

EXPENDITURE UPDATE AND BUDGET PRESSURE POINTS

A Report Prepared for the
Legislative Finance Committee

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This report provides an update on general fund and selected state special revenue expenditures through January, and highlights any pressure points or other issues that may signal a danger of either a supplemental or potential impact on operations to avoid an over expenditure. Potential cost pressures impacting the 2015 biennium will be discussed in more detail in the context of the Big Picture report in June.

SUMMARY

At this point in time:

- Expenditures are within anticipated levels for the major spending categories
- Human services expenditures and corrections populations are within and in some instances below levels anticipated by the legislature
- There are several areas where over-expenditure is either expected or possible, but none in the major spending areas with the exception of a known supplemental appropriation for K-12 education as a result of the veto of HB 316

At the same time, uncertainty over potential fire costs is the norm at this time of year. Other agencies with large general fund expenditures that may also be subject to volatility and staff will continue to closely monitor expenditures.

The following figure shows total HB 2 expenditures through January compared to the total HB 2 FY 2012 appropriation. HB 2 is used in this comparison to show ongoing state operations. January is 58.3% of the fiscal year. Please note that the figure includes one-time-only (OTO) appropriations and expenditures.

Expenditures Compared to Appropriations FY 2012 Through January House Bill 2 Only				
Fund Type	Appropriated	Expended	Remainder	Percent Expended
General Fund	\$1,600,502,365	\$850,637,829	\$749,864,536	53.1%
State Special	740,143,362	357,562,677	382,580,685	48.3%
Federal	2,084,669,878	922,831,916	1,161,837,962	44.3%
Proprietary	14,757,943	7,302,601	7,455,342	49.5%
Expendable Trust	<u>0</u>	<u>1,294</u>	<u>(1,294)</u>	
Total	<u>\$4,440,073,548</u>	<u>\$2,138,336,317</u>	<u>\$2,301,737,231</u>	48.2%

GENERAL FUND

Human services, corrections, and education (K-12 and higher) comprise almost 87% of total HB 2 general fund appropriations in FY 2012. Therefore, any overall look at HB 2 general fund is at heart saying whether or not those areas are collectively spending in general conformance with elapsed time.

The following figure highlights general fund expenditures through January for these agencies.

General Fund Expenditures by Selected Agencies
 HB 2
 FY 2012 through January

Agency	Appropriated	Expended	Remainder	Percent Expended
Office of Public Instruction	\$617,149,009	\$341,748,458	\$275,400,551	55.4%
Commissioner of Higher Education	187,890,485	119,240,183	68,650,302	63.5%
Corrections	168,825,854	87,465,642	81,360,212	51.8%
Public Health and Human Services	<u>413665131</u>	<u>190,435,911</u>	<u>223,229,220</u>	46.0%
Total	\$1,387,530,479	\$738,890,194	\$648,640,285	53.3%

Examining expenditures compared to the elapsed time can obviously provide only a useful starting point for determining potential issues with expenditures, and can be an early indication that additional analysis is needed.

Also, for certain functions a point in time expenditure can be misleading as to the agency's ability to stay within an appropriation for the entire year or biennium. For example:

- In times of increasing caseload/utilization in human services and/or populations in corrections, expenditures in the 2nd half will generally be higher than in the first half. Therefore, it is important to look at trends and whether those trends are generally in line with expectations when the budget was put together
- An overall look won't say whether certain areas within are stable and/or whether there are other revenues available for any over expenditures. For example, expenditures for restricted appropriations may be significantly less than elapsed time, skewing whether there is sufficient general fund remaining to fund ongoing operations if shortages occur
- The nature of some expenditures can mean that expenditures are not relatively uniform over time

K-12 Education

There are three primary factors that could result in a K-12 supplemental appropriation: 1) actual average number belonging (ANB) in excess of the assumption, which would increase BASE Aid costs; 2) transportation and retirement reimbursements at a higher level than anticipated; and 3) revenues to the guarantee account, which is a direct offset of general fund, at less than the projected amount.

There are no supplemental appropriation pressures in FY 2012 due to ANB, transportation, or retirement. The ANB count for FY 2012 was known during the 2011 legislative session and included in the budget. FY 2013 counts will be known in early March and can be compared to assumptions at that time. Any deviation in transportation and retirement costs, which would likely be minor, will also be known around that time.

Guarantee account revenues are higher than anticipated. However, there will be a supplemental in K-12 education for the 2013 biennium, rather than the reversion that would be anticipated due to the higher guarantee account revenues. When the legislature left in 2011, it assumed the passage of HB 316, which allocated an additional \$60 million in federal mineral royalties to the guarantee account as a direct offset of general fund. The size of the inflation increase for schools in SB 329, funding for which was in HB 2, was also contingent upon passage of this bill.

When the Governor vetoed HB 316, it had the net effect as shown in the following figure. The table also includes the potential supplemental based upon updated revenue estimates as of February 17 presented to the Revenue and Transportation Committee.

**Components of Anticipated OPI Supplemental
2013 Biennium**
(in Millions)

Factor	2013 Biennium
Mineral Royalty Reduction due to HB 316 Veto	(\$56.8)
Reduction in Inflation Adjustment Compared to Appropriation	<u>4.6</u>
Total Original Anticipated Supplemental	(\$52.2)
Revised Guarantee Account Revenue Estimates February 2012	<u>23.8</u>
Revised Potential Supplemental	<u>(\$28.4)</u>

Commissioner of Higher Education (OCHE)

The two largest general fund expenditures in OCHE are distributions to the university units and community colleges, and payments for student assistance. Timing of these expenditures is driving the total compared to a point in time and expenditures are as anticipated.

Department of Corrections

At this point, there are no indications that corrections costs will exceed the appropriation in FY 2012¹. Populations for all areas with the exception of the women's prison are below estimates and the appropriation is in line with anticipated growth in average daily populations (ADP) for the remainder of FY 2012 and the biennium.

Department of Corrections Populations Over (Under) Estimates Used for Budgeting 2013 Biennium		
Type	FY 2012	FY 2013
Secure Facilities		
Male Prison Beds	(81)	(85)
Female Prison Beds	4	11
Community Corrections		
Alternatives to Prison	(27)	(29)
Pre-release/Transitional Living	(78)	(107)
Specialized Supervision Programs	(15)	(19)
Probation and Parole	<u>(378)</u>	<u>(477)</u>
Total	<u>(575)</u>	<u>(706)</u>
Source: Department of Corrections		

¹ Because the Department of Corrections has a biennial appropriation, the determination of appropriation is from the allocation between the two years contained in HB 2.

The legislature provided the department with funding to contract for additional medium security beds and a request for proposal (RFP) was announced earlier this fiscal year for a 120 bed medium security facility, including some beds for inmates with long-term health issues. According to the department, the reduced growth in populations has caused it to withdraw the RFP for now, and reassess its timing. As of this writing the department estimates the RFP would be resubmitted sometime from April to July of 2012.

While a reversion is not anticipated at this time, because the department has a biennial appropriation any reversion that does take place would not occur until the end of the 2013 biennium.

Department of Public Health and Human Services (DPHHS)

DPHHS has significant general fund, particularly in Medicaid, that is largely driven by enrollment and service utilization. These factors can be volatile, and even relatively small variations can result in significant differences in expenditures from the anticipated levels. Consequently, expenditures in Medicaid and selected other human services programs are watched carefully during the year for indications that caseloads and/or utilization are varying significantly, and also the overall capacity of the department's general fund budget to cover overruns in any area.

The most recent budget status report (BSR) prepared by DPHHS projects a general fund reversion of \$5.0 million for FY 2012. The reversion is primarily due to:

- Moderating Medicaid enrollment, with hospital and physician costs estimated to be lower than appropriations
- Lower children's mental health Medicaid costs
- Lower costs at Montana Developmental Center

LFD staff review of the most recent BSR concluded that, absent unexpected cost increases, the reversion projected by DPHHS could be raised by another \$5.0 million general fund because:

- \$3.3 million of excess state special revenue supporting the Healthy Montana Kids (HMK) program could be used to offset general fund costs of eligible lower-income children receiving Medicaid services in compliance with 17-2-108(1), MCA
- \$2.2 million of general fund appropriated to support presumptive eligibility for HMK is shown as fully expended even though actual average enrollment year to date (90 children) is substantially below enrollment session projections (2,919 children)

Staff will continue to monitor and report to the LFC as necessary. LFD staff will present a report on the work the office is doing on the Medicaid model later in the meeting.

Statutory Appropriations

The following shows general fund statutory appropriations through January, by agency.

Statutory Appropriations
FY 2012 Through January

Fund Type	Appropriated	Expended	Remainder	Percent Expended
General Fund	\$176,713,353	\$76,363,042	\$100,350,311	43.2%
State Special	354,400,976	101,514,805	252,886,171	28.6%
Federal	42,106,298	23,770,435	18,335,863	56.5%
Capital Projects	388,582	355,192	33,390	91.4%
Proprietary	<u>36,400,880</u>	<u>22,789,574</u>	<u>13,611,306</u>	62.6%
Total	<u>\$610,010,089</u>	<u>\$224,793,048</u>	<u>\$385,217,041</u>	36.9%

Timing of expenditures from statutory appropriations is a major factor in how much of an appropriation has been expended. For example:

- In general fund, the State Auditor will transfer funds earmarked for fire and police pension funds in June, and none of the anticipated \$27.6 million had been expended as of the end of January
- In state special revenue, as of the end of January the Department of Revenue had distributed \$20.9 million of the total \$125.0 million to counties in oil and gas revenues

At this time, staff does not have concerns that any of the general fund statutory appropriations will exceed the anticipated levels.

PRESSURE AREAS AND OTHER FACTORS

This section discusses where there are pressure points on agencies that raise the risk of supplemental appropriations, or of significant programmatic changes to stay within appropriation levels.

Pressure Areas

There are several areas where cost overruns are anticipated or possible.

Office of Public Instruction (OPI)

As stated, a known supplemental currently estimated at \$28.4 million will occur in OPI due to the veto of HB 316. As stated under "PPL" below, this amount would likely increase as a result of the U.S. Supreme Court ruling on the PPL case.

Office of the Public Defender (OPD)

OPD is currently experiencing a significant increase in expenditures in the Great Falls region due to the recent spike in child abuse/neglect cases. While not as high, cases in several other areas are also on the upswing. As a consequence, the office estimates that expenditures will increase between \$200,000 and \$500,000. The office would undertake austerity measures with an unknown impact on operations, and any expenditure above the amount that could be mitigated will likely be requested in a supplemental appropriation.

Staff will continue to monitor this situation.

Board of Public Education (BPE)

Due to the departure of two long-time staff and resulting payouts, BPE has severely cut back on expenditures to stay within the biennial budget, including not replacing the two staff (which cuts the total number of staff in half) and significantly reducing operating expenses. Even with these austerity measures, on March 5, 2012 the

Governor's Office of Budget and Program Planning submitted notice for review and comment on an appropriation transfer of \$20,000 from FY 2013 to FY 2012 for the BPE. As part of this request, BPE states it will cover the reduced funding in FY 2013 through vacancy savings.

Montana Digital Academy

The Montana Digital Academy provides on-line instruction to Montana students around the state. As of this writing, the academy had secured a federal grant in addition to the general fund provided by the legislature that is allowing it to operate within its FY 2012 appropriation. However, projected expenditures will be extremely close to the amount available. In addition, the academy has projected student counts in FY 2013 that would result in expenditures in excess of the appropriation in that year, which would necessitate either limiting enrollment and/or attempting to secure additional funding.

Department of Justice

The legislature provided a general fund appropriation of \$767,377 each year of the biennium to allow the department to pursue major litigation. Primarily due to the U.S. Supreme Court agreeing to hear arguments in the PPL case, the appropriation for FY 2012 is over 98% expended. The department does not anticipate any further significant expenditure on this case, and has indicated it may request the transfer of appropriations authority from FY 2013 for any expenditure for other major litigation expenses for the remainder of the year. Whether a supplemental appropriation is requested of the 2013 Legislature will depend upon FY 2013 activity.

Insurance

The state self insures for property and casualty insurance through the Risk Management and Tort Defense Division of the Department of Administration. The claims for the Libby asbestos lawsuit were paid from the fund's assets and reserves were depleted. If necessary, in the 2013 biennium the division can request a general fund loan to cover any unanticipated claims costs or other losses. So, while the funds will have to be replenished next session, the division will likely be able to meet claims and other obligations until then.

This issue will be discussed further in the Big Picture report in June.

Other Factors

Federal Deficit Reduction

The federal budget and what it means to states is still in a high state of flux, with long-term trends anticipated to be potentially significantly less federal funds and/or growth for certain functions. However, how specifically this will play out still remains highly speculative. The reduction in the spending caps that dictate how much can be contained in the appropriations bills, coupled with the additional reductions required due to the failure of the budget super-committee, mean that the state can expect potentially sharp reductions in federal funding for numerous programs in FY 2013 and beyond.

Whether the reduction in federal funds would require action by the legislature on 2013 biennium budgets will obviously depend upon where the reductions occur and their magnitude, which will likely not be fully known until January 2013 when the legislature convenes.

This issue will be discussed in more detail in a report later in the meeting.

Montana Quality Education Coalition Lawsuit

The Montana Quality Education Coalition has filed suit in district court over the implementation of school inflation increases. Statute requires the Superintendent of Public Instruction to calculate an inflation factor for basic and per ANB entitlements using a statutory methodology, and to include this amount in the Office of Public Instruction budget. The suit alleges that the state must provide this inflationary increase.

The biennial difference between the statutory calculation of the state's share for the basic and per-ANB entitlements for the 2013 biennium and the amount that will actually be spent on the state's share after the veto of HB 316 is \$9.6 million. This calculation does not include the amount spent as one-time-only funds in the 2011 biennium. This amount was a one-time increase in entitlements of 2% in FY 2010 and in FY 2011. If the 2% had been considered ongoing, the additional cost in the 2013 biennium would have been \$22.5 million above the level that is expected to be spent.

Fire Costs

Fire costs are always an unknown until long after the season is officially over. The type of winter the state experiences is not always a good harbinger of the type of fire season that can be expected. Abrupt, prolonged changes in weather patterns can occur throughout the year, and where the fire happens will materially impact both the overall cost and the state share.

The LFD calculates an average fire season state share cost using the average of the previous seven years' costs with the high and low years factored out. Due to low cost fire seasons in 3 of the last 4 years, the average state share fire costs are now \$14 million. The state special revenue account available for fire costs totals \$5 million for the remainder of the 2013 biennium. So, if state share fire costs are near the average, the state special revenue fund would not be sufficient to cover costs.

Other funding sources are also available to cover fire costs prior to the legislative session. The Governor may use his emergency authority for qualifying expenses. The department can also use funds provided for operating expenses to cover fire costs until the legislature can provide a supplemental appropriation in the 2013 legislative session. A special session would not be required unless fire costs are so severe that current funding sources are exhausted and the department will run out of money for operations prior to the legislative session.

National Mortgage Settlement

It was announced on February 9th that an agreement had been reached in a dispute alleging illegal foreclosure practices between several large mortgage lending banks and all but one state (Oklahoma). The settlement consists of several parts, one of which is a direct cash payment to participating states. Attorney General Steve Bullock announced that Montana's total share was \$20.4 million. Included in this amount is a cash payment to the state of almost \$6.0 million, of which about \$500,000 is designated as civil penalties that could be used for any purpose². The remainder would, according to the attorney general, be used for "state counseling services".³

According to the attorney general's office, since the announcement of the settlement and as of this writing, there has been a development that could impact the amount available in the non-cash portion of the award and its timing. The cash payment, however, appears to be certain. The committee will be updated as additional information becomes available.

PPL Montana

In 2010 the Montana Supreme Court held that title to the Clark Fork, Missouri, and Madison Rivers passed to Montana when it was made in state in 1889, and that the state could charge rent to hydroelectric companies for use of riverbeds. PPL Montana filed suit alleging that the court erred and that whether the river was navigable at the time of statehood must be used to determine if the state held title to the riverbeds. In February the U.S. Supreme Court ruled that the Montana Supreme Court had erred and that each segment of a river must be examined

² Department of Justice, February 20, 2012.

³ According to the National Mortgage Settlement fact sheet, the direct payments to states "...may be distributed by the attorneys general to foreclosure relief and housing programs, including housing counseling, legal assistance, foreclosure prevention hotlines, foreclosure mediation, and community blight remediation. A portion of the funds may also be designated as civil penalties for the banks' robo-signing misconduct."

separately to determine navigability at the time of statehood⁴. The case was remanded back to the state to determine navigability using the criteria cited by the court.⁵

Revenues from three companies were potentially impacted by the ruling:

- 1) PPL Montana had been ordered to pay \$41 million for back rent by the state courts. According to legislative legal staff, the remand back to the state means that the \$41 million will be reduced, although by how much is not known⁶. Disposition of these funds was included in SB 410. If collected, the funds would be used to purchase land (subject to offsetting sales of an equal amount of land), with the interest to be deposited to the guarantee account (K-12 education). The guarantee account revenue assumptions included \$763,568 over the biennium from this source, which directly offsets general fund. Therefore, the delay in and possible loss of these funds would increase the supplemental appropriation for K-12 education already anticipated.
- 2) Avista and PacifiCorp each signed agreements with the state to settle rather than go to trial, with both agreeing to pay yearly rent. Each settlement specified the circumstances under which the rental amounts could be adjusted. In the 2013 biennium it was estimated that a total of \$8.5 million would be deposited to the guarantee account (which directly offsets general fund) for K-12 education from both sources, with future collections beginning in FY 2015 deposited to the school facility account (HB 165).

An examination of the settlement documents leads legislative legal staff to initially conclude that at this stage the state would not have to pay back rents already paid, which totaled \$21.1 million prior to the 2013 biennium. At the time of the Supreme Court ruling a spokesperson for Avista stated they did not believe the ruling impacted the settlement with the state and at this time they had no plans to pursue legal action.

⁴ Based on whether a segment was obstructed to the extent that travelers must portage.

⁵ For a more detailed discussion, see the memo from Legislative Services Division legal staff Julie Johnson, attached.

⁶ Memo from legislative legal staff Julie Johnson, February 2012.