NORTH DAKOTA LEGISLATIVE MANAGEMENT

Minutes of the

POLITICAL SUBDIVISION TAXATION COMMITTEE

Tuesday and Wednesday, March 1-2, 2016
Roughrider Room, State Capitol
Bismarck, North Dakota

Representative Jason Dockter, Chairman, called the meeting to order at 9:00 a.m.

Members present: Representatives Jason Dockter, Larry Bellew, Craig Headland, Kathy Hogan, Ben Koppelman, William E. Kretschmar, Mike Lefor, Alisa Mitskog, Gail Mooney, Naomi Muscha, Mike Nathe, Nathan Toman, Robin Weisz; Senators Brad Bekkedahl, Randall A. Burckhard, Dwight Cook, Tim Mathern, Jessica Unruh

Members absent: Representatives Mark A. Dosch, Lawrence R. Klemin; Senator Jim Dotzenrod

Others present: Representative Wesley R. Belter, Fargo, member of the Legislative Management
See Appendix A for additional persons present.

It was moved by Senator Mathern, seconded by Senator Burckhard, and carried on a voice vote that the minutes of the January 12-13, 2016, meeting be approved as distributed.

CONTRACTOR SALES AND USE TAX STUDY

Tax Department

Chairman Dockter called on Mr. Myles Vosberg, Director, Tax Administration Division, Tax Department, for a presentation (Appendix B) of the estimated cost savings to political subdivisions in regard to the proposed bill draft to eliminate the payment of sales and use tax on items purchased by or for an exempt entity and installed by a contractor. Mr. Vosberg said the information is provided as a followup to previously provided information and illustrates the amount of the $44.22 million biennial fiscal impact that represents a true loss to the state and the amount that represents potential property tax savings to taxpayers in various political subdivisions. He said the fiscal impact is broken down into three categories. He said the first category represents highway, state, and higher education contracts and accounts for $27.25 million of the total fiscal impact. He said assuming the price for these contracts would be reduced if the contractor was no longer factoring in sales tax costs, there could be a potential reduction in the amount appropriated to the agencies in category one in an equal amount. He said the second category represents primary school, secondary school, and political subdivision contracts and accounts for $11.7 million of the total fiscal impact. He said assuming a reduction in contract costs due to the elimination of sales tax, there could be a potential reduction in the amount of property tax levied at the local level in an equal amount. He said the final category represents federal, hospital, nursing home, intermediate and basic care, assisted living, and emergency service provider contracts and represents $5.3 million of the total fiscal impact. He said this amount represents the true loss in revenue to the state as it would not be offset by reduced appropriations to state agencies or property tax savings for taxpayers.

In response to a question from Representative Headland, Mr. Vosberg said local sales tax amounts have not been factored into the estimates he provided.

In response to a question from Representative Weisz, Mr. Vosberg said an example of a federal contract would be a contract with an Air Force base.

In response to a question from Senator Cook, Mr. Vosberg said if the bill draft was introduced during the 2017 legislative session, the fiscal note would indicate a $44.22 million fiscal impact because that amount represents the true loss in sales tax revenue to the state, despite any amounts that may be offset through reduced appropriations or lower property tax bills.

In response to a question from Senator Mathern, Mr. Vosberg said he does not envision any administrative difficulties with bill draft [17.0009.02000]. Mr. Vosberg said complications may arise with bill draft [17.0055.01000], as an exempt entity wishing to take advantage of the exemption may find the process of selecting and purchasing all of the materials the contractor requires to be quite confusing.

In response to a question from Representative Headland, Mr. Vosberg said a fiscal note generally provides the total loss in revenue to the state as well as any loss in revenue to political subdivisions.

Representative Headland said the committee should review additional information relating to the loss in local sales tax revenue before a final decision is made on either bill draft.

Mr. Vosberg said the Tax Department could provide further information regarding any losses in local sales tax revenue but some assumptions would need to be made regarding a local average rate and that amount would need to be further refined to account for additional variables.

Chairman Dockter requested the Tax Department provide this information at the committee's next meeting.

In response to a question from Representative Koppelman, Mr. Vosberg said nonprofit organizations are generally not exempt from paying sales tax. Mr. Vosberg said churches are exempt from paying sales tax on some purchases, such as bibles and hymnals, but the exemption is very limited.

ECONOMIC DEVELOPMENT TAX INCENTIVE STUDY

Chairman Dockter called on the Legislative Council staff for presentation of an updated copy of the *Economic Development Tax Incentive Study - Evaluation Chart*, the *Economic Development Tax Incentive Study - Angel Fund Investment Tax Credit* memorandum, and the *Economic Development Tax Incentive Study - Electrical Generating Facilities Sales Tax Exemption* memorandum. The Legislative Council staff said all three documents have been prepared to assist the committee in tracking its progress in reviewing incentives. She said the checkmarks on the evaluation chart indicate the incentives for which the committee has received adequate information to address the questions noted on the chart. She said she welcomed suggestions regarding any modifications to the checkmarks placed on the chart as a decision regarding whether sufficient information has been received to address each of the questions is somewhat subjective. She said she took the liberty of checking off some of the questions pertaining to incentives that had not been used in several years as it could be safely assumed that the committee faced constraints in reviewing these incentives due to lack of data.

The Legislative Council staff said the two updated background memorandums have been modified to include a brief summary and link to each incentive's corresponding multistate survey as well as a summary and links to any testimony provided by interested parties. She said additional written testimony (Appendices C, D, and E) received following the committee's last meeting has also been linked to the relevant background memorandums. She said each incentive background memorandum will be continuously updated as the committee receives additional testimony and information regarding the incentives.

In response to a question from Senator Burckhard, the Legislative Council staff said checkmarks have not been placed in the telecommunications infrastructure sales tax exemption column as the committee has yet to receive testimony from interested parties in regard to this incentive.

In response to a question from Senator Cook, the Legislative Council staff said the committee thought it prudent to add the telecommunications incentive for review this interim as the incentive is scheduled to expire.

Senator Cook said the telecommunications incentive was recently discussed at a National Conference of State Legislatures (NCSL) conference he attended and North Dakota was referenced as a model state. He said the materials provided at the conference might be a helpful resource when scheduling testimony on this incentive.

Senator Mathern said he hopes the committee will address all 18 incentives selected for review this interim.

In response to a question from Senator Cook, Chairman Dockter said a meeting was held with Regional Economic Models, Inc. (REMI) representatives to discuss the software rental and consulting services sought by the committee.

Chairman Dockter called on the Legislative Council staff to provide a summary of the outcome of the meeting.

The Legislative Council staff said after taking into consideration some of the materials the committee had already compiled on the selected incentives, REMI representatives agreed to reduce the quoted price for the software rental and the study of 18 incentives from $114,700 to $96,700. She said this represents an $18,000 reduction in the previously quoted price.

The Pew Charitable Trusts

Chairman Dockter called on the Legislative Council staff for a presentation (Appendix F) of information provided by The Pew Charitable Trusts (Pew) regarding suggested methods for proceeding with the committee's study of incentives. The Legislative Council staff said the materials provided by Pew suggest that a full economic analysis would be unnecessary, and even unhelpful, for some incentives. She said Pew suggested the committee consider posing a handful of key questions pertaining to the effectiveness of some of the incentives selected for review. She said Pew's materials also referenced a 2012 Virginia audit (Appendix G), which found incentives only sway business decisions about 10 percent of the time, meaning 90 percent of business activity occurs regardless of the existence of an incentive. She said Pew also provided a listing of reputable consultants, which was forwarded to the committee members, as this information was requested at the previous meeting.

In response to a question from Chairman Dockter, the Legislative Council staff said Pew does not provide consulting services similar to the services provided by REMI.

Chairman Dockter said despite the time and financial constraints the committee is facing, it still needs to do its due diligence to ensure adequate information is received in order to assess each incentive's rate of return.

Representative Nathe said the information in the Virginia audit is very telling and should be kept in mind as the committee moves forward with its study. He said the audit illustrates the fact that incentives may not have as great an impact as they are perceived to have.

Department of Commerce

Chairman Dockter called on Mr. Paul Lucy, Director, Economic Development and Finance Division, Department of Commerce, for a presentation (Appendix H) relating to any in-state presence or connections to this state an out-of-state company receiving investments from an angel fund may have. Mr. Lucy said the information in his report was gathered by surveying certified angel funds. He said the questions posed to certified angel funds included whether each company receiving investments from angel funds have or had operations in this state, use or used contract manufacturers in this state, or use or used products or services in this state. He said information provided by the 19 angel funds that responded indicated investments in 116 individual companies. He said of the 116 companies, 61 are North Dakota based, 76 have or had operations in this state, 22 use or used a contract manufacturer in this state, and 20 use or used products or services in this state. He said of the 55 companies identified as out-of-state companies, 18 have an operating presence in this state, 7 use or used a contract manufacturer in this state, and 4 use or used a product or service in this state.

In response to a question from Senator Mathern, Mr. Lucy said he was not aware of a situation in which loans were being granted for investment in an angel fund. Mr. Lucy said investments must be at risk in a fund for at least 3 years in order for the investment to be a qualifying investment for purposes of the tax credit.

In response to a question from Representative Weisz, Mr. Lucy said the Department of Commerce did not request information pertaining to the total amount invested by angel funds in the 55 out-of-state companies.

In response to a question from Representative Headland, Mr. Lucy said the department reviews the requirements laid out in statute when certifying an angel fund. Mr. Lucy said the department also reviews the fund's articles of organization, which generally contain a statement as to the fund's purpose. He said if a statement regarding the fund's purpose is not contained in a fund's articles of organization, the department will ask the fund for a statement to that effect.

Representative Headland said the 45 percent credit is rather generous and it does not appear angel funds are investing in the types of high-risk companies the legislature intended angel funds to invest in when the legislation was originally enacted. He said he is not convinced that the current use of angel funds is proper in regard to investments qualifying for a tax credit. He said it seems as though an angel fund can essentially invest in anything the fund chooses to invest in. In response, Mr. Lucy said the department often points out what it understands to be the legislative intent behind the credit. He said what an angel fund chooses to invest in from that point on is beyond the department's reach to influence.

Representative Headland said the committee has some work to do in this area as it appears some very generous credits are being awarded for investments individuals likely would have made without the incentive.

Chairman Dockter agreed and said a large part of the committee's study is centered around determining how incentives are being used and whether incentives are fulfilling the purposes for which they were originally created.

In response to a question from Representative Mitskog, Mr. Lucy said angel funds are precluded from investing in real estate for purposes of the tax credit.

Representative Belter said it appeared from Mr. Lucy's materials that 26 out-of-state companies receiving angel fund investments had no connection to this state. In response, Mr. Lucy said it is possible those companies may have a connection to the state at some point in the future.

In response to a question from Representative Nathe, Mr. Lucy said the department does not ask an angel fund to detail any positive impacts the state may receive in relation to an investment the angel fund makes in an out-of-state company. Mr. Lucy said the department is not authorized to require this type of information from an angel fund. He said he is also not sure of the extent to which angel funds would or could guarantee any positive impact to this state from out-of-state investments when an angel fund makes its initial application for certification.

In response to a question from Representative Nathe, regarding whether the number of angel funds might decrease if reporting criteria were tightened, Mr. Lucy said that might be a better question for angel fund operators.

Representative Nathe said it might be beneficial to include additional reporting criteria if taxpayer dollars are going to be impacted by providing credits for out-of-state investments. In response, Mr. Lucy said the addition of further reporting requirements would require additional monitoring and tracking of angel funds.

Chairman Dockter said additional criteria were added to renaissance zone incentives to decrease activities the legislature viewed as being in opposition to the original intent of the legislation.

In response to a question from Representative Weisz, Mr. Lucy said the department has the ability to deny recertifying an angel fund every 3 years.

In response to a question from Representative Mitskog, Mr. Lucy said information could be obtained regarding whether investments in out-of-state companies have resulted in additional investments in this state. Mr. Lucy said a more extensive survey of angel funds would be required to obtain this information.

In response to a question from Representative Headland, regarding whether there is anything that precludes a certified angel fund from investing in anything it chooses to invest in, Mr. Lucy said, other than restrictions on investing in real estate, the door is pretty wide open.

In response to a question from Senator Cook, Mr. Lucy said more extensive surveys would need to be conducted in order to determine the number of jobs created by angel funds and those which represent career opportunities.

Senator Cook said it may be beneficial for the committee to consider drafting a bill to add additional reporting requirements to angel funds rather than have Mr. Lucy attempt to obtain the additional information the committee is seeking through the use of surveys.

In response to a question from Senator Cook, Mr. Lucy said there is nothing in statute requiring the department to audit angel funds.

In response to a question from Representative Nathe, Mr. Lucy said he could provide the committee with a more accurate count of the out-of-state companies receiving investments that have no presence in this state.

Tax Department

In response to a question from Senator Cook, Mr. Joesph Becker, Auditor III, Research and Education Section, Tax Department, said once an angel fund is certified, the Tax Department operates under the assumption that any investment made by the angel fund is a qualifying investment. Mr. Becker said the Tax Department receives an investment reporting form from the angel fund listing the identity of all investors in the angel fund and the amount of each investment. He said the Tax Department checks the numbers provided on the angel fund reporting form against an investor's tax return to ensure the amounts referenced on each document reconcile. He said the State Auditor's office keeps a close eye on this credit so the Tax Department is always diligent in its review. He said the Tax Department's primary focus in regard to the credit is ensuring a taxpayer is not claiming a greater credit amount than the taxpayer is entitled to.

In response to a question from Senator Cook, Mr. Becker said he is not familiar with the loan situation Senator Mathern mentioned but would provide a written response regarding the use of loaned money for angel fund investments.

Mr. Becker provided a written response (Appendix I) following his testimony.

In response to a question from Representative Weisz, Mr. Becker said the Department of Commerce certifies angel funds and the Tax Department verifies that investments are made within the qualifying period and are appropriately reported to the Tax Department. Mr. Becker said beyond that, the Tax Department is simply reconciling the figures relating to the investments.

Angel Fund Bill Draft

Chairman Dockter called on the Legislative Council staff for presentation of a bill draft [17.0069.01000] restricting angel funds from investing in out-of-state companies for purposes of the angel fund investment tax credit. The Legislative Council staff said the bill draft was prepared after the committee raised concerns regarding a tax credit being awarded for investments made in an angel fund that were ultimately invested in out-of-state companies. She said the bill draft provides that investments in a company having its principal place of business outside of this state are not eligible investments for purposes of the tax credit. She said the bill draft allows for a delayed effective date of January 1, 2018, to allow angel funds adequate time to adjust their investment portfolios prior to the restriction going into effect.

Representative Mooney said it appears there are no checks and balances in place to monitor the actions of an angel fund after it is certified. She said the only process in place seems to be a system of self-policing. She said there are no clawbacks and no penalties in place if a fund makes investments that are outside the scope of the legislative intent behind the credit. She asked if the committee's incentive review process provides the committee an opportunity to add additional requirements to the credit to ensure angel funds are actually investing in companies that have some connection to this state.

In response, Chairman Dockter said the committee is tasked with reviewing the effectiveness of incentives to see if they are proving worthwhile for the state. He said he agreed that, once a fund is certified, it appears the fund can invest in pretty much anything it wishes.

Representative Nathe said the committee should pursue Senator Cook's suggestion to tighten up audit and reporting requirements relating to angel funds. He said he is not opposed to angel funds investing in out-of-state companies so long as this state is seeing a return on those investments. He said it does not appear this state is receiving any return on many of the investments currently being made in out-of-state companies.

Chairman Dockter requested Senator Cook and Representative Nathe work with the Legislative Council staff and the Tax Department to formulate suggestions for additional reporting and audit requirements for angel funds.

Comments from Interested Persons

Chairman Dockter invited comments from interested persons in attendance regarding the angel fund investment tax credit.

Mr. Tommy Kenville, Chair, Valley Angel Investment Fund, LLC, provided testimony (Appendix J) in favor of the angel fund investment tax credit. He said Valley Angel Investment Fund, LLC, has invested a total of $1.29 million through 12 separate investments. He said of those 12 investments, 8 investments have been in companies having offices, staff, or distribution or manufacturing facilities in this state.

Mr. Kenville said he would also like to read testimony provided in favor of the angel fund investment tax credit by Mr. Bruce Gjovig, Chief Executive Officer, University of North Dakota Center for Innovation Foundation, (Appendix K) and Mr. James Burgum, Co-founder and Managing Partner, Arthur Ventures, (Appendix L). Mr. Kenville said the testimony provided by Mr. Gjovig notes that 22 angel funds have invested roughly $41.3 million. He said Mr. Gjovig's testimony states the intent of the angel fund investment tax credit is to create an equity capital industry in North Dakota.

Mr. Kenville also read Mr. Burgum's testimony which states Mr. Burgum's belief is that the original goal of the angel fund investment tax credit had nothing to do with investment in North Dakota and that the intent of the credit was to provide a small tool in the broader strategy of developing a capital base in North Dakota. He said Mr. Burgum's testimony further stated that the success of the credit should not be gauged by the number of jobs created, or the resulting direct or indirect economic impacts, but rather by the number of dollars aggregated in North Dakota-based angel and venture capital funds.

In response to a question from Senator Cook, Mr. Kenville said he also questioned some of the numbers reported on page 4 of Mr. Burgum's testimony and said the numbers associated with North Dakota may have been underreported.

Chairman Dockter requested Mr. Kenville followup on those figures to see if any clarification could be provided to the committee.

In response to a question from Senator Cook, Mr. Kenville said North Dakota funds have syndicated deals with organized networks in South Dakota.

In response to a question from Representative Weisz, Mr. Kenville said, of the investments made by his fund, roughly four to six investments were made in businesses in this state, two to three investments were made in businesses having contracts or employees in this state, and two to four investments were made in businesses having no ties to this state.

In response to a question from Representative Weisz, Mr. Kenville said he is not aware what amount of the $41.3 million invested by the 22 North Dakota angel funds represents investments in out-of-state companies but he could try to locate that information for the committee.

Representative Nathe said he is stunned by the apparent misunderstanding of legislative intent noted in Mr. Burgum's testimony. He asked Mr. Kenville if he knew how prevalent this type of thinking was among other angel funds in the state and how angel funds were explaining the intent of the credit to taxpayers investing in angel funds. Mr. Kenville said he is not aware of how prevalent this thinking is among angel funds. He said he recently spoke with an angel fund investor who identified encouraging job creation in this state as one of his motives for investing in an angel fund.

In response to a question from Representative Nathe, Mr. Kenville said he is not sure what effect adding intent language to the statute would have as, realistically, there would not even be five in-state companies for his fund to invest in this year. Mr. Kenville said language requiring a 50 percent investment in in-state companies might be more workable.

In response to a question from Representative Mitskog regarding syndication, Mr. Kenville said there is never a deal so good that one fund should be the sole investor. Mr. Kenville said depending on the type of business, investments will generally start with one angel fund and be followed by investments from additional angel funds as those investment dollars grow. He said if a business requires additional investment dollars after North Dakota angel funds have contributed, investments from out-of-state angel funds will be sought to fill the remainder of the investment gap.

Senator Mathern said he appreciates the risk angel fund investors are taking but said North Dakota taxpayers are also taking a risk in subsidizing the availability of the credit. He asked if any studies have been completed to estimate the long-range payback of angel fund investments. He said long-range estimates are available in the field of education to project the societal payback for investing in kindergarten and pre-kindergarten education. He asked if it would be possible to estimate the long-range rate of return on angel fund investments, rather than simply rest on the hope that these investments will somehow benefit the state in the long run. In response, Mr. Kenville said it is true that angel fund investing is based on long-range returns but it is hard to predict which companies will be profitable.

In response to questions from Representative Headland, Mr. Kenville said many states have angel fund programs. Mr. Kenville said some states allow out-of-state investors to receive a refund in the amount of the credit that otherwise would have been applied to a taxpayer's in-state tax liability.

Chairman Dockter compared investing in angel funds to investing in the stock market and said taxpayers investing in angel funds are receiving a large credit for their investments whereas a taxpayer investing in the stock market, taking a similar amount of risk, is provided far less of a cushion in the form of a deduction of any losses that might occur due to that investment. He said it also takes several years for a taxpayer who is taking a deduction to recoup those losses compared to a taxpayer who is getting the full credit for a risky investment upfront. He said the state needs to take a hard look at the return it is receiving considering the high percentage associated with this credit.

In response to a comment from Senator Cook regarding the angel fund reporting requirements put in place by 2011 House Bill No. 1057, Chairman Dockter requested the Legislative Council staff provide the committee copies of the bill for further review.

Tax Department

Chairman Dockter called on Mr. Ryan Rauschenberger, Tax Commissioner, Tax Department, for presentation of sample dynamic fiscal notes and information pertaining to the number of states that require the use of dynamic fiscal notes. Mr. Rauschenberger reviewed the process associated with preparing a static fiscal note prior to reviewing a sample dynamic fiscal note. He said a dynamic revenue analysis attempts to establish the behavioral implications of a tax policy change. He said a dynamic revenue analysis seeks to answer questions such as whether a change in tax policy will effect the behavior of individuals or result in increases or decreases to state tax revenue. He said some states use input-output models to undertake dynamic revenue analysis and others use computable general equilibrium models. He said the REMI model the committee is considering uses a combination of both of these models. He said according to the Federation of Tax Administrators, 21 states use dynamic scoring for certain tax proposals. He said the majority of states use REMI software for dynamic revenue analysis. He said the article written by Peter Bluestone and Carolyn Bourdeaux (Appendix M), published by Tax Analysts, concludes that states use dynamic forecasting as more of a policy analysis tool. He said the article notes that states considering dynamic analysis need to recognize that dynamic revenue modeling can be useful for informing policy decisions, but that states should generally avoid using dynamic modeling for budgetary purposes. He said Minnesota used REMI for dynamic modeling in the past but has since abandoned the practice. He reviewed an example of a dynamic fiscal note completed by Utah's revenue department (Appendix N) and said the preparation of a dynamic fiscal note involves considerably more time and effort than the preparation of a static fiscal note.

Representative Headland said a dynamic analysis is only as good as the assumptions that are made in conducting the analysis.

In response to a question from Senator Burckhard, Mr. Rauschenberger said it was his understanding that Minnesota gravitated back towards static revenue analysis due to a tendency for legislators to want to base budgeting decisions off of the dynamic analysis.

In response to a question from Chairman Dockter, Mr. Rauschenberger said the time it takes to prepare a static fiscal note can range from minutes to days. Mr. Rauschenberger said Kathy Strombeck, Director, Research and Communications, Tax Department, completed approximately 300 fiscal notes during the 2015 legislative session.

In response to a question from Senator Cook, Mr. Rauschenberger said the fiscal notes related to income tax rate reductions during the 2015 legislative session may have been marginally different had a dynamic fiscal note been prepared, but noted that dynamic fiscal notes generally carry a 5- to 6-year delay before any impacts may be seen so there is a bit of a delayed effect when comparing dynamic fiscal notes to static fiscal notes.

Mr. Rauschenberger also reviewed an example of a dynamic fiscal note from Texas (Appendix O), which was completed as part of a legislatively created study. He said the Legislative Budget Board is tasked with preparing dynamic fiscal notes in Texas.

The Legislative Council staff said a copy of the Texas bill (Appendix P) that created the requirement for dynamic fiscal notes has been provided for the committee's review. She reviewed the circumstances that trigger the preparation of a dynamic fiscal note in Texas and noted the requirements also contain a lookback period to assess the accuracy of the dynamic fiscal note 5 years following its initial preparation.

In response to a statement from Chairman Dockter, Mr. Rauschenberger agreed that the results of a dynamic fiscal analysis are only as good as the information used to conduct the analysis.

In response to a question from Representative Headland, the Legislative Council staff confirmed that REMI representatives did state that the results of a dynamic revenue analysis using REMI software was highly accurate when the predicted results were compared to the actual results several years later.

Senator Cook said the language in the Texas statute seems to be trying to accomplish the same thing this committee is trying to accomplish which is determining whether economic development tools are proving effective. He said he found it particularly interesting that the Texas statute requires a review after 5 years to compare the actual results to the predicted results.

In response to a question from Chairman Dockter, Mr. Al Christianson, Director, Business Development & Government Affairs, Great River Energy, said the economic impacts predicted on a previous project using REMI software ended up aligning very closely to the project's actual outcomes.

Prevalence of Economists

Chairman Dockter called on the Legislative Council staff for a presentation (Appendix Q) of information provided by NCSL pertaining to the number of economists in legislative support agencies in other states. The Legislative Council staff said the information provided by NCSL was derived from a 2012 survey of legislative fiscal offices. She said the survey requested information regarding the number of economists and fiscal analysts each legislative service agency employed. She said not all states responded to the 2012 survey, and changes to staffing levels have occurred since the results were tabulated, but the information provides an overall picture of the makeup of fiscal staff in legislative service offices in other states. She said NCSL noted that it is common in many states for the governor's office to employ an economist for purposes of revenue forecasting. She said many states will also contract with private consultants through the governor's office to complete revenue forecasting tasks or seek the services of an in-state academic institution to undertake that analysis. She provided various updates to the information provided by NCSL and said the Legislative Council office in Colorado employs six economists; Michigan has a dedicated economist for both the House and the Senate; Oregon's Legislative Revenue Office, which is a permanent nonpartisan legislative service agency, employs five economists; and Florida's Office of Economic & Demographic Research employs both economists and demographers who undertake population forecasting. She said North Dakota's Legislative Council office does not employ an economist but said it should be noted that the Legislative Council office is not tasked with preparing fiscal notes. She said the Legislative Council office has the responsibility of assigning fiscal notes, but the task of actually preparing fiscal notes is undertaken by the agency impacted by the bill or resolution.

The Legislative Council staff said in regard to a question previously posed regarding the length of time an agency has to complete a fiscal note, rules pertaining to the preparation of fiscal notes are outlined in the Legislative Rules and provide that after a fiscal note is assigned by the Legislative Council, the recipient agency must return a completed fiscal note to the Legislative Council office within 5 days of receiving the request. She said this gives a committee an idea regarding the current turnaround time associated with completing a static fiscal note should the committee consider applying time frames to the preparation of dynamic fiscal notes.

In response to a question from Senator Cook, Mr. Kelvin Hullet, Economic Development Program Manager, Bank of North Dakota, said the Bank of North Dakota does not have an economist on staff but the Bank does conduct a fair amount of internal analysis regarding the state's economy and how it is functioning.

Department of Commerce

Chairman Dockter called on Mr. Justin Dever, Co-Deputy Commissioner, Department of Commerce, for a presentation (Appendices R and S) regarding the costs and benefits associated with various economic development tax incentives to determine an estimated return on investment and for information pertaining to the indirect or induced impacts of economic development tax incentives. Mr. Dever said the department undertook an analysis of the seed capital and agricultural processing facility investment tax credits. He said the department based its analysis on information provided by the Tax Department and Job Service North Dakota. He said employers are required to report employment figures to Job Service on a quarterly basis. He reviewed the cost and benefit side of both incentives and said the figures to do not take into account any construction jobs so they may be somewhat conservative. He said the chart illustrates very rough estimates, which are based upon averages. He said an analysis using the version of REMI's software recommended for rental by the committee would produce much more reliable results.

Mr. Dever reviewed the results for both credits and said for the seed capital investment tax credit, there was roughly a $2.1 million increase in state tax revenues, which equates to approximately a 14.6 percent annual rate of return. He said revenue impacts would continue through the 10-year period, so the impact in 2023 would be an estimated $3.8 million increase in state tax revenues, which equates to approximately a 26.5 percent annual rate of return. He said the estimated increase in state tax revenues in 2014 for the agricultural commodity processing facility investment tax credit was roughly $1.2 million, which equates to a 9.5 percent rate of return. He said by 2023, the estimated increase in state tax revenues is roughly $2.7 million, which equates to a 21.7 percent rate of return.

In response to a question from Representative Toman, Mr. Dever said the jobs referenced in his materials represent jobs that existed in each designated year, so some may have been existing jobs and some may have been newly created jobs.

In response to a question from Representative Headland, regarding whether REMI software can calculate what will happen if an incentive is eliminated, Mr. Dever said REMI's model is based on a baseline regarding what the economy currently looks like. Mr. Dever said the model assumes what the economy would look like if the referenced plants were not currently in existence in this state. He said this is the impact reflected on his chart. He said whether or not these plants would have been created without the incentive is not something the department can determine. He said those determinations are arrived at through studies similar to the 2012 Virginia audit the committee reviewed. He said it is doubtful that an incentive influences decisions 100 percent of the time.

Disclosure of Information Relating to Tax Incentives

Chairman Dockter called on the Legislative Council staff for a presentation regarding requirements found in other states pertaining to the disclosure of information by recipients of tax incentives. The Legislative Council staff said this information was requested in light of some of the difficulties the committee is having gathering adequate information to assess the effectiveness of incentives. She said she selected information from Rhode Island and Illinois as a sampling of information to review as both states received high marks in terms of the operation of their incentive accountability and reporting requirements. She said the Illinois Corporate Accountability for Tax Expenditures Act (Appendix T) provides a nice example of statutory language associated with reporting requirements and the Rhode Island report (Appendix U) provides a good visual example of what the final product related to any potential state reporting requirements might look like. She reviewed the information contained in the Rhode Island report and said the report does not serve to analyze the effectiveness of any particular incentive, but simply serves as an accounting of the incentives that were awarded.

Chairman Dockter said this information provides a good overview of the types of reporting and disclosure requirements that are found in other states.

Senator Cook said tax expenditure reports have become a topic of discussion in many states. He said he attended an NCSL conference that devoted an entire breakout session to the topic. He said this topic would need further discussion before the use of tax expenditure reports should be considered in this state.

Primary Sector Bill Draft

Chairman Dockter called on the Legislative Council staff for presentation of a bill draft [17.0077.01000] providing for a standard definition of primary sector business. The Legislative Council staff said a separate bill draft was reviewed by the committee at a prior meeting. She said the previous bill draft inserted uniform language into the nine separate sections of North Dakota Century Code in which primary sector business is defined. She said this bill draft provides the same result but takes a slightly different approach. She said this bill draft creates a single definition of primary sector business in Title 1 of Century Code and then references the definition within each of the nine existing definitions of primary sector business.

Department of Commerce

Chairman Dockter called on Mr. Lucy for comments regarding the bill draft [17.0077.01000]. Mr. Lucy said the department has a few suggestions pertaining to the draft language. He said the committee may wish to consider adding the phrase "in this state" to the end of the definition of primary sector business. He said this would clarify that the requirement for the creation of new wealth is measured at the state level, not the local level. He also reviewed two instances where language in the draft might be considered duplicative to the language provided in the primary definition and suggested the language be removed. He said the department could take a closer look at the draft and provide some additional comments at a future committee meeting.

Chairman Dockter said the department could submit its comments at the committee's next meeting.

In response to a question from Senator Cook, Mr. Lucy said the addition of the phrase "in this state" to the definition of primary sector business would clarify that an established business that is simply expanding into an additional community would not be bringing new wealth into the state for purposes of the definition. Mr. Lucy said it is the department's understanding that a primary sector business must create new wealth for the entire state, not just the community into which it may be expanding or relocating.

Senator Cook said he was not convinced this language should be added to the definition.

INCOME TAX RECIPROCITY STUDY

Tax Department

Chairman Dockter called on Mr. Becker for a presentation (Appendix V) of fiscal information pertaining to the income tax reciprocity agreement between North Dakota and Montana. Mr. Becker said the information provided in his handout pertains to data in addition to the 2013 tax year data previously provided to the committee. He reviewed the additional information and said the Tax Department does not have any other reciprocity agreements in place with Montana.

Mr. Becker also provided an overview of the income tax reciprocity agreement between North Dakota and Minnesota. He said the agreement between North Dakota and Minnesota was adopted in 1969 and is similar to the agreement between North Dakota and Montana, except the Minnesota agreement also contains provisions requiring an individual to maintain an abode in the individual's state of residence and return to that abode at least once each month. He said the Minnesota agreement is also broader than the Montana agreement as the Montana agreement only pertains to employee's wages, whereas the Minnesota agreement covers wages, and under certain conditions, income derived from a sole proprietorship or partnership.

In response to a question from Representative Koppelman, Mr. Becker said an individual's state of residence will receive an individual's tax if the individual makes such an election under the terms of the reciprocity agreement. Mr. Becker said if the reciprocity agreement was not in place, it would have a negative impact on individuals who work in Minnesota but live in North Dakota.

Senator Bekkedahl said historically many individuals from eastern Montana have come to western North Dakota for work due to the increased activity. He said this is especially true due to the recent oil boom.

Representative Headland said it appears that North Dakota's tax policy is essentially subsidizing Montana residents who choose to work in North Dakota due to the disparity in the number of Montana residents working in North Dakota as compared to the number of North Dakota residents working in Montana. He said Montana residents also benefit by receiving a sales tax exemption on purchases made in this state. In response, Mr. Becker said Montana is gaining revenue whereas North Dakota is losing revenue due to the disparity in employment numbers.

In response to a question from Representative Koppelman, Mr. Becker said the information in his handout only reflects the amount of wages that were exempt under the agreement. Mr. Becker said Montana was not able to provide the Tax Department with data regarding refund amounts.

In response to a question from Representative Headland, Mr. Becker said Minnesota withdrew from a similar agreement it had in place with Wisconsin. Mr. Becker said there were substantially more Wisconsin residents working in Minnesota than Minnesota residents working in Wisconsin so Minnesota requested Wisconsin provide compensation to reimburse Minnesota for the losses the state was experiencing due to the agreement. He said Minnesota decided to withdraw from the agreement following disagreements as to the rate at which the reimbursement payments were being remitted. He said talks between the two states are still ongoing but a new agreement has not been signed.

Representative Headland said it appears Minnesota withdrew from its agreement with Wisconsin as the state was experiencing the same disadvantages that North Dakota is experiencing in its agreement with Montana.

The Legislative Council staff said a copy of the newly signed reciprocity agreement (Appendix W) between Montana and North Dakota has been provided for the committee's reference. She said a new agreement was signed by the Tax Commissioner on January 8, 2016.

Workforce Safety and Insurance

Chairman Dockter called on Ms. Anne Jorgenson Green, Special Assistant Attorney General and Director of Legal Services, Workforce Safety and Insurance, for a presentation regarding reciprocal agreements for workers compensation coverage. Ms. Jorgenson Green said North Dakota's reciprocal agreement regarding workers compensation coverage has been in place with Montana since 1969. She said the agreement allows employees of a North Dakota or Montana employer to work for up to a year in the neighboring state without either employer having to purchase workers compensation coverage in the state in which they are temporarily working. She said employers maintain coverage in their home state and the exclusive remedy for any of the employer's employees injured on the job lies in the employer's home state. She said the agreement only applies to situations in which a home state employer brings its home state workers into the other jurisdiction. She said the agreement allows a 1-year certificate of extraterritorial coverage. She said any extensions to the 1-year period are available through a contractual arrangement that exists between the states. She said the certificate of extraterritorial coverage can be canceled at any time by either state.

In response to a question from Representative Koppelman, Ms. Jorgenson Green said workers compensation law permits an employer to take employees outside of the state for up to 30 days. Ms. Jorgenson Green said if an employer is planning to have employees working out-of-state in Montana for longer than 30 days, the employer should contact Workforce Safety and Insurance to obtain a certificate of extraterritorial coverage.

In response to a question from Representative Hogan, Ms. Jorgenson Green said prior to the oil boom about 50 certificates of extraterritorial coverage were being issued per year from 2006 through 2008. Ms. Jorgenson Green said in 2012, 231 certificates were issued to Montana employers bringing workers into North Dakota whereas only 70 certificates were issued to North Dakota employers bringing workers into Montana. She said this trend continued through 2014, but has since leveled off.

Additional Reciprocity Agreements

The Legislative Council staff said per the committee's prior request, she contacted additional state agencies regarding reciprocal agreements with Montana. She said the North Dakota Highway Patrol has a reciprocity agreement with Montana pertaining to farm-registered vehicles owned or operated by farmers or ranchers hauling their own farm products, supplies, or equipment. She said the agreement allows residents to be exempt from the other state's registration requirements for purposes of the interstate operation of those vehicles.

The Legislative Council staff said she also spoke with a representative of the North Dakota University System regarding higher eduction reciprocity agreements between North Dakota and Montana. She said the University System only has one official reciprocity agreement in place and that agreement is between North Dakota and Minnesota. She said the University System has contiguous state agreements in place, but those agreements simply address tuition reductions, rather than provide for full tuition reciprocity.

Committee Discussion and Directives

Chairman Dockter asked the committee what its wishes were in regard to the study. He noted the legislature did not have the appetite to pursue this topic during the 2015 legislative session, but the landscape may have changed due to the state's current budgetary situation.

Representative Headland said it is unfortunate that Montana will not share more information with North Dakota. He said it is difficult to make a decision without having information regarding the actual numbers.

Representative Koppelman said he is somewhat resistant to eliminating the reciprocal agreement with either Montana or Minnesota in light of the difficulties it would create for North Dakota workers working in either state.

Senator Cook said he does not favor going forward with any action to eliminate the Montana agreement because the only people that would be hurt by eliminating the agreement are North Dakota residents working outside of the state.

Representative Koppelman said with the nation beginning to climb out of the recent recession and with the recent decline in the energy industry, North Dakota may begin to see the number of workers coming in from out of state begin to level off.

Chairman Dockter said based on the committee's discussions, it does not appear that any additional information needs to be gathered regarding this study. He said individual legislators can always bring forward bill drafts on their own based on the information that was provided to the committee.

SOCIAL SERVICES FINANCING STUDY

County Social Services Finance Working Group

Chairman Dockter called on Mr. Joe Morrissette, Member, County Social Services Finance Working Group and Deputy Tax Commissioner, for a summary of the prior meeting of the working group and information pertaining to the current breakdown of counties based on the parameters of the proposed social services funding formula. Mr. Morrissette said the full working group has not met since the committee's last meeting but the subgroup to the working group did meet on January 26, 2016. He provided the committee with an update of the issues discussed by the subgroup, which included a decision to merge the economic assistance and social service formulas into a single formula. He said an effective date of January 1, 2018, was also discussed for the implementation of the funding formula. He said the formula would apply to the calendar year 2018 budget and distributions to the counties would occur beginning mid-December 2018, and continue 2 weeks prior to the start of each quarter. He said the working group is still discussing whether adjustments need to be made to distributions midway through the calendar year based on actual 2017 caseload information.

In response to a question from Chairman Dockter, Mr. Morrissette said a phase-in period has been discussed by the working group regarding a period in which counties could retain their individual factors should they choose to consolidate with other counties. Mr. Morrissette said the phase-in period would be structured in a similar manner to the phase-in used to address consolidations under the education funding formula.

In response to a question from Representative Nathe, Mr. Morrissette said caseload data for all of calendar year 2016 would be finalized in roughly June 2017, so that data would be the basis for the 2018 budget. Mr. Morrissette said there are no concerns regarding cases being disproportionately counted during certain peak times of the year because caseload data is counted on a month-by-month basis over the course of an entire calendar year, with the exception of low-income heating assistance cases, which are counted as one case per heating season.

In response to a question from Senator Mathern, Mr. Morrissette said the working group did not discuss which types of multicounty sharing agreements are the most advantageous but the working group did discuss the type of formal structure that would need to be in place to constitute a consolidation for purposes of the formula. Mr. Morrissette said specific language pertaining to consolidations is still being finalized.

In response to a question from Representative Hogan, Mr. Morrissette said the working group has not discussed how short-term assistance from a neighboring county would be accounted for. Mr. Morrissette said the working group has discussed the need to review current figures to ensure there is no double counting occurring in situations where one county is paying 100 percent of an employee's salary but also receiving a payment in addition to the amount required for that employee's salary from a neighboring county under the terms of a sharing agreement.

In response to a question from Representative Nathe, Mr. Morrissette said the working group will need to have further discussions regarding the reimbursement that would apply to a employee's work effort if the reimbursement rate that applies in the county the employee is located in differs from the reimbursement rate applied in the county the employee is providing services in under the terms of a sharing arrangement.

Representative Hogan said it is critical to allow the assistance practices that commonly occur between counties to remain in place under any type of state-funded formula.

In response to a question from Representative Koppelman, Mr. Morrissette said the 7 percent inflationary rate has been inserted into the formula for discussion purposes and was based on the annual increases in spending that have occurred over the past 4 to 5 years. Mr. Morrissette said the increase would be applied per year, not per biennium. He said the working group is still discussing whether it would make sense to tie that percentage to some type of index.

In response to a question from Representative Koppelman, Mr. Morrissette said the basis for the formula would be tied to what spending levels had been in the past but the legislature would have the ability to determine changes to reimbursement rates going forward, similar to determining the per student rates under the education funding formula.

Chairman Dockter said there are several indexes related to health care and social services that could be used.

Mr. Morrissette said there are indexes built by the federal Bureau of Economic Analysis that are components of the Consumer Price Index that are broken down into various categories.

In response to a question from Representative Headland regarding whether state funding for social services would be subject to allotments if the state experiences budget shortfalls, Mr. Morrissette said the funding might be subject to allotments unless there is some exception provided in the statutory language or some type of rainy day fund established, as was established with the school funding formula.

In response to a question from Representative Koppelman, Chairman Dockter said the intent is to create a formula and then allow the legislature to increase the baseline by a certain percentage each biennium.

In response to a question from Senator Mathern, Mr. Morrissette said the working group has discussed placing funding for the formula in a separate section of the Department of Human Services' agency bill so it is clear that this is a separate program so a shortfall in one area would not lend itself to removing funds dedicated to the formula.

Representative Hogan said counties did see reductions in allocations due to the current allotments so there is history to these cuts being passed along.

In response to a question from Representative Nathe, Mr. Morrissette said the working group is currently collecting 2015 data and will then focus on what the most appropriate inflationary adjustment might be to get to the implementation year of 2018. Mr. Morrissette said the formula does not look back to a new base year each year. He said the original base year does not change, similar to how the school funding formula operates.

In response to a question from Representative Weisz, Mr. Morrissette said the working group has discussed how to avoid penalizing consolidations that might result in a county moving from a higher factor to a lower factor as a result of the consolidation. Mr. Morrissette said the formula would provide for a transition period to allow a county to step down to any lower factor that might result due to the consolidated group's increased caseloads.

Representative Weisz said efficiencies may be realized through consolidations up to a point but the formula should not base factor considerations on caseloads alone. He said though a consolidated group may experience certain efficiencies due to a consolidation, there are other factors that come into play including increased travel costs due to the increased geographical size of the consolidated group. In response, Mr. Morrissette said the formula does not currently contain any factors to address this concern but the working group could certainly discuss the issue further.

Representative Hogan said it is likely that concerns, such as those Representative Weisz mentioned, will continue to arise as this is an entirely new concept. She said the school funding formula took years and she envisions the development of this formula will be a multiyear project as well. She said many unanticipated items will likely need to be addressed over the first 4 to 6 years of the formula's operation.

In response to a question from Representative Nathe, Mr. Morrissette said caseload projections similar to the detailed projections available using demographics for the education funding formula are not available for the social service funding formula. Mr. Morrissette said the new 2015 data might shed some light on caseload increases from 2014.

Mr. Morrissette said the working group is having ongoing discussions regarding whether counties may be permitted to carry forward any 2017 ending fund balance amounts to 2018. He said the school funding formula allows some carryover so a similar method could be used for the social service funding formula. He said the working group also discussed what to do with any carryover amounts in subsequent years and noted any amounts in excess of an allowed percentage could be placed in a special fund and used for grants to counties experiencing exceptional caseload growth. He said this could be structured in a similar manner to rapid enrollment grants under the education funding formula.

Mr. Morrissette said the working group discussed a county's authority to accept grants and the need for counties to receive prior approval from the Department of Human Services in order to ensure proper cost allocation of those funds. He said the working group also discussed allocation of the indirect costs associated with services offered to multiple parties, such as the portion of an auditor's time dedicated to completing payroll services for social service staff.

Representative Hogan said another variable that might need to be considered is any major program changes, especially federal changes that counties would not have control over. She said when Medicaid Expansion occurred Cass County had to add approximately five additional staff members. She said the formula might need to factor in program changes in addition to caseload changes.

Mr. Morrissette said the first of his handouts (Appendix X) is a document similar to one previously provided to the committee except the document has been modified to account for the working group's decision to merge the two formulas. He described the operation of the newly revised formula. He said the second document he provided (Appendix Y) illustrates the 47 groupings representing counties and consolidated county groups, and shows the 2014 data related to gross expenditures, Medicaid management information system (MMIS) claims, economic assistance payment amounts, and the total amount that brings you to the formula payment before the adjustments represented on the previous chart are applied. He said according to the 2014 data, 21 counties or consolidated groups would be subject to the maximum limit and 15 counties or consolidated groups would receive the hold harmless adjustment to bring those groups up to the 102 percent minimum. He said total formula payments would end up being just shy of $74 million compared to net calendar year 2014 expenditures of $67.4 million.

In response to questions from Senator Cook, Mr. Morrissette said the $67.4 million represents the amount that comes from county social service levies and the $73.9 million represents the formula payment that would come from general fund money. Mr. Morrissette said funding for the 2017-19 biennium would likely cover all of calendar year 2018 and the first 6 months of calendar year 2019. He said $250 million has been appropriated for the current biennium for the 12 percent property tax credit. He said, depending on the final 2015 figures, a reasonable estimate for the cost to implement the formula for the full biennium beginning in 2018 would be approximately $150 million to $170 million.

Senator Cook said he would hope all forms of property tax relief currently being offered would continue to be offered if the state takes over funding for social services.

In response to a question from Senator Cook, Mr. Morrissette said the amount of tax relief individual property owners would realize from a state takeover of the funding for social services would vary based on what the prior social service levy was in each county.

In response to a question from Senator Mathern, Mr. Morrissette said population was initially considered as a basis for the formula but caseload data ultimately had the most direct correlation to the expenditures the state is looking to assume.

In response to a question from Chairman Dockter, Mr. Morrissette said the minutes from the previous working group meeting would be approved for distribution following the next working group meeting.

In response to a question from Representative Headland, Mr. Morrissette said the formula will not address anything related to fluctuations in home valuations.

Chairman Dockter said home valuations should not be a concern if the formula is based on caseloads to determine reimbursement amounts.

Department of Human Services

Chairman Dockter called on Ms. Debra McDermott, Chief Financial Officer, Department of Human Services, for a presentation (Appendix Z) regarding yearly changes to economic assistance caseloads. Ms. McDermott said the information she provided does not reflect social service caseload data as those numbers are not yet available. She said the information reflected in her handout represents the last 4 years of work effort in various program areas. She said each number on her handout reflects cases counted by month, with the exception of cases relating to the low-income home energy assistance program, which are counted once per heating season. She said eligibility for foster care cases have also been counted as one case per month, but are based on placements occurring as of the first day of each month.

In response to a question from Chairman Dockter, Ms. McDermott said one individual participating in three separate assistance programs for an entire year would equal a count of 36 case-months for purposes of the formula.

In response to a question from Senator Mathern regarding whether the formula reflects need or funding, Ms. McDermott said caseload data is based upon eligibility criteria. Ms. McDermott said whether individuals actually come forward and apply for the services they would otherwise qualify for is a separate question.

In response to a question from Representative Hogan, Ms. McDermott said the working group made the decision to count foster care cases based on the first day of the month due to concerns regarding foster care cases transferring between multiple counties in a single month.

In response to a question from Representative Burckhard, Ms. McDermott said there were nearly 85,000 individuals qualifying for medical eligible programs in December 2015.

In response to a question from Representative Nathe, Ms. McDermott said cases falling within the economic assistance formula represent one of the six types of cases represented on her handout. Ms. McDermott said she will provide figures related to the social service formula once that data is available.

In response to a question from Representative Nathe, Ms. McDermott said, with the exception of foster care cases, the Department of Human Services has seen slight growth in most program areas over the past 3 months. Ms. McDermott said there may be fluctuations in child care assistance cases this spring as the eligibility requirements for that program will be changing on April 1, 2016.

In response to a question from Representative Bellew, Ms. McDermott said the Department of Human Services modified the eligibility requirements for the child care assistance program as a result of allotments. Ms. McDermott said the department eliminated the top two income brackets related to qualifying for child care assistance and also increased copayments. She said the changes will result in roughly 550 families, or 808 children that will no longer qualify for child care assistance.

In response to a question from Representative Bellew, Ms. McDermott said she could provide the committee with information related to the requirements for the temporary assistance for needy families and supplemental nutrition assistance programs.

In response to a question from Representative Hogan, Ms. McDermott said the numbers posted in the Department of Human Services' *Quarterly Budget Insight* publication will not correlate to the numbers associated with the formula because the formula counts the monthly work effort for cases, whereas the quarterly budget summary counts the number of cases per quarter.

In response to a question from Representative Nathe, Ms. McDermott said MMIS processes claims for eligible services provided by qualified service providers. Ms. McDermott said only the Medicaid-eligible cases within the cases reflected in her handout would be eligible for MMIS reimbursements.

In response to a question from Senator Cook, Ms. McDermott said she believed year limits related to receiving temporary assistance for needy families were eliminated as a result of federal policy changes.

North Dakota Association of Counties

Chairman Dockter called on Mr. Terry Traynor, Assistant Director, North Dakota Association of Counties, for a presentation (Appendix AA) of updated information regarding county ending fund balances and the number of mills each county has reduced from its budget, expressed in dollars, as a result of 2015 Senate Bill No. 2206. Mr. Traynor reviewed the updated information and said the average number of mills levied for social services in tax year 2014 was 14.99 mills and the average number of mills levied in tax year 2015 was 12.49 mills. He said this reduction is a result of the state's assumption of grant costs under 2015 Senate Bill No. 2206. He said in order to show the reduction in terms of dollars he applied 2014 tax rates to 2014 taxable values and then did the same for 2015 data. He said the results showed that counties would have levied $65 million, rather than the $51.8 million actually levied, had the state not assumed grant costs. He said the state's assumption of grant costs resulted in over $13 million in property tax savings for taxpayers.

Mr. Traynor said the only remaining costs for the state to assume are administrative and staffing costs. He said staffing costs pertain to the costs related to the staff necessary to determine eligibility and deliver social services such as costs for staff benefits, training, travel, and facility heat, light, and space. He said these costs have gone up in recent years. He said the largest contributors to increased costs include the recent 3 percent salary increases and more costly insurance plans.

Mr. Traynor said he would like to clarify one point made by a previous speaker regarding the $71 million referenced for county social service budgets. He said not all of the $71 million reflects property tax levies. He said about $20 million of that amount consists of federal or state funds that flow back to the county. He said when looking at the 2014 base year numbers, counties only levied about $50 million in property tax.

In response to a question from Senator Bekkedahl, Mr. Traynor said county effort is tracked by the Department of Human Services and forwarded up to the federal level for reimbursement. Mr. Traynor said the reimbursement amounts are then delivered to the Department of Human Services prior to being further distributed back out to the counties.

Representative Weisz said it might be useful to add a column showing the federal and state amounts so the committee can get an idea of total county costs and the net savings that would be received by the taxpayer if the state were to take over funding responsibility. In response, Mr. Traynor said he will take this request back to the working group.

In response to a question from Representative Bellew, Mr. Traynor said a breakdown of exactly what is included in each county's social service budget is available. Mr. Traynor said the challenge would be trying to assemble that information in a meaningful way as counties undertake their recordkeeping in a different manner.

Chairman Dockter requested Mr. Traynor attempt to provide this information to the committee at the next meeting.

In response to questions from Representative Lefor, Mr. Traynor said he is not aware of any rules or regulations that would result in lower rates of federal reimbursement due to the state taking over funding responsibility for social services. Mr. Traynor said he also does not have the exact figures for the amount of the stated $71 million that represents state reimbursements.

In response to a question from Representative Weisz, Mr. Traynor said the disparity in the figures reflected on his chart and those reflected on Mr. Morrissette's chart could be a result of one chart not taking into account the reductions realized from the state assumption of grant costs under 2015 Senate Bill No. 2206.

In response to a question from Senator Cook, Mr. Traynor said the working group is operating under the assumption that any proposed legislation would go into effect on January 1, 2018.

In response to a question from Senator Cook, Mr. Traynor said the working group is still considering options regarding what to do with ending fund balances as of December 31, 2017. Mr. Traynor said counties may need to retain a reserve as a cushion against any unforeseen circumstances. He said the amount of any allowable reserve would be a legislative decision. He said a statement regarding reserves would likely need to be defined in terms of a percentage and dollar amount because applying a percentage to a county that only had a budget of $200,000 to begin with would not amount to much in reserves.

In response to a question from Senator Cook, regarding what would happen to the remainder of funds exceeding that limit, Mr. Traynor said the working group noted that additional funds available as of December 31, 2017, are technically local taxpayer dollars so that fact should be kept in mind when deciding how those funds may be used. Mr. Traynor said the working group discussed possibly requiring the county to draw those funds down over a certain amount of time or dedicate those funds to other county general fund purposes. He said in regard to returning excess funds to property taxpayers, the Tax Department struggled with providing refunds in the past due to the constitutional prohibition on gifting. He said there would also be difficulty refunding dollars in the case of property taxpayers who no longer occupy their former residences.

Senator Cook said the bill draft could also require counties to levy fewer mills, equal to the amount exceeding any set limit, rather than refunding those dollars.

Chairman Dockter requested the Legislative Council staff look into options regarding what could be done with any remaining dollars available at the end of 2017.

Representative Nathe said the conversation is almost word for word the discussion the House Education Committee had during the 2015 legislative session regarding school ending fund balances. He said it would likely be easier to use a mill levy reduction option rather than a refund option to address any funds exceeding a county's limit.

In response to a question from Representative Nathe, Mr. Traynor said the only discussion the working group has had surrounding an ending fund balance percentage is in relation to the 35 percent amount noted in the school funding formula. Mr. Traynor said that percentage has yet to be vetted with the counties in regard to determining the percentage reserve the counties may require. He said this is a topic the working group is continuing to discuss.

Representative Nathe said he has some discomfort with allowing counties to carry forward large balances, especially in light of some of the discussions he has had with counties regarding the amount a county will pay for indigent burials. He said he takes issue with the fact that some counties will not budge on increasing the $2,100 allowed for indigent burials even though the information on Mr. Traynor's chart shows that many counties are carrying forward several millions in ending fund balances.

In response to a question from Senator Burckhard, Mr. Traynor said the reason some counties may have large reserves is due to the loss of a staff person and the inability of the county to replace that staff person. Mr. Traynor said, especially in small counties, if a staff person is lost midyear, and the county is unable to find a replacement for that person's position, the county may roll up significant funds in that year.

Chairman Dockter said Mr. Traynor's statement illustrates why the committee should be looking at a percentage amount, as well as a dollar amount, when considering the amount of a county's ending fund balance the county may be allowed to retain.

In response to a question from Senator Mathern regarding whether county staff typically work across program lines, Mr. Traynor said there is a fairly distinct separation between program staff. Mr. Traynor said this is partially due to the fact that staff need to keep track of their time for certain programs for the state's random moment in time study that leverages federal dollars. He said this would be challenging if employees were working in multiple areas. He said there are costs that cross over. He said a cost consultant analyzes the amount of indirect costs allocated to a county for central services on an annual basis. He said central services could include the portion of the county auditor's time spent completing social service related payroll as well as shared janitorial services, shared access to the county's computer network, or other services shared by multiple agencies. He said these indirect costs are allocated to the counties according to federal rules and then forwarded to the Department of Human Services to submit for federal reimbursement.

In response to a question from Representative Hogan, Mr. Traynor said the three counties that have numbers appearing in red on his handout are supplementing their budgets with general fund dollars. Mr. Traynor said those counties pay their costs, but never actually put those general fund dollars back into their social service fund so the fund shows a negative balance at the end of the year.

In response to a question from Representative Nathe regarding why most county ending fund balances seem to be growing each year, Mr. Traynor said he assumes it is because counties' costs continue to grow each year. Mr. Traynor said some of the larger counties try to keep a consistent relationship between their ending fund balance and their budget for the next year. He said when those counties levy taxes, they take into consideration what they have in their ending fund balance and what they need to levy in order to maintain the same proportional sized reserve for the following year. He said as budgets continue to grow, counties assess what percentage of their budgets need to remain on the books in case of an emergency.

In response to a question from Senator Bekkedahl, Mr. Traynor said whether rental costs paid by counties that rent social service facilities will be counted as eligible expenses is on the working group's list of issues that still need to be discussed. Mr. Traynor said some counties rent space from private parties and the rental amount shows up in that county's expenses as a direct cost when the counties apply for federal reimbursement. He said counties that have facility space located in county buildings reflect the amount of space allocated for social services within that building as an indirect cost. He said his preference is to have the formula cover both types of facility costs.

In response to a question from Representative Mitskog, Mr. Traynor said the hope is that implementing a new computer system to move the state toward a single eligibility system will result in cost savings on the economic assistance side of the formula due to less duplication of work by eligibility staff. Mr. Traynor said it is unknown how soon those cost savings might be realized.

In response to a question from Representative Hogan, regarding whether high ending fund balances could be due to vacancies, especially with the recruiting difficulties agencies have faced in the western part of the state, Mr. Traynor said that situation is a likely contributor to some of the high ending fund balances.

State Management of Human Service Budgets

Chairman Dockter called on the Legislative Council staff for a presentation (Appendix BB) of information received from NCSL regarding common ways states manage human service budgets. The Legislative Council staff said NCSL noted that the majority of state funding for social services is derived from the general fund. She said supplemental funds from other sources are used in some cases, such as this state's practice of supplementing social service budgets with property tax revenues. She said the most recent information NCSL had available was from a survey conducted in 2008 pertaining to each state's practice of earmarking taxes for specific purposes. She said every state earmarks taxes to some extent and a few states surveyed by NCSL earmarked more than 50 percent of their tax collections. She said the document summarizes the various categories earmarked taxes are devoted to including a category relating to health, welfare, and human services. She said earmarked taxes are devoted to this program area in 34 states. She said the largest sources of dedicated revenue for this program area are derived from tobacco tax revenue, which is dedicated in 23 states, and alcohol beverage tax revenue, which is dedicated in 13 states. She said the document provides a broad summary of how other states structure budgeting and revenue sources for certain programs.

Chairman Dockter called on the Legislative Council staff for a presentation (Appendix CC) regarding Michigan's use of business service centers as a means to improve the efficient management of core social service responsibilities. The Legislative Council staff said information regarding Michigan's social service structure was requested by the committee at its prior meeting. She said Michigan moved toward the use of business service centers as a means to provide for the efficient management of core social service responsibilities. She reviewed the delivery system for social services prior to the 2012 shift toward using business service centers. She said in 2012, Michigan's Department of Human Services established business service centers to alleviate director's burdens to complete operational tasks in order to allow directors to focus more on customer-based core program areas. She said business-related activities such as accounting, hiring, staffing allocations, travel requests, and facilities management were transferred from the local offices to six business service centers. She said a map (Appendix DD) illustrating the areas covered by the six business service centers has also been provided.

In response to a question from Senator Cook, the Legislative Council staff said she is not aware of the cost savings realized by Michigan due to the use of business service centers.

Senator Cook said it would be interesting to find out to what degree the Department of Human Services assesses what is being done in other states in order to determine if there is a better way to restructure or deliver services in this state. He said this is information that should be reviewed by the committee.

Chairman Dockter requested the Legislative Council staff contact the Department of Human Services and see if the department might be able to address the degree to which they review other state's systems.

Senator Mathern said he would prefer a more direct approach and would like to hear first hand from other states regarding recent structure changes and whether those changes have resulted in positive or negative impacts. In response, Senator Cook said he would be open to hearing directly from other states as well.

Chairman Dockter requested the Legislative Council staff see what information might be available from other states.

In response to a question from Representative Lefor, Representative Weisz said this state currently has eight regional human service centers that perform a variety of functions and services as well as several multicounty units. Representative Weisz said legislation has previously provided funding to support joint power agreements between counties for shared services. He said there are three to four counties in his district that currently share staff. He said some rural districts also share hard-to-find specialized staff over five to six different rural areas. He said he is not saying further efficiencies cannot be achieved, he just wants to make sure the committee is aware of some of the steps that have already been taken.

Representative Hogan said her experience with the social service system started in 1972. She said it might be beneficial for the committee to hear from someone in the Department of Human Services regarding how the current system has evolved over time. She said the 1997 "swap" legislation alone has a vast amount of associated legislative history. She said it is important for the committee to understand what aspects of the system have already been reviewed if it is considering any additional restructuring. She said she is always open to looking at the system further but the committee needs to keep in mind the need for access to the system, especially in regard to low-income individuals or seniors, in addition to cost effectiveness.

Senator Cook said Michigan was forced to make changes to its social service system due to budgetary concerns and he has been told the state saved roughly 20 percent on costs as a result of those changes. He said North Dakota may be forced to make similar changes due to its current budgetary outlook.

Senator Bekkedahl said he agrees with Representative Hogan that the committee needs to be careful regarding consolidations because if services are consolidated too much, some of the rural areas may suffer in regard to access. He said he also agrees with Senator Cook that the committee needs to look for efficiencies, but just hopes those efficiencies are not achieved at the expense of individuals who require services.

Privatized Services

Chairman Dockter called on the Legislative Council staff for a presentation (Appendix EE) of information received from NCSL regarding the privatization of social services. The Legislative Council staff said NCSL noted that many states are using private companies to provide case management and employment services though it is difficult to pinpoint exactly how many states are using privatized services and to what extent. She reviewed the document provided by NCSL and said the information provides a good overview of the types of privatized services that are offered in various program areas. She said in regard to the availability of privatized services in this state, the Department of Human Services already partners with several private service providers in addition to partnering with other state agencies and counties. She said the most notable private service providers, which other speakers have referenced in relation to the formula, are qualified service providers. She said qualified service providers are individuals or agencies that have agreed to provide services to a client. She said services provided by qualified service providers are partially funded by the Department of Human Services. She said the committee has been provided a handout (Appendix FF) detailing additional information pertaining to qualified service providers including information regarding how an individual or entity can become a qualified service provider and the types of services offered by qualified service providers.

The Legislative Council staff said in regard to the availability of qualified service providers in rural areas, the Department of Human Services offers a tool on its website that allows individuals to search by region or type of service to locate a qualified service provider in their area. She said the search yields a list of individuals or entities that have been verified by the Department of Human Services as having met all of the requirements to become a qualified service provider. She said the information available on the Department of Human Services' website, as well as the information provided by NCSL, gives the committee a better idea of the types of privatized services available on a national level and those available at the local level.

Representative Hogan said nationally, about 30 to 40 percent of the human service system is privatized. She said all nursing homes are privatized and nursing home services are generally paid through Medicaid. She said a large portion of the human service budget goes directly to private service providers so those providers are a substantial leg on the human services stool. She said by contract, voucher, or some other method of authorized payment, a large portion of the state's human service delivery system is already privatized. She said the appropriate question may be whether the state has the appropriate balance of state and privatized services. She said sometimes it is hard for rural communities to access qualified service providers so occasionally the county must step in and provide that safety net. She said the fact that the county acts as a safety net is why this discussion is so important.

Chairman Dockter said the committee will need to continue to review this topic.

Committee Discussion and Directives

Chairman Dockter requested the Legislative Council staff distribute a copy of 2011 House Bill No. 1057 based on Senator Cook's request from the previous day.

Senator Cook said 2011 House Bill No. 1057 contains several reporting requirements pertaining to the angel fund investment tax credit, which have since expired, that the committee should keep in mind as it seeks to tighten some of the reporting requirements related to the credit. He said there are several other items the committee may consider placing in a bill draft in addition to these reporting requirements.

Senator Mathern said he forwarded a copy of the email he mentioned regarding using loan funds to finance angel fund investments to the Legislative Council staff for further distribution to the committee members.

Chairman Dockter said the contents of the email could be further reviewed at a later meeting date.

Chairman Dockter asked if the committee had any additional comments regarding the committee's outstanding request for the 6-month rental of REMI software and consulting services.

Senator Cook said when the 64th Legislative Assembly passed Senate Bill No. 2057 requiring the 6-year study of incentives, few legislators were likely aware of REMI software or its capabilities. He said after learning more about the software he thinks it is something the state could benefit from using, especially when vetting the impact of economic development incentives. He said after reviewing the Texas legislation regarding dynamic fiscal notes it has become apparent that the committee has several outstanding questions that may need to be addressed before the software is acquired. He said questions regarding where the software should be housed if it is acquired, the agency or agencies tasked with using the software, and the degree to which the software should be used to generate dynamic fiscal notes still need to be addressed. He said the committee should also consider whether the state would benefit from having a state economist, and if so, which agency would be most suited to retain that position. He said it would be beneficial to hear from agencies such as the Tax Department, the Legislative Council, the Office of Management and Budget, and the Bank of North Dakota regarding some of these questions before the committee proceeds with the purchase of any associated software. He said he is aware that he was the individual who made the motion to recommend the rental of REMI software and consulting services, but in light of some of these questions, he feels obtaining the software at this time might equate to putting the cart before the horse. He said the committee would benefit from assembling a bill draft similar to the Texas legislation in order to sort out the answers to some of these questions. He said in light of these considerations, he feels it would be prudent for the committee to reconsider its actions at the prior meeting in regard to its recommendation to obtain REMI software and consulting services.

It was moved by Senator Cook, seconded by Senator Bekkedahl, and carried on a voice vote that the committee reconsider its action at the January 12-13, 2016, meeting at which the committee approved a motion recommending the Chairman of the Legislative Management approve funding of up to $114,700 for the committee's acquisition of consulting services and a 6-month rental of REMI software to assist the committee in its study of economic development tax incentives.

Senator Mathern said he agreed that there would be value to having the state use REMI software to analyze the potential impact of incentives before a decision is made to offer certain incentives. He said he would be in favor of Senator Cook's suggestion to pursue a bill draft to determine which agency might utilize dynamic forecasting to assist legislators in making informed decisions.

Representative Mitskog said it would be helpful to hear from representatives of the agencies referenced by Senator Cook to get their opinions on where REMI software would be best housed.

Chairman Dockter agreed regarding the value of receiving input from these agencies and said any acquisition of software for dynamic revenue forecasting would represent an investment in the state. He said he agreed with Senator Cook's suggestion to prepare a bill draft to answer some of the questions associated with the state's use of dynamic revenue forecasting.

Representative Belter said he would like to remind the committee of the situation that recently occurred regarding the state relying on the forecast provided by Moody's Analytics and noted it was individual legislators that took the initiative to assert that the numbers Moody's Analytics was forecasting were too optimistic. He said as the committee considers adding additional technology or advocating for a state economist, legislators should remain aware of the fact that they still have the individual responsibility to make good decisions and cautioned legislators not to get too carried away with hiring consultants as consultants do make mistakes.

Senator Cook requested that the angel fund email provided by Senator Mathern be forwarded to the Tax Department for review and further discussion at the committee's next meeting. He said it would also be beneficial to speak with some of the agencies mentioned in regard to undertaking dynamic fiscal analysis and review a bill draft containing several placeholders for the committee's consideration at a future meeting date. He said he would also suggest that the language in the bill draft specify that dynamic fiscal notes are not to be used for purposes of state budgeting.

Chairman Dockter requested the Legislative Council staff prepare a bill draft for review at a future meeting.

In response to a request from Representative Nathe, Chairman Dockter requested the Legislative Council staff request information from the Tax Department regarding how the 12 percent property tax credit would compare to a mill levy reduction resulting from a state assumption of social service costs.

Chairman Dockter said the next committee meeting would likely be sometime in the next 6 to 8 weeks and would likely consist of 1-day meetings going forward.

No further business appearing, Chairman Dockter adjourned the meeting at 2:00 p.m.

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Emily L. Thompson
Counsel

ATTACH:32