

# MICROFILM DIVIDER

OMB/RECORDS MANAGEMENT DIVISION

SFN 2053 (2/85) 5M



ROLL NUMBER

DESCRIPTION

1443

2005 HOUSE FINANCE AND TAXATION

HB 1443

2005 HOUSE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. **HB 1443**

House Finance and Taxation Committee

Conference Committee

Hearing Date **February 2, 2005**

Tape Number	Side A	Side B	Meter #
1	X		0.8
Committee Clerk Signature <i>Jamie Stein</i>			

Minutes:

**REP. RICK BERG, FARGO** Introduced the bill. This bill is part of the governor's budget package. The appropriations committee took some of those issues out of that budget. The purpose to have this before this committee, Jim Smith, is here to give you a brief history on the oil and gas permanent fund, but the purpose is how we set up the oil and gas fund and how it is working, and do we want to change how we use it in the future. Gave a background history to the 80's, stating we had high oil prices, and when we went into a legislative session and projected thirty five dollars a barrel, up from about fifteen, then all that projected revenue was appropriated by the legislature. Then we got into the interium, and oil went back down to twenty dollars and fifteen dollars a barrel, and we were forced to have an across the board cut to state spending. In my opinion, the reason we set this fund up, it is a little bit backwards, what it says that the first seventy one million will go into the general fund, everything above that will stay in this permanent oil tax fund. It will defer that money every two years, so that every session, we are

using seventy one million as revenue from oil. From my personal perspective, it was to have a stable budget line from oil revenue, then if we did have a spike, we wouldn't all of a sudden, increase our spending for the next twenty years, because of one spike, but would be able to see what actually did come in and then be thoughtful when we move into the next legislative session on how we want to appropriate that money.

**JIM SMITH, LEGISLATIVE BUDGET ANALYST, LEGISLATIVE COUNCIL STAFF,**

Gave an explanation of the permanent oil tax trust fund. See attached copy of analysis.

**REP. BELTER** Currently, everything above seventy one million goes into the permanent trust fund?

**JIM SMITH** That is correct, based on current law.

**REP. CONRAD** Does that mean we are going to have another bill?

**JIM SMITH** I think it is in the original bill HB 1015, which is the OMB appropriation bill.

**REP. BELTER** This move will actually take money out of the oil fund and puts it into the general fund.

**JIM SMITH** On a contingent basis.

**REP. WEILER** If in a biennium, let's say there is eighty four million in this trust fund, seventy one is going into the general fund, that other thirteen million, theoretically, could stay there, can that be touched?

**JIM SMITH** Any amount that goes into the permanent oil trust fund, (couldn't understand)

**PAM SHARP, DIRECTOR OF THE OFFICE OF MANAGEMENT & BUDGET**

Testified in support of the bill. See attached written testimony.

**REP. CONRAD** Yesterday, you said it was a philosophical difference, can you tell me your philosophy about using this instead of the other fund?

**PAM SHARP** I think what Lieutenant Governor Dalrymple said yesterday, is that it really probably doesn't matter what the name of the fund is, that you have the reserve in, as long as you have it reserved. This biennium, this permanent oil tax trust fund reserve does build up to a substantial amount of money. We have estimated for a little over forty million, the price of oil is actually higher than what we have in the revenue forecast. It is very likely that it will be more than forty one or forty two million dollars. Our philosophy is that it is a fund that is available and a good purpose for this fund would be a contingent fund.

**REP. DROVDAL** When this fund was established back in 1997, there was a good purpose for it, and that purpose was to stabilize the oil and gas prices. We are going away from that in broadening the purpose, by not stabilizing the general budget, and not necessarily worry about oil and gas prices, that we are going to actually end up with no fund, is what we are going to do.

**PAM SHARP** I don't believe there is a stated purpose in the statute in the use of the money. I don't recall if there was legislative intent behind that

**REP. DROVDAL** I can't believe that there wasn't legislative intent behind it, when this was put in. Maybe Mr. Smith could address that issue.

**JIM SMITH** Answered Rep. Drovdal's question, stating, the section just basically, talks about the transfer of the excess oil money into this permanent oil trust fund, the interest goes to the general fund. There is language that says the principal may be spent only by two thirds vote of each house. The statute itself, doesn't have any reference to use of the money.

**REP. BELTER** The way this bill reads then, if there is a shortfall, the entire amount in that oil trust fund, could be used.

**JIM SMITH** Right, plus there could be allotments.

**REP. WRANGHAM** Are there other trust funds that are built in to transfer to the general fund, or just this one?

**PAM SHARP** In the governor's budget, we have this is the only contingent one. There was a hearing on transferring funds, a health care trust fund, which takes fifteen million dollars from the health care trust fund and transfers it into the general fund. The only other transfers from the funds to the general fund, is the minerals trust, which is an ongoing transfer, which occurs every biennium. This transfer will only occur in the event of a revenue shortfall.

**REP. WEILER** Referred to the handout Jim Smith submitted, the forty one million, six hundred forty seven thousand ending fund balance for the 03-05 biennium, that is a beginning balance in the 05-07 biennium, is that the same forty one million dollars that, yesterday, when you were here on HB 1444, there were reserves proposed by the governor's budget of ten million ending balance, forty one million permanent - then the bill that is front of us will transfer forty one million into the general fund?

**PAM SHARP** If there were a revenue shortfall, you could take any money available in the permanent oil & tax trust fund, up to the amount of the revenue shortfall, to replenish the general fund.

**REP. BELTER** If you would so choose, you could do the allotment first, before you tapped into this fund?

**PAM SHARP** That is correct.

**REP. DROVDAL** As Rep. Berg mentioned earlier, this tax goes back to the 80's, when we had oil money coming in in larger quantities than we expected, and we spent every dime of it, then all of a sudden there was a downturn in oil activity and prices, and we had a revenue shortfall, then we had to come in with all kinds of new taxes to cover that, which the people referred, this whole bill came out of that so we would have a better philosophy, we all agreed that was not a good way to do it, this trust fund was actually put in to avoid that. As I look at this with HB 1015 coming through, we keep raising the amount that goes to the general fund up to the amount that is coming in, aren't we going back to the same philosophy we had when we were having trouble in the early 80's?

**PAM SHARP** I think this permanent oil tax trust fund, does act like a stabilizer for the general fund. Its revenues go down whether it is a result of the oil prices going down, or the result of something else, there is money available in the permanent oil tax trust fund. That is what we are proposing using it for. That is another discussion about raising the cap.

**REP. WEILER** If the oil prices drop, there won't be even the seventy one million in there, let alone money over and above the seventy one.

**PAM SHARP** So far, this biennium, we have already achieved the seventy one million dollars going into the general fund, and almost eight million, as of the end of December, has been reserved. All of the collections that normally, would have gone into the general fund, will go into the permanent tax trust fund.

**REP. BELTER** You did say this biennium, over eight million has gone into the trust fund?

**PAM SHARP** It hasn't gone into the trust fund yet, because transfer is not made until the end of the biennium, but it is reserved for deposit.

**ERIC HARDMEYER, PRESIDENT OF THE BANK OF NORTH DAKOTA** Testified in a

neutral position. See attached written testimony. Part of the testimony related to the Bank of North Dakota Financial Highlights. Second part of the testimony related to transfer of funds.

**REP. BELTER** What is the modest increase in interest rates, will that be a positive impact to your bank, or how would you read that?

**ERIC HARDMEYER** Income did grow last year, for the bank, about two and a half million dollars from 2003, what we saw there, the biggest chunk, was our ability to restructure our liabilities and had some expensive deposits, or debts that ran out, and were able to replace that with lower cost instruments. That was really not a function of rates going up, it was just an ability of replacing higher debt with lower debt costs. As we look into 2005, we look for a potential of higher interest rates, that will have a positive effect on the Bank of North Dakota.

**REP. SCHMIDT** Pam stated this eight million dollars which can't be transferred into the oil tax trust fund until the end of the biennium, I assume it is now invested, so when it transfers, do you go to a different investment?

**PAM SHARP** All of the general fund money has to be invested at the Bank of North Dakota, so that money is in the bank right now earning interest, and when it is transferred to the permanent oil tax trust fund, it will still be in the Bank of North Dakota, still earning interest.

With no further testimony, the hearing was closed.

2005 HOUSE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. **HB 1443**

House Finance and Taxation Committee

Conference Committee

Hearing Date **February 7, 2005**

Tape Number	Side A	Side B	Meter #
<b>1</b>	<b>X</b>		<b>14</b>
Committee Clerk Signature			

Minutes:

**COMMITTEE ACTION**

**REP. DROVDAL** Gave some history of what happened earlier in the 80's before the budget stabilization fund was created. We are now in the same situation in the oil industry as we were then, and I think that stabilization fund had a purpose and I think we still need it.

**REP. DROVDAL** Made a motion for a **do not pass**.

**REP. GRANDE** Second the motion. **Motion carried.**

**14 yes      0 no      0 absent**

**REP. DROVDAL** Was given the floor assignment.

Date: 2-7-05  
Roll Call Vote #: 1

2005 HOUSE STANDING COMMITTEE ROLL CALL VOTES  
BILL/RESOLUTION NO. HB 1443

House FINANCE & TAXATION Committee

Check here for Conference Committee

Legislative Council Amendment Number \_\_\_\_\_

Action Taken

Do Not Pass

Motion Made By

Rep. Drovdal

Seconded By

Rep. Grande

Representatives	Yes	No	Representatives	Yes	No
BELTER, WES, CHAIRMAN	✓				
DROVDAL, DAVID, V-CHAIR	✓				
BRANDENBURG, MICHAEL	✓				
CONRAD, KARI	✓				
FROELICH, ROD	✓				
GRANDE, BETTE	✓				
HEADLAND, CRAIG	✓				
IVERSON, RONALD	✓				
KELSH, SCOT	✓				
NICHOLAS, EUGENE	✓				
OWENS, MARK	✓				
SCHMIDT, ARLO	✓				
WEILER, DAVE	✓				
WRANGHAM, DWIGHT	✓				

Total (Yes) 14 No 0

Absent 0

Floor Assignment Rep. Drovdal

If the vote is on an amendment, briefly indicate intent:

**REPORT OF STANDING COMMITTEE (410)**  
February 7, 2005 11:46 a.m.

**Module No: HR-24-1967**  
**Carrier: Drovdal**  
**Insert LC: . Title: .**

**REPORT OF STANDING COMMITTEE**

**HB 1443: Finance and Taxation Committee (Rep. Belter, Chairman) recommends DO NOT PASS (14 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING). HB 1443 was placed on the Eleventh order on the calendar.**

**2005 TESTIMONY**

HB 1443

**ANALYSIS OF THE PERMANENT OIL TAX TRUST FUND 2003-05 AND 2005-07 BIENNIUMS  
(REFLECTING THE 2005-07 BIENNIUM EXECUTIVE BUDGET RECOMMENDATIONS)**

	2003-05 Biennium	2005-07 Biennium
Beginning balance	\$12,800,761	\$41,647,158
Add estimated revenues		
Oil and gas production tax and oil extraction tax collections	<u>\$40,756,397</u>	<u>\$0</u>
Total estimated revenues	<u>40,756,397<sup>1</sup></u>	<u>0<sup>2</sup></u>
Total available	\$53,557,158	\$41,647,158
Less estimated expenditures		
Transfer to the general fund (Section 6 of 2003 Senate Bill No. 2015)	<u>\$11,910,000</u>	<u>0</u>
Total estimated expenditures	<u>\$11,910,000</u>	<u>\$0<sup>3</sup></u>
Ending balance	<u>\$41,647,158</u>	<u>\$41,647,158</u>

**NOTE:** North Dakota Century Code (NDCC) Section 57-51.1-07.2 (1997 Senate Bill No. 2366) establishes a permanent oil tax trust fund and provides that at the end of each biennium beginning after June 30, 1997, all revenues deposited in the general fund during that biennium and derived from taxes imposed on oil and gas under Chapters 57-51 (Oil and Gas Gross Production Tax) and 57-51.1 (Oil Extraction Tax) which exceed \$71 million are to be transferred into the permanent oil tax trust fund. The State Treasurer is to transfer the interest earned on the fund to the general fund at the end of each fiscal year. The principal may only be spent upon a two-thirds vote of the members elected to each house of the Legislative Assembly.

<sup>1</sup>Estimated revenues - 2003-05 - The revised December 2004 revenue forecast for the 2003-05 biennium projects state oil and gas production tax and oil extraction tax revenues to exceed \$71 million by \$40.8 million; therefore, there is a projected transfer of \$40.8 million to the permanent oil tax trust fund at the end of the biennium.

<sup>2</sup>Estimated revenues - 2005-07 - The executive budget recommends amending NDCC Section 57-51.1-07.2 (in Section 18 of House Bill No. 1015 (2005)) to increase from \$71 million to \$84.5 million the general fund portion of oil extraction tax and oil and gas gross production tax. The executive revenue forecast estimates that oil tax collections during the 2005-07 biennium will total \$84.3 million. Therefore, the executive budget does not anticipate any transfers to the permanent oil tax trust fund during the 2005-07 biennium.

<sup>3</sup>Estimated expenditures - 2005-07 - The executive budget recommends a contingent transfer from the permanent oil tax trust fund and the Bank of North Dakota to the state general fund. Section 13 of House Bill No. 1015 (2005) provides that if during the 2005-07 biennium, the director of the Office of Management and Budget determines through revised projections that general fund revenue collections will not meet the revenues as forecast in the March 2005 legislative forecast, the director may transfer funds, up to the amount of the projected shortfall, from the permanent oil tax trust fund to the general fund, and if additional funds are required, the Industrial Commission shall transfer an additional amount of up to \$10 million from the earnings and accumulated and undivided profits of the Bank of North Dakota to the general fund.

**Testimony on HB 1443**  
**Pam Sharp**  
**Office of Management and Budget**  
**February 2, 2005**

My name is Pam Sharp and I am the Director of the Office of Management and Budget.

House Bill 1443 was originally in House Bill 1015, OMB's appropriation bill, but was made into a separate bill by this committee.

This bill provides for contingent transfers to the general fund in the case of a revenue shortfall. If a revenue shortfall occurs, the first contingent transfer would come from the permanent oil tax trust fund. If additional funds are needed after a transfer from the permanent oil tax trust fund, an additional transfer of up to \$10 million could come from the Bank of North Dakota. Any transfer from the Bank of North Dakota could not reduce the Bank's capital structure below \$150 million.

The director of the Office of Management and Budget could determine what portion of a revenue shortfall would be covered by transfers and what portion would be covered by an allotment.

**TESTIMONY TO THE  
HOUSE FINANCE AND TAXATION COMMITTEE**

**February 2, 2005**

**HOUSE BILL 1443**

**ERIC HARDMEYER - BANK OF NORTH DAKOTA**

	<b>BND Financial Highlights (millions)</b>				
	<u>2001</u>	<u>2002</u>	<u>2003</u>	Unaudited <u>2004</u>	Projected <u>2005</u>
Assets	\$2,107	\$1,974	\$1,953	\$2,015	\$2,000
Loans	\$1,276	\$1,330	\$1,392	\$1,456	\$1,506
Capital Ratio	\$ 170 8.07%	\$ 149 7.55%	\$ 153 7.83%	\$ 153 7.75%	\$ 160 8.00%
Income ROE	\$33.1 19.5%	\$32.2 21.6%	\$31.7 20.7%	\$34.2 22.4%	\$35.0 21.9%

Assets have remained fairly constant over the last four years, although loan volume has increased each year. The loan portfolio is diversified into four main categories: business, agriculture, student loans, and residential. The breakdown is as follows: business - \$480 million, agriculture - \$236 million, student loans - \$417 million, and residential - \$322 million. Additionally over the last three years, the Bank has sold over \$134 million in loans to the Student Loan Trust.

BND capital or equity has dropped from \$170 million in 2001 to current levels of \$153 million. This is attributed to the one time transfer of \$18 million to assist with the budget shortfall in the 2001-03 biennium. For the last five biennium's, the Bank has transferred to the general fund nearly \$270 million, making it the fifth largest source of revenue to the state.

The Bank of North Dakota is adequately capitalized at 7.75%. According to Federal Reserve regulations, to qualify as "well-capitalized", a financial institution must have at least 5% capital. A nation-wide comparison for banks of similar size is 8.16%, while the North Dakota average for all banks is 9.96%. Our internal goal is for BND to have equity of 8%.

Earnings have been consistent over the last four years, with BND achieving a record profit in 2004 of \$34.2 million (unaudited at this point). Earnings over the current biennium will be approximately \$67 million, allowing BND to grow capital by \$7 million after the general fund transfers.

The return on equity ratio, which averages over 21% for the last four years, represents the state's return on its investment in the Bank.

In November, 2004, Moody's Investor Service, a national rating agency, raised ND's issuer rating to Aa2 from Aa3. They cited as reasons: a history of conservative management, strong financial results, and a low debt burden. They also stated "the upgrade is based on a reassessment of benefits and potential risk from the operations of the Bank of North Dakota, the nation's only state-owned financial institution".

### **BND Capital Levels And Contingent Transfer to the General Fund**

Below is a historical account of equity levels, legislative-mandated equity floors, and general fund transfers. Please note that the drop in capital in 1995 was due to paying the shortfall in the Real Estate Trust. Also, the drop in capital in 2002 was due to a transfer to the general fund to assist with general fund shortfalls. The equity floor was first established by the legislature in 1994.

	(000's)		
<u>Year</u>	<u>Total Equity</u>	<u>Floor</u>	<u>GF Transfer</u>
1994	\$100,206	\$100,000	\$10,000
1995	\$76,000	\$100,000	---
1996	\$98,477	\$76,000	\$37,500
1997	\$128,888	\$76,000	\$12,715
1998	\$139,931	\$100,000	\$29,600
1999	\$139,275	\$100,000	\$15,000
2000	\$153,045	\$100,000	---
2001	\$170,496	\$140,000	\$50,000
2002	\$149,113	\$140,000	\$30,000
2003	\$153,744	\$140,000	\$34,000
2004	\$152,776	\$140,000	\$30,000
2005 Projected	\$160,000	\$150,000	<u>\$30,000</u>
			\$278,815

The Government Performance Committee has asked for an accounting of all contingent Bank of North Dakota transfers. Besides the on-going \$60 million transfer to the general fund, there are two contingent transfers. The \$10,000,000 contingent transfer as described in this bill and a \$6,500,000 contingency to make Water Commission bond payments if other revenue sources are insufficient.