

LEGACY FUND EARNINGS STUDY - BACKGROUND MEMORANDUM

STUDY OVERVIEW

Section 32 of Senate Bill No. 2015 (2019) ([Appendix A](#)) creates a legacy fund earnings committee to study the potential uses of legacy fund earnings. The committee consists of the Majority and Minority Leaders of the House and Senate, the chairmen of the House and Senate Finance and Taxation Committees, the chairmen of the House and Senate Appropriations Committees, two members of the legacy and budget stabilization fund advisory board appointed by their respective Majority Leaders, and the chairman of the Legislative Management. The study must include consideration of using the legacy fund earnings for tax relief, reinvestment, research and technological advancements, economic growth and diversification, workforce development, and career and technical education initiatives. The committee may review the operation of similar funds and may consider public input on the use of legacy fund earnings.

LEGACY FUND HISTORY

In 2010, the voters of North Dakota approved a constitutional amendment to create the legacy fund (Section 26 of Article X of the Constitution of North Dakota). Pursuant to the measure, 30 percent of oil and gas gross production and oil extraction taxes are deposited in the legacy fund. The measure restricted the expenditure of principal and earnings until after June 30, 2017. Any expenditure of principal requires a vote of at least two-thirds of the members elected to each house of the Legislative Assembly, and the expenditure of principal may not exceed 15 percent of the principal balance of the legacy fund during a biennium. The Legislative Assembly may transfer funds from any source to the legacy fund, which become part of the principal of the fund. The State Investment Board is responsible for investing the principal of the legacy fund. Interest earnings accruing after June 30, 2017, are transferred to the general fund at the end of each biennium. North Dakota Century Code Section 21-10-12 provides a definition for the earnings of the legacy fund. The earnings include interest, dividends, and realized gains and losses, but exclude unrealized gains and losses.

The 2011 Legislative Assembly established a legacy and budget stabilization fund advisory board to develop recommendations for the investment of the legacy fund and the budget stabilization fund. The goal of the investment strategy is principal preservation while maximizing total returns. The advisory board makes recommendations to the State Investment Board, including asset allocations and investment policies. The advisory board regularly reviews and approves the investment policy statement ([Appendix B](#)).

The 2011 Legislative Assembly created the strategic investment and improvements fund to provide funding for one-time expenditures related to state infrastructure or initiatives that improve the efficiency and effectiveness of state government (House Bill No. 1451). For the 2011-13 and 2013-15 bienniums, if the balance of the strategic investment and improvements fund exceeded \$300 million at the end of any month, 25 percent of any revenues deposited in the strategic investment and improvements fund were transferred to the legacy fund. The 2015 Legislative Assembly removed the requirement to transfer additional funding from the strategic investment and improvements fund to the legacy fund (House Bill No. 1377).

PREVIOUS STUDIES

Senate Bill No. 2124 (2013) provided for a study of methods to assure that the legacy fund provides the lasting benefits intended by the voters in the enacting constitutional measure. The Legislative Management assigned the study to the Government Finance Committee for the 2013-14 interim. The committee recommended House Bill No. 1033 (2015), attached as [Appendix C](#), to provide several definitions for constitutional provisions relating to the legacy fund and to clarify the process used to determine limitations on expenditures from the legacy fund. The bill also provided that earnings transferred from the legacy fund to the general fund at the end of a biennium are to be transferred back to the legacy fund and become principal unless certain criteria are met. The Legislative Assembly approved House Bill No. 1033 (2015); however, the Governor vetoed the bill.

The Legislative Assembly approved Senate Concurrent Resolution No. 4014 (2015) relating to a study of legacy fund reinvestment scenarios and potential priorities for legacy fund earnings. The Legislative Management did not select the study for consideration during the 2015-16 interim.

STATUS OF THE LEGACY FUND

During the budgeting process for the 2017-19 biennium, the 2017 Legislative Assembly included \$200 million of estimated legacy fund earnings in the general fund revenue forecast. The 2019 Legislative Assembly revised the general fund revenue forecast for the 2017-19 biennium to include \$300 million of estimated legacy fund earnings, an increase of \$100 million compared to the original estimate. An analysis of the legacy fund reflecting

the 2019 legislative revenue forecast is attached as [Appendix D](#). Based on information reported by the Retirement and Investment Office, the principal balance of the legacy fund is \$5.54 billion as of May 31, 2019. The 2017-19 biennium earnings of the legacy fund available to transfer to the general fund at the end of the biennium total \$455.26 million.

2019 LEGISLATIVE SESSION

The 2019 Legislative Assembly did not approve any bills related to designated uses of legacy fund earnings, but the following were considered during the session:

- **House Bill No. 1484** (Representative Boschee) would have appropriated \$275 million from the general fund derived from legacy fund earnings for various purposes, including a transfer of \$100 million to a health and human services stabilization fund.
- **House Bill No. 1504** (Representative Kempenich) would have deposited a portion of the legacy fund earnings in the general fund with the remainder transferred to a legacy earnings fund. The amount deposited in the general fund would have been equal to 5 percent of the 4-year average of legacy fund assets.
- **House Bill No. 1509** (Representative Hanson) would have transferred \$5 million from the general fund derived from legacy fund earnings to a paid family medical leave fund.
- **House Bill No. 1523** (Representative B. Koppelman) would have transferred excess state agency fund balances to the legacy fund after August 2021.
- **House Bill No. 1530** (Representative Headland) would have transferred 50 percent of legacy fund earnings to a legacy income tax reduction fund to provide income tax rate reductions.
- **Senate Bill No. 2141** (Senator O. Larsen) would have provided a funding allocation to each child at birth managed by the Bank of North Dakota and would have deposited unspent funding in the legacy fund.
- **Senate Bill No. 2282** (Senator Sorvaag) would have transferred 15 percent of legacy fund earnings to an economic diversification research grant fund.
- **Senate Concurrent Resolution No. 4005** (Senator Hogue) was a proposed constitutional amendment to create a fund for grants and loans to political subdivisions for infrastructure projects. The amendment would have transferred 15 percent of the principal of the legacy fund and 15 percent of the earnings to the fund.

The 2019 Legislative Assembly also considered **Senate Bill No. 2276** (Senator Heckaman), which would have expanded the investments of the legacy fund to include investments in state programs; however, the bill was not approved.

The 2019-21 executive budget recommended appropriating \$300 million from the general fund derived from legacy fund earnings for the following:

- The infrastructure revolving loan fund (\$55 million);
- The school construction assistance revolving loan fund (\$25 million);
- The Research North Dakota fund (\$20 million);
- North Dakota University System challenge grants (\$40 million);
- A new career academy building (\$30 million);
- A new state hospital building (\$35 million);
- A National Guard training center (\$15 million);
- A Theodore Roosevelt Presidential Library (\$50 million); and
- An unmanned aircraft systems statewide infrastructure network (\$30 million).

OTHER SIMILAR FUNDS

Norway's Government Pension Fund Global

The Government Pension Fund Global was established in 1990 to ensure responsible and long-term management of revenue from Norway's oil and gas resources with the intent that the fund would provide a benefit to current and future generations. The fund is invested in a variety of asset classes including equities, fixed-

income, and real estate. The fund is invested abroad to avoid undue influence on the Norwegian economy. The Norwegian government has not established a formal policy regarding withdrawals from the fund, but the fund is used to fund government operations. The fund is fully integrated with the state budget, and distributions from the fund are limited to the long-term expected real return of the fund, or approximately 3 percent.

As of March 31, 2019, the fund had a market value of approximately \$1.02 trillion. Investment of the \$1.02 trillion includes \$280 billion in fixed-income, \$710 billion in equities, and \$30 billion in real estate. In 2017, the investments of the fund generated \$117 billion, but in 2018, the investments of the fund lost \$55 billion.

Alaska's Permanent Fund

In 1976, the voters of Alaska approved a constitutional amendment to create the Permanent Fund to invest a portion of the state's mineral revenues as a way to generate income into perpetuity. Twenty-five percent of all mineral royalties, bonuses, and leases are deposited in the Permanent Fund. The fund's investments are diversified and include stocks, bonds, real estate, private equity, hedge funds, infrastructure, cash, and other assets. The income of the fund is distributed to Alaskan residents through the Permanent Fund Dividend program, which was established by law in 1980, and to the state's general fund for government operations. In 2017, the Alaskan legislature approved a distribution calculation based on 5.25 percent of the average market value of the fund for the first 5 of the preceding 6 years (similar to the distribution calculation for North Dakota's common schools trust fund).

As of March 31, 2019, the fund had a market value of \$66.2 billion, including \$13.1 billion in fixed-income, \$23.8 billion in equities, \$5.7 billion in real estate, \$8.4 billion in private equity, \$3.5 billion in infrastructure, \$5 billion in cash and short-term investments, and \$6.7 billion in other assets. The fund's income was \$6.8 billion in fiscal year 2017 and \$5.7 billion in fiscal year 2018.

Permanent Trust Funds in Other States

In addition to Alaska's Permanent Fund, New Mexico and Wyoming also maintain permanent trust funds, which produce earnings to support the state's government operations. New Mexico's Severance Tax Permanent Fund was created by the state's legislature in 1973, and the market value of the fund was \$5.4 billion as of June 30, 2018. Wyoming's Permanent Mineral Trust Fund was established through a constitutional amendment approved by the voters of Wyoming in 1974, and as of June 30, 2018, the fund had a market value of \$7.8 billion.

STUDY PLAN

The following is a proposed study plan for the committee's consideration of its study of the potential uses of legacy fund earnings:

1. Receive information regarding the investments and earnings of the legacy fund, including estimated future earnings;
2. Receive information regarding the investments and earnings of other similar funds;
3. Receive information regarding the costs and benefits of any potential initiatives that would use legacy fund earnings;
4. Receive testimony from interested persons regarding the study;
5. Develop recommendations and any bill drafts necessary to implement the recommendations; and
6. Prepare a final report for submission to the Legislative Management.

ATTACH:4