

THE OKLAHOMA EDUCATION LOTTERY

The Oklahoma Education Lottery was created by passage of SQ 705 and SQ 706 in 2004. Under the terms of these two measures, at least 30 percent of gross revenue during the first two years of the lottery, and 35 percent of gross revenue thereafter, would be dedicated as net proceeds to the Oklahoma Education Lottery Trust Fund for appropriation by the Legislature. The distribution of lottery net proceeds was specified as follows:

K - 12 funding, including early childhood programs	45%
Higher Education Tuition Assistance	
Capital projects (all levels of education)	
Technology improvement (all levels of education)	45%
Endowed Chair Professorships for Higher Education	
School for the Deaf and Blind	
School Consolidation Fund	5%
Teacher's Retirement Fund	5%

The Lottery Trust Fund is a certified fund, meaning that the Legislature can appropriate up to 95 percent of estimated collections for the upcoming fiscal year. If collections exceed the appropriated amount, the surplus is carried over and is available to be appropriated in subsequent years. If lottery revenues come in the below appropriated amount, agencies must either absorb the difference or the Legislature must identify additional funds.

Table 1 presents the revenue and expenditure history of the lottery for its five years of operation, along with projections for FY '11. For the most part, lottery sales have remained remarkably consistent, regardless of the up and downs of the economy, the addition of new games, and growing competition from tribal casinos and the new state lottery in Arkansas. Total revenue in the lottery's first year, FY '06, was \$191.0 million and grew modestly, by 6.5 percent, to 203.5 million in FY '07, with the addition of Powerball. However, revenues flattened in FY '08 and then declined by 5.5 percent to \$193.3 million in FY '09 before growing by 3.4 percent in FY '10.

Net proceeds from lottery revenues to the Oklahoma Education Lottery Trust Fund have totaled \$68.9 million in FY '06, \$69.4 million

in FY '07, \$78.4 million in FY '08 (which included carryover funds), \$69.2 million in FY '09 and \$70.0 million in FY '10. Revenues in FY '07 and FY '08 fell considerably below the certified estimate, creating a shortfall of in appropriations to the agencies and programs supported by lottery funds. In FY '10, revenues exceeded projections by \$6.5 million. Net proceeds in FY '10 are projected at \$66.5 million.

Lottery net proceeds are divided between several education agencies as set out by the statutes. As can be seen from Table 1, lottery funds have been dedicated by the Legislature to different education-related purposes in different years. For the most part, lottery revenues have been blended with other revenues to support programs, rather than being dedicated to any distinct, ongoing, and identifiable purpose. Current year (FY '11) appropriations includes \$61.6 million of lottery revenues out of total state appropriations of \$6.7 billion, or 1.0 percent.

Over the past several years, the Lottery Commission has advocated forcefully but unsuccessfully with the Legislature to amend the lottery statutes to eliminate or reduce the mandated profit percentage ensuring a fixed minimum (35 percent) as net proceeds. This change is intended to allow for higher payouts, which the Commission contends is needed to boost lottery sales and help the lottery increase funding for education.

	FY '06 Actual	FY '07 Actual	FY '08 Actual	FY '09 Actual	FY '10 Actual	FY '11 Budgeted
LOTTERY REVENUES						
Total Revenues	\$ 191.0	\$ 203.5	\$ 204.6	\$ 193.3	\$ 199.9	\$ 190.1
Share of net proceeds/profit	36.1%	34.1%	35.0%	35.8%	35.0%	35.0%
Net Proceeds	\$ 68.9	\$ 69.4	\$ 71.6	\$ 69.2	\$ 70.0	\$ 66.5
Available Prior-Year Carryover	\$ -	\$ -	\$ 6.8	\$ -	\$ -	\$ -
Total Net Proceeds plus Carryover	\$ 68.9	\$ 69.4	\$ 78.4	\$ 69.2	\$ 70.0	\$ 66.5
APPROPRIATIONS OF LOTTERY FUNDS						
General operating	\$ 28.0		\$ 39.9	\$ 31.2	\$ 28.5	\$ 27.7
Teacher pay raise		\$ 53.0				
Consolidation	\$ 3.1	\$ 5.9	\$ 4.4	\$ 3.5	\$ 3.2	\$ 3.1
OTRS	\$ 3.1	\$ 5.9	\$ 4.4	\$ 3.5	\$ 3.2	\$ 3.1
Total Lottery Funds for Common Education	\$ 34.2	\$ 64.8	\$ 48.7	\$ 38.2	\$ 34.9	\$ 33.9
Construction, renovations or repairs	\$ 23.0	\$ 33.0	\$ 35.4	\$ 27.3	\$ 25.0	\$ 24.3
General operating		\$ 13.7				
Scholarships	\$ 5.0					
Total Lottery Funds for Higher Education	\$ 28.0	\$ 46.7	\$ 35.4	\$ 27.3	\$ 25.0	\$ 24.3
General operating and construction		\$ 6.0	\$ 4.5	\$ 3.8	\$ 3.5	
Total Lottery Funds for Career Tech		\$ 6.0	\$ 4.5	\$ 3.8	\$ 3.5	\$ 3.4
Lottery Funds for Dept of Rehab Services		\$ 0.3				
Total Appropriations	\$ 62.2	\$ 117.8	\$ 88.6	\$ 69.3	\$ 63.4	\$ 61.6
Surplus/Shortfall	\$ 6.7	\$ (48.4)	\$ (10.2)	\$ (0.1)	\$ 6.6	\$ -

GAMING REVENUES

SQ 712, which Oklahoma voters approved in the fall of 2004, had two principal components:

- It authorized a set number of gaming terminals at each of three racetracks (Remington Park, Blue Ribbon Downs and Will Rogers), and authorized or prohibited specific categories of games;
- It set up a model compact between the state and Native American tribes to regulate Class III tribal gaming operations. Under the compact, tribes were authorized to operate specified Class III games in return for making exclusivity payments to the state.

The measure provides for the state to receive a share of gaming revenues generated by the compacting tribes and racetracks. The state's share of adjusted gross revenues begins at 4 percent of tribal games subject to the compact (10 percent for card games), and at 10 percent of revenues from racetrack gaming. The state share rises if revenues from particular tribes and racetracks exceed certain thresholds.

After an initial \$250,000 is allocated to the Department of Mental Health and Substance Abuse Services for gambling education and treatment, revenues are divided as follows:

- 87.5 percent to the 1017 Education Reform Fund, which can be appropriated only to the Department of Education.
- 12.5 percent to the Oklahoma Higher Education Learning Access Program (OHLAP) Trust Fund for scholarships.

State revenues from gaming have grown from \$2.3 million in FY '05 to \$18.7 million in FY '06, \$56.8 million in FY '07,

\$92.2 million in FY '08, \$119.0 million in FY '09, and \$132.1 million in FY '10. While gaming revenues continued to climb by a healthy 11 percent in FY '10, the rate of annual growth has clearly begun to slow. In the United States as a whole, total casino gaming revenues and tribal gaming revenues declined in 2009.

Of the \$132.1 million collected in FY '10, \$118.2 million (89.5 percent) came from tribal gaming and \$13.9 million (10.5 percent) from the racetracks. These revenues can be further broken down as follows:

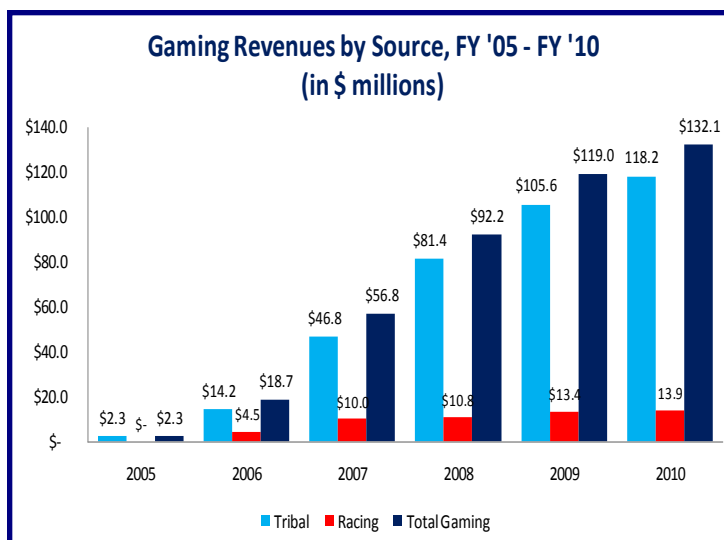
- Almost 65 percent of the \$118.2 million in tribal gaming revenues in FY '10 came from four tribes – the Chickasha (\$33.3 million), Choctaw (\$22.8 million), Cherokee (\$12.2 million) and Muskogee (Creek) (\$8.6 million). Revenue growth was greatest in FY '10 for the Choctaws,

Muskogee (Creek), and Otoe Missouriia, while ten tribes saw slight declines in revenues this past year. In total, 30 tribes paid exclusivity fees to the state under the compact.

- Revenue from *electronic games* made up 87 percent of tribal gaming revenues and grew 13 percent between FY '09 and FY '10. *Card games* made up the remaining 13 percent of gaming revenue and grew by just 3 percent in FY

'09. There were almost 54,000 machines in tribal casinos in Oklahoma in 2009, trailing only California.

- About 85 percent of racetrack gaming revenue is from machines at Remington Park (\$11.7 million) and 13 percent from Will Rogers Downs (\$1.9 million). The final 2 percent of FY '10 racetrack gaming revenues came from Blue Ribbon Downs (\$0.2 million), which ceased operations in November 2009.



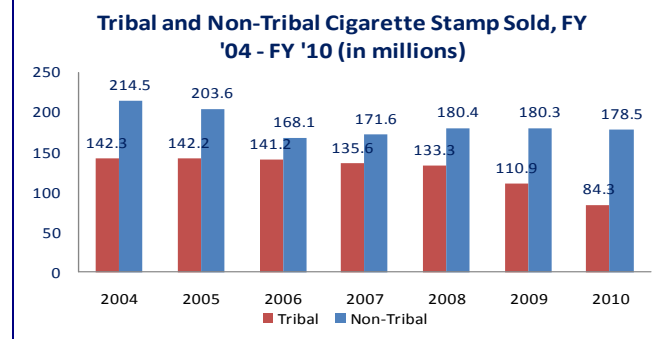
TOBACCO TAXES

Oklahoma voters in 2004 approved SQ 713, which increased the excise tax on cigarettes and other tobacco products, while eliminating the state and local sales tax on these products.

The amount of the tax increase approved by SQ 713 differed for tribal and non-tribal retailers. For non-tribal retailers, the cigarette tax was increased by 80 cents per pack of cigarettes to \$1.03 per pack, with an offsetting elimination of twenty-five cents per pack in state and local sales taxes. For tribal retailers, the situation was more complicated, with retailers subject to one of six different rates depending on their geographic location and status of their compact with the state. The tribal tax rate ranges from a maximum of 85.75 cents per pack for a tribe that has negotiated a revised compact with the state, to a minimum of 5.75 cents for tribes under a "proximity exemption". Taxes were also increased on other tobacco products.

A total of seven health care projects were targeted for support from new revenues generated by the tobacco tax increases, as follows:

- Oklahoma Health Care Authority for Medicaid provider payments and services for children with developmental disabilities (40.1 percent);
- Health Employee and Economy Improvement Act Fund to assist low-income employees buy into employer or public health insurance coverage (33.5 percent).
- Trauma Care Assistance Fund to support emergency trauma care (11.4 percent).
 - The share of revenue going to this Fund was decreased in 2009 to 10.8 percent, with 0.6 percent now going to the Emergence Response System Fund.
- Comprehensive Cancer Center Debt Service Fund for bond payments on a new OU cancer center (4.7 percent);
- OSU College of Medicine Fund for telemedicine and indigent care (4.7 percent);
- Department of Mental Health and Substance Abuse Services for adolescent substance abuse centers and services (4.0 percent);
- Tobacco Prevention and Cessation Fund for anti-tobacco efforts (1.0 percent)
- Breast and Cervical Cancer Treatment Fund to fund Medicaid



coverage of cancer treatment (0.7 percent).

Since passage of SQ 713, total cigarette sales have declined in Oklahoma. In FY '10, a total of 262.8 million cigarette stamps were sold, a 26.3 percent decrease compared to FY '04, the last full year under the old tax rate. Tribal sales have fallen sharply the past two years while non-tribal sales have remained steady.

The tax increase, which took effect mid-way through FY '05 (Jan. 1, 2005), initially generated an additional \$38.4 million in FY '05 before rising to \$107.1 million in FY '06, \$112.4 million in FY '07, \$123.1 million in FY '08, and \$135.0 million in FY '09. Revenues declined slightly in FY '10 to \$133.2 million.

When the tobacco tax increase was proposed, it was projected to generate \$103.6 million from non-tribal retailers and \$45.9 million from tribal retailers. In FY '10, net revenue collections from non-tribal retailers came in at \$102.6 million in FY '10, almost exactly in line with the state's original projections. Tribal tax collections for health care projects totaled \$30.7 million in FY '10. This is below initial projections, but significantly above collections in the first years under the new law. In FY '06, tribal sales yielded only \$11.6 million.

Most of the initial shortfall in tribal tobacco tax collections was the result of a shift in sales to retailers selling cigarettes with the lowest-tax 5.75 cent proximity exception rate. As a result of various measures aimed at curtailing tribal retailers from purchasing and reselling cigarettes stamped with the lowest rate, the prevalence of the exception rate has declined from over two-thirds of all tribal sales in FY '07 to just 4 percent in FY '10. The state negotiated a new "unity rate" of 51.5 cents per pack with several tribes which took in 2008 and accounted for 45 percent of tribal sales in FY '10.

Allocation of Increased Revenue from Cigarette and Tobacco Products, FY '05 - FY '10

	2005 Total	2006 Total	2007 Total	2008 Total	2009 Total	2010 Total
Oklahoma Health Care Authority	\$ 15,395,095	\$ 43,302,211	\$ 45,015,862	\$ 49,311,280	\$ 54,082,610	\$ 53,380,419
Health Employee and Economy Improvement Act Fund	\$ 12,873,394	\$ 36,209,940	\$ 37,642,694	\$ 41,224,132	\$ 45,222,944	\$ 44,635,821
Trauma Care Assistance Fund	\$ 4,376,965	\$ 11,311,167	\$ 12,798,389	\$ 14,019,643	\$ 14,317,543	\$ 14,350,042
Emergency Response System Fund	-	-	-	-	\$ 1,058,699	\$ 826,559
Comprehensive Cancer Center Debt Service Fund	\$ 1,803,145	\$ 5,071,903	\$ 5,272,565	\$ 5,775,567	\$ 6,334,123	\$ 6,251,936
OSU-COM Fund	\$ 1,803,145	\$ 5,071,903	\$ 5,272,565	\$ 5,775,567	\$ 6,334,172	\$ 6,251,936
Dept. of Mental Health and Substance Abuse Services	\$ 1,545,646	\$ 4,348,341	\$ 4,520,093	\$ 4,950,773	\$ 5,428,409	\$ 5,357,954
Tobacco Prevention and Cessation Fund	\$ 385,031	\$ 1,083,126	\$ 1,125,937	\$ 1,233,274	\$ 1,352,383	\$ 1,334,828
Breast and Cervical Cancer Treatment Fund	\$ 256,890	\$ 722,453	\$ 751,131	\$ 822,835	\$ 902,632	\$ 890,910
TOTAL HEALTH CARE PROJECTS	\$ 38,439,311	\$ 107,121,044	\$ 112,399,235	\$ 123,113,072	\$ 135,033,516	\$ 133,280,405

Amounts do not include rebates to replace lost sales tax revenues or tribal trust allocations