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Appropriations Committee  
February 08, 2018

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[LB938]

The Committee on Appropriations met at 1:30 p.m. on Thursday, February 8, 2018, in Room 1003 of the State Capitol, Lincoln, Nebraska, for the purpose of conducting a public hearing on LB938. Senators present: John Stinner, Chairperson; Rob Clements; Robert Hilkemann; John Kuehn; Mike McDonnell; Dan Watermeier; and Anna Wishart. Senators absent: Kate Bolz, Vice Chairperson; and Tony Vargas.

SENATOR STINNER: Welcome to the Appropriations Committee hearing. My name is John Stinner. I'm from Gering and represent the 48th Legislative District. I serve as Chair of this committee. I'd like to start off by having members do self-introductions, starting with Senator Clements.

SENATOR CLEMENTS: I'm Rob Clements from Elmwood. I serve Cass, part of Sarpy, and part of Otoe Counties, District 2.

SENATOR McDONNELL: Mike McDonnell, LD5, south Omaha.

SENATOR HILKEMANN: Robert Hilkemann, District 4, west Omaha.

SENATOR STINNER: John Stinner, District 48, all of Scotts Bluff County.

SENATOR WISHART: Senator Anna Wishart, District 27 in west Lincoln.

SENATOR STINNER: We'll have members coming in and out periodically; some are presenting bills. On the cabinet to your right you'll find green testifier sheets. If you are planning to testify today, please fill out a green sign-in sheet and hand it to the page when you come up to testify. If you will not be testifying at the microphone but would want to go on record as having a position on a bill being heard today there's white sign-in sheets on the cabinet where you may leave your name and other pertinent information. These sign-in sheets will become exhibits in the permanent record at the end of today's hearing. To better facilitate today's proceeding I ask that you abide by the following procedures. Please silence or turn off your cell phone. Order of testimony will be introducer, proponents, opponents, neutral, and closing. When we hear testimony regarding agencies, we will first hear from the representative of the agency. We will then hear testimony from anyone who wishes to speak on the agency's budget request. When you come up, we ask that you spell your first and last name for the record. Be concise. It is my request that you limit your testimony to five minutes. Written materials may be distributed to committee members as exhibits only while testimony is being offered. Hand them to the page for

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distribution to the committee and staff when you come up to testify. We need 12 copies. If you have written testimony but do not have 12 copies, please raise your hand now so the page can make copies for you. With that, we will begin today's hearing with LB938. Senator Hilkemann. [LB938]

SENATOR HILKEMANN: Okay, Senator Stinner, you're welcome to open. [LB938]

SENATOR STINNER: (Exhibits 1 and 2) Good afternoon, fellow Appropriations Committee members. For the record my name is John Stinner, spelled J-o-h-n S-t-i-n-n-e-r. I represent the 48th District, which is the entire county of Scotts Bluff. LB938 makes reforms to the Cash Reserve Fund ensuring that transfers into the fund are regularly made during revenue upswings and enacting an evidence-based maximum balance for the fund. These changes align with best practices identified by the Pew Charitable Trusts and their research on state rainy day funds. Under current law the Cash Reserve is financed with end-of-the-year surpluses that occur when General Fund revenue exceeds the projected forecast. This is commonly referred to as a forecasting error. While this practice has resulted in good reserve growth over the past decade, it relies on revenue overperforming its forecast to generate savings. The proposed additional rule ensures the state saves whenever there is an above-normal revenue growth, regardless of whether the actual revenue exceeds the forecast. Under LB938, at the close of the fiscal year the Treasurer is to make a transfer into the Cash Reserve Fund of whichever amount is greater, which is the greater of the forecasting error or half the revenue growth that exceeds the prior ten-year growth rate--the alternative rule proposed under LB938. This change would mean that the Cash Reserve Fund will always receive at least as much in transfers as it does under current law. The additional deposit formula would help in circumstances when revenue growth is above average but closely aligns to the forecast. Under current rules, this scenario would result in little or no deposits being made to the Cash Reserve. LB938 also sets a maximum balance in the Cash Reserve at 16 percent of the General Fund expenditures. Currently, Nebraska is one of just four states that lack the maximum balance over savings target for their rainy day fund. Pew's research has found that in most states a cap or savings target helps build consensus around the rainy day fund deposits by introducing greater transparency and clarity to the savings goals. The 16 percent cap proposed by LB938 is consistent with independent analysis by the Legislative Fiscal Office and by Pew. In 2016, fiscal volatility report submitted to this committee found that the adequate coverage for the next cyclical downturn would require savings equal to 16 percent of the General Fund revenue. Separately, Pew's analysis of tax data from the fiscal years 1999 through 2015 determined that the reserve at 16 percent of General Fund revenue would offset revenue shortfalls in full up to two years at 98 percent of the model recession scenarios. In other words, it would provide full protection against all but the most severe recessions. Basing a rainy day cap on past revenue performance ensures that sufficient resources will be available for future downturns without setting aside more than necessary and short-cutting any other priorities. Cap proposed by LB938 is consistent with the recommended approach. A representative from Pew

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has...or representatives from Pew have flown in from Washington, D.C., to offer their expert testimony and to provide additional responses to the bill and they should be able to answer research questions. Thank you and I welcome questions. [LB938]

SENATOR HILKEMANN: Thank you, Senator Stinner. Are there questions for Senator? Senator Clements. [LB938]

SENATOR CLEMENTS: Thank you, Senator Hilkemann. Thank you, Senator Stinner. The 16 percent of expenditures it says is...or revenue I guess is...excuse me, is that on a biennial basis or a one-year basis? [LB938]

SENATOR STINNER: It is. That is... [LB938]

SENATOR CLEMENTS: Is that times one year or two years? [LB938]

SENATOR STINNER: That's a good question. Sixteen percent, what was 700, that would be biennium, wouldn't it? No, it would be annual. Help me out. [LB938]

ROBERT ZAHRADNIK: It's annual. [LB938]

SENATOR STINNER: It is annual. You have \$4.4 billion annually times 16 percent, what do you come out? That's what it is. [LB938]

SENATOR CLEMENTS: Yeah, \$720 million. [LB938]

SENATOR STINNER: Yeah, that would be it. [LB938]

SENATOR CLEMENTS: One year's worth. [LB938]

SENATOR STINNER: One year. [LB938]

SENATOR CLEMENTS: Thank you. [LB938]

SENATOR STINNER: Good question. I lost my mind there for a second. [LB938]

SENATOR CLEMENTS: All right. Yeah, I was thinking... [LB938]

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SENATOR STINNER: What we're trying to do in this bill is set some kind of threshold in which to do this computation. Ten years might not be the right number actually. After we looked at the ten years, this last ten years, we had two down cycles and one up, which caused it to be about 2.7, 2.5 percent. So we're still searching for what that threshold should be. But we could be in situations where our forecasting could come out just about equal to where the actual is. So even though we'd be up 5, 5.2 percent, if we set a threshold to, say, 4, 4.5 and it comes in between there, then you do that half computation. Even though it automatically wouldn't go in, it kind of sets a floor on how much should be put in, in up years. So you'd set your threshold high enough. I was trying to capture business cycles over a shorter term period of time and the ten years, as I looked at this, doesn't work. So we're going to have to figure out what that threshold really needs to be. Virginia does this. I could go back and probably give you some examples, but that's why Pew is here today, just to give you some further information on this. [LB938]

SENATOR HILKEMANN: Additional questions for Senator Stinner? Thank you very much. You'll probably stick around to close. [LB938]

SENATOR STINNER: Yes. [LB938]

SENATOR HILKEMANN: Additional proponents for LB938. [LB938]

ROBERT ZAHRADNIK: Good afternoon, Chairman and members of the committee. My name is Robert Zahradnik, R-o-b-e-r-t Z-a-h-r-a-d-n-i-k. I'm a principal officer with the Pew Charitable Trusts. I and my colleagues at Pew have done extensive technical assistance work in Nebraska over the past several years and I'm pleased to be back testifying before the Appropriations Committee. Thank you for your consideration of LB938. This legislation makes reforms to the Cash Reserve Fund, ensuring that transfers into the fund are regularly made during revenue upswings and enacting an evidence-based maximum balance for the fund. These changes align with best practices identified by the Pew Charitable Trusts in our research on state rainy day funds. The changes proposed by LB938 reflect a growing national trend towards more closely tying rainy day fund revenue...rainy day funds to revenue volatility, which has been identified as a best practice in Pew's research. Since July 2014, when Pew published its first report on rainy day fund deposit rules, the number of states that link their deposit rules to volatility has increased from 12 to 20. With adoption of this bill, Nebraska would join this growing trend. Also since the Great Recession, nine states, including Nebraska, have conducted volatility studies mandated by law to help states better understand the trends that are driving revenue volatility. Four of these states directly link their rainy day fund cap or savings target to the findings of their volatility study. If LB938 is enacted, Nebraska would be the fifth state to put in place this best practice. When rainy day funds were initially created in states, most set their caps at 5 percent of General Fund spending. However, in an era of increased revenue uncertainty, many have since increased

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their limit so they are better prepared for a downturn. Most states now have caps set between 6 and 10 percent of spending. LB938 limits the growth of the Cash Reserve Fund to 16 percent of annual General Fund expenditures, which would be one of the highest caps in the nation. Only Maine, Nevada, North Dakota, and Texas would have a larger limit. I also want to note that Pew's research has found that credit rating agencies have taken notice of the policies that govern rainy day funds. Rating agencies advise states to align rainy day fund policies with the economy so that deposits, withdrawals, and savings targets are informed by the revenue volatility and the business cycle. Credit rating analysts from all three major agencies agree that well-managed states administer rainy day funds in a way that reinforces structural balance or a budget that is financially sustainable over several years. This means that policymakers make deposits into reserves during times of economic expansion and revenue growth, and while they make withdrawals during times of distress when revenue falls. Thank you for your time and I'm happy to answer any questions you have. [LB938]

SENATOR HILKEMANN: Okay. Thank you very much. Do we have questions? Senator Wishart. [LB938]

SENATOR WISHART: Well, thank you so much for being here today. I still have to figure out who that actor is that you look exactly like. [LB938]

ROBERT ZAHRADNIK: That question I can't answer. (Laugh) [LB938]

SENATOR WISHART: So I'm still trying to wrap my brain about...around all the parts of this bill. [LB938]

ROBERT ZAHRADNIK: Sure. [LB938]

SENATOR WISHART: Is there something in this bill that sets sort of a best practice in terms of how low we should go and then the fact we shouldn't go any lower than that in terms of our rainy day fund? What I'm trying to get at is I understand in tough years it's good to pull down that from... [LB938]

ROBERT ZAHRADNIK: Uh-huh. [LB938]

SENATOR WISHART: ...from the rainy day fund... [LB938]

ROBERT ZAHRADNIK: Sure. [LB938]

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SENATOR WISHART: ...when it's raining. But we should have an amount still left in there for emergency situations. I mean if we have natural disasters or something like that where we need to have an emergency fund, not just a rainy day fund. Is there any sort of best practice for how much we keep for an emergency in that rainy day fund that we do not go...that once we're kind of at that point maybe there is sort of a best practice for the Legislature then to say we can't pull any more from this? [LB938]

ROBERT ZAHRADNIK: It's a great question and it goes to a broader question of what is the purpose of your rainy day fund--in the case of Nebraska, your Cash Reserve Fund. Other states call them budget stabilization funds. And I think sometimes the issue gets complicated if a fund is used for more than one purpose. So the analysis that went into...the analysis that Pew did related to the 16 percent and to the deposit mechanism, that's all related to sort of looking at revenue and economic trends and really seeing the purpose of the Cash Reserve Fund as a smoothing mechanism. Right? When times are good you put money in; when times are bad you pull money out. And the analysis is really focused on that purpose. Nebraska is not alone in using their rainy day fund for purposes that go beyond budget stabilization. Other states do also use them for emergencies which...and it does make it tricky because when you have more than one purpose in mind it can sort of complicate the scenarios of when money goes in and when money comes out. We are in the process of doing some research on best practices related to emergency reserve funds. At this point, what I would say is I think a best practice is to have a clear purpose statement for your rainy fund, reserve fund, and then have a separate fund that's designed for dealing with natural disasters, which requires a different kind of analysis and a different kind of savings target and different rules for when the money is used. So I think that would sort of clarify the policy that you're thinking about. [LB938]

SENATOR WISHART: Okay. Thank you. [LB938]

ROBERT ZAHRADNIK: Uh-huh. [LB938]

SENATOR HILKEMANN: Additional questions? Yes, Senator Clements. [LB938]

SENATOR CLEMENTS: Thank you. Thank you, sir. [LB938]

ROBERT ZAHRADNIK: Uh-huh. [LB938]

SENATOR CLEMENTS: Are we...does this switch from a forecast revenue to actual revenue formula? [LB938]

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ROBERT ZAHRADNIK: So what this is proposing is to essentially say your current formula is based on, if revenues exceed the forecast, the amount above the forecast goes in a rainy day fund. That stays in place. It adds an additional mechanism that looks at...currently looks at a ten-year average and says if actual revenues are coming in above average then you look at half of that difference. And if that amount is greater than what the forecast error is then you would put that amount in the fund. So it's keeping your current mechanism. It's just adding on an additional mechanism, which is really designed to say if you have a year where revenue is growing rapidly but it happens to also be in line with the forecast, that's probably a time when you want to put some money aside. But the current formula wouldn't allow for that because it's in line with the forecast. So that's the intent. And I do...and Senator Stinner mentioned, we're happy to help sort of think through what the best mechanism for that is and...but that's what we're trying to accomplish. [LB938]

SENATOR CLEMENTS: And would the 16 percent be a recommendation because Nebraska might be more volatile in its revenues and some states...some states would be lower because they're more stable? [LB938]

ROBERT ZAHRADNIK: So that's a great question. And what's interesting is so the Fiscal Office did an analysis in the volatility study and they found that, based on historical forecast error, 16 percent is the...is an appropriate amount for the rainy day fund. We did a separate analysis looking at revenue volatility, but our analysis has sort of...it sort of has different options for how much risk tolerance the policymakers have. And the 16 percent is consistent with essentially trying to guard against 98 percent of potential revenue downturns over a two-year period, which is a fairly conservative approach. You could tweak those numbers and say we want to cover, you know, 90 percent over two years and that would get you at a lower level. But this kind of shows that there's some consistency between you can cover most downturns that are related to revenue volatility at 16 percent and it's also consistent with historical forecast error. [LB938]

SENATOR CLEMENTS: Thank you. So that...and you were saying that it isn't...that each state should analyze... [LB938]

ROBERT ZAHRADNIK: Yes. [LB938]

SENATOR CLEMENTS: ...their own percentage; that there isn't one percentage that every state should use. [LB938]

ROBERT ZAHRADNIK: Exactly. Yep. [LB938]

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SENATOR CLEMENTS: Thank you. [LB938]

ROBERT ZAHRADNIK: Yep. [LB938]

SENATOR HILKEMANN: What is the...what's an average that states have in their rainy day funds... [LB938]

ROBERT ZAHRADNIK: Currently... [LB938]

SENATOR HILKEMANN: ...or range? [LB938]

ROBERT ZAHRADNIK: Yeah. So there's a couple things. The...as I mentioned, the caps right now...so sort of going back in history when rainy day funds were first established, most states set them at 5 percent. There was really no analysis base that sort of supported that number. And what history has shown is the downfalls that most states experience during a recession, or typically over a two- to three-year period, are much larger than 5 percent. So states, there has been a trend of states raising their caps. Most states, as I said, have...their caps are set between 6 and 10 percent. The...I think the average balance, which I did actually go out of my way to print that out today and we--actually I'll do a promo while I'm looking--we have something on our Web site called "Fiscal 50," which has 50-state data on about a dozen fiscal indicators. And that's available to...and you can look at a comparison of Nebraska to other states. So for rainy day funds the 50-state median...so we expressed it in terms of number of days you could operate, so the 50-state median is about 20 days, a typical. That's the sort of median state. And right now Nebraska is actually above 50 days. So... [LB938]

SENATOR HILKEMANN: Above 50 days. [LB938]

ROBERT ZAHRADNIK: Fifty days, yeah. So Nebraska is, in terms of current balance, Nebraska is in the top four. So Nebraska always has a very...has a very admirable track record of savings. And the intent of this bill is to sort of codify kind of what is the savings target. Because there has been some, I think, discussion of at what point have we saved enough... [LB938]

SENATOR HILKEMANN: Uh-huh. [LB938]

ROBERT ZAHRADNIK: ...and can be able to sort of shift some of that money to other priorities. I do think there's an interesting question as once you reach that 16 percent cap, the money that would have gone into the rainy day fund, where does that money go? Because some of that money you may still want to think of that as more like one-time money, so you may want



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to use that for capital funding or other more like one-time purposes because...just because of the nature of those funds. But currently Nebraska does do a very good job of savings and has had a...has a good track record. [LB938]

SENATOR HILKEMANN: And following up on that, now we also have, by statute, we need to keep a 3 percent Reserve Fund. [LB938]

ROBERT ZAHRADNIK: Right. [LB938]

SENATOR HILKEMANN: Is that...is that...are you using that 3 percent Reserve Fund as part of this 50 days? This is 50 days up and beyond our 3 (percent). [LB938]

ROBERT ZAHRADNIK: Correct. Yeah. So that data is rainy day fund only. In terms of total reserves, you would be above that, yeah. [LB938]

SENATOR HILKEMANN: Okay. Senator Clements. [LB938]

SENATOR CLEMENTS: Is another purpose of this 16 percent limit to also use as a reference to show how adequate your reserves are from time to time... [LB938]

ROBERT ZAHRADNIK: Yes. Yeah. [LB938]

SENATOR CLEMENTS: ...so that if we get down to 5 percent, we can say that's not enough? [LB938]

ROBERT ZAHRADNIK: Right. [LB938]

SENATOR CLEMENTS: But right now we really don't have a guideline, I don't believe. [LB938]

ROBERT ZAHRADNIK: Right. [LB938]

SENATOR CLEMENTS: And so I... [LB938]

ROBERT ZAHRADNIK: And some...I mean some states use this threshold as a target--that's what we're shooting for. And others use it as a hard cap. Once they hit that number they don't put

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any more money in. That's a policy choice. If you say once we hit 16 (percent), that's kind of a decision point: Do you want to keep putting money in the Reserve Fund or do you want to divert it for other purposes? But I would caution those other purposes should be more one-time in nature because the money that would only go to the rainy day fund is typically sort of, kind of extra money and not necessarily money you want to put into your base budget. [LB938]

SENATOR CLEMENTS: Thank you. [LB938]

ROBERT ZAHRADNIK: Uh-huh. [LB938]

SENATOR HILKEMANN: Are there additional questions? Seeing none, thank you so much for coming. [LB938]

ROBERT ZAHRADNIK: Thank you. [LB938]

SENATOR HILKEMANN: (Exhibit 3) Are there additional proponents? Are there any here who would testify as opponents to this bill? Are there those here who would testify in the neutral position? Seeing none, Senator Stinner, you're welcome to close on LB938. Senator Stinner waives closing and so that will end the hearing on LB938. Oh, I'm sorry. I don't do this every day. So we do have a letter that we would like to include into the hearing for LB938 and it would be an exhibit from the OpenSky. [LB938]

SENATOR STINNER: Okay. That concludes our hearing on LB938. [LB938]