

# LEGACY FUND EARNINGS COMMITTEE

Section 6 of House Bill No. 1380 (2021) created the 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; the chairmen of the House and Senate Industry, Business, and Labor 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 legacy fund earnings for tax relief, research and technological advancements, innovation, economic growth and diversification, and workforce development.

Committee members were Representatives Chet Pollert (Chairman), Joshua A. Boschee, Jeff Delzer, Craig Headland, and Mike Lefor and Senators Jessica Bell, Joan Heckaman, Jerry Klein, Ronald Sorvaag, Terry M. Wanzek, and Rich Wardner.

Senator Ray Holmberg served on the committee until his resignation from the Legislative Assembly in June 2022.

## LEGACY FUND Overview

In 2010 North Dakota voters 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 approval 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 and providing a direct benefit to the state by investing a portion of the principal in the state. The advisory board makes recommendations to the State Investment Board, including asset allocations and investment policies. Section 21-10-11, as amended by 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.

### Additional Transfers to the Legacy Fund

House Bill No. 1451 (2011) 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. House Bill No. 1377 (2015) removed the requirement to transfer additional funding from the strategic investment and improvements fund to the legacy fund. While the provisions were in effect, approximately \$319 million was transferred from the strategic investment and improvements fund to the legacy fund.

### Allocation of Legacy Fund Earnings

Pursuant to constitutional provisions, 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. The bill 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 will 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 will be

retained in the legacy earnings fund as a reserve for any potential future bond payments, and up to \$100 million of excess earnings will 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.

## **Prior 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 Government Finance Committee recommended House Bill No. 1033 (2015) to provide definitions for constitutional provisions relating to the legacy fund, to clarify the process used to determine limitations on expenditures from the legacy fund, and to provide a method to transfer earnings back to the legacy fund to grow the fund until oil and gas development activity declines. The Legislative Assembly approved House Bill No. 1033; however, the Governor vetoed the bill.

### **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, included a percent of market value calculation, created a legacy earnings fund, and provided for the Legacy Fund Earnings Committee to study selected uses of legacy fund earnings.

## **Status**

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 \$871.69 million. As a reference, the actual legacy fund earnings transferred to the general fund at the end of the 2017-19 biennium, the 1<sup>st</sup> biennium in which earnings were transferred, was \$455.26 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 \$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.

Because House Bill No. 1380 (2021) established a percent of market value calculation and transferred legacy fund earnings immediately from the general fund to a newly created legacy earnings fund, the 2021 legislative revenue forecast did 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 balance of the legacy fund was \$7.9 billion as of June 30, 2022, including \$568.7 million of earnings available to transfer to the legacy earnings fund at the end of the biennium. The investment returns for the legacy fund for fiscal year 2022 reflect a loss of 10.1 percent compared to the benchmark's loss of 10.5 percent.

## **COMMITTEE CONSIDERATIONS**

### **Budget Information**

#### **Legislative Council**

The committee received information from the Legislative Council regarding the state budget and a comparison of ongoing revenues and appropriations. Ongoing general fund appropriations have exceeded ongoing general fund revenues since the 2015-17 biennium. The 2021-23 biennium general fund budget was balanced with one-time revenue sources, including a transfer from the strategic investment and improvements fund and the beginning balance. For the 2021-23 biennium, ongoing general fund revenues have exceeded the legislative forecast by 22 percent through July 2022. If ongoing general fund revenues continue to exceed the legislative forecast by 22 percent for the remainder of the biennium, ongoing general fund appropriations may exceed ongoing general fund revenues by \$400 million. The budgetary gap between ongoing general fund appropriations and ongoing general fund revenues may decrease to \$290 million in the 2023-25 biennium based on preliminary estimates for potential increases in ongoing general fund appropriations and revenues.

The committee reviewed legacy fund earnings scenarios based on the percent of market value calculation under Section 21-10-13. The percent of market value calculation for the 2023-25 biennium spending from the legacy earnings fund is \$486.6 million based on 7 percent of the 5-year average of legacy fund assets as of June 30, 2022. Using the actual legacy fund earnings for the 2021-23 biennium through June 30, 2022, \$82.1 million of earnings would be available to be retained in the legacy earnings fund as a reserve for future bond payments in addition to the \$486.6 million of earnings available for spending.

#### **Tax Information**

The Tax Department provided information on the status of the income tax credit authorized during the 2021 special legislative session in House Bill No. 1515. For fiscal year 2022, \$103.1 million of tax credits was claimed with approximately 277,000 tax returns eligible for a full or partial credit of up to \$350 for single filer returns and \$700 for married filing jointly returns. The committee reviewed the information as a part of its assigned responsibility to consider tax relief as a potential use of legacy fund earnings.

Based on information from the Tax Department, the oil extraction tax rate increased from 5 to 6 percent effective for June 2022 oil production because oil prices exceeded the "trigger" price for 3 consecutive months. As a result, the state may receive \$140 million of additional oil extraction tax collections if the higher tax rate is effective for oil production between June and October 2022. After the allocations to the Three Affiliated Tribes of the Fort Berthold Reservation, 30 percent of the additional tax collections are allocated to the legacy fund, providing additional revenue to the legacy fund during the 2021-23 biennium.

#### **Bond Issuances**

The committee received information from the Public Finance Authority regarding bonds issued to support infrastructure projects and programs as authorized in House Bill No. 1431 (2021). The Public Finance Authority issued \$710.1 million of bonds to finance \$680 million of authorized projects and programs, including \$389.2 million issued in December 2021 with a net interest rate of 2.71 percent and \$320.9 million issued in July 2022 with a net interest rate of 4.58 percent. The biennial repayment cost of the bonds is approximately \$101.8 million. Pursuant to the allocations from the legacy earnings fund, \$150 million is transferred to a legacy sinking and interest fund for the bonds payments with any remaining amounts available for a transfer to the Public Employees Retirement System main system plan.

#### **Other State Budget Information**

The Department of Mineral Resources provided information to the committee indicating oil drilling activity in North Dakota may continue for 10 to 20 years after which enhanced oil recovery methods will be needed to further develop oil production in the state. Since the legacy fund receives allocations from oil and gas tax revenues, changes in oil development activity may impact the revenue deposited in the legacy fund significantly.

The committee received information from the Department of Transportation regarding the status of the state highway fund. Approximately 60 percent of the revenue for the state highway fund is derived from the highway tax distribution fund. Since the allocations from the legacy earnings fund include an allocation the highway tax distribution fund, the state highway fund may have additional funding available for state highway projects.

The committee received information on the Clean Sustainable Energy Authority, which provides financial support for clean energy projects. Section 21-10-13 includes an allocation of up to \$30 million from the legacy earnings fund to the clean sustainable energy fund to support additional projects.

The committee received information from the Department of Commerce regarding the status of the innovation loan fund to support technology advancement. The fund had a balance of approximately \$27 million in March 2022, and the department anticipates the fund could be self-sustaining when the balance reaches approximately \$100 million. A portion of legacy fund earnings may be allocated to the innovation loan fund under Section 21-10-13.

The Public Employees Retirement System provided information on the actuarial funded ratio of the main system plan, which had a ratio of 71.1 percent as of June 2021. Any unspent money in the legacy sinking and interest fund after bond payments is transferred to the main system plan, and \$48.2 million may be available for a transfer during the 2023-25 biennium to increase the actuarial funded ratio.

### **Proposed Uses of Legacy Fund Earnings**

The committee received comments requesting support for additional township funding and to provide an allocation from the legacy earnings fund for county and township bridge projects.

Committee members also submitted proposals regarding uses of legacy fund earnings. One proposal included using allocations from the legacy earnings fund to support one-time initiatives to improve health and human services programs, which potentially could decrease future ongoing costs for the programs. An example of a one-time initiative to improve health and human services programs included a pilot program to provide temporary support for families transitioning out of state and federal economic assistance programs, which could have estimated savings of \$15 million per year if the program resulted in a 10 percent reduction in caseloads for the Department of Human Services.

A committee member submitted a proposal to provide a separate allocation from the legacy earnings fund to the Public Employees Retirement System main system plan rather than the current method of providing a transfer from the legacy sinking and interest fund after the bond payments.

Another committee member proposal would create an economic diversification research fund and a workforce development and enrichment fund to provide specific criteria for the eligible uses of funding allocated from the legacy earnings fund for university research programs and workforce enrichment initiatives.

### **Recommendations**

The committee makes no recommendation regarding the study of proposed uses of legacy fund earnings.