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Tax Rate Review Committee
July 23, 2013

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The Tax Rate Review Committee met at 10:30 a.m. on Tuesday, July 23, 2013, in Room 1003 of the State Capitol, Lincoln, Nebraska. Senators present: John Wightman, Chairperson; Greg Adams; Galen Hadley; and Heath Mello. Others present: Doug Ewald; Mike Calvert; and Patrick O'Donnell.

SENATOR WIGHTMAN: I think we'll go ahead and open our meeting. I talked to Mike earlier, and it sounded like we'll have a hard time getting through by the noonhour. But, joking. At any rate, we will open our meeting as the Tax Rate Review Committee. And I'll call upon Mr. Calvert.

MICHAEL CALVERT: Very good. Just for the benefit of a couple of you who are going through this for the first time, by statute--it's outlined on the first page--this specified committee meets twice a year. It meets in July and it meets in November on or after the 15th and before the 25th of each of those months. It's a little bit of a carryover from when the Board of Equalization used to meet in November and set tax rates on the heels of legislative action and revenue forecasts and so on and so forth. And then Senator Warner was interested as the Board of Equalization faded into obscurity in terms of that function, thought that there should be an opportunity for a committee of leadership to meet in November to review the financial outlook for the General Fund.

SENATOR MELLO: Michael?

MICHAEL CALVERT: Senator.

SENATOR WIGHTMAN: We're here and you're coming through fine.

SENATOR MELLO: Okay, great, Senator Wightman. Thank you.

SENATOR WIGHTMAN: Okay.

MICHAEL CALVERT: We're just getting started, Senator Mello.

SENATOR HADLEY: We're going to put this one on mute so we won't hear anymore from you. Thank you. (Laughter)

MICHAEL CALVERT: Well, to continue, Senator Warner was interested in having a meeting of legislative leadership in November to take a look at the financial outlook. And of course, things kind of moved a little bit slower at that time so you had to have some lead time going into the possibility of a special session before the end of the calendar year, and that was the intended timing. July was a selected time period for the meeting because it was an opportunity to bring in actual results compared to estimates at sine

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die. And then we would actually then take the end of fiscal year estimates incorporated into the financial status and show you how things had changed. So that was kind of the rationale for this meeting. In the past, has this committee actually petitioned the Governor to call a special session? Yes. In '85, I think '86, and I think it might have been '92 when there were some other instances where the issue was pretty apparent and the meeting made it abundantly clear that there was need for some action. So that's a little bit of history for the new members, the background. There is in law changed a year or so ago in 2012 session that requires an annual report that will be part of November meeting. And it will just be simply a letter conveying this document as updated in November and then discussing the previous report, that we won't take care of that until November. Okay. On page 2, there is a summary of actions and results since sine die, and the General Fund financial status on page 3 is brought up to date for the close of the fiscal year ending June 30. There is probably the easiest on page 4 there is a transactional listing changes to the General Fund financial status since sine die on 2013 is at the top of the page. At sine die for the current...for the budget biennium we are now in for fiscal '13-14 and '14-15, sine die 2013 we were a little over \$900,000 above the minimum reserve, i.e., were we below or above the 3 percent reserve that's required to be calculated in statute? We were above it by about \$964,000. Since that time, we closed out the fiscal year for actual net receipts of over \$52 million above the estimate at sine die. By law, that additional revenue transfers over to the Cash Reserve Fund so you have a net zero impact on your General Fund status. There's about \$5 million of accounting adjustments that occur at the end of the fiscal year that account for a variety of transactions that were not accounted for in the budgeting process. There is an assumed lapse of about \$20 million. In other words, a lapse is where an appropriation is no longer necessary and it expires. So it frees up funds available to the bottom line. We've estimated that to be about \$20 million. The bottom paragraph goes through a brief discussion in terms of what we're anticipating. There is a \$6 million known lapse related to an appropriation for the vet diagnostic lab project, and it was timing in terms of the initial appropriation was not necessary. That was lapsed. We also anticipate about \$14 million presumed lapses unexpended funds in Department of Health and Human Services. These are aid funds, aid appropriations lapse at the end of this past fiscal year. We vetted this with Department of Administrative Services budget and Health and Human Services and got no complaints. So we anticipate a freeing up of about \$20 million worth of funds as shown in the status on page 3. In addition, there are some carryover obligations. We have to recalculate the minimum reserve because it's a function of revenues and expenditures in the biennium. So we have a current financial status that is now about \$7.4 million above the minimum reserve. Mathematically, we are able to make estimates going into the future two years, and it's based on a series of assumptions. And those are outlined in the later pages, but essentially what we do is look at major cost centers and provide long-range revenue estimates. And given that scenario, are you in balance or not? And in the long run, it looks like the current financial status will remain within balance to the 3 percent reserve for the foreseeable future through the budget biennium ending June 30, 2017. So the financial picture is

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quite good, at least for the foreseeable future. We do have, if you'll look on page 6, something I'd like to point out where actual receipts and growth rates are shown. You'll see in the lower right-hand corner actual '12-13 growth rates on an adjusted basis are about 6.7 percent of total General Fund revenues. We adjust for tax rate and base changes, and we had one major outlier--and we were talking about it with the Tax Commissioner here earlier--where we had an estimated, and I emphasize estimated, about a \$125 million burst of individual income tax in April related to what we believe to be capital gains. So if you adjust for that in terms of an adjusted growth rate, you'll have individual income growing at 8 percent, affects the overall bottom line such that your adjusted growth rate is 6.7 percent. That gives you a measure of growth according to the economy. If you look at calculated just nominally in terms of what we budgeted, it's closer to 10 percent. But that \$125 million in April is not going to show up again next year. In fact, one of the concerns that I have for revenue forecast going into the future is that if those were in fact capital gains that were incurred in April of 2013, you're probably going to give some of that back into the future because those capital gains won't be there in future years. It's just a matter of magnitude and timing to try and calculate that out. We don't know what that will be. The Department of Revenue's research folks that do revenue estimates along with our revenue forecaster will have to work on that for the next couple of years. I don't think it is going to be a significant offset. It will spread out over a number of years, but it will eventually affect future statuses as we move forward into the future. Overall, the outlook is quite good.

SENATOR WIGHTMAN: As far as...I know capital gains was a big part of that, but farm income being up was also a major part of that.

MICHAEL CALVERT: Yes.

SENATOR WIGHTMAN: Wouldn't that be correct? Could you...

DOUG EWALD: Farm income, I mean, in the last two years has been pretty consistent so. And the last two years were both very good years.

SENATOR WIGHTMAN: Okay.

MICHAEL CALVERT: When it comes to capital gains, too, one of the things that we've talked about is the tendency is to think of capital gains in terms of investments, stock market, that sort of thing. There could have been a significant contribution in terms of land sales.

SENATOR WIGHTMAN: Right. I think that's where the capital gains came in largely.

MICHAEL CALVERT: Yeah. And part of the problem we're going to be up against and Department of Revenue will be, too, is we won't have a better assessment of the impact

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that we saw last April until sometime in November when federal tax tapes are available to the department and our analysts and their analysts are going to be able to go through and work with that. You'll get a better sense of the contribution of capital gains but how much is going to be related to stock market type transactions and how much is related to land transactions is going to be a little bit hard to disaggregate. In fact, when we met with the Forecast Board in April, we thought the impact on capital gains was going to be about \$125 million. I wouldn't be surprised if it's going to be more in terms of actual.

SENATOR HADLEY: Mike, if we assume...the Legislature and the Governor, if we assume that we want x percent of our General Fund to be in the rainy day fund, the Cash Reserve...

MICHAEL CALVERT: Yes, um-hum.

SENATOR HADLEY: ...should we make an adjustment to add the estimated capital gains to that to...you know, I...let's say we...

MICHAEL CALVERT: Sure.

SENATOR HADLEY: ...estimate that we want \$600 million in the Cash Reserve and part of that we build up is because of the...

MICHAEL CALVERT: Yeah, I understand.

SENATOR HADLEY: So should we go to 750 to take care of that?

MICHAEL CALVERT: Interestingly enough, it's already been taken care of automatically because when the Legislature first sets a budget, there follows a certified estimate of revenue, in other words, the revenue estimate used to balance the budget. For the fiscal year that we just finished, June 30, 2013, that certified estimate goes all the way back to sine die 2012 plus or minus any legislation. So the revenue target for the fiscal year we just ended was an older, lower revenue estimate. As we moved through time, the revenue estimates went up and our actuals exceeded that estimate by over \$250 million, \$260 million, of which capital gains contributed a big portion to that. By law, there is a transfer to the Cash Reserve Fund that has already occurred because '12-13 revenue estimates exceeded the certified estimate. So if you go to the financial status on page 3, line 3 there in the second column you see a negative \$285.2 million, \$285.3 million, that is a transfer from the General Fund to the Cash Reserve Fund. And you'll see that same number in the Cash Reserve status down at the bottom. Well, of that \$285 (million), at least \$125 (million) of it was probably related to capital gains. So in terms of the way the law operates, we've already captured that excess revenue and put it in the rainy day fund by operation of current law.

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SENATOR HADLEY: But we have to be able to make sure that the body understands that part of that Cash Reserve then is this...

MICHAEL CALVERT: Sure.

SENATOR HADLEY: ...capital gain and not saying this is something that we can spend...

MICHAEL CALVERT: And I think...yeah.

SENATOR HADLEY: ...because eventually it will come back.

SENATOR WIGHTMAN: That we can consider it's going to increase again, yeah.

MICHAEL CALVERT: Right. And, Senator, one of the things that our office does and Tom will do a write-up, we do an end of session recap that usually comes out in August. And one of the points that I think that will be very important to make is that the source of assets going into the Cash Reserve Fund, a big part of it is that one-time burst of capital gains and the fact that you exceeded the revenue estimate. And part of it is related to that capital gains so we'll make that point. And we've always made the point that any money...the way the Cash Reserve operates now, just about every dollar that goes into that rainy day fund we consider it a one-time source, you know. It's...and we emphasize that with the Appropriations Committee and with members of the Legislature as we work with them.

SENATOR WIGHTMAN: Anything else? I think it's pretty obvious we don't need to look at probably increasing the sales tax or anything, which is what we're here to consider doing. But I don't think that...that's not happened in my five years in the Legislature, and I don't think it's likely to now. Anything else? If not, do we...again, I want to welcome you two new members.

SENATOR HADLEY: Well, we certainly have played a big part in getting that Cash Reserve up there, haven't we, Speaker? The former committee kind of...

DOUG EWALD: Don't we...do we need a motion?

SENATOR WIGHTMAN: We need a motion, yeah. We need a motion not to take any action.

DOUG EWALD: So moved.

SENATOR MELLO: Second.

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SENATOR WIGHTMAN: Okay. It's been moved and seconded that we take no action as far as increasing any taxes so all in favor...I'll call a roll call vote.

SENATOR MELLO: Okay.

NATALIE SCHUNK: Senator Wightman.

SENATOR WIGHTMAN: Yes.

NATALIE SCHUNK: Senator Adams.

SENATOR ADAMS: Yes.

NATALIE SCHUNK: Senator Hadley.

SENATOR HADLEY: Yes.

NATALIE SCHUNK: Senator Mello.

SENATOR MELLO: Yes.

NATALIE SCHUNK: Doug Ewald.

DOUG EWALD: Yes.

SENATOR WIGHTMAN: Motion carried. With that, we have nothing that we need to do as a group today so.

MICHAEL CALVERT: Next meeting will be sometime in November, and I'll notify you of the date.

SENATOR WIGHTMAN: Does somebody want to move we're adjourned?

SENATOR HADLEY: I'll move for adjournment.

SENATOR WIGHTMAN: Second. I'll second. All in favor say aye. Motion is hereby adjourned.