STINNER: And welcome to the Appropriations Committee hearing. My name is John Stinner. I'm from Gering and represent the 48th District. I serve as chair of the committee. I'd like to start off by having members do self-introductions starting with Senator Erdman.

ERDMAN: Steve Erdman, District 47: 10 counties in the Panhandle.

CLEMENTS: Rob Clements from Elmwood, District 2: Cass County and parts of Sarpy and Otoe.

O'DONNELL: Mike O'Donnell, LD5, south Omaha.

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

BOLZ: Senator Kate Bolz, District 29.

DORN: Senator Myron Dorn, District 30, which is Gage County and the southeast fourth of Lancaster.

STINNER: Assisting the committee today is Brittany Bohlmeyer, our committee clerk. Our page today is Cadet Fowler, excuse me, Fowler. He is studying film studies at the University of Nebraska-Lincoln. On the cabinet to your right you will find green testifier sheets. If you are planning on testifying today, please fill out the sign-in sheets and hand it to the page when you come up to testify. If you will not be testifying at the microphone but want to go on record as having a position on a bill being heard today, there are 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 proceedings, I ask that you abide by the following procedures. Please silence or turn off your cell phones. Order of testimony will be introducer, proponents, opponents, neutral, closing. When we hear testimony regarding agencies, we will first hear from a representative of the agency. We will then hear testimony from anybody who wishes to speak on the agency's budget request. We ask that when you come up to the microphone spell, spell your first and last name for the record before you testify. Be concise. It is my request that you limit your testimony to five minutes. Written materials may be distributed to the committee members as exhibits only while testimony is being offered. Hand them to the page for distribution to the committee and staff when you come 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 LB638.

BOLZ: Good afternoon, Senator Stinner.

STINNER: Good afternoon, Chairperson Bolz and the Appropriations Committee. For the record, my name is John, J-o-h-n, Stinner, S-t-i-n-n-e-r, and I represent District 48, which is all of Scotts Bluff County. The purpose of the LB638 is to modify the current deposit rule to the Cash Reserve Fund. The current rule requires a transfer from the General Fund to the fund in excess of actual General Fund receipts from estimated receipts for the fiscal year. In other words, by fiscal year-- or forecasting error. LB638 would add an alternative rule and require that the greater of the two amounts be deposited into the fund. The formula for the alternative rule which I have distributed to, distributed to you is as follows. The difference between the annual percentage increase in current fiscal year net receipts and the 20 year average annual percentage increase of the net receipts excluding the lowest year multiplied by the actual General Fund net receipts for the current fiscal year multiplied by 50 percent. I'll let that sink in for a second. LB638 would also cap the deposits allowed into the fund at 16 percent of expenditures to allow for other budgetary priorities. The reason LB638 is necessary is to ensure the transfers into the Cash Reserve Fund are regularly made during revenue upswings and to enact an evidence-based maximum balance for the fund. Currently, our method for depositing into the fund is based solely on forecasting error. Under current law, the fund is financed with an end-of-the-year surpluses which occur when the General Fund exceeds that forecast. While this practice results in good reserve growth, it relies on revenue overperforming as its forecast to generate savings. Adding this alternative rule aligns with best practices identified by Pew Charitable Trust in their research on state rainy day funds. They are here today to testify on their findings. But before I handed over to Pew, I'd just like to reiterate a few points. The first is the change will always maintain at least as much in the transfer as it does in current law today. LB638 simply adds an alternative rule and selects the greater of the two amounts. The second is that the rainy day funds work best when balances increased during economic growth periods and are primarily used during down periods. States most effectively accomplish this with policies that require deposits to a rainy day fund when revenue growth exceeds a clearly defined threshold. And lastly, Nebraska is one of just four states that lack a maximum balance or savings target for the rainy day fund. Pew's research has found that establishing evidence-based methods for depositing into the rainy day fund and finding a consensus-based savings target as laid out under LB638 leads to a greater transparency and clarity in savings goals. Thank you, and I welcome your questions.

BOLZ: Thank you, Senator Stinner. Questions for Senator Stinner? Go ahead, Senator Erdman.

ERDMAN: Thank you, Senator Bolz. Thank you, Senator Stinner. So I can conclude from reading the fiscal note and the information that was handed out this would allow us to never have a greater amount than 16 percent of our annual budget?

STINNER: That would, it would be capped at 16 percent.

ERDMAN: So, without doing the math, do you know what that would be this year?

STINNER: It would be--you have about a $5 billion budget times 16. That's $800 million.

ERDMAN: $800 million, OK. Thank you.

BOLZ: Go ahead, Senator Dorn.

DORN: I'm probably, I probably will save my question for them. I just, my curiosity is, I guess, this type of formula that we're proposing here, approximately how many times would that actually be the larger amount and how many times would it be the other way? And I think maybe I'll wait and ask Pew that.

STINNER: Yeah, I think you go back and do a look-back over the 20 years, probably four or five times it would have been used because your budget expenditures actually were up above the trend line or close to the trend line. So we're using a 20-year trend line, we're kicking out one of the, you know, say you have a black swan event. So you kick out that black swan event, which doesn't affect it too much. And I actually did a computation here, and I probably should have passed it out. But for an example, our 20-year, our 20-year trend line right now is about 4.22 percent increase in revenue. Between '18 and '19, the actual was 5.4 percent or the difference was 1.3 percent, 1.32 percent. So I'd take that 1.32 percent times our, our actual expenditures, that was $4.8 million-- or billion, excuse me. And I'd come up with $63 million-- I'd divide that in half-- $31 million would be the deposit. And I think it was more in line with some other-- I think our deposit, well, we're not through '18-19 yet so. But it was projected to be $63, it's obviously going to change. But I think you can, you can see that in the up years you would be taking advantage of that calculation. But if it's greater on the normal by forecasting error, that would go into the, into the reserve. We just want to make sure there's some level of sophistication and methodology for adding to the reserve.

DORN: Thank you.

BOLZ: I just wanted to ask you a question about the 16 percent. I mean, 16 percent of General Fund expenditures is, is, it's a number we've heard before. It's a number we're pretty comfortable with in terms of an ideal or a target because it's a percentage of the overall expenditures. My-- the question I have is, if that's a guide, it's not a magic number. Are there any circumstances in which you can perceive or foresee or imagine wanting more than 16 percent in your cash reserve?

STINNER: You know, and I think we have to come to terms with this part of the computation as well. And 16 percent really is the maximum reserve for the economic shock absorber. In other words, it's the, it's the 4 years of 4 percent downturns. That's how, how they arrived at it. If you look at your volatility that's, that would be, that would be fully funded. Now we don't, we don't borrow as a state. And so when I take a look back at the last six sessions, in fact, happen to have it right here, 52-- or I think it's 52 percent, excuse me, 57 percent, $333 million was taken out of the reserve for one-time expenditures on capital improvements. So when we talk about 16 percent, that's really from the economic side of things. Now all of a sudden you may be in a situation where you're going to build a prison, where you're going to-- where you have some extraordinary event over and above that that you need to really start to accrue those dollars up. That would be, you have to look at it both ways and that's what we've been using it as is a dual purpose fund. And so that would maybe change the computation.

BOLZ: Yeah, not to-- I don't mean to belabor it, and it's a Friday. But yeah, I think because we have used our cash reserves for strategic statewide investments and as kind of our contingency and our savings fund it, it makes me wonder whether or not we should have multiple types of reserves or what other kinds of structures--

STINNER: We certainly should do two computations. One is the 16 percent maximum reserve, then take a look at the bid. And there is a budget out there, a six-year budget for capital improvement. Which, is there something in there that would not be funded through, through our normal course, we'd have to look at that one big, big expenditure and then you'd have to embed that into your computation as well so. It's--

BOLZ: Go ahead, Senator Clements.

CLEMENTS: Thank you, Vice Chair Bolz. Thank you, Senator Stinner. I'm just wondering, I'm not clear where this money is going if, in a good year, if we didn't do this what happens to the extra funds?

STINNER: In, in a good year you would say-- say that you do 6 percent, OK? Trend line is 4.22, say that revenue is going to increase 6 percent but your budget is 4.5. That's how much you're going to spend. You can go back and take a look at that computation to say, OK, instead of spending it, we're going to take half of that and put it into the reserve.

CLEMENTS: Yeah.

STINNER: Sit differently if it was 5 percent. It would probably work out to where that computation would be greater than the forecasting error.

CLEMENTS: I see.

STINNER: So your, your forecast was 6 percent, your revenue was 6 percent. Your trend line is 4.22. Then you do the computation and see that the forecast-- you didn't have a forecasting error at all at that point. Well, you'd have to do it over trend line basis. You would embed that into your budget.

CLEMENTS: Have you-- does this formula come from somewhere? Do other states use something like this?

STINNER: We do, yeah. And I think Pew can speak to that. Some states use a six, six-year average. One state uses a 10. I choose 20 because I still, I like to have that smoothing effect and a long-term trend line as opposed to maybe a shorter one that's more volatile, that moves up and down. So that's, that's why I chose the 20. And I did that 20-year to look back quite a little bit in terms of how, how the budget growth is in different categories. And so I thought that was the best way, and we've actually worked with several different trend lines, everywhere from 5 years to 10 years. And I just felt like this was the least volatile.

CLEMENTS: Thank you.

BOLZ: Well, I guess we'll have, we'll continue the conversation. I, I hesitate to put a cap at all on savings versus having that be the decision of each legislative body as it comes forward. But I will say that I hope that we get to the day where we have 16 percent and we can aspire to that right now.

STINNER: And I agree with that. The only thing that I was trying to do is say, what's fully funded? And that's, that's why I'm trying to put the 16 and say that's fully funded. Now if we choose as a Legislature to put additional funds away then so be it so. But I think you have to talk about fully funded because it sets a target for you and, and it, it allows you to accrue yourself in good times to that level.

BOLZ: Remind me how many months of cash flow is 16 percent.

STINNER: I'm sorry?

BOLZ: Remind me how many months. It's just two?

STINNER: Yeah.

BOLZ: Right.

STINNER: Right.

BOLZ: Great, thank you. OK, further questions? All right, thanks, Senator Stinner. Proponents, please. Welcome.

STEPHEN BAILEY: Thank you, Chairperson Bolz and members of the committee. For the record, my name is Stephen Bailey with the Pew Charitable Trust. That is Stephen, S-t-e-p-h-e-n, Bailey, B-a-i-l-e-y. It's really a pleasure to be here. I have personally studied state savings policies for six years at Pew, including the policies that govern rainy day funds like the Cash Reserve Fund. And I'm really grateful for the opportunity to speak today. The legislation being heard today centers around two really important policy questions. One, should the state save money into the Cash Reserve Fund when revenue is growing above normal? And then two, is there a point when the state has saved enough in the Cash Reserve Fund? And then, if so, should that maximum level be determined in an evidence-based way? And so based on Pew's 50-state research into state rainy day fund best practices, we have found that the answer is yes to both of those questions. And because LB638 would modify the state's Cash Reserve Fund to meet those best practices, Pew is a proponent today of LB638. The first provision modifies when the state saves into the Cash Reserve Fund. Nebraska has a strong track record of saving, setting aside money to the cash reserve when revenue exceeds its forecast. LB638 would not change that rule. Instead, it fills a potential gap or missed opportunity to save. Under current rules, when revenue is growing above normal but that above-normal growth has been accurately forecast, the state would save little to no money. So just as a hypothetical example, if revenue ended up growing at 10 percent but the state accurately forecast that revenue would grow at 10 percent, by the current rule the state would save no money in the rainy day fund. And so when we talk about this alternative rule saving based off of revenue growth, right now 20 states are doing that. That's up from 9 prior to the Great Recession. And more states are moving to this way because they realized that a failure to set aside this above-normal growth can lead to taking unsustainable or possibly nonrecurring revenue and putting it towards ongoing commitments. So really, regardless of what the revenue forecast is, the most ideal time to save is when a revenue is growing above normal because you know by definition that it's going to inevitably drop below at some point. So really to have a true smoothing fund, a true budget stabilization fund, you want this fund to operate, capturing money when it's growing above normal and then being able to use it when it drops below. And so to fix this, LB638 calls for the states to save either the greater of the current rule based on the revenue forecast or half of the above average revenue growth. And so in this way the state would just fill that gap for times when the current rule might result in under saving but still utilize the current rule when appropriate. And in no situation, as pointed out by Senator Stinner, would LB638 save less than the current law. Then the second policy aspect of the bill would add an evidence-based maximum limit or cap to the Cash Reserve Fund. Undeniably, setting aside money for future needs requires a tradeoff. Each dollar saved and directed into reserves is a dollar that cannot be spent on public programs, tax reductions, paying down other liabilities or other important capital projects. A failure to save enough means a prospect a significant program cuts or tax increases when residents can least afford it. So to strike that balance, policymakers turn to caps for the rainy day fund, to set an amount that they're comfortable with it growing without oversaving or hoarding money. So all but four states right now have some kind of cap or limit or target on their rainy day fund, and Nebraska is one of those four states. And as has been discussed, the 16 percent cap is based on an evidence-based target for revenue volatility and guarding against revenue volatility. And so if the purpose of the rainy day fund or the Cash Reserve Fund was to offset revenue volatility and really offset the, all but the most severe recessions then that 16 percent would be appropriate. However, if you think the purpose for the cash reserve extends beyond that then obviously maybe a more appropriate target is appropriate. Or if you think you just want to offset a moderate recession then perhaps a lower target is appropriate. But either way, if a cap was in place, we would suggest that the state follows best practices found in states like Utah, North Carolina, and in Minnesota where they regularly are evaluating the cap based on the change in volatility and based on the purpose of the fund. And so in conclusion, Nebraska has a really strong track record for savings. The changes proposed in LB638 are based on best practices that many states have adopted since the Great Recession and would work not only to bolster the current rules but also just help ensure that the state hasn't helped to manage the next recession without oversaving. So with that, Chairperson Bolz, I would welcome any questions if needed.

BOLZ: Well, thanks for joining us today. We appreciate it. Questions? Go ahead, Senator Dorn.

DORN: Thank you, Vice Chair Bolz. Thank you for coming, I appreciate this. I'm assuming that you've done the math. Take so many years back, 10 or 20, or we're using 20 years. How many extra dollars would this have put in our so-called rainy day fund?

STEPHEN BAILEY: We have done the math. I don't have that number on hand, but I have a handout that I'd like to hand out to the committee after this presentation, if that's all right. And I can highlight that number for you, Senator. And I would just add, Chairperson and Senator, that more often than not the current rule, the rule based on forecast error, would be the overprevailing rule. It's really looking for those times when revenue volatility is growing in every state, federal changes especially can lead to one-time spikes that forecasters can predict. And it's those times when you might be able to predict those spikes that you want to make sure you can save.

DORN: And, Chairman Stinner, part of the reason for bringing the bill-- or I don't know, I think he made the comment, or maybe you did, that if we have 9 percent growth, which I don't know if we've ever had that, but if you have 9 percent growth and the forecast was for 9 percent growth now we contribute zero dollars to our rainy day fund. That is the years or those are the times where you should be contributing because you have the, I call it the financial ability to do it better. And yet, with our current policy, we won't be up, we-- it would not happen.

STEPHEN BAILEY: And Chairperson, Senator, I think when we're going in the states without the strong savings rule we would recommend just this alternative rule, the savings based off of growth. But I think the LB638 is very practical in taking a very good rule that has worked for the state of Nebraska and then just adding to it to making sure that you're just covering those gaps and not totally reforming how the state is saving.

BOLZ: Just one brief question. I like this bill, I think it's practical and smart. Within our current framework and system, it makes a lot of good sense. Is, if we were not currently in Nebraska and looking at how to best leverage the Nebraska system, is there another state that has a different but better savings policy? Is there a state that's doing, building up their cash reserve better than us?

STEPHEN BAILEY: I think through this bill-- inside Nebraska it's a perfect fit. I think if there was a hypothetical state, it would really depend on what those revenue fluctuations were. There's some states where they have one or two especially volatile tax sources that you would want to isolate and make sure they're not spiking. So I think one of the best examples is Texas with their oil and gas revenue. These specifically are isolating that because that is just the source of their greatest volatility. So instead of looking at their general fund overall, they're looking at just one really volatile source. But for Nebraska, just given the ebbs and flows of the General Fund throughout the business cycle, a rule that like this is an ideal rule. The model that we always speak to is what Virginia does. They us a six-year average and they set aside 6 percent-- 50 percent of above-trend growth. But LB638-- but we've seen in Virginia at the same time that six-year average can fluctuate a lot from year to year in the sense that you have a few bad years and your deposit threshold is much lower. And so having this 20-year average is gonna give you a lot more stability in budgeting, I think, from year to year when you think of savings.

BOLZ: That's a good answer, thank you. OK, thank you very much. Appreciate it. Further proponents? Good afternoon.

WILLIAM KAY: Hi, good afternoon. Good afternoon, Vice Chair Bolz and members of the Appropriations Committee. My name is William Kay, W-i-l-l-i-a-m K-a-y, and I'm the Weitz fellow with OpenSky Policy Institute. I'm filling in today for Renee Fry, who is out. We conceptually support LB638, as a strong cash reserve is essential to the fiscal health of the state. To illustrate why a strong cash reserve is so important, we need to look no further than the recession of the early 2000s compared to the Great Recession. In the early 2000s, a recession hit and there were no federal stimulus funds. At the time, the state had a small cash reserve of about $110 million, less than 5 percent of annual General Fund appropriations. Faced with a $759 million budget shortfall, legislators increased sales and income tax rates, as well as other taxes, and made painful cuts to K-12 and higher education, property tax relief, and other services. In fiscal year '08-09, during the Great Recession, Nebraska had about 17 percent of annual General Fund revenue or $578 million saved in the Cash Reserve Fund. And we still spent $986 million in federal stimulus, cash reserve, and other one-time money on top of cuts to schools and other services to get through the recession. Having at least the recommended amount in the cash reserve will help prevent major cuts to our schools, roads, and other key services when the economy takes a downturn this is particularly important considering a federal stimulus package is unlikely to occur the next time we enter a recession. We do have a couple of concerns. There have been many times in recent history that the cash reserve was used to help finance major capital projects for the state. In fact, the preliminary budget this year calls for a $55 million transfer to the Capital Construction Fund for fiscal year '21. We are concerned that the 16 percent cap could impair our ability to save sufficient resources that are intended for use for a capital project. Furthermore, the governor-- Government Finance Officers Association recommends governments have two months spending in reserve or 16.7 percent of annual General Fund appropriations. We are also concerned that LB638 could require a larger deposit than the Legislature would prefer to make, such as when coming out of a recessionary period, when we are trying to catch up on areas of the budget that have been underfunded, or in times when we are facing an urgent situation such as a large federal fine or a response to a lawsuit. Therefore, we would recommend increasing or removing the cap and giving the bill a safety valve for times when the state may be facing an extenuating circumstance and a deposit into the cash reserve could end up doing more harm than good. Thank you and I would be happy to answer any questions.

BOLZ: Thank you, Mr. Kay. Any questions?

WILLIAM KAY: Go ahead, Senator Erdman.

ERDMAN: Thank you, Senator Bolz. So are you a proponent or an opponent?

WILLIAM KAY: We're a proponent.

ERDMAN: Thank God.

WILLIAM KAY: Yes, I'm testifying as a proponent today.

ERDMAN: OK.

WILLIAM KAY: Yeah.

BOLZ: Go ahead, Senator Dorn.

DORN: Just ask a question here. The last paragraph down here, explaining that a little more, I guess. You know, I'm concerned that would require larger deposit coming out of a recessionary, I mean, you're, we're theoretically in a recessionary time now. So coming out of this you're concerned that that could require a larger cash influx into the cash reserve than what--

WILLIAM KAY: Yeah.

DORN: --maybe should be or could?

WILLIAM KAY: Yeah. Well, often when you're, when you've entered a recession and you're first coming out of it you could see what would look on paper like really fast revenue growth. But depending on what your starting point was that could be, if you're starting from a lower place. So we're concerned that in that situation it could, revenue growth would appear rapid but we would be coming out of a recession so it might not be the ideal time to be--

DORN: So that's more of how the economy is performing, though, than what we're doing in this in this equation, I call it then. Because, I mean, we're, if we've been in a recession and the economy is going good then that would a pack-- impact this, could impact this more, not the calculation of how we do this?

WILLIAM KAY: OK.

DORN: I'm just asking. I don't know

WILLIAM KAY: That's a-- yeah. I don't, I don't think-- I'd be happy to look, look some more into that.

DORN: I don't, and that's just a question I have. I don't--

WILLIAM KAY: Of course. Yeah.

DORN: Because to me, when we're having good economic times that's when then we have the ability to more, to put some more into it and it doesn't affect us as much. But maybe, maybe I, maybe I'm not understanding at all either, so I guess that's just my thought.

WILLIAM KAY: Yeah, I can look more into that and send some information out. Yeah.

BOLZ: I appreciate your question, Senator Dorn, and I was thinking along some of the same lines. But nothing prohibits the Appropriations Committee from using cash reserve dollars for additional needs coming out of recession under this, under this saving structure. There's nothing I'm missing in the bill, is there?

WILLIAM KAY: No.

BOLZ: It would more be that there would have to be the proactive will of the Appropriations Committee to pull it out of the cash reserves for increasing needs post revenue.

WILLIAM KAY: Right.

BOLZ: Post recession.

WILLIAM KAY: Yeah, exactly.

BOLZ: OK. OK, great. OK.

WILLIAM KAY: Thank you.

BOLZ: Thank you. Any further proponents? Do I have any opponents? Don't you dare. Anyone here in a neutral capacity? Senator Stinner, would you like to close?

STINNER: Very, very quickly, very shortly, this is an alternative methodology that in growing times I think would, would help us to put dollars aside into the reserve that may not be there, $422 right now is the 20-year trend line. I'd love to be able to expect, you know, have that much money available right now but it's also the Legislature-- that it doesn't prohibit the Legislature for putting more dollars aside for capital improvements. We're, we're putting more money into it. There's no prohibition against it. This is just a way of taking advantage of an uptick, that we would discipline ourselves to put half the money over the $422 into the reserves. So that's--

BOLZ: Go ahead. Thank you, Senator Stinner. Go ahead, Senator Clements.

CLEMENTS: Thank you, Vice Chair. Thank you, Senator Stinner. I was wondering with the most recent forecast that Nebraska had what percentage growth would that amount to. I don't recall.

STINNER: Our, our last, last forecast we had changed obviously. We were at 5 percent, now I think we're at 4.4. So we're almost right on top of the trend line. But it would cause us to, you know, possibly put a little bit into the reserve.

CLEMENTS: Thank you.

BOLZ: OK, thank you, Senator.

STINNER: Thank you.

BOLZ: I have a letter for the record on LB638 from Stephen Bailey, associate manager of the Pew Charitable Trust in support. I think with that we close the hearing on LB638.