GOVERNMENT FINANCE COMMITTEE

The Government Finance Committee was assigned the following responsibilities:

1. A study pursuant to Section 1 of 2013 Senate Bill No. 2125 regarding methods to assure that the legacy fund provides the lasting benefits intended by the voters in enacting the constitutional measure.
2. A study pursuant to Section 16 of 2013 House Bill No. 1452 regarding the feasibility and desirability of existing and possible state retirement plans, including an analysis of both a defined benefit plan and a defined contribution plan with considerations and possible consequences for transitioning to a state defined contribution plan.
3. A study pursuant to Section 40 of 2013 House Bill No. 1015 regarding the foundation aid stabilization fund, including anticipated growth in the fund, appropriate funding levels, options for the disposition of excess funding if appropriate funding levels are exceeded, the reallocation of oil extraction taxes currently being deposited in the fund, and the feasibility and desirability of proposing changes to the constitution relating to the foundation aid stabilization fund.
4. A study pursuant to Section 38 of 2013 House Bill No. 1015 regarding the process of appropriating funds for salaries and wages and the state's classification system, including the feasibility and desirability of appropriating a lump sum amount to each agency for salaries and wages, without identifying specific purposes for the funding and allowing the agency head the flexibility to use the funding as necessary to accomplish the duties and responsibilities of the agency, and the effect of this change on the state's classification and benefits system and on the process of reporting by the agency on its use of the funds to the Legislative Assembly.
5. A study pursuant to Section 39 of 2013 House Bill No. 1015 regarding the feasibility and desirability of establishing a maximum state contribution to the cost of state employee health insurance premiums.

In addition, the Chairman of the Legislative Management also assigned the committee the following duties:

1. Review the State Board of Higher Education's activities relating to any agreement or financing associated with the purchase of the Research Enterprise and Commercialization building from the University of North Dakota Research Foundation on the campus of the University of North Dakota.
2. Review state budget information, including monitoring the status of revenues and appropriations.

Committee members were Representatives Jeff Delzer (Chairman), Larry Bellew, Joshua A. Boschee, Bette Grande, Craig Headland, Rick Holman, Lisa Meier, Kylie Oversen, Don Vigesaa, and Clark Williams and Senators Dwight Cook, Gary A. Lee, Donald Schaible, Ronald Sorvaag, Terry M. Wanzek, and Rich Wardner.

STUDY OF THE LEGACY FUND

Pursuant to Section 1 of 2013 Senate Bill No. 2124, the Government Finance Committee was assigned a study of the legacy fund. The study was to review methods to assure the legacy fund provides the lasting benefits intended by the voters enacting the constitutional measure that created the fund.

Fund History

The legacy fund was created in 2010 when the voters of North Dakota approved a constitutional amendment--now Article X, Section 26, of the Constitution of North Dakota--to provide that 30 percent of oil and gas gross production and oil extraction taxes on oil and gas produced after June 30, 2011, be transferred to the legacy fund. The principal and earnings of the legacy fund may not be spent until after June 30, 2017, and any expenditure of principal after that date requires a vote of at least two-thirds of the members elected to each house of the Legislative Assembly. Not more than 15 percent of the principal of the legacy fund may be spent during a biennium. The Legislative Assembly may transfer funds from any source to the legacy fund and such transfers become part of the principal of the fund.

The State Investment Board is responsible for investment of the principal of the legacy fund. Interest earnings accruing after June 30, 2017, are transferred to the general fund at the end of each biennium. Section 21-10-11 creates a legacy and budget stabilization fund board to develop recommendations to the State Investment Board for the investment of funds in the legacy fund and the budget stabilization fund. The board consists of two members of the Senate appointed by the Senate majority leader, two members of the House of Representatives appointed by the House majority leader, the Director of OMB or designee, the President of the Bank of North Dakota or designee, and the Tax Commissioner or designee. The section provides the goal of investment for the legacy fund is principal preservation while maximizing total return.

Section 15-08.1-08, created by the 2011 Legislative Assembly in House Bill No. 1451, establishes the strategic investment and improvements fund. The fund is intended to provide funding for one-time expenditures relating to improving state infrastructure or for initiatives to improve the efficiency and effectiveness of state government. The section provides if the balance of the strategic investment and improvements fund exceeds $300 million at the end of any month, 25 percent of any revenues received for deposit in the strategic investment and improvements fund must instead be deposited in the legacy fund.

Status of the Legacy Fund

The following is the status of the legacy fund for the 2011-13 and 2013-15 bienniums as of June 2014:

	2011-13 Biennium Actual		2013-15 Biennium Estimated	
Beginning balance		$0		$1,280,714,486
Add estimated revenues				
30 percent of oil and gas gross production and extraction tax collections	$1,132,412,536[1]		$1,785,986,831[2]	
Transfer of oil and gas tax revenues from the strategic investment and improvements fund	138,644,808[3]		251,596,164[3]	
Transfer of other revenue sources from the strategic investment and improvements fund	7,356,917[4]		22,793,114[4]	
Investment earnings	2,300,225[5]		66,016,026[6]	
Total estimated revenues		1,280,714,486		2,126,392,135
Total available		$1,280,714,486		$3,407,106,621
Total estimated expenditures and transfers		0[7]		0[7]
Estimated ending balance		$1,280,714,486		$3,407,106,621[8]

[1]This amount does not reflect any transfers from the strategic investment and improvements fund.

[2]Estimated revenues - The amount shown reflects actual oil and gas gross production tax and oil extraction tax revenue allocations through March 2014 with an updated projection for the remainder of the biennium. The updated projection is based on average daily oil production of 950,000 barrels of oil per day and a price of $85 per barrel of oil for the remainder of the biennium. The total estimated oil and gas tax collections are approximately $5.95 billion for the 2013-15 biennium, excluding an estimated allocation of approximately $450 million to the Three Affiliated Tribes. This amount does not reflect any transfers from the strategic investment and improvements fund.

[3]Pursuant to Section 15-08.1-08, if the unobligated balance of the strategic investment and improvements fund exceeds $300 million at the end of any month, 25 percent of any revenues received for deposit in the strategic investment and improvements fund in the subsequent month must be deposited instead into the legacy fund. This amount does not reflect additional transfers from the strategic investment and improvements fund from revenue sources other than oil and gas tax revenue.

[4]This amount reflects transfers to the legacy fund from the strategic investment and improvements fund from revenue sources other than oil and gas tax revenue, pursuant to Section 15-08.1-08.

[5]This amount reflects actual investment earnings for fiscal year 2012.

[6]This amount reflects actual investment earnings for fiscal year 2013 and estimated investment earnings for fiscal year 2014.

[7]The principal and earnings of the legacy fund may not be spent until after June 30, 2017.

[8]The OMB August 2014 revised revenue forecast projects a legacy fund balance of $3,823,919,403 on June 30, 2015.

Appropriations from the Legacy Fund

The committee learned the Legislative Assembly may make appropriations from the legacy fund prior to June 30, 2017, but the funds may not be disbursed or expended until after that date. Earnings from the legacy fund are required to be transferred to the general fund at the end of each biennium, but the Legislative Assembly may appropriate the funds directly from the legacy fund before any transfer is made to the general fund. The only limitation on appropriating and expending money from the legacy fund is the principal and earnings of the fund cannot be expended until after June 30, 2017, a two-thirds vote of the members elected to each house of the Legislative Assembly is required for an expenditure of principal of the fund, and not more than 15 percent of the principal of the fund may be expended during a biennium.

The Legislative Assembly during the 2013 regular legislative session enacted in statute a definition of earnings in respect to the legacy fund. The definition provides that unrealized gains or losses are not to be included in the determination of fund earnings. The fund earnings accruing after June 30, 2017, are to be transferred to the general fund at the end of each biennium. The first transfer from the legacy fund to the general fund will occur at the end of the 2017-19 biennium. The Legislative Assembly has the ability to appropriate the earnings of the legacy fund directly from the legacy fund prior to the earnings being transferred to the general fund.

Recommendation

The committee recommends a bill [15.0057.03000] to provide several definitions for constitutional provisions relating to the legacy fund and clarifies the process used to determine limitations on expenditures from the legacy fund. The bill also provides that earnings transferred from the legacy fund to the general fund at the end of a biennium are to be transferred back to the legacy fund and become principal unless certain criteria are met.

STUDY OF STATE EMPLOYEE RETIREMENT PLANS

Pursuant to Section 16 of 2013 House Bill No. 1452 the Government Finance Committee was assigned a study of existing and potential state employee retirement plans, including an analysis of defined benefit and defined contribution plans and the feasibility, desirability, and consequences of transitioning to only a state defined contribution plan.

Background Information

The Public Employees Retirement System (PERS) is governed by North Dakota Century Code Chapter 54-52 and includes the PERS main system, judges' retirement system, National Guard retirement system, law enforcement with prior main service, law enforcement without prior main service, and an optional defined contribution retirement plan; Highway Patrolmen's retirement system; Job Service North Dakota retirement plan, and retiree health benefits fund. The plan is supervised by the Retirement Board and covers most employees of the state, district health units, and the Garrison Diversion Conservancy District. A county, city, or school district may choose to participate on completion of an employee referendum and on execution of an agreement with the board.

The Public Employees Retirement System had 21,091 active members on July 1, 2012. Of this total, 20,738 were active members of the main system, 49 were active members of the judges' retirement system, 32 were active members of the National Guard retirement system, 207 were active members of the law enforcement retirement system with prior main service, and 65 were active members of the law enforcement retirement system without prior main service. The Highway Patrolmen's retirement plan had 145 active members and the Job Service retirement plan had 19 active members.

Main System Defined Benefit Plan

The PERS main system defined benefit plan is funded from employer contributions, employee contributions, and investment earnings. Contributions are calculated based on a percentage of gross pay. From 1977 through 1989, the employer contribution was 5.12 percent and the employee contribution was 4 percent. In lieu of state employee salary increases in 1983 and 1984, the state began to pay the 4 percent employee contribution. In 1989 the employer contribution was reduced by 1 percent and reallocated for a retiree health benefit credit.

The following is a summary of employer and employee contributions to the retirement plan since 1989:

1989 Through December 31, 2011		Effective January 1, 2012		Effective January 1, 2013		Effective January 1, 2014	
Employer	Employee	Employer	Employee	Employer	Employee	Employer	Employee
4.12%	4.00%[1]	5.12%	5.00%[1]	6.12%	6.00%[1]	7.12%	7.00%[1]

[1]The state pays 4 percent of the employee share of retirement contributions.

Benefit Levels and Recent Changes in Benefit Calculations

Members of the main public employees retirement plan are eligible for a normal service retirement benefit at age 65 or when age plus years of service is equal to at least 85 (commonly known as the "Rule of 85"). Retirement benefits under the defined benefit plan are calculated using the following mathematical formula provided in Section 54-52-17(4):

Final average salary[1] x benefit multiplier (2%)[2] x years of service credit[3] = monthly single life retirement benefit

[1]For employees who retired prior to August 1, 2010, the final average salary was the average of an employee's highest salaries in 36 of the last 120 months worked. For members who terminate employment on or after August 1, 2010, it is the average of the employee's highest salaries in 36 of the last 180 months worked.

[2]The benefit multiplier is the rate at which benefits are earned. The current benefit multiplier is 2 percent.

[3]The service credit is the amount of public service an employee has accumulated under PERS for retirement purposes.

The following is a summary of benefit changes approved by the Legislative Assembly since 1977:

Year	Benefit Multiplier	Change in Retirement Rule Levels
July 1977	1.04%	
July 1983	1.20%	
July 1985	1.30%	Rule of 90 established as an alternative for retirement eligibility
July 1987	1.50%	
July 1989	1.65%	

Year	Benefit Multiplier	Change in Retirement Rule Levels
July 1991	1.69%	
August 1993	1.725%	Rule of 90 changed to Rule of 88
January 1994	1.74%	
August 1997	1.77%	Rule of 88 changed to Rule of 85
August 1999	1.89%	
August 2001	2.00%	

Similar adjustments were also made to the benefit calculations of members who retired prior to the above changes being made. Benefits were increased in amounts that equaled the benefit multiplier changes. In addition, retirees received a 13th check in 2006 and 2008. In 2006 the 13th check was equal to half of the retiree's normal monthly check and in 2008 the 13th check was equal to three-fourths of the retiree's normal monthly check.

Actuarial Funded Ratio

The actuarial funded ratio is the percentage of the retirement fund's actuarial value of assets to its actuarial accrued liabilities. The actuarial value of assets is determined by spreading market appreciation or depreciation over five years. This procedure results in recognition of all changes in market value over a five-year period resulting in less volatility in the funded ratio of the plan.

Below is a summary of the actuarial funded ratio of the PERS plan since 1990.

Year	Actuarial Funded Ratio
1990	101%
1991	101%
1992	101%
1993	100%
1994	99%
1995	103%
1996	104%
1997	109%
1998	111%
1999	109%
2000	115%
2001	111%
2002	104%
2003	98%
2004	94%
2005	91%
2006	89%
2007	93%
2008	92%
2009	85%
2010	73%
2011	70%
2012	65%
2013	62%

Defined Contribution Plan

The Legislative Assembly authorized the use of an optional defined contribution retirement plan effective January 1, 2000. Chapter 54-52.6 provides the plan is available to state employees who are in positions not classified by Human Resource Management Services, excluding employees of the judicial branch and employees under the control of the State Board of Higher Education. Additionally, between October 1, 2014, and July 31, 2017, any new state employee may elect to participate in the plan. An eligible employee may make an election at any time during the first six months of employment to participate in the defined contribution plan rather than the defined benefit plan. An election to participate in the defined contribution plan is irrevocable. A plan participant will remain in the defined contribution plan if the employee discontinues service in an unclassified position and becomes reemployed in a classified position.

The following is a summary of contribution levels for the defined contribution retirement plan:

Prior to December 31, 2011		Effective January 1, 2012		Effective January 1, 2013		Effective January 1, 2014	
Employer	Employee	Employer	Employee	Employer	Employee	Employer	Employee
4.12%	4.00%[1]	5.12%	5.00%[1]	6.12%	6.00%[1]	7.12%	7.00%[1]

[1]The state pays 4 percent of the employee share of retirement contributions.

Individual accounts are designated for each participant, and retirement benefits are based on the employer and employee contributions to the accounts plan and investment earnings on funds in the account. As of June 2013, there were 218 active members enrolled in the defined contribution retirement plan.

Previous State Employee Retirement Plans

North Dakota Old Age and Survivor Insurance (1947)

Prior to 1950 under federal law, state employees were ineligible to participate in the federal Social Security program. As a result, in 1947 the Legislative Assembly approved House Bill No. 182 creating the North Dakota Old Age and Survivor Insurance System (OASIS) plan, which became effective on July 1, 1947. Section 52-09-02 of the *North Dakota Old Age and Survivor Insurance System Law of 1949* stated the purpose of the system was "to promote economy and efficiency in the public service by providing an orderly means whereby employees who become superannuated may, without hardship or prejudice be replaced by more capable employees, . . .improve public employment . . . , reduce excessive personnel turnover and offer suitable attraction to high grade men and women to enter public service in the state."

The OASIS plan was a contributory retirement plan for state, county, and other political subdivision employees. The plan excluded certain groups, including policemen, firemen, and teachers in public schools and colleges. The eligibility requirements for participants were similar to Social Security and included:

- A retirement age of 65.
- At least 40 quarters of employment with credible earnings in 6 of the last 12 quarters.
- Contribution rates to the plan beginning in 1947 were 1 percent of the first $3,000 of an employee's annual salary provided by the employee and 1 percent of the first $3,000 of an employee's annual salary provided by the employer. By 1955 the contribution rates had increased to 1.5 percent of the first $4,800 of an employee's annual salary provided by the employee and 1.5 percent of the first $4,800 of an employee's annual salary provided by the employer. The contribution rates for employees and employers were increased to 2 percent each on the employee's first $4,800 of an employee's annual salary for 1956 and 1957.

Retirement benefits were based on a percentage of an employee's average monthly wages and years of service.

An analysis of the OASIS plan prepared in 1956 by the Bureau of Business and Economic Research at the University of North Dakota for the Legislative Research Council concluded the plan had not accomplished its objectives and it could not be expected to do so. The basic features of the plan were not consistent with the objectives, and the plan should be changed. Furthermore, the report recommended the change should be structured to allow employees to participate in Social Security.

In 1950 Title II of the Social Security Act was amended by the addition of Section 218 to permit the extension of coverage to employees of the state but was limited to states with no existing retirement program, which voided the applicability for the state of North Dakota because of the OASIS plan. This exclusion was amended by the federal government in 1954 to allow a state-federal agreement where state employees could now become covered by Social Security, with or without a state retirement plan, when certain conditions were met. These conditions included:

- The state must authorize coverage.
- Existing employees covered by an existing retirement plan must elect, through a referendum, to be included in Social Security.
- The state must pay retroactive contributions to Social Security for each quarter of coverage earned by present employees after the effective date of the agreement and to the date on which the agreement was made.

In 1955 the Legislative Assembly passed House Bill No. 736, which enabled the state to make an agreement with the federal government. On December 20, 1956, Governor C. Norman Brunsdale called a referendum for all covered employees and allowed employees to choose coverage under Social Security rather than the OASIS plan.

The adoption of Social Security was intended as a benefit to both the state of North Dakota and its employees. The employees already receiving retirement benefits under the OASIS plan were allowed to continue in the OASIS plan. Additionally, any state employee that would have benefited more under the OASIS plan than Social Security was allowed to elect continuation in the OASIS plan.

By 1957, the state concluded the OASIS plan was not actuarially sound and could not function as a self-supporting plan. The accrued liabilities ($40,830,172) of the fund were in excess of the assets ($15,282,808), and the rate at which liabilities were accruing was far greater than the rate at which assets were accruing. To reverse this would have required changes not consistent with the objectives the OASIS plan was designed to promote. If the objectives of the plan to permit early retirement and reduce excessive turnover were accomplished, then the accomplishment would have rendered the plan insolvent.

In 1957 the Legislative Assembly approved Senate Bill No. 45, which closed the OASIS plan on July 1, 1957. The majority of employees had transitioned to Social Security as authorized by 1955 House Bill No. 736. Contributions necessary to fund the remaining participants in the OASIS plan were provided from an employer contribution of 4 percent of the first $4,800 of annual wages. The employer contribution percentage was changed by the Legislative Assembly during the period from 1957 to 1966. From 1966 to 1989, provisions were in place that triggered the employer contributions on and off depending on the funding needs of the OASIS fund. The schedule below presents the contribution percentages.

Period	Employer Contribution Rate[1]
1957 to 1959	4%
1959 to 1961	3.5%
1961 to 1963	3%
1963 to 1966	2%
1966 to 1989	1% - Only as necessary

[1]Employer contributions were calculated on the first $4,800 of annual wages for each employee.

In 1989 the Legislative Assembly approved House Bill No. 1118, which discontinued the employer contribution after June 30, 1989. In 1999 the Legislative Assembly approved House Bill No. 1170, which repealed the employer contribution section. Any future funding requirements for the OASIS plan, for which the OASIS fund was not sufficient to pay, would be provided with appropriations through the general fund. The Legislative Assembly provided a $19,000 general fund appropriation in each of the 2005-07 and 2007-09 bienniums for paying remaining benefits under the OASIS plan.

Money Purchase Plan (1965)

In the early to mid-1960s, North Dakota was one of only a few states remaining that did not offer a state retirement plan to its employees. There was no other retirement plan provided for state employees after the OASIS plan was closed, and most employees transitioned to Social Security in 1956 and 1957. In 1965 the Legislative Assembly approved Senate Bill No. 164 creating the employees' retirement program, which became effective on July 1, 1966, structured as a money purchase plan (similar to a defined contribution plan). This plan only applied to state employees in 1966 but was amended in 1969 to include employees of counties, cities, and noncertified employees of school districts.

In 1966 the employer and employee contributions were fixed at 4 percent of salary with the employer's contributions being assessed only on the first $7,500 of annual wages. In 1969 contributions were assessed on the first $12,500 of each employee's annual wages, and in 1975 the amount increased to the first $15,000 of annual wages.

Contributions were fixed with the new money purchase plan, but the benefits varied. Each employee's monthly lifetime benefit payments were determined by the value of the employee's fund at the time of retirement.

The 1975-76 interim State and Federal Government Committee studied the feasibility of adopting a benefit formula retirement plan for state employees. The committee determined fluctuations in the market did not provide a reliable way for employees to determine their retirement benefits, which resulted in more risk and uncertainty to the employee. Based on an actuarial study conducted by Martin E. Segal Company, Inc., and other considerations, the committee recommended 1977 Senate Bill No. 2068 to change the Public Employees Retirement System from a money purchase plan to a benefit formula-type plan.

Benefit Formula Plan (1977)

In 1977 the Legislative Assembly approved Senate Bill No. 2068 creating the benefit formula retirement plan (a defined benefit plan), which became effective on July 1, 1977, and all members of the money purchase plan were covered under the new plan. This plan allowed members to receive credit for years of service prior to July 1, 1966--the effective date of the money purchase plan. As with the money purchase plan, the benefit formula plan required a 4 percent of salary benefit contribution for employees and a 5.12 percent of employee's salary benefit contribution for employers (with no employer maximum limit).

This new plan allowed employees to contribute a fixed percentage of their salary and receive a fixed benefit upon retirement. Testimony supporting the new plan indicated it was to provide increased benefits for long-term employees and give employees more security in retirement.

Types of Retirement Plans Used in Other States

The committee received information regarding state employee retirement plans in other states. The committee learned all states offer some form of retirement plan to state employees. Most plans fall into one of the following three categories:

- Defined benefit plans - Provide a lifelong annuity upon retirement that is based on factors such as final average salary, length of service, and benefit multipliers.
- Defined contribution plans - Provide individual employee retirement accounts which normally consist of employee contributions, employer contributions, and investment earnings. Final retirement benefits are based on total contributions and investment earnings or losses.
- Hybrid plans - Combine elements of defined benefit plans and defined contribution plans. Some states offer a cash balance plan which uses individual accounts similar to a defined contribution plan except that a minimum level of investment return is guaranteed.

A National Conference of State Legislatures (NCSL) study in 2012 detailed the number of states and Washington, D.C., and Puerto Rico that offer each type of plan as follows:

- Thirty-two states and Puerto Rico have a defined benefit plan only for state employees.
- Two states and Washington, D.C., have a defined contribution plan only for state employees.
- Three states have a cash balance plan only for state employees.
- Thirteen states have either a hybrid retirement plan or allow employees the option of choosing which type of plan to participate in.

Other States Public Employee Retirement Plans

The committee reviewed a report prepared by the Wisconsin Legislative Council comparing major public employee retirement systems. The report provides details regarding 87 major retirement systems that cover state employees, teachers, and political subdivisions employees. Major findings in the report include:

- Participants in 17 of the 87 plans are not covered by Social Security. In plans where employees are not covered by Social Security, the benefit multiplier is generally higher than in plans where employees are also covered by Social Security. For plans in which employees are covered by Social Security, the benefit multiplier ranges from 1 to 2.5 percent. For plans in which employees are not covered by Social Security, the benefit multiplier ranges from 2 to 2.5 percent.
- Employee contribution rates increased in 22 plans from 2008 to 2010 and employer contribution rates increased in 47 plans between 2008 and 2010. However, 19 plans had employer contribution rates decrease between 2008 and 2010. Some of the employer contribution rates are based on actuarial valuations which cause rates to adjust automatically.
- The average funding ratio of all plans reviewed was 73.4 percent for fiscal year 2010.

Recent Changes to Other States' Retirement Plans

The committee learned several states have recently made changes to state employee retirement plans. The following is a summary of changes in selected states.

Montana

The Montana Legislature enacted changes in 2011 and 2013 affecting the Montana PERS. Major changes included:

- In 2013 the employee contribution rate for all participants was increased from 6.9 to 7.9 percent. The employer contribution rate was increased by 1 percent on July 1, 2013, and is being increased by 0.1 percent each year for 10 years beginning July 1, 2014.
- Benefit plan calculations for new hires after June 30, 2011, were adjusted.
- The annual cost-of-living adjustment (COLA) for all current and future retirees is set at 1.5 percent as long as the retirement system maintains a funding level of at least 90 percent. The COLA is reduced by 0.1 percent for each 2 percent the funding level is below 90 percent. If the amortization period of the unfunded liability is 40 years or greater, the COLA will be zero.
- A portion of natural resources taxes will be deposited in the PERS fund.

In October 2013, a group of retired Montana state employees filed a lawsuit challenging the changes made by the Montana Legislature to the COLAs. The retired employees are contending the changes violate a contract the employees had with the state relating to retirement benefits.

Tennessee

Pursuant to statutory changes in 2013, the Tennessee Consolidated Retirement System is creating a hybrid retirement plan for employees hired on or after July 1, 2014. The hybrid plan includes both a defined benefit and defined contribution component. The employee contribution will total 7 percent--5 percent is allocated to the defined benefit plan and 2 percent is allocated to the defined contribution plan. However, the employee may choose not to make the 2 percent contribution to the defined contribution plan. The total employer contribution is 9 percent--4 percent is allocated to the defined benefit plan and 5 percent is allocated to the employee's defined contribution account. The defined benefit multiplier is 1 percent under the new plan.

Kansas

In 2012 the Kansas Legislature enacted changes to the Kansas PERS. Effective January 1, 2015, new state employees (with some exceptions) will be placed in a new cash balance retirement plan tier. Employees will provide a contribution of 6 percent, and the state will provide a contribution based on years of service. The state contribution will range from 3 percent for employees with less than 5 years of service to 6 percent for employees with more than 24 years of service. The employee accounts receive interest credits of 5.25 percent per year and may receive additional interest credits of up to 4 percent if the investment rate of return is 10 percent or more for that fiscal year. However, the additional interest credits are limited based on the funding ratio of the entire PERS.

Rhode Island Retirement Security Act

The Rhode Island Retirement Security Act of 2011 became effective on July 1, 2012, and made several changes to the regular state employee retirement plan. The Act made changes to the retirement plans of both current workers and retirees in addition to new hires by changing from a defined benefit plan to a hybrid defined benefit and defined contribution plan and making other adjustments. Under the new hybrid plan, employees pay 3.75 percent to the defined benefit component of the plan and 5 percent to the defined contribution component of the plan.

The Act also provided other changes to the retirement plan. The Act suspended automatic COLAs if the retirement plan is less than 80 percent funded. Any COLA awarded is based on plan investment returns with a maximum adjustment of 4 percent. The Act also changed the vesting period from 10 years to 5 years, adjusted the benefit multiplier from a tiered system to 1 percent per year of service, and adjusted eligible retirement dates.

In June 2012, a lawsuit was filed against the state of Rhode Island by several entities representing retired state employees who claimed the Act breached a contract the employees had with the state. Both parties agreed to conduct mediation sessions.

Projected Costs to Close the Defined Benefit Plan to New State Employees

The committee received information regarding the actuarially calculated costs relating to the public employees defined benefit retirement plan if state employees hired after January 1, 2016, are required to participate in a defined contribution benefit plan.

The Segal Company Projections

The committee received information in March 2014 from The Segal Company (Segal) which is the consulting actuary for PERS. Segal reported that if the defined benefit plan was closed to new employees, the state portion of the plan would be able to pay benefits until the year 2046. There would be a projected contribution shortfall of $3,688,100,000 for future benefits to be paid after 2046. However, a payment of $162.8 million could be made to the retirement plan on July 1, 2015, to fully offset the state portion of the future projected contribution shortfall. The estimated payment of $162.8 million needed to fully fund the state portion of the plan is based on an 8 percent investment return. However, the committee learned the asset allocation of the plan's investments may need to be adjusted near the projected end of the plan, which to move to more short-term investments would potentially reduce the plan's investment return.

Independent Review by Arthur J. Gallagher & Co.

The committee requested and received approval from the Chairman of the Legislative Management to enter an actuarial consulting contract with Arthur J. Gallagher & Co. Representatives of Arthur J. Gallagher & Co. (Gallagher) reviewed the July 1, 2013, actuarial valuation of the PERS plan conducted by Segal and the March 2014 study conducted by Segal regarding estimated costs to close the main state employee defined benefit retirement plan.

Gallagher reviewed assumptions used by Segal and suggested the committee consider reviewing plan projections using alternative assumptions. Suggested alternative assumptions were provided for investment returns, salary increases, payroll growth, employee mortality, and employee retirement rates.

Gallagher reported minimal differences resulting from its review of Segal's July 2013 valuation report but did have differences compared to Segal's March 2014 study results. The following three significant findings were identified by Gallagher relating to the March 2014 study results:

	Gallagher Finding	Gallagher Comments
Finding 1 - Disclosure	• Segal made adjustments to the valuation outputs to reduce projected benefit payments from years 2014 through 2028 without disclosing in their report the reason for the change or the cost impact.	• Actuarial Standards of Practice (ASOP) No. 41 states that an actuarial report should "identify the methods, procedures, assumptions, and data used by the actuary with sufficient clarity that another actuary qualified in the same practice area could make an objective appraisal of the reasonableness of the actuary's work as presented in the actuarial report." • Segal's March 6, 2014, study states that "cost estimates are based on the July 1, 2013 actuarial valuation."
Finding 2 - Methodology	• Segal explained the reduction in projected benefit payments was due to "The current valuation assumptions (as approved by the Board of Trustees) appear to have higher rates of assumed retirement than are currently being observed." • Segal said no other adjustments were made. This implies: No larger benefit payments for deferred retirements. No adjustments for higher contributions due to fewer retirements.	• Gallagher results, as demonstrated on July 1, have shown that adjustments to retirement assumptions do not significantly impact present values (i.e., either the plan pays a retiree less for longer or more for a shorter period). • Segal's actuarial valuation shows no change to the contribution requirement in the prior year due to retirement experience.
Finding 3 - Omission	• Segal excluded from the study the impact of participants entering after July 1, 2013, and before the assumed closure date of January 1, 2016.	• The inclusion of participants during this period adds significant benefit payments to the plan. However, additional assumed member and employer contributions are nearly offsetting.

Gallagher indicated the findings create a difference between Segal's projections and Gallagher's projections. If only the state employees group was closed and separated from nonstate employees, the insolvency date of the plan would be in 30 years as determined by Gallagher compared as to 35 years as determined by Segal. The estimated one-time contribution on July 1, 2015, to fully fund the retirement plan would be $301 million as calculated by Gallagher compared to $162.8 million under Segal's projections.

Gallagher reported if the plan were closed to both state employees and nonstate employees the insolvency date of plan would be in 32 years as determined by Gallagher compared to 42 years as determined by Segal. The one-time contribution under this scenario would be $445 million as calculated by Gallagher compared to $99 million under Segal's projections.

Segal provided comments regarding differences in the projected actuarial costs calculated by Segal and by Gallagher to close the main state employee retirement plan to new employees effective January 1, 2016. Segal indicated the major difference in the calculations is due to an adjustment made by Segal to the amount of future benefit payments. The adjustment was inadvertently not reported by Segal to PERS or to Gallagher when disclosing projection assumptions.

Other Testimony Received

The committee received comments from other interested person. Major comments made include:

- Concern that making changes to the state employee retirement plan could affect the ability of the state to recruit and retain employees.
- Concern that state employees currently enrolled in the defined contribution retirement plan do not believe they will have adequate funds for retirement.

Recommendation

The committee recommends a bill [15.0176.04000] to provide for changes to the main state employee retirement plan. Under the bill, an eligible employee hired for the first time after December 31, 2015, will be required to enroll in the defined contribution plan under Chapter 54-52.6, rather than the defined benefit plan. The bill does not affect

Supreme Court or district court judges, employees eligible to participate in the National Guard retirement plan or the law enforcement plan, employees of a political subdivision, or employees of the State Board of Higher Education and state institutions under the jurisdiction of the board that are participating in the TIAA-CREF retirement plan. State employees currently in the defined benefit plan and those hired before January 1, 2016, who elect to participate in the defined benefit plan will continue to participate in the defined benefit plan. However, during the last six months of 2016, a state employee participating in the defined benefit plan may make an irrevocable election to transfer to the defined contribution plan. The bill also changes the vesting period for employees participating in the defined contribution plan to allow for participants to fully vest in employer contributions after one year of service instead of four.

As discussed later in this report in the study of the foundation aid stabilization fund, the committee is recommending a separate bill to create a public employee retirement stabilization fund that may be used to address the unfunded liabilities of state employees participating in the main retirement plan.

STUDY OF THE FOUNDATION AID STABILIZATION FUND

Pursuant to Section 40 of 2013 House Bill No. 1015, the committee was assigned a study of the foundation aid stabilization fund including:

- Anticipated growth in the fund;
- Appropriate funding levels;
- Options for the disposition of excess funding if appropriate funding levels are exceeded;
- The reallocation of oil extraction taxes currently being deposited in the fund; and
- The feasibility and desirability of proposing changes to the constitution relating to the fund.

Fund History

The foundation aid stabilization fund was created in 1994 when the voters of North Dakota approved a constitutional amendment, now Article X, Section 24, of the Constitution of North Dakota, to provide that 20 percent of oil extraction tax revenue be allocated as follows:

- 50 percent (of the 20 percent) to the common schools trust fund.
- 50 percent (of the 20 percent) to the foundation aid stabilization fund.

The principal of the foundation aid stabilization fund may only be spent upon order of the Governor to offset foundation aid reductions made by executive action due to a revenue shortfall. Section 54-44.1-12 provides the Director of the Budget may order an allotment to control the rate of expenditures of state agencies. This section provides an allotment must be made by specific fund and all departments and agencies that receive money from a fund must be allotted on a uniform percentage basis, except that appropriations for foundation aid, transportation aid, and special education aid may only be allotted to the extent the allotment can be offset by transfers from the foundation aid stabilization fund. One budget allotment has occurred since the foundation aid stabilization fund was created in 1994. During the 2001-03 biennium, funding of $5,500,639 was transferred to the Department of Public Instruction to offset a reduction in state school aid and special education payments resulting from a 1.05 percent budget allotment ordered by Governor John Hoeven in July 2002.

Article X, Section 24, of the Constitution of North Dakota, provides the interest income of the foundation aid stabilization fund must be transferred to the general fund on July 1 of each year. However, the State Treasurer's office allocates the interest income to the general fund on a monthly basis.

Status of the Foundation Aid Stabilization Fund

The following is the status of the foundation aid stabilization fund for the 2011-13 and 2013-15 bienniums as of June 2014:

	2011-13 Biennium Actual		2013-15 Biennium Estimated	
Beginning balance		$140,193,764		$335,364,942
Add revenues				
Oil extraction tax allocations	$195,171,178		$327,804,364[1]	
Total revenues		195,171,178		327,804,364
Total available		$335,364,942		$663,169,306
Less expenditures and transfers				
Transfer to foundation aid program	$0[2]		$0[2]	
Total expenditures and transfers		0		0
Ending balance		$335,364,942		$663,169,306

[1]Estimated revenues - Based on actual oil extraction tax collections deposited in the fund through March 2014 and an updated projection for the remainder of the biennium. The updated projection is based on average daily oil production of 950,000 barrels of oil per day and a price of $85 per barrel of oil for the remainder of the biennium.

[2]Estimated expenditures - As provided in Article X, Section 24, of the Constitution of North Dakota, the principal of the foundation aid stabilization fund can only be used to offset foundation aid reductions made by executive action due to a revenue shortfall. No foundation aid reductions as a result of a revenue shortfall are currently anticipated in the 2013-15 biennium.

Potential Fund Balances Based on the August 2014 Revised Revenue Forecast

The schedule below provides updated projections for the 2013-15 and 2015-17 biennium estimated amounts available in the foundation aid stabilization fund based on the revised revenue forecast released by the Office of Management and Budget (OMB) in August 2014.

	2013-15 Biennium Revised Revenue Forecast	2015-17 Biennium Preliminary Revenue Forecast
Beginning balance	$335,364,942	$710,975,584
Add estimated oil extraction tax revenues	375,610,642[1]	517,915,350[2]
Total available - End of biennium	$710,975,584	$1,228,890,934

[1]The estimated revenues are based on OMB's revised revenue forecast, which anticipates average daily oil production increasing to 1.3 million barrels per day and a price of $90 per barrel for the remainder of the 2013-15 biennium.

[2]The estimated revenues are based on OMB's preliminary 2015-17 biennium revenue forecast, which anticipates average daily oil production increasing from 1.3 million barrels per day to 1.4 million barrels per day during the 2015-17 biennium and a price of $90 per barrel for the 2015-17 biennium.

Historical Fund Balances Compared to Total Foundation Aid or State Aid to Schools

The committee reviewed the following schedule which compares the foundation aid stabilization fund balance at the end of each biennium since 1999 to the total funding for foundation aid or state aid to schools appropriated each biennium.

	Foundation Aid Stabilization Fund Balance at the End of the Biennium	Total Foundation Aid or State Aid to Schools Appropriated for the Biennium[1]	Foundation Aid Stabilization Fund Balance at the End of the Biennium as a Percentage of the Total Foundation or State Aid Appropriated for the Biennium
1999-2001	$10,517,143	$585,734,476	1.80%
2001-03	$8,991,303	$628,345,368	1.43%
2003-05	$16,098,385	$665,628,056	2.42%
2005-07	$29,009,838	$698,565,879	4.15%
2007-09	$65,750,547	$780,765,879	8.42%
2009-11	$140,193,764	$1,274,254,480[2]	11.00%
2011-13	$335,364,942	$1,350,992,316[3]	24.82%
2013-15 estimated	$663,364,942	$1,835,700,000[4]	36.14%

[1]Total foundation aid appropriated from the general fund and state tuition fund.

[2]The Legislative Assembly provided, as part of state school aid, $295 million from the general fund for mill levy reduction grants to school districts. In addition to funding from the general fund and the state tuition fund, the 2009 Legislative Assembly provided, as state school aid, $85.6 million from federal funds available through the American Recovery and Reinvestment Act of 2009.

[3]The Legislative Assembly provided, as part of state school aid, $341.8 million from the general fund for mill levy reduction grants to school districts and $5 million from the oil and gas impact grant fund for rapid enrollment growth grants.

[4]The Legislative Assembly provided integrated formula payments totaling $1.75 billion that includes $656.5 million for the property tax relief component. The Legislative Assembly also provided $13.6 million for rapid enrollment growth grants.

Use of Budget Stabilization Fund for State School Aid Payments

The budget stabilization fund was established in 1987 and contains funds that may be used to offset a general fund revenue shortfall. Any amount in the state general fund in excess of $65 million at the end of the biennium must be transferred to the budget stabilization fund. However, the maximum balance of the fund is limited to 9.5 percent of the general fund budget as approved by the most recently adjourned Legislative Assembly. Based on general fund appropriations made during the 2013 regular legislative session, the maximum fund balance is currently $583.5 million.

The Governor may order a transfer from the budget stabilization fund to the general fund if the Director of OMB projects general fund revenues for the biennium will be at least 2.5 percent less than estimated by the most recently adjourned Legislative Assembly. The amount transferred is limited to the difference between an amount 2.5 percent less than the original legislative general fund revenue forecast and the revised forecast prepared by OMB.

In the event the Governor orders a budget allotment, funding from the foundation aid stabilization fund is to be used to offset the budget allotment for foundation aid, transportation aid, and special education aid payments to schools. If the projected revenue shortfall is 2.5 percent or less, the foundation aid stabilization fund would be used to offset the entire allotment. If the projected revenue shortfall is 2.5 percent or greater, it appears that any allotment of school aid payments in excess of 2.5 percent may be offset by either a transfer from the foundation aid stabilization fund or the budget stabilization fund. The determination of which funding source to use for allotments in excess of 2.5 percent would be made by the Governor, who has the authority to order transfers from either fund subject to constitutional and statutory provisions.

The committee reviewed the following schedule which details how much funding would be used from the foundation aid stabilization fund and budget stabilization fund to offset a revenue shortfall based on the budget stabilization fund being used to replace state school aid payments funding due to a general fund revenue shortfall:

Use of Foundation Aid Stabilization Fund and Budget Stabilization Fund to Offset Allotments - Based on Using the Budget Stabilization Fund for State School Aid Payments

Allotment/Revenue Shortfall Amount	State School Aid Payments - General Fund	Other General Fund Appropriations	Total
First 2.5 percent - Foundation aid stabilization fund	$42,384,350	$0	$42,384,350
From 2.5 to 11 percent - Budget stabilization fund[1]	$144,162,591	$439,383,208	$583,545,799
From 11 to 47.6 percent - Foundation aid stabilization fund	$620,980,592	$0	$620,980,592

[1]The Legislative Assembly in 2013 House Bill No. 1015 provided $720 million of general fund appropriations be excluded from the calculation used to determine the maximum balance of the budget stabilization fund. Therefore, the current fund balance of the budget stabilization fund is equal to approximately 8.5 percent of total general fund appropriations for the 2013-15 biennium.

Options for a Minimum Fund Balance

The committee received information regarding options to provide for a minimum foundation aid stabilization fund balance and to allow excess funds to be used for other purposes. The committee reviewed the following schedule detailing minimum fund balances that would be required for the foundation aid stabilization fund based on a minimum fund balance equal to selected percentages of general fund appropriations for state school aid payments:

Percentage of 2013-15 Biennium General Fund Appropriations for State School Aid Payments	Minimum Fund Balance
5 percent	$84,768,700
10 percent	$169,537,400
15 percent	$254,306,100
20 percent	$339,074,800
25 percent	$423,843,500

The committee learned if the minimum foundation aid stabilization fund balance was equal to 15 percent of state school aid payments for the 2013-15 biennium, the estimated balances of the budget stabilization fund and foundation aid stabilization fund would provide enough funding for state school aid payments to offset a general fund revenue shortfall of approximately 25 percent.

Recommendation

The committee recommends the following:

1. A bill [15.0055.02000] clarifying the use of the foundation aid stabilization fund and budget stabilization fund for state school aid payments in the event of a general fund revenue shortfall. The bill provides that the funds be used in the following order relating to state school aid payments:
   - The foundation aid stabilization fund is to be used to offset the first 2.5 percent of a general fund allotment.
   - The budget stabilization fund is to be used to offset any general fund revenue shortfall in excess of 2.5 percent.
   - After the budget stabilization fund is depleted, any remaining general fund allotment may be offset with funds from the foundation aid stabilization fund.
2. A concurrent resolution [15.3010.03000] to amend Article X, Section 24, of the Constitution of North Dakota. The provisions of the resolution would permit the Legislative Assembly to appropriate or transfer any principal balance in the foundation aid stabilization fund in excess of 15 percent of the general fund appropriation for state school aid for the most recently completed biennium for the purpose of:

- Making low-interest loans for school construction projects;
- Addressing existing or anticipated unfunded benefit obligations of state retirement funds; or
- Other education-related purposes.

3. A bill [15.0189.03000] to establish a school construction assistance loan fund and a public employee retirement stabilization fund. The school construction assistance loan fund would only be available to be used for low-interest school loans as designated by the Legislative Assembly. The funds in the public employee retirement stabilization fund would be available to offset any unfunded liability of state employees participating in the main retirement plan. The State Investment Board would be responsible for investing moneys in the public employee retirement stabilization fund. The bill includes a contingency that would make the transfers into these funds from the foundation aid stabilization fund effective only upon approval of the resolution by the Legislative Assembly in 2015 and by the voters in June 2016. The bill provides for a transfer of $250 million into the school construction assistance loan fund and a transfer of $200 million into the public employee retirement stabilization fund.

STUDY OF THE PROCESS OF APPROPRIATING STATE AGENCY SALARIES AND WAGES

The committee was assigned a study of the process of appropriating state agency salaries and wages pursuant to Section 38 of 2013 House Bill No. 1015. The study was to include a review of the feasibility and desirability of appropriating a lump sum amount to each agency for salaries and wages, without identifying specific purposes for the funding and allowing the agency head the flexibility to use the funding as necessary to accomplish the duties and responsibilities of the agency, and the effect of this change on the state's classification and benefits system and on the process of reporting by the agency on its use of the funds to the Legislative Assembly.

Current Budget Process for Salaries and Wages

State Agency Budget Requests

The budgeting process for state employee salaries and wages begins during the spring and summer of even-numbered years. State agencies submit their budget requests to OMB. The budget requests include a specific number of full-time equivalent (FTE) positions and the projected salaries of existing employees on July 1 of the following year. The requests may include additions or deletions of FTE positions and related funding changes. The requests are reviewed and adjusted for inclusion in the executive budget recommendation. When the executive budget recommendation is prepared, funding is added to agency budgets for recommended salary and fringe benefit increases. The executive budget may also recommend the addition or deletion of agency FTE positions and related funding.

Appropriation Bills and Line Items

The executive budget recommendation is presented to the Legislative Assembly through the introduction of appropriation bills. The appropriation bills contain line items that provide funding for specific purposes including salaries and wages. The appropriation bills also contain the number of FTE positions an agency is authorized. Most agency appropriation bills include a salaries and wages line item that provides funding for salaries and fringe benefits such as health insurance premiums, retirement contributions, social security taxes, workers' compensation premiums, and unemployment taxes. Funding may also be included in the salaries and wages line item for temporary employee salaries and overtime. Certain agency appropriation bills have line items that are program-based and provide all funding for a program including salaries and benefits, operating expenses, and capital expenses. An example of a program-based appropriation bill is the Department of Corrections and Rehabilitation bill which has line items for adult services and youth services.

After the appropriation bills are introduced, the Legislative Assembly reviews the bills and makes adjustments as desired. Adjustments may be made to the level of salary increases, the number of FTE positions authorized, and any other funding item. Once approved by both chambers of the Legislative Assembly, each bill is delivered to the Governor for signature and becomes effective July 1 following the legislative session unless the bill includes an emergency clause which may provide that certain items or the entire bill becomes effective earlier.

When an agency's appropriation bill becomes effective, the state agency is allowed to expend funds as provided in each line item of the bill for purposes designated by the line item. An agency may also adjust the number of FTE employees under its control up to the number authorized in the bill. An agency may request approval from the Emergency Commission to transfer funds between line items. An agency may also request approval from the Emergency Commission to expend additional federal or other funds received by the agency. Budget Section approval is required for any line item transfer exceeding $50,000 or for an agency to accept federal or other funds in excess of $50,000. Upon recommendation of the Emergency Commission and approval of the Budget Section, an agency may also add FTE positions. However, the approval to add FTE positions is only effective for the remainder of the biennium during which the positions were approved.

Salaries and Wages Appropriations for North Dakota University System Institutions

The appropriations for the North Dakota University System institutions are made in a block grant format. All funding for the operations of an institution, including salaries and benefits, operating expenses, utilities, and other expenses, are appropriated in an operations line item. Each institution has the flexibility to use the operations funding as desired. The State Board of Higher Education also has the authority to adjust the number of authorized FTE positions at each institution as needed subject to the availability of funds.

State Employee Classification System

The Central Personnel System Act was approved by the 1975 Legislative Assembly. The Act created the Central Personnel Division of OMB and the State Personnel Board, which are provided for in Chapter 54-44.3. The purpose of the Central Personnel Division is to establish a unified personnel administration system for classified employees of the state. The purpose of the State Personnel Board is to oversee the development and administration of the classification system. The Central Personnel Division was changed to North Dakota Human Resource Management Services in August 2003 pursuant to 2003 Senate Bill No. 2092.

The Human Resource Management Services Division of OMB has authority to adopt policies, rules, and procedures regarding classification and compensation plans, salary administration, personnel administration actions, and compliance with state or federal law or rule pertaining to merit personnel systems.

The Human Resource Management Services uses a class evaluation system to determine a grade for each classified position. A salary range is assigned for each grade based on a market policy point which is determined based on Job Service North Dakota data, regional state government data, Hay Group compensation database information, and information from a custom survey of 103 benchmark job classes to a broad range of North Dakota employers.

Section 54-44.3-20 provides that all positions within the state are included in the classification system except for positions specifically excluded, including elected officials, employees of the legislative and judicial branches, employees under the control of the State Board of Higher Education, and others.

As of December 2012, state agencies employed 7,167 classified employees with an average employee age of 46.4 years, average years of service of 13.1, and an average annual salary of $48,554. As of December 2012, there were a total of 770 unclassified employees excluding employees of the University System.

Process of Appropriating Salaries and Wages in Other States

Minnesota

Prior to 1993, Minnesota appropriated funding for state employee salaries and wages based on FTE positions similar to the North Dakota process. In 1993 the Minnesota Legislature changed from this process to a lump sum appropriation process. Under the lump sum appropriation process, the Minnesota Legislature discontinued its reference to FTE positions and specific appropriation line items and began appropriating funds by agency or program in total. The intent of the legislature in making this change was to focus more decisionmaking on agency and program performance and outcomes rather than the specific costs of operating the agency or program. According to representatives of the Minnesota Legislature, the focus on performance and outcomes has not occurred as intended when the change was made in 1993.

In Minnesota, rather than having one appropriations committee in each chamber like North Dakota, the 10 to 12 standing committees in each chamber appropriate funds for state agency operations. For example, the higher education standing committee appropriates funding for higher education and the human services committee appropriates funding for human services programs. Each committee may take a different approach regarding the extent to which budget detail is considered as part of developing each agency's budget.

The starting point for determining an agency's funding level for the following budget year is the previous year's appropriation approved by the legislature. The Governor makes budget recommendations that include reference to the number of FTE positions for each agency or program. The Governor includes those recommendations in appropriation bills introduced to the legislature. The committee developing the budget for the agency may choose to use the bill containing the Governor's recommendations or prepare its own bill. The legislature does not include funds in agency budgets specifically for salary increases or health insurance increases. Those items would need to be provided by the agency within the funding approved by the legislature, usually based on an overall percentage increase for the agency or program. Again, the level of detail varies by the committee assigned to develop the agency's budget.

Montana

Montana uses a process similar to North Dakota's for appropriating funds for salaries and wages, including basing the appropriations on FTE positions. Montana does, however, reduce permanent employees' salaries and wages funding by 4 percent for all agencies having more than 20 FTE employees for anticipated savings from vacant positions and employee turnover.

South Dakota

South Dakota uses a process similar to North Dakota's for appropriating funds for salaries and wages, including basing the appropriations on FTE positions. The Governor, in preparing the executive budget recommendation, includes funding for the anticipated salaries and wages, salary increases, health insurance premiums, and other fringe benefits for the authorized number of FTE positions for each agency. Some years, rather than appropriating funds to each agency for salary increases, the funding will be appropriated as a funding pool in the Bureau of Finance and Administration to be allocated to each agency during the fiscal year. The South Dakota Legislature, as part of its review of agency budgets during the session, receives information on each agency's actual salaries and wages expenditures during the previous fiscal year compared to the amount appropriated. The legislature may choose to reduce funding for salaries and wages if the actual expenditures were substantially less than the amounts appropriated.

Iowa

Iowa uses a process similar to North Dakota's for appropriating funds for salaries and wages, including basing the appropriations on FTE positions. However, Iowa does not include funding for salary increases for state employees in each executive branch agency's appropriation. Instead, it appropriates a lump sum amount to the Iowa Department of Management, which is responsible for allocating an appropriate amount to each agency for providing salary increases for state employees in the agency.

New Mexico

Prior to 2014, New Mexico was using a process similar to North Dakota's for appropriating funds for salaries and wages. The funding was based on the number of authorized FTE positions. During its 2014 legislative session, the New Mexico legislature changed its process and discontinued basing salaries and wages funding on the number of FTE positions for all state agencies. This change resulted from legislative concerns with state agencies being authorized FTE positions but not filling the positions, which resulted in the legislature appropriating more funding than necessary for salaries and wages. Because this change was just implemented, the specifics of how future appropriations for salaries and wages has not yet been determined but will likely be based on actual salaries and wages spending of the agency for the current fiscal year and adjusted as necessary for the budget year under consideration.

Nevada

Nevada uses a process similar to North Dakota's for appropriating funds for salaries and wages, including basing the appropriations on FTE positions. Nevada does, however, reduce permanent employees' salaries and wages for each agency by anticipated savings resulting from vacant positions. Salaries and wages funding is reduced by an amount equal to the agency's vacant position savings averaged over the previous three-year period.

Wisconsin

Wisconsin uses a process similar to North Dakota's for appropriating funds for salaries and wages, including basing the appropriations on FTE positions. However, instead of allowing agencies to project their employee salary levels for the first month of the new biennium, Wisconsin appropriates funding for salaries and wages based on actual salary levels being paid at the time the budget request or the executive budget is prepared. This amount is considered the base level funding for salaries and wages and is the amount appropriated to each agency for next fiscal period. The Governor recommends, and the legislature approves, as adjusted, a lump sum amount that is appropriated to the Wisconsin Department of Administration as a funding pool for executive branch agencies containing funding anticipated to be needed for salary increases, health insurance increases, or other salary-related adjustments. This amount is available for transfer to state agencies, upon request, justification, and approval by the Department of Administration for additional salaries and wages funding needed by the agency if the agency is unable to provide adequate funding for its salaries and wages within its base level funding amount. The amounts and reasons for the transfers are reported to the Wisconsin Legislative Fiscal Bureau.

Wyoming

Wyoming uses a process similar to North Dakota's for appropriating funds for salaries and wages, including basing the appropriations on FTE positions. The Governor, in preparing the executive budget recommendation, includes funding for the anticipated salaries and wages and related fringe benefits for the authorized number of FTE positions for each agency. Funding for salary increases is appropriated as funding pools to higher education, the executive branch, the judicial branch, and the legislative branch. During the fiscal year, amounts are allocated to each agency from the pools. The Governor recommends and the legislature determines the pool amounts based on the amounts needed to bring employees' salaries to a specified percentage of the market; therefore, salary increases vary by employee occupation based on market conditions.

Recommendation

The committee makes no recommendations regarding its study of the process of appropriating state agency salaries and wages.

STUDY OF CONTRIBUTIONS TO STATE EMPLOYEE HEALTH INSURANCE PREMIUMS

Pursuant to Section 39 of House Bill No. 1015, the committee was assigned a study of the state contribution to the cost of state employee health insurance premiums, including the feasibility and desirability of establishing a maximum state contribution.

Background Information

Chapter 54-52.1 provides group medical insurance is available to any employee who meets the eligibility requirements of being a permanent employee of the state. To be eligible, an employee must be at least 18 years of age, occupy a regularly funded position, work a minimum of 20 hours per week, and work at least 20 weeks each year. Temporary employees who work a minimum of 20 hours per week and 20 weeks per year may purchase health insurance at their own expense or the employing agency may pay the premium.

The 1963 Legislative Assembly enacted Chapter 52-12 which authorized state agencies, either individually or jointly with other agencies, to enter a group hospitalization and medical care plan and group life insurance plan for each agency's employees. The agencies were required to pay $5 per month for each participating employee's insurance premium. An employee could elect to participate in either a single or family plan. The 1971 Legislative Assembly repealed Chapter 52-12 and enacted Chapter 54-52.1 establishing the uniform group insurance program. The program was placed under the authority of the Public Employees Retirement Board. The board was required to solicit bids and contract for the provision of insurance benefits coverage with an insurance carrier determined by the board.

From 1971 to 1983, Blue Cross Blue Shield of North Dakota provided and administered the health insurance benefits plan for public employees. In 1983 the Retirement Board was authorized by Section 54-52.1-04.2 to establish a plan of self-insurance for providing health benefits coverage under an administrative services-only contract or a third-party administrator contract if the board determined during any biennium that a self-insured plan is less costly than the lowest bid submitted by an insurance carrier. The board exercised the option to implement a self-insurance health benefits plan and administered the program in that manner from July 1, 1983, through June 30, 1989.

Rising health care costs in the state were the primary reason for the cashflow difficulties experienced in the health benefits plan. In the 1985-87 biennium, the Legislative Assembly appropriated funds for a 20 percent premium increase, and claims costs increased 42 percent.

Although the Retirement Board began its administration of the self-insured health benefits plan on July 1, 1983, with reserves of $2,143,880, claim expenditures and other expenses of the program exceeded premium income and other revenue in 1984. By June 1987, the fund balance, as indicated in audited financial statements of the plan, was a negative $4,759,963 with estimated outstanding claims payable of $4,600,000.

In 1987 the Retirement Board incorporated various cost-containment components into the health benefits plan which included:

1. Implementation of a program of concurrent review of inpatient hospitalizations designed to eliminate unnecessary treatment or prolonged hospital stays and to allow consideration of less expensive appropriate treatment for long-term medical care.
2. Implementation of a program of mandatory second surgical opinions for certain elective surgeries. (This program did not generate anticipated results and after a one-year trial period was discontinued.)
3. Expansion of contract deductibles to include all inpatient, outpatient, and physician services.
4. Increase in the coinsurance base from the first $2,000 in charges to the first $4,000 in charges.
5. Implementation of a preferred pharmacy program.
6. Establishment of a separate premium rate for retirees, based on retiree claims experience.
7. Introduction of a $25 copayment for each hospital emergency room visit.
8. Adjustment of the Medicare coordination of benefits formula applied to retiree members of the plan.

Due to the introduction of these cost-containment initiatives and the availability to public employees of a number of attractive health maintenance organization plans, approximately 3,350 membership contracts constituting 23 percent of the total contracts of the health benefits plan were lost during the 1987 open enrollment period, resulting in a decrease of approximately $563,000 per month in premium income.

The decision by the Medcenter One HMO, a health maintenance organization that had the largest PERS eligible enrollment, to discontinue its participation agreement with PERS as of July 1, 1988, and substantial increases in premiums charged by other health maintenance organizations resulted in a substantial number of public employees choosing the PERS health benefits plan during the 1988 open enrollment period.

In January 1989, the Retirement Board voted to end the state-funded health insurance program and buy the coverage from Blue Cross Blue Shield of North Dakota. Officials of PERS predicted the state would end the 1987-89 biennium with a $3.5 million deficit and would need to increase premium rates by 65 percent in 1989-91. The Blue Cross Blue Shield bid of about $35 million to fund state employees' health insurance for the 1989-91 biennium included provisions that the company would absorb about $5 million in unpaid claims when it took over in July 1989.

Senate Bill No. 2026 (1989) appropriated $1.2 million from the fund for unemployment compensation claims to PERS for the state group health program for the period beginning January 1, 1989, and ending June 30, 1991.

Until 1993, the health insurance program charged premiums based on each employee's election of a single or family plan. Beginning in the 1993-95 biennium, the Retirement Board began to charge a combination rate that is a blended rate per employee whether a single or family plan is chosen. The blended rate enables agencies to budget the same premium rate for all employees; therefore, an agency's budget is not adversely affected if an employee electing to receive single health insurance coverage quits and is replaced by an employee electing to receive family coverage. The schedule below shows the premiums charged since the program began in 1963.

Biennium	Single Plan	Percentage Change	Family Plan	Percentage Change	Combination Rate	Percentage Change
1963-65	$5.00		$21.00			
1965-67	$8.55	71.0%	$21.50	2.4%		
1967-69	$10.75	25.7%	$25.00	16.3%		
1969-71	$14.45	34.4%	$34.90	39.6%		
1971-73	$15.95	10.4%	$41.90	20.1%		
1973-75	$14.46	(9.3%)	$41.90	0.0%		
1975-77	$19.50	34.9%	$59.95	43.1%		
1977-79	$25.50	30.8%	$67.42	12.5%		
1979-81	$34.84	36.6%	$87.40	29.6%		
1981-83	$42.68	22.5%	$107.07	22.5%		
1983-85	$50.28	17.8%	$140.28	31.0%		
1985-87	$60.00	19.3%	$168.00	19.8%		
1987-89	$68.28	13.8%	$191.28	13.9%		
1989-91	$99.82	46.2%	$280.39	46.6%		
1991-93	$108.00	8.2%	$304.00	8.4%		
1993-95					$254.00	
1995-97					$265.00	4.3%
1997-99					$301.00	13.6%
1999-2001					$349.72	16.2%
2001-03					$409.09	17.0%
2003-05					$488.70	19.5%
2005-07					$553.95	13.4%
2007-09					$658.08	18.8%
2009-11					$825.66	25.5%
2011-13					$886.62	7.4%
2013-15					$981.69	10.7%

From 1963 through 1969, the state contributed $5 per month toward the cost of health insurance for state employees. State employees paid any additional amount for single or family coverage. During the 1969-71 biennium, the state contributed $7.50 per month. For the period 1973 through 1979, the state paid the cost of a single health insurance plan. Employees choosing a family plan paid any additional cost. Since 1979, the state has paid the full cost of either a single or family plan for eligible state employees.

The schedule below provides information on health insurance premiums and the cost of health insurance increases since the 1997-99 biennium.

Biennium	Monthly Premium	Increase From Previous Biennium	Percentage Increase	General Fund	Special Funds	Total
State Employee Health Insurance Increases (Excluding Higher Education)						
1997-99	$301	$36	13.6%	$7,026,674	$3,619,802	$10,646,476
1999-2001	$350	$49	16.3%	$6,989,537	$3,858,174	$10,847,711
2001-03	$409	$59	16.9%	$11,182,551	$6,001,252	$17,183,803
2003-05	$489	$80	19.6%	$8,027,122	$8,258,216	$16,285,338
2005-07	$554	$65	13.3%	$5,335,798	$7,903,870	$13,239,668
2007-09	$658	$104	18.8%	$9,115,817	$12,346,031	$21,461,848
2009-11	$826	$168	25.5%	$15,889,790	$20,215,824	$36,105,614
2011-13	$887	$61	7.4%	$7,179,809	$5,995,847	$13,175,656
2013-15	$982	$95	10.7%	$11,127,312	$9,700,989	$20,828,301

The committee learned that a PERS consultant is estimating health insurance premium rates to increase by 21 percent during the 2015-17 biennium, from $982 per month to $1,185 per month. Insurance plan reserves may be used to pay for a portion of the increased premiums. Adjustments may also be made to the plan benefits to reduce premium amounts.

High-Deductible Health Plan

Section 54-52.1-18, as enacted by the 2011 Legislative Assembly, requires the Public Employees Retirement Board to develop and implement a high-deductible health plan with a savings account as an alternative to the regular health insurance plan. The section requires the difference between the cost of single and family health plan for state employees to be deposited in a health savings account for the benefit of the participating employee. The high-deductible health plan has higher annual deductibles and larger out-of-pocket costs which are partially offset by the employer contribution to the health savings account. The health savings account is not subject to federal income tax at the time of deposit and funds may be carried over and used in subsequent years. The account is owned by the participant, the state makes contributions to the account, there is no fund balance limit, funds in the account continue into subsequent years if not used, and the account is portable if the employee discontinues employment with the state. The state currently contributes $60.74 per month into the account for employees with a single plan and contributes $147 per month into the account for employees covered under a family plan.

As of April 2013, there were 15,262 state contracts for the regular health insurance benefit, and 122 employees were enrolled in the high-deductible health plan.

Calculation of Health Insurance Premiums

The committee learned during the spring and summer of even-numbered years, PERS begins the process to obtain bids for state employee health insurance policies for the following biennium. Bids are normally returned in August, reviewed by PERS, and then submitted to OMB for inclusion in the executive budget.

Bids received for health insurance premiums generally include several options that may affect the amount of the premium. Options include changes in deductible amounts, coinsurance amounts, copayment amounts, and prescription drug benefits. The health insurance plan may also have reserves that can be used to buy down the cost of premiums.

Health Insurance Premiums Paid by Political Subdivisions

The committee received information regarding health insurance premiums paid by political subdivisions in the state. The percentage of a single plan paid by political subdivisions ranged from 75 to 100 percent. The percentage of a family plan paid by political subdivisions ranged from 41 to 100 percent.

State Employee Health Insurance Premiums Paid by Other States

The committee reviewed a report prepared by NCSL detailing the amount of health insurance premiums paid by other states for state employees during 2012. The report indicated the average monthly cost of a standard individual health insurance policy was $562.69, with the state paying on average $492.50 and the employee paying on average $70.40. The average monthly cost of a family health insurance policy was $1,412.52, with the state paying on average $1,111.74 of the premium and the employee paying on average $300.50.

Federal Affordable Care Act

The committee learned the state health plan is exempt from certain provisions of the federal Affordable Care Act as long as the grandfathered status is continued. The grandfathered status may be lost if certain existing plan benefits are not maintained or if the employer contribution to employees' health insurance premiums is reduced by more than

5 percent from the contribution rate in effect on March 23, 2010. If an employee is required to pay more than 5 percent of a single or family premium rate the state also may lose its grandfathered status.

Estimated Employee Costs Based on Percentage Contributions for Premiums

The committee learned for the 2013-15 biennium, state agencies are charged a blended rate of $981.69 per month for a state employee's health insurance premium. The blended rate is based upon a single health insurance plan rate of $472.74 per month and a family health insurance plan rate of $1,139.34. As of March 2014, there were 3,384 employees with a single plan and 11,687 employees with a family plan. The schedule below details the monthly cost to state employees if they were required to pay a percentage of their health insurance premiums based on 2013-15 biennium premium rates.

Monthly Premium[1]	1 Percent of Premium	2 Percent of Premium	3 Percent of Premium	4 Percent of Premium	5 Percent of Premium
Single plan - $472.74	$4.73	$9.45	$14.18	$18.91	$23.64
Family plan - $1,139.34	$11.39	$22.79	$34.18	$45.57	$56.97

[1]Reflects monthly premiums for the 2013-15 biennium.

The table below details the estimated biennial amounts that would be paid by state employees if they were required to pay a percentage of health insurance premiums based on 2013-15 biennium premium rates.

Estimated Total Biennial Amounts to Be Paid by State Employees for Health Insurance Based on Percentage of Premium Paid

	Number of Plans	1 Percent	2 Percent	3 Percent	4 Percent	5 Percent
Single plan	3,384	$384,152	$767,491	$1,151,643	$1,535,795	$1,919,946
Family plan	11,687	3,194,758	6,392,322	9,587,080	12,781,838	15,979,401
Total	15,071	$3,578,910	$7,159,813	$10,738,723	$14,317,633	$17,899,347

Recommendation

The committee recommends a resolution [15.3018.01000] to continue the study of state employee health insurance premiums, including a review of the feasibility and desirability of the state health plan retaining its grandfathered status under the federal Affordable Care Act.

STUDY OF THE PURCHASE OF THE RESEARCH ENTERPRISE AND COMMERCIALIZATION BUILDING ON THE CAMPUS OF THE UNIVERSITY OF NORTH DAKOTA

Pursuant to the directive of the Chairman of the Legislative Management, the committee was assigned a study of State Board of Higher Education activities relating to any agreement or financing associated with the purchase of the Research Enterprise and Commercialization (REAC) building from the University of North Dakota (UND) Research Foundation. As part of the study, the committee was to review the following:

- Proposed use or obligation of state or other funding for which the state was not legally obligated to pay;
- The manner in which the negotiations to purchase the building complied with legislative intent and how the interests of taxpayers were weighed against the interest of the creditors; and
- The effect of the provisions of the State Board of Higher Education's ground lease with the foundation on the disposition of the building if the building was not purchased by the State Board of Higher Education.

Background

In November 2006, UND entered a ground lease with the UND Research Foundation to lease approximately 45,000 square feet of state-owned land to the foundation for the construction of the REAC building. Section 54-01-27 allows state agencies or institutions to enter agreements to lease real property owned by the state to private entities. The UND Research Foundation, which is registered with the Secretary of State as a private nonprofit entity, obtained financing for the building, and construction began in 2008 and was completed in 2009.

The 2013 Legislative Assembly through Section 23 of Senate Bill No. 2003 authorized the State Board of Higher Education to enter agreements to purchase the REAC building from the UND Research Foundation and enter agreements to finance the purchase. The section further requires the State Board of Higher Education to provide a report to the Budget Section regarding the purchase of the building.

Building History and Construction

The committee learned the previous President of UND undertook a project to increase research and commercialization facilities on the campus. A nonprofit research foundation was formed to generate financial support and partners for the construction of a building on campus. The research foundation obtained financing for the building which was eventually constructed. However, soon after construction was complete, an economic downturn reduced the market demand for the type of facilities included in the building and the foundation experienced financial difficulties.

The committee learned the cost to construct the REAC building was $17,114,539 and research equipment and furniture for the building cost an additional $1,780,656. The following schedule details the sources of the funding for the project:

REAC Building - Sources of Funds for Construction and Equipment	
Federal Economic Development Administration grant	$1,499,621
Centers of excellence project funding	3,557,547
Department of Commerce (centers of excellence funding)	1,493,664
City of Grand Forks	500,000
Department of Energy and centers of excellence	1,079,451
Loans	10,000,000
Total	$18,130,283

The schedule below details liabilities incurred by the UND Research Foundation to construct the building.

UND Research Foundation - Liabilities Incurred to Construct the REAC Building	
Bremer Bank - Construction loan	$6,250,000
Bremer Bank - Working capital loan	250,000
North Dakota Development Fund	1,000,000
Tax-exempt bond issued through Grand Forks County	2,500,000
Capital leases for furniture	494,141
Total	$10,494,141

As of December 31, 2012, the UND Research Foundation had total liabilities of $9,612,945. The foundation currently has no liabilities due to UND assuming the liabilities associated with the building.

Provisions of Ground Lease

The committee reviewed the ground lease of state land between the State Board of Higher Education (acting through UND) and the UND Research Foundation. The ground lease agreement for the REAC building provided for the following:

- The foundation had the right to obtain a loan secured by the facility but was prohibited from encumbering the land.
- A lender with a security interest in the building could assume possession of the building, but only subject to the terms of the lease to which the foundation was bound and subject to the approval of the State Board of Higher Education and UND.
- If the foundation or an assignee lender had defaulted on terms of the lease or if any of the conditions were present to allow UND to exercise its right to immediately terminate the lease, UND would have had the right to demand that the building be removed from the property or could have negotiated other terms with the lender.

The committee learned there are no statutory provisions that specifically address the construction of a building by a private party on land leased from the state. The original ground lease between UND and the UND Research Foundation was terminated when UND purchased the REAC building on September 16, 2013.

Building Research and Office Space

The committee learned the REAC building contains 31,982 rentable square feet, of which 14,263 square feet are currently leased to private entities and 3,436 square feet are occupied by the UND School of Medicine and Health Sciences. A $1.5 million federal Economic Development Administration grant was used for a portion of the building construction costs. A requirement of receiving the federal Economic Development Administration grant funds is that the facility be used for economic development purposes, including the growth and development of technology-based companies focusing on life sciences and advanced engineering. Due to the grant, a maximum of 20 percent of leasable space in the building may be used for offices. Repayment of the grant would remove the space use restrictions on the building.

The committee reviewed the following schedule detailing the amount of space leased in the REAC building for fiscal years 2009 through 2013 and the related lease income:

Fiscal Year	Square Feet Leased	Lease Income
2009[1]	17,964	$252,049
2010	17,964	$547,693
2011	30,893[2]	$1,039,706
2012	30,893[2]	$1,774,209
2013	22,066	$604,022

[1]The facility was first occupied in January 2009.

[2]Includes 10,502 square feet leased by UND in fiscal year 2011 and 9,262 square feet leased by UND in fiscal year 2012. The space was leased pursuant to an agreement between UND and the UND Research Foundation.

As of July 2014 the building occupancy rate is above 60 percent. Approximately 10 percent of leasable space in the REAC building is unfinished. The space is being left unfinished to allow potential lessees the opportunity to customize the space for their needs.

The committee learned UND has provided the following lease and support payments to the UND Research Foundation since 2009:

Lease agreement payment made in fiscal year 2011	$335,000
Lease agreement payment made in fiscal year 2012	1,441,374
Support payment made in fiscal year 2013	250,000
Total	$2,026,374

Financing of Building Purchase

The committee learned UND issued a request for proposal on July 2, 2013, for a loan to purchase the REAC building. On September 12, 2013, Bremer Bank and UND entered into a contract for Bremer to provide UND with a $9.8 million loan to purchase the REAC building. The contract specified the loan term is for 20 years at a 5.38 percent interest rate. The purchase of the building took place on September 16, 2013.

University System Foundations

The committee learned there are more than 20 foundations that exist for the support of University System institutions. State Board of Higher Education policy requires each institution to have an agreement in place with an institution foundation that specifies several items, including services provided by each entity, accounting requirements, government functions delegated to the foundation, and reporting relationships for shared employees.

The committee learned several institution foundations have obtained loans for capital and other projects. There are approximately 30 projects at nine institutions that required a foundation to obtain a loan.

Recommendation

The committee makes no recommendations regarding its study of the purchase of the Research Enterprise and Commercialization Building on the campus of UND.

STATE BUDGET INFORMATION

The Chairman of the Legislative Management assigned the committee various budget-related duties, including monitoring state revenues and expenses, receiving updated general fund revenue forecasts, reviewing the status of major state funds, and receiving information regarding state agency budgets and cost-to-continue items.

Status of the General Fund and Selected Special Funds

The committee received updates regarding the status of the general fund and selected special funds. The following is a summary of original and revised 2013-15 biennium general fund and selected special fund ending balance estimates:

Fund	Actual Balance - June 30, 2013	Estimated Balance - June 30, 2015 (Legislative Forecast)	Estimated Balance - June 30, 2015 (Preliminary Revised Forecast)
General fund	$1,396,059,186	$87,043,928	$583,594,519[1]
Budget stabilization fund	$583,545,799	$583,545,799	$583,545,799
Legacy fund	$1,314,842,496	$3,096,602,513	$3,823,919,403
Foundation aid stabilization fund	$335,364,942	$615,436,791	$710,975,584
Property tax relief fund	$341,790,000	$657,000,000	$657,000,000

[1]Does not reflect any potential transfers at the end of the 2011-13 biennium from the general fund to the budget stabilization fund pursuant to Chapter 54-27.2.

2015-17 Biennium Preliminary General Fund Revenue Forecast

The committee received information regarding the revised general fund revenue forecast for the 2013-15 biennium and the preliminary 2015-17 biennium general fund revenue forecast. The following schedule compares the forecasts:

General Fund Revenue Forecasts					
	2013-15 Biennium			2015-17 Biennium	
Tax Type	2013-15 Biennium Legislative Estimates	Revised 2013-15 Biennium Forecast	Difference	2015-17 Biennium Preliminary Forecast	Difference From 2013-15 Biennium Revised Forecast
Sales and use	$2,472,947,500	$2,469,840,100	($3,107,400)	$2,667,659,000	$197,818,900
Motor vehicle excise	323,123,500	289,673,958	(33,449,542)	349,409,000	59,735,042
Individual income	797,654,355	1,032,509,203	234,854,848	1,060,828,000	28,318,797
Corporate income	377,739,645	456,823,247	79,083,602	470,489,000	13,665,753
Insurance premium	73,352,976	81,593,441	8,240,465	77,600,000	(3,993,441)
Financial institutions	0	(4,871,446)	(4,871,446)	0	4,871,446
Oil and gas production	133,834,002	146,071,108	12,237,106	133,834,000	(12,237,108)
Oil and gas extraction	166,165,998	153,928,892	(12,237,106)	166,166,000	12,237,108
Gaming	8,174,696	7,497,781	(676,915)	7,000,000	(497,781)
Cigarette and tobacco	57,953,000	59,567,291	1,614,291	61,560,000	1,992,709
Wholesale liquor	19,142,000	18,518,019	(623,981)	18,867,000	348,981
Coal conversion	39,300,000	38,875,236	(424,764)	39,578,000	702,764
Mineral leasing fees	19,000,000	28,448,054	9,448,054	19,000,000	(9,448,054)
Departmental collections	74,394,098	80,669,034	6,274,936	80,600,000	(69,034)
Interest	32,666,716	21,669,430	(10,997,286)	21,600,000	(69,430)
Total	$4,595,448,486	$4,880,813,348	$285,364,862	$5,174,190,000	$293,376,652

Oil and Gas Tax Allocations

The committee reviewed the following schedule detailing the August 2014 revised estimate of allocations of oil and gas production and oil extraction taxes for the 2013-15 biennium and the preliminary estimate for the 2015-17 biennium.

Estimated Allocations of Oil and Gas Production and Oil Extraction Taxes			
	2013-15 Biennium	2015-17 Biennium	Difference
General fund	$300,000,000	$300,000,000	$0
Legacy fund	2,454,395,777	3,186,498,242	732,102,465
Property tax relief fund	341,790,000	341,790,000	0
Strategic investment and improvements fund	1,289,798,492	2,019,825,077	730,026,585
Political subdivisions	776,469,055	967,489,008	191,019,953
Tribal allocations	513,309,913	583,200,000	69,890,087
Foundation aid stabilization fund	375,610,642	517,915,350	142,304,708
Common schools trust fund	375,610,642	517,915,350	142,304,708
Resources trust fund	747,021,283	1,031,630,700	284,609,417
Oil and gas impact grant fund	240,000,000	240,000,000	0
State disaster fund	22,000,000	22,000,000	0
North Dakota outdoor heritage fund	23,790,719	29,577,773	5,787,054
Renewable energy development fund	3,000,000	3,000,000	0
Energy conservation fund	1,200,000	1,200,000	0
Well plugging and site reclamation fund	10,000,000	10,000,000	0
Oil and gas research fund	10,000,000	10,000,000	0
Total	$7,483,996,523	$9,782,041,500	$2,298,044,977

The oil and gas tax allocations for the 2015-17 biennium are based on an average daily oil price of $90 per barrel and average daily oil production ranging from 1.3 million to 1.4 million barrels.

Oil and Gas Information

The committee received information regarding oil and gas development in the state. The committee learned the first phase of drilling in the Bakken Formation is nearing completion while the second phase of drilling will take approximately 20 years. Approximately 2,000 wells per year are expected to be drilled in western North Dakota. There are currently 15,097 active producing wells in the state and the number of active wells may increase to 60,000 by the year 2035. The operation of 185 drilling rigs generates approximately 22,000 temporary drilling jobs and another 13,000 temporary jobs building infrastructure.

The committee learned oil spacing units and well pads are being designed to drill multiple wells. The Bakken and Three Forks Formations contain several layers and up to four different wells may be drilled into a layer. Up to 20 wells may be drilled on a typical 1,280-acre spacing unit. Current oil development technology allows a well to extract approximately 4 to 12 percent of the oil in the Bakken formation. However, oil producers are conducting pilot projects which may allow for up to 24 percent of oil to be recovered.

The committee learned pipeline infrastructure to transport oil and gas has expanded which is reducing the amount of truck traffic in oil and gas development areas. Oil companies are also working to expand natural gas gathering lines which will decrease the amount of natural gas flared at oil wells. The Industrial Commission recently approved rules to reduce gas flaring to 26 percent beginning October 2014.

The committee learned it is difficult to predict the price of oil produced in North Dakota. Additional pipeline and rail transportation options are increasing the number of available markets for North Dakota oil. However, some major markets are experiencing excess inventories of sweet crude oil which may lead to weak crude oil prices in the future. The required price per barrel of oil for a well to be profitable can significantly vary by county. For a well to be profitable in Divide County, the price of oil needs to be at least $85 per barrel while the breakeven point in McKenzie County is $28 per barrel.

The committee learned that based on average daily oil production of 1.3 million to 1.4 million barrels, a one dollar change in the average daily oil price results in a change in biennial oil tax collections of $106.4 million. Based on an average daily oil price of $80 per barrel, a 100,000-barrel change in the average daily oil production results in a biennial change in oil tax collections of $630.7 million.

Transportation Information

The committee received an update on transportation issues. The committee learned the 2013 Legislative Assembly appropriated $620 million of funding from the general fund with an emergency clause to allow the Department of Transportation to begin road projects immediately. Some of the projects this funding is being used for include a four-lane road project near Watford City and Alexander, highway bypasses at Williston and Watford City, and improvements to other state roadways in areas affected by energy development.

The committee reviewed the following schedule detailing 2013-15 biennium funding for road construction projects:

2013-15 Biennium Road Construction Funding (Amounts Shown in Millions)

	Western North Dakota	Central and Eastern North Dakota	Total
State funding for state highway projects	$1,161.6		$1,161.6
Statewide transportation improvement program (federal funds, state matching funds, local matching funds)	148.8	$450.0	598.8
Federal funding for emergency relief projects (carryover over 2011-13 biennium)	31.1	77.0	108.1
State funds for transportation funding distributions to non-oil-producing political subdivisions		100.0	100.0
State funds for non-oil-producing county roadway projects		120.0	120.0
State funds for oil-producing county roadway projects	160.0		160.0
State funds for oil-impacted township roads	8.8		8.8
Total	$1,510.3	$747.0	$2,257.3

The committee received an update on transportation funding estimates for the 2015-17 biennium. The estimated amount of federal highway funding to be received by the Department of Transportation in the 2015-17 biennium is uncertain because Congress has not yet approved an appropriation bill to distribute federal highway funds to states. The state has been receiving approximately $240 million of federal highway construction funding each year. State motor vehicle fuels taxes and motor vehicle registration fee collections have been increasing during the past several bienniums. However, the department expects the growth in collections to stabilize during the 2015-17 biennium.

Housing Incentive Fund

The committee received an update on the housing incentive fund. The committee learned the fund was established to assist in the development of affordable multifamily rental housing units to be occupied by essential service workers and low- to moderate-income level families. For the 2013-15 biennium, the fund consists of $15.4 million of general fund appropriations and up to $20 million of contributions from private entities. Private entities are eligible to receive an income tax credit for any amounts contributed to the fund.

Funds were awarded during two separate application periods in 2013. During the first round of applications, a total of 18 projects received support totaling $20.4 million. One project that was awarded $1.5 million in funds was discontinued; therefore, the funding was reallocated during the second round of applications. During the second round of applications, a total of 16 projects were awarded support totaling $16.5 million.

Department of Human Services Budget Information

The committee received updates on the Department of Human Services budget. The committee learned the department anticipates receiving all budgeted federal funding during the 2013-15 biennium and does not anticipate any major federal fund variances for the 2015-17 biennium. Major budget issues for department for the 2015-17 biennium include costs-to-continue Medicaid grants, workforce issues, and Medicaid Expansion.

The committee learned approximately 13,000 individuals are enrolled in Medicaid Expansion. Preliminary data indicates most enrollees are adults with children and most enrollees live in rural areas. The department estimated that 20,500 individuals would become eligible under Medicaid Expansion. The department is providing information to the public regarding the expanded Medicaid program through the department's website, public service announcements, and partnerships with other agencies, such as the Indian Affairs Commission.

Department of Public Instruction Budget Information

The committee received information regarding the budget of the Department of Public Instruction. The committee learned 13.6 percent of the department's $2.16 billion budget is federal funds. The department anticipates receiving all of the federal funds included in its 2013-15 budget.

The committee received information regarding state school aid payments. The committee learned the total 2013-15 biennial appropriation for state school aid was in excess of $1.8 billion. The department anticipates $19.8 million of this amount will not be spent.

The committee learned that after a decline by 25,000 students over a 15-year period ending in 2010, statewide projections show moderate enrollment increases over the next decade. Enrollment is estimated to increase by 3,500 students annually during the next biennium. The department estimates an additional $275 million will be needed for state school aid for the 2015-17 biennium relating to costs to continue, anticipated per student payment increases, and the increased projected enrollment. Of this amount, the state share would be approximately $200 million. The enrollment is expected to remain steady or increase in North Dakota's major cities' school districts, while enrollment in many of the small rural school districts is expected to experience declines.

University System Budget Information

The committee received an update on the 2015-17 biennium general fund budget request for the University System. The committee learned the University System will be requesting approximately $27 million for cost-to-continue items, $49 million to be distributed through the higher education funding formula based on completed student credit-hours, and 2015-17 biennium salary and benefit increases consistent with the executive budget recommendation. The University System is also requesting $203 million for capital projects, $32 million for increased extraordinary repairs base funding, and $20 million for deferred maintenance.

Common Schools Trust Fund

The committee received information regarding the common schools trust fund. The committee learned the federal Enabling Act of 1889 granted 2.5 million acres of land to the state for support of common (public) schools. The Enabling Act requires proceeds from the sale of the land to be placed in a permanent school fund, and interest from the fund is to be used to support common schools. Approximately 668,000 acres of land were also granted to the state for the benefit of other public institutions. Other revenue sources for the common schools trust fund include mineral royalties, a percentage of oil extraction taxes, tobacco settlement proceeds, and investment gains or losses.

The common schools trust fund currently consists of 635,000 acres of surface lands, 1.5 million acres of mineral rights, and approximately $3 billion of investment assets. The investment assets are estimated to increase to $4.4 billion by the 2017-19 biennium. Biennial distributions to common schools are in an amount equal to 10 percent of the five-year average value of investment assets of the fund. Approximately $130.3 million will be distributed from the fund during the 2013-15 biennium, and distributions during the 2015-17 biennium are estimated to be $204.3 million.

OTHER INFORMATION RECEIVED

The committee received other comments regarding the committee's assigned studies and other information regarding:

- Oil and gas impact grants.
- Agriculture commodity prices and farm incomes.
- The child support lien registry.

- The use of temporary positions by state agencies.
- Budget issues for the Department of Corrections and Rehabilitation.
- The resources trust fund.
- Budget request extensions granted by OMB.
- Legislative Council reports including the *2013-15 Biennium Report on Compliance with Legislative Intent*, the June 2014 *Analysis of Major State Trust Funds*, the 2015-17 Biennium Preliminary General Fund Budget Outlook, and updated *Budget and Fiscal Trends*.