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Lottery Profits Flat; Increasing Retailer Outlets Is Critical to Increasing Sales

at a glance

Growth in Lottery transfers to the Educational Enhancement Trust Fund has leveled off and current forecasts indicate continued slowing of revenue growth due to the economic recession.

The Lottery has taken several steps to maximize its sales and transfers to education, including joining Powerball, adding instant ticket vending machines, and redesigning Lotto. While the Legislature could consider authorizing new games such as video lottery, keno, vending machines for on-line games, and Internet-based games, these options would likely increase associated negative social costs and could conflict with the proposed Indian gaming compact. A more acceptable alternative would be for the Lottery to increase the number of participating retailers, as its market penetration rate is lower than that of other successful state lotteries.

The Lottery's operating expense rate continues to decline, making it among the most efficient U.S. lotteries. It could realize additional efficiencies by continuing to explore ways to reduce costs for leasing office space, providing field support functions, and compensating retailers.

Scope

As directed by the Legislature, OPPAGA examined the Department of the Lottery and assessed options to enhance its earning

capability and improve its efficiency, including alternatives for providing Lottery field support services.¹

Background

Following voter approval of a constitutional amendment, the 1987 Legislature enacted the Florida Public Education Lottery Act. The act created the Department of the Lottery to generate funds for education and to enable the state's citizens to play state operated lottery games. The Lottery provides both on-line and scratch-off games. On-line games allow players to pick from a range of numbers on a play slip. On-line game tickets are printed by terminals that are connected to the Lottery's central computer system for a drawing at a later date. Scratch-off games sell tickets with a latex covering that players scratch-off to determine whether they have won.

The Lottery is headquartered in Tallahassee with nine district offices that serve the dual

¹ Section 24.123, *F.S.*, requires an annual financial audit of the Lottery, which is to include recommendations to enhance the Lottery's earning capability and efficiency. The Joint Legislative Auditing Committee directed OPPAGA to conduct the assessment of Lottery efficiency, while the Auditor General was directed to conduct the required financial audit of the Lottery. Chapter 2009-81, *Laws of Florida*, also directed OPPAGA to examine alternative field support service delivery models and the effectiveness of major advertising and promotional campaigns for lottery games (see OPPAGA Report No. 10-17).

role of providing field support services to retailers and acting as prize redemption and payment centers.² The Lottery's nine district offices sell and redeem tickets and act as a hub for the field support services.

The Lottery generates revenue from the sale of both on-line and scratch-off tickets. The Lottery is self-supporting and receives no general revenue. For Fiscal Year 2009-10, the Legislature appropriated \$139 million and 438 positions for Lottery operations.

Since its inception, the Lottery's core functions to produce, advertise, and sell tickets have been outsourced to retailers and private vendors. To sell Lottery products, the Lottery contracts with a wide range of retailers across the state such as supermarkets, convenience stores, gas stations, and newsstands. Retailers receive commissions for selling Lottery products at a rate of 5% of the ticket price in addition to 1% of the prize value for redeeming winning tickets. Retailers can also receive bonuses for selling select winning tickets and performance incentive payments.

The Lottery procures several major services from private vendors including those below.

- In January 2005, the Lottery entered a six-year contract with GTECH, its on-line gaming system vendor, to provide computer systems, retailer terminals, software, telecommunications, and technical support services.
- In November 2007, the Lottery entered a three-year contract with Machado Garcia-Serra Advertising, Inc., for Hispanic market advertising.
- In October 2008, the Lottery entered a six-year contract with Scientific Games to print, market, and distribute scratch-off game tickets.
- In September 2009, the Lottery entered a three-year contract with St. John & Partners

Advertising and Public Relations Inc., for English market advertising.

In Fiscal Year 2009-10, approximately 66%, or \$91.5 million, of the Lottery's \$139 million appropriation was allocated to pay vendors for advertising and on-line and scratch-off games. Retailer commissions are paid directly from sales revenues and do not appear in the department's appropriation.

Lottery Transfer Performance

In Fiscal Year 2008-09, the Lottery transferred \$1.3 billion to the Educational Enhancement Trust Fund; \$4 million more than in the prior year. The Lottery exceeded its legislatively approved transfer performance standard of \$1.206 billion for Fiscal Year 2008-09 and has reported a primary objective of transferring at least \$1 billion annually to the Educational Enhancement Trust Fund. The department has a long-term goal to increase annual education transfers to \$1.5 billion by Fiscal Year 2012-13.

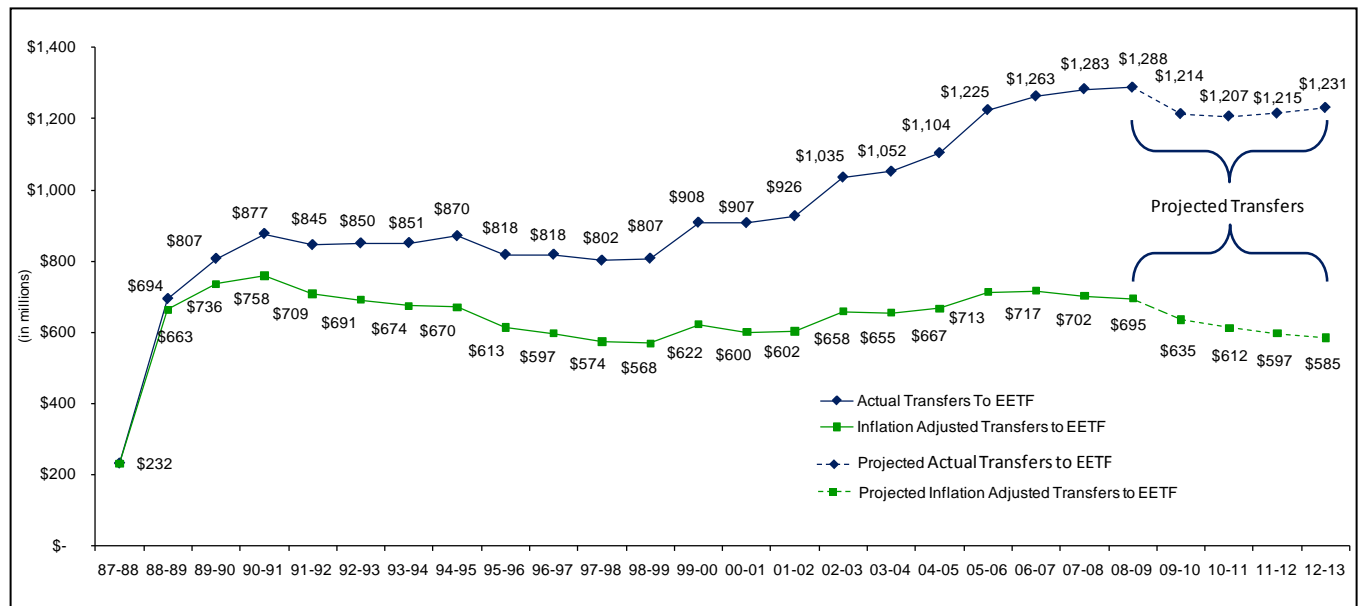
As shown in Exhibit 1, Lottery transfers to education have leveled off, due primarily to the depressed economy that limits consumers' discretionary spending on lottery products. The October 2009 Revenue Estimating Conference projected that Lottery transfers to education will decline by \$75.6 million in Fiscal Year 2009-10 and by about \$7 million in 2010-11 before increasing the following year (see Exhibit 1). These projections indicate that the Lottery must make a concerted effort to increase its transfers or offer a declining value to the state.

The effect of inflation also lowers the purchasing value of the Lottery's transfers to education. As shown in Exhibit 1, inflation adjusted transfers to education has remained relatively flat over the past 20 years and has declined annually since 2006-07. Inflation will continue to erode the value of the Lottery's education transfers unless the Lottery increases the dollar value of the transfers to at least meet the rate of inflation.

² Lottery retailers can pay prizes up to \$599. District offices can pay up to \$250,000 for Florida Lottery prizes and up to \$1 million for Powerball. Prizes exceeding these amounts must be collected at Lottery headquarters in Tallahassee.

Exhibit 1

**Unadjusted Transfers to Education Increased \$4 Million (0.3%) in Fiscal Year 2008-09
But Are Projected to Decline in 2009-10¹**



¹ Projected transfers from the October 14, 2009 Revenue Estimating Conference were adjusted for inflation using a five-year average rate of 1.6%.

Source: OPPAGA analysis of Lottery financial data, Revenue Estimating Conference, October 14, 2009, and U.S. Department of Labor, Bureau of Labor Statistics, Consumer Price Index.

Revenue Enhancement Options

The Lottery has taken several steps in the past year to maintain and increase its sales and transfers to the Educational Enhancement Trust Fund, including joining Powerball, adding instant ticket vending machines, and redesigning its Lotto game. While generally successful, these steps have not reversed the overall trend of relatively flat Lottery transfers to education.

We assessed two strategies the Lottery could implement to increase sales and transfers in future years; both require legislative approval. First, the Lottery could implement additional games that have been used in other states, such as video lottery and a keno game. However, these options would likely increase the negative social costs of gambling and could conflict with the proposed Indian gaming compact (see Appendix A for a list of additional game options). Second, the Lottery could

expand product distribution by adopting new ways of selling lottery tickets and expanding its retailer network, as Florida's market penetration is relatively low compared to other states. Expanding the number of retailers would likely increase sales with relatively low negative social consequences (see Appendix B for a list of additional product distribution options).

The Lottery has launched Powerball, installed vending machines, and redesigned Lotto to maintain sales and transfers. In January 2009, Florida became the 30th state to join Powerball, a multi-state jackpot game. With jackpots starting at \$20 million and increasing with each rollover, Powerball offers players the chance to win large jackpots for \$1 per play.³ Powerball reached sales of \$233.4 million in Florida

³ Between January 4, 2009, and October 15, 2009, Florida has had one player win a \$189 million jackpot, 13 winners at the \$1 million prize level, 49 winners at the \$200,000 level, and a total of more than 8.5 million players winning more than \$275.8 million.

during the last six months of Fiscal Year 2008-09 which translates to approximately \$94.9 million in transfers to education.⁴ The February 2009 Revenue Estimating Conference estimated that 51.9% of Powerball sales were due to a shift in sales from other Lottery products, resulting in an estimated \$45.7 million net transfer to education in Fiscal Year 2008-09. Without the addition of Powerball to the Florida Lottery product mix, Lottery transfers to education would likely have declined about 3% in Fiscal Year 2008-09.

The Lottery has continued to refresh its games to stimulate sales and to ensure an effective product mix. For example, with the addition of Powerball in January 2009, the Lottery concluded that there was no longer a need for Lotto to be designed as a super jackpot game, and it redesigned its add-on feature and launched Lotto Xtra on October 11, 2009. Xtra offers players the opportunity to multiply their non-jackpot winnings by up to five times with \$1 more per play. During the first 16 Xtra drawings, nearly 10% of Lotto players opted to pay the additional dollar, adding \$5.8 million in sales. The Xtra number, from 2 to 5, is drawn at random preceding the Lotto drawing to determine the non-jackpot cash prize multiplier for that draw.

Also, between August and October 2009, the Lottery installed 1,000 instant ticket vending machines across the state at existing retailers to increase scratch-off ticket sales.^{5, 6} Vending machines are used by 29 other U.S. lotteries, producing more than \$2 billion in national sales in 2007-08. The Lottery's first experience using vending machines, which was discontinued in 2002, found that they were cost-effective in only certain locations. The Lottery conducted an instant ticket vending

machine pilot study in 2007 and concluded that the machines were cost-effective in grocery stores, and it has installed the instant ticket vending machines primarily in these locations. During the first 15 weeks, scratch-off weekly sales averaged about \$2,500 per vending machine, and the May 2009 Revenue Estimating Conference projected the net fiscal impact of the vending machines will be \$3.4 million annually after expenses.⁷ In addition to increasing scratch-off ticket sales, the vending machines provide players convenient access to a larger selection of games, transmit sales in real-time, allowing the Lottery to better track ticket sales, and improve retailer operational efficiency.

Some new Lottery products could generate substantial revenues but would represent expanded gambling. There are several options for Lottery games that could attract new players and substantially increase state revenues. For example, Florida could introduce video lottery terminals, which could generate an additional \$404 million to \$648 million in transfers to education, while introducing keno (a quick draw game) could generate between \$64 million and \$358 million in additional transfers.^{8, 9} In Fiscal Year

⁷ Comparing 13 weeks of sales between October 12 and January, 2008 to 2009-10, retailer's with instant ticket vending machine scratch-off sales increased 18% in contrast to a 2% decline in scratch-off sales for all Lottery retailers.

⁸ Fast keno or a quick draw game is an on-line lottery game in which players choose as many as 10 numbers from a panel of 80 numbers in the hope of matching their choices to those drawn by a central computer. Keno is similar in principle to other on-line games, but it is more frequent (normally every five minutes) and normally played in a social setting such as a bar or restaurant. Video lottery terminals are player activated and can be programmed to play casino-style games such as poker, blackjack, keno, and bingo; or simulate mechanical slot machines or roulette wheels.

⁹ OPPAGA's keno revenue estimates are based on other states' per capita sales performance, while video lottery terminal revenue estimates are based on Florida's net income per slot machine. The keno range is based on high and low state per capita sales after excluding the outlier states from the upper and lower quartiles. The video lottery terminal range is based on Florida's pari-mutuel lowest net income per slot machine to the highest net income per slot machine. For keno, the Fiscal Year 2010-11 projected on-line transfer rate to the Educational Enhancement Trust Fund of 40.29% and a 31.09% blended transfer rate for video lottery terminal estimates. Lottery administrative costs for operating video lottery terminals at pari-mutuel facilities are assumed to be covered by licensing fees.

⁴ On-line game transfer rates averaged 40.68% for Fiscal Year 2008-09.

⁵ Section 24.105(9)(a)4., *F.S.*, provides that the only player-activated machine which may be utilized is a machine which dispenses instant lottery game tickets following the insertion of a coin or currency by a ticket purchaser.

⁶ The Lottery's cost to lease the 1,000 vending machines from its on-line vendor, GTECH, is \$329 per month per vending machine or \$3,948,000 per year. On May 27, 2009, the Lottery received spending authority to lease the 1,000 vending machines.

2007-08, 6 states operated video lottery terminals and 13 offered keno.

Another option would be for Florida to sell the multi-state Mega Millions game, which operates similar to Powerball. The Lottery could offer both games, as the multi-state lottery associations are expected to permit states to cross-sell Powerball and Mega Millions starting in early 2010. Currently, Georgia participates in Mega Millions and Florida in Powerball. Rather than potentially lose sales to Georgia, particularly when Mega Millions offers large jackpots, Florida could keep sales in-state by selling both games. Since Powerball drawings are held Wednesday and Saturday, and Mega Millions drawings are held Tuesday and Friday, cross selling provides players more choice. Based on other states' sales, the Lottery could generate an additional \$26 million to \$35 million in transfers to education by offering Mega Millions.¹⁰ However, potential sales shifts from Lotto could substantially weaken the game's viability.

However, adding some new lottery games would represent an expansion of legalized gambling and could produce negative social costs. Video lottery terminals and keno are considered to be more addictive than traditional lottery games and could contribute to problem and pathological gambling rates and increase law enforcement costs to combat crime typically associated with gambling. A small percentage of gamblers develop pathological addictions leading to a variety of financial, physical, and emotional problems. Studies indicate that problem and pathological

gamblers can suffer financial hardship, bankruptcy, unemployment, and may resort to crimes to support their addictive behavior as well as commit domestic violence, engage in substance abuse, and/or commit suicide. Studies have shown that the negative effects associated with problem gambling may take as long as three to four years to manifest. As a result, some long-term adverse effects are not immediately apparent when legalized gambling is approved or expanded.

The National Gambling Impact Study Commission estimated that the annual average costs of job loss, unemployment benefits, welfare benefits, poor physical and mental health, and problem or pathological gambling treatment to society are approximately \$1,195 per pathological gambler per year and approximately \$715 per problem gambler per year.

Further, implementing video lottery terminals, quick-draw games, and Internet lottery games could conflict with the proposed Indian gaming compact. The compact, as currently drafted, would grant Florida tribes exclusive rights to operate some types of gambling, and it appears that expanded Lottery games could conflict with these provisions.

Some states are using vending machines for on-line games and are planning to implement Internet-based games. Several of the top performing state lotteries are starting to use new vending machine technology to dispense on-line games.¹¹ However, the Florida Lottery does not have legislative authorization to use vending machines to dispense on-line game tickets since the law was written before such technology existed. Authorizing player activated vending machines for on-line games could facilitate the recruitment of large corporate accounts such as Walmart and CVS.¹²

¹⁰ No real experience by other states cross-selling Powerball and Mega Millions yet exists. Therefore, the transfer estimate is subject to error. OPPAGA's revenue estimate for the Mega Millions game is based on other states' per capita sales performance. These figures were multiplied by Florida's projected population for Fiscal Year 2010-11 to determine an estimated sales amount. These sales amounts were then reduced by the estimated transfer rate to the Educational Enhancement Trust Fund and further reduced by a sales shift estimate. The Fiscal Year 2010-11 projected on-line transfer rate to the Educational Enhancement Trust Fund of 40.29% was used while the sales shift estimate used was 80%.

¹¹ Top-performing state lotteries; based on per capita sales that are beginning to use on-line vending machines include Georgia, Michigan, and New Jersey.

¹² Currently, Walmart and CVS do not sell lottery products anywhere in the U.S., but the Florida Lottery continues to pursue these retailer outlets.

Full service vending machines (i.e., selling both on-line and scratch-off games) may be attractive to large corporate chains, as they minimize on-site required labor and provide increased player choice and potential for larger sales. For example, the most recently available 2007 data provided by GTECH indicates that Lottery sales from adding full service vending machines at 167 Walmart super stores could potentially provide from \$71 million to \$140 million annually in transfers to education. As of October 2009, Walmart operated 167 Supercenters and 112 smaller stores in Florida.¹³

Selling Lottery products over the Internet could increase sales but legal barriers would need to be addressed. Other states that permit player-activated terminals sell subscriptions for select on-line games over the Internet, but do not offer individual on-line or scratch-off tickets. For instance, New Hampshire sells Tri-State Megabucks and Powerball subscriptions over the Internet, but requires a New Hampshire mailing address, and telephone number, and a charge card to make the purchase. Florida law currently restricts the use of player-activated terminals and does not authorize the use of credit cards for lottery purchases without purchase of \$20 in other goods. According to Lottery estimates, if Florida performed at average levels, annual sales through subscriptions could generate an additional \$10 million in transfers to education.

Selling individual lottery tickets over the Internet requires enhanced technology to ensure that Internet sales are made within a state's borders. Currently, no U.S. lottery is selling individual lottery tickets over the Internet, but New Hampshire is developing plans to launch such individual game sales in 2010. British Columbia does offer Internet-based games. The British Columbia Lottery

Corporation uses computer infrastructure to ensure player identification and location.

There are conflicting interpretations about whether federal law authorizes Internet sales of lottery products. Proponents argue that federal law may be interpreted to allow intrastate Internet gambling so long as a bet is initiated, received, and paid within the same state. However, opponents contend that it is not feasible to ensure that Internet lottery sales occur only intrastate because data transmitted by the Internet likely crosses state lines. The U.S. Department of Justice has not issued an opinion on the matter. Internet sales could provide players with increased access but, given the convenience and privacy of play, may also increase associated negative social consequences.

Increasing the retailer network would increase revenues while largely avoiding negative social consequences. Increasing the number of retailers that sell lottery tickets has the potential to increase revenues by making lottery products more readily available to residents and tourists. Nationwide data on state lotteries shows that there is a significant relationship between per capita sales and the number of residents per retailer, with states achieving higher sales when they have more retailers per 10,000 residents. However, the Florida Lottery ranks 15th in retailer density among 42 U.S. lotteries (excluding the Iowa Lottery that did not report the number of its on-line retailers for 2007-08).

In Fiscal Year 2007-08, the top nine U.S. lotteries ranked by per capita sales had an average of 1,200 residents per retailer. During that period, the Florida Lottery averaged almost 1,400 residents per retailer, and ranked 10th among U.S. lotteries in per capita sales. To meet the top-performing states' average market penetration, the Lottery would need to expand its retail network from 13,500 to 15,000 retailers.¹⁴ Adding 1,500 new retailers has the

¹³ This estimate is based on a projection made by the Lottery's on-line vendor assuming optimistic sales conditions. The projection estimates that average sales would be \$2.2 million per center. OPPAGA calculated the profit using a blended transfer rate of 31.09% and considering current economic conditions.

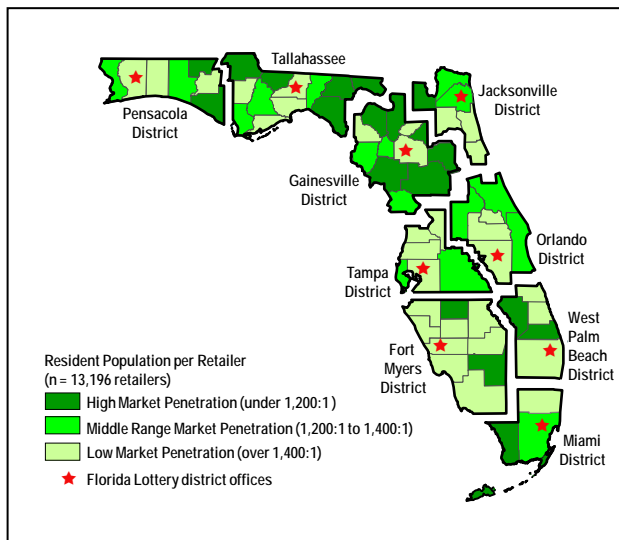
¹⁴ To do so, the Lottery would need spending authority to operate additional sales terminals, as it is currently authorized up to 13,500 terminals.

potential to generate about \$32 million annually in additional transfers to the Educational Enhancement Trust Fund.

The Lottery's current market penetration rate varies across the state with pockets of the highest market penetration typically found in rural counties (see Exhibit 2). Approximately half (32) of Florida's 67 counties have low market penetration, including highly populated urban counties such as Broward, Hillsborough, Orange, and Palm Beach. These areas represent the greatest opportunity to expand the department's retailer network.

Exhibit 2

Retailer Market Penetration Varies Across the State



Source: OPPAGA analysis of Lottery data.

The department has taken steps to recruit additional retailers, but it has also lost many retailers due to factors including the current economic conditions, which have forced some participating businesses to close. In Fiscal Year 2008-09, the Lottery recruited 2,087 new retailers but lost 2,173, for a net loss of 86 outlets.

Both headquarters and district staff work to recruit corporate and independent retailers. Corporate chain accounts represent multiple retailer outlets and the potential for significant sales and education transfers. Currently, both

the Office of Business Development, located in the Lottery's Tallahassee headquarters, and five sales executives, distributed across the state, participate in corporate chain recruitment. It is important that the Lottery balance its recruitment efforts between independent and corporate accounts and continue to specifically target and coordinate efforts to increase corporate retailers. More corporate outlets would have a positive effect on both sales and transfers to education.

To increase the number of independent retailers, the Office of Business Development employs three primary recruiting methods: calls to prospective retailers, retailer recruitment seminars, and responding to retailer inquiries from the Lottery's website, telephone, mail, and fax. To recruit independent retailers in the field the department conducted a 'sales blitz' retailer recruitment competition.

The department's inspector general recently reviewed these activities and concluded that, in general, recruitment seminars and outreach phone calls produced limited return on investment, while the department's website and the field recruitment 'sales blitz' were more effective. However, the Lottery's Office of Business Development disagreed with this assessment and asserted that its retailer recruitment seminars were successful. With the exception of the retailer recruitment seminars, neither the Office of the Inspector General nor the Office of Business Development performed a cost benefit analysis to assess the cost effectiveness of the department's other recruitment methods.

The Office of Business Development has hosted 10 retailer recruitment seminars across Florida over the past three years to educate prospective independent retailers about the benefits of becoming a Florida Lottery retailer. These events were relatively expensive – the department estimated that it spent \$370,000 hosting eight of the seminars, and this estimate

did not include all associated costs.¹⁵ Collectively, the department recruited 38 new retailers through the seminars.¹⁶

The Lottery's Division of Sales conducted a district-level retailer recruitment competition, or 'sales blitz', for three months in 2008 (January thru March). This effort used the department's 115 sales representatives to solicit new retailers, with a goal of obtaining 500 new retailers. This effort recruited 294 new retailers. The department did not track how much time staff spent conducting these recruiting efforts, and thus its per-retailer recruitment cost cannot be identified.¹⁷

Also, the department has not assessed its recruitment efforts to determine which mechanisms work best in different areas of the state and which methods are most successful in recruiting retailers with the highest sales potential. While the Lottery began tracking retailer referrals in October 2008, it has examined only select recruitment mechanisms in detail and has attempted to calculate a return on investment for only one. In addition, the department does not collect information on its staff costs associated with retailer recruitment efforts, which limits its ability to evaluate the cost efficiency of those efforts. As a result, the department does not have an overall perspective on the effectiveness of its recruitment efforts.

¹⁵ The Lottery held eight seminars located in Fort Myers, Gainesville, Jacksonville, Hollywood, Orlando, Pensacola, Tallahassee, and West Palm Beach. The estimated cost for these events did not include staff costs to plan the event; typically one FTE dedicated for nine weeks per seminar. The Lottery did not collect documented cost information for seminars held in Miami in 2006 and Tampa in 2007.

¹⁶ We estimate that, as of June 30, 2009, these additional retailers produced Lottery sales that resulted in approximately \$619,000 in education transfers; this figure is based on OPPAGA's analysis of the recruitment mechanisms and their rate of return.

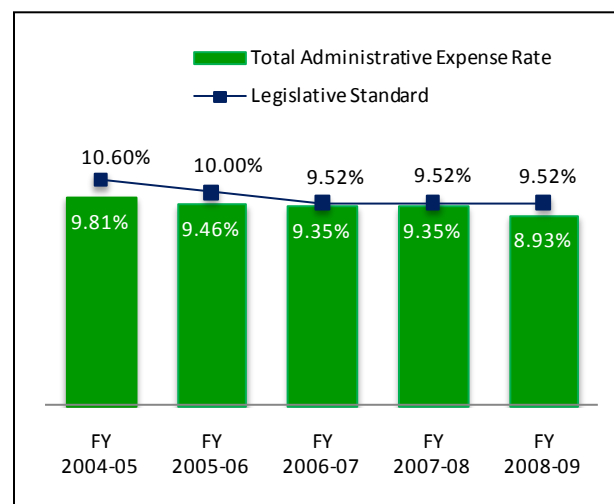
¹⁷ We estimate that these additional retailers produced sales that resulted in about \$8.5 million in education transfers.

Operational Efficiency Options

The Lottery has reduced its administrative costs as a result of lower vendor fees. There are two areas where the Lottery may be able to achieve additional administrative cost reductions—modifying its retailer commissions and reducing excess office space. In addition, the department may be able to realize operational and/or cost efficiencies by examining how it provides field support services.

The department's administrative expense rate has declined. The Lottery's administrative expenses in relation to its sales continue to be lower than the legislative standard as shown in Exhibit 3 and this rate has declined over time. After increasing in each of the last five years, the Lottery reduced its administrative expenses in the Fiscal Year 2008-09 by 10%, or \$38 million. This was primarily due to a reduction in vendor fees in the new scratch-off ticket contract.

Exhibit 3
The Lottery's Administrative Expense Rate Has Declined Over Time



Source: OPPAGA analysis of Lottery performance information submitted to the Legislature.

The department could modify its retailer commissions to reduce costs. The Lottery's current retailer commission structure pays disproportionately high commissions for selling some lottery tickets. These commissions are based on 5% of the ticket price and 1% of prize redemptions. While retailers incur the same costs to sell all tickets, they receive higher commissions without increased labor costs when they sell \$20 and \$30 scratch-off tickets. Retailers receive five cents for every \$1 ticket sold, \$1 for each \$20 ticket sold, and \$1.50 for each \$30 ticket sold. The department expressed concern that some retailers may not stock higher priced tickets if the department changes its commission structure; potentially reducing income and overall education transfers. This could be addressed by adopting a commission structure that is tied to performance and actual transfers to education.

Consistent with prior OPPAGA recommendations, the 2009 Legislature directed the Department of Lottery, in proviso language, to study the retailer commission structure for all games and develop alternatives for rewarding retailers' performance. The department's report is due January 31, 2010.

Leased headquarters space continues to exceed Lottery needs. Currently, the Lottery pays \$496,000 annually to lease about 30,623 square feet of excess office space and it needs to consolidate its special use space. Since the late 1990s the Lottery has reduced its need for headquarters office and warehouse space through staff reductions and outsourcing functions like telemarketing and scratch-off ticket distribution. At the same time, however, the Lottery has not commensurately reduced the amount of space it leases.

With the assistance of the Department of Management Services' tenant broker, the Lottery recently renegotiated the lease for its 159,759 square foot headquarters building and is in its second year of a 10-year lease. The Lottery's annual lease payment is \$2.6 million for Fiscal Year 2009-10. In effect, the Lottery pays a

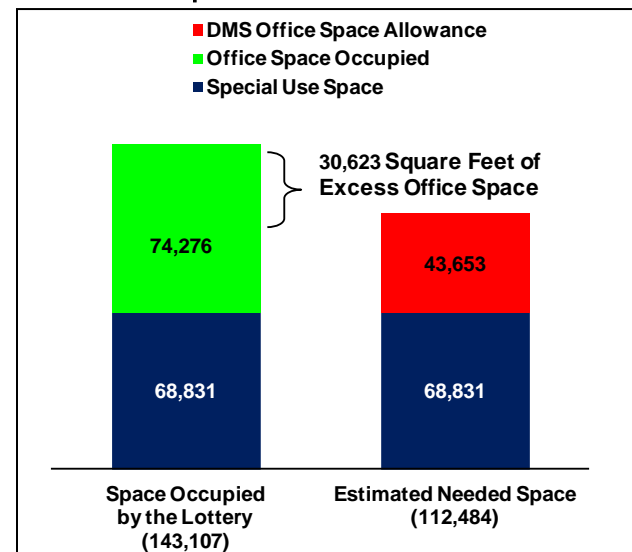
combined office and warehouse rate of \$16.19 per square foot for its headquarters building.¹⁸

The Lottery occupies 143,107 square feet of the building after subleasing 16,652 square feet to three of its major vendors.¹⁹ Of the 143,107 square feet occupied by the Lottery, 74,276 square feet is office space and 68,831 square feet is special use space (e.g., conference and training centers, secure storage areas, cafeteria/break rooms, winner conference areas and warehouse space).

While the Lottery occupies about 74,276 square feet of leased office space for its 242 headquarters employees (i.e., about 300 square feet per employee) it needs only 43,653 square feet of office space according to Department of Management Services standards.²⁰ Therefore, as shown in Exhibit 4, the Lottery leases about 30,623 square feet of excess office space (see Appendix C for a detailed inventory of department headquarters space).

Exhibit 4

The Lottery Leases About 30,623 Square Feet of Excess Office Space



Source: OPPAGA analysis of Lottery data.

¹⁸ The Lottery's lease rate includes janitorial services and lawn care but does not include utilities.

¹⁹ The Lottery currently subleases office and warehouse space, reducing its lease payments by \$232,400 in Fiscal Year 2009-10 (\$169,745 for office space and \$62,655 for warehouse space).

²⁰ In addition to the 242 employees, 16 Lottery employees have offices located in special use space and 4 District 1 sales representatives housed in the headquarters building are not assigned office space.

In addition, the Lottery should consolidate its special use space. This space includes 45,421 square feet of conference and training centers, secure storage areas, a cafeteria, winner conference areas, and 23,410 square feet of warehouse space occupied by the Lottery. Based on our review and facility observations, much of the special use space is underutilized. For example, the conference and training centers are used infrequently and rarely simultaneously; indicating that there may not be a need for both centers. Our tour of the Lottery's warehouse space found that it was underutilized and used in part to store empty boxes, excess furniture, and surplus gaming equipment, that could likely be consolidated or properly disposed.

To address this issue, the General Appropriations Act has annually, for the last six years, required the Lottery to develop a plan to consolidate its lease of office space where economical and to sublet excess office and warehouse space to suitable tenants.²¹ The Lottery is in the process of reducing its excess leased headquarters office space by 4,220 square feet. To do this, the department is moving its leased offsite production studio; where winning lottery numbers are drawn, to its headquarters. The new studio will occupy 3,756 square feet of space at the headquarters building. The facility is currently under construction and the department anticipates moving draw productions to the new facility beginning April 2010. To further reduce excess space, the department expanded the amount of subleased space by subleasing 464 square feet to its advertising firm.

In response to the appropriations proviso, the department reports that it has sought to find an appropriate tenant but has not been able to do so due, in part, to concerns that portions of the Lottery headquarters are high security areas. The Lottery has not yet developed a written headquarters consolidation plan, but it plans to develop a proposal to renovate its

headquarters facility using landlord provided tenant improvement funds and present this proposal to the department secretary in spring 2010. Department officials reported that this proposal is expected to consolidate excess office space to make it more readily available for sublease and improve operational efficiencies by moving like units in close proximity to one another. The Lottery should work with the Department of Management Services in developing its renovation and consolidation plan, as the department has expertise in evaluating the space needs of state agencies. Collectively, the two agencies should evaluate the Lottery's current and future space needs, develop a consolidation plan, define space available to sublet, and find a suitable tenant.

The Lottery should continue to evaluate alternative field support services delivery models

As the Lottery is a sales operation, functions that support ticket sales are critical to its success in generating funds for education. The Lottery maintains a workforce of 115 field sales representatives that work directly with retailers to promote sales. These staff visit retailers, deliver new game point-of-sale materials, recruit and train new retailers, and assist in stocking, ordering, and display. Each sales representative provides support for an average of 125 retailer accounts along an established route. In addition, the Lottery has 12 field sales managers that supervise the field support staff, and five sales executives that service and support corporate chain accounts. Together, these staff, sales representatives, field support managers, and sales executives, make up field support services. The department spends \$10.8 million annually for field support services, including salaries and benefits and related expenses.²²

²² This figure is based on the number of field sales representatives, sales managers, and sales executives employed as of November 2009.

²¹ Chapter 2009-81, *Laws of Florida*.

In contrast, at least six other states, including one of the top performing state lotteries, have outsourced all or part of their field support staff. There are advantages and disadvantages associated with outsourcing this function, and there is relatively little data to compare the Florida Lottery's costs to those of the other states. The Lottery should prepare an updated business case study to inform a decision on whether to outsource field support services.

Six states have outsourced all or part of their lottery sales force. At least six states currently outsource either all or a portion of their lottery sales force; four outsource all sales representative functions, and two partially outsource these functions.²³ Lottery administrators from these states indicated that this outsourcing has generally been successful. One of the states, Pennsylvania, is among the top 10 performing lotteries in the nation, ranking eighth, based on per capita sales.

Two of these states (Texas and Pennsylvania) have a sales force comparable in size to Florida. Texas contracts for its entire sales force of 140,

while Pennsylvania employs 92 state sales representatives and contracts for 18 support field positions; for a total sales force of 110. The remaining four states have smaller sales forces than Florida.²⁴

There are advantages and disadvantages to outsourcing field support services, but little cost-effectiveness information is available. States that have outsourced their sales forces reported that this option provided them with greater flexibility in obtaining needed positions, but cautioned that service contracts must be well-written and sufficiently detailed to ensure consistent, quality service. The primary disadvantage cited by these states was that their lotteries did not directly supervise their sales force. Several state lottery administrators reported that once outsourced, it would be prohibitively expensive to bring this function back in-house due to the infrastructure needed to provide field support services. Exhibit 5 summarizes the advantages and disadvantages associated with outsourcing field support services.

²³ Nebraska, Oklahoma, Texas, and West Virginia outsource the entire state lottery sales force, while Delaware and Pennsylvania outsource a portion of the lottery sales force. Pennsylvania uses contracted staff primarily for training and support of their employed sales force, while in Delaware three outsourced field staff perform the same functions as three state-employed sales staff. All of the states that have outsourced all or part of their field sales force have used this service delivery model long-term; three since inception of the state's lottery and three for a decade or longer.

²⁴ Oklahoma has an outsourced sales force of 20 positions, while Nebraska has 13 positions. West Virginia has 16 and Delaware has 6 positions, of which 3 are outsourced and 3 are state employees.

Exhibit 5

There Are Several Pros and Cons Related to Outsourcing Lottery Field Support Services

Field Support Delivery Option	Pros	Cons
Outsource field support services	<ul style="list-style-type: none"> Increased flexibility to hire staff and modify staffing to meet changing needs Potential to reduce costs if vendor(s) can provide comparable services cheaper than the \$10.8 million currently paid by the department (includes salaries/benefits; fleet supervision) Shifting employment to a contractor reduces the state's liability for long-term benefits and retirement. A vendor may be more qualified to provide training to both sales representatives and retailers. Ability to incentivize the sales force to increase sales and/or retailers Ability to provide flexible schedules Ability to contractually hold vendor accountable for specific sales figures Ability to focus staff to target areas for special projects or attention Potential to shift district facility costs to a vendor No staff union restrictions 	<ul style="list-style-type: none"> Department no longer has direct line authority over sales force representatives. Department/sales reps lose the direct relationship with retailers. Requires high level of communication to ensure that goals, objectives, operations are clearly communicated Legislative oversight and accountability is limited since services are no longer performed by state employees. Transition time of 3-6 months could result in decreased sales and/or service to retailers. Significant up-front infrastructure costs if services are later brought back in-house Department may incur a onetime expense of up to \$736,000 in accrued leave if existing sales force was no longer employed. Potential additional state unemployment compensation costs if current sales reps are not hired by the contractor/vendor
Outsource a portion of field support services	<ul style="list-style-type: none"> Allows the department to compare costs and operations on a pilot basis Could represent a cost savings to the state if a portion of the cost of field support services could be borne by a vendor at a lower cost 	<ul style="list-style-type: none"> Could result in a divided and unequal workforce if there are varying levels of access to training and information and/or differing pay and incentive bonus structures Information and data access may be restricted for vendor-employed sales reps. Currently, no need to 'supplement' or 'support' the state's existing sales force Costs to bring outsourced operations in-house when pilot ends

Source: Interviews with other states and Florida Lottery administrators, district personnel, and sales representatives.

We could not determine whether outsourcing the Florida Lottery's field support services would be cost-effective. Neither of the two national vendors (GTECH and Scientific Games) that provide lottery field support services would provide cost information about the outsourced lottery sales forces they provide. The two vendors reported that this information is proprietary and both would likely submit a proposal should Florida seek to outsource the function. Likewise, most states with outsourced lottery sales forces were unable to provide cost data because they could not break out the cost for these services from their total contract costs.

The two states that could provide estimated costs for outsourced field support staff reported that their cost per field representative ranged from \$75,000 to \$138,000.²⁵ The Florida Lottery's cost for field support services averages about \$97,000 annually per field representative, including salaries, benefits, supervision, and vehicle costs; however, this figure excludes costs for new vehicle purchases

²⁵ The Pennsylvania Lottery reported that it pays its vendor approximately \$2.5 million for 18 contract field support positions; or approximately \$138,000 annually per contracted position. The Nebraska Lottery reported that its contracted sales representatives cost about \$75,000 annually when salary, benefits, incentives, and fleet costs are included.

and storage space that sales representatives use at district offices.²⁶

The Lottery should update its field support services business case study. Florida statutes require state agencies considering outsourcing a function to develop a business case that evaluates the feasibility, cost-effectiveness, and efficiency of outsourcing the service.²⁷ The business case must include a detailed description of services; an analysis of advantages and disadvantages; a cost-benefit analysis; specific performance standards; and, a description of necessary legislative and budgetary actions.

The department has considered the option of outsourcing its field support services in the past and, in 2004, submitted a draft business case proposal to the Legislature. The draft report recommended conducting an open and competitive bid to take into account increased retailer numbers and to allow for multiple vendors to respond. Although the Center for Efficient Government in February 2005 approved the Lottery to proceed with the bid, the department has taken no further action. Instead, the department reports that it adopted efficiencies identified through the business case process while retaining the function in-house. Since that time, economic conditions have changed and additional operational efficiencies may exist.

The Lottery should update its field support services business case study to clearly define its operations and related costs, identify potential operational efficiencies, and assess the potential risks and benefits of outsourcing the function. If these results indicate potential benefits and acceptable risks for outsourcing field support services, the department should issue a formal request for proposals to determine whether outsourcing field support services could be cost effective. As part of this process, the Lottery's sales division should

submit its own proposal to maintain the function within the department. This process would enable the department to determine whether contracting out field support services in Florida would pose acceptable risks and produce material costs savings.

Recommendations

There are steps that both the Legislature and the Department of Lottery can take to increase sales, reduce administrative expenses and ultimately increase transfers to education.

Department Recommendations

We recommend that the Department of Lottery take several steps to enhance its revenues and increase its efficiency.

Consider offering Mega Millions, another multi-state lottery game. Introducing a second multi-state super jackpot game could increase transfers to education. The Lottery should carefully evaluate the benefits and disadvantages of adding another multi-state game and provide the results of its assessment to the Legislature.

Take additional steps to increase the number of participating retailers. We recommend that the department examine its market penetration geographically by type of retailer to identify specific areas in need of additional retailers based on the population rate, and to target retailer recruitment efforts in locations with low penetration rates and trade styles that have not been saturated, such as independent grocery stores, drug stores, and liquor stores. When the department approaches 13,500 terminals, the maximum currently authorized, it should request legislative budget authority to increase the number of retailer terminals.

Evaluate and report on retailer recruitment efforts and target increasing corporate accounts. We recommend that the department evaluate its retailer recruitment efforts by conducting a cost-benefit ratio analysis that includes all associated planning and production costs, to determine what methods work best where and to identify an

²⁶ This cost figure is based on the number of sales representatives employed as of November 2009.

²⁷ Section 297.0571, F.S.

acceptable cost per retailer per recruiting method. This information should be collected on a regular basis and reported to executive management. In addition, the department should establish standard criteria to be used by both the Office of the Inspector General and the Office of Business Development to evaluate specific recruitment mechanisms. To maximize the number of retailers statewide, the department should also target its recruitment efforts on increasing corporate chain accounts.

Request legislative authorization to install additional Instant Ticket Vending Machines. If instant ticket vending machines meet or exceed projected sales levels, we recommend that the department seek legislative authority to expand the number of instant ticket vending machines statewide with the option of installing the equipment in both existing and new retail outlets.

Examine the retailer commission structure. We recommend that the department continue to review its retailer commission payment structure including prize cashing bonus and incentives to reward retailers for performance that reflects the volume of tickets sold and their contribution to education.

Work with the Department of Management Services to reduce excess office space. To ensure the state's short- and long-term interests are maintained, the Legislature should direct the Department of Lottery to develop a space consolidation plan in conjunction with the Department of Management Services. This plan should clearly identify space to be consolidated where economical, particularly excess office and redundant special use space, including the warehouse, and to clearly identify space most suitable for sublease. In this way, rather than shopping for a sublet tenant based on undefined available space, the Department of Management Services and the Lottery can search for a tenant that is appropriate for the defined available sublet space. This plan should then be presented to the Legislature for approval before the Lottery may proceed with

any further renovation plans. The Legislature should also direct the Department of Management Services to evaluate the Lottery's current and future headquarters space needs, identify options for meeting those needs, and present the options to the Legislature.

Update the business case study. We recommend that the department update its field support services business case study. If the results indicate that the benefits and risks of outsourcing field support services are acceptable, it should issue a request for proposals for the function. For complete comparative information, the Lottery's sales division should submit a proposal to maintain the services in house.

Legislative Recommendations

We also recommend that the Legislature consider authorizing the Lottery to expand its current games to enhance revenues.

- Authorize the Lottery to offer on-line game vending machines. The Legislature could consider authorizing the department to use vending machines to distribute on-line products. Vending machines selling both scratch-off and on-line games have the potential to appeal to large corporate retailers not currently distributing Lottery products.
- Consider authorizing the Lottery to offer Internet sales. The Legislature could consider selling Lottery products over the Internet, but would need to address several legal barriers. The Legislature would at a minimum need to authorize player activated technology for purposes of purchasing Lottery products over the Internet. To ensure against the potential for violating federal law, the Legislature may need to request the U.S. Justice Department issue an opinion regarding the legality of an intrastate system for Internet sales of Lottery products under the intrastate provision of the Unlawful Internet Gambling Enforcement Act.

- Consider authorizing new games, but consider social implications. The Legislature could consider expanding Lottery games which have the greatest potential to significantly increase transfers to education (video lottery terminals and keno), but this would entail an expansion of legalized gambling in the state.

Agency Response ———

In accordance with the provisions of s. 11.51(5), *Florida Statutes*, a draft of our report was submitted to the Secretary of the Department of the Lottery for review and response. The Secretary's written response to this report is in Appendix D.

Appendix A

New Lottery Game Options

New games that attract new players have the potential to substantially increase revenues to the Lottery. While the Legislature could consider authorizing the Lottery to offer new games such as video lottery and a keno game, these options would likely increase the negative social costs of gambling and could conflict with the proposed Indian gaming compact. The following table lists these and other game options that could increase Lottery sales and transfers to education, their advantages and disadvantages, and estimated revenues where we were able to develop reasonable estimates

Table A-1
New Games Could Raise Over \$500 Million for Education

Option	Advantages	Disadvantages
Video Lottery Terminals Players use video terminals that can be programmed to play casino-style games such as poker, blackjack, keno, and bingo, or simulate mechanical slot machines or roulette wheels.	<ul style="list-style-type: none"> ▪ Potential recurring transfers to education range from \$404 million to \$648 million per year. ▪ To reduce issues/concerns about underage players, play could be limited to pari-mutuel facilities such as racetracks or establishments with liquor licenses. 	<ul style="list-style-type: none"> ▪ Because of its rapid play style, it may be more addictive than other lottery games increasing social costs associated with problem and pathological gambling. ▪ Could violate conditions of the proposed Indian gaming compact ▪ Represents a substantial change for gambling in Florida by permitting casino-style lottery games statewide and could be criticized by anti-gambling groups ▪ Would require legislative action to legalize player-activated terminals in Florida ▪ If launched in racinos (i.e., horse or dog race tracks with casinos), it could erode sales of traditional Florida Lottery games within certain market segments. ▪ Could be considered an expansion of gambling
Fast Draw Keno On-line lottery game in which players choose as many as 10 numbers from a panel of 80 numbers in the hope of matching their choices to those drawn by the central computer at Lottery headquarters. It may be played frequently (e.g., every five minutes) on monitors in social settings such as bars or restaurants.	<ul style="list-style-type: none"> ▪ Potential recurring transfers to education range from \$64 to \$358 million per year. ▪ It can be limited to existing areas where betting is allowed such as pari-mutuel facilities or social settings such as bars and restaurants. 	<ul style="list-style-type: none"> ▪ Fast keno is more addictive than traditional lottery games, though not as addictive as video lotteries. ▪ Could be regressive in that a larger percentage of disposable income from lower socio-economic players is wagered ▪ Could be considered an expansion of gambling
Daily Keno On-line lottery game in which players choose as many as 10 numbers from a panel of 80 numbers in the hope of matching their choices to those drawn by the central computer at Lottery headquarters. Similar in principle to other on-line games. It may be played weekly or daily.	<ul style="list-style-type: none"> ▪ Potential recurring transfers to education range from \$6.8 to \$11.2 million per year. 	<ul style="list-style-type: none"> ▪ Could be considered an expansion of gambling

Option	Advantages	Disadvantages
Mega Millions Powerball states and Mega Millions states now have the authority to cross-sell games.	<ul style="list-style-type: none"> ▪ Potential recurring transfers to education range from \$26 million to \$35 million annually. ▪ It offers players greater opportunities for very large jackpots. 	<ul style="list-style-type: none"> ▪ More frequent mega jackpots could reduce incentive for occasional players to respond to large jackpots. ▪ Probable sales shift from Powerball and Florida Lotto ▪ Could be considered an expansion of gambling
Higher Priced Scratch-off Games As the economy strengthens or the value of the dollar depreciates, higher priced scratch-off games can be offered (e.g., \$50 games)	<ul style="list-style-type: none"> ▪ Since 2002, most scratch-off growth in transfers to education in Florida has been due to higher price point games proving higher priced tickets have significant revenue generating potential. ▪ Compared to other states offering high priced tickets, Florida is an industry leader in \$20 and \$30 scratch-off game sales proving its success in this area and potential to sell high priced tickets. 	<ul style="list-style-type: none"> ▪ Higher priced scratch-off games are contingent on the strength of the economy. Only Texas is currently offering tickets above \$30. ▪ Florida's experience with \$30 ticket was not encouraging and the growth in scratch-off sales has begun to level off indicating there are limits to what will sell. ▪ Only seven states offer scratch-off tickets over \$20 dollars, including Connecticut, Florida, Indiana, New Hampshire, New York, Pennsylvania, and Texas. Texas offers the only \$50 game.
Monitor Games Computer animated games simulating horse racing, golf, etc. that are played on in-store monitors similar to the way Keno is played.	<ul style="list-style-type: none"> ▪ May have less association to casino gambling than Keno ▪ Could appeal to emerging markets of Lottery players that have grown up playing computer games ▪ Allows the Lottery to recruit new retailers in social venues such as bars and restaurants 	<ul style="list-style-type: none"> ▪ Because of its rapid play style, it could be more addictive than traditional lottery games. ▪ Could be regressive in that a larger percentage of disposable income from lower socio-economic players is wagered ▪ Could be considered an expansion of gambling
Instant On-line Games These games allow players to find out the results instantly or as soon as the tickets are printed from the lottery terminal.	<ul style="list-style-type: none"> ▪ On-line tickets would have more graphic images and can use familiar games such as Bingo and Tic Tac Toe. 	<ul style="list-style-type: none"> ▪ May have small player base ▪ Could produce shift in sales from traditional scratch-off games ▪ Could be considered an expansion of gambling
Pulltabs/Breakopen Tickets Players win instantly by 'breaking open' the ticket instead of scratching off the covering. Pulltabs can be sold in sets that have a predetermined number of winning tickets. Retailers order individual sets guaranteeing them of a specific number of winners in each deal.	<ul style="list-style-type: none"> ▪ Potential recurring transfers to education range from \$2 to \$10 million per year. ▪ May be possible to increase Lottery sales by offering a new product that can be sold in controlled establishments not considered traditional lottery retailers such as bars 	<ul style="list-style-type: none"> ▪ Pulltab/Breakopen tickets would compete with the same funding source as scratch-off games, which could cause a decrease in sales for scratch-off games due to lower prize payouts. ▪ Could cause shift in sales from other Lottery products, particularly scratch-off games ▪ Implementation would require lease or purchase of validation equipment. ▪ Could be considered an expansion of gambling
Interactive Games Players purchase a ticket at a Lottery retailer and take it home to play an interactive game on the Lottery website or through a CD-Rom.	<ul style="list-style-type: none"> ▪ Potential recurring transfers to education range from \$4 to \$6 million per year. ▪ Play style offers more intrinsic value than a traditional paper lottery ticket and may be more marketable. ▪ Attractive to the young adult market (20-34 years) ▪ Can have validation codes to prevent underage gambling and underage players would not be permitted to redeem tickets even if they played the CD 	<ul style="list-style-type: none"> ▪ Higher operational costs than other scratch-off style games ▪ Could lose some entertainment value since gratification is deferred, as players must play the game on a computer, not on the premises ▪ May increase underage gambling by appealing to younger market segments ▪ Could be considered an expansion of gambling

Source: OPPAGA analysis of industry and Lottery information.

Appendix B

Product Distribution Options

Increasing the number of retailers has the potential to increase revenues by making lottery products more readily available to residents and tourists and has been shown to drive lottery sales more than advertising or jackpot size. Florida's retailer penetration rate lags behind that of the top performing states. New equipment such as on-line vending machines and product distribution through the Internet could also increase the number of retailers and subsequent revenue. The following table lists these and other product distribution options that could increase Lottery sales and education transfers, their advantages and disadvantages, and estimated revenues where we were able to develop reasonable estimates.

Table B-1
Expanding Product Distribution Could Raise Over \$32 Million for Education

Option	Advantages	Disadvantages
Expand Retailer Network Add additional Lottery retailers in both traditional locations such as convenience and grocery stores and non-traditional locations such as airports, hotels, and restaurants.	<ul style="list-style-type: none"> Should result in incremental sales increases if terminals are placed in the right retailer locations Florida has been below the average in terminal density compared to other successful Lottery states so expanding its network should improve per capita sales. Could increase product distribution and awareness, making products available to new players that don't shop where products are currently being sold Adding 1,500 new retailers has the potential to generate about \$32 million annually in additional transfers to the Educational Enhancement Trust Fund. 	<ul style="list-style-type: none"> Requires legislative budget approval for more terminals Retailer expansion has been difficult during recession because retailer closings have been higher than new retailers recruited. The non-traditional lottery business model may require the approval of different products and distribution strategies. May require additional lottery staff to service new accounts
Expand Instant Ticket Vending Machines (ITVMs) Self-service vending machines for Scratch-off tickets are currently being installed in 1,000 Lottery retailers.	<ul style="list-style-type: none"> Allows additional product facings at high volume Lottery retailers Latest technology provides improved functionality, better security, and better accounting. Early ITVM sales show increases in retailer sales where ITVMs are sold. Could be cost-effective where scratch-off tickets are not being sold, such as in hotels and restaurants 	<ul style="list-style-type: none"> Requires legislative budget approval for more ITVM units Requires monitoring of underage play Some criticize the potential ease of access to problem gamblers.
Authorize Full-Service Vending Machines The Legislature would amend the law to permit player activated vending machines that are capable of selling on-line quick pick tickets.	<ul style="list-style-type: none"> Provides more convenience to players who do not want to stand in line to purchase tickets Successful in other Lottery states May attract large corporate retailers currently not selling lottery products Provides a business model allowing retailer network expansion into non-traditional retailer locations, e.g., in airports and hotel. Would not require a modification to the Lottery retailer contracts that require retailers to carry both scratch-off and on-line games Could potentially increase transfers to education by a range of \$71 million to \$140 million annually 	<ul style="list-style-type: none"> Requires a Florida Statute change to allow player activated terminals for on-line games Requires legislative budget approval Requires monitoring of underage play Some criticize the potential ease of access to problem gamblers Could be considered an expansion of gambling

Option	Advantages	Disadvantages
Authorize Internet Sales The Legislature would enact laws to authorize intrastate Internet sales of Lottery products.	<ul style="list-style-type: none"> Provides more convenience to players who prefer to purchase their Lottery products from their personal computer or cellular device Canadian lotteries are selling individual games over the Internet using technology that detects the players location (e.g., British Columbia Lottery Corporation at www.bclc.com). 	<ul style="list-style-type: none"> The state would need to request the U.S. Justice Department to issue an opinion regarding the legality of an intrastate system for Internet sales of Lottery products under the intrastate provision of the Unlawful Internet Gambling Enforcement Act. Absent a clear answer from the federal government, authorizing Internet sales of Lottery products could violate federal law. Could be considered an expansion of gambling
Subscription Play Players can subscribe to on-line game drawings for up to one year in advance on the Florida Lottery website.	<ul style="list-style-type: none"> Potential to generate about \$10 million annually in additional transfers to the Educational Enhancement Trust Fund Internet technology has made subscription services must easier and more cost-effective for lotteries to manage. Key benefits for the consumers are no missed draws, no waiting in lines, and ease of prize claims. Provides the ability for people to play who may not be able to otherwise such as seasonal residents and physically challenged residents Subscription play is offered in about 15 U.S. lotteries. 	<ul style="list-style-type: none"> Use of credit cards for lottery purchases without purchase of \$20 in other goods would require law change. Must comply within federal laws that restrict subscriptions from out-of-state players unless they have in-state mailing addresses Game changes require communication with players and possibly a replacement ticket. Because all prize payments will be paid automatically, subscription play will generate no unclaimed prize funds. Could be considered an expansion of gambling
Selling at Grocery Store Checkout Lanes Grocery stores typically have between 5 and 15 checkout lines that could be used to distribute lottery products.	<ul style="list-style-type: none"> May increase product distribution points and make it easier to purchase and redeem lottery products Could increase sales because it encourages impulse purchases and is a player convenience 	<ul style="list-style-type: none"> It could cause some accounting issues for grocery stores in tracking the sales at every checkout line. Would require expenditures for dispensers for each grocery store to display/merchandise the product at the point of purchase May be difficult to get supermarkets to participate because it would require reconfiguring their operation and systems
Paying at the Pump for Scratch-off Games Paying at the pump for lottery tickets would give another distribution outlet for purchasing lottery tickets. Ideally, the consumer would be able to combine their gas and Lottery purchase.	<ul style="list-style-type: none"> A play at the pump option would add player convenience and may attract new players who might not otherwise seek somewhere to play. 	<ul style="list-style-type: none"> Most likely would require the purchase of special dispensing machines like instant ticket vending machines and this technology is in development Florida laws require credit card purchases for lottery tickets have \$20 sales of other products. Florida laws currently do not allow player-activated terminals. Paying at the pump for gas eliminates the need for many consumers to go inside which will have a direct impact on all product sales inside the store. Adverse reaction from retailers who want players to come into the store Could present site-based security issues, such as theft or underage purchase

Source: OPPAGA analysis of industry and Lottery information.

Appendix C

Lottery Headquarters Leased Space

As shown in Table C-1, current floor plans show the Lottery's headquarters building has 159,759 square feet of rentable floor space including 130,461 square feet of office space (located mostly on the top two floors of a four-story building) and 29,298 square feet of air-conditioned warehouse space (located on the bottom floor and two stories high). The Lottery leases about 30,623 square feet of excess office space.

Table C-1
The Lottery Leases About 30,623 Square Feet of Excess Office Space

Lottery Headquarters Space	Square Feet¹	Total Square Feet¹
Rentable Floor Space (warehouse and office)		159,759
Special Use Space (warehouse)		
Subleased to Lottery Vendor (GTECH)	5,888	
Lottery Occupied	23,410	
Rentable Warehouse Space	29,298	
Rentable Office Space		130,461
Special Use Space (office)		
Subleased to Lottery Vendor (GTECH)	9,312	
Subleased to Lottery Vendor (Scientific Games)	988	
Subleased to Lottery Vendor (St. John & Partners)	464	
Bathrooms	3,642	
Public Reception Areas (for winners and to check security)	2,460	
Draw Studio (for public viewing of number draws)	3,756	
Elevator Machine Room	162	
Security CAS Backup	499	
Mail Room and Janitorial Services	1,695	
Armory	451	
Office (for computer repair)	165	
Information Resource Management Data Center	5,150	
Ledge (for B1 to B2 access)	373	
Security File Room	317	
Forensics Labs	559	
Evidence Room	54	
Test Lab	169	
Evidence Storage	166	
Filing Records Storage	241	
Information Technology Training/Testing and Auditing	2,878	
Inspector General Confidential Interview Room	145	
Secured Storage	190	
Merchandise Inventory	391	
Cafeteria	2,248	
Employee Records File Room	332	
District Customer Service	154	
Training Center	1,306	
Conference Center	4,792	
Draw Room (for monitoring draws)	160	
Net Usable Area (Special Use Space)	43,219	
Circulation 30% of net usable space ²	12,966	
Total Usable Special Use Space	56,185	

Lottery Headquarters Space	Square Feet ¹	Total Square Feet ¹
Remaining Rentable Office Space (Rentable Office minus Special Use Space)		74,276
Personnel Space ³		
Executive (enclosed office)	3,150	
Administrator (enclosed office)	1,500	
Managers Requiring Confidentiality (enclosed office)	4,900	
Professionals (workstation)	11,680	
Para Professional (workstation)	1,380	
Support Space ²		
Reception	600	
LAN Rooms	600	
Open Files	1,521	
Storage	600	
Pantry	800	
Copy	800	
Conference/Meeting Rooms	3,650	
Net Usable Space (sum of Personnel and Support Space)	31,181	
Circulation 40% of net usable space ²	12,472	
Total Usable Personnel and Support Space	43,653	
Excess Leased Rentable Office Space		30,623

¹ Measurements taken from the Lottery's most current floor plans dated May 22, 2007; Lottery reported measurements; and OPPAGA calculations of floor plan space.

² Based on the DMS space allocation worksheet (FM 4100 R05/04) allowances.

³ Based on the DMS space allocation worksheet allowances cross walked to Lottery staff positions.

Source: OPPAGA analysis of Lottery headquarters floor plans, building tour, interviews with Lottery and DMS officials, and DMS space allocation worksheet.

Appendix D

CHARLIE CRIST
Governor



LEO DIBENIGNO
Secretary

FLORIDA LOTTERY

January 28, 2010

Gary R. VanLandingham, Ph.D.
Director
Office of Program Policy Analysis and
Government Accountability
111 West Madison Street
Tallahassee, Florida 32399-1475

Dear Dr. VanLandingham:

Thank you for the opportunity to respond to your office's report entitled "Lottery Profits Flat; Increasing Retailer Outlets Is Critical to Increasing Sales." Our response is organized around your recommendations.

Consider offering Mega Millions, another multi-state lottery game.

Introducing a second multi-state super jackpot game could increase transfers to education. The Lottery should carefully evaluate the benefits and disadvantages of adding another multi-state game and provide the results of its assessment to the Legislature.

The Lottery concurs with this recommendation and is currently in the process of evaluating the benefits and disadvantages of adding another multi-state game. We will keep the Legislature apprised as that evaluation proceeds. One study indicates that, among U.S. lotteries, the Florida Lottery has the least to gain by launching Mega Millions at this time, given the fact that we have offered Powerball for only one year and have not yet realized its full sales impact. In addition, the negative impact a second multi-state game could have on our in-state Florida Lotto game could jeopardize the very nature and sustainability of that game. The Lottery would be better served to take the time to learn from other states' experiences before making a decision about whether to join Mega Millions or to wait for a possible National Game at a later date.

Take additional steps to increase the number of participating retailers.

We recommend that the department examine its market penetration geographically by type of retailer to identify specific areas in need of additional retailers based on the population rate, and to target retailer recruitment efforts in locations with low



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penetration rates and trade styles that have not saturated, such as independent grocery stores, drug stores, and liquor stores. When the department approaches 13,500 terminals, the maximum currently authorized, it should request legislative budget authority to increase the number of retailer terminals.

The Lottery concurs with this recommendation and is currently modifying the telephone outreach retailer recruitment program and pursuing other alternatives to strengthen the recruitment of new Lottery retailers. This includes, but is not limited to revising the assigned work structure within the Business Development unit to improve the telephone outreach retailer recruitment program, holding geographically-focused sales outreach missions in addition to two retailer recruitment seminars annually, reducing the overall cost of the retailer recruitment seminars, conducting specific retailer recruitment advertising on the Lottery's website, conducting on-going upgrades to the new retailer recruitment system to further improve monitoring and tracking of the success of the program, and continuing to provide lead source support to the Sales Team for future state-wide retailer recruitment contests. Finally, the Business Development unit conducts ongoing research to identify new recruitment ideas having the potential to increase the size and quality of the Florida Lottery's retailer network.

Evaluate and report on retailer recruitment efforts and target increasing corporate accounts.

We recommend that the department evaluate its retailer recruitment efforts by conducting a cost-benefit ratio analysis that includes all associated planning and production costs, to determine what methods work best where to and to identify an acceptable cost per retailer per recruiting method. This information should be collected on a regular basis and reported to executive management. In addition, the department should establish standard criteria to be used by both the Office of Inspector General and the Office of Business Development to evaluate specific recruitment mechanisms. To maximize the number of retailers statewide, the department should also target its recruitment efforts on increasing corporate chain accounts.

The Lottery concurs with this recommendation. The Business Development unit will work with the Corporate Sales Team and other units of the Lottery to conduct a comprehensive Return on Investment analysis, using mutually agreed-upon standard criteria appropriate for our various recruitment methods.

The Lottery already collects, on an on-going basis, in-depth information on all retailer prospects using its Retailer Recruitment System (RRS). The RRS was designed to monitor, manage, track and help to identify new recruitment opportunities. The RRS provides the Lottery with an extensive data base for use in evaluating the cost-effectiveness of its retailer recruitment efforts. The Business Development unit evaluates weekly and monthly reports from the RRS to assess retailer recruitment efforts and to identify ways to increase the number of Lottery retailers.

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Jointly, the Lottery's Business Development and Corporate Sales units will re-double their efforts to increase the effectiveness of corporate recruitment efforts. However, the challenge of current economic conditions and the programs already underway should be recognized.

Presently, the Business Development unit begins its solicitation effort with a corporate retailer prospect by providing a tailored presentation to that prospect. Should the prospect respond with expressions of interest, a more in-depth formal proposal is submitted, complete with detailed estimates of the sales, customer traffic and other benefits the corporation could experience in selling the Lottery product line as well as offers of assistance in expediting Lottery retailer application procedures. This proposal is followed up by calls to the appropriate, executive-level points of contact within the corporation with offers to answer further questions and resolve any issues.

An alternative sequence is sometimes followed, particularly by the Lottery's Corporate Sales unit. There, the practice is to start by approaching regional or district corporate managers with the notion of selling Lottery products in the hope of engaging those people in convincing corporate headquarters of the advantages of partnering with the Lottery. Once any interest is registered, the follow-up procedures can be much the same as in the first approach.

Request legislative authorization to install additional Instant Ticket Vending Machines.

If instant ticket vending machines meet or exceed projected sales levels, we recommend that the department seek legislative authority to expand the number of instant ticket vending machines statewide with the option of installing the equipment in both existing and new retail outlets.

The Lottery concurs with this recommendation and is closely monitoring the incremental impact of the current allocation of 1,000 Instant Ticket Vending Machines. Once the department has sufficient data to support a legislative request for additional units, the department may seek additional legislative budget authority.

Examine the retailer commission structure.

We recommend that the department continue to review its retailer commission payment structure including prize cashing bonus and incentives to reward retailers for performance that reflects the volume of tickets sold and their contribution to education.

The Lottery concurs with this recommendation. As mandated in the General Appropriations Act for this fiscal year, the Lottery is completing a thorough analysis of the structure of its retailer compensation program. This study will be submitted to the

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chairs of the Senate Committee on General Government Appropriations and the House Government Operations Appropriations Committee by January 31.

The Retailer Compensation study will analyze the issues identified in proviso language, including the idea of fixed compensation per ticket, performance incentives, Florida's compensation compared to other U.S. lotteries and the impact of inflation on Lottery retailer earnings. To accomplish this, a variety of research techniques will have been used including direct discussions with Lottery retailers through surveys, focus groups and interviews. It is the Lottery's hope that the study's findings will provide the basis for improving the program in ways that strengthen the Lottery's relationship with its retailers, improve customer service and promote increased sales and educational enhancement funding.

Work with the Department of Management Services to reduce excess office space.

To ensure the state's short- and long-term interests are maintained, the Legislature should direct the Department of Lottery to develop a space consolidation plan in conjunction with the Department of Management Services. This plan should clearly identify space to be consolidated where economical, particularly excess office and redundant special use space, including the warehouse, and to clearly identify space most suitable for sublease. In this way, rather than shopping for a sublet tenant based on undefined available space, the Department of Management services and the Lottery can search for a tenant that is appropriate for the defined available sublet space. This plan should then be presented to the Legislature for approval before the Lottery may proceed with any further renovations plans. The Legislature should also direct the Department of Management Services to evaluate the Lottery's current and future headquarters space needs, identify options for meeting those needs, and present the options to the Legislature.

The Lottery concurs with OPPAGA to continue working with DMS to reduce excess office space. The Florida Lottery has been diligent in attempting to sublease excess office space to include consultation with the Department of Management Services as well as its DMS-authorized tenant broker (Cushman & Wakefield "C&W").

The state's interests were enhanced by engaging C&W to assist in the renegotiation of the lease at the headquarters facility. C&W assessed the market and evaluated options such as other available private lease space, state-owned space, and build-to-suit. C&W's business review recommended that the Lottery negotiate a lease renewal with restructured terms. The recommendation was based on the absence of private or state space suitable to the Lottery's needs, and the fact that prevailing market rates were in excess of what the Lottery was paying. Additionally, a build-to-suit option was determined to be cost prohibitive. Finally, relocation expenses of several million dollars were also a factor in C&W's analysis. The Lottery could only consider such expenditures if the Legislature indicated a desire to appropriate the funding.

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Given this information, the Lottery opted for a lease renewal that resulted in immediate savings to the State rather than pursuing alternatives that might have resulted in greater savings and close conformity to DMS standards, but only after many years of delay and deferment of those cost savings. The restructured lease terms resulted in annual rate reductions averaging \$50,000, as well as the landlord absorbing janitorial and lawn care services of approximately \$170,000 annually. Finally, the landlord agreed to tenant improvement funds of \$2.34 million for the renovation of the facility.

In an effort to further streamline business operations and better utilize available space, the Lottery is relocating its televised game drawings to the headquarters building in April 2010, which will use 3,756 square feet of the “excess” space identified by OPPAGA last year.

The Florida Lottery continuously seeks opportunities to streamline its facilities operations to achieve administrative efficiencies and economies. The Lottery, with the concurrence of DMS, also recognizes that achieving the present DMS-recommended standards for a facility that was built over 20 years ago, for a unique business organization and in accordance with different building codes, would require significant reconstruction involving major additional funding.

The Lottery has made significant gains in reducing “excess office space” as defined by OPPAGA as a review of previous OPPAGA reports show:

OPPAGA Annual Report	Excess HQ Office Space
2006	62,903 sq. feet
2007	58,804 sq. feet
2008	55,413 sq. feet
2009	56,653 sq. feet
2010	30,623 sq. feet

Update the business case study.

We recommend that the department update its field support services business case study. If the results indicate that the benefits and risks of outsourcing field support services are acceptable, it should issue a request for proposals for the function. For complete comparative information, the Lottery’s sales division should submit a proposal to maintain the services in house.

The Lottery concurs with this recommendation and will update its business case study by January 2011. Should the findings warrant that we do so, the Lottery then will consider a competitive procurement to provide the basis for a decision on out-sourcing.

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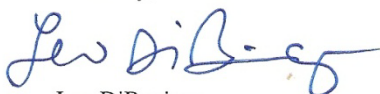
While concurring with the recommendation, it must be said that the quality of our field service operations has improved dramatically during the six years since the previous business case proposal was submitted. Internally, our sales staff is highly regarded throughout the Lottery; externally, Lottery retailers give this unit 90% satisfaction ratings in our annual retailer survey.

Very few state lotteries outsource their field service sales team. Therefore, finding suitable examples of best practices and lowered costs will be difficult. The main reason nearly all states maintain lottery sales staff as public employees is because this structure provides a higher level of supervision and direct oversight that would naturally be reduced by allowing a private vendor to provide that service.

Finally, it is important to bear in mind that the cost of a field sales team is not eliminated by outsourcing. Rather, it is merely paid to a private vendor to conduct the same critical services. The budget savings, if any, may be minimal if the primary objective – which the Lottery believes it should be – is to maintain at least the same level of quality service to retailers and players.

In closing, the Florida Lottery always welcomes constructive suggestions for ways to improve our performance and productivity. Thank you for the time and attention your staff and you have devoted to this year's review.

Sincerely,



Leo DiBenigno
Secretary

cc: Dennis Harmon, Deputy Secretary
Andy Mompeller, Inspector General
Marcy Jackson, Chief Financial Officer
Terry Perkins, Chief Administrative Officer
Ken Hart, General Counsel

The Florida Legislature

Office of Program Policy Analysis and Government Accountability



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