

LOTTERY INVESTMENTS

Certain Lottery prizes awarded are payable to the winners in annual installments ranging from 19 years to life of the prize winners, with the first payment being made at the time of the drawing. Effective July 30, 1985, the law provides that the State Treasurer may, with consent of the Director, contract to invest in securities which provide payments corresponding to the Department's obligations to these winners.

Money may be invested only in bonds, notes, certificates of indebtedness, treasury bills, or other securities constituting direct obligations of the United States of America and all securities or obligations the prompt payment of principal and interest of which is guaranteed by a pledge of the full faith and credit of the United States of America.

August 31, 2014

	Fair Value
Chase	\$ 34,442,379
PNC	<u>254,886,471</u>
Total	\$ 289,328,850

Interest Rate Percentages:

Minimum interest rate	1.806%
Maximum interest rate	7.741%

Investment Income and Average Yield Rate:

Investment Income	\$ 3,749,525
Average Yield Rate	6.168%

Monthly investment income and the average yield rate is an "effective" income amount and yield rate. There is no cash realization of interest income by the Lottery Department. The yield rate is computed by dividing the effective investment income for the month by the average present value of the investments for the month.

Broker-Dealers:

Smith Barney
UBS Financial Services
HSB Securities, Inc.
Morgan Stanley
Wachovia Securities
Bank of America

Security Holders:

Chase
PNC

(5) Investments and Prizes Payable in Installments

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Department will not be able to recover the value of its investments that are in the possession of an outside party. Investments are held by the custodial bank's trust department in the name of the State Treasurer.

Interest rate risk is the risk that an investment's fair value decreases as market interest rates increase. Typically, this risk is higher in debt securities with longer maturities. The Department purchases investments with maturities scheduled to coincide with cash requirements. Interest rate risk is managed according to the purpose of the investments and the projected time frame for the use of these assets.

The risk that the Department will actually realize material losses from its investments in government securities resulting from changes in market interest rates is mitigated by the low probability that these securities will have to be sold prior to maturity.

The fair value of the securities is reflected in the accompanying financial statements of the Deferred Prize Winners Trust Fund as assets and as reserved fund equity. The original cost of the securities plus accrued interest is \$27,869,271 more than fair value as of August 31, 2014. These securities were purchased at discount rates ranging from 1.806% to 7.741% and mature in annual installments over a period of 25 years.

Investments in prize securities are in the form of United States Treasury zero-coupon bonds. Investments are held by a custody bank in the name of the State Treasurer. Credit ratings are not required for U.S. Government and agency securities that are explicitly guaranteed by the U.S. government. The fair value and investment maturities of the investments at August 31, 2014 are as follows:

Investment Maturities (In Years)	Fair Value Amount
Less than 1 year	\$ 37,817,143
1 to 5 years	90,354,019
6 to 10 years	76,474,128
More than 10 years	<u>84,683,560</u>
Total	<u>\$289,328,850</u>

The Department has an unconditional obligation to pay all grand prizewinners the future value of the prize. The fair value of the future prize payments, which is reported in the Deferred Prize Winners Trust Fund, follows:

	Current	Long-Term	Total
<u>For the Fiscal Year:</u>			
2014-2015	\$38,604,667	\$ -	\$38,604,667
2015-2016		33,055,667	33,055,667
2016-2017		25,600,667	25,600,667
2017-2018		18,316,667	18,316,667
2018-2019		18,413,667	18,413,667
2019-2024		92,016,335	92,016,335
2024-2029		65,613,000	65,613,000
2029-2034		49,123,000	49,123,000
2034-2039		19,907,000	19,907,000
Total Future Prize Payments	38,604,667	322,046,003	360,650,670
Less Present Value Adjustments	2,173,318	97,017,773	99,191,091
Present Value of Future Prize Payments	36,431,349	225,028,230	261,459,579
Add Adjustment to Reflect Fair Value	1,385,794	26,483,447	27,869,271
Fair Value of Future Prize Payments as of August 31, 2014	\$37,817,143	\$251,511,707	\$289,328,850

8. Investments and Prizes Payable in Installments

Prior to July 30, 1985, certain prizes awarded were payable to the winners in annual installments ranging from 10 years to life of the prize winners, with the first payment being made at the time of the drawing. The Department entered into agreements with insurance companies under which the Department purchased annuities under group contracts that provide payments corresponding to the Department's obligation to these winners.

Interest rate risk is the risk that an investment's fair value decreases as market interest rates increase. Typically, this risk is higher in debt securities with longer maturities. The Department purchases investments with maturities scheduled to coincide with cash requirements. Interest rate risk is managed according to the purpose of the investments and the projected time frame for the use of these assets.

The investment in prize annuities are subject to fluctuations in fair value due to interest rate risk, but these annuities are held to maturity to satisfy the annual installment obligations to prize winners. The fair value at maturity is the face value of the annuity, regardless of the fluctuations in value during the time period that the investments are outstanding.

As required by generally accepted governmental accounting principles, the present value of the annuities and the present value of the related liabilities have been reported in the financial statements for those annuities which were purchased in the name of the Department and which the Department has retained the rights of ownership. The Department would be liable for future payments if the insurance companies were to default on their payments. The investments in annuities have a weighted average maturity of 4.48 years. The present value of future prize payments, which is reported in the State Lottery Fund, follows:

	Current	Long-Term	Total
<u>For the Fiscal Year</u>			
2014-2015	\$62,000	\$ 0	62,000
2015-2016		62,000	62,000
2016-2017		62,000	62,000
2017-2018		62,000	62,000
2018-2019		62,000	62,000
2019-2024		174,000	174,000
2024-2029		0	0
2029-2034		0	0
Total Future Prize Payments	62,000	422,000	484,000
Less: Present Value Adjustments	1,559	49,182	50,741
Present Value of Future Prize Payments as of August 31, 2014	<u>\$60,441</u>	<u>\$372,818</u>	<u>\$433,259</u>