FISCAL IMPACT REPORT

		ORIGINAL DATE	02/02/21		
SPONSOR	Stewart	**LAST UPDATED**	03/04/21	**HB**	
SHORT TITLE	Reserve Funds' Transfers			**SB**	59
				ANALYST	Iglesias

REVENUE (dollars in thousands)

Estimated Revenue*					Recurring or Nonrecurring	Fund Affected
FY21	FY22	FY23	FY24	FY25		
-	$126,000.0	$75,700.0	$50,800.0	$47,600.0	Recurring	General Fund Operating Reserve
-	($126,000.0)	($75,700.0)	($50,800.0)	($47,600.0)	Recurring	Tax Stabilization Reserve

Parenthesis ( ) indicate revenue decreases

* Interaction between the operating reserve and the tax stabilization reserve depends on the balance of the operating reserve as a percentage of prior year recurring appropriations. See fiscal implications section for discussion and Attachment 1 for an illustration of the proposed changes. Note: the fiscal impact table was updated to reflect the consensus February 2021 mid-session updates.

SOURCES OF INFORMATION
LFC Files

SUMMARY

Synopsis of Bill

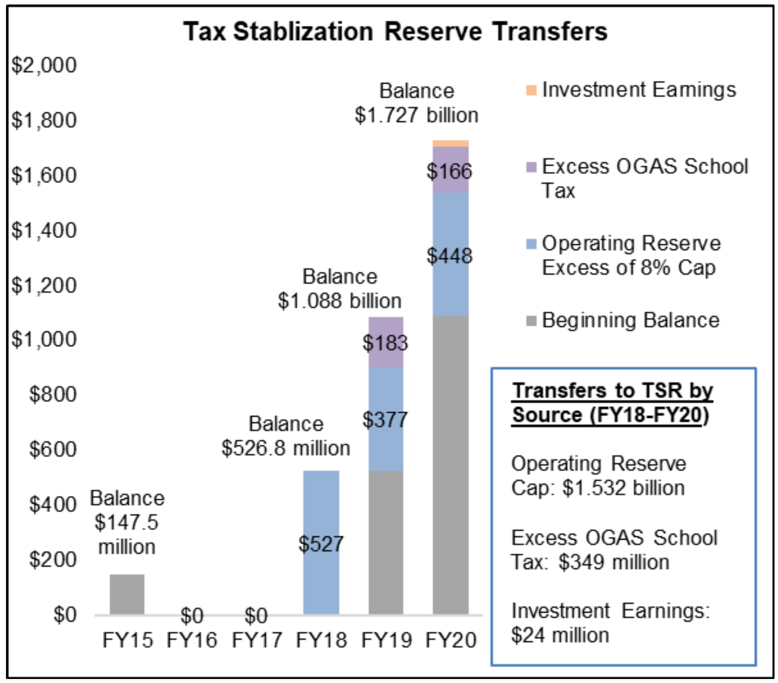
Senate Bill 59 makes two changes to the function of transfers to and between general fund reserves. First, the bill increases the cap on the operating reserve to 15 percent (up from the current 8 percent) of prior year recurring appropriations, thereby increasing the threshold that triggers a transfer from the operating reserve to the tax stabilization reserve (TSR). Second, the bill sends the distribution of excess oil and gas emergency school tax revenues above the five-year average to the operating reserve (instead of the current distribution directly to the tax stabilization reserve).
The effective date of this bill is July 1, 2021

FISCAL IMPLICATIONS

Operating Reserve Cap. When the distribution of excess severance tax revenue to the TSR was created in the 2017 session and the TSR was transformed into a working rainy day fund, the existing operating reserve cap issue was not revisited. Because the operating reserve balance is capped but the TSR is not, distributions to the TSR continued regardless of the size of the fund or the state's total reserves. To the extent the Legislature has a target level for reserves, there is a risk of growing the more restrictive TSR at the expense of the less restrictive operating reserve.[1]

By raising the operating reserve cap to 15 percent of prior year recurring appropriations, this bill raises the threshold at which unbudgeted revenues in a given fiscal year are transferred to the TSR and would keep more of those dollars in a reserve fund accessible by a simple majority vote.

Notably, the operating reserve cap is most responsible for the large transfers to the TSR in recent years. In 2017, the tax stabilization reserve balance was zero after it was emptied to shore up the FY16 budget during the oil price bust. From FY18 to FY20, the TSR received $1.6 billion in transfers, 85 percent of which came from distributions from the operating reserve in excess of the 8 percent cap.



Two distributions from the excess oil and gas school tax transfer have occurred since the enactment of that provision in FY19. This mechanism serves an important role in reducing general fund volatility and makes up less than a quarter of the recent TSR distributions.

Due to a revenue structure that is highly dependent on volatile sources, the Legislature and the executive have recognized the need for higher reserve balances to manage that volatility. However, the interaction of the operating reserve and TSR under current law has made the balances of general fund reserves more restrictive.

The February 2021 consensus revenue estimate projected oil and gas school tax revenues in excess of the five-year average to be $126 million in FY22, with additional projected excess revenues for FY23-FY25.

This bill continues to send the distribution of excess oil and gas school tax revenue to reserves, but sends the excess to the operating reserve instead of the tax stabilization reserve. This maintains the stabilization features of the excess school tax distribution while making some of the reserve balances more accessible by the Legislature (*see "general fund stabilization" discussion in the Significant Issues section*).

Under this bill, excess oil and gas school tax revenue would first go to the operating reserve instead of the TSR. However, if this transfer would bring the balance of the operating reserve

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[1] This issue was the primary reason for the passage of Chapter 34, 2020 session (HB341) in the 2020 session, which set a "floor" for the operating reserve equal to 1 percent of appropriations.

above the bill's 15 percent cap, any amount above that cap would still transfer to the TSR (*see Attachment 1 that illustrates the proposed reserve decision tree*). In effect, the bill provides greater liquidity in one bucket of the general fund reserves by sending these revenues first to the less restrictive operating reserve, while still allowing the potential for transfers to the TSR.

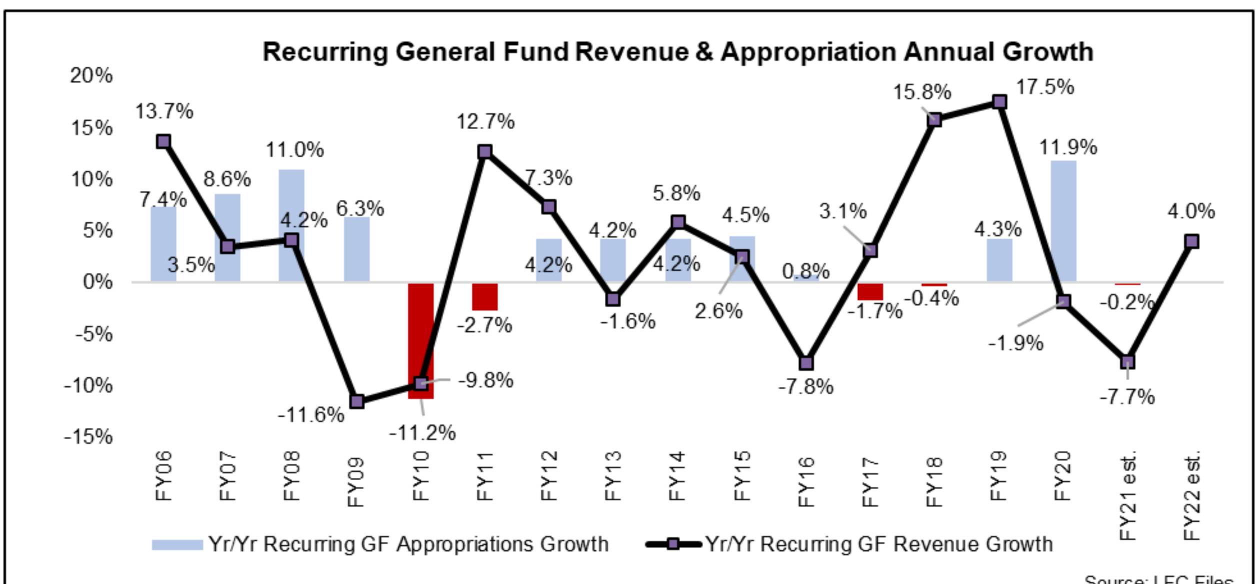
SIGNIFICANT ISSUES

General Fund Stabilization. The provision to send school tax in excess of the five-year average to reserves simplifies the revenue estimating process and helps mitigate swings in both forecasted and actual general fund revenue. For example, between December 2018 and December 2020, the forecasted amount of total severance tax revenue varied by nearly $400 million between the highest amount projected and the lowest amount projected; however, the estimate for the general fund distribution of the school tax varied by about a third of that amount.

Additionally, this stabilization mechanism is allowing general fund revenue to continue to grow despite the recent price collapse. Even though severance tax revenue is currently expected to fall $94 million from FY20 to FY21, the amount of severance tax revenue to the general fund is actually expected to increase $19 million.

In the 2020 session, lawmakers took similar steps to manage the volatility of federal royalty revenue – which on average experiences revenue swings of 25 percent or more – by sending revenue in excess of the five-year average to the newly created early childhood trust fund. Additionally, if general fund reserves are greater than 25 percent, any excess oil and gas school tax revenue would be sent to the early childhood trust fund[2] rather than the tax stabilization reserve. This bill would continue to send excess oil and gas school tax revenues to the early childhood trust fund if reserves balances exceed 25 percent of recurring appropriations.

Given the volatile nature of energy-dependent revenues, these stabilization mechanisms help to prevent unsustainable revenue growth – like the 15.8 percent and 17.5 percent growth in FY18 and FY19, respectively – from being baked into recurring budgets.



[2] The early childhood education and care fund, known as the "early childhood trust fund", was created in the 2020 session (Chapter 3, HB83).

General Fund Reserves. The general fund operating reserve provides an important buffer for the general fund in the event of a revenue shortfall. Each year, the Legislature provides transfer authority in the General Appropriation Act (GAA) that prevents the need for a special session in the event revenues fall short of the estimate by a modest amount. If revenues fall short of appropriations by the amount designated in the GAA or less, the governor, with Board of Finance approval, could authorize a transfer from the operating reserve to cover the shortfall without having to call a special session. However, if there were insufficient funding in the operating reserve, it could force a special session to identify other sources of funding from which to cover appropriations or require budget cuts.

Both the operating reserve and the TSR cannot be accessed without specific legislative authority. Each of those reserve funds are statutorily created and have their own requirements to be accessed. The Legislature can appropriate from the operating reserve with a simple majority vote. The TSR, also referred to as the "rainy day fund," is the most restrictive general fund reserve account. Under current law, funds can be appropriated from the TSR only if: 1) the governor declares it "necessary for the public peace, health and safety" and only with the vote of two-thirds of both the House and Senate; or 2) revenues are projected to fall short of authorized appropriations for the current and next fiscal year and the House and Senate approve a transfer to the general fund with a majority vote to cover the projected insufficiency for either or both fiscal years.

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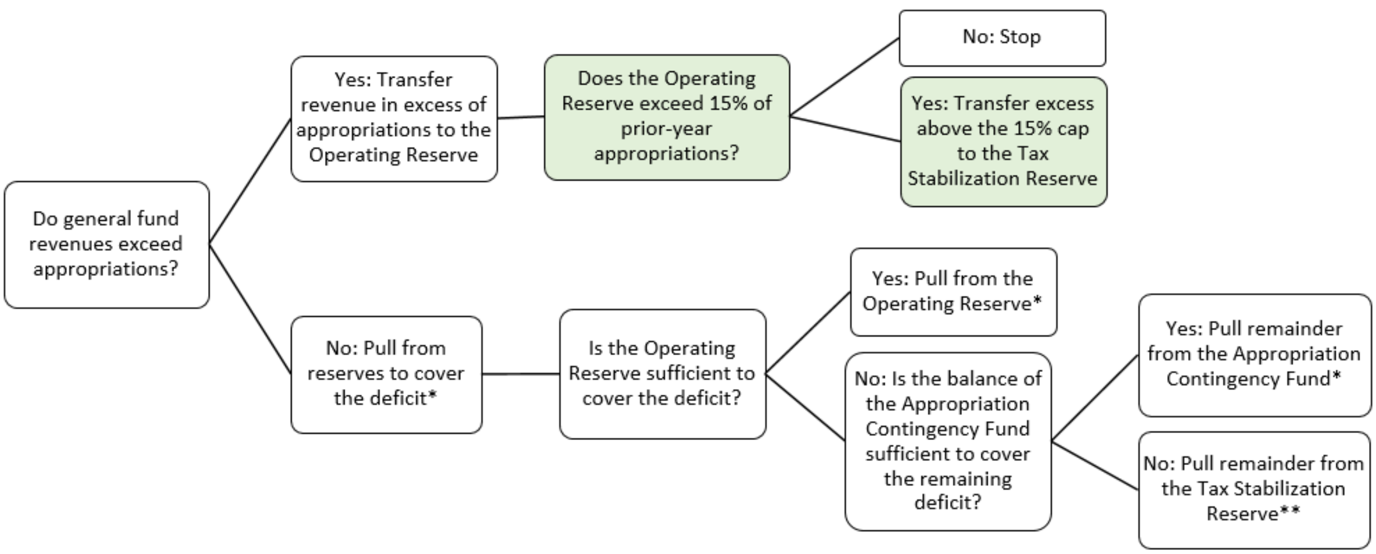
ATTACHMENT 1

Proposed Changes to Reserve Transfers

SB59 Proposed Decision Tree – Revenue Surplus and Deficits

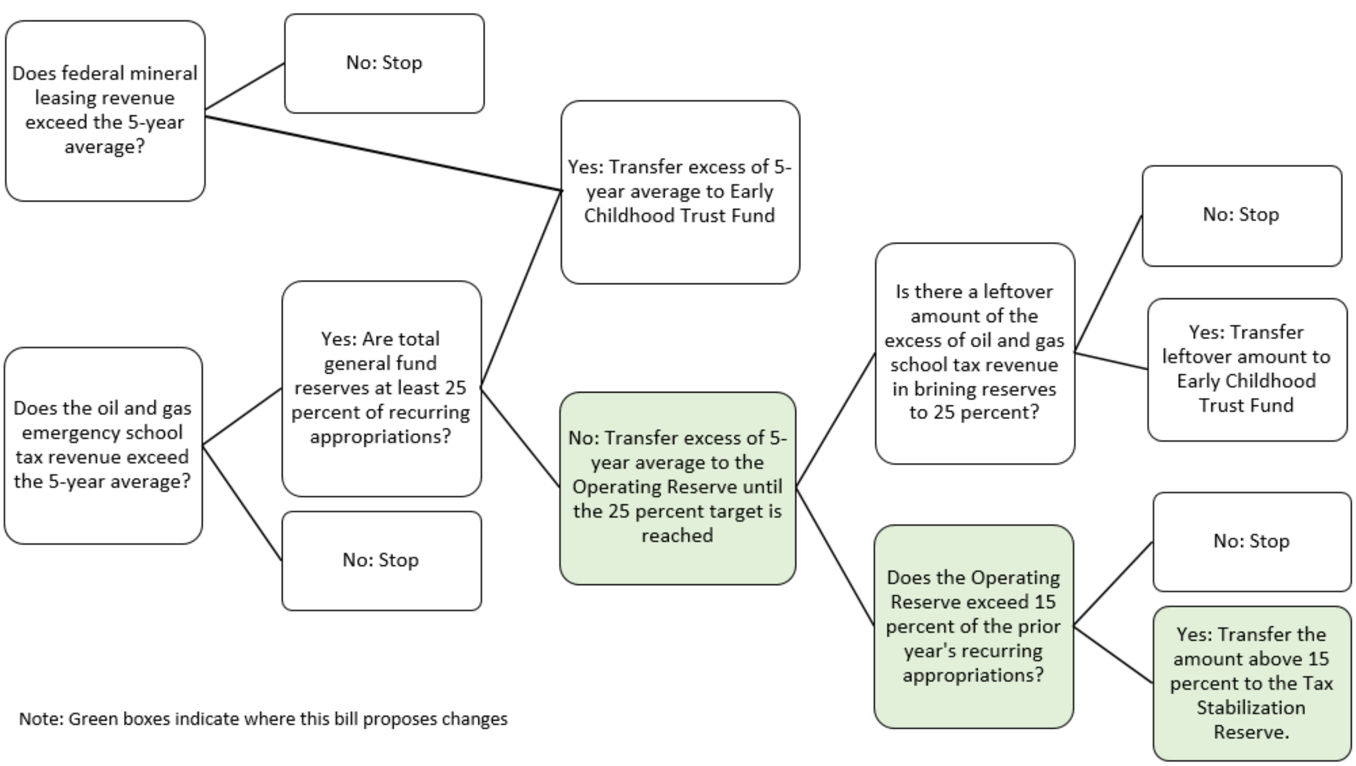


*Requires transfer authority in the GAA

**Requires additional transfer authority. In the event of an emergency and all revenues to the general fund, including transfers from the Operating Reserve and the Appropriation Contingency Fund, are insufficient to cover the fiscal year's appropriations, the Legislature may appropriate the amount necessary to cover the insufficiency.

Note: Green boxes indicate where this bill proposes changes

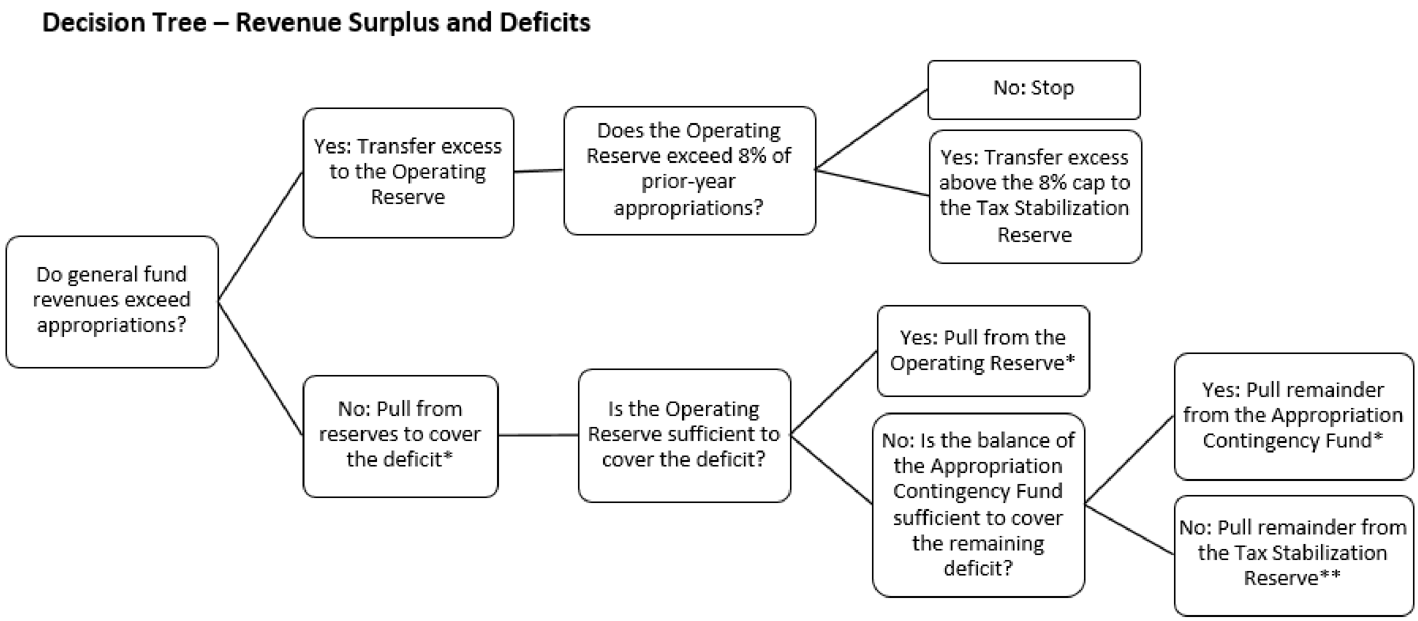
SB59 Proposed Above-Trend Oil and Gas Revenue Decision Tree*



Note: Green boxes indicate where this bill proposes changes

ATTACHMENT 2

Reserve Fund Transfers per Current Law



*Requires transfer authority in the GAA

**Requires additional transfer authority. In the event of an emergency and all revenues to the general fund, including transfers from the Operating Reserve and the Appropriation Contingency Fund, are insufficient to cover the fiscal year's appropriations, the Legislature may appropriate the amount necessary to cover the insufficiency.