

**MINUTES OF THE
EXECUTIVE APPROPRIATIONS COMMITTEE**

Tuesday, October 20, 2015 – 2:00 p.m. – Room 445 State Capitol

Members Present:

Rep. Dean Sanpei, Co-Chair
Sen. Lyle W. Hillyard, Co-Chair
Sen. Jerry W. Stevenson, Vice Chair
Rep. Brad L. Dee, Vice Chair
Sen. J. Stuart Adams
Sen. Gene Davis
Sen. Luz Escamilla
Sen. Peter C. Knudson
Sen. Karen Mayne
President Wayne L. Niederhauser
Sen. Ralph Okerlund
Rep. Patrice M. Arent
Rep. Joel K. Briscoe
Rep. Rebecca Chavez-Houck

Rep. Francis D. Gibson
Rep. James A. Dunnigan
Speaker Gregory H. Hughes
Rep. Brian S. King
Rep. Brad R. Wilson

Members Excused:

Sen. Jim Dabakis

Staff Present:

Mr. Jonathan Ball, Legislative Fiscal Analyst
Mr. Steven Allred, Deputy Director
Ms. Greta Rodebush, Legislative Secretary

Note: A copy of related materials and an audio recording of the meeting can be found at www.leg.utah.gov.

1. Call to Order/Approval of Minutes

Co-Chair Sanpei called the meeting to order at 2:45 p.m.

MOTION: Sen. Hillyard moved to approve the minutes of August 18, 2015. The motion passed unanimously with Sen. Stevenson absent for the vote.

2. Federal/Non-federal Grants Review

Mr. Ken Matthews, Federal Assistance Management Officer, Governor's Office of Management and Budget (GOMB), presented the "Federal and Non-Federal Grants Report" dated October 20, 2015. Mr. Gary Syphus, Fiscal Analyst, LFA, provided assistance.

Under federal grants, there were four new grants requiring legislative action and one new grant and one reapplication of an existing grant approved by the Governor's Office.

Under non-federal grants, there were two new grants requiring legislative action and two new grants approved by the Governor's Office.

Mr. Matthews also reported that for this month, no grant requiring EAC approval would require additional state money if federal funding for the program were to be reduced or eliminated.

MOTION: Sen. Hillyard moved to recommend acceptance of the federal and non-federal grants as outlined on page 1 of the handout entitled, “Federal/Non-Federal Grants Review and Approval” under the heading, “Grants Requiring EAC Review and Recommendation” and dated today, October 20, 2015. The motion passed unanimously with Sen. Stevenson absent for the vote.

3. Pew Charitable Trust Presentation on Sustainable Long Term Fiscal Policies

Ms. Brenna Erford and Mr. Steve Bailey, Pew Charitable Trust, presented research on state budget policies that support and enhance states’ long-term fiscal health. Ms. Erford remarked that “Utah has repeatedly emerged as a leader” in the area of long-term fiscal planning. She noted in particular, the practice of studying revenue volatility on a regular basis in order to inform reserve policy – a practice that Utah has had in place since 2009. This volatility study has been used to inform savings targets of Utah’s two main reserve funds.

Mr. Bailey referred to a slide presentation, “[Pew - Evidence-Based Practices for Managing the Business Cycle](#),” to discuss how best to manage revenue volatility and uncertainty in the business cycle. He spoke on the causes and impacts of revenue volatility on state budgets; policies and practices that Pew has identified to best manage swings in state revenue; and revenue volatility in Utah and improving Utah’s savings policies. Mr. Bailey also presented a brief overview of the work Pew’s research team did with the State of Wyoming by adapting Minnesota’s evidenced-based methodology for setting an ideal savings target. Finally, Mr. Bailey discussed Utah’s innovative approach to financing capital projects by shifting funding over to debt and current reserves.

Mr. Bailey identified ways Utah can improve volatility management in the areas of deposits into and withdrawals from the rainy day funds. Pew recommended depositing a percentage of above-trend revenue to the rainy day funds, and to allow withdrawals based on cyclical declines in the economy and/or state revenues.

Ms. Erford and Mr. Bailey responded to committee questions regarding the current status of Minnesota’s reserve funds, Utah’s reserve deposit and withdrawal rules, Virginia’s approach to managing reserve funds, Utah’s volatility ranking, the size of Utah’s rainy day funds relative to the State budget, Utah’s methodology around trend lines, and the evaluation of tax incentives.

Mr. Ball highlighted some examples of what Utah is doing to improve its own processes regarding trend analysis and business cycle management.

Sen. Hillyard called attention to “[State of Utah Financial Highlights](#)” behind Tab 4, which includes preliminary FY 2015 budget information for budgeted reserves and surplus.

4. Fiscal Health Check-up: FY 2015 Preliminary Results, FY 2016 Revenue Update

LFA staff presented several updates to the Reserves section of the [Fiscal Health Dashboard](#).

FY 2015 Year-end Transfers to Rainy Day Fund Accounts

Ms. Clare Tobin Lence, Fiscal Analyst, LFA, discussed FY 2015 year-end transfers to the General and Education Fund Rainy Day Accounts in accordance with Utah Code 63J-1-312, which incorporated the increased cap for transfers passed in H.B. 333 (2015 General Session).

By statute, the Division of Finance automatically transfers 25 percent of the revenue surplus into the rainy day fund accounts. If the Legislature has appropriated funds out of the accounts in the last ten years and has not entirely replaced that amount through appropriations, the Division will transfer an additional 25 percent for a total of 50 percent of the revenue surplus. Automatic deposits to the General Rainy Day Fund are capped such that the balance does not exceed 9 percent of General Fund appropriations for the year in which the surplus occurred. Similarly, automatic deposits to the Education Rainy Day Fund are capped such that the balance does not exceed 11 percent of Education Fund appropriations.

Ms. Lence indicated that the Medicaid Rainy Day Fund and the Disaster Recovery Fund also receive money from any General Fund surplus. Because there was no General Fund surplus for FY 2015, no new deposits were made to the General Rainy Day Fund or to the Medicaid Rainy Day or Disaster Recovery Funds. The current account balance in the General Rainy Day Fund is \$141.2 million, which represents 6 percent of General Fund appropriations.

For FY 2015, Ms. Lence reported a surplus of \$119 million in the Education Fund. As such, the Division of Finance transferred \$59 million to the Education Rainy Day Fund. The current balance in this fund is \$349.5 million, which represents 10 percent of Education Fund appropriations.

Ms. Lence called attention to two more updates on the Fiscal Health Dashboard, General Fund Restricted (GFR) Balances and Nonlapsing Balances. For FY 2015, GFR Balances decreased by 14.2 percent or \$31 million for a total of balance of \$187 million. Nonlapsing Balances increased by about 13 percent or \$35 million for a total balance of approximately \$310 million.

FY 2015 Preliminary Lapsing and Nonlapsing Balances

Mr. Brian Wikle, Fiscal Analyst, LFA, presented the Issue Brief, "[FY 2015 Preliminary Lapsing and Nonlapsing Balances](#)." As of October 9, 2015, the Division of Finance calculates that state agencies will lapse \$29.9 million back to the General and Education funds and \$48.0 million back to other funds for FY 2015. Preliminary numbers also indicate that state agencies and public education will carry forward \$309.9 million from FY 2015 to FY 2016 as nonlapsing balances.

Mr. Wikle referred to Table 1 on page 2 of the issue brief, which shows the FY 2015 preliminary lapsing and nonlapsing balances by agency. The nonlapsing balances are also shown by subcommittee for FY 2009 through FY 2015 in Figures 1 through 10 beginning on page 3.

FY 2015 Preliminary Fund Balances

Mr. Wikle presented the Issue Brief, "[FY 2015 Preliminary Fund Balances](#)." He reported that as of October 9, 2015, preliminary balances in General Fund restricted accounts total about \$366 million and preliminary balances in Education Fund restricted accounts total about \$768 million including rainy day funds.

Mr. Wikle briefly called attention to the table on page 1 that summarizes the state's preliminary fund balances, revenues, and expenditures in each of the fund categories. He also referred to two tables that were included in the report in response to recommendations made to the EAC in November 2013: "Preliminary Balances of Negative \$100,000 or Less" and "Inmate Accounting and Offender Obligations Account Activity." In addition, Mr. Wikle referred to a summary chart on page 3 that identifies the total number of funds by fund category, and the charts on pages 4 through 26, which list individual funds, revenue sources, and budget detail on the preliminary FY 2015 fund balances.

Revenue Update

Dr. Andrea Wilko, Chief Economist, LFA, and Dr. Thomas Young, Senior Economist, LFA, presented the "[Revenue Update](#)" for October 20, 2015. The report includes the details of FY 2015 year-end revenue and budget surpluses, a range forecast for FY 2016, and an update of the economic indicators. Dr. Wilko indicated that an updated point forecast for FY 2016 and new forecasts for FY 2017 will be presented in the December EAC meeting.

Utah ended FY 2015 with a \$96.2 million General and Education Fund revenue surplus. The report states that the revenue surplus was due "almost entirely to better-than-expected growth in withholding and gross final payments to the Education Fund." When adjusting for expenditures and transfers to the Education Fund Reserve Budget Account, the FY 2015 budget surplus is \$43.8 million.

Based on current collections and updated indicators, revenues could be \$40 million below to \$190 million above current estimates in FY 2016. This is largely due to strong income tax growth.

The General Fund ended FY 2015 with a \$23.0 million revenue deficit. Dr. Wilko noted that when adjusted for some budget changes, the budget deficit is closer to \$15.2 million. The details of this shortfall are reflected on the chart on page 1 of the report, "Surplus/Deficit by Revenue Type (Thousands)." The largest factors behind the revenue deficit were softer than expected sales tax revenue (\$14.8 million) and weak severance tax revenue.

In response to Sen. Adams' inquiry about the rate of growth in sales tax, Dr. Wilko responded that Utah's sales tax grew by 4.8 percent, and based on the major economic indicators, Utah is in a recovery to boom period.

Sen. Okerlund asked about the loss of sales tax revenue to Internet sales. Dr. Wilko indicated that the growth in online sales is contributing to the drag on sales tax revenue by approximately \$37 million.

President Niederhauser asked if the \$29.9 million that state agencies lapsed back to the General and Education funds is included in the FY 2015 budget surplus of \$43.8 million. Dr. Wilko confirmed that the lapsed monies were included in the budget surplus. She also clarified that the \$15.2 million revenue deficit in the General Fund is after the lapsing funds have been counted.

The Transportation Fund ended FY 2015 about \$2 million below target because of lower than anticipated growth in special fuel tax revenue. It is anticipated that the Transportation Fund revenue will end FY 2016 between \$10 million below to \$5 million above the current FY 2016 target.

The Education Fund ended FY 2015 with a revenue surplus of \$119.2 million. When expenditure side adjustments and revenue transfers are made to the rainy day fund, the budget surplus is \$59.5 million. In FY 2016, Education Fund revenue is expected to be \$30 million to \$175 million above target.

Finally, Dr. Wilko reported on corporate value to GDP, Federal outlays, and economic indicators. The overall economic picture for Utah is strong with expected growth in employment, wages, housing, dwelling permits, and residential and nonresidential permit values.

Rep. Wilson asked how the State is going to cover the \$15.2 million revenue deficit in the General Fund. Dr. Wilko indicated that balances from FY 2015 that are carried over into FY 2016 could be used to cover the deficit along with other funding sources. Mr. Ball mentioned that cash flow could be used to offset the budget deficit as well.

Dr. Thomas Young, Senior Economist, LFA, discussed Utah's unemployment, U.S. household formation, home prices, retail sales, collections to date, and the difference between two measures of unemployment: U-3 (traditional unemployment) and U-6 (disaffected and marginally attached employment). Dr. Young pointed out that while U-3 is at or near historical lows, the difference between U-3 and U-6 is double what it was the last time Utah's unemployment was below 4 percent.

Dr. Young reported that household formation in the U.S. based on a 12-month moving average began increasing in the latter half of 2014 as Millennials started forming their own households. More recently, household formation has decreased slightly, although the formations are still at a high level compared to what we've seen in the past 8 years of recovery and boom. He indicated that this should be a positive driver of growth in the coming years.

Analyses also show that home price appreciation in Utah is about average in the middle single digits. Retail sales are healthy and overall sales tax in the state is growing faster than most areas nationwide. And finally, revenue on the whole is coming in above target, largely due to individual income tax.

5. Revenue Estimates on Local Option Sales Taxes for Transportation

Mr. Ball briefly commented on the issues associated with a local sales tax increase for transportation as outlined in the Issue Brief, "[HB 362 Sales Tax Increase](#)."

HB 362 from the 2015 General Session allows counties, if approved by majority vote, to impose a 0.25 percent sales tax increase for transportation-related expenditures. Of the 29 counties, 17 counties have placed the issue on the ballot, representing a potential sales tax increase of about \$108 million. Mr. Ball mentioned one concern and that is, if H362 is approved, the local sales tax increase may diminish the state's taxing capacity.

Dr. Young discussed the sales tax component of HB 362 in greater detail including a geographic view of potential sales tax increase by county; a state and local sales tax rate comparison; three tax increases from the 2015 General Session; distribution of the potential sales tax increase to public transit districts, county legislative bodies, and cities/towns/unincorporated areas within each county; and total sales tax allocation by entity.

Dr. Young reported that the 0.25 percent potential tax increase places the average Utah sales tax burden at about 7 percent, just behind Georgia and higher than North Carolina. For a family making \$50,000 per year, and spending \$20,000 on non-food taxable items, the potential sales tax increase is about \$50 per year. By way of comparison, the property tax increase on a \$250,000 primary residential home is about \$47 per year, and the gas tax increase for an individual driving 13,000 miles per year is about \$42. In total, the three tax changes represent about \$260 million in tax liability adjustments.

6. USOR Legislative Audit Report

Ms. Leah Blevins, Audit Supervisor, OLAG, presented "[A Performance Audit of USOR's Budget and Governance](#)" dated September 8, 2015. Mr. Tim Osterstock, Audit Manager, OLAG, and Mr. Jake Dinsdale, Audit Staff, OLAG, provided assistance.

Ms. Blevins provided some background information on the Utah State Office of Rehabilitation's (USOR) ability to manage its budget, which has resulted in requests for additional funds in the last two years and appearances before various oversight bodies. In February of 2015, the Social Services Appropriations Subcommittee requested an audit of USOR.

The audit finds that there were two main causes of USOR's recent budget problems. The primary cause was a lack of substantive budget management, oversight, or control within USOR and the Utah State Office of Education (USOE). This resulted in USOR management operating the program with little financial information or understanding. The secondary cause was a rise in USOR clients which increased program costs. As the number of clients grew, USOR could and should have made use of a waiting list to control the number of clients the program was serving. Instead, USOR decided to serve all clients despite a lack of ongoing funding.

USOR's budget mismanagement resulted in a \$4.9 million deficit in 2014, the elimination of about \$17 million of federal spending reserves, a \$6.3 million supplemental appropriation in 2015, and a potential \$5-6 million federal penalty that will reduce future VR grant awards.

Mr. Dinsdale discussed in greater detail USOR's inflated working budget as outlined in Chapter II of the audit.

Ms. Blevins also discussed USOR and USOE's budget processes; lines of communication between the Utah State Board of Education (USBE), USOE, and USOR; lack of oversight and governance; the possibility of moving USOR to another department in state government, specifically the Department of Workforce Services; and the appropriateness of using the Visually Impaired Trust Fund (VITF) for vocational rehabilitation expenses.

At the beginning of Ms. Blevins' presentation, she indicated that since these problems have come to light, the USBE, USOE, the new superintendent, and USOR have made aggressive changes to their operations, oversight and staff, and they all report that they intend to continue doing so.

Rep. Gibson noted some significant changes that have taken place within the Board, USOE, and USOR. Ms. Blevins concurred with those changes. She did point out that written policies and procedures have yet to be changed.

Rep. Chavez-Houck asked Mr. Stephen Jardine, Fiscal Analyst, to recount what the Social Services Appropriations Subcommittee did to deal with this issue and requests for additional funding. Mr. Jardine summarized the issue as presented in the Issue Brief, "[Utah State Office of Rehabilitation – Fiscal Status and Audit Follow Up](#)." Rep. Chavez-Houck felt that at some point in time, it would be important to include how USOR clients and families feel about this issue.

Sen. Davis asked if the program is fulfilling its mission in terms of education and training and if the waiting list was going to require another infusion of money. Ms. Blevins responded that while the audit did not address USOR's mission specifically, as far as they could tell, USOR was serving its clients.

Mr. Darin Brush, Executive Director, USOR, explained that USOR implemented an order of selection in February 2015, which created a waiting list consisting of three categories. He stated that USOR continues to serve clients that were already in plan prior to the supplemental appropriation and prior to the order of selection being implemented. Mr. Brush said that USOR intends to open the waiting list next month to individuals who are in the most significantly disabled category. Mr. Brush indicated that USOR is working on a modeling system that leads USOR to believe that it can serve existing clients as well as the most significantly disabled. Because of the new processes that are in place, Mr. Brush was not certain about the need for additional funding.

Sen. Davis was not in favor of moving USOR to DWS, where the focus is on employment rather than education.

Co-Chair Sanpei indicated that because the EAC meeting had started late, the Committee would only have time to hear Agenda Item 7, SAGE Test Question Contract and Revenue.

President Niederhauser requested that the Social Services Appropriations Subcommittee be given the opportunity to review the governance issues in the audit. Ms. Blevins responded that the subcommittee heard the audit in September but due to the lack of a quorum, the subcommittee did not act on the audit at that time but will do so in the future.

Mr. Brad C. Smith, State Superintendent, USOE, indicated that the Utah State Board of Education had voted to move USOR out from under the direction of the Board. He pointed out though that transition is a real expense.

Rep. Gibson asked if USOE had dedicated resources to address those concerns.

Mr. Dave Thomas, Vice Chair, USBE, commented on the problems associated with USOR and the Board's position regarding the governance of USOR.

Rep. King asked why the board decided to recommend moving USOR from USOE. Mr. Thomas indicated that the mission of USOR seems different than USOE's mission for K-12 children. The Board is also concerned about its losing focus on this program when the problems are taken care of. Rep. King understood that the community of people with disabilities do not want USOR moved from USOE. Mr. Thomas responded that all of the individuals he talked to in the disability community want the Board to have oversight of USOR.

Sen. Hillyard expressed disappointment that the State Board of Education was not able to take care of this problem in 2014. He was deeply concerned that if USOR is moved out of USOE to Social Services, we may lose the opportunity of using Education funds for these programs.

Superintendent Smith and Vice Chair Thomas further explained the USOE's understanding of the issues and the Board's position on governance.

Sen. Hillyard commented that the focus should be on rehabilitating people so that they can get jobs and function in society.

7. SAGE Test Question Contract and Revenue

Mr. Ben Leishman, Fiscal Analyst, LFA, introduced the topic outlined in the memorandum, "Licensing of Student Assessment of Growth and Excellence Test Items," dated October 13, 2015 behind Tab 7. He explained that in fall 2014, the Utah State Board of Education (Board) received a request to license Utah's SAGE (Student Assessment of Growth and Excellence) test items to three states: Florida, Arizona, and Tennessee. The Board has since received a fourth request, from the State of Ohio, to license test items.

During the 2015 General Session, the Legislature passed the following intent language for these licensing agreements:

The Legislature intends that the State Board of Education use any nonlapsing balances generated from the licensing of Student Assessment of Growth and Excellence (SAGE) questions to other states to develop additional assessment questions and provide professional learning for Utah educators.

Mr. Leishman indicated that the Board would provide an update on the licensing agreements, including, participating states, anticipated revenues, and how the funds are being expended.

Mr. Scott Jones, Associate Superintendent for Business and Operations, Utah State Office of Education (USOE), reported since 2012-2013, the SAGE test program received an annual appropriation of \$6.7 million. To date, including revenues generated from the licensing agreements to other states, USOE has expended \$29,396,961 million. Mr. Jones explained that it is difficult to estimate revenues that the contracts would generate because states have the flexibility to select different test packages, which they may or may not use. He reported that USOE had received approximately \$7 million in offsets from the licensing agreements thus far.

Superintendent Brad C. Smith, USOE, proposed that the funding that was generated by the four states, funding that is over and above the legislative appropriation and generated by the four states, be used for three primary uses. Two of the uses have already been addressed and approved by the Legislature - Assessment to Achievement and Item Development. Superintendent Smith also proposed that one-time funding be used to pay for the current cost of four new employees, three managerial accountants and a federal grants compliance officer, which would improve and increase the accounting capacity at USOE. He indicated that USOE would be requesting ongoing funding for these positions in the FY 2017 budget cycle.

Rep. Gibson expressed support for USOE's immediate request for one-time funding.

Co-Chair Sanpei remarked that the Committee would not be able to take any action without a quorum present. Rep. Gibson asked about USOE's time frame. Superintendent Smith responded that he would like to move forward with this request as quickly as possible.

Mr. Ball commented that because the funding is in the same line item that USOE is proposing to use it in, USOE could redirect the money as they so choose. Superintendent Smith said that given the importance of the item, he was prepared to move forward even with the risk in mind.

8. Corrections Space, Jail Contracting, and Daily Rate

This agenda item was not heard in committee.

9. CTE Comprehensive Study Progress Report

This agenda item was not heard in committee.

10. DNR Sage Grouse Contract Update and Review

This agenda item was not heard in committee.

11. Other Business

There were two reports included behind Tab 11 for committee review: "[Utah Office of Inspector General – Medicaid Services 2015 Annual Report](#)," and "[Justice Reinvestment Initiative Status](#)."

MOTION: Sen. Hillyard moved to adjourn. The motion passed unanimously with Sen. Adams, Sen. Escamilla, Sen. Knudson, Sen. Okerlund, Sen. Mayne, Rep. Briscoe, and Rep. Wilson absent for the vote.

Co-Chair Sanpei adjourned the meeting at 5:00 p.m.