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OPPAGA
OFFICE OF PROGRAM POLICY ANALYSIS & GOVERNMENT ACCOUNTABILITY

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Lottery Transfers Have Recovered; Options Remain to Enhance Transfers

at a glance

Lottery transfers to the Educational Enhancement Trust Fund increased by $103 million in Fiscal Year 2012-13 to $1.424 billion. Adjusted for inflation, these transfers represent a recovery compared to transfers made prior to the beginning of the recession in 2007. To increase sales during 2013, the Lottery continued to launch new products and enhance product distribution.

Several additional game and product distribution options are available to increase transfers to education. However, some of these options could represent expanded gambling.

The Lottery's operating expense rate continues to meet legislative performance standards and is the third lowest in the nation. For additional efficiencies, the Legislature could consider removing the prohibition against purchasing lottery vending machines.

Increasing the Lottery's current level of advertising expenditures is not likely to translate into an increase in net revenues, as we estimate that the return to the Educational Enhancement Trust Fund for $1.00 of advertising is between $0.29 and $1.60, with a midpoint of $0.94. Although the Lottery appears to have reached a saturation point for its advertising expenditures, major reductions in advertising have the potential to adversely affect transfers to education.

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.[1, 2]

Background

The Department of the Lottery generates funds for education by selling draw and scratch-off games. Draw games allow players to select from a range of numbers on a play slip. Draw game tickets are printed by terminals that are connected to the Lottery's contracted terminal-based gaming system for a drawing at a later time. Scratch-off games are tickets with latex covering that players scratch off to determine instantly whether they have won.

The Lottery is self-supporting and receives no general revenue. For Fiscal Year 2013-14, the Legislature appropriated $155.5 million from Lottery sales revenue and authorized 420 positions for Lottery operations. Prizes and retailer commissions are paid directly from sales revenues and do not appear in the department's appropriation. In Fiscal Year 2012-13, prizes were

[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 assess efficiency and the Auditor General to conduct the financial audit.

[2] A complete list of prior OPPAGA reports that identify revenue enhancement and operational efficiency options for the Department of the Lottery is available on our website.

$3.16 billion and retailer commissions were $278.5 million.[3] Total ticket sales for this time period were $5 billion, ranking Florida the 2nd highest among U.S. lotteries in total sales.[4]

Since its inception, the Lottery has outsourced its core functions to produce, advertise, and sell tickets. In Fiscal Year 2013-14, the Lottery allocated approximately 74%, or $115.5 million, of its $155.5 million appropriation to produce and advertise draw and scratch-off games. Vendor contracts include those listed below.

- A contract with Scientific Games International to print, market, and distribute scratch-off game tickets. This contract expires in September 2018.
- A contract with GTECH Corporation to provide a terminal-based system for its draw games. The terminal-based gaming system provided by GTECH Corporation includes computer systems and retailer terminals, scratch-off and full-service vending machines, telecommunications, and technical support services. This contract expires in March 2015.
- A contract with St. John & Partners for general market advertising services. This contract expires in August 2015.
- A contract with Machado Garcia-Serra for Spanish language advertising services. The maximum term of the contract ends in May 2014, and the department is in the process of procuring a new contract.

Revenue Performance

In Fiscal Year 2012-13, the Lottery transferred $1.424 billion to the Educational Enhancement Trust Fund, $103 million more than the prior year. Adjusted for inflation, these transfers represent a recovery compared to transfers made prior to the beginning of the recession in 2007.

Transfers exceeded the legislative standard of $1.206 billion, the Lottery's internal objective of transferring at least $1 billion annually to the Educational Enhancement Trust Fund, and the Revenue Estimating Conference forecast.[5] Revenues are projected to continue to increase during the current fiscal year. The November 2013 Revenue Estimating Conference projected that the Lottery's transfers to education will be $1.483 billion, an increase of $59 million, in Fiscal Year 2013-14.

Revenue Enhancement Options

The Lottery has taken steps in the past year to maintain and increase its sales and transfers to the Educational Enhancement Trust Fund, such as enhancing its product mix by adding higher priced ($25) scratch-off games (Millionaire and 100X the Cash). The Lottery estimates that the Millionaire game earned an additional $71 million in transfers since its launch in September 2012, and the 100X the Cash game earned an additional $43 million in transfers since its launch in September 2013.

The Lottery has continued to increase its product distribution outlets through instant ticket vending machines. In addition, the Lottery deployed 500 full-service vending machines as of November 2012, which dispense both scratch-off and draw game tickets, as authorized by the 2012 Legislature. Lottery estimates that it earned an additional $29 million from the use of full-service vending machines during Fiscal Year 2012-13, and it will exceed the impact conference estimates of $21 million based on use of 350 full-service vending machines during 2013-14.

In May 2013, the Lottery also implemented Mega Millions, which is a multi-state game similar to Powerball. We estimate that the Lottery will

[3] To sell its 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.

[4] Also, Florida ranked first among U.S. lotteries in the percentage increase in total sales for 2012-13.

[5] The Lottery's legislatively-approved performance standards are reported in its long-range program plan: *Long Range Program Plan Fiscal Years 2014-15 through 2018-19*, Florida Lottery, September 30, 2013.

achieve additional revenues of $43 million from implementing Mega Millions in Fiscal Year 2013-14, after accounting for the shift from sales of other Lottery products. We previously recommended that the Lottery consider offering Mega Millions to enhance its revenues.

To further increase sales and transfers, the Lottery could implement additional games or expand product distribution by adopting new ways of selling lottery tickets. Some of these options are discussed below. Appendix A details new game options and Appendix B lists additional product distribution options, along with their advantages and disadvantages. The estimated values of the revenue enhancements presented in Appendices A and B are based on individual options; if multiple options were implemented concurrently, the fiscal impact of each would likely be smaller due to shifts in sales from one game to another. Fiscal impact estimates assume lottery customers and retailers would be educated and ready to play as soon as new games or product distribution options were made available. However, actual sales would likely begin at lower levels during a startup period. In addition, adding new lottery games or expanding distribution options could represent an expansion of legalized gambling and could produce negative social costs.[6, 7]

For purposes of this report, we did not evaluate whether new game or product distribution options could affect revenues from the gaming compact between the State of Florida and the Seminole Tribe of Florida.[8] If the Lottery were to implement a new option, it would need to determine whether the implementation would have any potential impact on compact revenues.

[6] For more information on the negative social costs, see *Lottery Profits Flat; Increasing Retailer Outlets is Critical to Increasing Sales*, OPPAGA Report No. 10-16, January 2010; and *Gambling Impact Study*, Spectrum Gaming Group, October 2013.

[7] Fiscal impact estimates presented in this report do not account for negative social costs and shifts of other taxable economic activity. These factors could reduce the net revenue to the state.

[8] A gaming compact between the State of Florida and the Seminole Tribe of Florida was approved by the Governor on April 7, 2010, ratified by Ch. 2010-29, *Laws of Florida*, and approved by the U.S. Department of the Interior on July 6, 2010. The gaming compact provides the Tribe with partial but substantial exclusivity with respect to the play of covered games in exchange for payments to the state derived from gaming proceeds.

New lottery games could generate substantial revenues, but could represent expanded gambling

Florida could consider adding lottery games such as fast keno or another type of monitor game that might attract new players and substantially increase state revenues. Fast keno is a draw lottery game in which players choose from 10 to 12 numbers from a panel of 80 numbers in the hope of matching their choices to 20 numbers drawn by a central computer. Fast keno is similar in principle to other draw games, but occurs more frequently (typically every four to five minutes).

As shown in Appendix C, 15 U.S. lotteries offer fast keno.[9, 10] A wide variety of retailers in these states participate, such as convenience stores, grocery stores, liquor stores, tobacco stores, bars, restaurants, fraternal organizations, and bowling alleys. Participating retailers often have monitors in their establishments that display game results to players. However, some states also offer "keno-to-go" whereby players may purchase tickets from retailers, leave the establishment, and check for winning numbers on the Lottery's website.

We estimated that implementing fast keno could generate approximately $107 million in additional annual transfers to education.[11, 12] To implement fast keno in Florida, the Legislature would need to grant budget authority for the Lottery to spend

[9] Lotteries in California, Delaware, the District of Columbia, Georgia, Kansas, Maryland, Massachusetts, Michigan, Missouri, New York, Ohio, Oregon, Rhode Island, the U.S. Virgin Islands, and West Virginia offer fast keno.

[10] Connecticut is in the planning stages of implementing fast keno.

[11] We estimated a range of potential fast keno revenue ($18 million to $642 million, with a median of $107 million) based on the highest and lowest per capita sales in states that offer fast keno, which we applied to Florida's estimated population for 2015. Our estimate assumes a transfer rate to the Educational Enhancement Trust Fund of 30.38%, based the average fast keno payout in other states of 60.62%, and an administrative expense rate of 9%, which was determined by the Florida Lottery. The estimate also assumes that 10% of sales would be shifted from existing game sales.

[12] Our estimate is based on the median per capita sales for states that offer fast keno. However, Florida Lottery administrators believe that Florida's sales experience would take several years to build, depending on a factors associated with launching fast keno, such as needing to recruit new retailers, e.g., bars and other social establishments. In addition, Lottery administrators believe fast keno sales in Florida would more closely resemble that of Georgia, which would lower the estimate to $95 million.

sales revenue to acquire or contract for a fast keno gaming system.[13] Fast keno is reportedly more addictive than traditional lottery games due to its fast play style.

Some U.S. lotteries also offer other monitor games, which are computer simulations of poker, bingo, or horse racing.[14] As with fast keno, retailers have monitors that display game results to players. Winning numbers are randomly drawn by a central computer, and draws occur frequently (typically every four to eight minutes). We estimated that implementing a monitor game could generate approximately $19 million in additional transfers per year.[15] As with fast keno, monitor games may be more addictive than traditional lottery games.

New ticket-selling methods could also generate additional revenues

The Legislature and the Lottery could consider expanding product distribution, as shown in Appendix B. For example, selling lottery products over the Internet could increase sales and provide more convenience to players. The U.S. Department of Justice released a legal opinion in December 2011 that found state lotteries' use of the Internet and out-of-state transaction processors to sell lottery tickets to adults within their states' borders does not violate federal law.

Subsequent to this decision, Illinois, Georgia, and Minnesota have begun online sales of individual lottery draw game tickets.[16] In March 2012, Illinois became the first state to sell individual draw game tickets over the Internet. The Illinois Lottery website allows players who are over the age of 18 and are residents of Illinois to purchase tickets for Lotto, Mega Millions, and Powerball. In 2012-13, the Illinois Lottery sold $6.5 million in lottery tickets over the Internet. As of November 2012, individuals who register on the Georgia Lottery website are able to purchase Mega Millions, Powerball, and Fantasy 5 tickets online while located within the state of Georgia. Between November 2012 and October 2013, the Georgia Lottery sold $1.3 million in lottery tickets over the Internet. In addition, the Minnesota Lottery modified its subscription website in September 2013 to allow registered players to purchase individual tickets for six draw games, including Lotto, Mega Millions, and Powerball.[17] Players must be at least 18 years old and located within the state while making purchases.

Potential revenue from implementing Internet sales in Florida is uncertain at this time. U.S. lotteries have been selling tickets over the Internet for a relatively short period of time. Only Georgia and Illinois have had Internet sales for at least a year, and first year sales for Illinois were likely affected by implementation issues. The Illinois Lottery redesigned its Internet sales website to make it more user-friendly after players experienced problems with the user interface.

Offering lottery products over the Internet would require statutory revisions. Florida law currently restricts the use of player-activated terminals and does not authorize the use of credit cards or other instruments issued by a bank for lottery purchases without a purchase of $20 in other goods.[18] In addition, the state would need to comply with federal laws that require state regulations to include age and location verification to reasonably

[13] In addition, implementing fast keno may require legislative action to modify the requirement for a drawing to be witnessed by an accountant, given that electronic drawings could occur every five minutes (s. 24.105(9)(d), *F.S.*).

[14] We identified five U.S. lotteries that offer monitor games: Kansas, Maryland, Massachusetts, Rhode Island, and the District of Columbia.

[15] We estimated a range of potential monitor game revenue ($6 million to $123 million, with a median of $19 million) based on the highest and lowest per capita sales in states that offer monitor games, which we applied to Florida's estimated population for 2015. Our estimate assumes a transfer rate to the Educational Enhancement Trust Fund of 30.38%, based the average fast keno payout in other states of 60.62%, and an administrative expense rate of 9%, which was determined by the Florida Lottery. The estimate also assumes that 10% of sales would be shifted from existing game sales.

[16] In addition to these three states, in November 2013, the Delaware Lottery launched online casino gaming on three casino websites. The participating casinos already offer video lottery terminals, which can be programmed to play casino-style games, such as poker, blackjack, fast keno, and bingo, or simulate mechanical slot machines or roulette wheels.

[17] Minnesota Lottery officials are also considering adding an online version of scratch-off games.

[18] Section 24.105(9)(a), *F.S.*, restricts the use of player-activated machines and s. 24.118(1), *F.S.*, requires the purchase of no less than $20 of other goods and services in order to use a credit card or other instrument issued by a bank to purchase lottery products.

block access to minors and persons located outside the state. As has happened in other states, retailers may oppose this option due to concerns that they would lose lottery sales commissions and revenues from sales of other in-store products, as players would no longer need to visit a retailer to make a lottery purchase.

Subscription sales is another product distribution method that could increase sales. Other states permit subscription sales for certain draw games through the mail or via the Internet.[19] Typically, players purchase subscriptions for three months' to a year's worth of drawings for numbers they select or request as quick picks. Players make purchases by filling in forms and submitting them on the lottery's website or downloading forms and mailing them in with a payment. For instance, New Hampshire sells Hot Lotto, Mega Millions, Powerball, and Tri-State Megabucks subscriptions over the Internet. Players must be 18 years of age or older and have a New Hampshire mailing address. We estimated that annual sales through subscriptions could generate an additional $4 million in transfers to education.[20] As with Internet sales, retailers may oppose this option due to concerns that they would lose lottery sales commissions and revenues from sales of other in-store products.

[19] We identified 11 U.S. lotteries that offer subscription sales for draw games: Illinois, Maine, Maryland, Massachusetts, Minnesota, New Hampshire, New York, North Carolina, North Dakota, Vermont, and Virginia. Six lotteries accept credit cards, two require players to mail in a check or money order, and three require a valid bank account for electronic fund transfers. Of the three states that require an electronic fund transfer, one state (North Carolina) is planning to allow use of debit cards in the future.

[20] We estimated a range of potential subscription sales revenue ($1 million to $11 million, with a median of $4 million) based on the highest and lowest per capita sales in states that offer subscription sales, which we applied to Florida's estimated population for 2015. Our estimate assumes a transfer rate to the Educational Enhancement Trust Fund of 40.54%, based on the November 2013 Revenue Estimating Conference projected draw game transfer rate for FY 2015-16. The estimate also assumes that 5% of sales would be shifted from existing game sales per the Florida Lottery.

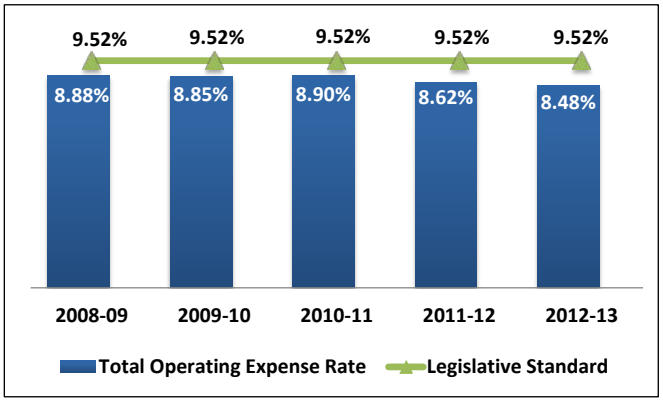
Operational Efficiency Options

The Lottery continues to keep its expenses as a percentage of sales low and below the legislative standard. For additional efficiencies, the Legislature could consider removing the statutory prohibition against purchasing lottery vending machines, which would provide the department with more flexibility when pursuing cost savings in lease-versus-buy procurement decisions.

The Lottery's operating expense rate is lower than the legislative standard

The Lottery's operating expenses in relation to its ticket sales continue to be lower than the legislative standard, as shown in Exhibit 1.[21] Compared to other U.S. lotteries, the Florida Lottery had the 3rd lowest operating expense rate in Fiscal Year 2011-12, behind New Jersey and Massachusetts.[22]

Exhibit 1
The Lottery's Operating Expense Rate Continues to Be Below the Legislative Standard



Source: Department of the Lottery long range program plans.

[21] Operating expenses include payments to gaming vendors and retailer commissions.

[22] Florida Lottery's ranking is based on the latest fiscal year data available from La Fleur's *2013 World Lottery Almanac*, excluding state lotteries that offer video lottery terminals.

The department continues to implement initiatives to improve its operational efficiency. For example, the department has renegotiated some of its vendor contracts to achieve cost savings. Department officials report that they renegotiated the contract with Scientific Games and exercised two two-year renewals, resulting in savings of approximately $16 million over the four-year life of the renewal period. According to department officials, they also renegotiated the contract with St. John & Partners to reduce the rate of compensation for advertising and provide additional services at no cost to the Lottery.

The department also has an initiative to avoid penalties assessed by the IRS when prizewinners do not accurately report their identifying information. The Lottery relies on prizewinners to report their identifying information accurately, but when they do not do so, the Lottery is assessed penalties. The department has been able to mitigate those fines, but responding to IRS correspondence is time-consuming and requires staff effort to retrieve data. The department became more proactive in collecting the correct information at the time the prize is paid by participating in the IRS's Taxpayer Identification Number Matching Program at no cost to the state. This program allows the Lottery to compare prizewinner information against IRS taxpayer information on a quarterly basis and identify potential problems.

In addition, the department is planning a pilot program in which district offices paying prizewinners will check the information provided by the winner against IRS records. If the information is returned as incorrect, Lottery staff will be able to obtain the correct information while the winner is present in the district office.

The Lottery has streamlined its retailer recruitment processes and no longer plans to complete a cost-benefit analysis

The department's Sales Division is responsible for recruiting independent and corporate retailers to sell lottery products, thus enhancing Lottery revenues by maintaining and expanding the retailer network. In our 2011 report, we recommended that the department annually complete a retailer recruitment cost-benefit analysis and use the resulting data to evaluate the cost efficiency of several recruitment activities, adjust these efforts as needed, and plan future activities.[23] We made this recommendation due to uncertainty regarding the cost effectiveness of some of the recruitment strategies the department was using, including recruitment seminars and district outreach missions.

Department administrators had planned to conduct a cost-benefit analysis at the end of Fiscal Year 2012-13, but decided not to do so because the department shifted its recruitment focus to increasing sales at its existing corporate retailers and recruiting additional corporate chain stores, while reducing the effort spent on recruiting independent retailers.[24] Department administrators made these changes because corporate chain retailers tend to generate higher sales volume than small independent retailers. In addition, corporate retailers have a lower risk of insolvency than independent retailers.

The department is working with its existing corporate retailers to gain approval to use methods such as plan-o-grams and automatic ticket re-ordering, as well as to increase the number of displays (product facings) and secondary sales locations through the use of lottery vending machines.[25] For recruitment, the department has developed a list of retail chains that do not sell Lottery products. Department staff maintains contact with the corporate headquarters of these chains to try to gain approval to offer Lottery products in their stores, even if only on a pilot basis.[26] The department also streamlined its operations by merging the

[23] *Lottery Profits Decline; Options Available to Enhance Transfers to Education*, OPPAGA Report No. 11-12, March 2011.

[24] *Lottery Revenue Has Increased Over the Past Year; Options Remain to Enhance Transfers*, OPPAGA Report No. 13-02, January 2013.

[25] Plan-o-grams are monthly notifications from the Department of the Lottery that inform retailers of the top selling scratch-off games so that they can stock and prominently display the top sellers.

[26] The Department of the Lottery implemented a pilot project with Walmart in which lottery products are being sold in 63 of the retailer's Neighborhood Market stores. Currently, Florida is the only U.S. lottery for which Walmart sells lottery products.

former Business Development unit into the Sales Division. Formerly, the two units both had responsibilities for corporate retailer recruitment.

In addition, the department has eliminated recruitment activities that it determined were not worth the investment of time and resources. For example, the department is no longer conducting recruitment seminars and district outreach missions to recruit independent retailers, and has eliminated staff positions at the central office that used to take calls from interested retailers and route the referrals to district offices. For independent retailers, the department primarily depends on referrals from its website. The site directs potential retailers to the district offices, which are responsible for following up on these leads. Sales representatives are also responsible for contacting new retailers they see opening up for business in their regions.

In addition, the Department of the Lottery is participating in the one-stop business registration portal initiative. The initiative, led by the Department of Revenue, is intended to give individuals and businesses a single point of entry for actions such as completing applications for licenses, registrations, or permits to transact business in the state.[27] According to Lottery officials, when the portal is implemented, the Lottery will receive contact information for businesses interested in becoming lottery retailers.

Although the department has not increased the number of retailers in its network, department officials cited an overall increase in sales as indicating that their shift in recruitment focus has been successful. In Fiscal Year 2008-09, corporate retailers accounted for 47% of approximately $3.973 billion in gross ticket sales, while in Fiscal Year 2012-13, corporate retailers accounted for 52% of approximately $5.012 billion in gross ticket sales. In addition, a July 2013 survey of Florida Lottery retailers found that their satisfaction with the volume of lottery sales has increased from 84% in 2010 to 90% in 2013.

[27] Chapter. 2012-139, *Laws of Florida*.

Current statutes prohibit the purchase of vending machines

Florida statutes currently require the Department of the Lottery to lease all vending machines.[28] The Lottery leases 1,500 instant ticket vending machines (ITVMs) and 500 full-service vending machines from GTECH.

We identified four other state lotteries that own ITVMs, one of which conducted a cost benefit analysis of the merits of owning versus leasing.[29] The Iowa Lottery conducted an analysis in 2004 and determined that over a six-year period, it would spend approximately $3.7 million in ownership costs for 325 ITVMs compared to $5 million to lease the machines. The cost of ownership included the purchase price, monthly maintenance, and occasional machine relocations.[30, 31] For 24-game ITVMs, the size used by the Florida Lottery, the annual savings was approximately $950 per ITVM from owning rather than leasing.[32] The Iowa Lottery has used the machines it purchased for nine years, and thus continued to realize cost savings.[33, 34] If the Florida Lottery experienced similar savings for its 1,500 ITVMs, it would save approximately $1.4 million annually over a six-year period, a total of $8.4 million.

[28] Section 24.111 (2)(h), *F.S.*

[29] The Iowa, Maryland, New York, and Pennsylvania lotteries own instant ticket vending machines. Only the Iowa Lottery had documentation of a cost benefit analysis conducted when lottery officials made the initial decision to purchase rather than lease the machines.

[30] Lotteries may need to move vending machines from one retailer to another, such as when a retailer goes out of business.

[31] The Iowa Lottery contracted with the vendor from which it purchased the machines to maintain and relocate them when necessary.

[32] The Florida Lottery leases ITVMs that can hold 24 scratch-off games. The Iowa Lottery's analysis calculated savings over a six-year period for a mixture of five sizes of machines. The machine sizes ranged from those that would hold 8 scratch-off games ($430 annual savings per machine) to those that would hold 24 scratch-off games ($950 annual savings per machine).

[33] The machines are now nearing the end of their useful life.

[34] The calculation of savings does not include some of the costs of ownership, such as disposal of the machines at the end of their useful life.

Florida and other state lottery officials we contacted had mixed views on whether lotteries should own or lease vending machines. Officials of lotteries that have chosen to purchase vending machines believed that their overall costs were lower than if they made monthly lease payments, even including the costs of maintaining and relocating machines. Officials from state lotteries that lease vending machines, including those from the Florida Lottery, believe it is more advantageous to lease vending machines. They cited the upfront costs for purchasing the machines, as well as the costs and not having to deal with matters such as technology upgrades, machine theft or damage, liability, maintenance, relocation, and disposal; all of which can be covered in a lease agreement.

Given the potential for cost savings, the Legislature could consider amending s. 24.111(2)(h), *Florida Statutes*, to give the Lottery authority to purchase vending machines when cost effective. Pending this statutory change, as part of the Lottery's procurement to replace its contract with GTECH, it should solicit separate bids for leasing and for purchasing vending machines. The Lottery should consider requesting that vendor proposals to sell vending machines include all associated costs, such as maintenance, relocation, and disposal. The Lottery should use this information to determine which procurement method is most cost beneficial to the state.

Return to the Educational Enhancement Trust Fund from Lottery Advertising—

Advertising is one of several factors that affect Lottery sales; increasing advertising is not likely to increase transfers to education

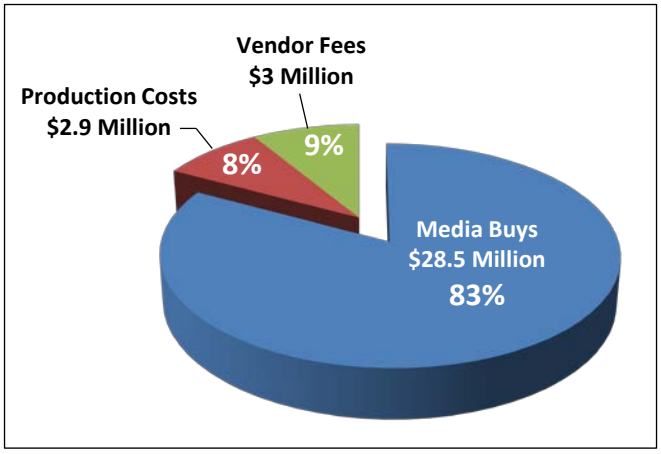
Although advertising increases lottery ticket sales, jackpot amounts and other factors have more influence on sales. Increasing the Lottery's current level of advertising expenditures is not likely to translate into an increase in net revenues, as we estimate that the return to the Educational Enhancement Trust Fund (transfers to education) for $1.00 of advertising is less than one dollar ($0.94). While the Lottery appears to have reached a saturation point for its advertising expenditures, major reductions in advertising have the potential to adversely affect transfers to education.

To assess Lottery advertising effectiveness, we analyzed the relationship between advertising expenditures and sales over seven years (from July 2006 to June 2013) using department data for its 10 market areas. We provide a range and midpoint for estimates of the return to the trust fund from advertising expenditures; the midpoint is the best estimate of the return to the trust fund, and there is a 95% probability that the actual return falls within the range.[35] The econometric model we used to estimate the advertising return to the trust fund is strong, explaining 81% of the variation in Lottery ticket sales. (See Appendix D for a more detailed discussion of our research methodology.)

The Lottery spends significant funds each year on advertising. Lottery advertising costs include media buys (TV and radio airtime, billboard space, Internet and print advertisement), production costs, and fees paid to advertising vendors. As shown in Exhibit 3, the Lottery reports spending a total of $34.4 million on media buys, production costs, and vendor fees in Fiscal Year 2012-13. The majority of these expenditures were for media buys (83%), while production costs accounted for 8% and vendor fees 9%. These expenditures represent less than 1% of the Florida Lottery's total ticket sales of $5 billion in Fiscal Year 2012-13.

[35] We do not present an analysis of the return to the trust fund for specific draw game and scratch off advertising or for media types (e.g., billboards radio, and TV) as our estimate ranges had considerable overlap, indicating there were no significant differences.

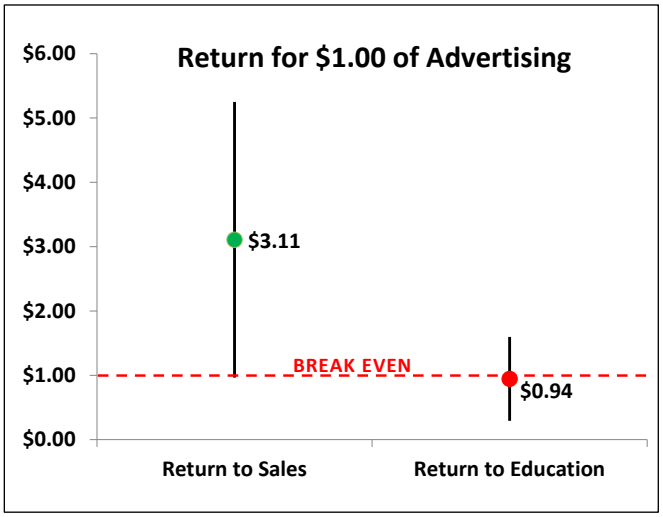
Exhibit 3
For Fiscal Year 2012-13, the Florida Lottery Reported Spending $34.4 Million on Media Buys, Production Costs, and Vendor Fees[1]



[1] Does not include $3.3 million for special events, strategic sponsorships, and the live drawing studio.

Source: OPPAGA analysis of data from the Department of the Lottery.

Exhibit 4
Increased Lottery Advertising Is Not Likely to Increase Net Education Revenues



Source: OPPAGA analysis of data from the Department of the Lottery.

Advertising is one of several factors that affect Lottery sales. Our econometric analysis found that although advertising increases lottery ticket sales, most (approximately 80%) of the variation in sales over our study period was explained by six other factors: jackpot size, time of the year, market area, retailer density, general economic conditions, and the introduction of Powerball in Florida in 2009. For example, per capita Lottery sales are substantially higher when large jackpots are available for draw games such as Powerball, during the winter holiday season, in market areas near the Alabama boarder (a state that does not have a lottery), and when the economy is strong. After controlling for the other factors, advertising explained less than 1% of the variation in Lottery sales.

Higher levels of advertising expenditures are not likely to increase transfers to education. Our analysis indicated that at current advertising levels, $1.00 in advertising increases Lottery gross sales by an amount ranging from $0.96 to $5.25, with a midpoint of $3.11 (see Exhibit 4). However, this gross sales analysis does not take into account prize payouts and expenses that reduce the amount of revenue that would be available for transfer to the Educational Enhancement Trust Fund.

After accounting for all costs, including prize payouts, retailer commissions, and other operating expenses, approximately 30% of each dollar in sales was transferred to the Educational Enhancement Trust Fund during the seven-year study period. After accounting for this transfer rate, the estimated range of the net return to education for an additional dollar of advertising is between $0.29 and $1.60; the midpoint is $0.94.[36]

During the seven-year evaluation period, the department reduced the portion of advertising expenditures devoted to production costs. Therefore, we conducted an additional analysis limited to the last two years to determine whether these lower costs would result in a positive return to the trust fund. However, this analysis also showed that the midpoint in the range of possible net revenues was less than $1.00. We estimated that $1.00 of advertising expenditures over the two-year period of Fiscal Years 2011-12 and 2012-13 yielded a range of net revenue from $0.30 to $1.63. The midpoint is $0.96.

Our analysis suggests that advertising for Lottery products may have reached the saturation point—where an additional dollar of advertising

[36] This estimate controls for factors including jackpot amounts, time of the year, market area, retailer density, economic conditions, and the introduction of Powerball in Florida.

expenditures returns an additional dollar of revenue to education. Therefore, an increase in expenditures on advertising might exceed the corresponding returns to the Educational Enhancement Trust Fund. However, the study period included the worst economic downturn in recent Florida history, and thus our estimates of the return to the trust fund may understate future returns on advertising spending during a period with a strong economy.[37]

It should be noted that our findings do not necessarily show that advertising spending is too high for two reasons. First, the saturation point is within our model's estimated range, and thus there is still a possibility of positive returns from advertising. Second, experiences in other states suggest that major reductions in Lottery advertising may adversely affect education funding. A study of three states that significantly curtailed lottery advertising (two states eliminated television advertising and the third reduced its advertising budget by 97%) showed that large reductions in advertising expenditures result in substantial reductions in sales, and thus may reduce net transfers.[38, 39] (For more information on the econometric analysis we used, see Appendix D.)

Recommendations

While the department and the Legislature have increased transfers to education, additional actions could increase sales and efficiency and ultimately increase transfers to education.

Department Options

We recommend that the Department of the Lottery continue efforts to expand the retailer network. We also recommend that when the department seeks bids to replace its contract with GTECH, it solicit bids for both leasing and purchasing vending machines. The Lottery should consider requesting that vendor proposals to sell vending machines include all associated costs, such as maintenance, relocation, and disposal. The Lottery should use this information to determine which procurement method is most cost beneficial to the state.

Legislative Options

The Legislature could consider authorizing the Lottery to expand its current games and product distribution methods to enhance revenues, as described in Appendices A and B. If the Legislature is interested in a particular option, it could direct the Department of the Lottery to provide a more detailed analysis that includes advantages and disadvantages, potential revenues and costs, timeframes for implementation, needed statutory changes, and any impacts on the gaming compact with the Seminole Tribe of Florida.

In addition, the Legislature could consider amending s. 24.111(2)(h), *Florida Statutes*, to give the Department of the Lottery authority to purchase vending machines when cost effective.

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 E.

[37] Florida's unemployment rate was below 5%, the approximate natural rate of unemployment, for only the first 22 months of the 84-month study period. Our analysis showed that the economic downturn significantly reduced Lottery sales. However, possibly due to the limited duration of strong economic performance in the study period, we were unable to determine whether the economic downturn reduced the effectiveness of Lottery advertising.

[38] The three states were Illinois, Massachusetts, and Washington.

[39] Zhang, P. "Economic Analysis of State Lotteries in the United States." (Unpublished doctoral dissertation, University of Maryland, 2004.)

Appendix A

New Lottery Game Options

New games that attract new players have the potential to substantially increase revenues to education. Exhibit A-1 lists new game options, their advantages and disadvantages, and estimated revenues where we were able to develop reasonable estimates. The estimated revenues are based on individual options; if multiple options were implemented concurrently, the fiscal impact of each would likely be smaller due to shifts in sales from one game to another. Some new games that could generate significant revenue, such as fast keno, could increase the negative social costs of gambling. Estimates of annual revenue assume full implementation by July 1, 2014. However, some options would require additional time to implement, such as launching a keno or monitor game. For purposes of this report, we did not evaluate whether new game options could affect revenues from the gaming compact between the State of Florida and the Seminole Tribe of Florida.[40] If the Lottery were to implement a new option, it would need to determine whether the implementation would have any potential impact on compact revenues.

Exhibit A-1
New Games Have the Potential to Increase Revenues to Education

Option	Advantages	Disadvantages
Fast Keno Players choose from 10 to 12 numbers from a panel of 80 numbers in the hope of matching their choices to 20 numbers drawn by the central computer at Lottery headquarters; may be played frequently (e.g., every four to five minutes). Players watch a monitor at a retailer location to determine if they have won, or leave the premises and check the lottery's website for the winning numbers. Implementing this option may require legislative action to modify the requirement for a drawing to be witnessed by an accountant, given that electronic drawings could occur every four to five minutes (s. 24.105(9)(d), *F.S.*).	▪ Could generate approximately $107 million per year in recurring transfers to education[1] ▪ Can be limited to social settings such as bars, restaurants, and fraternal organizations, although other U.S. lotteries allow traditional lottery retailers to participate. Some state lotteries also offer "Keno-to-Go" at traditional lottery retailer sites whereby players purchase tickets, leave the premises, and check the lottery website to see if they have won. See Appendix C for more information on U.S. lotteries that offer fast keno. ▪ Would help the Lottery recruit new retailers in social venues	▪ Fast keno is reportedly more addictive than traditional lottery games ▪ Could be considered an expansion of gambling ▪ Requires legislative budget approval for a fast keno gaming system ▪ Sales are dependent on new retailer participation ▪ Requires careful analysis of impacts on Lottery Revenue Bond rate floor[2]
Daily Keno Players choose as many as 10 numbers from a panel of 80 numbers in the hope of matching their choices to 20 to 22 numbers drawn by the central computer at Lottery headquarters.	▪ Could generate approximately $10 million per year in recurring transfers to education[3]	▪ Could be considered an expansion of gambling ▪ Requires careful analysis of impacts on Lottery Revenue Bond rate floor[2]

[40] A gaming compact between the State of Florida and the Seminole Tribe of Florida was approved by the Governor on April 7, 2010, ratified by Ch. 2010-29, *Laws of Florida*, and approved by the U.S. Department of the Interior on July 6, 2010. The gaming compact provides the Tribe with partial but substantial exclusivity with respect to the play of covered games in exchange for payments to the state derived from gaming proceeds.

Option	Advantages	Disadvantages
Monitor Games Computer animated games, such as simulated horse racing, poker, and bingo, that are played on in-store monitors similar to the way fast keno is played Implementing this option may require legislative action to modify the requirement for a drawing to be witnessed by an accountant, given that electronic drawings could occur frequently (s. 24.105(9)(d), *F.S.*)	▪ Could generate approximately $19 million per year in recurring transfers to education[4] ▪ 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 ▪ Could be limited to pari-mutuel facilities or social settings, such as bars and restaurants	▪ Because of its rapid play style, it could be more addictive than traditional lottery games ▪ Could be considered an expansion of gambling ▪ Requires legislative budget approval for a new gaming system ▪ Requires careful analysis of impacts on Lottery Revenue Bond rate floor[2]
Expand Higher Priced Scratch-Off Games Standard scratch-off games offered at prices of $25 or more, with higher prizes and prize payout percentages	▪ Could generate significant revenues ▪ The Lottery's recent $25 scratch-off games (Millionaire and 100X the Cash) generated significant sales. The Lottery estimates that the Millionaire game earned an additional $71 million in transfers since its launch in September 2012, and the 100X the Cash game earned an additional $43 million in transfers since its launch in September 2013.	▪ Florida's previous introduction of $30 tickets generated lower than expected sales, but this may have been due to the play style of the ticket and the state of the economy at the time ▪ Requires careful analysis of impacts on Lottery Revenue Bond rate floor[2]

[1] We estimated a range of potential fast keno revenue ($18 million to $642 million, with a median of $107 million) based on the highest and lowest per capita sales in states that offer fast keno, which we applied to Florida's estimated population for 2015. Our estimate assumes a transfer rate to the Educational Enhancement Trust Fund of 30.38%, based on the average fast keno payout in other states of 60.62%, and an administrative expense rate of 9%, which was determined by the Florida Lottery. The estimate also assumes that 10% of sales would be shifted from existing game sales.

[2] Proceeds from Lottery Revenue Bonds have been used to finance the cost of constructing, acquiring, reconstructing, or renovating educational facilities at various locations throughout the state. The term bond rate floor is one the Lottery uses to describe and monitor the lowest Educational Enhancement Trust Fund transfer rate allowed in order to ensure the Lottery remains in compliance with the covenants established with each bond issuance. Therefore, the Lottery would need to ensure that prize payouts and expenses for new games enable it to meet or exceed the minimum transfer rate needed to remain in compliance with bond covenants.

[3] We estimated a range of daily keno revenue ($5 million to $24 million, with a median of $10 million) based on the highest and lowest per capita sales in states that offer daily keno, which we applied to Florida's estimated population for 2015. The estimate assumes a draw game transfer rate to the Educational Enhancement Trust Fund of 40.54%, based on the November 2013 Revenue Estimating Conference projected transfers for Fiscal Year 2015-16, and that 5% of the sales would be shifted from existing game sales.

[4] We estimated a range of potential monitor game revenue ($6 million to $123 million, with a median of $19 million) based on the highest and lowest per capita sales in states that offer monitor games, which we applied to Florida's estimated population for 2015. Our estimate assumes a transfer rate to the Educational Enhancement Trust Fund of 30.38%, based on the average fast keno payout in other states of 60.62%, and an administrative expense rate of 9%, which was determined by the Florida Lottery. The estimate also assumes that 10% of sales would be shifted from existing game sales.

Source: OPPAGA analysis of lottery industry and Department of the Lottery information.

Appendix B

Product Distribution Options

Making lottery products more accessible and convenient for players by expanding product distribution has the potential to substantially increase revenues to education. Authorizing product distribution through the Internet, increasing the number of retailers, and expanding the use of full-service vending machines have the potential to increase revenues by making lottery products more readily available to residents and tourists. Exhibit B-1 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. The estimated revenues are based on individual options; if multiple options were implemented concurrently, the fiscal impact of each would likely be smaller due to shifts in sales from one point of sale to another. Estimates of annual revenue assume full implementation by July 1, 2014. However, some options would likely require additional time to implement. For purposes of this report, we did not evaluate whether new product distribution options could affect revenues from the gaming compact between the State of Florida and the Seminole Tribe of Florida.[41] If the Lottery were to implement a new option, it would need to determine whether the implementation would have any potential impact on compact revenues.

Exhibit B-1
Expanding Product Distribution Has the Potential to Increase Revenues to Education

Option	Advantages	Disadvantages
Authorize Internet Sales The Legislature would enact laws to authorize intrastate Internet sales of lottery products Implementing this option would require statutory changes to allow player-activated terminals (s. 24.105, F.S.), and allow use of credit cards or other instruments issued by a bank for lottery purchases without requiring purchase of $20 in other goods (s. 24.118, *F.S.*)	▪ Provides more convenience to players who prefer to purchase their lottery products from their personal computer or cellular device	▪ Must comply with federal laws that require state regulations to include age and location verification to reasonably block access to minors and persons located outside the state ▪ Requires legislative budget approval for enhanced systems and technology ▪ Could be considered an expansion of gambling ▪ As has happened in other states, retailers may oppose this option due to concerns that they would lose lottery sales commissions and revenues from sales of other in-store products, as players would no longer need to visit a retailer to make a lottery purchase
Subscription Play The state would allow players to subscribe to game drawings for up to one year in advance on the Florida Lottery website. For prizes under a specified amount (e.g., $600), players would receive automatic credit or the Lottery would mail them a check. Implementing this option may require statutory changes to allow player-activated terminals (s. 24.105, *F.S.*), and allow use of credit cards or other instruments issued by a bank for lottery purchases without requiring purchase of $20 in other goods (s. 24.118, *F.S.*)	▪ Could generate approximately $4 million per year in recurring transfers to education[1] ▪ Internet technology has made subscription services much 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	▪ Must comply within federal laws that require state regulations to include age and location verification to reasonably block access to minors and persons located outside the state ▪ Game changes require communication with players and possibly a replacement ticket ▪ Could have an effect on unclaimed prize funds, as prizes may be automatically credited to players ▪ Could be considered an expansion of gambling ▪ As has happened in other states, retailers may oppose this option due to concerns that they would lose lottery sales commissions and revenues from sales of other in-store products, as players would no longer need to visit a retailer to make a lottery purchase

[41] A gaming compact between the State of Florida and the Seminole Tribe of Florida was approved by the Governor on April 7, 2010, ratified by Ch. 2010-29, *Laws of Florida*, and approved by the U.S. Department of the Interior on July 6, 2010. The gaming compact provides the Tribe with partial but substantial exclusivity with respect to the play of covered games in exchange for payments to the state derived from gaming proceeds.

Option	Advantages	Disadvantages
Paying at the Pump for Lottery Products Players would be able to purchase lottery products as part of the transaction involved in purchasing gasoline at the pump[2] Implementing this option may require statutory changes to allow player-activated terminals (s. 24.105, *F.S.*), allow use of credit cards or other instruments issued by a bank for lottery purchases without requiring purchase of $20 in other goods (s. 24.118, *F.S.*), modify the definition of and requirements for lottery retailers (ss. 24.103 and 24.112, *F.S.*), modify the definition of and requirements for lottery vending machines (s. 24.112, *F.S.*), address the prohibition against selling lottery tickets at anything other than the price set by the Lottery (s. 24.117, *F.S.*), and address the prohibition against taking compensation for claiming a lottery prize on behalf of someone else (s. 24.118 *F.S.*).	▪ The ability to purchase tickets at the pump would increase convenience and avoid the loss of sales from players who have no need to walk into the store to pay for gas. Ideally, the consumer would be able to combine their gas and lottery purchase. ▪ Offering this option at ATMs may help expand the retailer network to non-traditional locations	▪ Could be considered an expansion of gambling ▪ Paying at the pump eliminates the need for many consumers to go inside stores, which might affect the sale of other products retailers sell. However, Minnesota Lottery officials found that to date, in-store sales have not been negatively affected.
Expand Retailer Network Add additional corporate and independent Lottery retailers in both traditional locations, such as convenience and grocery stores, and non-traditional locations, such as chain drug stores, mass merchandisers, home improvement centers, bars, and restaurants	▪ Adding 200 new retailers has the potential to generate about $9 million annually in additional transfers to education[3] ▪ Florida has been below average in terminal density compared to other successful Lottery states, so expanding its network could improve per capita sales ▪ Could increase product distribution and awareness, making products available to new players who do not shop where products are currently being sold	▪ 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 development of different products, compensation frameworks, and distribution strategies ▪ May require additional lottery staff to service new accounts
Expand Full-Service Vending Machines Increase the number of full-service vending machines that dispense both scratch-off and draw game tickets	▪ An impact conference predicted net education funding gains of $21 million in the first full year of deploying 350 full-service vending machines ▪ Allows additional product access at high volume Lottery retailers ▪ Provides more convenience to players who do not want to stand in line to purchase tickets ▪ May attract large corporate retailers currently not selling lottery products because the vending machines minimize the need for on-site operators and increase player choice and the potential for larger sales ▪ Allows retailer network expansion into non-traditional retailer locations, such as airports, because the vending machines minimize the need for on-site operators	▪ The 2012 Legislature provided budget authority of $2.9 million to lease full-service vending machines.[4] Expanding the number of machines would likely require legislative budget approval to lease more vending machine units. ▪ Requires monitoring of underage play ▪ Some criticize the potential ease of access by problem gamblers

Option	Advantages	Disadvantages
Electronic Instant Ticket Vending Machine Players touch a video screen and receive the image of the instant ticket on the screen to reveal the outcome of the ticket Implementing this option may require modifying the definition of and requirements for lottery vending machines (s. 24.112, *F.S.*)	▪ The Department of the Lottery projected potential recurring transfers to education ranging from $33 million to $114 million per year depending on how implemented ▪ Provides a business model allowing retailer network expansion into non-traditional retailer locations, such as bars and restaurants	▪ Requires legislative budget authority to purchase or lease electronic instant ticket vending machines ▪ Requires monitoring of underage play ▪ Some stakeholders criticize the potential ease of access by problem gamblers

[1] We estimated a range of potential subscription sales revenue ($1 million to $11 million, with a median of $4 million) based on the highest and lowest per capita sales in states that offer subscription sales, which we applied to Florida's estimated population for 2015. Our estimate assumes a transfer rate to the Educational Enhancement Trust Fund of 40.54%, based on the November 2013 Revenue Estimating Conference projected draw game transfer rate for FY 2015-16. The estimate also assumes that 5% of sales would be shifted from existing game sales per the Florida Lottery.

[2] The Minnesota Lottery has developed the technology and payment processes needed to implement this option, and began to offer lottery purchases at gas stations and ATMs in October 2012. After pilot testing the system, the Minnesota Lottery will be expanding its distribution points. To make purchases, players use a debit card and select the option to purchase lottery tickets as part of the transaction for purchasing gas or using an ATM. The lottery purchase shows on the receipt, and they may also choose to receive a text message and/or register on the lottery website to track their purchases. The lottery automatically credits the bank account associated with the debit card for prizes under $600. The Missouri Lottery is in the planning stages of implementing this option.

[3] We estimated potential revenues from expanding the retailer network by assuming that the 200 retailers would achieve at least the average weekly gross sales new retailers achieved in 2013. The estimate assumes all 200 terminals being active for a full year and that 20% of their sales would be shifted from existing retailers.

[4] The Lottery's Fiscal Year 2013-14 appropriation to lease full-service vending machines was lower ($1.6 million) than in Fiscal Year 2012-13 ($2.9 million) due to a one-time equipment allowance from the vendor.

Source: OPPAGA analysis of lottery industry and Department of the Lottery information.

Appendix C

Other U.S. Lotteries Offer Fast Keno

We identified 15 U.S. lotteries that offer fast keno.[42] As shown in Exhibit C-1, a wide variety of retailers participate, such as bars, bowling alleys, convenience stores, fraternal organizations, grocery stores, liquor stores, restaurants, and tobacco stores.

Table C-1
Fifteen U.S. Lotteries Offer Fast Keno at a Wide Variety of Venues

U.S. Lottery[1]	Name of Fast Keno Game	Examples of Retailers/ Venues
California	Hot Spot	Bars, bowling alleys, casinos, convenience stores, fraternal organizations, grocery stores, and restaurants
Delaware	Keno	Bars, casinos, convenience stores, liquor stores, restaurants, and tobacco stores
District of Columbia	D.C. Keno	Convenience stores, grocery stores, liquor stores, and restaurants
Georgia	Keno!	Bars, convenience stores, fraternal organizations, grocery stores, and restaurants
Kansas	Keno	Bars, convenience stores, fraternal organizations, grocery stores, and restaurants
Maryland	Keno	Bars, bowling alleys, convenience stores, grocery stores, restaurants, and tobacco stores
Massachusetts[2]	Keno	Keno: Bars, convenience stores, fraternal organizations, grocery stores, restaurants, and tobacco stores Keno-to-Go: Convenience stores, grocery stores, liquor stores, pharmacies, and tobacco stores
Michigan[2]	Club Keno	Keno: Bars, bowling alleys, fraternal organizations, and restaurants Keno-to-Go: Convenience stores, grocery stores, pharmacies, and tobacco stores
Missouri[2]	Club Keno	Keno: Bars, bowling alleys, fraternal organizations, and restaurants Keno-to-Go: Bars, bowling alleys, convenience stores, fraternal organizations, grocery stores, liquor stores, pharmacies, restaurants, and tobacco stores
New York	Quick Draw	Bars, convenience stores, grocery stores, pharmacies, and restaurants
Ohio[2]	Keno	Keno: Bars, fraternal organizations, liquor stores, restaurants, and tobacco stores Keno-to-Go: Bars, convenience stores, fraternal organizations, grocery stores, liquor stores, pharmacies, restaurants, and tobacco stores
Oregon[2]	Keno	Bars, bowling alleys, convenience stores, fraternal organizations, grocery stores, liquor stores, restaurants, and tobacco stores
Rhode Island[2]	Keno	Keno: Bars, bowling alleys, convenience stores, fraternal organizations, grocery stores, liquor stores, and restaurants Keno-on-the-Go: Convenience stores, grocery stores, liquor stores, pharmacies, and restaurants
U.S. Virgin Islands	Caribbean Keno	Bars, convenience stores, grocery stores, pharmacies, and restaurants
West Virginia	Keno Bonus	Bars, bowling alleys, convenience stores, fraternal organizations, liquor stores, and restaurants
TOTAL U.S. LOTTERIES	**15**	

[1] Six states (Alabama, Alaska, Hawaii, Mississippi, Nevada, and Utah) do not operate a lottery.

[2] The Massachusetts, Michigan, Missouri, Ohio, Oregon, and Rhode Island lotteries offer "Keno-to-Go" whereby players can purchase tickets for keno drawings, leave the retailer's premises, and check for winning numbers on the Lottery website.

Source: OPPAGA analysis of information from U.S. lottery websites.

[42] Connecticut is in the planning stages of implementing fast keno.

Appendix D

Method Used to Estimate the Return to Education from Advertising Lottery Products

To estimate transfers to the Educational Enhancement Trust Fund generated by Lottery advertising, we used ordinary least squares time series regression. This statistical method uses the correlation between the timing of lottery sales and media expenditures to estimate the return in sales for $1.00 spent in media expenditures, which can be converted to estimate the impact of $1.00 in advertising expenditures on transfers to the Florida Educational Enhancement Trust Fund.

Data. The Department of the Lottery provided sales data for the 84-month period between July 2006 and June 2013, and advertising expenditure data for the period March 2006 through June 2013. We used these slightly different time periods because sales tend to slightly lag advertising expenditures; prior research on lottery advertising concluded that advertising spending affects sales in the month that the expenditure was made as well as subsequent months. The department also provided data on lottery retailers and advertised jackpots. The University of Florida's Bureau of Economic and Business Research provided county-level data on population and taxable sales, and we obtained county-level unemployment information from the U.S. Bureau of Labor Statistics.

Methods of analysis. We used ordinary least squares time series regression to estimate monthly lottery sales per capita generated by $1.00 in monthly media expenditures per capita (excluding advertising production costs and vendor fees). We aggregated these data by month and market area, producing 84 months of observations for Florida's 10 market areas (n=840). Our model included media expenditures per capita for the current and two prior months, as well as combined monthly jackpot amounts for on-line games, population per lottery retailer, a flag for the months affected by the economic downturn, the calendar month (allowing us to adjust sales for seasonal patterns), and the market area. We also adjusted for the introduction of Powerball, a large multi-state jackpot game, to Florida in January 2009 by including a "Powerball era" flag and allowing the relationship between jackpots and sales to be different before and after the introduction of Powerball. The market area variables adjusted for local differences that influence sales, such as population characteristics that are not otherwise included in the model. We adjusted for serial correlation in the time series data using a correction based on the Durbin-Watson statistic. The final model explained 81% of the variation in lottery sales.

The return for media expenditures (e.g., purchased radio and television airtime or billboard space) is the estimated regression coefficient from the model described above. We applied two adjustment factors to this coefficient to produce an estimate of the return to the Educational Enhancement Trust Fund (transfers to education) per dollar of total advertising expenditures. First, we calculated the estimated return in sales from total advertising expenditures, including media, production, and advertising agency costs. We did this by multiplying the estimated return for media expenditures by the ratio of media expenditures to total advertising expenditures (0.78).

Second, we multiplied the estimate calculated above by 0.304 to reflect the results in terms of transfers to education. During our study's seven-year timeframe, about 30% of lottery sales were transferred to the Educational Enhancement Trust Fund to be used for education.

Statistical results. Our model found sales were strongly influenced by six factors: jackpot size, seasonality, market area, retailer density, general economic conditions, and the introduction of Powerball. For example, the introduction of Powerball significantly increased sales throughout Florida, and had a much larger effect on sales in the two market areas that share a boarder with Alabama, a state that does not have a lottery. These six factors explained over 80% of the variation in per capita Lottery sales.

In contrast, advertising had a statistically significant but modest effect on sales. After controlling for the other factors, advertising explained less than 1% of the variation in Lottery sales.

As shown in Exhibit D-1, the model produced confidence intervals, which are shown as the range of predicted estimates of the return from advertising. Overall, we estimate that $1.00 of advertising expenditures generated $0.94 (range of return from $0.29 to $1.60) in transfers to education.

Exhibit D-1
One Dollar of Advertising Expenditures Generates $0.94 in Transfers to Education

Expenditures	Estimate	Range
Lottery sales per $1.00 in media expenditures	$4.00	$1.24 to $6.76
Lottery sales per $1.00 in total advertising expenditures	$3.11	$0.96 to $5.25
Transfers to the Educational Enhancement Trust Fund	$0.94	$0.29 to $1.60

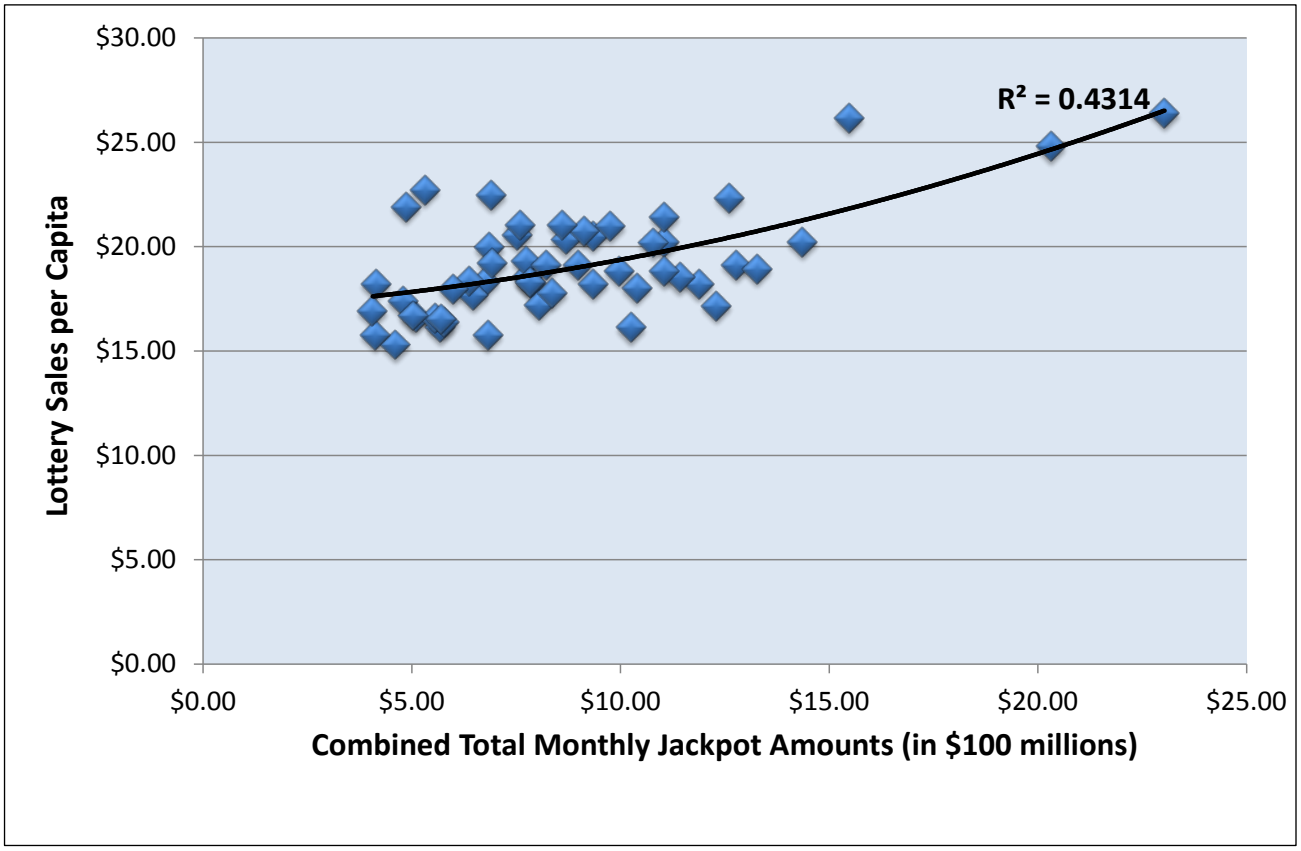
Source: OPPAGA analysis.

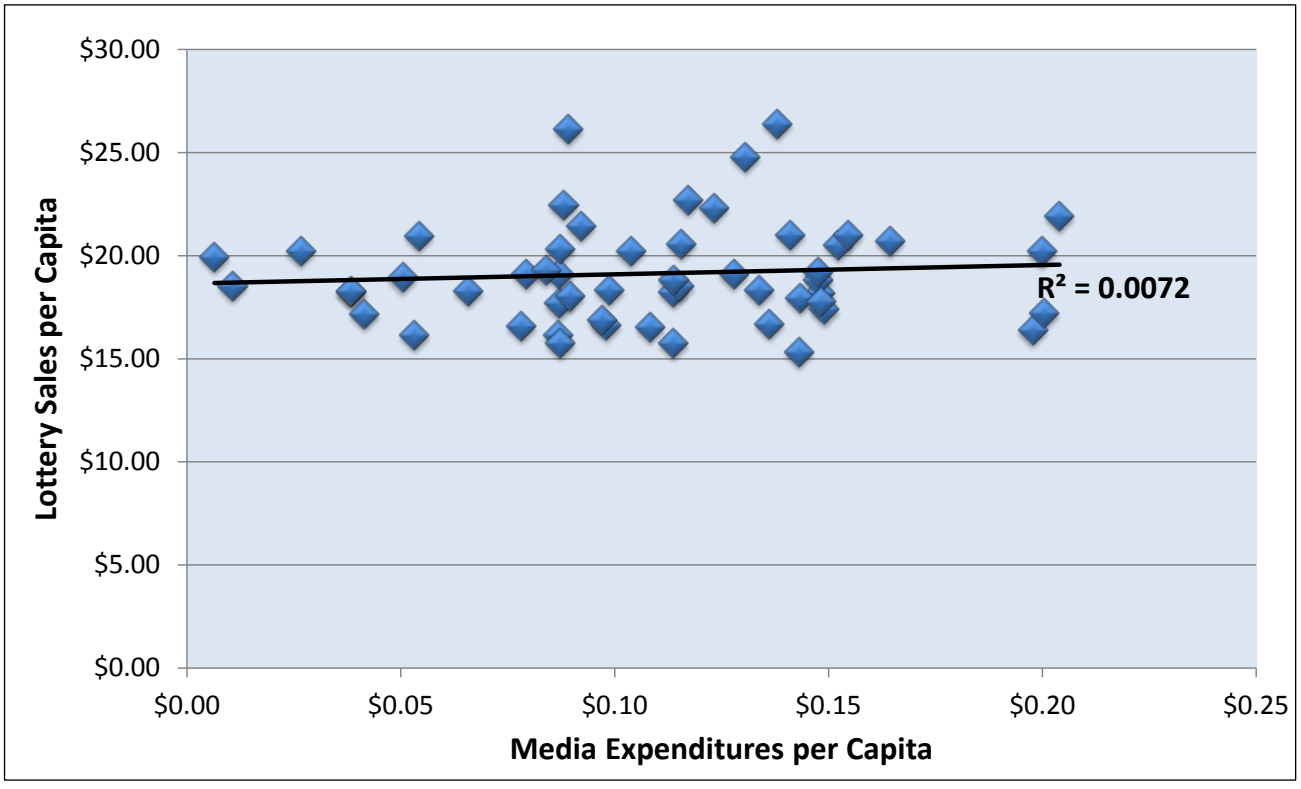
The estimated transfers to education per dollar of total advertising expenditures shown in Exhibit D-1 are based on adjustment factors calculated for the full study period. However, because the Department of the Lottery reduced the portion of advertising expenditures devoted to production costs in recent years, we conducted an additional analysis to determine whether advertising expenditures during recent time periods resulted in a positive return to the trust fund. If we assume reducing production costs did not change the effectiveness of media expenditures, and apply the adjustment factors from just the last two years of our study period (Fiscal Years 2010-11 and 2012-13), estimated transfers to education increase from $0.94 to $0.96 per dollar of advertising expenditures. However, this is still below the break-even point of $1.00.

The relationships shown in our model are also apparent in bivariate scatterplots. For example, the scatterplots in Exhibit D-2 show that total statewide monthly per capita lottery sales are highly correlated with jackpot size, but have a relatively weak correlation with per capita Lottery media expenditures.[43] The relationship between advertising and sales is strengthened by including media spending in prior months in the model, but remain modest.

[43] Since the introduction of Powerball had a substantial effect on the relationship between jackpot size and Lottery sales, Exhibit D-2 only shows the relationships for the period after Powerball was introduced in Florida.

Exhibit D-2
Lottery Sales Have a Stronger Relationship to Jackpots than Advertising





Source: OPPAGA analysis of data from the Department of the Lottery.

Appendix E

RICK SCOTT
Governor

FLORIDA Lottery

CYNTHIA F. O'CONNELL
Secretary

January 31, 2014

Phillip Twogood
Director
Office of Program Policy Analysis and
Government Accountability
111 West Madison Street
Tallahassee, Florida 32399-1475

Dear Mr. Twogood:

Thank you for the opportunity to respond formally to your office's report: *"Lottery Transfers Have Recovered; Options Remain to Enhance Transfers."* We appreciate the diligence of your staff to thoroughly analyze the Lottery's performance over the years to help identify opportunities to increase our revenues and efficiencies, and we will take your recommendations under consideration.

We also appreciate the report mentioning the Florida Lottery's recent sales achievements in surpassing a new milestone of $5 billion in annual sales and transferring yet another record amount to the Educational Enhancement Trust Fund (EETF). Florida now ranks the 2nd highest among U.S. lotteries in total sales.

Our response is in regard to the "*Return to the Educational Enhancement Trust Fund from Lottery Advertising*" section of the report beginning on page 8.

Lottery Response to "Return to the Educational Enhancement Trust Fund from Lottery Advertising"

Based on 25 years of experience and historical sales data, the Florida Lottery concludes that its advertising dollars are far more effective than the OPPAGA model illustrates and that the Lottery has not yet reached a saturation point in return on investment. Our advertising effectiveness studies[1] over the past decade including industry analysis, category comparisons from the advertising industry and methodologies used by the Revenue Estimating Conference (REC) as well as independent economists, have consistently shown higher returns in sales and transfers to the EETF. The clearest evidence of advertising effectiveness can be seen by its contribution to the three-year sales growth in Scratch-off game sales.

[1] Battelle Memorial Institute, La Fleurs Almanac, 4 A's , Nielsen Ad*views

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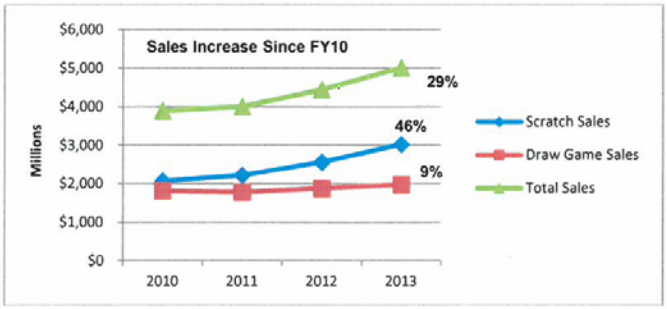
1. **Increased allocation of advertising expenditures and integrated marketing efforts contributed to Scratch-off games' three-year sales growth.**

While we agree that jackpots have a significant impact on draw game sales, they have had less of an impact on Scratch-off sales, and therefore sales as a whole, in recent years. The chart shown below illustrates that Florida Lottery total sales have grown by 29% over the past three years and Scratch-off game sales are leading the pace. Scratch-off sales have increased by 46% over the past three years while draw game sales have increased by 9%.

Scratch-off Sales Have Fueled the Lottery's 3-Years Sales Growth



As illustrated in the table below, FY2010 Scratch-off sales were approximately $2 billion and in FY2013, Scratch-off sales set a new milestone by surpassing $3 billion in annual sales. This sales growth was sustained during periods of both high and low draw game jackpots, indicating that the increase in advertising spending and marketing efforts have been a contributing factor. In FY2013, Florida's 18% sales increase in Scratch-off games led all U.S. lotteries in percentage increase for that category. By comparison, over the past three years, draw game sales have increased by 9% with the impact of introduction of the big jackpot multi-state games, POWERBALL in FY2009 and MEGA MILLIONS in FY2013.

Scratch-off Sales Have Increased By Almost $1 Billion In the Past Three Years. [2]

(sales in thousands)

Fiscal Year	Scratch Sales	% Change	Draw Game Sales	% Change	Total Sales	% Change
2010	$2,078,133		$1,822,365		$3,900,498	
2011	$2,225,676	7%	$1,783,040	-2%	$4,008,716	3%
2012	$2,566,991	15%	$1,882,905	6%	$4,449,896	11%
2013	$3,028,527	18%	$1,984,469	5%	$5,012,996	13%
Change since FY2010	$950,394	46%	$162,104	9%	$1,112,498	29%

[2] Source: Florida Lottery Weekly Trend Reports

The catalyst to Scratch-off game sales success since FY2003 has been the legislative authorization to increase prize payouts. Additionally, the introduction of self-service vending machines has increased distribution points and sales since their introduction into the marketplace in FY2009. However, in FY2010, a significant change in our Scratch-off game strategy has been to increase the advertising expenditures and retailer-integrated marketing efforts in support of the Scratch-off games.

The following chart shows that over the past three years the allocation of advertising expenditures has shifted toward an emphasis on Scratch-off games. Since the Lottery has no direct control over the draw game jackpot size, the Lottery directs marketing efforts to those sales factors it can influence. As a mature Lottery, Scratch-off games represent an opportunity to keep new and fresh products in the marketplace and these continual game launches require advertising support, which is another reason for our shift in priorities. Increased advertising and marketing efforts for Scratch-off games along with additional distribution points created by the introduction of self service vending machines, has undoubtedly contributed to the three-year sales growth of this product line.

Ad Budget Allocations for Scratch-off Games Have Increased over the Past 3 years

	Percentage of Advertising Budget		
Fiscal Year	Scratch	Draw Games	Education/Brand
2010	22.7%	73.3%	3.9%
2011	35.5%	62.0%	2.5%
2012	51.1%	47.7%	1.2%
2013	52.4%	42.5%	5.1%*
Change since FY10	29.7%		1.2%

Florida Lottery

*25th anniversary brand refresh

Brand advertising is an investment for future growth of the Lottery. Therefore it is important to note that a portion of Lottery advertising dollars is spent on building the corporate brand as well as communicating the education funding mission message. The sales effects of such efforts are more indirect and longer term.

2. **Three years of record setting sales and transfers indicate that the Florida Lottery is on a growth track.**

The Florida Lottery has continuously set new revenue transfer records over the past three years and there is no evidence that advertising and transfers are at a saturation point.

EETF Transfers from Sales Have Set New Records for the Past 3 Years

Fiscal Year	EETF Transfers from Sales Only (in thousands)
2010	$1,147,130
2011	$1,122,591
2012	$1,258,622
2013	$1,359,977

Source: Florida Lottery Audited Financial Statements

Florida currently ranks 2nd in total dollars transferred to government beneficiary among all U.S. Lotteries [3]

State	FY12 Government Revenues (Total)
New York	$2,877.99
Florida	$1,321.60
California	$1,300.24
Texas	$1,155.52
Pennsylvania	$1,060.89
Massachusetts	$983.79
New Jersey	$950.08
Georgia	$901.33
Michigan	$786.92
Ohio	$771.03

The Lottery's advertising effectiveness compares favorably to other Lottery states and other consumer category competitors. Industry analysis suggests a strong correlation between sales and advertising. As illustrated in the table below, when compared to lotteries of similar populations, Florida generates $133 in sales per ad dollar spent while its ad budget represents only 0.75% of Lottery sales, ranking the Florida Lottery as one of the highest in advertising efficiency among our lottery peers.

[3] Source: LaFleur's Magazine, Sept/Oct 2013.

Florida Ranks as One of the Highest in Advertising Efficiency among its Lottery Peers

State	Ad Budget as % of Sales	Sales per $1 Spend
Florida	0.75%	$133
Ohio	0.79%	$127
Texas	0.80%	$125
Pennsylvania	1.06%	$94
California	1.09%	$91
New York	1.31%	$77
Illinois	1.63%	$61

Source: LaFleur's 2013 Almanac and LaFleur's Magazine, Sept/Oct 2013

3. **Media expenditures alone have more direct influence on advertising.**

Since the 2010 OPPAGA report recommendation, the Lottery has been working to maximize advertising effectiveness by increasing the proportion of its advertising funding devoted to media rather than production. The 2014 OPPAGA report indicated an increase in advertising effectiveness in the past two years as stated on page 9.

The 2010 OPPAGA report based its Return to Education of $1.57 for every $1.00 of Advertising spent on media costs only, which unfortunately, was not included in the 2014 report. Media expenditures alone are a more direct measure of advertising effectiveness than the combined costs of advertising, production, and agency fees. Eliminating the two additional administrative factors, as was done in the 2010 OPPAGA report, demonstrates that media spend alone results in a positive return to education.

The OPPAGA report states that *"...the saturation point is within our model's estimated range, and thus there is still a possibility of positive returns from advertising"* and further states that the *"study period included the worst economic downturn in recent Florida history, and thus our estimates of the return to the trust fund may understate future returns on advertising spending during a period of a strong economy."* While advertising probably helped stave off impacts from the 2008 economic downturn, under the current upward economic trend it is more likely that advertising effectiveness will continue to improve in the future.

Again, we would like to thank you and your staff for your diligent efforts to help us increase our revenues and efficiencies and offering us the opportunity to provide additional information to express our views.

Sincerely,

Cynthia O'Connell
Secretary

cc: Bruce Hoffmann, Chief of Staff
David Bishop, Deputy Secretary
Tom Delacenserie, Deputy Secretary
Ellyn Hutson, Chief Financial Officer
Louisa Warren, Acting General Counsel
Andy Mompeller, Inspector General

OPPAGA Clarification

Regarding page 5 (section titled "Media expenditures alone have more direct influence on advertising.") of the Department of the Lottery's letter of response:

OPPAGA's 2010 and 2014 econometric analyses of returns to the Educational Enhancement Trust Fund accounted for media buys and total advertising costs in a consistent manner. The costs of production and vendor fees were included in both analyses to accurately reflect the full cost of advertising expenditures.

The Florida Legislature

Office of Program Policy Analysis and Government Accountability

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