number of winning tickets cashed, and the retailer's compliance with a marketing sales agreement. Retailers receive a bonus when they meet specified marketing standards. In addition, game-related expenses include costs for purchasing scratch tickets and vendor compensation for maintenance and support of the online gaming system (ticket costs and vendor fees).

Other operating costs that are not game-related consist of: marketing and communications expenses; wages and benefits for lottery employees; and other administrative operating expenses. Marketing and communications activities include public relations, product management, advertisement displays, research, Web site management, media advertising, and other expenses related to marketing such as sponsorships, promotions, event marketing, and giveaways.

Summary data. Table 4 provides a summary for direct and other operating expenses, total beneficiary distributions, and total ticket sales for FY 2004-05 and FY 2005-06. For FY 2005-06, direct operating expenses for prizes were 60.1 percent of total lottery revenue. Other game-related expenses for retailers, ticket costs, and vendor fees increased this percentage another 9.5 points to 69.6 percent of total revenues. Additional marketing and administrative costs brought total operating expenses and prize money to 73.2 percent of total sales. Distributions to beneficiaries for this same time period made up 26.8 percent of total lottery revenue or about \$125.6 million of \$417.0 million.

Table 4: Lottery Expenses, Distributions, and Ticket Sales
 FY 2003-04 and FY 2004-05
(in millions)

Direct Operating Expenses	FY 2004-05	% of Total Sales	FY 2005-06	% of Total Sales
Prizes	\$249.5	59.8%	\$281.6	60.1%
Retailer Commissions	27.8	6.7%	31.0	6.6%
Bonus	3.9	0.9%	3.6	0.8%
Tickets Costs and Vendor Fees	9.9	2.4%	9.7	2.1%
Sub Total	\$291.1	69.8%	\$326.0	69.6%
Other Operating Expenses	FY 2004-05	% of Total Sales	FY 2005-06	% of Total Sales
Marketing and Communications	8.6	2.1%	8.9	1.9%
Wages and Benefits	7.9	1.9%	8.2	1.7%
Other Operating Expenses	6.0	1.4%	3.6	0.8%
Sub Total	\$22.5	5.4%	\$20.7	4.4%
Summary	FY 2004-05	% of Total Sales	FY 2005-06	% of Total Sales
Total Operating Expenses (including prize money)	\$336.1	75.1%	\$367.4	73.2%
Total Beneficiary Distributions	\$103.7	24.9%	\$125.6	26.8%
Total Ticket Sales*		*\$401.3		*\$417.0

Source: Colorado Department of Revenue and Colorado Lottery.

*"Total Ticket Sales" revenue reported to the department by the Colorado Lottery is not the sum of "Total Operating Expenses" and "Total Beneficiary Distributions". The Colorado Lottery has other investment revenue earnings along with varying asset balances that factor into revenues and expenditures. Investment revenue and asset balances were omitted because they make up less than 1 percent of the revenue and expenditure totals in the table summary section.