



North Dakota Legislative Council

Prepared for the Legacy Fund Earnings Committee
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LEGACY FUND EARNINGS STUDY - BACKGROUND MEMORANDUM

STUDY OVERVIEW

Section 6 of House Bill No. 1380 (2021) 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 or their legislative designees; the Chairmen of the House and Senate Finance and Taxation Committees or their legislative designees; the Chairmen of the House and Senate Appropriations Committees or their legislative designees; the Chairmen of the House and Senate Industry, Business and Labor Committees or their legislative designees; two members of the Legacy and Budget Stabilization Fund Advisory Board appointed by their respective Majority Leaders; and the Chairman of the Legislative Management or the Chairman's designee. The study must include consideration of using the legacy fund earnings for tax relief, reinvestment, research and technological advancements, innovation, economic growth and diversification, and workforce development.

LEGACY FUND HISTORY

Overview

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 and principal of the legacy fund. The earnings include interest, dividends, and realized gains and losses, but exclude unrealized gains and losses. The principal includes all the money in the legacy fund not identified as earnings.

Legacy and Budget Stabilization Fund Advisory Board

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. House Bill No. 1425 (2021) requires the asset allocation plan of the legacy fund to include a target allocation of 10 percent for in-state fixed income investments and a target allocation of 10 percent for in-state equity investments. The advisory board regularly reviews and approves the investment policy statement with the most recent policy statement approved in February 2021 ([Appendix A](#)).

Additional Transfers to the Legacy Fund

The 2011 Legislative Assembly, in House Bill No. 1451, 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. 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, in House Bill No. 1377, removed the requirement to transfer additional funding from the strategic investment and improvements fund to the legacy fund.

Allocation of Legacy Fund Earnings

Pursuant to constitutional provisions, the legacy fund earnings are transferred to the general fund at the end of each biennium after June 30, 2017. House Bill No. 1380 (2021) created a process to immediately transfer any

legacy fund earnings deposited in the general fund to a newly created legacy earnings fund. House Bill No. 1380 also established a percent of market value calculation to determine the amount of legacy fund earnings available for spending each biennium. The percent of market value is based on 7 percent of the 5-year average of legacy fund assets. The earnings available for spending would be transferred from the legacy earnings fund to other state special funds and designated for other purposes determined by the Legislative Assembly. A portion of the excess earnings would be retained in the legacy earnings fund as a reserve for any potential future bond payments, and up to \$100 million of excess earnings would be transferred to the legacy fund to become part of the principal with the remaining excess earnings transferred to the strategic investment and improvements fund.

PREVIOUS STUDIES

2013-14 Interim

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 enacting the 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), 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; however, the Governor vetoed the bill.

2015-16 Interim

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.

2019-20 Interim

Senate Bill No. 2015 (2019) created a Legacy Fund Earnings Committee to study the potential uses of legacy fund earnings. The committee reviewed the history and status of the legacy fund. The committee received information on the state budget; other sovereign wealth funds, including the Alaska permanent fund; and the potential concerns for the current process of administering the legacy fund earnings. The committee also received comments regarding proposed uses of legacy fund earnings.

As a result of the study, the committee recommended:

- House Bill No. 1037 (2021) relating to the establishment of a percent of market value method for determining the amount of legacy fund earnings available to be spent each biennium and the creation of a legacy earnings fund; and
- House Bill No. 1038 (2021) relating to a Legacy Fund Earnings Committee.

The Legislative Assembly did not approve House Bill Nos. 1037 and 1038; however, House Bill No. 1380, which was approved by the Legislative Assembly, included a percent of market value calculation, created a legacy earnings fund, and provided for a Legacy Fund Earnings Committee to study selected uses of legacy fund earnings.

STATUS OF THE LEGACY FUND

During the budgeting process for the 2019-21 biennium, the 2019 Legislative Assembly included \$100 million of estimated legacy fund earnings in the general fund revenue forecast. The 2021 Legislative Assembly revised the general fund revenue forecast for the 2019-21 biennium to include \$736 million of estimated legacy fund earnings, an increase of \$636 million compared to the original estimate. The actual legacy fund earnings transferred to the general fund at the end of the 2019-21 biennium totaled approximately \$871.69 million.

Senate Bill No. 2362 (2019) included a contingent transfer of \$64.37 million from legacy fund earnings deposited in the general fund to the common schools trust fund if the legacy fund earnings transferred to the general fund at the end of the 2019-21 biennium were at least \$164.37 million. The 2019 Legislative Assembly approved the contingent transfer to correct a shortfall of oil extraction tax revenues deposited in the common schools trust fund in prior bienniums. Since the actual legacy fund earnings were approximately \$871.69 million and exceeded the threshold of \$164.37 million, \$64.37 million of legacy fund earnings deposited in the general fund at the end of the 2019-21 biennium was transferred to the common schools trust fund.

Since House Bill No. 1380 establishes a percent of market value calculation and transfers legacy fund earnings immediately from the general fund to a newly created legacy earnings fund, the 2021 legislative revenue forecast ([Appendix B](#)) does not reflect any estimated legacy fund earnings as general fund revenue for the 2021-23 biennium.

Based on information reported by the Retirement and Investment Office, the principal balance of the legacy fund is \$8.2 billion as of October 31, 2021. The 2021-23 biennium earnings of the legacy fund available to transfer to the legacy earnings fund at the end of the biennium total approximately \$353.44 million through October 31, 2021.

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 current process of allocating legacy fund earnings;
3. Receive information regarding potential uses of legacy fund earnings for tax relief, research and technological advancements, innovation, economic growth and diversification, and workforce development;
4. Receive information regarding proposals to establish a statutory committee to award grants for university research programs and workforce enrichment initiatives;
5. Receive information regarding proposals to define the use of research, innovation, and workforce enrichment funding;
6. Receive information regarding proposals to develop reporting requirements for entities receiving funds from the clean sustainable energy fund and from grants awarded for university research, innovation, and workforce enrichment initiatives;
7. Receive testimony from interested persons regarding the study, including input from representatives of economic development entities, agricultural organizations, research entities, the Innovation Loan Fund to Support Technology Advancement Committee, workforce development entities, higher education institutions, and the Parks and Recreation Department;
8. Develop recommendations and any bill drafts necessary to implement the recommendations; and
9. Prepare a final report for submission to the Legislative Management.

ATTACH:2