

E75D
State Lottery and Gaming Control Agency

Operating Budget Data

(\$ in Thousands)

	<u>FY 16</u> <u>Actual</u>	<u>FY 17</u> <u>Working</u>	<u>FY 18</u> <u>Allowance</u>	<u>FY 17-18</u> <u>Change</u>	<u>% Change</u> <u>Prior Year</u>
General Fund	\$20,275	\$21,922	\$20,083	-\$1,838	-8.4%
Adjustments	0	120	-35	-155	
Adjusted General Fund	\$20,275	\$22,042	\$20,048	-\$1,993	-9.0%
Special Fund	71,706	76,580	80,842	4,262	5.6%
Adjustments	0	0	-53	-53	
Adjusted Special Fund	\$71,706	\$76,580	\$80,788	\$4,209	5.5%
Adjusted Grand Total	\$91,981	\$98,621	\$100,837	\$2,215	2.2%

Note: Includes targeted reversions, deficiencies, and contingent reductions.

- The fiscal 2018 allowance includes a fiscal 2017 general fund deficiency of \$120,000 for costs associated with the gaming program's central system and the opening of a sixth gaming facility in fiscal 2017.
- The adjusted fiscal 2018 allowance increases by \$2.2 million over the adjusted fiscal 2017 appropriation, due primarily to personnel and information technology expenditures. General funds decline in the allowance and are supplemented by an increase in special funds due to an increase in funds available from the State Lottery and Gaming Control Agency's (SLGCA) share of video lottery terminal revenue.

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

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Personnel Data

	<u>FY 16 Actual</u>	<u>FY 17 Working</u>	<u>FY 18 Allowance</u>	<u>FY 17-18 Change</u>
Regular Positions	314.60	324.10	324.10	0.00
Contractual FTEs	<u>8.75</u>	<u>8.75</u>	<u>8.75</u>	<u>0.00</u>
Total Personnel	323.35	332.85	332.85	0.00

Vacancy Data: Regular Positions

Turnover and Necessary Vacancies, Excluding New Positions	12.15	3.75%
Positions and Percentage Vacant as of 12/31/16	16.00	4.94%

- The fiscal 2018 allowance for SLGCA includes 324.1 regular full-time equivalent (FTE) positions. This is unchanged from fiscal 2017.
- SLGCA reports 16.0 vacant positions at the end of calendar 2016, a vacancy rate of 4.94%.
- Contractual staff remains constant at 8.75 FTEs. However, contractual salaries increase considerably in the fiscal 2018 allowance as discussed below.

Analysis in Brief

Major Trends

Traditional Lottery Sales Reach a Record High in Fiscal 2016: Proceeds from traditional lottery sales pay for prizes, agent earnings, and contribute general fund revenue to the State. Strong sales resulted in record-setting levels for SLGCA in fiscal 2016.

New Performance Measures on Lottery Retailers: SLGCA promotes and sells its products through a network of over 4,450 retailers across the State. In the fiscal 2018 budget submission, SLGCA included a new performance objective and new performance measures that reinforce its goal to “support Maryland businesses and the lottery retail network.”

Rate of Casino Audit Findings Decline: SLGCA has been responsible for the financial accountability and reporting of the State’s gaming program since fiscal 2008. In fiscal 2014, SLGCA began reporting measures that demonstrate its oversight role of the State’s gaming facilities. Specifically, SLGCA is reporting the number of audits and audit findings related to casino accounts, records, and control procedures. In fiscal 2016, the rate of audit findings declined considerably.

Issues

Instant Ticket Games and Powerball Sales Drive Record-setting Year: A record-setting increase in sales of traditional lottery games was driven largely by a significant uptick in sales of instant ticket and Powerball games in fiscal 2016. SLGCA has aimed considerable marketing efforts toward the instant ticket market. This, combined with relatively high payout rates for instant tickets, and a large Powerball jackpot contributed to the record-setting sales. **The Department of Legislative Services (DLS) recommends that SLGCA comment on its current trend of sales and revenues, and in particular, the current mix of games, the emphasis on instant tickets, and the return to the General Fund.**

Video Lottery Terminal and Gaming Program – Sixth Casino Opens: Since fiscal 2008, SLGCA has been tasked with the responsibility of administering the State’s gaming program including: the regulation and licensing of operators; accounting for and distribution of revenues; managing the program’s central system; and the ownership of a portion of the gaming machines. The sixth, and last authorized, gaming facility opened in December 2016, pushing revenues significantly higher and triggering changes to the revenue distribution. Additionally, SLGCA seeks to make statutory changes to machine ownership that will affect gaming revenues and agency expenditures. **DLS recommends that SLGCA comment on the status of the State’s gaming program. Specifically on the impact of the sixth casino, on the overall revenues to the State, and on the revenue and expenditure impact of its departmental legislation.**

Recommended Actions

	<u>Funds</u>
1. Reduce the increase in contractual salaries.	\$ 135,613
Total Reductions	\$ 135,613

Updates

Lottery Retailers by County: According to SLGCA, as of the end of calendar 2016, there were 4,451 lottery retailers. This is a small increase over the number of retailers in fiscal 2016 (1.9%) Of these, 330 retailers participate in the Expanded Cashing Authority Program and are allowed to cash winnings of up to \$5,000. All other retailers may cash winning tickets up to \$600.

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State Lottery and Gaming Control Agency

Operating Budget Analysis

Program Description

Since 1973, the State Lottery and Gaming Control Agency (SLGCA) has administered and operated lottery games to generate revenue for the State. The lottery currently offers the following games: Pick 3, Pick 4, Keno, Instant Ticket Games, Keno Bonus and Super Keno Bonus, Mega Millions, Powerball, Bonus Match Five, Multi-Match, Racetrax and Racetrax Bonus, 5 Card Cash, and most recently, Cash4Life.

All games, except Instant Ticket 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 Ticket 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 SLGCA. In 2008, the commission was expanded to address additional responsibilities stemming from the video lottery terminal (VLT) legislation. SLGCA is responsible for the administration of the VLT program including accounting for and distributing VLT revenues, managing the program's central system, and regulating and licensing of operators. In fiscal 2012, SLGCA's responsibilities were further expanded to include the regulation of table games at the previously authorized VLT facilities, among other new duties.

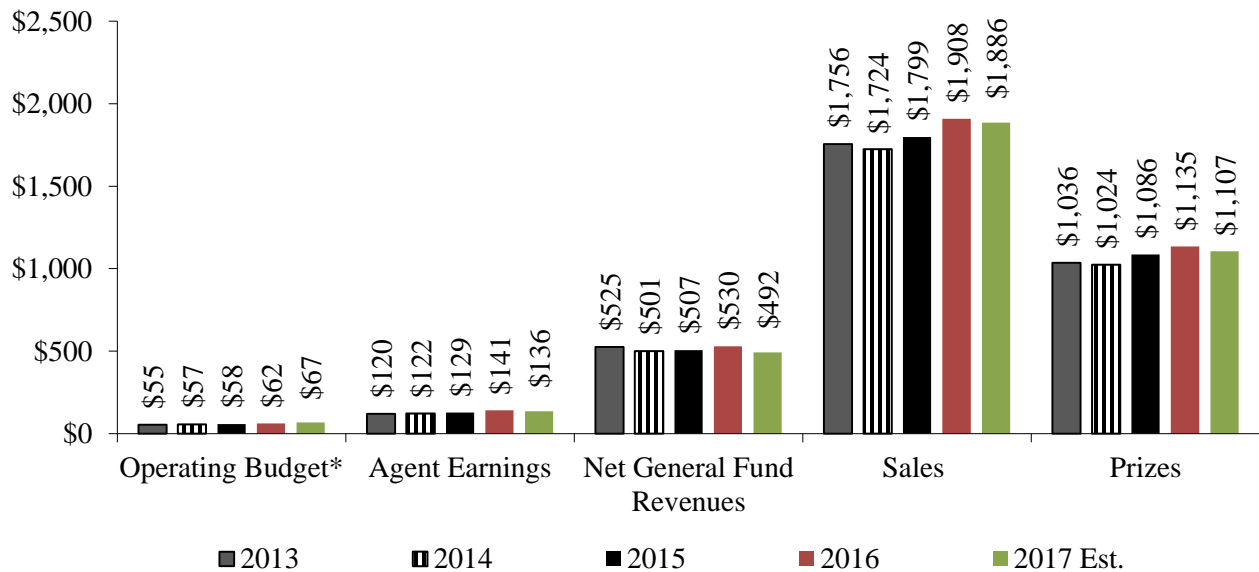
Performance Analysis: Managing for Results

1. Traditional Lottery Sales Reach a Record High in Fiscal 2016

Proceeds from the traditional lottery games pay for prizes, agent earnings, and all operating expenses of SLGCA. In fiscal 2016, 59.5% of sales paid for prizes, 7.4% paid for agent commissions and redemption fees, 3.2% paid for agency operations, and 29.9% was credited as revenue to the State (including a small percentage forwarded to the Maryland Stadium Authority per statute). **Exhibit 1** shows total lottery sales and the distribution of those sales from fiscal 2013 through an estimate for fiscal 2017.

Fiscal 2016 marked a year of significant gains for the lottery. Sales, revenues, prize payouts, and agent earnings all experienced increases in fiscal 2016. Sales grew over 6% to a record high of \$1.91 billion. Driving this increase were increases in sales of instant tickets and Powerball games. However, although projections still remain healthy, this level of sales is not expected in fiscal 2017. A more in-depth discussion of sales and revenues can be found in the Issues section of this analysis.

Exhibit 1
Lottery Sales and Expenditures
Fiscal 2013-2017 Est.
(\$ in Millions)



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

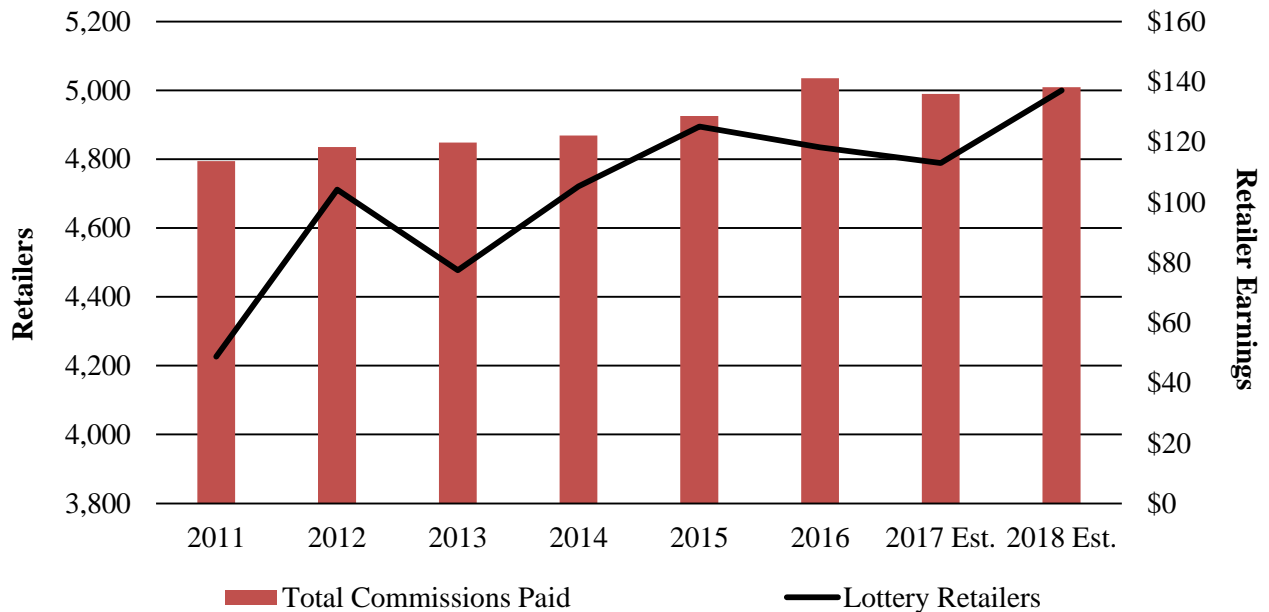
Note: General fund revenues exclude disbursements to the Maryland Stadium Authority.

Source: State Lottery and Gaming Control Agency

2. New Performance Measures on Lottery Retailers

SLGCA is able to achieve its sales goals because of its network of lottery retailers. According to SLGCA, as of the end of calendar 2016, there were 4,451 lottery retailers. Of these, 330 retailers participate in the Expanded Cashing Authority Program and are allowed to cash winnings of up to \$5,000. All other retailers may cash winning tickets up to \$600. Agents earn 5.5% of sales at retail establishments as well as 3.0% in cashing commissions. **Exhibit 2** shows the number of agents and their earnings from fiscal 2011 through an estimate for fiscal 2018.

Exhibit 2
Lottery Retailers and Earnings
Fiscal 2011-2018 Est.
(\$ in Thousands)



Source: State Lottery and Gaming Control Agency

SLGCA has included a new performance objective and new performance measures in the fiscal 2018 budget submission. The lottery aims to “support Maryland businesses and the lottery retail network.” Other than paying the retailers their earned commission, it is unclear how the performance measures in Exhibit 2 demonstrate how SLGCA meets the objective of supporting Maryland businesses. SLGCA should consider adding measures that quantify the amount of promotional materials, equipment, and other physical materials that are provided to the retailers.

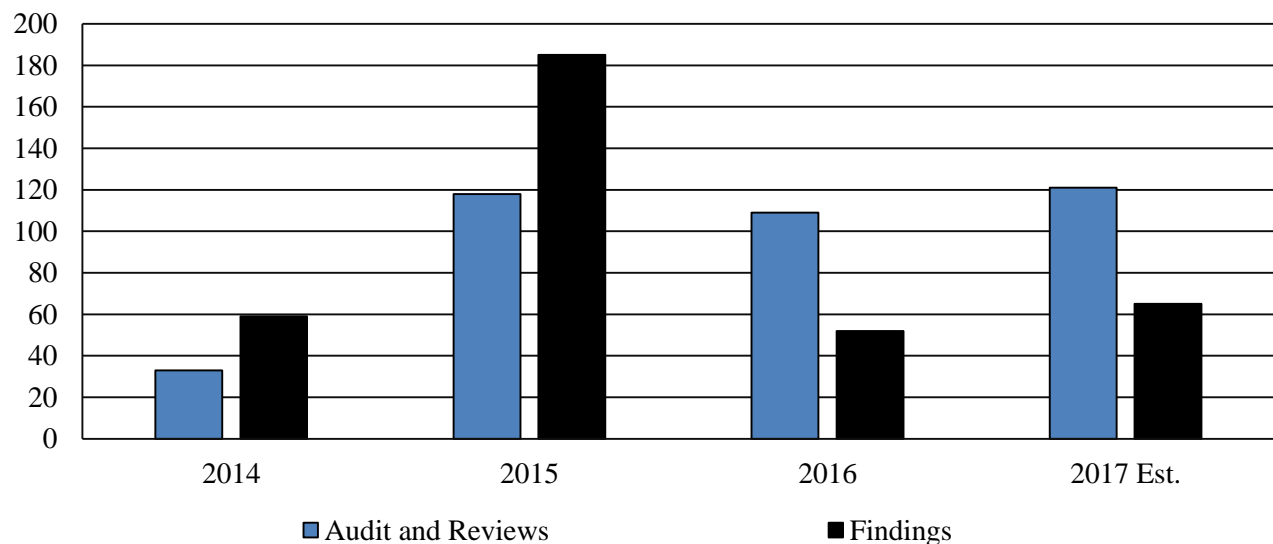
3. Rate of Casino Audit Findings Decline

At the encouragement of the Department of Legislative Services (DLS), SLGCA began to report performance measures for its gaming program in the fiscal 2016 budget cycle. SLGCA’s responsibilities associated with the State’s gaming program started in 2008. An entirely new division was established with new and unique duties that enable the regulation and oversight of the casino facilities. It is, therefore, important to have performance oversight through the legislative budget process. The statute requires that SLGCA issue regulations requiring regular audits of gaming facilities. Those audits must disclose whether the accounts, records, and control procedures maintained

by the video lottery operation licensees are as required by statute and by regulation. SLGCA is now reporting on the number of casino audits and reviews and the number of findings.

According to SLGCA, once a gaming facility is alerted to a finding, the facility management must report on how it will address the finding. Depending on the severity of the finding, SLGCA's enforcement division may issue appropriate disciplinary action. SLGCA will then perform follow-up audit test work to ensure that the finding has been resolved. As shown in **Exhibit 3**, the number of findings declined significantly in fiscal 2016. SLGCA advises that numerous, but minor, infractions were found in fiscal 2015 and have since been corrected. SLGCA may wish to consider adding a performance measure that would track the rate in which findings are resolved and the number of repeat findings at any one facility.

Exhibit 3
Gaming Facilities – Audits and Findings
Fiscal 2014-2017 Est.



Source: State Lottery and Gaming Control Agency

Fiscal 2017 Actions

Proposed Deficiency

The fiscal 2018 allowance includes a fiscal 2017 deficiency of \$120,000 in general funds for increased costs related to the gaming central system that were incurred with the opening of the State's sixth casino in Prince George's County in December 2016. The system's vendor earns a monthly fee

and that fee increases as the number of gaming facilities increases. The fiscal 2017 budget was compiled before the exact opening date of the casino was known.

Cost Containment

At the November 2016 Board of Public Works (BPW) meeting, SLGCA's fiscal 2017 appropriation was reduced by \$982,000 in special funds. SLGCA contracts with a vendor to operate the central system that administers the regular lottery games program. It was determined that based on sales and expected costs, budgeted funds for this contract could be reduced in fiscal 2017. Special funds not spent by the agency accrue to the general fund as revenue.

Section 20 Position Abolitions

The fiscal 2017 budget bill included a provision that reduced 657 positions statewide, but did not specify which positions. In June, a BPW item enumerated each reduced position and allocated a funding reduction. SLGCA was reduced by 3.5 positions including: 1.0 public affairs officer, 1.0 program administration, and 1.5 administrators. SLGCA's funding was reduced by \$70,000 in general funds and \$100,000 in special funds.

Proposed Budget

SLGCA's fiscal 2018 allowance increases by \$2.2 million, or 2.2%, after adjustments for deficiencies and across-the-board reductions. **Exhibit 4** details the changes in the allowance as compared to fiscal 2017.

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

How Much It Grows:	General <u>Fund</u>	Special <u>Fund</u>	<u>Total</u>
Fiscal 2016 Actual	\$20,275	\$71,706	\$91,981
Fiscal 2017 Working Appropriation	22,042	76,580	98,621
Fiscal 2018 Allowance	<u>20,048</u>	<u>80,788</u>	<u>100,837</u>
Fiscal 2017-2018 Amount Change	-\$1,993	\$4,209	\$2,215
Fiscal 2017-2018 Percent Change	-9.0%	5.5%	2.2%

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Where It Goes:

Personnel Expenses

Turnover adjustments.....	\$426
Reclassification	145
Employee retirement.....	143
Increments and other compensation.....	49
Other fringe benefit adjustments.....	10
Workers' compensation premium assessment	-65
Contingent pension reduction	-89
Employee and retiree health insurance	-234

Other Changes

Regular Lottery Operations

Central system.....	1,248
Software and information technology upgrades	323
Contractual staff.....	136
Equipment	55
Advertising.....	-95
Motor vehicles	-117

Video Lottery Terminal and Gaming Operations

Central system.....	270
Equipment	45
Security services	-120
Other	85

Total	\$2,215
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Note: Numbers may not sum to total due to rounding.

Personnel

SLGCA has grown significantly over the last several years due to the expansion of its responsibilities related primarily to the introduction of casino gaming to the State. In fact, between fiscal 2008 and 2017, personnel grew from 172 regular full-time equivalents (FTE) to 324 FTEs. The fiscal 2018 allowance marks the first time since 2008 that no new positions are added to SLGCA's budget in response to its expanded scope.

The allowance does include, however, an increase in personnel funding due primarily to a decrease in the budgeted turnover rate. The fiscal 2018 budget reflects a turnover rate of 3.75%, a decrease from 5.7% in the current year. This results in an increase of over \$426,000 in personnel funds for SLGCA in fiscal 2018. This is consistent with a recent decline in actual vacancies reported by SLGCA. At the end of calendar 2016, SLGCA had 16 vacant positions, a 4.94% vacancy rate. This is considerably less than the 10-year average mid-year vacancy rate of 11%.

Across-the-board Reductions

The fiscal 2018 budget bill includes a \$54.5 million (all funds) across-the-board contingent reduction for a supplemental pension payment. Annual payments are mandated for fiscal 2017 through 2020 if the Unassigned General Fund balance exceeds a certain amount at the close of the fiscal year. This agency's share of these reductions is \$35,183 in general funds and \$53,458 in special funds. This action is tied to a provision in the Budget Reconciliation and Financing Act (BRFA) of 2017.

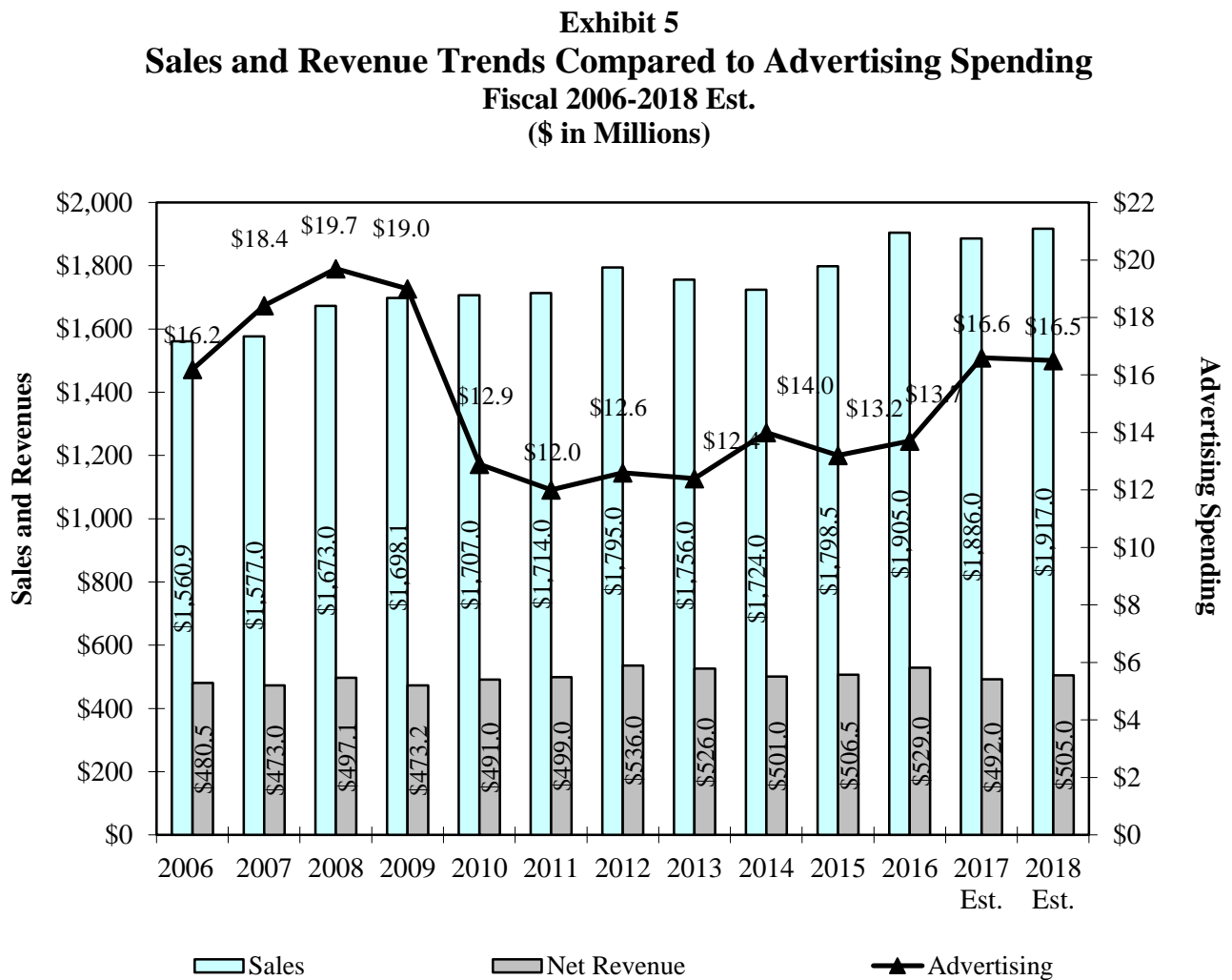
Regular Lottery Operations

Absent gaming operations, the fiscal 2018 allowance increases by almost \$2.0 million over fiscal 2017. The primary reason for the increase is a \$1.2 million increase in SLGCA's central system contract. The central system connects SLGCA with its system of retailers and monitors and accounts for all regular lottery sales. The cost of the contract is driven by sales and is budgeted by estimating sales for the next fiscal year. However, it should be noted that SLGCA had planned to be operating under a new contract for an enhanced central system with an entirely new cost structure. There is no evidence of the new contract in the fiscal 2018 allowance. The current contract with the system's vendor was originally set to expire at the end of fiscal 2016. However, due to implementation delays, the contract was extended for an additional year. After a lengthy procurement process, SLGCA awarded a new multi-year contract for an enhanced central system, but competing bidders filed a protest in September 2016. The protest is currently with the State Board of Contract Appeals. This will likely necessitate a further extension of the existing contract.

Regardless of the outcome of the bid protest, the new central system is expected to carry significantly higher costs than the current system. However, it is also expected that the modernized system will enable SLGCA to better manage instant ticket inventory and to analyze sales data to better market its products. In the short term, SLGCA had to increase its information technology budget as it continues to operate with an aging system (an increase of \$290,000).

SLGCA's contractual FTEs remained constant in fiscal 2018. However, contractual salaries increase considerably (a net of \$125,000, or 45%). SLGCA added 1 new position, a chief marketing officer, as a contractual position in lieu of creating 1 new regular FTE. The position is responsible for directing SLGCA's marketing strategy and the work of the creative service unit and the product development unit. The increase in funds is almost exclusively related to this new position.

SLGCA’s advertising budget has fluctuated over the last few years. The allowance for fiscal 2018 shows only a modest reduction (\$95,000). **Exhibit 5** shows the recent history of sales and revenues as compared to the advertising budget.



Source: Governor’s Budget Books, Fiscal 2006-2016; Lottery Budget, Fiscal 2005-2018

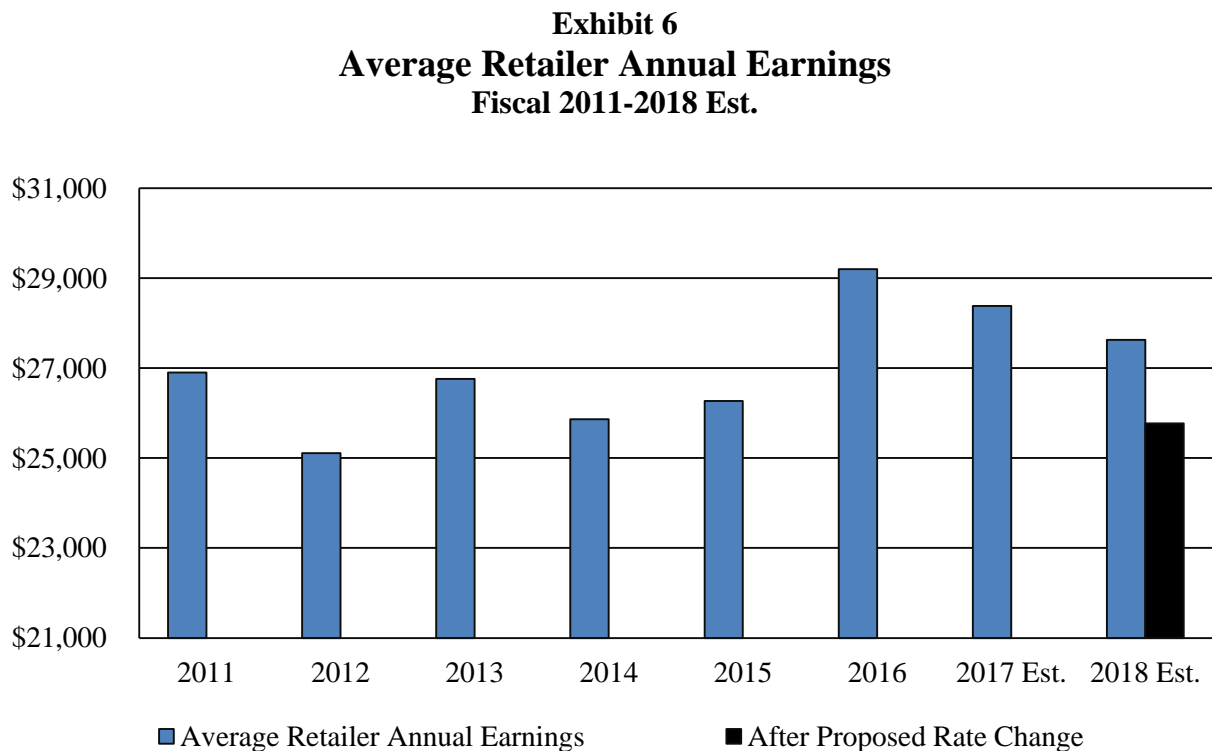
As demonstrated by the exhibit, it is difficult to claim any certainty about the impact of advertising on lottery sales. Many other factors affect player behavior, notably the occurrence of large jackpot sales as was experienced in fiscal 2016. However, it must be noted that SLGCA’s strategy of focusing marketing efforts on instant tickets seems to have had some effects. In fiscal 2017, the SLGCA’s marketing plan is to direct about 63.0% of its advertising funds (excepting advertising agency fees) toward instant ticket sales. Updated revenue estimates for fiscal 2017 show instant tickets sales

increasing by 3.1%, while overall sales decline by 1.2%. This is consistent with the strategy and funding over the last couple of years.

As mentioned above, the SLGCA's licensed retailers earn 5.5% of sales in commissions for selling lottery products through their retail establishments. As part of a cost containment initiative, the BRFA of 2009 (Chapter 487) decreased the agent sales commission from 5.5% to 5.0% in fiscal 2010 through 2012. The BRFA of 2012 (Chapter 1 of the first special session) kept the commission at 5.0% for fiscal 2013. Chapter 1 of the 2012 second special session increased the commission back to 5.5% effective January 1, 2013.

According to SLGCA, as of fiscal 2015, Maryland retailers earn the third highest commission of any in the country when accounting for sales commission plus cashing commission (blended commission). In addition, SLGCA pays for all equipment and promotional material for the licensed retailers. Retailers pay no application or licensing fees. They must, however, employ sufficient staff to respond to lottery customers.

Exhibit 6 shows the average annual earnings per retailer between fiscal 2011 and an estimate for fiscal 2018. The annual earnings range from just over \$25,000 to just over \$29,000. Increases in ticket sales and the increases in prizes (for cashing commissions) significantly benefit retailers.



Source: State Lottery and Gaming Control Agency

DLS recommends adding a provision to the BRFA of 2017 that lowers the sales commission for lottery retailers from 5.5% to 5.0% for fiscal 2018 and 2019. This action would increase revenues to the General Fund of approximately \$9.3 million in fiscal 2018. Conversely, on average, agent earnings would decline by approximately \$1,860 as shown in Exhibit 6.

VLT and Gaming Operations

Absent regular lottery operations, the fiscal 2018 allowance for SLGCA's gaming operations grows by only 1% over the fiscal 2017 working appropriation. This is due primarily to an increase in the central system that monitors the State's gaming program due to the first full year of operation of the facility in Prince George's County. The allowance relies much heavier on special funds in fiscal 2018. SLGCA receives 1% of VLT revenue to offset the costs to regulate the program. Historically, special funds have been insufficient to cover all its costs and, therefore, general funds were required. In fiscal 2018, SLGCA's special funds are increasing due to the increase in VLT revenue generated by the first full year of operation of the sixth casino. As such special funds increase by \$2.3 million, enabling a general fund reduction of \$2.0 million.

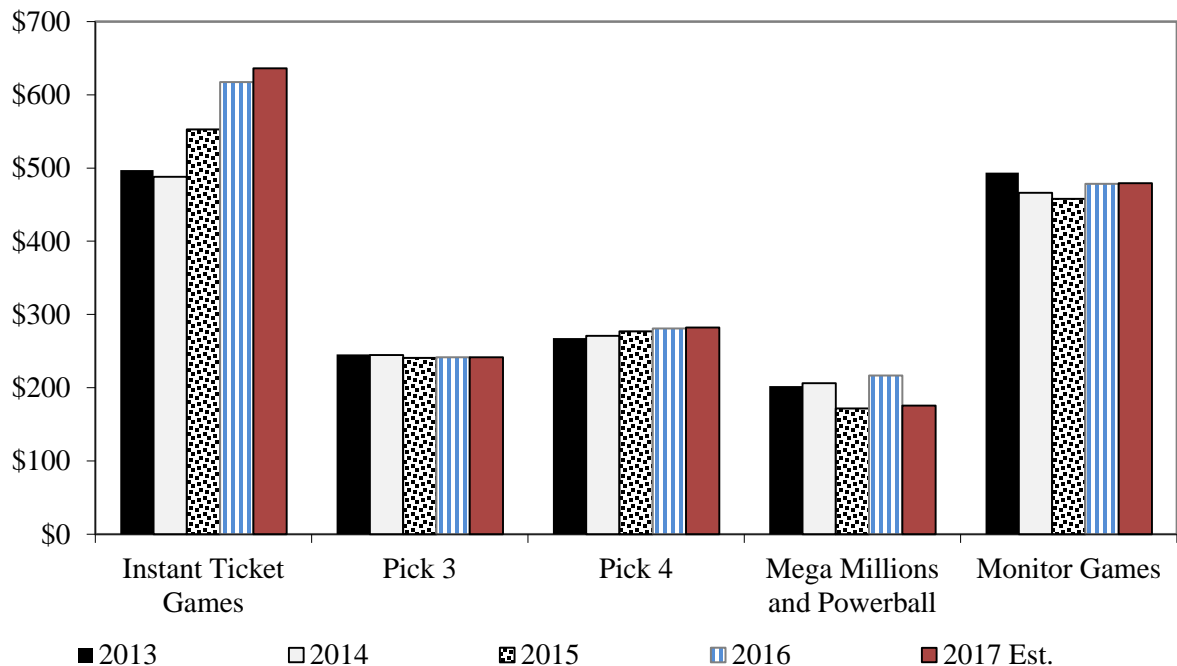
As part of their regulatory duties, SLGCA licenses casino employees and requires fingerprinting of those employees. The fiscal 2018 allowance declines by about \$120,000 due to a decline in the number of new employees and the associated fingerprinting fees.

Issues

1. Instant Ticket Games and Powerball Sales Drive Record-setting Year

An increase in sales of traditional lottery games in fiscal 2016 was driven largely by a significant uptick in sales of instant ticket and Powerball games. **Exhibit 7** shows the total sales of selected games from fiscal 2013 through an estimate for fiscal 2017. The exhibit clearly shows the relative popularity of the games, with instant tickets and monitor games claiming most of the sales.

Exhibit 7
Sales – Selected Games
Fiscal 2013-2017 Est.
(\$ in Millions)



Source: State Lottery and Gaming Control Agency

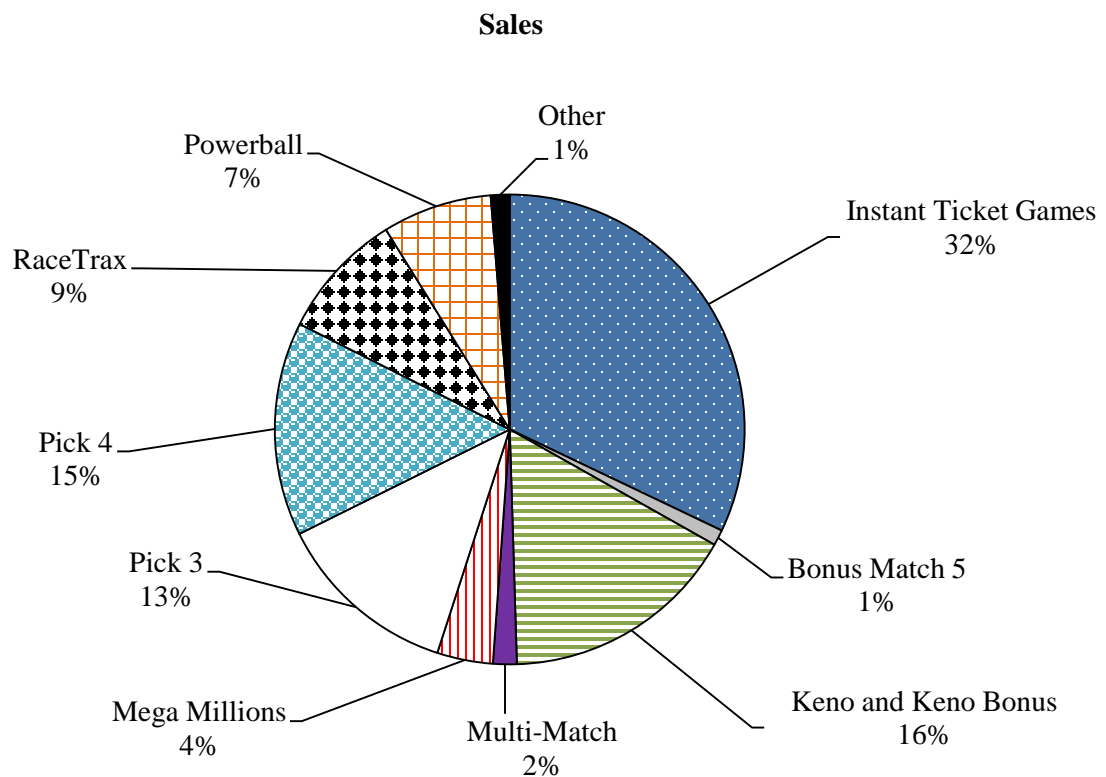
Several years ago, SLGCA took note that its sales of instant tickets were underperforming as compared to other states. As such, SLGCA has increased its effort to market these games. Sales of instant tickets grew by 13.8% in fiscal 2015 and by another 11.7% in fiscal 2016. A more moderate rate of growth (3.1%) is expected in fiscal 2017.

In contrast to instant tickets, sales of Powerball, and other jackpot games, are driven much more by jackpot size than by marketing efforts. In fiscal 2016, sales of jackpot games grew by 26.4% over fiscal 2015. In January 2016, there was a \$1.6 billion jackpot; a record high. This drove sales up considerably.

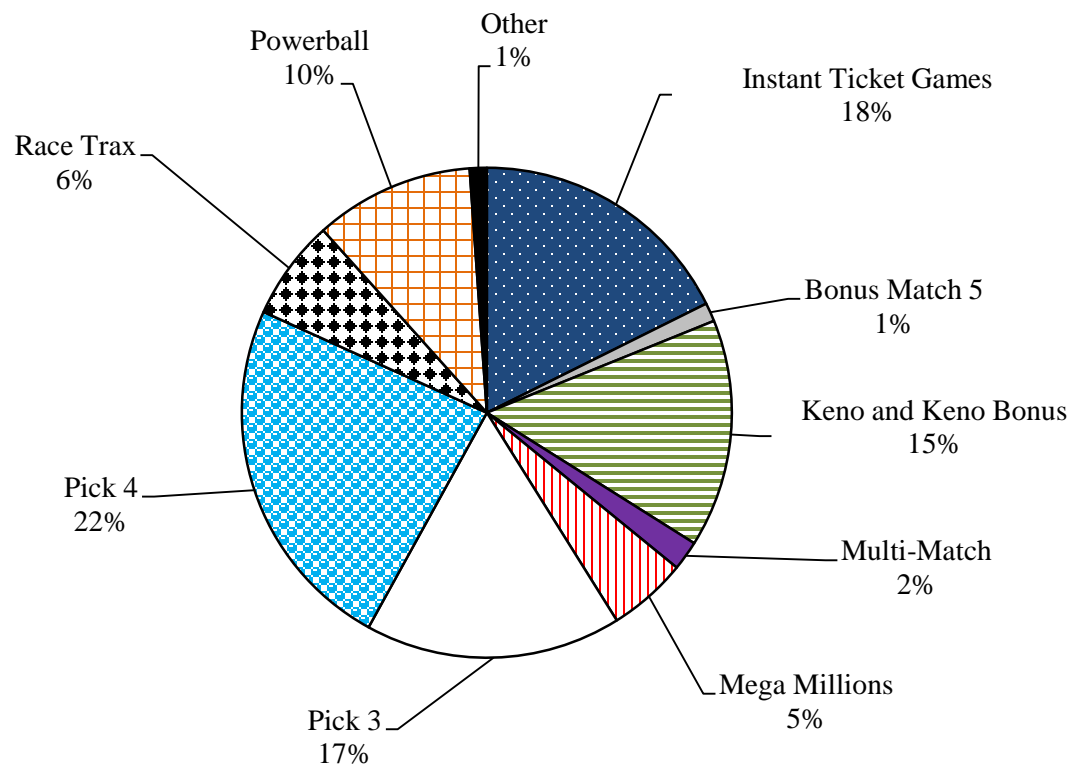
The mix of games is important to maintaining customer interest and to the returns to the General Fund. Because of this variety, any negative impact on revenues from one game can be mitigated by other games.

Exhibit 8 shows sales and revenues for each game type in fiscal 2016. As shown, Instant Ticket Games make up 32.0% of sales, but only 18.0% of revenue. In fiscal 2015, Instant Ticket Games made up 30% of sales and still only 18.0% of revenue. Instant tickets are popular, in part, because of the relatively high payout rates, which determine the revenues to the State. The higher the payout, the less return to the State. By another means of illustration, instant ticket sales grew by 11.7% in fiscal 2016, while revenues to the State from instant tickets grew by 10.3%. This is worth considering as SLGCA continues to place advertising emphasis on increasing instant ticket sales.

Exhibit 8
Sales and Revenues
Fiscal 2016



Revenues



Source: State Lottery and Gaming Control Agency

DLS recommends that SLGCA comment on its current trend of sales and revenues, and in particular, the current mix of games, the emphasis on instant tickets, and the return to the General Fund.

2. Video Lottery Terminal and Gaming Program – Sixth Casino Opens

Since fiscal 2008, SLGCA has been tasked with the responsibility of administering the VLT program for the State. This includes the regulation and licensing of operators, accounting for and distributing VLT and table game revenues, managing the program's central system, and the purchase or lease of gaming machines.

Background

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

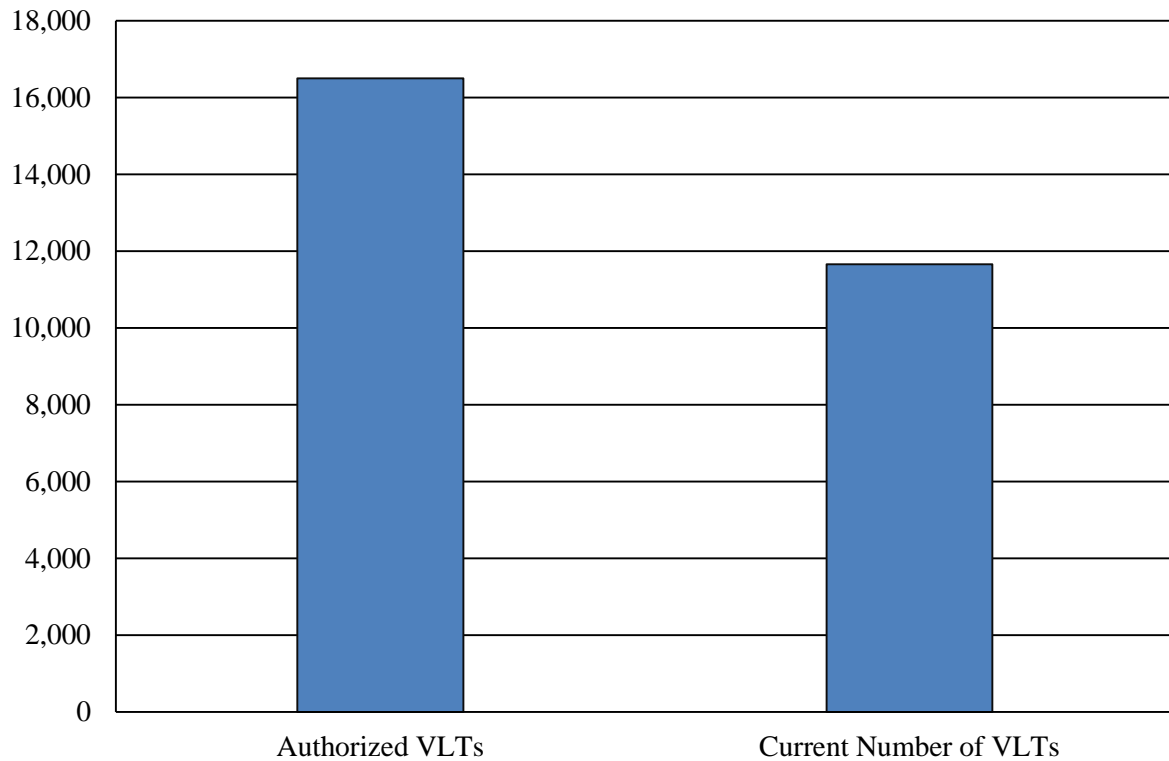
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- ***Cecil County:*** Penn Cecil Maryland Inc. (Penn Cecil) was awarded a license to operate a VLT facility with 1,500 VLTs in Perryville in Cecil County. The facility opened to the public with 1,500 VLTs on September 27, 2010. It currently houses 850 machines and 20 table games. The facility is now owned by Gaming and Leisure Properties, Inc.
- ***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 and no table games.
- ***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 2016, the facility has placed into operation 3,906 VLTs and 209 table games.
- ***Allegany County:*** On April 26, 2012, Evitts Resort, LLC 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 currently has 662 VLTs and 17 table games. It is now owned by Golden Entertainment, Inc.
- ***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. The facility opened in August 2014 with 2,500 VLTs and 147 table games. It currently has 2,202 VLTs and 179 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 facility opened in December 2016 with 3,237 VLTs and 165 table games.

The mix of VLT machines and table games has consequential implications for the State's revenue. The amount of revenue accruing to the State is less from table games than it is for VLT machines. This 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. To the extent that VLT machines are replaced with table games, the State's share of potential revenue declines. However, the mix must be calibrated appropriately to maximize the total potential revenue. In 2015, SLGCA contracted with a consultant who determined that, despite the difference in the State share of revenue, the gaming market in Maryland indicates that a reduction from the original number of authorized VLTs and an increase in table games would, in the long run, be beneficial for both the operators and the State.

Exhibit 9 shows the maximum amount of VLTs that are authorized by statute statewide as compared to the number of VLTs currently housed at the casinos. The casinos operate about 70.1% of the allowable number of machines. This is due, in part, to the subsequent change in statute to allow table games and the increasing popularity of table games.

Exhibit 9
Video Lottery Terminals
Authorized vs. Current Count



VLT: video lottery terminal

Source: State Lottery and Gaming Control Agency

Revenues

SLGCA accounts for and disperses the revenue derived from the State's gaming facilities. **Exhibit 10** shows the gross revenue from the facilities in fiscal 2016, compared to the estimate of that revenue. Revenues for both VLTs and table games exceeded expectations.

Exhibit 11 details the revised estimates for VLT and table games in fiscal 2017 and 2018. The expectation is that table games continue to post strong gains; while VLT revenues, although growing, will not be as robust as originally projected.

Exhibit 10
Disposition of Maryland Gaming Facilities Gross Revenues
Fiscal 2016
(\$ in Millions)

	<u>2016</u> <u>Estimate</u>	<u>2016</u> <u>Actual</u>
Video Lottery Terminal Revenues		
Education Trust Fund	\$312.9	\$322.0
Facility Owner	295.6	304.3
Horse Racing Purse Account	48.7	50.1
Local Impact Aid	38.6	39.7
Racetrack Facility Renewal Account	6.8	7
State Lottery Agency	7.6	7.8
Small, Minority, and Women-Owned Business Account	10.5	10.8
Subtotal	\$720.7	\$741.7
Table Games		
Education Trust Fund	75.0	\$80.5
Facility Owner	300.1	321.8
Subtotal	\$375.1	\$402.3
Total	\$1,095.8	\$1,144.0

Source: Board of Revenue Estimates; Department of Legislative Services

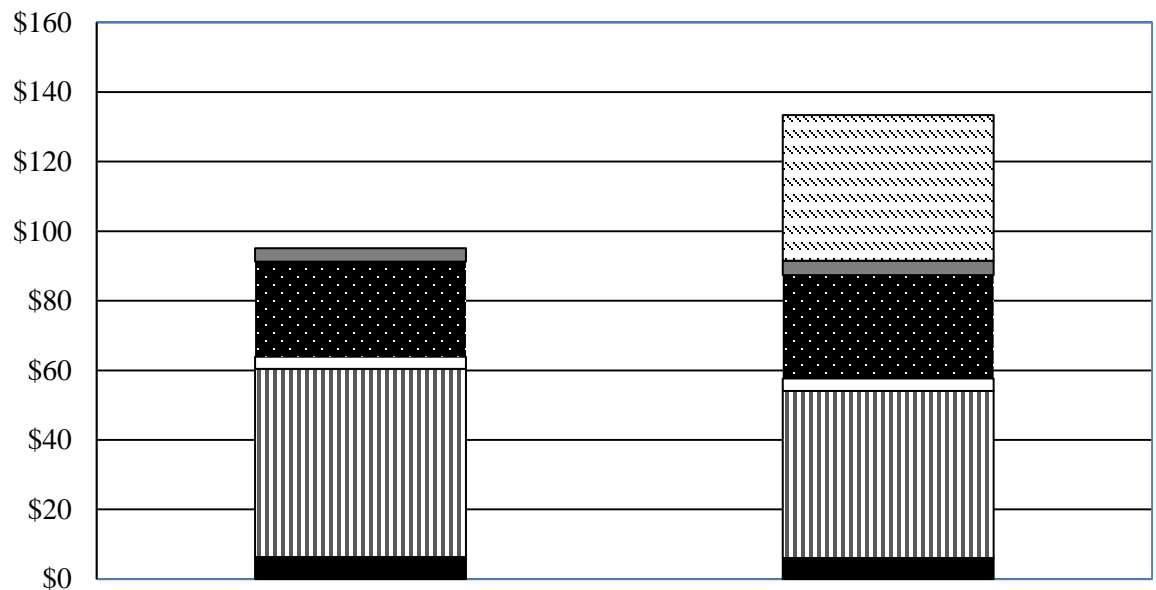
Exhibit 11
Maryland Gaming Facilities Estimated Revenues
Fiscal 2017-2018
(\$ in Millions)

	<u>Estimate</u> <u>2017</u>	<u>Revised</u> <u>Estimate</u> <u>2017</u>	<u>Difference</u>	<u>Estimate</u> <u>2018</u>	<u>Revised</u> <u>Estimate</u> <u>2018</u>	<u>Difference</u>
Video Lottery Terminals	\$916.4	\$921.2	\$4.8	\$1,144.3	\$1,132.4	-\$11.9
Table Games	508.2	540.2	32.0	626.6	658.5	31.9
Total	\$1,424.6	\$1,461.4	\$36.8	\$1,770.9	\$1,790.9	\$20.0

Source: Board of Revenue Estimates; Department of Legislative Services

Although the casino in Prince George’s County just recently opened, it is already having a significant effect on State revenues. To illustrate its impact, **Exhibit 12** shows December 2015 revenue versus December 2016 revenue by casino. December is the only month available for the Prince George’s County casino as of the writing of this analysis. Further, it only represents three weeks of revenue for the new casino. Regardless, the significant impact is clearly observable; there is a 40% difference in total revenue. It should be noted that the facility in Anne Arundel County saw a sizable decline in revenue from December 2015 to 2016. However, additional data is required before any conclusions may be drawn about the sustained impact of the new casino.

Exhibit 12
Gross Revenues – Impact of Sixth Casino
December 2015 vs. 2016
(\$ in Millions)



	Dec. 2015	Dec. 2016
▨ MGM		\$41.9
■ Ocean Downs	\$3.9	4.1
■ Horseshoe	27.3	29.7
□ Rocky Gap	3.5	3.6
▤ Maryland Live	54.1	48.0
■ Hollywood – Perryville	6.3	6.1

■ Hollywood – Perryville ▤ Maryland Live □ Rocky Gap ■ Horseshoe ■ Ocean Downs ▨ MGM

Source: State Lottery and Gaming Control Agency

Prior to the opening of the Prince George’s County facility, the owners of the facility requested a reduction in the number of planned VLT machines for the casino floor, from 3,600 to a minimum of 3,321. The owners believed this request is consistent with current market factors that show a trend toward table games and away from VLT machines. SLGCA approved the planned reduction and the facility opened with 3,237 VLTs and 165 table games.

Gaming Revenue Distribution Changed Upon Opening of Sixth Casino

The statute specifies the distribution of casino revenues, including the distribution to the facility operators. The distribution of VLT owners varies by facility based on a number of factors. **Exhibit 13** details the operator share of VLT revenues at certain benchmarks that are set in statute.

Exhibit 13
Casino Operator Share of Video Lottery Terminal Revenue
Fiscal 2017 through 2020

	<u>Horseshoe Casino Baltimore</u>	<u>Maryland Live!</u>	<u>Hollywood Casino at Perryville</u>	<u>The Casino at Ocean Downs</u>	<u>Rocky Gap Casino and Resort</u>	<u>MGM National Harbor Casino</u>
Original 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 County License (as of the December 2016 Opening)	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%

VLT: video lottery terminal

Source: State Lottery and Gaming Control Agency

The ownership of the VLT machines transferred to the facility operators in April 2015. This only affected the existing facilities in Anne Arundel and Cecil counties. Facilities with fewer than 1,000 machines did not have to assume ownership of their machines; SLGCA retained ownership. 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. This adjustment equates to less support for the Education Trust Fund. However, SLGCA is spending considerably less in State funds to support the machine ownership for these facilities.

Another adjustment took place upon the opening of the sixth casino 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 fiscal 2012 after other facilities were already in operation. To adjust for the increased and unexpected competition from a sixth casino, operator shares were adjusted upward for the facilities in Anne Arundel County and Baltimore City. This increase in operator share must be used for marketing, advertising, promotional costs, and capital improvements. The lottery commission has the discretion to further increase operator share by up to 5% after July 1, 2019, at the facilities in Anne Arundel and Cecil counties and Baltimore City.

New and Recent Regulatory and Legislative Changes

In late summer 2016, the Administrative, Executive, and Legislative Review Committee approved a regulatory change that, in general, repealed specific rules about table games that were set in regulation and instead specified the need for SLGCA Commission's approval for table game rules submissions. This gives the casino operators much more flexibility in setting rules, including how much is paid out in winnings to players. Indeed, some of the State's casinos have used that flexibility to lower the payouts available to players. It should be noted, however, that payout rates for VLTs are still set in regulation. Last year, the commission amended the regulations to lower the required average annual payouts from VLTs. These are recent changes, and it is unclear the impact they will have on player behavior and ultimately State revenues.

It should also be noted that SLGCA has introduced a departmental bill (House Bill 91) that would further alter the revenue distribution. The bill transfers the ownership of the remaining State-owned machines to the owners at the Rocky Gap and Ocean Downs facilities by March 31, 2020. This would entitle the owners to an increase in their share of the revenue by 6 percentage points or by 10 percentage points if the transfer occurs before January 1, 2018. Again, this would result in less funds available for the Education Trust Fund. However, SLGCA estimates that, given the costs to the State to own or lease the machines, a transfer of ownership and a change in the casino share of revenue would result in a net gain to the State.

DLS recommends that SLGCA comment on the status of the State's gaming program. Specifically, on the impact of the sixth casino on the overall revenues to the State, and on the revenue and expenditure impact of its departmental regulatory and legislative changes.

Recommended Actions

	<u>Amount Reduction</u>
1. Reduce the increase in contractual salaries. The increase in funds is for a new chief marketing position. This position would be more appropriately filled within a regular full-time equivalent position rather than contractually. The State Lottery and Gaming Control Agency should reclassify an existing vacancy for this position.	\$ 135,613 SF
Total Special Fund Reductions	\$ 135,613

Updates

1. Lottery Retailers by County

SLGCA is able to achieve its sales goals because of its network of lottery retailers. According to SLGCA, as of the end of calendar 2016, there were 4,451 lottery retailers. This is a small increase over the number of retailers in fiscal 2016 (1.9%). Of these, 330 retailers participate in the Expanded Cashing Authority Program and are allowed to cash winnings of up to \$5,000. All other retailers may cash winning tickets up to \$600. Agents earn 5.5% of sales at retail establishments as well as 3.0% in cashing commissions. **Exhibit 14** shows the total number of retailers in each county.

Exhibit 14
Maryland Lottery Retailers – By County
(As of December 2016)

<u>County</u>	<u>Retailer Count</u>	<u>Percentage</u>
Allegany	62	1.4%
Anne Arundel	432	9.7%
Baltimore	702	15.8%
Baltimore City	695	15.6%
Calvert	69	1.6%
Caroline	29	0.7%
Carroll	128	2.9%
Cecil	100	2.2%
Charles	137	3.1%
Dorchester	29	0.7%
Frederick	150	3.4%
Garrett	28	0.6%
Harford	192	4.3%
Howard	155	3.5%
Kent	16	0.4%
Montgomery	430	9.7%
Prince George's	600	13.5%
Queen Anne's	51	1.1%
St. Mary's	103	2.3%
Somerset	15	0.3%
Talbot	38	0.9%

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<u>County</u>	<u>Retailer Count</u>	<u>Percentage</u>
Washington	114	2.6%
Wicomico	83	1.9%
Worcester	93	2.1%
Total	4,451	100.0%

Source: State Lottery and Gaming Control Agency

Appendix 1
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 2016					
Legislative Appropriation	\$24,861	\$78,284	\$0	\$0	\$103,145
Deficiency Appropriation	0	0	0	0	0
Budget Amendments	142	232	0	0	374
Reversions and Cancellations	-4,729	-6,809	0	0	-11,538
Actual Expenditures	\$20,275	\$71,706	\$0	\$0	\$91,981
Fiscal 2017					
Legislative Appropriation	\$21,700	\$77,353	\$0	\$0	\$99,053
Cost Containment	0	-982	0	0	-982
Budget Amendments	222	208	0	0	430
Working Appropriation	\$21,922	\$76,580	\$0	\$0	\$98,502

Note: Does not include targeted reversions, deficiencies, and contingent reductions. Numbers may not sum to total due to rounding.

Fiscal 2016

The fiscal 2016 original appropriation was increased by a budget amendment to offset a 2% employee pay reduction. Specifically, general funds increased by \$142,000 and special funds increased by \$232,000. However, final expenditures fell significantly below the original appropriation. The State Lottery and Gaming Control Agency (SLGCA) reverted approximately \$4.7 million in general funds. Additionally, SLGCA canceled over \$6.8 million in special funds under its gaming program. SLGCA was able to renegotiate the leases with video lottery terminal vendors, enabling a significant saving to the State.

Fiscal 2017

The fiscal 2017 working appropriation is slightly less than the original appropriation for SLGCA. SLGCA's fiscal 2017 budget was reduced by \$982,000 in a November 2016 Board of Public Works action. SLGCA contracts with a vendor to operate the central system that administers the regular lottery games program. It was determined that based on sales and expected costs, budgeted funds for this contract could be reduced in fiscal 2017. This decline was offset somewhat by an increase in general funds (\$221,563) and special funds (\$208,417) related to the fiscal 2017 salary increment budget amendment.

Appendix 2
Object/Fund Difference Report
State Lottery and Gaming Control Agency

<u>Object/Fund</u>	<u>FY 16 Actual</u>	<u>FY 17 Working Appropriation</u>	<u>FY 18 Allowance</u>	<u>FY 17 - FY 18 Amount Change</u>	<u>Percent Change</u>
Positions					
01 Regular	314.60	324.10	324.10	0.00	0%
02 Contractual	8.75	8.75	8.75	0.00	0%
Total Positions	323.35	332.85	332.85	0.00	0%
Objects					
01 Salaries and Wages	\$ 23,972,965	\$ 25,090,719	\$ 26,546,014	\$ 1,455,295	5.8%
02 Technical and Spec. Fees	422,128	461,809	590,005	128,196	27.8%
03 Communication	377,277	413,527	369,751	-43,776	-10.6%
04 Travel	71,513	59,000	59,000	0	0%
06 Fuel and Utilities	164,548	256,216	172,775	-83,441	-32.6%
07 Motor Vehicles	249,733	550,144	444,508	-105,636	-19.2%
08 Contractual Services	51,274,490	55,786,379	56,777,343	990,964	1.8%
09 Supplies and Materials	217,593	291,000	286,000	-5,000	-1.7%
10 Equipment – Replacement	63,526	132,500	122,500	-10,000	-7.5%
11 Equipment – Additional	13,893,751	14,118,000	14,170,416	52,416	0.4%
13 Fixed Charges	1,273,742	1,332,011	1,376,906	44,895	3.4%
14 Land and Structures	0	10,000	10,000	0	0%
Total Objects	\$ 91,981,266	\$ 98,501,305	\$ 100,925,218	\$ 2,423,913	2.5%
Funds					
01 General Fund	\$ 20,274,795	\$ 21,921,528	\$ 20,083,420	-\$ 1,838,108	-8.4%
03 Special Fund	71,706,471	76,579,777	80,841,798	4,262,021	5.6%
Total Funds	\$ 91,981,266	\$ 98,501,305	\$ 100,925,218	\$ 2,423,913	2.5%

Note: Does not include targeted reversions, deficiencies, and contingent reductions.

**Appendix 3
Fiscal Summary
State Lottery and Gaming Control Agency**

<u>Program/Unit</u>	<u>FY 16 Actual</u>	<u>FY 17 Wrk Approp</u>	<u>FY 18 Allowance</u>	<u>Change</u>	<u>FY 17 - FY 18 % Change</u>
00 State Lottery Agency	\$ 91,981,266	\$ 98,501,305	\$ 100,925,218	\$ 2,423,913	2.5%
Total Expenditures	\$ 91,981,266	\$ 98,501,305	\$ 100,925,218	\$ 2,423,913	2.5%
General Fund	\$ 20,274,795	\$ 21,921,528	\$ 20,083,420	-\$ 1,838,108	-8.4%
Special Fund	71,706,471	76,579,777	80,841,798	4,262,021	5.6%
Total Appropriations	\$ 91,981,266	\$ 98,501,305	\$ 100,925,218	\$ 2,423,913	2.5%

Note: oes not include targeted reversions, deficiencies, and contingent reductions.

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