NORTH DAKOTA LEGISLATIVE MANAGEMENT

Minutes of the

GOVERNMENT FINANCE COMMITTEE

Thursday, June 7, 2018
Roughrider Room, State Capitol
Bismarck, North Dakota

Senator Ronald Sorvaag, Chairman, called the meeting to order at 9:00 a.m.

Members present: Senators Ronald Sorvaag, John Grabinger, Jordan Kannianen, Lonnie J. Laffen, Gary A. Lee, Terry M. Wanzek; Representatives Joshua A. Boschee, Jeff Delzer, Ron Guggisberg, Craig Headland, Corey Mock, Mike Nathe, Gary Paur, Brandy Pyle, Shannon M. Roers Jones, Mike Schatz, Don Vigesaa

Member absent: Representative Rick C. Becker

Others present: Representative Jim Schmidt, Huff, member of the Legislative Management
Allen H. Knudson, Legislative Council, Bismarck
See Appendix A for additional persons present.

It was moved by Representative Mock, seconded by Representative Boschee, and carried on a voice vote that the minutes of the March 7, 2018, meeting be approved as distributed.

STUDY OF TRANSPORTATION-RELATED FUNDING

At the request of Chairman Sorvaag, Mr. Shannon Sauer, Chief Financial Officer, Department of Transportation, presented information (Appendix B) regarding estimated transportation revenues for the 2019-21 biennium, transportation funding options presented during the Department of Transportation's (DOT) transportation symposium (Appendix C), including the estimated additional 2019-21 biennium revenues that would be generated for each option, and costs compared to fees charged for various services including driver's licenses and vehicle registrations.

Mr. Sauer said projected revenues for the 2019-21 biennium are anticipated to be $1.29 billion, $22.1 million more than 2017-19 biennium estimated revenues of $1.27 billion. He said federal funding is expected to remain at $673.4 million and highway tax distribution fund revenues are expected to be $20.3 million more than the 2017-19 biennium.

Mr. Sauer provided information (Appendix B) on estimated potential revenue sources for the state highway fund including the estimated annual revenue the options could generate. He discussed a value capture option. He said value capture utilizes the concept that a public investment such as transportation infrastructure may increase adjacent land value. He said value capture would convert a portion of the increased property value as public revenue through some taxation method such as property tax for use on transportation infrastructure.

Mr. Sauer said fees collected through the driver's license operations are estimated to generate $4.7 million per year during the 2019-21 biennium, with an estimated cost of $7.15 million.

In response to a question from Chairman Sorvaag, Mr. Sauer said implementing a per mile tax would require an electronic reporting mechanism, annual mileage checks, or self reporting. He said automatic reporting may eventually be available in new vehicles.

In response to a question from Chairman Sorvaag, Mr. Sauer said DOT believes the most feasible changes to current revenue sources for transportation funding are through fuel taxes and motor vehicle registrations.

In response to a question from Representative Guggisberg, Mr. Sauer said the Western Association of State Highway and Transportation Officials has been discussing the use of vehicle miles traveled as a method for generating revenue to support transportation infrastructure and methods to coordinate across state borders.

In response to a question from Representative Nathe, Mr. Sauer said that DOT would need to increase the 6-year driver's license fee by $26, from $15 to $41 in order to generate sufficient revenue to cover the cost of producing a driver's license. He said driver's licenses would still be renewed every 6 years for an average annual cost of $6.83 compared to the current average annual cost of $2.50.

In response to a question from Representative Vigessa, Mr. Sauer said the cost of issuing a REAL ID driver's license and a standard driver's license is the same.

In response to a question from Representative Mock, Mr. Sauer said a driver's licenses renewal fee of $41 for 6 years makes the annual cost of $6.83 more comparable to Minnesota, which charges $6.31 per year.

In response to a question from Representative Nathe, Mr. Sauer said increasing vehicle registration fees by $10 is estimated to generate $6.1 million annually or $12.3 million per biennium for the state highway fund.

In response to a question from Representative Vigessa, Mr. Sauer said the current federal highway funding program is effective through federal fiscal year 2020.

In response to a question from Representative Delzer, Mr. Sauer said the same Governor's 2019-21 budget reduction guidelines apply to special funded agencies as to agencies receiving funding from the general fund.

In response to a question from Representative Nathe, Mr. Mark Nelson, Deputy Director, Department of Transportation, said DOT has been working with the Governor's office regarding fees charged by the agency. He said DOT has been authorized to proceed with drafting legislation to increase fees if it is determined to be necessary.

Senator Wanzek suggested DOT review its costs and related fees and propose necessary adjustments to each Legislative Assembly to ensure that fee revenues are sufficient to cover its costs.

Senator Laffen said that DOT should ensure its fee revenues are sufficient to cover the associated costs, rather than the Legislative Assembly having to initiate changes to rates in order to match costs.

Mr. Wayde Swenson, Director of Operations, Department of Transportation, presented information (Appendix B) regarding the history of public-private partnership (PPP) projects. He said North Dakota Century Code Section 24-02-45.1 authorizes the Director of DOT to enter into cooperative agreements with private entities for the construction of an item on the state highway system, which will benefit the private entity and the traveling public. He said in the past DOT would enter an agreement with a city or county where the project was located, the city or county would receive funds from the private entity, and the project would be constructed with the funds received by the city or county.

In response to a question from Chairman Sorvaag, Mr. Swenson said private entities contact cities, counties, or DOT, requesting changes to roads for improvements that impact the private entity's business. He said for example, a company may request a city to add a stop light near the company's parking lot exit and it will pay the additional costs for that improvement to the infrastructure.

Senator Laffen said the DOT example could be considered a reverse PPP. He said as in a normal PPP the state would seek a private organization to construct a project and through a contractual agreement authorize the private organization to complete the project.

In response to a question from Representative Mock, Mr. Swenson said typical PPP contracts include provisions for maintenance of the project.

In response to a question from Representative Delzer, Mr. Thomas K. Sorel, Director, Department of Transportation, said DOT has participated in small PPP projects, but larger projects, which could include tolls, would need to be considered and approved by the Legislative Assembly.

Mr. Russ Hanson, Associated General Contractors of North Dakota, provided public comment (Appendix D) regarding the design-build delivery method of construction for highway projects. He expressed concern with the design-build method and noted potential disadvantages, including reduced competition.

In response to a question from Representative Vigessa, Mr. Hanson said that even with fewer road construction projects currently being bid, out-of-state contractors are still maintaining a physical presence in the state.

In response to a question from Representative Vigessa, Mr. Hanson said the state has a lowest bidder policy. He said most states that have a local bidder preference law have a reciprocity statue which allows states with similar reciprocity statutes to participate in bidding.

In response to a question from Representative Roers Jones, Mr. Hanson said the Associated General Contractors of North Dakota does not support the PPP method of construction for the same reasons it does not support the design-build method of construction.

Representative Roers Jones commented that there are often additional costs incurred by construction companies when working out of state which makes it more difficult to compete against local contractors.

Mr. Bill Kalanek, North Dakota Association of Plumbing, Heating, and Mechanical Contractors, commented regarding the design-build delivery method of construction for highway projects. He expressed concern with the design-build method and the use of subcontractors on those projects. He said a design-build project has all participating companies selected and does not allow subcontractors outside of that group to bid on parts of the project.

In response to a question from Senator Lee, Mr. Kalanek said when public funds are being used on a project, all organizations should have an opportunity to bid on the project.

At the request of Chairman Sorvaag, Senator Lee and Representative Schmidt presented information regarding their experience at a seminar in San Diego, California, which discussed utilizing the PPP method for water projects. Senator Lee explained that very few water projects are using the PPP method. He said the projects being done using the PPP method require a clearly defined project, a clearly defined revenue source, specific provisions regarding the risks on the project, and a defined maintenance plan. Representative Schmidt commented about his discussion with financial institutions present at the seminar and their reluctance to use PPP on water projects as a result of the available revenue sources.

In response to a question from Chairman Sorvaag, Representative Schmidt said the sustainability and revenue source for water projects is a concern for companies looking to invest in a PPP project.

Senator Laffen commented that PPP projects are popular for states with a lack of available resources to pay for projects. He said Indiana needed to construct a new highway, entered into a PPP agreement, and has experienced many problems with the project.

STUDY OF REVENUE VOLATILITY

At the request of Chairman Sorvaag, Dr. William W. Wilson, Professor, Department of Agribusiness and Applied Economics, North Dakota State University, presented information (Appendix E) regarding oil prices, volatility, and risk for government budget-related revenues.

Dr. Wilson said in 2015 Mexico began utilizing oil price hedges by purchasing options to lock in prices at $76.40 as a result of its experience in the decline in oil prices. He said in 2016 it cost Mexico $1.09 billion at a strike price of $49 per barrel. He said previously Mexico had purchased options at a strike price of $76.40 per barrel at a cost of $773 million. He said the resulting market for its oil averaged $49.78 per barrel providing Mexico with an additional $26.62 per barrel when it exercised its oil options. He said 50 percent of Russia's income comes from oil revenue and when oil prices shift from $140 per barrel to $30 per barrel to $70 per barrel, it has a major impact on its budget. He said in 2016 Russia chose to use Mexico's strategy.

Dr. Wilson said Alberta, Canada studied hedging its oil revenue, ultimately determining it was better to address revenue volatility through fund management rather than hedging. He said Texas experienced oil revenue decline from $8.9 billion to $2.5 billion in 2014-15. He said the decline in revenue prompted Texas to utilize the collar method of hedging. He said the collar strategy utilizes the purchase of puts and calls, where the cost of the put is offset by the sale of a call. He said hedging oil can result in more cost than gain. He said to date in 2018 many drilling companies that hedged 2018 output at $50 to $55 per barrel are expected to experience hedging losses, such as one company that lost $69 million. He said since North Dakota does not have control over production, it has quantity risk since the state never knows how much oil will be produced.

In response to a question from Chairman Sorvaag, Dr. Wilson said Mexico and Russia own the oil being hedged, while Texas is hedging the revenue generated through taxation.

Representative Delzer commented that sales and use tax revenue volatility is a larger issue for North Dakota. He said oil revenue volatility is largely mitigated through a revenue allocation formula to various funds.

In response to a question from Chairman Sorvaag, Dr. Wilson said collars should be used when current oil prices are adequate. He said Mexico and Russia have adopted risk policies to guide their hedging processes.

Senator Wanzek said he understands the benefit with hedging and more specifically the collar method, but has concerns with government getting involved in hedging. He said explaining why the state decided to spend millions of dollars to purchase put options when oil prices increase in favor of the state would be difficult.

In response to a question from Senator Wanzek, Dr. Wilson said the state needs to have a risk policy in place that defines when hedging can be used and how it can be used. He said the focus of government entities is to lock in revenue for budgeting purposes.

In response to a question from Representative Headland, Dr. Wilson said if the state would choose to proceed with hedging, he would expect the state to contract through an investment banker to conduct the hedging based on the polices established by the Legislative Assembly. He said the state should study how implementation of hedging would work before doing so.

In response to a question from Representative Paur, Dr. Wilson said the cost of hedging increases as the length of time of the hedge increases.

In response to a question from Senator Wanzek, Dr. Wilson said he believes Alberta chose not to utilize hedging because of public perception.

Representative Headland commented that these types of management tools contain risk. He expressed concern with the state getting involved in hedging.

STUDY OF STATE FLEET SERVICES

Ms. Robin Rehborg, Director, State Fleet Services Division, Department of Transportation, presented information (Appendix F) regarding costs associated with the operation of State Fleet Services (SFS), detail regarding the components included in the development of SFS rates, and 2019-21 biennium budgeted SFS rates with explanations of changes from 2017-19 biennium rates. She said the SFS budget for the 2017-19 biennium is approximately $71 million with operating costs of $36.3 million and capital asset costs of $34.7 million.

In response to a question for Representative Paur, Ms. Rehborg said DOT asks its vendors to provide future prices for 3 years for fuel.

In response to a question from Chairman Sorvaag, Ms. Rehborg said the state fleet consists of approximately 3,500 vehicles.

Ms. Erin Kramarich, Director, Business Rental Sales, Enterprise Holdings Inc., provided comments (Appendix G) regarding its discussions with DOT and its analysis of the current state of the motor pool. She said there are five main objectives which Enterprise Holdings Inc., (EHI) can assist the state--fiscal responsibility, efficiency, technology, safety, and employee satisfaction. She said EHI could improve the cost-effectiveness of SFS.

In response to a question from Chairman Sorvaag, Ms. Kramarich said if the state would rent EHI vehicles for its fleet services, the vehicles could be offsite or on location. She said the vehicles may also be used by nonstate employees through its normal rental process. She said currently EHI is working with the states of Montana, Utah, and Pennsylvania. She said Utah has privatized its entire motor pool while Pennsylvania utilizes EHI, the state's motor pool, and mileage reimbursement.

In response to a question from Chairman Sorvaag, Ms. Kramarich said EHI's preliminary review of North Dakota's state fleet finds that EHI could improve the cost-effectiveness of SFS by supplementing certain classes of vehicles.

In response to a question from Representative Nathe, Ms. Kramarich said the preliminary review estimates savings of $150,000 over a 6-month period. She said this does not include any additional cost-savings due to less maintenance costs incurred by SFS.

In response to a question from Representative Paur, Ms. Kramarich said EHI has 12 locations in North Dakota.

In response to a question from Representative Delzer, Ms. Kramarich said the vehicles which would be used to supplement state fleet may be registered in another state.

In response to a question from Representative Nathe, Ms. Kramarich said the state already has a rental car agreement for insurance and the vehicles used under a program where EHI supplements state fleet would have coverage under that contract.

In response to a question from Representative Vigesaa, Ms. Rehborg said approximately 2,000 state fleet vehicles are of the type that could be included in the supplemental group.

In response to a question from Senator Wanzek, Ms. Rehborg said state fleet vehicles are required to be marked and only driven by state employees.

In response to a question from Representative Nathe, Ms. Rehborg said SFS generally sells its sedans after 5 or 6 years and a one-ton pickup after 7 to 10 years.

In response to a question from Representative Nathe, Ms. Rehborg said if DOT chooses to contract with EHI, vehicle maintenance would be addressed in the contract.

In response to a question from Senator Grabinger, Ms. Rehborg said the state is not required to pay federal fuel taxes on its fuel purchases.

OTHER DUTIES

Mr. Brad Darr, Maintenance Division Director, Department of Transportation, presented information (Appendix H) regarding the results of DOT's study on the manner in which DOT provides snow and ice control services on the state highway system, pursuant to Section 10 of 2017 Senate Bill No. 2012. He said DOT is evaluating the data and anticipates providing a complete report to the Legislative Management by June 20, 2018.

In response to a question from Representative Vigessa, Mr. Darr said DOT has conducted a survey of its snow and ice control services.

Mr. Russ Buchholz, Information Technology Division Director, Department of Transportation, presented the results of a study (Appendix I) on benefits of allowing wireless telecommunication infrastructure within state highway rights of way and what, if any, requirements of allowing the installation may be in the public interest, pursuant to Section 14 of 2017 Senate Bill No. 2012. He said the study was a cooperative study with DOT and the Information Technology Department. He said the study recommends that companies work with adjacent landowners and only consider right of way access if there is no other alternative.

In response to a question from Senator Lee, Mr. Buchholz said cellular companies have been submitting requests to install equipment within state highway rights of way. He said the companies find it more cost-effective to install small transmitters on existing structures along the highway. He said the items would be installed or constructed on the area of the right of way furthest from the roadway.

Ms. Karlene Fine, Executive Director, Industrial Commission, introduced Mr. Kirk Lindemann, Certified Public Accountant, Partner, Eide Bailly LLP, who presented the results and recommendations of a gain-sharing study at the Mill and Elevator (Appendix J), pursuant to Section 30 of 2017 Senate Bill No. 2014. Mr. Lindemann said based on the findings, specifically the earnings analysis along with consideration of compensation data comparisons and other financial and nonfinancial aspects of maintaining the gain-sharing program, the gain-sharing program at the Mill and Elevator is financially feasible.

In response to a question from Chairman Sorvaag, Mr. Lindemann said safety was one of the factors included in the gain-sharing study.

In response to a question from Representative Nathe, Mr. Vance Taylor, President and General Manager, Mill and Elevator, said although not required, some employees may work 7 days a week since the mill operates 24 hours every day. He said on average, 25 percent of the employees work 7 days a week.

In response to a question from Chairman Sorvaag, Mr. Taylor said the employees have chosen to operate on three shift rotations rather than four shift rotations.

Mr. Taylor said the gain-sharing program is a critical part of employee compensation. He said it is used as a tool to improve employee efficiency and to retain employees.

STATE BUDGET INFORMATION

Mr. Joe Morrissette, Director, Office of Management and Budget, presented information (Appendix K) regarding the status of the general fund and other state budget information. He presented the following information on the preliminary status of the general fund for the 2017-19 biennium to date through May 2018:

Unobligated general fund balance - July 1, 2017		$65,000,000
Add		
Revenues collected to date		2,059,134,901
Remaining forecasted revenues		2,312,980,954
Balance obligated for authorized carryover from the 2015-17 biennium		99,271,093
Total estimated available		$4,536,386,948
Less		
2017-19 biennium general fund ongoing appropriations	($4,295,624,415)	
2017-19 biennium general fund one-time appropriations	(14,638,226)	
Balance obligated for authorized carryover from the 2013-15 biennium	(99,271,093)	
Total appropriations and adjustments		(4,409,533,734)
Estimated general fund balance - June 30, 2019		$126,853,214[1]

[1]Section 54-27.2-02 provides that any end of the biennium balance in excess of $65 million must be transferred to the budget stabilization fund, up to a cap of 15 percent of general fund appropriations.

Mr. Morrissette said actual general fund revenue collections are $42.3 million more than forecasted. He said the balance of the budget stabilization fund is $100.3 million and the legacy fund balance is $5.49 billion as of May 2018. He said as of May 2018, oil and gas tax revenues are $323.6 million more than May 2017 legislative forecast.

At the request of Chairman Sorvaag, the Legislative Council staff presented a memorandum entitled *North Dakota Taxable Sales and Purchases Quarterly Report for the Quarter Ending December 31, 2017*. The memorandum provides quarterly information regarding North Dakota taxable sales and purchases for the fourth quarter of the 2016 and 2017 calendar years.

No further business appearing, Chairman Sorvaag adjourned the meeting at 2:35 p.m.

Chris Kadrmas
Fiscal Analyst

ATTACH:11