

Budget Planning Workshop and Regular Board Meeting
New Mexico Lottery Authority
May 10, 2012

Call to Order: Marcus Real called the meeting to order at 9:03 a.m. Present and constituting a quorum were Ken Hoeksema, Reta Jones, Marcus Rael, Herman Tabet and Mark Koson. Absent was Clifford Stroud. The following employees were present from NMLA: Tom Romero, Sylvia Jaramillo, Adriana Binns, Evelyn McKnight, Pam Poteat, Dave Ramirez, Vince Torrez, Linda Hamlin, Michael Boland, Karla Wilkinson, Mary Stanford, Jessica Jinzo, Gale Johnson and Wilma Atencio. Also present from Intralot was Steve Schwickert, Matt Worley, Bob Conklin, Levi Tenbrink, Jim Wible and Elisa Walker-Moran with LFC.

Approve Agenda: M. Rael advised that item "III" be removed from agenda; Mr. Nino Trujillo is unable to attend. Mr. Rael asked if there were any additional changes. T. Romero requested that item "VII" (4511 Osuna Road NE Lease) be moved and discussed before item "VI" Proposed Budget for FY 2013. M. Rael advised that he would like to discuss "Old Business" and questions the board had for the NM Council on Problem Gambling. M. Rael entertained a motion to approve the amended proposed agenda. R. Jones made the motion to approve the proposed agenda as amended. K. Hoeksema second. All in favor, 5-0. There was no further discussion.

Old Business: M. Rael advised that there were some questions the board had for the NM Council on Problem Gambling and approval of the contract. H. Tabet stated he was unaware that this item would be discussed and that he was still against it. H. Tabet reported that according to the report provided by NM Council on Problem Gambling, the lottery makes up only 1% of problem gambling problems and the lottery contributes more than the Indian casinos. L. Tenbrink reported that the lottery is the most widely accessible form of gaming in NM and currently 98% of compulsive gamblers do play the lottery. 5% of individuals in treatment, state that their main source of gambling is the lottery. L. Tenbrink provided a report that was requested at the previous meeting. The board's concern is that the lottery is subsidizing a larger and unfair percentage of the NM Council Problem Gambling's annual budget compared to what the report states. M. Rael requested that the NM Council Problem Gaming return to the next board meeting to discuss the report provided by L. Tenbrink.

Revised FY 2012 Budget – Board Action: T. Romero presented the Revised Fiscal Year 2012 Budget. Tom reported that prior to the record Mega Million jackpot run up the lottery was approximately \$12 million dollars behind the original budget. Thanks to a Powerball run up and the record Mega Million run up we experienced a sales increase resulting in our revised revenues being approximately \$2.3 million dollars less than our original budget.

The \$2 Powerball helped and has increased our sales overall but we have lost wagers. It's still too early to tell because jackpots and number of wagers we've lost fluctuate by drawing, but overall we have increased our sales and as a percentage doing as good and better than many other states. The prize expense, commissions and related vendor expenses are consistent with the revenues. Salaries are slightly less due to vacant positions during the year.

The increase to the line item for leases is to cover the expenses for the 4501 Osuna building. The lease expires March 31, 2013. The building owner and landlord are separate from the owners of the 4511 Osuna property.

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Other line items were reduced by executives and staff based on the budget changes taking place throughout the year.

S. Jaramillo presented some highlights to the Fiscal Year 2012 revised Budget.

Instant Ticket sales were reduced by \$8 million dollars. Along with this reduction, prize tickets were also reduced by 8.82%, translating to \$300 thousand dollars. Drawing Game sales were increased by \$7 million dollars for Powerball and \$4.5 million dollars for Mega Millions. Roadrunner Cash was reduced by \$2.2 million dollars, \$2.4 million dollars for Hot Lotto and \$1.6 million for Quicksters. Total Draw Game sales were increased by \$5.4 million dollars. Total revenue was reduced by almost \$3 million dollars for fiscal year 2012, which is a change of 1.65%. The game expenses that are direct line items to sales (prize expense, retailer commissions, on-line vendor fees, ticket vendor fees, and shipping and postage fees) were also reduced for the changes in sales. Promotions, drawing game expense and game membership were reduced just for cost savings. Operating expenses were reduced by \$88 thousand dollars or 1.61%. With all the changes, net income was reduced by \$416 thousand dollars.

R. Jones commented about the on-going concern about instant ticket sales and to take the instant ticket sales down by \$8 million dollars is very troubling, in terms of where the lottery is heading. Another concern is the legislative issue. To improve ticket sales, the lottery needs to do more advertising and yet it is a struggle for the lottery due to the mandate of a 30% return to the state on a monthly basis. There is a need to focus on this line item, either to do something legislatively or think outside the box in terms of stopping this downward trend for instant tickets. The Board is in consensus on this issue. What is the strategy on bringing the instant ticket sales up?

The lottery stated that there will be a full on strategy of advertising campaign of instant tickets for the upcoming fiscal year. It is a disturbing trend and the lottery has weekly meetings to discuss and strategize on ways to get the sales up. The downward trend started in 2008 and this is the same year that the advertising budget was cut from \$3 million dollars to \$2.2 million dollars and the year the 30% mandate began. Instant tickets sales are down over \$29 million dollars since 2007.

It was discussed that a more realistic budget be put in place in regards to Instant Ticket sales and not create an expectation that sales may not be reached. Also discussed was to address the legislative issue of the mandate and return to the state.

M. Rael entertained a motion to approve the FY 2012 Revised Annual Budget. H. Tabet made the motion to approve the FY 2012 Revised Annual Budget. K. Hoeksema second. All in favor, 5-0.

Strategic Plan: The Board was presented with a draft strategic plan for fiscal year 2013.

4511 Osuna Road NE Lease: T. Romero reported that the current lease expires March 31, 2013. The current lease is \$11.93 blended or approximately \$28,400 dollars per month. After several months of negotiations with our landlord, the lottery has reached a proposal that we believe is financially beneficial to the Lottery.

The new lease would take effect July 1, 2012 and the monthly rate would be reduced to approximately \$26,000 per month through March 31, 2013. The landlord will assume 50% of the property tax costs each year.

The landlord has agreed to replace two warehouse coolers, the heating, air and cooling systems at the lottery including maintenance of those systems, pay 25% up to \$3,500 for xeriscaping, contribute up to \$10,000 for an electrical panel that the lottery would like to add for additional power, pay electrical costs in excess of \$1,500 per each occurrence, and have annual interior/exterior inspections and repairs to be mutually agreed upon.

Both parties have agreed that the new agreement will better define maintenance responsibilities of each party including but not limited to the landlord being responsible for all exterior parking and structural as well as foundation, roofing and exterior and load bearing walls.

From April 1, 2013 through March 31, 2018 (five years) a blended rate of \$10.07 or approximately \$24,000 monthly. The next five years through 2023, the rate would be \$10.27 or approximately \$24,500 monthly. If the Lottery exercises a five year extension option, the rate would be \$10.47 and approximately \$25,000 monthly. The new agreement will save the Lottery approximately \$600,000 over the ten years approximately a nine month term.

M. Rael asked if this lease has been approved by the landlord or is it still in the process. T. Romero reported that the lease is currently in the landlord's attorney's possession for review. The lottery with legal counsel did the initial draft of the agreement, sent it to the landlord, they had some changes. The lottery legal counsel made the revised changes, sent the agreement back to the landlord for review and had no issues, but wanted their own attorney to review the agreement.

M. Rael asked if we can even approve it today. There is a chance that there could be additional changes. M. Rael stated that he would hate to approve the agreement today and it comes back with changes.

B. Conklin reported that what the lottery is seeking approval to move ahead with the agreement "in principal" by the landlord.

M. Rael reported for clarification that the CEO would like for the board to agree to allow the CEO to enter into a lease with the landlord?

B. Conklin reported "correct".

M. Rael stated that but were not sure whether this lease is that lease?

B. Conklin reported "that's correct".

M. Rael asked if it would be more prudent to wait until we knew what the lease looked like.

H. Tabet commented that "were giving the CEO the option to deal on the board's behalf".

M. Rael's concern is that he doesn't want any major portion of the lease changed and that is why the landlord signed the "letter of intent".

R. Jones asked if the board and lottery could come up with a compromise, such as if the Board is allowed to say "we agree in principal" to the terms and leave it up to the chairman of the board to review. R. Jones is prepared and in agreement to proceed with the lease based on principal as outlined to the board by T. Romero. K. Hoeksema is in agreement in principal.

M. Rael is in agreement to approve the lease in principal with the understanding that if there is a substantial change, the chairman of the board, will bring it back to the board for review. M. Rael requested that this is reflected clearly in the minutes and reflected in the language in the motion, we can proceed.

M. Rael was under the impression that the board was approving a lease that the lottery and landlord had already agreed to, but now there may be another revision and M. Rael wanted to avoid this issue.

T. Romero reported that he's been working with the landlord and his lawyers all week and that is why the landlord signed a "statement of intent" as outlined and presented by T. Romero. T. Romero presented draft language for consideration, if the board wanted to proceed.

Language for consideration:

The lottery is requesting Board approval for the CEO to enter into a new lease with NMLB, LLC for the property and facility located at 4511 Osuna Rd NE Albuquerque NM contingent upon a mutually acceptable agreement by both parties and review by Lottery legal counsel, approval by Board Chair and CEO, and based upon the following minimum terms:

Those terms would include effective no later than July 1, 2012 and from July 1, 2012 to March 31, 2013 the base monthly rate would be \$26,000; April 1, 2013 to March 31, 2018 base monthly rate would be \$24,000; April 1, 2018 to March 31, 2023 base rate would be \$24,500; and if exercised, a five year option to extend to 2028 at a rate of \$25,000 monthly. NMLB, LLC further agrees to pay 50% of the property taxes and make several improvements to the property and assume responsibility for some maintenance items as well as better define costs to be assumed by both tenant and landlord.

M. Rael asked to draw the board's attention to paragraph #7, the early termination provision in the lease. This provision is the provision M. Rael commented on at a previous meeting and thanked legal for putting this provision in the lease. It gives the lottery the legal protection that is afforded for a government entity.

M. Rael entertained a motion to approve the lease, along the lines of the CEO's language. R. Jones made the motion to approve the lease at 4511 Osuna Road NE. K. Hoeksema second. All in favor, 5-0. There was no further discussion

Proposed FY 2013 Budget – General Update: T. Romero is requesting a cost of living increase for staff. Staff salary has been frozen for 4 years and while the economy is still recovering, the cost of insurance keeps rising.

T. Romero requested a "Cost of Living" adjustment for staff, excluding CEO for a 1-2% adjustment. For those staff members that are below \$35,500, it would be a 2% increase. For those staff members that are from \$35,500 to \$55,000, it would be 1 1/2%, for those staff members who are in excess of \$55,000, it would be a 1% cost of living adjustment. In addition, the lottery has included one additional AS/400 programmer and an Administrative Assistant position. T. Romero is requesting Board approval for the "cost of living" adjustment.

S. Jaramillo presented the FY 2013 Consolidated Annual Budget to include a projection of a \$40.5 million dollars return to the State for FY 13. Net Instant Sales - \$67.9 million, Net Drawing Sales - \$67 million, Total Net Sales - \$135 million, Retailer Fees - \$11 thousand, Total Operating Revenues - \$135 million, Gross Revenues - \$135 million, translating to \$1,462,000 (1.07%) less than the FY 12 Original Budget, but \$833,000 (.62%) more than the FY 12 Revised Budget.

Total Game Expenses – 65.73% of Gross Revenues. Prize Expense – 53.91% of Gross Revenues, Retailer Commissions – 6.68% of Gross Revenues. On-line vendor fees are budgeted at 1.5% of net sales plus gross receipts tax for the year or 1.61% total. Advertising expenses are budgeted at \$2.3 million or approximately 1.7% of Gross Revenues. Total Operating expenses – 4.27% of Gross Revenues.

Ticket Vendor fees are based on the contractual cost of printing tickets of 1.48% of net Instant Ticket Sales for our primary printing vendor, the cost of any tickets purchased from our secondary vendor under the new contract, and some residual costs for two games remaining from the old contract, plus any applicable PDF bar code costs, licensing fees, and special fees.

Present Proposed Budget for FY 2013 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. Quickster sales (Super 7's)
 - 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

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- 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

M. Rael asked a question on the Mega Million sales for FY 2012 it was \$9.5 million dollars and the revised budget was \$14 million, mostly due to the run up. Is it reasonable to expect that for FY 2013, we will be at \$12 million dollars for Mega Millions? T. Romero reported that this is a reasonable budgeted amount.

K. Hoeksema inquired about Instant Ticket sales and historically we have seen it decrease over the last several years and the lottery has built in a small decrease for FY 2013. Given history and expectations, are we building in too much for the upcoming budget?

T. Romero reported that while we have seen the decline in sales for several years; however, we do see that it is slowing down and at some point it has to level off. And with what the executives have planned out for the upcoming fiscal year as presented in the Strategic Plan, it is a reasonable budgeted amount.

K. Hoeksema inquired about the "National Game" that has been in discussion for the past year. Is it realistic that it will be introduced this year and what about the cannibalization to other games, possibly to instant tickets. It appears that people are spending about the same amount on lottery as previous years.

T. Romero reported that there's a big push by other state lotteries to start this National game this coming fiscal year, but it doesn't necessarily mean that the lottery needs to launch the game right away.

R. Jones reiterated her concern from earlier about instant tickets sales, the mandate and the lottery cutting the budget down an additional \$450 thousand dollars for FY 2013. There should be some sort of contingency plan by the lottery and the board. What happens if the lottery can't meet the 30% return and what areas would be cut?

T. Romero reported that the lottery does monitor its budget on a daily basis, what sales are, how there doing and schedule out when items are purchased. The Finance department ensures we stay on track and meets daily with the CEO to ensure we will meet the mandate to the state. Worst case scenario is that some big ticket items will not be purchased by the lottery, equipment will not be replaced, promotions and advertising will be stopped.

M. Koson had some questions on the FY 2013 Budget (Salary/Benefits, Professional Fees, Travel, Advertising, etc.) S. Jaramillo responded to each question with no further discussion.

There was no further discussion or questions on Budget.

T. Romero requested approval by the board to approve the FY 2013 Budget as presented.

M. Rael entertained a motion to approve the proposed Budget for FY 2013. M. Koson made the motion to approve the FY 2013 Budget as presented. H. Tabet second. All in favor, 5-0. There was no further discussion.

Disposal of obsolete, worn out or unusable tangible personal property: T. Romero reported that beginning last year, the Lottery participated in the NM State's annual auction that takes place usually in July or August of each year under the direction of the N.M.S.P. All of the divisions worked together to put a list of all the equipment, materials, furniture, outdated equipment, security systems, retailer equipment that we could dispose of this year. All items listed on the list have fully depreciated and the value of said property on the balance sheet on June 30th will be zero.

Pursuant to state statutes, 13-6-1 NMSA, we are requesting Board approval to dispose of obsolete, worn out or unusable tangible personal property through the state auction.

M. Rael entertained a motion for board approval to Dispose of obsolete, worn out or unusable tangible personal property as provided on the list. R. Jones made the motion to approve the disposal of obsolete, worn out or unusable tangible personal property as provided on the list. K. Hoeksema second. All in favor, 5-0. There was no further discussion.

Financial Audit Extension for FY 2012: M. Boland presented the Financial Audit Extension for 2012. Moss Adams has performed the financial audit for the last two years related to this RFP. The RFP has a one year contract with an option to extend for two more years. The lottery has already extended it for one year. Internal Audit is requesting approval to extend for the second option year, subject to State Auditor's approval. The total amount of the contract is \$45,475 per year.

M. Rael entertained a motion to approve the Financial Audit Extension for FY 2012 to Moss Adams. H. Tabet made the motion to extend the Financial Audit. R. Jones second. All in favor, 5-0.

BOARD CHAIR

Announcements: None

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 12:19 am.