

NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE RESEARCH COMMISSION

STATE LEGISLATIVE BUILDING

RALEIGH, NC 27601



December 15, 2016

TO THE MEMBERS OF THE LEGISLATIVE RESEARCH COMMISSION:

Attached for your consideration is the report to the 2017 Regular Session of the 2017 General Assembly. This report was prepared by the Legislative Research Commission's Committee on Savings Reserve Account, pursuant to G.S. 120-30.17(1).

A handwritten signature in blue ink, appearing to read "Brent Jackson", written over a horizontal line.

Senator Sen. Brent Jackson
Co-Chair

A handwritten signature in black ink, appearing to read "Nelson Dollar", written over a horizontal line.

Representative Rep. Nelson Dollar
Co-Chair

Co-Chairs
Committee on Savings Reserve Account
Legislative Research Commission

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LEGISLATIVE RESEARCH COMMISSION

COMMITTEE ON SAVINGS RESERVE
ACCOUNT

NORTH CAROLINA GENERAL ASSEMBLY



REPORT TO THE
2017 SESSION
of the
2017 GENERAL ASSEMBLY
OF NORTH CAROLINA

DECEMBER 15, 2016

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TRANSMITTAL LETTER

December 15, 2016

TO THE MEMBERS OF THE 2017 REGULAR SESSION
OF THE 2017 GENERAL ASSEMBLY

The Legislative Research Commission herewith submits to you for your consideration its report and recommendations to the 2017 Regular Session of the 2017 General Assembly. The report was prepared by the Legislative Research Commission's Committee on Savings Reserve Account, pursuant to G.S. 120-30.17(1).

Respectfully submitted,

Senator Harry Brown

Representative David Lewis

Co-Chairs
Legislative Research Commission

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LEGISLATIVE RESEARCH COMMISSION MEMBERSHIP

2016 – 2017

Senator Harry Brown
Co-Chair

Representative David Lewis
Co-Chair

Senator Phil Berger, Ex Officio
Senator Tamara Barringer
Senator Dan Blue
Senator Paul Lowe.
Senator Wesley Meredith.

Representative Timothy Moore, Ex Officio
Representative Becky Carney
Representative Ted Davis
Representative Jason Saine

PREFACE

The Legislative Research Commission, established by Article 6B of Chapter 120 of the General Statutes, is the general purpose study group in the Legislative Branch of State Government. The Commission is co-chaired by the President Pro Tempore of the Senate and the Speaker of the House of Representatives, or their designees, and has additional members appointed from each house of the General Assembly. Among the Commission's duties is that of making or causing to be made, upon the direction of the General Assembly, "such studies of and investigation into governmental agencies and institutions and matters of public policy as will aid the General Assembly in performing its duties in the most efficient and effective manner" (G.S. 120-30.17(1)).

The Legislative Research Commission authorized the study of Savings Reserve Account, under authority of G.S. 120-30.17(1). The Committee was chaired by Senator Sen. Brent Jackson and Representative Rep. Nelson Dollar, Co-Chairs of the Committee. The full membership of the Committee is listed under Committee Membership. A committee notebook containing the committee minutes and all information presented to the committee will be filed in the Legislative Library by the end of the **2017-2019** biennium.

COMMITTEE PROCEEDINGS

The Legislative Research Commission's Committee on Savings Reserve Account met 4 times: April 13, 2016, November 30, 2016, December 8, 2016, and December 15, 2016.

The Committee's Charge can be found [here](#). The following is a brief summary of the Committee's proceedings. Informational materials and resources from each Committee meeting are available on the Committee website, which can be reached [here](#). These materials are also available in the Legislative Library.

Meeting of April 13, 2016

The Committee first met on April 13, 2016, in Room 544 of the Legislative Office Building in Raleigh. After opening remarks by the Co-chairs, Mr. Luke Gillenwater from the Bill Drafting Division read the Committee Charge. Mrs. Karen Hammonds-Blanks of the Fiscal Research Division then presented an overview of North Carolina's Savings Reserve Account. Finally, the Committee heard from Mr. Robert Zahradnik with the Pew Charitable Trusts about Savings Reserve Practices in other States. Mr. Zahradnik's presentation noted, among other things, that:

- Savings reserve deposits can be used to smooth revenues, especially those from volatile sources.
- Deposits to savings reserves from year-end surpluses means that savings are not directly tied to the business cycle and that saving becomes a low priority.
- North Carolina is one of only 5 states that does not have explicit savings reserve withdrawal guidelines.
- In deciding how large savings reserve balances should be, state legislatures should consider reasons for savings, desired level of coverage, and desired years of coverage.

At the conclusion of Mr. Zahradnik's presentation, the Committee asked Pew to analyze and model revenue data specific to North Carolina and to provide recommendations for the Committee's consideration.

On April 13, 2016, the Co-chairs of the Committee sent a letter to the full Legislative Research Commission in which they requested to continue the Committee's work in the interim following the 2016 Regular Session of the 2015 General Assembly. At a meeting on April 25, 2016, the Commission approved a motion by Senator Barringer to "recommend to the Speaker of the House and the President Pro Tem that the Committee on Savings Reserve Account ...be authorized to continue [its] studies and submit [its] final report[] to the LRC by December 16, 2016."

Meeting of November 30, 2016

The Committee met for the second time on November 30, 2016, in Room 544 of the Legislative Office Building in Raleigh. The meeting began with a summary of the Committee's previous meeting presented by Mr. Evan Rodewald of the Fiscal Research Division. Mr. Rodewald's summary included a brief overview of the statute that creates and governs the Savings Reserve Account, an overview of the current balance of the Account, and a summary of the key points from Mr. Zahradnik's presentation at the April 13, 2016, meeting of the Committee.

This was followed by a presentation from Mr. Stephen Bailey with the Pew Charitable Trusts about savings policies that would promote long-term budget stability in North Carolina. This presentation was a response to the Committee's request at its prior meeting that Pew analyze and model revenue data specific to North Carolina and provide recommendations for the Committee's consideration. Mr. Bailey's presentation did the following:

- Made the point that a successful savings reserve policy saves a portion of higher-than-normal revenue growth and that doing so prevents unreliable revenues from funding the general budget while simultaneously generating larger reserves to use when revenues decline.
- Made the point that a successful savings reserve policy also identifies clear conditions when savings can be used based on revenue or economic criteria and that doing so ensures savings are only used in times of revenue declines or economic distress, promotes long-term structural stability, and sends positive signals to credit agencies.
- Looked at other states' savings reserve policies and modeled what effect similar policies would have had if they had been in place in North Carolina.

Mr. Bailey's presentation was followed by Committee discussion about the Committee's future work. The meeting concluded with a request by the Chairs that staff work with Mr. Bailey on draft legislation to be considered by the Committee at its next meeting.

Meeting of December 8, 2016

The Committee met for the third time on December 8, 2016, in Room 544 of the Legislative Office Building in Raleigh. The meeting began with a presentation by Mrs. Kristin Walker of the Fiscal Research Division. Mrs. Walker walked the Committee through the various decisions that needed to be made before a bill could be drafted. Mr. Bailey was again present and participated in the Committee discussion. The committee discussed the issues Mrs. Walker presented and made decisions about what sort of legislation it wanted to recommend. The Committee finished the meeting with instructions to staff to draft legislation implementing the Committee's recommendations, which included all of the following:

- A trigger that would set aside 15% of year over year revenue growth in any year where there was revenue growth

- Direction that the Governor and the NCGA set aside the 15% amount prior to budget considerations
- A target cap that took into account the economic modeling used in Minnesota to look at revenue volatility. The model should cover two years of any given downturn and cover nine out of ten downturn scenarios.
- Withdrawal rules that restrict the Reserve's usage to year-over-year revenue declines, budget deficits, legal settlements and emergencies as defined in GS 166A
- A cap on the yearly withdrawal amount of 7.5 of the prior year's General Fund net appropriations operating budget
- A "safety valve" clause which would allow for the withdrawal of funds for other purposes than those listed under the withdrawal rules and also at a higher amount upon a 2/3s vote of the General Assembly

Meeting of December 15, 2016

The Committee met for the fourth time on December 15, 2016, in Room 643 of the Legislative Office Building in Raleigh. Mr. Ben Stanley with the Bill Drafting Division presented the bill that the Committee had requested be drafted at the previous meeting and also presented this report. After some Committee discussion, the Committee adopted an amendment to include testimony received on December 14, 2016, from the Pew Charitable Trusts in the report. It then voted to recommend the legislation and to send the report containing it to the full Legislative Research Commission.

COMMITTEE MEMBERSHIP

2015-2016

Senate Members:

Senator Sen. Brent Jackson, Co-Chair

Senator Sen. Harry Brown
Senator Sen. Ben Clark
Senator Sen. Kathy Harrington
Senator Sen. Bob Rucho

House of Representatives Members:

Representative Rep. Nelson Dollar, Co-Chair

Representative Rep. Dean Arp
Representative Rep. Chuck McGrady
Representative Rep. Bobbie Richardson
Representative Rep. Paul Stam
Representative Rep. David R. Lewis, Ex
Officio

COMMITTEE CHARGE

The LRC Committee on Savings Reserve Account shall study methods for increasing the amount of funds transferred to the Savings Reserve Account. As part of its study, the Committee shall do all of the following:

1. Examine potential costs and benefits of requiring one or more of the following to be transferred periodically to the Savings Reserve Account:
 - a. Growth in General Fund revenue in excess of a benchmark growth rate.
 - b. A particular percentage or dollar amount of General Fund revenue each fiscal year.
 - c. Some portion of growth in the sources of revenue identified pursuant to subdivision of this subsection each fiscal year.
 - d. Interest earned on special funds.
2. Identify specific sources of state revenue that are especially volatile.
3. Consider how the timing of transfers to the Savings Reserve Account affects the amount transferred and the stability of the General Fund.
4. Determine the appropriate target balance of the Savings Reserve Account, if different from the goal set forth in G.S. 143C-4-2.
5. Any other matters the Commission deems relevant to its efforts to increase the amount of funds in the Savings Reserve Account.

The Committee shall submit its report to the Commission on or before April 15, 2016. The Commission shall report its findings and recommendations, including any proposed legislation, to the 2016 Regular session of the 2015 General Assembly [Note that these deadlines were subsequently amended, as described in the "Committee Proceedings" section of this report].

STATUTORY AUTHORITY

NORTH CAROLINA GENERAL STATUTES ARTICLE 6B.

Legislative Research Commission.

§ 120-30.17. Powers and duties.

The Legislative Research Commission has the following powers and duties:

- (1) Pursuant to the direction of the General Assembly or either house thereof, or of the chairmen, to make or cause to be made such studies of and investigations into governmental agencies and institutions and matters of public policy as will aid the General Assembly in performing its duties in the most efficient and effective manner.
- (2) To report to the General Assembly the results of the studies made. The reports may be accompanied by the recommendations of the Commission and bills suggested to effectuate the recommendations.
- (3), (4) Repealed by Session Laws 1969, c. 1184, s. 8.
- (5), (6) Repealed by Session Laws 1981, c. 688, s. 2.
- (7) To obtain information and data from all State officers, agents, agencies and departments, while in discharge of its duty, pursuant to the provisions of G.S. 120-19 as if it were a committee of the General Assembly.
- (8) To call witnesses and compel testimony relevant to any matter properly before the Commission or any of its committees. The provisions of G.S. 120-19.1 through G.S. 120-19.4 shall apply to the proceedings of the Commission and its committees as if each were a joint committee of the General Assembly. In addition to the other signatures required for the issuance of a subpoena under this subsection, the subpoena shall also be signed by the members of the Commission or of its committee who vote for the issuance of the subpoena.
- (9) For studies authorized to be made by the Legislative Research Commission, to request another State agency, board, commission or committee to conduct the study if the Legislative Research Commission determines that the other body is a more appropriate vehicle with which to conduct the study. If the other body agrees, and no legislation specifically provides otherwise, that body shall conduct the study as if the original authorization had assigned the study to that body and shall report to the General Assembly at the same time other studies to be conducted by the Legislative Research Commission are to be reported. The other agency shall conduct the transferred study within the funds already assigned to it.

LEGISLATIVE PROPOSALS

A BILL TO BE ENTITLED
AN ACT TO STRENGTHEN THE SAVINGS RESERVE, AS RECOMMENDED BY
THE LEGISLATIVE RESEARCH COMMISSION.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 143C-4-2 reads as rewritten:

"§ 143C-4-2. ~~Savings Reserve Account and appropriation of General Fund unreserved fund balance.~~Reserve.

(a) ~~Creation and Source of Funds.~~Creation. — The Savings Reserve Account is established as a reserve in the General Fund. ~~The Controller shall reserve to the Savings Reserve Account one-fourth of any unreserved fund balance, as determined on a cash basis, remaining in the General Fund at the end of each fiscal year.~~ Fund and is a component of the unappropriated General Fund balance.

(b) General Use of Funds. — ~~The Savings Reserve Account is a component of the unappropriated General Fund balance.~~ Funds In each fiscal year, funds reserved to the Savings Reserve Account shall be available for expenditure only upon an act of appropriation by the General Assembly, expenditure, in an aggregate amount that does not exceed seven and one-half percent (7.5%) of the prior fiscal year's General Fund net appropriations operating budget, upon appropriation by a majority vote of the membership of the Senate and House of Representatives present and voting for any of the following purposes:

- (1) To cover a decline in General Fund revenue from one fiscal year to another.
- (2) To cover the difference between that fiscal year's base budget needs and projected revenue.
- (3) To pay costs imposed by a court or administrative order.
- (4) To provide relief and assistance from the effects of an emergency, as that term is defined in G.S. 166A-19.3.

(b1) Extraordinary Use of Funds. — In each fiscal year, funds reserved to the Savings Reserve shall be available for expenditure upon a two-thirds vote of the membership of the Senate and House of Representatives present and voting for any of the following purposes:

- (1) To use for any of the purposes set forth in subdivisions (1) through (4) of subsection (b) of this section in an aggregate amount that exceeds seven and one-half percent (7.5%) of the prior fiscal year's General Fund net appropriations operating budget.
- (2) For a purpose not set forth in subdivisions (1) through (4) of subsection (b) of this section in any amount.

(c) ~~Goal for Savings Reserve Account Balance.~~ — ~~The General Assembly recognizes the need to establish and maintain sufficient reserves to address unanticipated events and circumstances such as natural disasters, economic downturns, threats to public safety, health, and welfare, and other emergencies. It is a goal of the General Assembly and the State to accumulate and maintain a balance in the Savings Reserve Account equal to or greater than eight percent (8%) of the prior year's General Fund operating budget.~~

(d) Transfer of Funds into Savings Reserve. – Each Current Operations Appropriations Act enacted by the General Assembly shall transfer to the Savings Reserve fifteen percent (15%) of each fiscal year's estimated growth in State tax revenues, except that if that transfer would cause the balance of the Reserve to exceed the recommended Savings Reserve balance developed pursuant to subsection (e) of this section then the amount transferred pursuant to this subsection shall be reduced accordingly.

(e) Consensus Estimate. – The Office of State Budget and Management and the Fiscal Research Division of the General Assembly shall jointly develop and annually produce an evaluation of the adequacy of the Savings Reserve based on the volatility of North Carolina's General Fund tax structure, which shall take into consideration relevant statistical and economic literature. After completing the evaluation, these entities may revise the methodology as needed to estimate the target for the Savings Reserve balance, which shall be calculated so as to be sufficient to cover two years of need for nine out of ten scenarios involving a decline in General Fund revenue from one fiscal year to the next fiscal year. The recommended balance shall be expressed as a percentage of the prior year General Fund net appropriations operating budget. The Office of State Budget and Management shall report this percentage to the Chairs of the House of Representatives and Senate Appropriations and Finance Committees no later than February 1 of each year.

(f) General Assembly May appropriate Additional Funds. – Nothing in this section shall be construed to prohibit the General Assembly from depositing additional funds into the Savings Reserve.

SECTION 2. G.S. 143C-3-5(b) reads as rewritten:

"§ 143C-3-5. Budget recommendations and budget message.

...

(b) Odd-Numbered Years. – In odd-numbered years the budget recommendations shall include the following components:

(1) A Recommended State Budget setting forth goals for improving the State with recommended expenditure requirements, funding sources, and performance information for each State government program and for each proposed capital improvement. The Recommended State Budget may be presented in a format chosen by the Director, except that the Recommended State Budget shall clearly distinguish program base budget requirements, program reductions, program eliminations, program expansions, and new programs, and shall explain all proposed capital improvements in the context of the Six-Year Capital Improvements Plan and as required by G.S. 143C-8-6.

(1a) The Governor's Recommended State Budget shall include a base budget, which shall be presented in the budget support document pursuant to subdivision (2) of this subsection.

...

(3) A Current Operations Appropriations Act that makes appropriations for each fiscal year of the upcoming biennium for the operating expenses of all State agencies as contained in the Recommended State

Budget, together with a Capital Improvements Appropriations Act that authorizes any capital improvements projects.

- ...
- (6) The Governor's Recommended State Budget shall include a transfer to the Savings Reserve of fifteen percent (15%) of the estimated growth in State tax revenues for each fiscal year of the upcoming biennium. This subdivision applies only if, and to the extent that, the balance of the Savings Reserve remains below the recommended Savings Reserve balance developed pursuant to G.S. 143C-4-2(e)."

SECTION 3. G.S. 142-15.4 reads as rewritten:

"§ 142-15.4. Savings from refinancing of general obligation bonds to be placed in the Savings Reserve ~~Account~~ Reserve.

(a) Whenever general obligation bonds issued or incurred by the State are refinanced:

- (1) The General Assembly shall not reduce the funds appropriated for servicing the refinanced debt during the fiscal biennium in which the refinancing occurs.
- (2) The State Controller shall, in conjunction with the State Treasurer, periodically transfer the savings resulting from the refinancing of the debt to the Savings Reserve ~~Account~~ established pursuant to G.S. 143C-4-2 during the fiscal biennium in which the refinancing occurs.
- (3) The Director of the Budget shall, in the fiscal biennium immediately following the refinancing, adjust the amount of debt service funded in the base budget so that it aligns with actual debt service needs.

(b) Subsection (a) of this section applies only if, and to the extent that, the balance of the Savings Reserve remains below the recommended Savings Reserve balance developed pursuant to G.S. 143C-4-2(e)."

SECTION 4. G.S. 142-96 reads as rewritten:

"§ 142-96. Savings from refinancing of special indebtedness to be placed in the Savings Reserve ~~Account~~ Reserve.

(a) Whenever special indebtedness issued or incurred pursuant to this Article is refinanced:

- (1) The General Assembly shall not reduce the funds appropriated for servicing the refinanced debt during the fiscal biennium in which the refinancing occurs.
- (2) The State Controller shall, in conjunction with the State Treasurer, periodically transfer the savings resulting from the refinancing of the debt to the Savings Reserve ~~Account~~ established pursuant to G.S. 143C-4-2 during the fiscal biennium in which the refinancing occurs.
- (3) The Director of the Budget shall, in the fiscal biennium immediately following the refinancing, adjust the amount of debt service funded in the base budget so that it aligns with actual debt service needs.

(b) Subsection (a) of this section applies only if, and to the extent that, the balance of the Savings Reserve remains below the recommended Savings Reserve balance developed pursuant to G.S. 143C-4-2(e)."

SECTION 5. G.S. 143C-5-4(b)(8) reads as rewritten:

"(8) Statutory transfers to reserves. – Notwithstanding G.S. 143C-4-2 and G.S. 143C-4-3, funds shall not be reserved to the Savings Reserve ~~Account~~ or the Repairs and Renovations Reserve ~~Account~~ and the State Controller shall not transfer funds from the unreserved fund balance to those ~~accounts~~ reserves on June 30 of the prior fiscal year."

SECTION 6. G.S. 147-86.11(e)(7) reads as rewritten:

"(7) The State Controller may use cash reserved to the Savings Reserve ~~Account~~ and cash from other funds, including special funds, that is not needed temporarily to meet the cash flow needs of the General Fund, but only to the extent that this authority can be used without jeopardizing the ability of reserves or funds, including special funds, to meet their ongoing obligations. Any cash transferred from reserves or funds, including special funds, shall be fully restored by the end of the fiscal year in which the funds were transferred, and interest shall be paid on all cash transferred to the General Fund pursuant to this subdivision from interest-bearing accounts."

SECTION 7. During the 2019 Regular Session of the General Assembly, it is the intent of the General Assembly to study whether the changes to the Savings Reserve enacted in this act have successfully accomplished its purpose of establishing and maintaining sufficient reserves to address unanticipated events and circumstances such as natural disasters, economic downturns, threats to public safety, health, and welfare, and other emergencies.

SECTION 8. Sections 3 and 4 of this act are effective July 1, 2017. The remainder of this act becomes effective October 1, 2017.

ADDITIONAL TESTIMONY

The Staff of the Committee received the following testimony from the Pew Charitable Trusts on December 14, 2016:



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Philadelphia, PA 19103-7077 F 215.575.4939

901 E Street NW, 10th Floor P 202.552.2000
Washington, DC 20004 F 202.552.2299
pewtrusts.org

TESTIMONY OF

**Robert Zahradnik, Director and Stephen Bailey, Senior
Associate State Fiscal Health Project at The Pew
Charitable Trusts**

**North Carolina Committee on Savings
Reserve Account December 15, 2016**

**In Support of Committee's Proposed Recommendations and
Legislation "An Act to Strengthen the Savings
Reserve"**

Chairman Dollar, Chairman Jackson, and members of the Committee on Savings Reserve Account:

Thank you for the opportunity to testify regarding the Committee's recommendations and proposed legislation to the General Assembly. Upon review of the Committee's recommendations and proposed legislation as set forth during the December 8, 2016 meeting, Pew supports "An Act to Strengthen the Savings Reserve" because it contains the following elements consistent with best practices for long-term budgeting, as identified by Pew research, in relation to the Savings Reserve Account.

1. Creates a savings deposit rule tied to revenue volatility
2. Clearly defines objective conditions for fund use with one of those conditions tied to revenue volatility
3. Establishes an evidence-based fund savings target

4. Provides a mechanism to re-evaluate the rules governing the fund

First and foremost, by setting aside 15 percent of year-over-year revenue growth, North Carolina would join 15 states that tie their rainy day fund deposits directly to revenue or economic growth. As highlighted in Pew's report "Building State Rainy Day Funds," the proposed deposit rule closely follows one found in Tennessee, where savings has become a straightforward, predictable practice, rather than a yearly debate. There are two key benefits for states that choose to save based on revenue or economic growth. First, states are able to save the most when revenues are highest. Second, unsustainable revenues are prevented from being used to fund recurring expenditures. After all, above-normal revenues cannot be relied on from year to year, so it is better to save those funds for the times when revenues decline. By depositing a portion of revenue growth into the rainy day fund, those unsustainable dollars are not available to fund recurring expenditures, helping to keep the budget structurally balanced.

Second, the bill improves the state's withdrawal provisions. Currently, North Carolina is one of only five states without clear conditions for fund use. The proposed legislation establishes clear conditions for use and includes the ability to cover a decline in general fund revenue from one year to the next. This is consistent with a Pew-identified best practice to link withdrawals to objective measures tied to revenue volatility. These types of conditions ensure reserves are only used in times of revenue or economic distress.

Third, fewer than five states are using evidence – like revenue volatility and forecast error – to determine how much they should save to meet their fund goals. By recommending that the Office of State Budget and Management and the Fiscal Research Division of the General Assembly perform a risk-based analysis using a similar technique found in Minnesota, the state would become a national leader at identifying an appropriate rainy day fund target.

Finally, should the bill pass the General Assembly, the legislation prudently calls for a review of the changes to the Savings Reserve Account after three years. This can help ensure the policy changes are achieving the intended purpose as established by the Committee and provides an opportunity for adjustments if needed.

By voting to recommend "An Act to Strengthen the Savings Reserve" to the General Assembly, Pew believes the Committee on Savings Reserve Account would take a step to improve the state's ability to weather times of economic uncertainty in the future. Additionally, the recommendations would make North Carolina a leader at managing revenue volatility. Should the Committee approve the

recommendations, Pew offers its support and resources to assist in promoting the benefits to the General Assembly. Thank you again for your time and for considering these recommendations.

