INTERIM JOINT COMMITTEE ON APPROPRIATIONS AND REVENUE

Minutes of the 2nd Meeting
of the 2019 Interim

July 9, 2019

Call to Order and Roll Call

The 2nd meeting of the Interim Joint Committee on Appropriations and Revenue was held on Tuesday, July 9, 2019, at 1:00 PM, in Room 149 of the Capitol Annex. Senator Christian McDaniel, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Senator Christian McDaniel, Co-Chair; Representative Steven Rudy, Co-Chair; Senators Tom Buford, Matt Castlen, Rick Girdler, Stan Humphries, Alice Forgy Kerr, Morgan McGarvey, Stephen Meredith, Gerald A. Neal, Dennis Parrett, Robin L. Webb, Stephen West, and Phillip Wheeler; Representatives Lynn Bechler, Danny Bentley, Myron Dossett, Joseph M. Fischer, Kelly Flood, Jim Glenn, David Hale, Mark Hart, Angie Hatton, Dennis Keene, Russ A. Meyer, Jason Nemes, Ruth Ann Palumbo, Melinda Gibbons Prunty, Brandon Reed, Steve Riley, John Sims Jr, Wilson Stone, James Tipton, and Susan Westrom.

Guests: Robin Kinney, Associate Commissioner, Office of Finance and Operations, Department of Education; Chay Ritter, Branch Manager, Funding and Reporting Branch, Division of District Support, Office of Finance and Operations, Department of Education; David Eager, Executive Director, Kentucky Retirement Systems; and Perry Nutt, Staff Economist, Legislative Research Commission.

LRC Staff: Jennifer Hays, Cynthia Brown, Katy Jenkins, and Chase O'Dell

Approval of Minutes

A motion was made by Representative Reed, seconded by Representative Gibbons Prunty, to approve the minutes of the June 4, 2019 meeting. The minutes were approved by voice vote.

Education Funding

Robin Kinney, Associate Commissioner, Office of Finance and Operations, Department of Education, and Chay Ritter, Branch Manager, Funding and Reporting Branch, Division of District Support, Office of Finance and Operations, Department of Education, discussed the Support Education Excellence in Kentucky (SEEK) formula.

Robin Kinney testified that, in 1985, 66 poor property districts formed together to challenge the overall educational system in Kentucky. As a result, the system was declared unconstitutional pursuant to Section 183 of the Kentucky Constitution. The decision resulted in the Kentucky General Assembly enacting the Kentucky Education Reform Act (KERA) in 1990, which included the SEEK funding mechanism. The SEEK funding formula has not changed much in 30 years. KRS 157.350 sets forth SEEK eligibility requirements.

SEEK is an allocation formula used to disperse funds to school districts. Once a district receives the funds, the funds can be utilized by the district to make it as efficient and effective as possible.

Mr. Ritter testified that the first input into the SEEK formula is the Aggregate Average Daily Attendance (AADA); which each district reports to the Kentucky Department of Education (KDE). The statewide AADA is about 593,000. Other inputs into the formula include funding for free lunch for at-risk children, funding for children with disabilities, home hospital (H/H) for students unable to physically attend school, and funding for students with limited English proficiency (LEP). Mr. Ritter stated that $214 million has been appropriated for pupil transportation through SEEK in each of the last several budgets. The most recent calculation for districts' transportation costs totaled about $376 million.

Districts that have increased local revenue to a level known as 'tier one' may receive additional funding through the budget. About $160 to $170 million each year is given to tier one districts. Local revenue and effort are a big part of SEEK. Districts are required to levy a minimum equivalent tax rate of 30 cents per $100 of assessed property. All of the school districts combined generate about two-and-a-half billion dollars in tax revenues.

Mr. Ritter stated that 'nickels' are nickel-equivalent taxes that help districts dedicate funds to facilities renovation and new construction. Each district is required to have the Facilities Support Program of Kentucky (FSPK). The equalization formula for nickels is formula driven and impacted by local property assessment and statewide equalization level.

In response to a question from Senator McDaniel, Mr. Ritter stated that 'local effort' is determined based on assessed value. In response to another question, Ms. Kinney confirmed that, if a local county has a poor collection percentage, that factor will be one of the biggest determinants in large fluctuations of funding for the county's schools.

In response to a question from Representative Stone, Mr. Ritter and Ms. Kinney stated that the 2019-2020 budget was the first budget that included language stating that unexpended SEEK funds would be allocated for pupil transportation. In response to another question, Mr. Ritter and Ms. Kinney confirmed that the General Assembly would need to include that language in the next budget for unexpended SEEK funds to continue be allocated for pupil transportation. Representative Stone expressed his hope that the legislature would find a way to help with transportation costs.

In response to a question from Senator Kerr, Ms. Kinney stated that Jefferson County has over 100 languages spoken in its schools. In response to another question from Senator Kerr, Ms. Kinney stated that she would provide Senator Kerr with a list of the category five schools.

In response to a question from Representative Sims, Mr. Ritter and Ms. Kinney testified that the SEEK per pupil rate has been at $4,000 only during the current biennium. In response to another question from Representative Sims, Ms. Kinney stated that school districts are using federal funds for various expenditures within the educational system. In response to another question, she said that different school districts have different financial needs based upon the population, enrollment, and debt of the district. In response to a final question from Representative Sims, Mr. Ritter stated that the SEEK formula accounts for property wealth within districts. A school district with high property wealth receives less from the state because of the ‘local effort.’ A district with low property wealth and local effort will receive more state assistance.

In response to a question from Representative Dossett, Mr. Ritter stated that there is no guarantee that the state will match the recallable nickel if it is passed by a district. Rather, it depends upon the language in each biennium budget bill.

In response to a question from Senator McDaniel, Ms. Kinney stated that each county must have a school district, but that she was not aware of guidelines regarding how many schools must be in a district. In response to another question from Senator McDaniel, Mr. Ritter testified that KDE has field staff who visit districts throughout the year. KDE has an audit process to check a district’s attendance records and other records.

In response to a question from Senator Neal, Ms. Kinney stated that the SEEK formula does not include a process by which to determine whether a viable level of student service delivery is being maintained in the state.

In response to a question from Representative Rudy, Mr. Ritter testified that less than 10 school districts are levying an occupational tax. The district occupational tax is levied on taxpayers who live and work in the district.

Kentucky Retirement Systems

David Eager, Executive Director, Kentucky Retirement Systems (KRS), discussed actuarial assumptions for KRS.

Mr. Eager testified that the actuary’s job is to come up with the appropriate amount of money that the state, cities, and counties should contribute to fund retirements. Actuaries know the age of each systems' members, how much money each member earns, how much service each member has, the gender of each member, and each member's occupation. Actuaries do not know how much money that investments will earn, how long members are going to live, when members are going to retire, how long members will stay in a job, or if members will become disabled.

An experience study of KRS is statutorily required every five years. The experience study for the five-year period ending June 30, 2018, was conducted by the actuary, Gabriel, Roeder, Smith & Company (GRS). The KRS Board agreed with and approved the actuarial assumptions recommended by GRS as a result of the study. The assumptions will determine contribution rates for the Kentucky Employees Retirement System (KERS) plan and the State Police Retirement System (SPRS) plan for Fiscal Years 2021 and 2022. The new rates will go into effect June 1, 2020. The assumptions will also determine contribution rates for the County Employees Retirement System (CERS) for Fiscal Year 2021.

Mr. Eager stated that KRS went many years relying on assumptions that were outdated. When KRS adjusted the interest assumptions in 2017, that action drove the contribution rate from 49 percent to 83 percent. It had to be done because the system was underfunded and underestimated for a long time.

Mr. Eager highlighted changes to the assumptions made by KRS. KRS added two years to the assumed life expectancy of members. Turnover varies between systems, with KERS non-hazardous having higher turnover, and CERS non-hazardous having lower turnover. KRS also made investment earning assumptions 1.25 to 1.50 percent lower than previously assumed, depending on the system.

KRS is projecting what the life expectancy will be for members who will be retiring for the next 40 years, and that there will be a higher cost associated with it. Previous experience studies used the national mortality tables, but KRS will now determine mortality based on its own membership. People in the KRS live longer than the national average. Starting in 2020, the life expectancy assumption for males age 65 will increase from 19 years to 21. The assumption for females age 65 will increase from 22 years to almost 24. The state will have to pay more money in benefits because people are staying in the system longer.

Due to the new assumptions, employer contribution rates and requirements are recommended to rise. The recommended contribution rate for KERS non-hazardous will rise four percent, resulting in $59 million more needed to fund that system. The contribution requirement for KERS hazardous will increase by four million dollars. The rate will increase by 3 and a half percent for CERS non-hazardous, requiring $86 million more. The CERS hazardous contribution rate is recommended to increase from 46.5 percent to 57.6 percent. The contribution rate for SPRS is recommended to increase 13 percent. The new recommendations modestly lower the funded status of each retirement system.

In response to a question from Senator McDaniel, Mr. Eager stated that life expectancy is ascending. The KRS board deferred to the actuary's forecast as it relates to life expectancy. KRS needs to ask for funding that matches the level 'prescribed' by the actuary. In response to another question from Senator McDaniel, Mr. Eager testified that he did not know if the Kentucky Teachers' Retirement System (KTRS) was still using stock assumptions.

In response to a question from Representative Hatton, Mr. Eager said that from KRS' standpoint, it would be irresponsible to fund the system less than the actuary recommends. The solution to city funding problems is not to cut pensions. A big adjustment in the assumptions made was necessary because small adjustments had not been made over time.

In response to a question from Senator Wheeler, Mr. Eager testified that there is very little liability associated with the tier three cash-hybrid plan, because it has been in place for five years. If the state continues to fund at the full Actuarially Required Contribution (ARC), the contribution rate for a new person coming into KRS will be 3.05 percent in 2043. Tier three will have a positive impact.

In response to a question from Representative Tipton, Mr. Eager stated that the funded ratio for CERS non-hazardous was higher 10 years ago. In response to another question from Representative Tipton, Mr. Eager said that incorrect assumptions in the past were a big contributor to the funded ratio of CERS consistently decreasing over time, even when employers were paying 100 percent of the recommended contribution rate. KRS was in a negative cash flow for 15 years. In response to another question, Mr. Eager testified that KRS non-hazardous payroll growth will be -10 percent this year. Representative Tipton stated that at some point there will be an economic downturn that puts stressors on investment returns; continuing to say that it is important to have accurate assumption rates. Mr. Eager stated that KRS needs to amend the system to rely less on contributions based on payroll growth.

In response to a question from Senator Buford, Mr. Eager said that last year, KRS was 'shorted' $132 million because quasi-governmental agencies were allowed to pay a 49 percent contribution rate, and the state did not appropriate the difference. It will cost KRS $121 million next year. In response to another question from Senator Buford, Mr. Eager testified that he knows of three bills being considered related to quasi agencies, with the net-present cost of them totaling $800 million. Senator Buford stated that if the legislature allows quasi agencies to have the lesser contribution rate, it could result in $1.5 billion to the negative side of the bottom line over 20 years.

In response to a question from Senator McDaniel, Mr. Eager stated that after September 1, it will be much more expensive to buy time. In response to a follow-up from Senator McDaniel, Mr. Eager said that a person conventionally retiring will not see a change in benefits due to changes in actuarial assumptions. It may affect reduced benefits for early retirement.

In response to a question from Representative Nemes, Mr. Eager said that the difference between the contribution rate quasi agencies pay, and what the agencies would pay at the full rate, will be $121 million next year. Representative Nemes questioned why the actuarial analysis on the proposed quasi agency pension bill did not take into account what taxpayers would have to pay if the legislature did nothing. Mr. Eager stated that the actuarial analysis provided information for the costs of the five options for quasi agencies within the proposed bill.

In response to a question from Senator West, Mr. Eager testified that the funded ratio for KERS non-hazardous is 12.9 percent, and that it will likely decrease. In response to another question, he stated that KERS has positive cash flow for the first time in 15 years. If things do not change, the asset and liability levels will grow.

In response to a question from Representative Meyers, Mr. Eager testified that he did not know whether the administration has discussed ways to create new revenue or increase revenue.

Tobacco Settlement Funds

Perry Nutt, Staff Economist, Legislative Research Commission, discussed tobacco settlement funds.

Mr. Nutt testified that Kentucky signed the Master Settlement Agreement (MSA) in 1998. Under the terms of the contract, Kentucky receives a payment each April from cigarette manufacturers that have signed the MSA. On average, over the past 20 years, Kentucky has received about $111 million each year under the MSA.

In the 2000 Regular Session, House Bill 583 created the Tobacco Settlement Agreement Fund (TSAF), which divided all MSA payments into three funds. The Agricultural Development Fund (ADF) receives 50 percent of the moneys, the Early Childhood Development Fund (ECDF) receives 25 percent, and the Health Care Improvement Fund (HCIF) receives 25 percent. In the same year, House Bill 611 created the ADF and specified that MSA money distributed to the ADF would be divided into two accounts; with 65 percent of funds going to the state account, and 35 percent going to the county account. In the 2000 Regular Session, House Bill 706 created the ECDF. In the same session, House Bill 517 created the HCIF and specified that MSA money distributed to the fund was to be allocated to three areas; 70 percent of funds are to go to the Kentucky

Access Insurance Program, 20 percent of funds are to go to the Lung Cancer Research Program, and 10 percent of funds are to go to substance abuse treatment for minors.

Mr. Nutt testified that tobacco dollars do not lapse to the general fund at the end of the fiscal year, rather they can carry forward. Tobacco dollars are tracked separately from other general fund dollars.

From 2000 to 2014, MSA appropriations closely followed the statutory distribution formula. Starting in Fiscal Year 2015, the approach was changed. For tobacco appropriations, the debt service is first taken off the top, with distributions then being made to the three funds.

Mr. Nutt stated that the current budget predicts $118.1 million in MSA receipts for Fiscal Year 2020. Mr. Nutt reviewed the various areas receiving general fund tobacco appropriations for Fiscal Year 2020. For Fiscal Year 2020, the ADF will receive $42,636,600 in appropriations, with the ECDF receiving $27,930,800, and the HCIF receiving $17,391,400.

In response to a question from Senator Buford, Mr. Nutt stated that there have been a few years in which there was a deficit in the general fund receipts, while also a surplus in the tobacco receipts. The unanticipated tobacco receipts have sometimes lapsed back into the general fund to help in a deficit situation. In response to a statement from Senator Buford, Mr. Nutt stated that while there may have been money taken out of Kentucky Access in the past, it was not general fund tobacco money.

Representative Stone stated that the MSA was the result of a settlement between tobacco companies and state attorney generals, with approximately 40 states agreeing to the settlement. States receive funds from the agreement based on the amount of tobacco sales in the state. Kentucky has spent the funds it receives from the MSA well. The MSA has had many positive effects.

Senator Webb stated that Kentucky is an international model as it relates to the handling of MSA funds.

Correspondence Received

Senator McDaniel reviewed the correspondence received from Jenny Bannister, Deputy Director, Office of Budget Review (LRC).

List of Reports Received Since June, 2019

Senator McDaniel reviewed the list of reports received by the committee since June, 2019.

Adjournment

With no further business before the committee, the meeting was adjourned at 2:28 p.m.