



FIVE MAJOR FUNDS

Introduction

The purpose of this memorandum is to provide a brief description of five reserve or trust funds in the state treasury. South Dakota's treasury contains 240 separate funds with assets (September 30, 2002) of more than six billion dollars. The one underlying reason for creating a separate fund in the state treasury is to segregate money. Beyond that, there are many reasons to segregate money and to provide for a separate accounting.

This issue memorandum will not address all funds in the state treasury, but rather focus on five recently created funds that are of considerable interest to the Legislature and the citizens of South Dakota. These funds were created statutorily by the Legislature or the People of South Dakota by amending the Constitution.

In some cases, laws governing these funds have changed since their creation. This issue memorandum will focus on the funds as they currently operate.

The first of these funds is the Budget Reserve Fund. It was created by the 1991 Legislature at the urging of Governor Mickelson. Later in 1995, the Legislature created the Property Tax Reduction Fund. The voters created the

trust fund containing the net proceeds from the sale of state cement enterprises (hereafter referred to as the Dakota Cement Trust Fund) on April 10, 2001. In special session in December 2000, the Legislature placed the constitutional amendment on the ballot in the form of a Senate joint resolution. The voters also created the Health Care Trust Fund and the Education Enhancement Trust Fund on April 10, 2001. The Legislature placed these constitutional amendments on the ballot in the form of a Senate joint resolution during the 2001 regular legislative session.

The Budget Reserve Fund

The Budget Reserve Fund (SDCL 4-7-31 and 4-7-32) was created in order to provide the Governor and Legislature with a pool of money available to address revenue shortfalls resulting from unforeseen circumstances.

Money into the Budget Reserve Fund.

The act establishing the Budget Reserve Fund provided that the balance of the fund be set at a maximum of five percent of the previous year's general fund appropriation through the general appropriations bill (or to twenty million dollars in FY1992). Since that time, at the end of a fiscal year unobligated money in the state general fund has

been transferred to the Budget Reserve Fund so that the maximum balance in the fund at the start of the next fiscal year is equal to five percent of the previous year's general fund appropriation.

As such, the Budget Reserve Fund came into being on July 1, 1992, with a balance of twenty million dollars. Since that time the Budget Reserve Fund has grown as the state general fund budget has grown. Statute provides that money into the budget reserve fund comes from one of two sources: (1) any general funds unspent at the end of the previous fiscal year (reversions); or (2) any total general fund revenues in excess of the amount budgeted. The 2002 Legislature increased the maximum amount of the budget reserve fund from five percent of the previous year's general fund appropriation through the general appropriations bill to ten percent of that amount. The balance of the budget reserve fund may fall below the ten percent maximum if there is not enough unboligated cash available for transfer to reach the ten percent maximum or if there are expenditures out of the budget reserve fund.

Money out of the Budget Reserve Fund.

The only way to spend money out of the budget reserve is by way of a special appropriation. This means that a two-thirds vote of each house of the Legislature is required to spend out of the Budget Reserve Fund.

History of expenditures/transfers out.

1. Following the death of Governor Mickelson, the 1993 Special Session transferred \$3,978,204 from the Budget Reserve Fund to the general fund. This amount consisted of: \$1,500,000 for a state airplane, \$2,458,204 to cover the cost of the riot at the state penitentiary in Sioux

Falls, and \$20,000 to pay for the gubernatorial transition expenses.

2. The 1994 Legislature transferred \$3,072,303 from the Budget Reserve Fund to the general fund. This amount consisted of: \$1,451,303 to pay for the state's costs associated with flooding in eastern South Dakota in the spring of 1993; \$1,021,000 to pay for the state's share of the costs of fighting the Galena fire in 1988; and \$600,000 to cover remaining costs associated with the prison riot.
3. The second special session of the 1994 Legislature addressed the revenue shortfall brought about by the shutdown of the video lottery. The Legislature allowed the transfer of \$1,255,442 per week from the Budget Reserve Fund to the general fund for the duration of the video lottery shutdown. The shutdown lasted fourteen weeks and a total of \$17,576,188 was transferred from the Budget Reserve Fund to the general fund.
4. The 1996 Legislature transferred \$1,287,713 from the Budget Reserve Fund to the general fund to cover the state's costs associated with flooding in eastern South Dakota in the spring of 1995.
5. The 2002 Legislature transferred \$6,641,700 from the Budget Reserve Fund to the general fund to address revenue shortfalls in the FY2002 budget.

Restrictions on expenditures out of the Budget Reserve Fund.

Statute clearly specifies that expenditures out of the Budget Reserve Fund may be made only to address needs arising from unforeseen emergencies or unforeseen revenue shortfalls.

Maximum amount in the Budget Reserve Fund. The Budget Reserve Fund is capped at ten percent of the previous year's general fund appropriation through the General Appropriations Act. For FY2003, this maximum amount is \$85.1 million.

The Property Tax Reduction Fund

The Property Tax Reduction Fund was created by the 1995 Legislature. The Property Tax Reduction Fund was created to serve as a separate fund to serve as a source of revenue to the state general fund to provide property tax relief through state aid to education.

Money into the Property Tax Reduction Fund. Money flows into the Property Tax Reduction Fund from one of two sources. The first source is the state's share of video lottery (which currently runs at approximately \$103.8 million per year). The second source is any money in the general fund at the end of the fiscal year after the transfer to the Budget Reserve Fund is made. As such the second source is made up of general funds which have been appropriated but not spent (reversions) and revenues in excess of the adopted revenue estimate.

Money out of the Property Tax Reduction Fund. There are no special restrictions on spending money out of the Property Tax Reduction Fund. The Commissioner of Finance and Management may transfer money in the fund to the general fund in order to provide property tax relief through state aid to education. Money in the Property Tax Reduction Fund may also be transferred to the general fund through an act of the Legislature. Given these rules, money moves out of the Property Tax Reduction Fund into the general

fund with such ease that the Property Tax Reduction Fund may be considered part of the general fund.

History of expenditures/transfers out. Since the creation of the Property Tax Reduction Fund, annual transfers have been made to the general fund for the purpose of providing part of the funding needed to meet the state's obligation for state aid to education. The 2002 Legislature made an additional transfer of \$6,641,700 out of the Property Tax Reduction Fund to the general fund to address revenue shortfalls in the FY2002 budget.

Restrictions on expenditures out of the Property Tax Reduction Fund. There are no restrictions on the expenditure of money out of the Property Tax Reduction Fund.

Maximum amount in the Property Tax Reduction Fund. The Property Tax Reduction Fund is capped at fifteen percent of the previous year's general fund appropriations through the General Appropriations Act. For FY2003, this maximum amount is \$127.6 million.

Dakota Cement Trust Fund

Late in 2000, Governor Janklow negotiated the sale of the South Dakota Cement Plant. In December 2000 the Legislature met in special session to consider legislation providing the use of the funds from the sale. The Legislature placed two measures on the ballot to amend the South Dakota Constitution. The first measure created a trust fund and provided for an annual transfer of twelve million dollars from the Dakota Cement Trust Fund to the general fund. The second measure provided that except for the annual twelve million dollar transfer, the original principal of

the Dakota Cement Trust Fund forever remain inviolate. The Legislature may distribute an amount equal to five percent of the value of the Dakota Cement Trust Fund less twelve million dollars for the support of education. This means that the value of the Dakota Cement Trust Fund must exceed \$240,000,000 before any money in the fund may be used for the support of education.

Money into the Dakota Cement Trust Fund. On April 1, 2001, \$238,000,000 from the sale of the cement plant was deposited into the Dakota Cement Trust Fund. After the twelve million dollar transfer to the general fund and interest earnings on the fund, the balance in the Dakota Cement Trust Fund on October 31, 2002 was \$229,032,363.

Money out of the Dakota Cement Trust Fund. As mentioned above, the South Dakota Constitution provides for an annual transfer of twelve million dollars from the Dakota Cement Trust Fund to the general fund. After that, the Legislature may spend an amount equal to five percent of the Dakota Cement Trust Fund minus twelve million dollars on education.

History of expenditures/transfers out. Thus far, the only transfers out of the Dakota Cement Trust Fund are the annual twelve million dollar transfers to the general fund, one on June 1, 2001, and the second on June 2, 2002.

Restrictions on expenditures out of the Dakota Cement Trust Fund. The South Dakota Constitution specifies that when the balance of the Dakota Cement Trust Fund is sufficient, the Legislature may distribute money from the fund "for the support of education, but not for the replacement of state aid to general

education or special education...." It is important to note that other trust funds allow for the Legislature by a super majority to invade the principal of the trust fund or spend the money in the trust fund for purposes other than those provided for in the Constitution or statute. This is not the case with the Dakota Cement Trust Fund. The South Dakota Constitution has the Dakota Cement Trust Fund locked up very tightly.

Education Enhancement Trust Fund

The voters, by amending the South Dakota Constitution, created the Education Enhancement Trust Fund. This measure was placed on the ballot by the 2001 Legislature. The constitutional amendment provided that all money in the state treasury received as a result of the agreement between the state and major United States tobacco product producers (commonly referred to as the tobacco lawsuit) be deposited into the Education Enhancement Trust Fund. In addition, the constitutional amendment provided that nearly \$5.7 million in the Youth-at-Risk Trust Fund be transferred to the Education Enhancement Trust Fund. The constitutional amendment provides that the Education Enhancement Trust Fund be used for education enhancement programs--provided that the principal of the fund may never be invaded nor may money in the fund be used for purposes other than education enhancement programs unless appropriated by a three-fourths vote of each house of the Legislature.

Money into the Education Enhancement Trust Fund. Money into the Education Enhancement Trust Fund comes from four different sources: (1) revenues received under the provisions of the

tobacco lawsuit between the first payment received in March of 2000 and April 2002; (2) money in the Youth-at-Risk Trust Fund; (3) interest earnings on the principal; (4) revenue received from the assignment of tobacco payments (tobacco securitization); and (5) interest earnings on the money from the securitization.

Securitization. In late summer and early fall of 2002, Governor Janklow assigned future revenues from the tobacco lawsuit to the South Dakota Educational Enhancement Corporation (SDEEC). The SDEEC then sold \$278,045,000 of bonds, with the revenue from the tobacco lawsuit now assigned to the SDEEC to be used to retire the bonds. After expenses of issuing the bonds and maintaining a sufficient reserve, the SDEEC transferred \$243.6 million to the state treasury, which was placed into the Education Enhancement Trust Fund. After the bonds are retired, SDEEC will assign future revenues from the tobacco lawsuit to the state. Depending upon interest rates, the bonds will be retired anywhere between the years 2018 to 2032.

Money out of the Education Enhancement Trust Fund. Article XII, section 6 of the Constitution and SDCL 4-5-29.2 provide that an amount equal to four percent of the market value of the assets of the Education Enhancement Trust Fund may be transferred to the general fund, so long as the principal of the fund is not invaded. Money transferred from the education enhancement trust fund must be used for education enhancement programs. The Education Enhancement Trust Fund may not be used for purposes other than education enhancement nor may the principal of the fund be invaded unless approved by

a three-fourths vote of each house of the Legislature.

History of expenditures/transfers out. The 2002 Legislature appropriated \$3,245,367 out of the Education Enhancement Trust Fund to continue assisting South Dakota's public school districts acquiring and utilizing technology.

Restrictions on expenditures out of the Education Enhancement Trust Fund. As mentioned earlier, the Constitution allows for expenditures from the Education Enhancement Trust Fund to be used only for education enhancement programs. The Constitution leaves it to the Legislature to define education enhancement programs. Again, the only exception to the education enhancement restriction is the Constitution's allowance for expenditures out of the Education Enhancement Trust Fund for purposes other than education enhancement, provided that the expenditure is approved by a three-fourths vote of each house of the Legislature.

Health Care Trust Fund

In 2000 the Legislature authorized the funding mechanism for the Intergovernmental Transfer (IGT) Fund. (See *SDCL 28-6-28 to 28-6-36, inclusive.*) This fund would later be named the Health Care Trust Fund.

History. South Dakota took advantage of a Medicaid loophole which allowed the state to assume, on paper, that the state's entire Medicaid nursing home population was served by the five facilities in the state that are run by local governments. Federal law allows states to reimburse nursing homes that are run by local units of government at the

higher Medicaid rate. By written agreement with the state, the nursing homes would remit (minus a small handling fee of approximately \$5,000 per year) to the state the difference between the higher Medicaid rate and the lower Medicaid rate. The federal portion of the remittance was credited to the IGT Fund. The fee funds used to “leverage” the federal moneys are credited back to their original funds. Many states have taken advantage of this Medicaid loophole, some for over a decade. Due to this trend, the federal government has closed this windfall. By January 1, 2003, South Dakota will be eligible to use the IGT mechanism for only the Medicaid nursing home populations that are owned or managed by local government.

Authorizing Implementation of the Health Care Trust Fund.

1. For FY 2001, the Special Committee on Appropriations amended the General Appropriations Act by appropriating \$47,500,000 (\$15,000,000 from other funds and \$32,500,000 from federal funds) to the Department of Social Services on May 21, 2001.
2. For FY 2002, the Legislature appropriated \$42,800,000 from all funds (\$14,300,000 from other funds and \$28,500,000 from federal funds) in the General Appropriations Act (HB 1233). On June 13, 2002, the Special Committee on Appropriations amended the General Appropriations Act by appropriating another \$3,000,000 from other funds.
3. FY 2003, the Legislature appropriated \$21,000,000 from all funds (\$7,255,500 from other funds and \$13,744,500 from federal funds) in the General Appropriations Act (SB 187).
4. For future fiscal years, the Trust Fund should have receipts of \$1.4 million annually.

Expenditures from the IGT fund. During 2001 the Legislature passed SB 14 which authorized the expenditure of \$1.6 million from the IGT Fund. Senate Bill 14 amended the FY 2001 appropriations bill and authorized any unspent funds to be carried over into FY2002. These are the only monies from the IGT Fund that have been approved for expenditure to date. Six hundred thousand dollars was appropriated to the Department of Health--\$100,000 for public access defibrillation equipment, and \$500,000 for diabetes screening. Approximately \$160,000 was used for diabetes screening in FY 2001; the rest of the money was utilized for anti-terrorism preparations. The remaining one million dollars was appropriated to the Department of Human Services for neuromuscular devices.

Constitutionally created fund. At the special election held on April 10, 2001, the people approved a constitutional amendment that, in part, created the Health Care Trust Fund. This new fund received the principal of the IGT fund minus the \$1.6 million that was appropriated. According to Article XII, Section 5 of the Constitution, the Investment Council shall invest the principal amount in stocks, bonds, mutual funds, and other financial instruments. Beginning in FY2003, the State Treasurer shall make an annual distribution from the Health Care Trust Fund to the general fund. These monies are to be appropriated for health care related programs. The principal of the fund can only be appropriated by a three-fourths vote of the members-elect of each house of the Legislature.

However, the constitution says: "The calculation of the distribution shall be defined by law and may promote growth of the fund and a steadily growing distribution amount." (emphasis added) S.D. Const. Art. XII, § 5.

2002 Session. For FY2003, the Legislature distributed \$2,590,638 from the Health Care Trust Fund to the general fund for the Divisions of Medical Services (\$1,295,319) and Nursing Facilities (\$1,295,319) in the Department of Social Services. The Legislature also passed SB 40 (2002 S.L. Ch. 26, § 3) which provides for a 4% distribution from the trust fund, based upon its market value, to the general fund.

Summary

Fortunately for the citizens of South Dakota, the Governor and Legislature

have resisted the temptation to spend all monies available to them, but rather set aside large sums of money when available for the public good. This wisdom and discipline has resulted in just over \$700 million (estimated) being in the five funds at the end of FY2003. While the presence of these funds does not remedy the current budget difficulty facing the Legislature, without these funds the budget picture would be much dimmer.

Appendix A shows the condition of the budget reserve fund and the property tax reduction fund.

Appendix B shows a brief financial history of the three constitutional trust funds.

Appendix C shows the relevant statutory and constitutional provisions.

This issue memorandum was written by Dale Bertsch, Chief Analyst for Fiscal Research and Budget Analysis; Reed Holwegner, Senior Fiscal Analyst; and Anne Mertz, Senior Fiscal Analyst for the Legislative Research Council. It is designed to supply background information on the subject and is not a policy statement made by the Legislative Research Council.
