

**Budget Workshop
New Mexico Lottery Authority
May 18, 2011**

Call to Order: Marcus Real called the meeting to order at 9:05 a.m. Present and constituting a quorum were Herman Tabet, Nino Trujillo, Marcus Rael, Clifford Stroud, and Ken Hoeksema. Absent was Reta Jones. The following employees were present from NMLA: Tom Romero, Adriana Binns, Sylvia Jaramillo, Evelyn McKnight, Pam Poteat, Dave Ramirez, Vince Torrez, Joan Camera, Rebecca Welch, Linda Hamlin, and Wilma Atencio. Also present from Intralot – New Mexico was Steve Schwickert, General Manager and Blair Johnson, Business Analyst.

Approve Agenda: M. Rael entertained a motion to approve the proposed agenda. K. Hoeksema made the motion to approve the proposed agenda. N. Trujillo second. All in favor, 5-0. There was no further discussion.

Revised FY 2011 Budget – Board Action: T. Romero reported that sales for Fiscal Year 2011 are not what was forecasted or expected. Fiscal Year to date, we're approximately \$10.7 million behind in Powerball and \$2.5 million behind in scratcher sales. Although Mega Million is approximately \$6.6 million in revenues it does help offset some of the loss from our draw games. Draw games, like Powerball, Mega Million, Hot Lotto, Road Runner Cash and PICK 3 are jackpot driven; higher the jackpots, higher the sales. Unfortunately, Powerball and Mega Million Jackpots keep getting hit, more often than anticipated or forecasted by their respective associations, resulting in considerably less sales. The economy this year, especially with the rising fuel prices has had an adverse affect on our overall sales. The lottery continues to face competition from other areas like local entertainment, the restaurant industry, casinos and other entertainment venues. Our statutory minimum 30% monthly return has placed limitations on what the lottery can do to offset these sales. It limits our advertisement, prize payouts and retailer incentives to help boost sales.

T. Romero is asking for approval on the FY 2011 Revised Budget. T. Romero reported that the original FY 2011 Budget gross revenue was forecasted at approximately \$146 million, the lottery has revised this amount down to approximately \$132.7 million. This will result in our 30% return to the state from \$43.8 million to \$39.8 million. S. Jaramillo presented the Revised Fiscal Year 2011 Budget.

M. Rael asked why revenues for Road Runner Cash (\$3.5 million) and PICK 3 (\$600 Thousand) went up, as presented by S. Jaramillo. T. Romero reported that there were some changes made to the Road Runner Cash game, which made it more appealing to players and the Jackpots have increased with each drawing, until it gets hit. Jackpot amounts for Road Runner cash have gone up.

M. Rael asked why the professional fees went up \$55 thousand and requested an explanation on the Network Service Contract. S. Jaramillo stated that the total amount for professional fees was actually \$90 thousand dollars, attorney fees were reduced by \$40 thousand dollars. D. Ramirez responded that the IT Department is in the process of going out to Bid/RFB to reconfigure the lottery's entire network system. The current network system has been in existence for 15 years and most of the hardware is antiquated. The IT department would like to modernize the system with new hardware and software by using CISCO. D. Ramirez stated that he spoke with individual vendors and estimated that it would cost \$55 thousand dollars to overhaul the entire network system. D. Ramirez anticipates the hardware equipment will be in the facility by the end of June 2011. The network system will be up and running, by the end of July or early August 2011.

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M. Rael asked if all the monies allocated for this project, \$90 thousand dollars, will be spent this fiscal year. Will there be any expenses for the next fiscal year? S. Jaramillo responded that \$30 thousand has been budgeted for next fiscal year for any overflow of work that doesn't accrue this fiscal year. The entire network system will cost approximately \$90 thousand dollars to \$120 thousand dollars. T. Romero reported that the network restructure is critical to the lottery's operation and security. Initially, the lottery had a network engineer position and staffed, once the employee resigned, the network was found to be in less than stellar form. Therefore, it is critical that this RFP is sent out and awarded. The overall cost would be high initially, but once the network administrator is in place with all its working mechanism, the annual cost to maintain the network system will be considerably low. D. Ramirez stated that all bids are due June 5, 2011.

H. Tabet requested an update on the building next door, located at 4501 Osuna Road NE. S. Jaramillo advised that we have a new realtor, Maestas and Ward. The agreement that the lottery had with the original realtors was expiring and the owner of the building asked if he could get involved and brought in this new realtor to get the building sub-leased. The new owner wants a long term lease. The current lease expires in 2013. The lottery has discussed several options with the owner, like a buyout, a new lease agreement or finding other avenues to offset the high cost of the current lease. GTECH was sub-leasing the building next door until their contract ended in 2008 and moved out of state. The sub lease with GTECH was only through their commitment with the lottery. When the contract ended the building next door reverted back to the lottery. The building next door is a unique building in its design and set up by having a large computer room; it's difficult to get it leased.

M. Rael asked if the lottery lawyer has reviewed the lease. There should be a clause in the lease that would allow the lottery out of the lease. Like all government contracts have or should have, there should be a clause that states "if there are no appropriations, then the lease can terminate". Does the current lease have a clause like this and if we don't, why not. Who negotiated the lease? T. Romero reported that the lease was negotiated back in 1995 by the executive staff and the lottery lawyer at that time. The current executive staff did take the current contract for both buildings to legal for review to see if there were any provisions that would allow the lottery to terminate the contract. At one point, executive staff believed they had a document that would allow them to terminate the lease, but when the owner was contacted about the impending termination, the owner came back with his lawyers and advised that the contract couldn't be terminated. The lottery lawyer reviewed the contract thoroughly and advised that the contract couldn't be terminated until 2013. The lottery building and the building located at 4501 Osuna Road NE are two separate buildings, with two separate owners and contracts. When the lease expires in 2013, the lottery is left with the one contract for the lottery building. Negotiations for the current building will take place.

M. Rael requested a letter, phone call or email from the lottery lawyer as to why a public entity cannot get out of a contract, if appropriation isn't made. M. Rael stated that we can break the contract and would like an explanation as to why the contract cannot be terminated. Public entities are allowed to break a contract if there are no appropriations made for it.

There were no revisions requested by the Board. S. Jaramillo requested board approval for the FY 2011 revised annual budget.

M. Rael entertained a motion to approve the FY 2011 Revised Annual Budget. C. Stroud made the motion to approve the FY 2011 Revised Annual Budget. H. Tabet second. All in favor, 5-0.

Strategic Plan: The Board was presented with a draft strategic plan for fiscal year 2012.

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Proposed FY 2012 Budget – General Update: T. Romero reported that the gross revenue for FY 2012 is forecasted at approximately \$136.4 million and 30% return of approximately \$40.9 million. In order to achieve a balance budget for FY 2012 and to maintain the 30% return to the state for the legislative lottery scholarship, several categories in the budget were reduced, like merit increase for staff and retailer equipment that hasn't been replaced for 15 years. The FY 2012 Budget is a 6.6% decrease from the original FY 2011 budget. S. Jaramillo provided a detailed presentation of the FY 2012 Budget.

Present Proposed Budget for FY 2012 with Discussion and Questions – Board Action: Items reviewed line item by line item were:

- a. Operating Revenues
 - a. Instant ticket sales
 - b. Powerball sales
 - c. Mega Millions sales
 - d. Roadrunner Cash sales
 - e. Hot Lotto sales
 - f. Pick 3 sales
 - g. New game sales
 - h. Prize tickets
 - i. Spoiled, stolen and promotional tickets
 - j. Retailer fees
 - k. Bad debt
 - l. Total operating revenues

- b. Non-Operating Revenues
 - a. Interest income
 - b. Other income
 - c. Total non-operating revenues

- c. Gross Revenues

- d. Game Expenses
 - a. Prize expense
 - b. Retailer commissions
 - c. On-line vendor fees
 - d. Advertising
 - e. Ticket vendor fees
 - f. Shipping and postage
 - g. Promotions
 - h. Drawing game
 - i. Responsible gaming
 - j. Game membership
 - k. Total game expenses

- e. Operating Expenses
 - a. Salaries, wages and benefits
 - b. Leases and insurance
 - c. Utilities and maintenance
 - d. Depreciation expense

- e. Professional fees
 - f. Other expenses
 - g. Materials and supplies
 - h. Travel
 - i. Total operating expenses
- f. Operating Income
 - g. Net Income

N. Trujillo asked the status on new retailers, like Walgreens, CVS, and Dollar General. P. Poteat reported that the lottery secured a meeting with CVS and sent out a presentation to them. We received a call back from headquarters and we were told that they aren't moving into any new states and to contact them again at the end of the year. The corporate accounts representative is currently working with Family Dollar and other dollar stores, not necessarily Dollar General, but they are on the list to contact and set up meetings. Walgreens is not interested in placing any lottery in their stores.

K. Hoeksema asked about the line item "new game sales" that is budgeted for \$1.9 million. What does it entail? A. Binns reported that there are a couple of new games that the lottery is considering. There is a discussion at the national level of introducing a national game. The lottery has also been in discussion with Intralot about introducing a new game that's referred to "Instant On-Line Game", it's a combination game of an instant ticket, played like an instant ticket, but is printed at the terminal. No specifics at this time. M. Rael then asked if there are no specifics, why is the lottery including the \$1.9 million in the proposed budget. A. Binns reported that the lottery is planning on introducing a "new game" this next fiscal year. If there are no plans for the national game, then the lottery will proceed with the Instant On-Line game. S. Jaramillo reported that the \$1.9 million is projected from January 2012 and is half a year of sales.

K. Hoeksema asked why the increase in Instant Tickets for this fiscal year. T. Romero reported that the lottery is taking a realistic approach to the budget, but has optimism in regards to instant tickets. Sales have been behind the last couple of years, but have stabilize enough that the lottery can move forward with new innovative ideas to increase sales, such as adding new retailer locations, putting out new innovative games, such as Desert Bingo, using social media outlets to attract new players and using new strategies to get players into the store, by developing specific advertisements at specific retailer locations throughout the state. Retailers seem more apt to putting up banners and signs, if the signage is more specific to a particular store.

K. Hoeksema inquired about the Legislative Lottery Scholarship program, legislative bills that were introduced this year and expectations at the upcoming Legislative Session. T. Romero reported that he anticipates that there will be changes to the lottery scholarship program, unsure of exact changes at this time. Some areas that have been discussed are increasing the GPA, partial benefits, repayment, and other requirement changes. T. Romero reported he has a meeting scheduled with HED in July.

C. Stroud asked S. Jaramillo about "other income" listed at \$50 thousand dollars. S. Jaramillo reported that was for the current lease agreement for the lottery building. There's a clause in the agreement that the lottery will receive \$50 thousand dollars for building improvements.

M. Rael asked Intralot (S. Schwickert) for additional information on the Instant On-Line Game. S. Schwickert reported that the game has been implemented in several states, Ohio being the most successful state. A presentation was made to the NM Lottery back in March 2011. The Instant On-Line game is an easy game to launch; not a lot of printing issues, just your basic background. Prize structure is easy to build. Implementation of this game and put it out into the market is fairly quickly. Montana is launching a progressive version in the fall. D. Ramirez advised that the Instant Product Manager was currently working on several prize structures for this game. M. Rael requested that Intralot present a presentation on this game for the Board of Directors.

M. Rael asked if there are any security concerns. S. Schwickert reported that there were a couple of security concerns at the start of the game in Montana and both concerns have been addressed. First concern was retailers in Montana were playing out of the drawer and the concern was retailers paying for these instant tickets that they were playing themselves. The second concern was addressed quickly; unscrupulous retailers were selling losing tickets to the player. Retailers had the printing machines underneath the counter and would sell tickets that the retailer already played to the customers. The fix to this was to place tunes to the printing machines and/or placing the printing machines above the counter, so that players could see the tickets being printed. S. Schwickert reported that this is an "instant game" that is printed at the retailer terminal when your purchase it, instead of it being printed at SGI Games or GTECH warehouse and all the logistics to get it to the retailer and sell it.

M. Rael asked why materials and supplies went up \$45 thousand dollars. S. Jaramillo reported that the MIS Division is replacing some infrastructure equipment. D. Ramirez reported that the MIS Division has been upgrading servers for the disaster recovery site. M. Rael asked that he thought this was part of the Network RFP. D. Ramirez stated that the equipment being purchased for the network RFP is switches and firewalls, these are servers which hold data for the lottery. This will allow the lottery to upgrade to windows 2007. The lottery is currently using windows XP.

M. Rael stated that the travel line item significantly went up. S. Jaramillo reported that this amount actually went down from the original budget in 2011, but it did go up from our revised budget. The lottery has held back on travel for FY 2011, due to sales. The lottery is looking at the opportunity to attend some of the conferences, such as NASPL and NASPL sub-committee meetings that are designed for specific areas such as finance, audit, warehouse, instant product, marketing/graphics, etc... Travel arrangements are done by each division and they are encouraged to stay within the travel and business plan policy. Government rates are used when possible, economy class tickets are purchased when traveling by air and staff look for the cheapest and best rates when making arrangements for their training whether its in-state or out of state travel. Travel, per diem and lodging for the outside sales representatives also comes out of this line item.

M. Rael asked under operating expenses, leases and insurance, how much of the \$603 thousand dollars is for the empty building next door. S. Jaramillo reported that an estimated \$7 or \$8 thousand dollars a month is paid out for the empty building. M. Rael requested an exact amount of what is paid out for the empty building.

N. Trujillo asked if the Board Chair would review the lease. N. Trujillo asked if the lottery protests the taxes. S. Jaramillo reported that the owner protested the taxes last year, because he plans to sub-lease it again.

M. Rael stated that it is not in the public's interest for the lottery to pay for an empty building, a building that is not being used, paying \$96 thousand dollars annually in rent, not including insurance and taxes. M. Rael requested a detailed list of what is being paid out for the building next door.

T. Romero stated that the lottery did ask for a legal opinion previously and thought the lottery could break the contract and give notice. The issue at hand now is that the issues that were agreed upon by executive staff back in 1995 and the current executive staff has no knowledge or control of the agreements made back in 1995. The lottery was set up in 1995-1996 as a separate and apart from the State of New Mexico and while the lottery understands the earlier discussion about public funds, the lottery does not receive any appropriations from the state. M. Rael stated that he understands and is aware that the lottery doesn't receive appropriations from the state. However, as a public entity, it is not in the public's interest for the board to appropriate funds from the lottery budget to pay on an empty building. M. Rael further suggested and recommends that the money budgeted for the building next door is removed from the FY 2012 annual budget.

C. Stroud asked if the lottery would move that amount into legal fees, when the owner decides to sue us for non-payment. M. Rael did respond that there is the possibility of a lawsuit. If we don't have the money in the budget and we do not appropriate the funds as an authority which is statutorily created as a public entity, there will be a battle, but thinks it will be much less expensive or he could be wrong. M. Rael stated that the case law is clear. As a public entity, if you do not have the funds and you do not make that appropriation as a board, the fight is over. It's the appropriation that the board makes for the lottery. N. Trujillo agrees with this action.

S. Jaramillo asked if the entire amount spent on rent and other expenses for the building next door is removed or will the entire amount or a portion go into legal fees. T. Romero suggests that a portion go into legal fees. T. Romero will ask the lottery attorney draft a letter and send it on behalf of the lottery to the owner. This will become a legal issue. The lottery can advise the owner that the lottery board didn't make appropriations for the building located at 4501 Osuna Road NE. S. Jaramillo advised that the rent was paid for May and a payment will be made for June 2011 under the revised FY 2011 budget.

K. Hoeksema asked how long it will take to get an established opinion on the lease agreement and if it's beneficial for the lottery. Doesn't want the process to be extended and the legal fees costing more than what was originally budgeted for this building. M. Rael stated that the board can meet again in June 2011 to modify the budget, if necessary. T. Romero stated that he's not disagreeing with the board on the action they are recommending, but it is his responsibility to address his concern to the board members that the lottery has received legal opinion in the past and the lottery was advised that they are bound to the lease agreement/contract. M. Rael asked to see a copy of this letter. T. Romero's other concern is if the lottery loses, not only do we continue paying for the building, the lottery will have to pay legal fees, plus their legal fees, plus any punitive fees, not entirely sure on this. M. Rael stated that there can't be any punitive damages.

T. Romero stated that if the board approves the FY 2012 budget without the money budgeted for the building next door today, May 18, 2011 and if the legal opinion takes several months, there are no restrictions that will prevent the board from approving a revised budget for FY 2012 after July 1, 2011.

S. Jaramillo reported that the monthly rent for the building next door is approximately \$7539.28, for an annual total of \$90,471.36, plus taxes, insurance and utilities.

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M. Rael entertained a motion to approve the budget for 2012 fiscal year. C. Stroud makes a motion subject to reducing the budget for 2012 by the amount, the triple net lease on the property identified at 4501 Osuna Road NE. M. Rael asked if the budget is being reduced by that amount or is it being put to a different use. Is there a general fund? T. Romero responded that if we reduce the budget by that amount, it will drop to the bottom line. S. Jaramillo asked if it should be added to legal fees; the consensus was no. C. Stroud stated that the budget for 2012 will be reduced by the amount of the total triple net amount of the lease (Lease, Insurance, Property Tax and utilities). N. Trujillo second. All in favor, 5-0. There was no further discussion.

Disposal of obsolete, worn out or unusable tangible personal property: T. Romero reported since inception and approximately three years ago, the lottery never really had a policy or procedure or arrangements made to dispose of obsolete, worn out or unusable property. We do have a policy in place the board adopted a few years ago, but again trying to figure out how exactly get rid of this property is where we started running into some problems. What we did find out and what we were aware of is each year, the New Mexico Department of Public Safety Headquarters in Santa Fe holds a public auction, where state agencies and entities are allowed to bring property over and they hold this auction, they get rid of the property and a small fee is paid to the auctioning company through the Department of Public Safety. The rest of the monies made go back to those agencies' general fund.

One of our agents, Randy Bertram, a lottery employee; at one time actually help run the auction for the State Police at the New Mexico Department of Public Safety. This year working with the finance staff, we discussed this option and agreed that this would be a good option for the lottery to take 15 years of stuff, equipment and property collected and get rid of the stuff. All of the divisions working together put together a list of all the equipment, materials, furniture, outdated equipment, security systems, radios, retailer equipment that we could dispose of this year. Following the Policy and Procedure and the auction process by the Department of Public Safety, it requires that the lottery present this list to the board of directors for approval to dispose of obsolete, worn out or unusable tangible personal property. All items listed on the list have fully depreciated and the value of said property on the balance sheet for the lottery is zero.

M. Rael entertained a motion for board approval to Dispose of obsolete, worn out or unusable tangible personal property. C. Stroud made the motion to approve the disposal of obsolete, worn out or unusable tangible personal property as presented by T. Romero. K. Hoeksema second. All in favor, 5-0. There was no further discussion.

ADJOURNMENT:

M. Rael entertained a motion to adjourn the meeting. C. Stroud moved to adjourn the meeting. H. Tabet second. All in favor, 5-0. The meeting was adjourned at 11:25 am.