

E75D
State Lottery and Gaming Control Agency

Operating Budget Data

(\$ in Thousands)

	<u>FY 14</u>	<u>FY 15</u>	<u>FY 16</u>	<u>FY 15-16</u>	<u>% Change</u>
	<u>Actual</u>	<u>Working</u>	<u>Allowance</u>	<u>Change</u>	<u>Prior Year</u>
General Fund	\$81,648	\$71,205	\$25,821	-\$45,384	-63.7%
Deficiencies and Reductions	0	176	-824	-1,000	
Adjusted General Fund	\$81,648	\$71,381	\$24,997	-\$46,383	-65.0%
Special Fund	70,100	70,655	78,718	8,063	11.4%
Deficiencies and Reductions	0	2,995	-345	-3,340	
Adjusted Special Fund	\$70,100	\$73,649	\$78,372	\$4,723	6.4%
Adjusted Grand Total	\$151,748	\$145,030	\$103,370	-\$41,660	-28.7%

Note: The fiscal 2015 working appropriation reflects deficiencies and the Board of Public Works reductions to the extent that they can be identified by program. The fiscal 2016 allowance reflects back of the bill and contingent reductions to the extent that they can be identified by program.

- The fiscal 2016 budget includes several deficiency appropriations for the State Lottery and Gaming Control Agency. Specifically, the budget includes two general fund deficiencies for the final bond payment for State-owned video lottery terminal (VLT) machines and to complete an eLicensing system. Additionally, there are two special fund deficiencies for an increase in instant ticket printing and for payment to veterans' organizations related to instant ticket lottery machines. The deficiencies are partially offset by fiscal 2015 cost containment actions.
- After fiscal 2015 and 2016 cost containment actions, the adjusted fiscal 2016 allowance declines by \$41.7 million from the fiscal 2015 working appropriation. The decline is almost exclusively related to the State's VLT and gaming program, specifically related to the transfer of VLT ownership from the State to the facility owners. The fiscal 2016 decline is partially mitigated by an increase in funds necessary to fund the veterans' organizations instant ticket machine program.

Note: Numbers may not sum to total due to rounding.

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Personnel Data

	<u>FY 14 Actual</u>	<u>FY 15 Working</u>	<u>FY 16 Allowance</u>	<u>FY 15-16 Change</u>
Regular Positions	309.50	308.60	317.60	9.00
Contractual FTEs	<u>7.75</u>	<u>6.75</u>	<u>6.75</u>	<u>0.00</u>
Total Personnel	317.25	315.35	324.35	9.00

Vacancy Data: Regular Positions

Turnover and Necessary Vacancies, Excluding New Positions	14.41	4.67%
Positions and Percentage Vacant as of 1/1/15	23.00	7.45%

- The fiscal 2016 allowance includes 9 additional full-time equivalent positions under the VLT and gaming program for increased licensing and compliance responsibilities, largely associated with the impending opening of the gaming facility in Prince George's County.
- As of January 2015, the agency had 23 vacant positions, primarily within the VLT and gaming program. This is above the amount required to meet budgeted turnover.

Analysis in Brief

Major Trends

Sales Agent Earnings Increase; Sales and Prizes Decline: Lottery sales agent commission increased to a five-year high mark in fiscal 2014. However, sales, revenues, and prize payouts posted decreases in fiscal 2014.

Small Increase in Advertising in Fiscal 2014; Total Sales Expected to Increase in Fiscal 2015: After several years of flat advertising funding, the lottery agency received a small increase in funds in fiscal 2014. Sales remained down in fiscal 2014 but are rebounding in the current fiscal year.

New Performance Measures for the Gaming Program: The lottery agency has been responsible for the State's VLT and gaming program since 2008. At the encouragement of the Department of Legislative Services (DLS), the agency has begun reporting performance measures for its gaming program with the submission of the fiscal 2016 allowance. Measures include audit reviews and findings and licensure efficiency.

Issues

Traditional Lottery Sales Decline in Fiscal 2014: The sales of traditional lottery games decline for the second consecutive year after more than a decade of positive growth. Of the lottery's most popular traditional games, only one type experienced an increase in sales in fiscal 2014. However, a rebound is expected in total sales in fiscal 2015. **DLS recommends that the lottery agency comment on the current trend of sales and revenues, including the impact of the competition from the State's casino facilities. The agency should further comment on its plans for new games in light of the suspension of its latest jackpot game.**

VLT and Gaming Program: Fifth Facility Opens, Revenues Fluctuate: Since 2008, the lottery agency has been tasked with the responsibility of administering the gaming program for the State. The agency is responsible for the regulation and licensing of operators; accounting for and distribution of revenues; managing the program's central system, and the purchase or lease of a portion of the gaming machines. The State's fifth gaming facility opened in August 2014, and a sixth facility is planned after July 1, 2016. Revenues continue to fluctuate as the gaming market matures, and the facilities are making adjustments to their mix of VLTs and table games. **DLS recommends that the Budget Reconciliation and Financing Act (BRFA) of 2015 be amended to extend the 10% reduction in the VLT allocation for local impact aid to horse racing purse enhancement; horse racetrack redevelopment; and to the Small, Minority, and Women-Owned Business Account. This recommendation would also include a provision that would transfer the savings in fiscal 2016 to the Education Trust Fund. This action would increase funds available to the Education Trust Fund, thereby enabling a reduction in general funds under the Foundation Program in fiscal 2016. Further, DLS recommends that the BRFA be amended to make the 10% reduction to all of these allocations permanent in order to benefit the Education Trust Fund in the**

out-years. DLS also recommends that the committees consider a BRFA provision to increase the State's share of revenue from table games to 25% from 20%.

DLS also recommends that the lottery agency comment on the status of the State's gaming program including the recent developments related to the mix of table games and VLTs at the casino facilities.

Recommended Actions

1. Add language reducing allocations of video lottery terminal proceeds and provide for the transfer of those funds to the Education Trust Fund contingent on the enactment of legislation that authorizes the transfer.

E75D
State Lottery and Gaming Control Agency

Operating Budget Analysis

Program Description

Since 1973, the State Lottery and Gaming Control Agency has administered and operated lottery games to generate revenue for the State. The lottery currently offers the following games: Pick 3, Pick 4, Keno, Keno Bonus and Super Keno Bonus, Mega Millions, Powerball, Bonus Match Five, Instant Games, Multi-Match, Racetrax and Racetrax Bonus, and 5 Card Cash.

All games, except Instant Games, are draw games, meaning that players pick their numbers or use computer-generated numbers, receive a ticket, and then wait for a drawing to see if they have won. With Instant Games, players scratch off a latex covering on a ticket play area to reveal preprinted combinations. Games are sold through lottery agents, which are private businesses that receive commissions and fees in exchange for selling the games to the public.

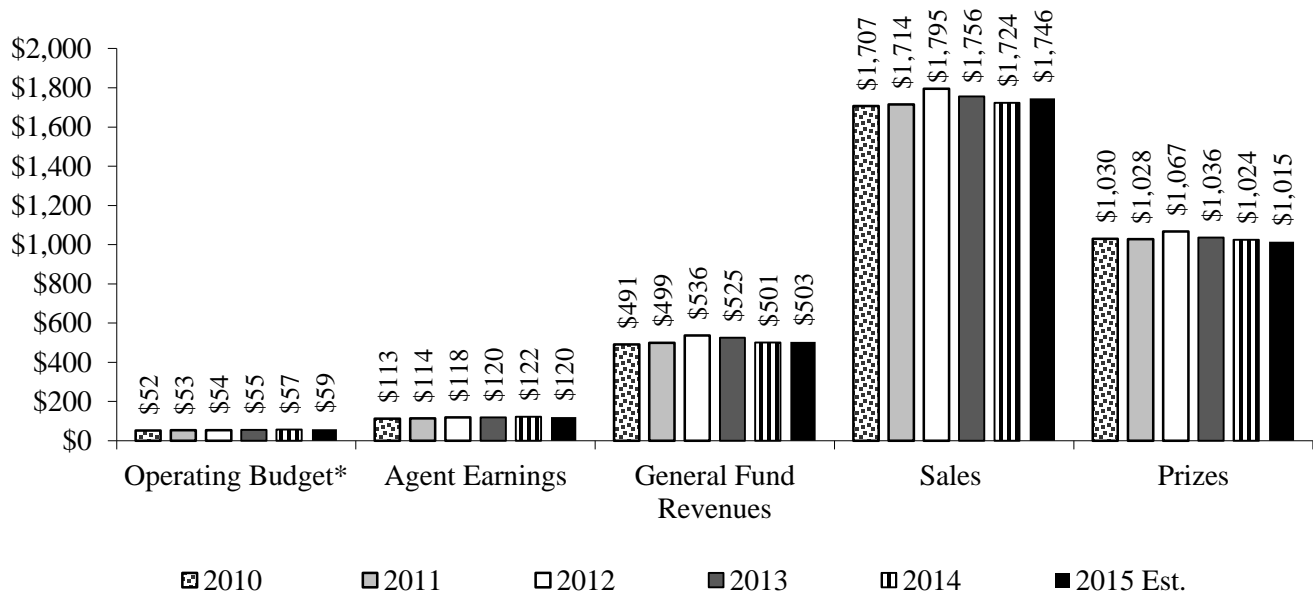
The State Lottery Gaming and Control Commission has oversight responsibility for the agency. In 2008, the commission was expanded to address additional responsibilities stemming from the video lottery terminal (VLT) legislation. The agency is responsible for the administration of the VLT program, including accounting for and distributing VLT revenues; managing the program's central system; and regulation and licensing of operators. In 2012, the agency's responsibilities were further expanded to include the regulation of table games at the previously authorized VLT facilities, among other new duties. The agency's divisions include Executive; Administration, Finance, and Operations; Information Technology; Sales; Marketing and Communications; Legal; and Gaming and Enforcement.

Performance Analysis: Managing for Results

1. Sales Agent Earnings Increase; Sales and Prizes Decline

Proceeds from the traditional lottery games pay for prizes, agent earnings, and all operating expenses of the agency. In fiscal 2014, 59.0% of sales paid for prizes, 6.8% paid for agent commissions and redemption fees, 3.3% paid for agency operations, and 29.9% was credited as revenue to the State (a small percentage is forwarded to the Maryland Stadium Authority per statute). **Exhibit 1** shows lottery sales and the distribution of total sales. Prize payouts surpassed \$1 billion in fiscal 2009 and have not fallen below that mark. Agent earnings increased in fiscal 2014 by about \$2.3 million. Agents earn 5.5% of sales at retail establishments and also earn fees for cashing some winning tickets. The agent sales commission was held at 5% from fiscal 2010 through calendar 2012 for cost containment. The increase in agency earnings reflect the return to the historical rate. Sales and revenues are discussed in further detail in the Issues section of this analysis.

Exhibit 1
Lottery Sales and Expenditures
Fiscal 2010-2015 Est.
(\$ in Millions)



*The operating budget does not include funds to operate the video lottery terminal program.

Note: General fund revenues exclude disbursements to the Maryland Stadium Authority.

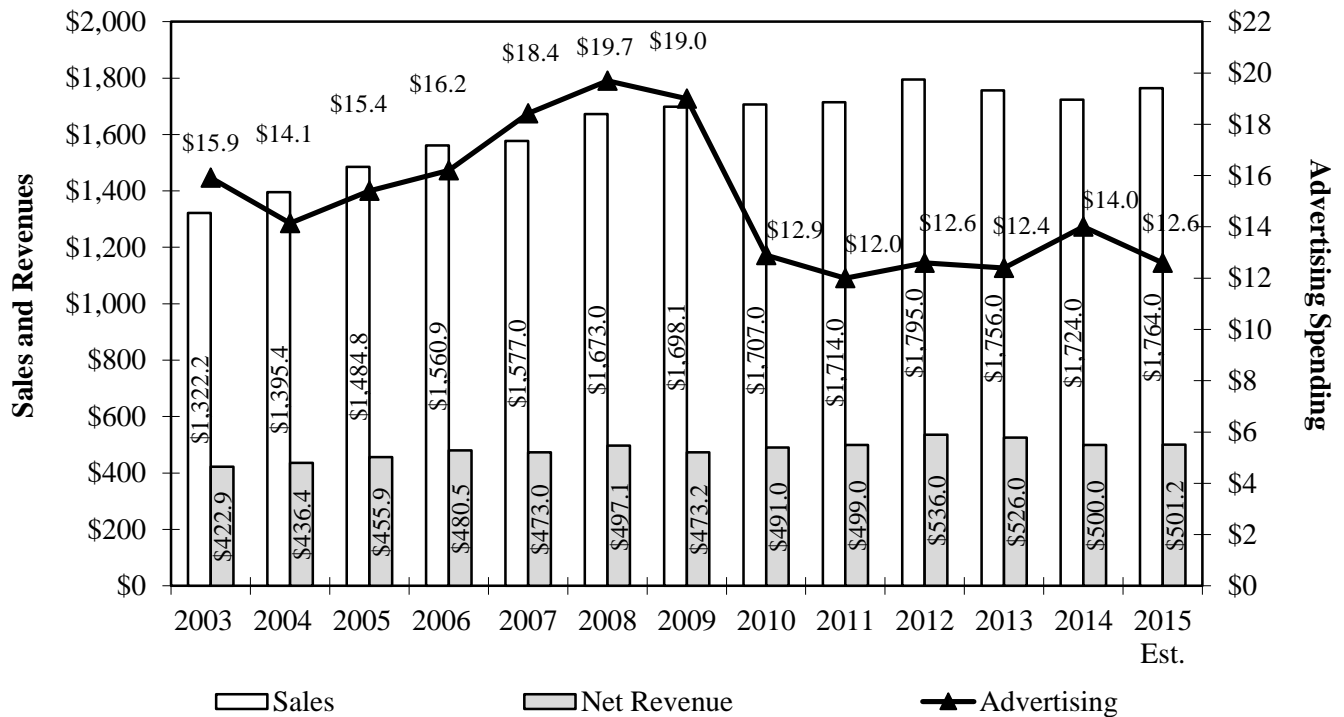
Source: Governor's Budget Books, Fiscal 2010-2016

2. Small Increase in Advertising in Fiscal 2014; Total Sales Expected to Increase in Fiscal 2015

Traditional lottery games resulted in \$1.72 billion in sales in fiscal 2014. This is the second year of decline after 15 straight years of increases in sales.

Exhibit 2 shows sales and revenues as compared to the agency's total advertising expenditures. Advertising expenditures include funds for radio, television, print, and other advertisements, as well as promotional events and materials. Cost containment in fiscal 2010 reduced the advertising budget by \$6 million from the original fiscal 2010 appropriation. The budget has since remained fairly flat. However, record sales were achieved between fiscal 2010 and 2012. The decline in sales in fiscal 2013 is thought to be attributable to the increased competition from gaming facilities and not from a reduced level of advertising. The fiscal 2014 budget included a one-time increase in advertising for the agency. Some games are experiencing an increase in sales in fiscal 2015; however it is unclear if it a result of the increased advertising in fiscal 2014.

Exhibit 2
Sales and Revenue Trends Compared to Advertising Spending
Fiscal 2003-2015 Est.
(\$ in Millions)



Source: Governor's Budget Books, Fiscal 2006-2016; Lottery Budget, Fiscal 2005-2015

3. New Performance Measures for the Gaming Program

At the encouragement of the Department of Legislative Services (DLS), the agency has begun reporting performance measures for its gaming program with the submission of the fiscal 2016 allowance. The agency began its responsibilities associated with the State's gaming program in 2008. An entirely new division has been established with new and unique duties that enable the regulation and oversight of the casino facilities. It is, therefore, important for performance oversight through the legislative budget process.

Specifically, the agency is reporting on audit review and findings of casinos and bingo halls and on the number of licenses and the time it takes to issue licenses. The agency has a goal to complete an individual gaming license investigation within 10 days. The limited data shows that the agency has improved in this measure, going from 14 days to investigate a license applicant in fiscal 2013 to 8 days

in fiscal 2014. The agency must also license vendors associated with the gaming facilities. Certified vendors are defined as those vendors conducting more than \$100,000 worth of business with a facility. The processing time to license certified vendor applicants declined from 50 days in fiscal 2013 to 26 days in fiscal 2014. It should be noted that the agency's licensing staff increased between fiscal 2013 and 2014.

Fiscal 2015 Actions

Proposed Deficiency

The fiscal 2016 budget includes approximately \$4.6 million in fiscal 2015 deficiencies for the agency: almost \$3.0 million in special funds and \$1.6 million in general funds.

Specifically, under traditional lottery operations, the budget reflects \$2,531,000 in special funds for vendor payments for instant ticket lottery machines that are housed at licensed veterans' organizations as authorized by Chapter 1 of the second special session of 2012. Also under traditional lottery operations, the allowance includes \$463,688 in special funds to pay increased costs for the contract for instant ticket printing. There has been significant growth in the sales of instant tickets in fiscal 2015, necessitating an increase in cost to print tickets. As of January 2015, instant ticket sales were \$40 million over the same time the previous year.

Under the VLT and gaming program, a proposed deficiency increases general funds in fiscal 2015 by \$1 million to facilitate the final payment for the 2011 purchase of VLTs. The transfer of machine ownership from the State to the facility owners is effective March 31, 2015. To effectuate that transfer, the lottery agency needs to complete its bond payments earlier than originally scheduled. The agency will sell the machines and use the proceeds for the payment. However, that sale will generate an estimated \$1 million less than what is required for the final bond payment. Finally, there is a fiscal 2015 general fund deficiency (\$600,000) to complete the agency's eLicensing system. The system will automate much of the licensing procedures associated with the State's VLT and gaming program including automatically generated renewal notices. It will more accurately differentiate between the specific types of licenses (*i.e.*, manufacturers, principals, vendors) and will improve the tracking of licensees that transfer between casinos.

Cost Containment

The State Lottery and Gaming Control Agency participated in the fiscal 2015 cost containment actions, as shown in **Exhibit 3**. In July 2014, the Board of Public Works (BPW) withdrew \$100,000 in general salary expenditures of the agency. Additionally, the agency also participated in the statewide 2% general fund reduction, which equates to a reduction of over \$1.4 million in the agency's fiscal 2015 working appropriation. The cost containment actions are mitigated, however, by the deficiency appropriations as discussed above.

Exhibit 3
Fiscal 2015 Reconciliation
(\$ in Thousands)

<u>Action</u>	<u>Description</u>	<u>General Fund</u>	<u>Special Fund</u>	<u>Federal Fund</u>	<u>Reimb. Fund</u>	<u>Total</u>
Legislative Appropriation with Budget Amendments		\$71,305	\$70,655	\$0	\$0	\$141,959
July BPW		-100	0	0	0	-100
Working Appropriation		\$71,205	\$70,655	\$0	\$0	\$141,859
January BPW Across the Board	2% across-the-board reduction.	-1,424	0	0	0	-1,424
Deficiency Appropriations		1,600	2,995	0	0	4,595
Total Actions Since January 2015		\$176	\$2,995	\$0	\$0	\$3,171
Adjusted Working Appropriation		\$71,381	\$73,649	\$0	\$0	\$145,030

BPW: Board of Public Works

Source: Department of Legislative Services

Proposed Budget

After adjusting for cost containment actions, the lottery agency's budget declines by over \$41.6 million, or 28.7%, in fiscal 2016. **Exhibit 4** details the specific changes to the allowance.

Exhibit 4
Proposed Budget
State Lottery and Gaming Control Agency
(\$ in Thousands)

How Much It Grows:	<u>General Fund</u>	<u>Special Fund</u>	<u>Total</u>
Fiscal 2014 Actual	\$81,648	\$70,100	\$151,748
Fiscal 2015 Working Appropriation	71,381	73,649	145,030
Fiscal 2016 Allowance	<u>24,997</u>	<u>78,372</u>	<u>103,370</u>
Fiscal 2015-2016 Amt. Change	-\$46,383	\$4,723	-\$41,660
Fiscal 2015-2016 Percent Change	-65.0%	6.4%	-28.7%

Where It Goes:

Personnel Expenses

Increments and other compensation annualization (prior to cost containment).....	\$593
Turnover adjustments.....	436
Employee and retiree health insurance.....	422
New positions (9 regular positions for duties associated with the new Prince George's County gaming facility)	420
Retirement contributions.....	325
Other fringe benefit adjustments	15
Workers' compensation premium assessment	-20
Section 21: Abolition of employee increments	-288
Section 20: 2% salary reduction.....	-374

Other Changes

Net change from fiscal 2015-2016 2% reduction.....	917
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Regular Lottery Operations

Veterans' organization instant ticket machine vendor	9,115
Increase in instant ticket printing	1,236
Increase in rent	58
Motor vehicle purchases and maintenance.....	-226
Instant ticket machine lease – final payment in fiscal 2015.....	-1,344

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Where It Goes:

VLT and Gaming Operations

Start-up costs – Prince George’s County facility	1,258
Decline in software and other misc. information technology costs.....	-506
Decline in VLT maintenance	-6,285
Decline in bond payments for VLT ownership	-9,680
Decline in VLT leases	-38,119
Other.....	387
Total	-\$41,660

VLT: video lottery terminal

Note: Numbers may not sum to total due to rounding. The fiscal 2015 working appropriation reflects deficiencies and the Board of Public Works reductions to the extent that they can be identified by program. The fiscal 2016 allowance reflects back of the bill and contingent reductions to the extent that they can be identified by program.

Cost Containment

In fiscal 2016, the Administration has implemented several across-the-board reductions. This includes a general 2% reduction, elimination of employee increments, and a 2% salary reduction. The lottery agency’s share of these reductions is \$824,660 in general funds and \$345,213 in special funds.

Regular Lottery Operations

Absent VLT and gaming operations, the fiscal 2016 allowance for regular lottery operations increases by over \$9.9 million in special funds. The increase is primarily attributable to the first full year’s operations of the veterans’ organizations’ instant ticket machine program. Chapter 1 of the second special session of 2012 authorized the lottery agency to issue licenses to veterans’ organizations for up to five instant ticket machines. The agency began issuing licenses in fiscal 2015. To date, 41 organizations participate in the program, and about 160 machines are currently in operation. The bulk of the increase in the allowance relates to the vendor payment: the vendor provides the instant ticket machines, the tickets, and the central monitoring system. The vendor receives a portion of the net proceeds of the machines. Similarly, the veterans’ organizations earn a sales and cashing commission from the total proceeds. Additionally, the Maryland Veterans Trust Fund receives 10% of total proceeds. The general fund receives the remainder. The lottery projects general fund revenue related to the program to be \$412,000 in fiscal 2015 and \$844,000 in fiscal 2016.

Also increasing the allowance, albeit by a smaller margin, is the increase in instant ticket printing costs. Sales of instant tickets (scratch-offs) are expected to increase in fiscal 2015 and 2016, necessitating an increase in printing costs. Partially mitigating the increase under regular lottery operations is the cessation of payments for the capital lease of instant ticket machines in fiscal 2015.

VLT and Gaming Operations

The statute governing the regulatory framework of the VLT and gaming program specifies that the lottery agency is allowed to retain 2% of the gross VLT revenue as special funds for the administration of the program. The lottery's share of VLT revenues will decrease to 1% after the transfer of ownership of VLT machines from the State to the facilities, as discussed below. Additional special funds are generated through licensing fees of the gaming operators, employees, and vendors. However, these special funds are not sufficient to cover all the costs associated with the gaming program. Before cost containment, the fiscal 2016 allowance includes \$25.8 million in general funds and \$9.6 million in special funds for VLT and gaming operations.

Personnel

The fiscal 2016 allowance includes approximately \$420,200 in general funds for 9 new positions under the VLT and gaming program. The new positions will be responsible for duties associated with the upcoming opening of a sixth gaming facility in Prince George's County. The facility may not open before July 1, 2016 (fiscal 2017); however, the lottery agency must have staff prior to the opening for licensing the casino employees and vendors (5 new positions). Compliance officers are also required prior to the opening for background checks, fingerprinting, and training (4 new positions). To the extent that the casino opens at the earliest allowable time, the lottery agency will also need to have additional staff on board before the end of fiscal 2016. It is, therefore, possible that a deficiency appropriation will be required in the fiscal 2017 allowance.

As the larger casinos mature, the lottery agency expects a large uptick in employee and vendor license renewals and employee turnover. The new licensing positions will also address the increase in workload associated with the expected renewals and new licenses from turnover.

VLT Machines

Chapter 1 of the second special session of 2012 altered the provisions governing the ownership of the VLT machines at the facilities. The legislation specified that the Baltimore City and Prince George's County facility operators will own or lease VLTs at their respective facilities, and the lottery agency retains responsibility for ownership or leasing of VLTs and associated equipment at the facilities in Allegany and Worcester counties. However, the facilities in Allegany and Worcester counties could apply to the lottery agency for permission to assume ownership or the right to lease each VLT used by the facility. For the existing facilities in Anne Arundel and Cecil counties, the facilities would own or lease the machines beginning April 1, 2015, after the State Master Contract with VLT manufacturers expires on March 31, 2015. The savings to the State from requiring VLT facilities to own or lease the VLTs must be appropriated to the Education Trust Fund.

The fiscal 2016 allowance reflects a full year of the savings associated with the transfer of the machines. Costs for the machines include lease costs for *leased machines*; and bond payments, maintenance, and software upgrades for *purchased machines*. Specifically, machine lease costs decline by a net of \$38.1 million in general funds. The allowance reflects costs to lease machines associated

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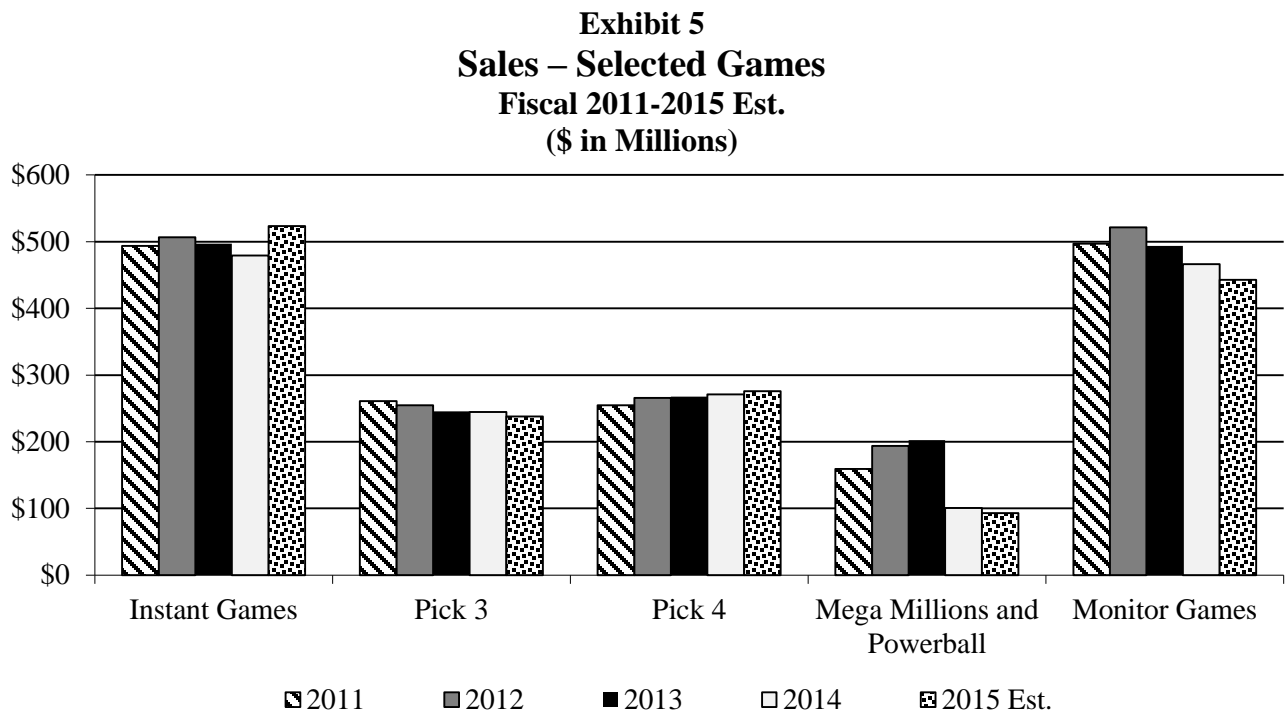
with the facilities in Allegany and Worcester counties (\$9.4 million in general funds and \$8.2 million in special funds). The remaining facilities are responsible for the procurement of their own machines.

Finally, as mentioned above, the sixth facility in Prince George's County is expected to open in early fiscal 2017. This will require some start-up activities in fiscal 2016. Notably, information technology infrastructure will need to be in place prior to the opening. The fiscal 2016 allowance includes approximately \$1.3 million for these start-up costs.

Issues

1. Traditional Lottery Sales Decline in Fiscal 2014

Of the lottery's most popular traditional games, only Pick 4 experienced an increase in sales in fiscal 2014. **Exhibit 5** shows the total sales of selected games from fiscal 2011 through an estimate for fiscal 2015. The exhibit clearly shows the relative popularity of the games, with instant tickets and monitor games, like Keno, claiming most of the sales.



Source: Maryland State Lottery Agency

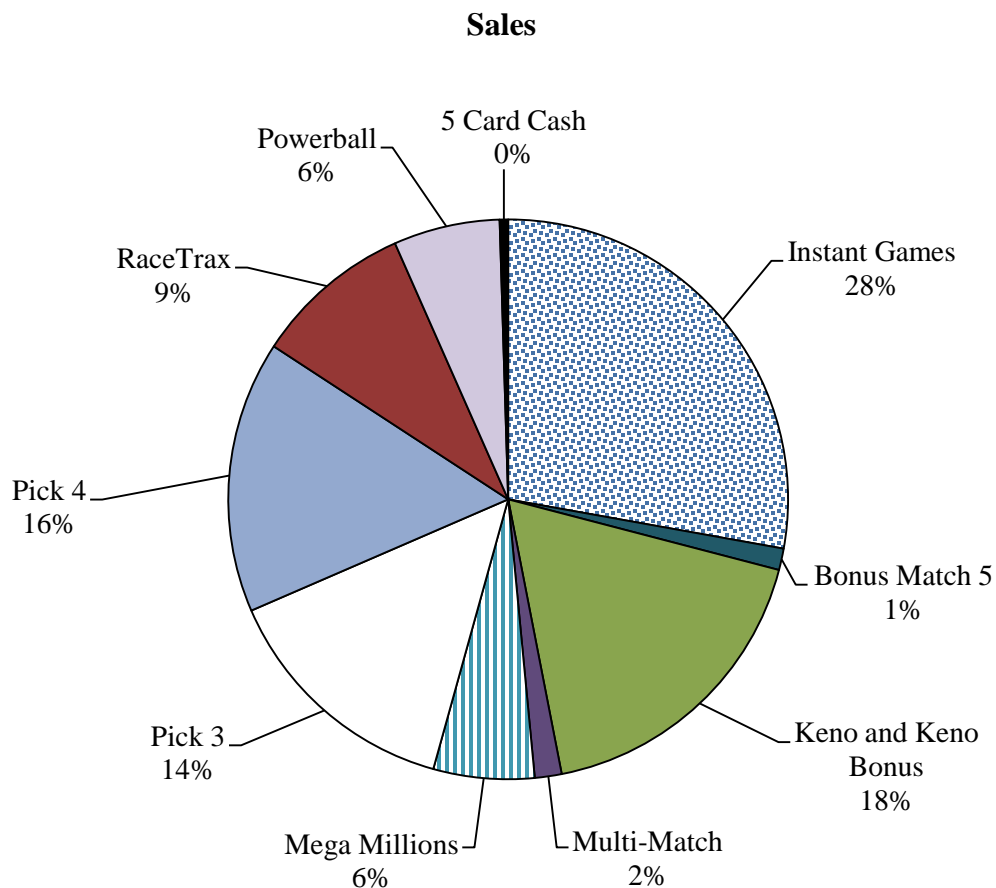
Jackpot games, Mega Millions and Powerball, posted unusually poor results in fiscal 2014, falling over 50% from fiscal 2013. The decline demonstrates how strongly sales are tied to large jackpots. In 2013, there were two extremely large jackpots, including a \$600 million jackpot in May. By contrast, there was only one large jackpot in fiscal 2014 (\$425 million) reducing customer interest in the game.

Monitor games, like Keno and Racetrax, also experienced a notable decline in sales. It appears that monitor games are the games that are most vulnerable to competition from the casinos. Monitor game sales fell 5.4% in fiscal 2013 and another 10.3% in fiscal 2014. Instant games fell for the second consecutive year in fiscal 2014; however, based on sales to date in fiscal 2015, a significant rebound is expected.

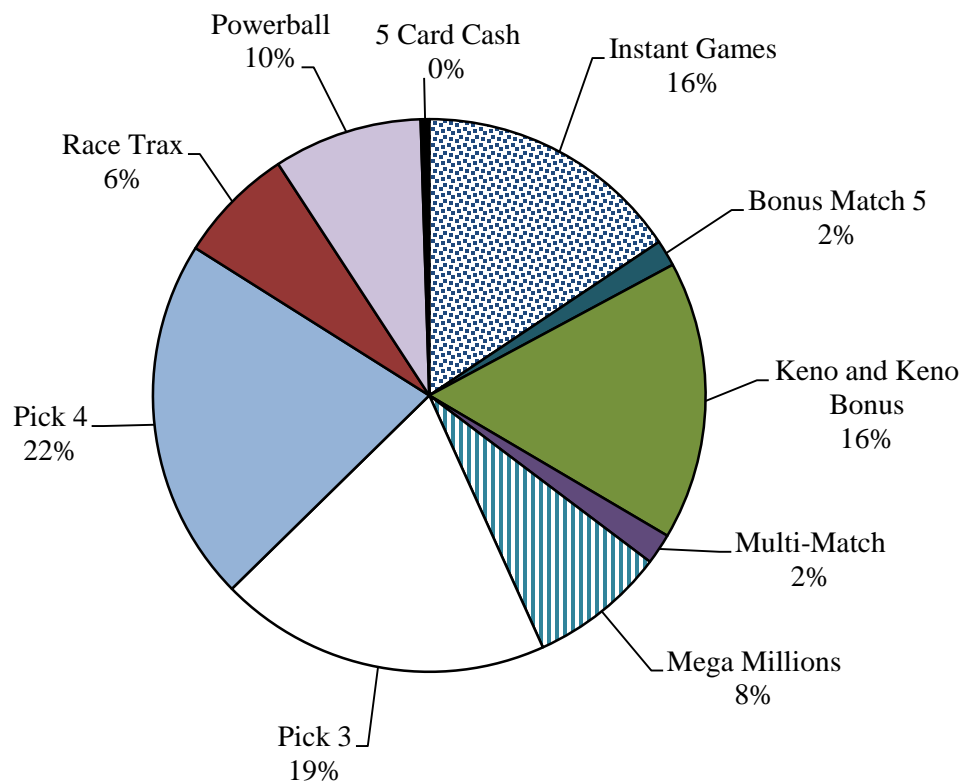
The mix of games is important to maintaining customer interest and to the returns to the general fund. Because of this variety, any negative impact on revenues from one game can be mitigated by other games.

Exhibit 6 shows sales and revenues for each game type in fiscal 2014. As shown, instant tickets make up 28% of sales, but only 16% of revenue. Instant tickets are popular, in part, because of this high payout. The lack of large jackpots is evidenced in the exhibit as Powerball makes up only 6% of sales, but accounts for 10% of revenue.

Exhibit 6
Sales and Revenues
Fiscal 2014



Revenues



Note: 5 Card Cash accounts for 0.4% of sales and 0.5% of revenues.

Source: State Lottery Agency

Suspension of New Jackpot Game

In May 2013, the lottery agency asked the Legislative Policy Committee (LPC) for approval to enter into a new multi-state jackpot game; Monopoly Millionaire's Club. After receiving LPC approval, the lottery agency debuted the game in October 2013. The game is a jackpot game, similar to Powerball, where players must match drawn numbers on a weekly basis. The lottery expected that the game would attract players by allowing more million dollar prizes in a single draw than any other lottery game. Research has shown that players prefer to see tens of millions of dollars in prizes split among many winners rather than one or two players winning hundreds of millions.

After accounting for any substitution effect, the lottery agency expected to increase annual sales by between \$31 million and \$47 million through the introduction of the new game. However, in December 2014, the lottery agency announced that it would suspend the game due to disappointing sales. Other participating states came to the same conclusion.

DLS recommends that the lottery agency comment on the current trend of sales and revenues, including the impact of the competition from the State's casino facilities. The agency should further comment on its plans for new games in light of the suspension of its latest jackpot game.

2. VLT and Gaming Program: Fifth Facility Opens, Revenues Fluctuate

Since 2008, the lottery agency has been tasked with the responsibility of administering the VLT program for the State. This has included the regulation and licensing of operators; accounting for and distributing VLT revenues; managing the program's central system; and the purchase or lease of gaming machines. Legislation passed during the second special session of 2012 significantly expanded the agency's responsibilities and altered its current responsibilities.

Background

The Video Lottery Facility Location Commission (location commission) is tasked with the review and awarding of facility licenses. The location commission has awarded video lottery operation licenses for the following:

- **Cecil County:** Penn Cecil Maryland Inc. (Penn Cecil) was awarded a license to operate a VLT facility with 1,500 VLTs in Perryville in Cecil County. The facility opened to the public with 1,500 VLTs on September 27, 2010. It currently houses 1,158 machines and 22 table games.
- **Worcester County:** Ocean Enterprise 589, LLC (Ocean Downs) was awarded a license to operate a facility with 800 VLTs at Ocean Downs Racetrack in Worcester County. The facility opened with 750 VLTs on January 4, 2011, but now has the full complement of 800 VLTs.
- **Anne Arundel County:** PPE Casino Resorts, LLC was awarded a license to operate a facility with 4,750 VLTs adjacent to Arundel Mills Mall in Anne Arundel County. In June 2012, the Maryland Live! facility opened with 3,171 VLTs. As of January 2015, the facility has placed into operation 4,222 VLTs and 189 table games.
- **Allegany County:** On April 26, 2012, Evitts Resort, LLC (Evitts) was awarded a video lottery operation license to own and operate a video lottery facility adjacent to the Rocky Gap Lodge and Resort, subject to certain contingencies. The facility opened in May 2013 and has 577 VLTs and 17 table games.
- **Baltimore City:** On July 31, 2012, the location commission awarded the Baltimore City casino operation license to CBAC Gaming, LLC for a facility with 3,750 VLTs, subject to certain contingencies. That facility opened in August 2014 with 2,500 VLTs and 147 table games.

- **Prince George’s County:** On December 20, 2013, the location commission awarded the Prince George’s casino operation license to MGM National Harbor, LLC for a facility with 3,600 VLTs and 140 table games. The statute allows the casino to open as soon as July 2016.

Revenue

The agency accounts for and disperses the revenue derived from the State’s gaming facilities. **Exhibit 7** shows the gross revenue from the facilities over fiscal 2014, compared to the estimate of that revenue. Revenues for both VLTs and table games fell short of expectations. To the extent that revenues fail to meet projections, general fund deficiencies must be provided in the following year to make up the shortfall in the Education Trust Fund.

Exhibit 7			
Maryland Gaming Facilities			
Gross Revenues			
Fiscal 2014			
(\$ in Millions)			
	<u>2014</u>	<u>2014</u>	<u>Difference</u>
	<u>Estimate</u>	<u>Actual</u>	
Video Lottery Terminal Revenues			
Education Trust Fund	\$282.7	\$277.1	-\$5.6
Facility Owner	205.7	202.1	-3.6
Horse Racing Purse Account	39.8	38.9	-0.9
Local Impact Aid	31.5	30.8	-0.7
Racetrack Facility Renewal Account	9.7	9.5	-0.2
State Lottery Agency	11.8	11.6	-0.2
Small, Minority and Women-Owned Business Account	8.6	8.4	-0.2
Subtotal	\$589.8	\$578.4	-\$11.4
Table Games			
Education Trust Fund	\$52.1	\$51.0	-\$1.1
Facility Owner	208.4	203.9	-4.5
Subtotal	\$260.5	\$254.9	-\$5.6
Total	\$850.3	\$833.3	-\$17.0

Source: Board of Revenue Estimates; Department of Legislative Services

Exhibit 8 shows the current and upcoming fiscal year projections. For fiscal 2015, VLT revenue estimates have been revised downward by \$26 million. Conversely, table game revenue projections have improved. Based on this trend, the fiscal 2016 estimates have been adjusted accordingly.

Exhibit 8
Maryland Gaming Facilities
Estimated Revenues
Fiscal 2015-2016
(\$ in Millions)

	Estimate <u>2015</u>	Revised Estimate <u>2015</u>	<u>Difference</u>	Estimate <u>2016</u>	Revised Estimate <u>2016</u>	<u>Difference</u>
Video Lottery Terminals	\$715.4	\$689.4	-\$26.0	\$781.3	\$726.8	-\$54.5
Table Games	328.9	366.1	37.2	363.9	390.4	26.5
Total	\$1,044.3	\$1,055.5	\$11.2	\$1,145.2	\$1,117.2	-\$28.0

Source: Board of Revenue Estimates; Department of Legislative Services

The statute specifies the distribution of casino revenues, including the distribution to the facility operators. The distribution of VLT revenue to the owners varies by facility based on a number of factors. **Exhibit 9** details the operator share of VLT revenues at benchmarks that are set in statute.

Exhibit 9
Casino Operator Share of VLT Revenue
Current through Fiscal 2020

	<u>Horseshoe Casino Baltimore</u>	<u>Maryland Live!</u>	<u>Hollywood Casino at Perryville</u>	<u>The Casino at Ocean Down</u>	<u>Rocky Gap Casino and Resort</u>	<u>MGM National Harbor Casino</u>
Current Operator Share	39%	33%	33%	43%	50%	-
Share after VLT Ownership Transfer – April 2015	39%	41%	39%	43%	50%	-
Share after Issuance of Prince George’s license (not before July 1, 2016)	46%	49%	39%	43%	50%	44%
Lottery Commission May Award Increase in Operator Share after July 1, 2019	46% – 49%	49% – 51%	39% – 44%	43%	50%	44%

Source: State Lottery and Gaming Control Agency

As mentioned above, the ownership of the VLT machines will transfer to the facility operators in April 2015. This only affects the facilities in Anne Arundel and Cecil counties. Facilities with fewer than 1,000 machines do not have to assume ownership of their machines. For the larger facilities, their share of revenues was adjusted upward to account for the fact that the facilities will be responsible for the procurement of their machines.

Another adjustment to operator share will occur once the license is issued for the facility in Prince George’s County. The State’s gaming program was originally planned with a total of five casinos. A sixth one was added by legislation in 2012; after other facilities were underway. To adjust for the increased, and unexpected, competition from a sixth casino, the operator shares were again adjusted upward for the facilities in Anne Arundel County and Baltimore City. The increase in operator share must be used for marketing, advertising, promotional costs, and capital improvements. The lottery commission may choose to further increase operator share by up to 5% until July 1, 2019, at the facilities in Anne Arundel and Cecil counties and Baltimore City.

In contrast to this tiered and somewhat complicated structure, table game revenue is distributed: 80% to the facility owners and 20% to the State for deposit in the Education Trust Fund. The distinction is largely based on industry standards and on the recognition that table games are more costly to operate for the facility owner due primarily to labor costs.

Consultant Study

In June 2014, the lottery agency procured a consultant as part of its statutory duties to provide continual analysis of the gaming industry, specifically to examine a potential reduction of VLTs at the casinos. The facilities reimburse the agency for the costs of the consultant. In January 2015, the lottery and its consultant released studies on the optimal number of VLT machines versus the optimal number of table games.

Also in January 2015, the Maryland Live! Casino and the Horseshoe Casino in Baltimore submitted requests to the lottery agency and commission to reduce the number of VLT machines and to increase the number of table games at their respective facilities. Specifically, Maryland Live! has requested the reduction of 300 VLTs and an increase of 13 table games. Similarly, the Horseshoe Casino requested the reduction of 300 VLTs and an increase of 30 table games.

The significant difference in the State share of revenues between VLTs and table games necessitates a close scrutiny when determining the appropriate mix of gaming options. The consultant has determined that, despite the difference in the State share of revenue, the gaming market in Maryland indicates that a reduction in VLTs and an increase in table games would, in the long run, be beneficial for both the operators and the State. Accordingly, in late January 2015, the lottery commission approved the requests of both Horseshoe Casino and Maryland Live! to alter the mix of gaming options. However, given the significant difference in the State's share of revenue between VLTs and table games, DLS is concerned that the benefit may be overstated, especially if the trend to replace VLTs with table games continues. Legislation has been introduced in the 2015 session to increase the State's share of the table game revenues. It is estimated that an increase in the rate from 20% to 25% could increase revenues for the Education Trust Fund by \$19.5 million in fiscal 2016 and up to \$28.0 million in the out-years.

DLS recommends that the committees consider a Budget Reconciliation and Financing Act (BRFA) provision to increase the State's share of revenue from table games to 25% from 20%.

Gaming Revenues and Fiscal 2016 Budget Actions

The BRFA of 2015 includes a provision that would transfer a portion of the VLT revenues that are dedicated to local impact aid to the Education Trust Fund in fiscal 2015 and 2016. This would enable a matching reduction in general fund appropriation for the State share of the Foundation Program under the Maryland State Department of Education. General fund savings would total \$4,073,964 in fiscal 2015 and \$3,887,697 in fiscal 2016. The jurisdictions that benefit from local impact aid would each experience a 10% decline in their respective share of the impact aid.

As shown in Exhibit 9, the uses of net VLT revenues are not limited to local impact aid. The revenues are also used for horse racing purse enhancement; horse racetrack redevelopment; and for small, minority, and women-owned businesses.

DLS recommends that the BRFA of 2015 be amended to extend the 10% reduction in the VLT allocation for local impact aid to horse racing purse enhancement; horse racetrack redevelopment; and to the Small, Minority, and Women-Owned Business Account. This recommendation would also include a provision that would transfer the savings in fiscal 2016 to the Education Trust Fund. This action would increase funds available to the Education Trust Fund, thereby enabling a reduction in general funds under the Foundation Program in fiscal 2016. Further, DLS recommends that the BRFA be amended to make the 10% reduction to all of these allocations permanent in order to benefit the Education Trust Fund in the out-years.

DLS also recommends that the lottery agency comment on the status of the State's gaming program including the recent developments related to the mix of table games and VLTs at the casino facilities.

Recommended Actions

1. Add the following section:

SECTION XX: AND BE IT FURTHER ENACTED, That the General Fund appropriation under R00A02.01 shall be reduced by \$6,655,315 contingent upon the enactment of legislation transferring video lottery terminal revenue to the Education Trust Fund.

Further provided that \$6,655,315 in special fund appropriations be reduced as follows:

<u>Appropriation Code</u>	<u>Program Title</u>	<u>Special Fund Reduction Amount</u>
<u>P00E01.02</u>	<u>Maryland Racing Commission – Division of Racing Reduce Purse Enhancements by 10%</u>	<u>\$4,908,113</u>
<u>P00E01.05</u>	<u>Maryland Facility Redevelopment Program – Division of Racing Reduce Racetrack Facility Funds by 10%</u>	<u>\$686,921</u>
<u>T00F00.15</u>	<u>Small, Minority, and Women-owned Business Investment Account Reduce Small Business Assistance by 10%</u>	<u>\$1,060,281</u>

Further provided that the Governor is authorized to process a special fund budget amendment up to \$6,655,315 to recognize the new revenue in the Education Trust Fund.

Explanation: This action would reduce various components of the special fund allocation of video lottery terminal proceeds by 10%. Instead, funds would be transferred to the Education Trust Fund, enabling a reduction in education general funds, contingent upon the enactment of a provision in the Budget Reconciliation and Financing Act of 2015 to transfer the funds.

Current and Prior Year Budgets

Current and Prior Year Budgets State Lottery and Gaming Control Agency (\$ in Thousands)

	<u>General Fund</u>	<u>Special Fund</u>	<u>Federal Fund</u>	<u>Reimb. Fund</u>	<u>Total</u>
Fiscal 2014					
Legislative Appropriation	\$86,464	\$69,391	\$0	\$0	\$155,854
Deficiency Appropriation	-182	827	0	0	645
Budget Amendments	126	239	0	0	365
Reversions and Cancellations	-4,760	-356	0	0	-5,116
Actual Expenditures	\$81,648	\$70,100	\$0	\$0	\$151,748
Fiscal 2015					
Legislative Appropriation	\$71,134	\$70,639	\$0	\$0	\$141,773
Cost Containment	0	-100	0	0	-100
Budget Amendments	71	116	0	0	187
Working Appropriation	\$71,205	\$70,655	\$0	\$0	\$141,860

Note: Numbers may not sum to total due to rounding. The fiscal 2015 working appropriation does not include January 2015 Board of Public Works reductions and deficiencies.

Fiscal 2014

In fiscal 2014, actual expenditures for the lottery agency fell below the original appropriation. This is primarily due to unexpended general funds related to VLT machines, in addition to negative deficiencies related to statewide cost containment actions. However, several actions mitigated the decline in funds. Specifically, the original appropriation for fiscal 2014 increased by over \$126,400 in general funds and by \$238,618 in special funds due to cost-of-living and annual salary review adjustments. Also, several deficiencies for fiscal 2014 were included in the agency's fiscal 2015 budget allowance. Under the agency's regular lottery operations, the appropriation grew by \$620,000 in special funds to supplement the increased costs of a contract for instant ticket printing. Similarly, there was an additional \$485,000 in special funds for increased advertising fees and new sponsorships. The allowance also included fiscal 2014 deficiencies for the agency's gaming program. Specifically, \$92,468 in general funds was included to support the addition of 8 new positions. As mentioned above, over \$4.7 million in general funds was reverted, largely due to lower than expected lease costs for VLT machines.

Fiscal 2015

The fiscal 2015 appropriation was reduced by \$100,000 in special funds due to the July 2014 cost containment actions taken by BPW. The agency achieved these savings by holding open several vacant positions. A budget amendment adds \$187,000 for the fiscal 2015 cost-of-living adjustment.

**Object/Fund Difference Report
State Lottery and Gaming Control Agency**

<u>Object/Fund</u>	<u>FY 14 Actual</u>	<u>FY 15 Working Appropriation</u>	<u>FY 16 Allowance</u>	<u>FY 15 - FY 16 Amount Change</u>	<u>Percent Change</u>
Positions					
01 Regular	309.50	308.60	317.60	9.00	2.9%
02 Contractual	7.75	6.75	6.75	0.00	0%
Total Positions	317.25	315.35	324.35	9.00	2.9%
Objects					
01 Salaries and Wages	\$ 19,783,590	\$ 22,619,543	\$ 24,810,217	\$ 2,190,674	9.7%
02 Technical and Spec. Fees	244,175	339,677	351,674	11,997	3.5%
03 Communication	451,728	484,442	482,888	-1,554	-0.3%
04 Travel	176,042	59,000	59,000	0	0%
06 Fuel and Utilities	151,136	222,592	222,592	0	0%
07 Motor Vehicles	299,598	408,295	181,998	-226,297	-55.4%
08 Contractual Services	50,051,497	50,174,383	59,278,745	9,104,362	18.1%
09 Supplies and Materials	1,372,896	509,000	211,000	-298,000	-58.5%
10 Equipment – Replacement	156,203	166,647	132,500	-34,147	-20.5%
11 Equipment – Additional	69,175,290	57,060,087	17,596,522	-39,463,565	-69.2%
13 Fixed Charges	9,639,060	9,805,777	1,201,322	-8,604,455	-87.7%
14 Land and Structures	247,174	10,000	10,000	0	0%
Total Objects	\$ 151,748,389	\$ 141,859,443	\$ 104,538,458	-\$ 37,320,985	-26.3%
Funds					
01 General Fund	\$ 81,648,418	\$ 71,204,643	\$ 25,820,899	-\$ 45,383,744	-63.7%
03 Special Fund	70,099,971	70,654,800	78,717,559	8,062,759	11.4%
Total Funds	\$ 151,748,389	\$ 141,859,443	\$ 104,538,458	-\$ 37,320,985	-26.3%

Note: The fiscal 2015 working appropriation does not include January 2015 Board of Public Works reductions and deficiencies. The fiscal 2016 allowance does not reflect contingent or across-the-board reductions.

Fiscal Summary
State Lottery and Gaming Control Agency

<u>Program/Unit</u>	<u>FY 14 Actual</u>	<u>FY 15 Wrk Approp</u>	<u>FY 16 Allowance</u>	<u>Change</u>	<u>FY 15 - FY 16 % Change</u>
00 State Lottery Agency	\$ 151,748,389	\$ 141,859,443	\$ 104,538,458	-\$ 37,320,985	-26.3%
Total Expenditures	\$ 151,748,389	\$ 141,859,443	\$ 104,538,458	-\$ 37,320,985	-26.3%
General Fund	\$ 81,648,418	\$ 71,204,643	\$ 25,820,899	-\$ 45,383,744	-63.7%
Special Fund	70,099,971	70,654,800	78,717,559	8,062,759	11.4%
Total Appropriations	\$ 151,748,389	\$ 141,859,443	\$ 104,538,458	-\$ 37,320,985	-26.3%

Note: The fiscal 2015 working appropriation does not include January 2015 Board of Public Works reductions and deficiencies. The fiscal 2016 allowance does not reflect contingent or across-the-board reductions.