

*Colorado Legislative Council Staff Fiscal Note*  
**STATE and LOCAL  
 FISCAL IMPACT**

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<b>Drafting Number:</b> LLS 12-0717	<b>Date:</b> February 14, 2012
<b>Prime Sponsor(s):</b> Rep. Coram; Sonnenberg Sen. Tochtrop; Spence	<b>Bill Status:</b> House Agriculture <b>Fiscal Analyst:</b> Harry Zeid (303-866-4753)

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**TITLE:** CONCERNING REGULATION OF THE STATE LOTTERY BY THE STATE LOTTERY DIVISION IN THE DEPARTMENT OF REVENUE, AND, IN CONNECTION THEREWITH, AUTHORIZING THE INSTALLATION OF VIDEO LOTTERY TERMINALS UNDER THE CONTROL OF THE DIVISION.

Fiscal Impact Summary	FY 2012-2013	FY 2013-2014
<b>State Revenue</b>		
Cash Funds		
Lottery Fund	\$35,957,063	\$71,914,125
<b>State Expenditures</b>		
Cash Funds		
Lottery Fund:		
Funds available for Distribution to Stakeholders	\$34,274,178	\$70,440,329
Lottery Division Expenses	1,682,885	1,473,796
<b>FTE Position Change</b>	19.0 FTE	21.0 FTE
<b>Effective Date:</b> Upon signature of the Governor, or upon becoming law without his signature.		
<b>Appropriation Summary for FY 2012-2013:</b> See the State Appropriations section.		
<b>Local Government Impact:</b> See the Local Government Impact section.		

**Summary of Legislation**

The bill authorizes the Colorado Lottery Commission to license no more than two lottery retailers to install and operate video lottery terminals at up to three sites within the state. The bill defines a video lottery terminal (VLT) to mean an electronic computerized game machine that: is networked and can be monitored, controlled, and audited by a central technology system; upon insertion of cash value, is available to play a video game of chance authorized by the Lottery Division; and uses microprocessors to award to a player, on the basis of chance, free games or credits evidenced by a printed pay voucher redeemable for currency. The bill states that a video lottery terminal is not a machine or device that directly disburses coins, cash, tokens, or any item of value other than a printed pay voucher; or a machine or device defined as a slot machine in the state constitution.

Prior to installation of VLT machines or operation of a site, local approval is required by either a majority of the governing body or a majority of the voters in the city or county where the VLT site is to be located. The local governing body may impose annual video lottery impact fees of up to \$5.0 million per location, adjusted annually for inflation, to be paid by the lottery retailer to defray the costs of the on- and off-site impacts directly related to the operation of the VLTs.

Lottery retailers must be a pari-mutuel licensee. VLTs must be located in an age-controlled area (as defined by rule of the Colorado Lottery Commission), on premises that are owned or controlled by the lottery retailer. Lottery retailers are entitled to receive compensation equal to 70 percent of net machine income. Net machine income is defined as cash value placed into a VLT minus the value of all free games awarded and all pay vouchers issued by such terminal. The remainder of the proceeds from the operation of VLTs, as reduced by expenses and prizes, must be distributed in accordance with Section 3 (1) (b) (III) of article XXVII of the state constitution.

The Colorado Lottery Commission may approve the operation of up to 2,500 VLTs at each of three sites, one of which may be at a licensed horse racetrack location. The bill restricts the three VLT sites to one site in Pueblo County, one site in a jurisdiction east of the Continental Divide that is outside of Pueblo County, and one site west of the Continental Divide. The Commission is given rule-making authority to implement the bill and to monitor and regulate VLTs. Each VLT game is subject to approval by the Commission in accordance with its rules. Only games licensed and authorized by the Commission may be offered, and each machine may not have any means of manipulation that would affect the probability of winning a game. Lottery retailers are responsible for all expenses necessary to purchase or lease, install, maintain, and operate VLTs on their premises.

The bill creates the Colorado College Scholarship Fund in the State Treasury. With certain exceptions for the Public School Capital Construction Assistance Fund and moneys allocated to community colleges, all new revenue that would otherwise be allocated to the General Fund pursuant to Section 3 (1) (b) (III) of article XXVII of the state constitution (the Great Outdoors Colorado program, or GOCO) will be transferred to the Colorado College Scholarship Fund. Moneys in the fund are subject to annual appropriation by the General Assembly for the direct and indirect costs of implementing and administering a college scholarship program. The General Assembly is directed to establish the college scholarship program by bill during the 2013 legislative session for the purpose of increasing access to undergraduate postsecondary education for Colorado residents.

### **State Revenue and Expenditures**

Assuming that the VLT locations can be open for business on January 1, 2013, and after deduction of the lottery retailer compensation at 70 percent of net machine income and Lottery Division expenses, state revenue is estimated at **\$34.3 million** for **FY 2012-13**. For the first full year of operation, state revenue is estimated to be **\$70.4 million in FY 2013-14**. This estimate is based on the assumption that a VLT location in the Denver area will operate 2,500 machines and that the other two locations will operate 1,250 machines each. If the number of VLTs at the other two locations approaches 2,500 machines per location as authorized by the bill, it is reasonable to expect a greater amount of revenue to the state. However, as the number of VLTs increase, the average net machine revenue may be reduced. After expenses, state revenue will be transferred to stakeholders in the following year.

**Estimated Net Machine Revenue.** Currently, there are 14,500 slot machine devices in operation in Colorado. The largest casino in the state has 1,478 slot machine devices. Based on 2011 data from the Division of Gaming in the Department of Revenue, the statewide average daily take-per-machine is \$131.35. This is for slot machine activity from 40 locations in Cripple Creek, Central City, and Black Hawk, with an average of 363 slot machine devices per location. The average daily net machine revenue for a VLT outlet in the Denver Metropolitan Area with 2,500 machines may be higher than the statewide average for slot machine devices (the average daily take-per-machine in Black Hawk was \$168.20). Two other locations elsewhere in the state (presumably the Pueblo and Grand Junction areas), however, may experience a lower average daily revenue per machine than the statewide average for slot machines. For purposes of this fiscal note, the average daily net machine revenue for VLTs is estimated at the statewide average for slot machine devices. Although the bill authorizes the Lottery Commission to license up to 2,500 VLTs per location, this fiscal note assumes a total of 5,000 VLTs will be operational in the state (24 hours per day, 7 days per week) beginning January 1, 2013.

**Distribution of Net Revenue after Expenses.** Of the proceeds received from the operation of VLTs, and after the Lottery Division remits the 70 percent compensation due to lottery retailers, the balance of the proceeds, less prizes and expenses, will be distributed in accordance with section 3 (1) (b) of article XXVII of the state constitution. In addition, the bill creates the Colorado College Scholarship Fund to increase the access of Colorado residents to undergraduate postsecondary education. Revenue from VLTs that would otherwise be allocated to the General Fund, pursuant to the state constitution and other statutory provisions, except for moneys required to be transferred to the Public School Capital Construction Assistance Fund and to community colleges, are transferred to the Colorado College Scholarship Fund for distribution, as established by bill that the General Assembly must pass during the 2013 session.

Table 1 identifies the projected annual revenue from VLT proceeds for FY 2012-13 and FY 2013-14 assuming a January 1, 2013, start date and a total of 5,000 VLTs in operation.

<b>Table 1. HB12-1280 Projected Revenue Distribution for FY 2012-13 and FY 2013-14</b>		
	<b>FY 2012-13*</b>	<b>FY 2013-14</b>
Average Daily Net Machine Revenue after Prizes	\$131.35	\$131.35
Number of Video Lottery Terminals	5,000	5,000
Daily Revenue	<u>656,750</u>	<u>656,750</u>
Annual Revenue (one-half year for FY 2012-13)	\$119,856,875	\$239,713,750
Less: Lottery Retailer (Sales Agent) Revenue @ 70 %	83,899,813	167,799,628
Equals: State Revenue @ 30 %	35,957,063	71,914,125
Minus: Expected State Lottery Division Expenses	<u>1,682,885</u>	<u>1,473,796</u>
<b>Equals: Net Revenue Available for Distribution After Expenses</b>	<b>\$34,274,178</b>	<b>\$70,440,329</b>

\*One-half year impact, assuming a January 1, 2013, start date.

***Distribution of Net Revenue after Expenses.*** The bill lays out the criteria for the distribution of net revenue after expenses. For FY 2012-13, community colleges will receive 84 percent of proceeds up to a combined total of \$29 million from this source and from moneys allocated to community colleges from limited gaming proceeds (currently projected to be \$6.2 million for FY 2012-13). In future years, community colleges will receive a combined total of \$29 million from the two sources, adjusted annually for inflation (projected to be 3.7 percent in 2012 and 3.4 percent in 2013). The Public School Capital Construction Assistance Fund, commonly known as the Building Excellent Schools Today (or BEST) Act, will receive 16 percent of proceeds up to a combined total of \$5.5 million from this source and moneys allocated to the fund from general lottery proceeds (currently projected to be about \$700,000 per year). In future years, lottery moneys allocated to the BEST Act program will be a combined total of \$5.5 million, adjusted annually for inflation. The spillover of all remaining moneys from VLTs will be credited to the Colorado College Scholarship Fund for annual appropriation by the General Assembly for college scholarships and related administrative costs.

***State Lottery Division Expenses.*** By statute, all expenses of the division, including the expenses of organized crime investigation and prosecution relating to the lottery, are paid from the Lottery Fund. The Lottery Commission will incur costs to promulgate rules as necessary to implement and to monitor and regulate the operation of video lottery terminals (including hours of operation, minimum age, types of machines, etc). The Director of the State Lottery Division and the Commission will experience increased workload and costs to manage and regulate the operation of VLTs.

Annual expenditures of the division will depend on the level of the division's involvement in the operation of the new VLT program. A clearer picture of the resource requirements will emerge after the Commission adopts rules to oversee regulation of the games. For example, the Lottery Commission may impose additional license fees for the lottery retailer and for employees of the lottery retailer that work in various capacities at the lottery outlet.

As shown in Table 2, the Lottery Division will require a minimum of **\$1,682,885 and 19.0 FTE during FY 2012-13, and \$1,473,796 and 21.0 FTE in each year thereafter beginning in FY 2013-14.** These will include positions in law enforcement, information technology, accounting and auditing. Expenses of the division will be paid from the Lottery Fund prior to distributions to stakeholders, as authorized by the bill.

<b>Table 2. Lottery Division Expenditures Under HB 12-1280</b>		
<b>Cost Components</b>	<b>FY 2012-13</b>	<b>FY 2013-14</b>
Personal Services	\$1,011,886	\$1,131,611
FTE	19.0	21.0
Operating Expenses	18,050	19,950
Capital Outlay	98,763	0
Guns and Vehicles	98,059	84,559
Internal Control Software	250,000	0
Office Lease Space	35,623	39,372
Authorized Centrally Appropriated Items	170,504	198,304
<b>TOTAL</b>	<b>\$1,682,885</b>	<b>\$1,473,796</b>

***Impact on Limited Gaming and Other Lottery Games.*** Adding three new VLT locations to the Colorado market with up to 2,500 video lottery terminals per location will to an unknown degree compete directly and effectively with Colorado's limited stakes gaming industry. The new facilities will reduce future gaming in the three Colorado mountain communities where gaming is legal. Depending on the location, the Tribal casinos in southwestern Colorado, may be negatively impacted as well, although these casinos pay no state tax. To a lesser extent, bingo, and other lottery games may also experience a loss of playership. Other forms of public entertainment, as well as travel to other gambling destinations outside of Colorado may also be impacted by the local availability of VLTs. Other than recognizing a potential loss, no estimate on these impacts or the effects on state tax revenue from these sources has been made at this time.

**Background on Current Colorado Lottery and Limited Gaming Distributions of Proceeds**

For informational purposes, distributions of current Colorado Lottery and Limited Gaming proceeds are described below.

***Current Distributions from the Colorado Lottery.*** After prizes and expenses, the state constitution requires that lottery proceeds be distributed as follows: 40 percent to the Conservation Trust Fund; 50 percent to the Great Outdoors Colorado Trust Fund (GOCO); and 10 percent to the Colorado Division of Parks and Recreation. Revenue to GOCO is capped at \$35 million, adjusted for inflation using 1992 as the base year (\$56 million for FY 2010-11). Any amount above the limit is distributed into the Lottery Proceeds Contingency Reserve Fund, which was \$0.7 million for FY 2010-11. The General Assembly currently allocates these funds for health and safety issues in public schools (the BEST Act).

***Current Distributions from Limited Gaming.*** Limited gaming is authorized by the Colorado state constitution, but by a section separate and distinct from the Colorado Lottery. State gaming revenue is distributed by formula based on the state constitution and implementing statute. Moneys are distributed to the original recipients of gaming funds based on the following formula: 28 percent to the State Historical Society; 12 percent to Gilpin and Teller counties; and 10 percent to the towns of Cripple Creek, Central City and Black Hawk. The remaining 50 percent is credited to the General Fund and earmarked for several different funds and programs. In 2008, Colorado voters approved Amendment 50 to the state constitution which raised the maximum individual wager to \$100, added new table games, and allowed for 24 hour gaming operations. Additional state revenue generated by these changes is earmarked as follows: 78 percent to the Colorado Community College System; 12 percent to Gilpin and Teller counties; and 10 percent to the three gaming cities.

### **Impact on New Job Creation and Local Economies**

It is recognized that up to three new VLT facilities of the magnitude contemplated by the bill will create both positive and negative impacts on the state and local economies. The facilities will create a significant number of both direct and indirect jobs and will have a synergistic effect on nearby entertainment and tourist venues. Conversely, infrastructure modifications such as roads and the need for an increase in other local government services such as law enforcement will be required. These impacts are beyond the scope of fiscal note analysis and have not been estimated.

### **Local Government Impact**

Local approval by either a majority of the governing body or a majority of the voters in the city or county where the VLT premises are to be located is required prior to commencement of VLT operations. An opening date of January 1, 2013, is assumed to be a reasonable assumption for a lottery retailer to open for business in three locations in the state. Local governments will incur minimal costs to hold a vote of the governing body or include an issue on the ballot of the 2012 coordinated election.

The bill authorizes the local governing body where the operation is located to impose annual video lottery impact fees of up to \$5.0 million, adjusted annually for inflation, paid by the lottery retailer to defray the costs of the on- and off-site impacts directly related to the operation of the VLTs. These payments will come from the lottery retailer's 70 percent share of net machine income.

Local governments and other government agencies that are recipients of current limited gaming revenue will most likely receive reduced distributions in the future from limited gaming, as some gamblers switch their gaming habits to include frequenting VLT locations.

**State Appropriations**

For FY 2012-13, the fiscal note indicates that the Department of Revenue State Lottery Division should receive increased spending authority of \$1,682,885 and 19.0 FTE from the Lottery Fund. All remaining distributions to the Public School Capital Construction Assistance Fund, distributions to community colleges, and distributions to the Colorado College Scholarship Fund will be made in the fiscal year following collection of the funds.

**Departments Contacted**

Revenue      Education      Higher Education      State Treasurer