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TAX RATE REVIEW COMMITTEE  
November 19, 2014

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The Committee on Tax Rate Review met at 1:30 p.m. on Wednesday, November 19, 2014, in Room 1003 of the State Capitol, Lincoln, Nebraska. Senators present: John Wightman, Chairperson; Galen Hadley; and Health Mello. Senators absent: Greg Adams. Also present: Mike Calvert and Kim Conroy.

SENATOR WIGHTMAN: With that, I think we'll go ahead and open.

MICHAEL CALVERT: Very good.

SENATOR WIGHTMAN: And Senator Hadley is trying to get out of here early, so.

SENATOR HADLEY: Work, work, work.

MICHAEL CALVERT: I apologize, Senator Hadley. It'll probably be just a titch longer than normal just because we're going through a transition into a new budget cycle, so there's a couple of things I need to bring up.

SENATOR HADLEY: Okay.

SENATOR WIGHTMAN: We could be on the other side of five minutes instead of the short side then.

MICHAEL CALVERT: Yeah, maybe just a little bit. I placed a new copy of the report at your places. There was an error on one of the pages, I think it was page 14, and just...rather than giving you an errata sheet I just gave you a whole new report, so. The report that you have before you deals with the forthcoming budget cycle for fiscal '15-16 and '16-17. It also includes for the first time building a scenario for the next two budget years thereafter. So it gets a projection out to June 30, 2019, based on a series of

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assumptions and a construct of a scenario that's described in the rest of the report. The estimates are based on current law that you have before you. They are based on October Forecast Board projections for the current fiscal year, FY '15, and for the next two fiscal years, '16 and '17. The revenue projections in the out-biennium, the next two years that we've added, are based on the historical average methodology which is described later in the report, and probably as importantly our initial assessment of budget requests. Budget requests are submitted on September 15th. Staff and Tom and I, we go through those requests and we try and reevaluate and reassess what some of the assumptions were into the future in terms of what we might see in this next budget cycle based on the requests that were received. There is a projected shortfall. The financial status is on page 4, and you will see on line 28 there is a projected imbalance of about \$50.1 million below the minimum reserve. Minimum reserve calculates out at roughly about \$260 million for the next budget biennium, and the estimate is about \$50 million below. The shortfall stays relatively static going into the next biennium because revenues and expenditures are fairly evenly matched during that time period. Fifty million dollars in terms of a shortfall is relatively small. There are some things we already have in process and we're very much aware of that will very likely close if not completely eliminate that gap. Revenue growth adjusted for rate and base changes is fairly modest over the three years of the current status. It's very close to the average over 33 years. Revenue growth that's implied in the Forecast Board estimates for the current year and the next two years, revenue growth is about 6.3 percent in the current fiscal year, 5.1 (percent) in '15 and '16, and 4.8 (percent) in FY '16 and '17. That's on line 32 of your financial status. Following biennium revenue growth calculates out at about 3.8 percent per year. This is based on the historical average methodology which basically forces everything to a 5 percent average year over year for the five years. So if we've got three consecutive years at or above average growth rate, then those two years very likely, based on a cyclical pattern, we are projecting would be on a somewhat lower growth rate that averages about somewhere around 3.8 percent. One thing I think that's very important to point out is that typically when we have done this before and done the projections over the five-year period, we force everything to an

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average growth rate of 5 percent. We have changed that. We have a target now at 4.75 percent which is recognized on the financial status on line 34 on the last column. The reason that is being done is because of the individual income tax changes that indexed brackets essentially has eroded the long-term growth capacity for the individual income tax. So that is roughly about a half a percent year-over-year growth on average on just the individual income tax, and it translates into about two-tenths, quarter of a percent, thereabouts, on total net receipts in the future. So we will be using that lower benchmark as we go forward into future years. Spending growth is relatively modest. In the next biennial period as projected there are a couple of things that you need to be aware of. The relatively modest low growth are driven by two things. If you go to page 2 at the top, overall projected budget results are driven by some modest growth in TEEOSA as projected under current law at about a 2.1 percent average growth, and TEEOSA happens to be the single largest General Fund budget item, if you will. Medicaid is the second largest and it's actually about a 7.6 percent average growth over the two-year period, but that's not because of medical costs or participation rates. It is driven by the federal cost share. We have...I think this is probably about the sixth, fifth or sixth consecutive year where the federal share of the Medicaid has declined, i.e., they are contributing less and less to the Medicaid costs. Our peak was somewhere around 60-61 percent federal cost share six years ago. We will...these projections basically put us at about 51 percent, thereabouts. So it has been a fairly significant decline over that time period. And that ratio is calculated based on personal income growth for Nebraska, vis-a-vis personal income growth for all other states. And it's kind of a three-year moving average. Well, we've been steadily looking better than the rest of the country. And, therefore, our federal cost share has declined. Another thing I should point out is the projected budget items that we have built into this scenario are summarized on page 2. But I need to point out that there are no new funds in our projections based on prison population and/or reform issues. They're yet to emerge and be resolved in the next legislative session. It does include a removal of about \$4.2 million in housing inmates in county jails. That was added under the premise that it was going to be a one-time item. Well, we have recognized that as a one-time item, but I'm

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not absolutely sure that that's going to happen. So that will be a potential future adjustment. A bright spot...

SENATOR MELLO: Mike, in part because they requested it in their budget? I mean...

MICHAEL CALVERT: Yes. I mean, we saw that in the budget request. I know that when it was put in the budget originally it was anticipated or thought to be a one-time stopgap measure. Well, the one-time stopgap might last a little bit longer than one year. (Laugh) So I don't know. That's going to be up to, obviously, Appropriations Committee and the Legislature as a whole to decide. The bright spot is our Cash Reserve Fund. Projected at the bottom of the financial status on page 4 is the balance of about \$769 million. I would characterize that about \$707 million of it is in the bank, so to speak. It is a reliable dollar amount to anticipate in the Cash Reserve Fund. Sixty-one point five million of that larger estimate is based on the assumption that we hit the revenue target that the Forecast Board set for us this last October which is above the certified, so theoretically we've parked \$61 million more at the end of this fiscal year in the Cash Reserve Fund. But we haven't finished the fiscal year yet and we don't know what that revenue amount is going to actually be. It could be more or it could be less. We don't know.

SENATOR WIGHTMAN: That is the highest it's ever been, isn't it?

MICHAEL CALVERT: Yes. In nominal terms it is the highest. Percentagewise, it's comparable to about three or four years ago. We probably do hit a peak somewhere around 17 percent. I know there's a table in here that shows the Cash Reserve balance as a percent of revenues. And I think it does, percentagewise, it's at or very close to the peak. And there is a discussion about the Cash Reserve in another section, I believe, that is on page 6. There are some budget risks listed on page 3 that I think are important. Again, nothing is included with respect to prison overcrowding or reform issues, anything related to prison construction. The status does not include anything for state claims. There could be some claims that might be fairly substantial.

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SENATOR WIGHTMAN: Yes.

SENATOR MELLO: Mike, in the budget risks also, is there anything...I wasn't able to find it in regards to the report in regards to the IV-E disallowance payment that we owe the federal government of \$22 million, as well as the \$5.5 million state settlement for the Kansas...the Republican River Compact. I didn't see either one.

MICHAEL CALVERT: Well, that is actually I think we...is covered under the deficits on page 22.

SENATOR MELLO: Okay.

MICHAEL CALVERT: You'll see individual items for foster care. Let's see, yeah. IV-E disallowance, IV-E disallowance, and I think it's also built in the budget scenario if I recall correctly.

SENATOR HADLEY: Right.

MICHAEL CALVERT: Yeah, in future years. So there's annualization. That should be, let's see...

SENATOR MELLO: Only because I thought we held off on the \$5....I know the Governor last year had put the \$5.5 million payment out of the Cash Reserve in for the settlement, and we held off on it due to consideration by the Attorney General's Office.

MICHAEL CALVERT: Yeah. I know there are...

TOM BERGQUIST: There's nothing in there for (inaudible) water.

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MICHAEL CALVERT: Nothing in there for water, but I'm looking for the IV-E on the annualization in future years.

TOM BERGQUIST: Page 5. (Inaudible).

MICHAEL CALVERT: Is that on page 5, that list down there, Tom? I'm just not spotting it. Okay. I guess I don't have it.

TOM BERGQUIST: Well, they had...there was a request. Their request included IV-E for '15-16, but that really duplicated the request in the deficit.

SENATOR MELLO: That's what I thought you, yeah, told me.

TOM BERGQUIST: Right. So there really isn't an annualizing of the (inaudible).

MICHAEL CALVERT: Okay.

SENATOR MELLO: It's a one-time request. Okay.

TOM BERGQUIST: Yeah.

MICHAEL CALVERT: My mistake.

TOM BERGQUIST: We originally had it in '14-15 as a request and took that out and put it in when they came in with the deficit.

MICHAEL CALVERT: Okay, okay. So then that is covered under the deficit section.

SENATOR MELLO: Okay.

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MICHAEL CALVERT: Okay.

TOM BERGQUIST: But nothing for the water claim or any other claims. Mostly (inaudible) related that may come out of this corrections issue.

MICHAEL CALVERT: Yeah. There also is nothing that is included with respect to property tax relief. Since that seems to be a fairly popular subject, we thought we ought to point that out. There is nothing really there beyond the ongoing level of...the property tax credit. I think we set that at, what, \$140 million was the total amount this last session. So that has continued at...

SENATOR WIGHTMAN: The ongoing credit is in. You don't take any increases into account.

MICHAEL CALVERT: Right, right. We don't make any...we just operate under current law and the most current budget actions in this particular case, so we've sustained it at that level. I do want to point out, and it's not covered here, but there, you know, I would characterize it as something of a revenue risk. If you look at the last four years of growth on a rate-base adjusted basis, we're at about 6.5 percent on average for the last four years of actual. If you include the current year forecast of 6.3 percent and then you look at the next two years that are forecast, you're looking at an average that's about 6 percent over a seven-year period. That's well above average, and if you look at the cyclical pattern in terms of revenue growth, it just seems to suggest to me that there are increasingly risks as we march through time in terms of a lower rate of growth with respect to General Fund revenues. There is that potential. If there is, in fact, cycle and it kind of replicates itself on that kind of six- to seven-year time frame, that becomes then a consideration as to how you manage the Cash Reserve Fund. One of the last points I'll make is that the Cash Reserve Fund balance is high. And the last time, the last cycle that we drew upon the Cash Reserve Fund to offset some budget difficulties, we drew upon roughly \$259 million from the Cash Reserve Fund. But that fails to recognize that

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we also got over \$650 million from the federal government to help us work through that budget shortfall and minimize the budget cuts and minimize any need for revenue enhancements. I don't like to make bets but I'm kind of suspecting that the federal government is not going to ride to our rescue the next down cycle. So it becomes kind of the...part of the rationale as to why is a Cash Reserve balance in excess of \$700 million and roughly 16-17 percent of your total revenues in any one year is more defensible.

SENATOR WIGHTMAN: So if we took the expenses we had the last time we had the shortfall, plus what the government put in, we'd be at probably just under that amount, wouldn't...

MICHAEL CALVERT: Oh, we're under it. If you take what the federal government shipped to us and that was a direct offset to the General Fund bottom line,...

SENATOR WIGHTMAN: Yeah.

MICHAEL CALVERT: ...along with the Cash Reserve and we also had some extraordinary cash fund lapses where we took money from other funds, it was about \$986 million total over that biennial period. And so it was a substantial sum. And for those of you that were here, that was still kind of a painful experience.

SENATOR HADLEY: Very painful.

MICHAEL CALVERT: Yeah. So I'm done. Any questions?

SENATOR WIGHTMAN: Thank you. Any questions?

MICHAEL CALVERT: Oh, and the last item on the list is I will file the annual report that's required under law. You may recall about three or four years ago there was a



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requirement that we file the annual report. And what it consists of is your July report, this November report, and then a cover letter that simply says here's the filing and we incorporate by reference the tax expenditure report that's published by the Department of Revenue. So there will be a letter that I attach, so all you need to do is just authorize that I submit that.

SENATOR WIGHTMAN: Thank you, Mike. Are there any other questions anybody has? If not, do we have a motion?

SENATOR MELLO: I move that we submit the report to the Executive Board.

SENATOR HADLEY: Second.

SENATOR WIGHTMAN: Moved and seconded that we submit the report to the Executive Board. We'll do a roll call vote.

NATALIE SCHUNK: Senator Wightman.

SENATOR WIGHTMAN: Yes.

NATALIE SCHUNK: Senator Hadley.

SENATOR HADLEY: Yes.

NATALIE SCHUNK: Commissioner Conroy.

KIM CONROY: I want to just raise this. I don't think the Tax Commissioner is an actual member of the committee. I think the committee is here to meet with me, in the statutory language, and I don't think the Tax Commissioner...

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SENATOR MELLO: Gets to vote?

KIM CONROY: Well,...

SENATOR MELLO: Do you want to vote? (Laugh)

KIM CONROY: No. It says...

SENATOR MELLO: I'd like it if you voted, Kim. That would be great.

KIM CONROY: It says, "The Tax Rate Review Committee shall meet with the Tax Commissioner." The first sentence, though, says: the Speaker of the Legislature and the Chairpersons of the Executive Board, Revenue Committee, and Appropriations Committee shall constitute a committee known as the Tax Rate Review Committee. The Tax Rate Review Committee shall meet with the Tax Commissioner. I don't believe that I am a member of the committee.

MICHAEL CALVERT: Fascinating.

KIM CONROY: I am here to meet with you.

MICHAEL CALVERT: Nice catch.

SENATOR WIGHTMAN: We won't consider you a negative vote.

KIM CONROY: That's my legal viewpoint in what this (inaudible).

SENATOR WIGHTMAN: Thank you.

SENATOR MELLO: Do you want to give us a stamp of approval at least?

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KIM CONROY: (Laugh) I think I am here to answer your questions if you have them.

SENATOR WIGHTMAN: We still have one...

KIM CONROY: So I am not going to vote.

NATALIE SCHUNK: And Senator Mello.

SENATOR MELLO: Yes.

SENATOR WIGHTMAN: Motion carried. I guess that's all we had to take care of today,...

MICHAEL CALVERT: Yes.

SENATOR WIGHTMAN: ...so Mike has already said he's going to submit that the Fiscal Analyst's report I guess, so.

MICHAEL CALVERT: Thank you.

SENATOR MELLO: It's your last Tax Review Committee, John. Congratulations. Thank you.

SENATOR WIGHTMAN: That's right. That's right. I've spent probably more than a half-hour on this during my six years. (Laughter) Thank you.