PRELIMINARY BUDGET OUTLOOK
FOR THE 2015 BIENNIUM

A Report Prepared for the

62nd Legislature

By

Legislative Fiscal Division

June 12, 2012

MONTANA LEGISLATIVE FISCAL DIVISION

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EXECUTIVE SUMMARY

The estimate of the 2015 biennium structural balance is a refreshing change from the estimate provided two years ago. The Legislature approved spending at a level lower than the potential spending outlined in the 2010 report level plus revenue levels and trends have improved substantially in the past two years. These factors combined with lighter spending pressures have improved the outlook for the 2015 structural balance.

In addition to a positive structural balance in the 2015 biennium, a higher than anticipated 2013 biennium ending fund balance is expected. The final anticipated ending fund balance at the end of the 2011 session was $150.4 million. If the spending and revenues anticipated in this report hold true, the 2013 ending fund balance will be $331.0 million higher than anticipated or $481.4 million.

The following recaps the major points found in this report:

1) Revenue is currently estimated to be 5.1% higher in the 2013 biennium than anticipated during session. Revenue in the 2015 biennium is currently anticipated to be 7.1% higher than the revenue in the 2013 biennium. (See also the upside risk stated in number 5 below.)
2) Spending growth rates have slowed from growth rates in previous biennia. Specifically, secure care in the Department of Corrections has leveled off; the inflation for schools that is statutorily based on the previous years' CPI is anticipated to be 0.89% in FY 2014 and 2.3% in FY 2015, and the growth in Medicaid caseloads appear to have slowed from previous growth rates.
    a. Spending is split into 3 components of varying degrees of prior legislative commitment:
        i. The base budget in this report is the level of spending approved by the previous legislature less one-time appropriations, or $3.676 billion in the 2013 biennium
        ii. The present law budget is that level of spending authorized by the previous session to continue at the current level, or $254 million.
        iii. Current service level consists primarily of temporary funding approved by the previous legislature that was approved for ongoing services. This amount is substantially smaller than the report of two years ago and is estimated at $33.6 million.
    b. Other Spending Pressures
        i. Pension liabilities: the unfunded and unamortized portion of the pension liabilities is a legal liability of the state. The ranges of choices for the legislature to consider are demonstrated in the pension report to be presented to the Legislative Finance Committee and the State Administration and Veterans' Affairs Committee on June 12. The biennial cost of the range of Scenarios 1 through 3 is $31.6 million to $244 million.
        ii. Other key costs pressures: No inflationary pay increases have been given to state employees in four years, no inflationary increases have been given to most providers of services to Human Services, and many other spending demands have been held constant or with low growth for four years. As a result, pressure points may have developed in ways that cannot be estimated by this analysis.

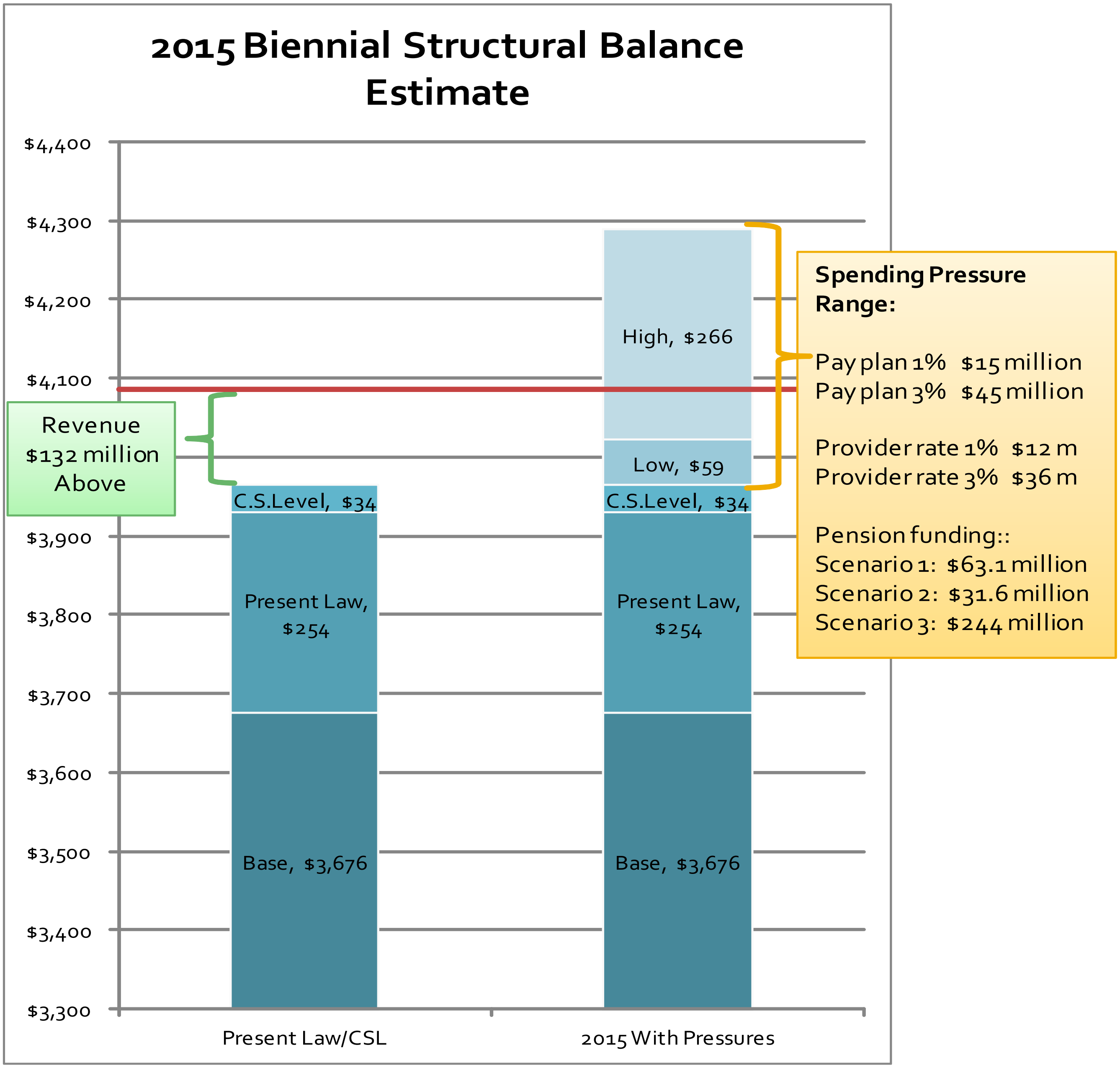
    Note that present law and the base budget is the only definition considered in statute to be ongoing spending from the previous biennia. Current service level funding and other spending pressures are new proposals to be considered by the next legislature, but do comprise current services of the state.

3) Structural balance: The revenue and spending trends, assuming present law and current services are funded in the manner described above, result in a structural balance of $132 million for the 2015 biennia. In other words or revenue is greater than assumed spending by $132 million or 3.3% of biennial spending. If only present law spending were considered, the structural balance would be $165 million or 4.2% of biennial spending.

4) The ending fund balance at the end of the 2013 biennia is anticipated to be $331 million above the session anticipated level of $150 million. This over $300 million increase could be available for one time investments.
5) Net upside risk associated with development of natural resources in Montana and North Dakota: The Fiscal Division staff believes the revenue and spending impacts from the current and potential development of natural resources in Montana and North Dakota are not fully assessed at this time.
    a. There is significant upside revenue risk to this forecast. IHS Global Insight is updating the economic forecasts of the region as a result of the recent and proposed development. The updated forecast is not yet available and no commitment has been made by IHS Global Insight as to when they will complete this forecast. For more information please see Natural Resource Development section.
    b. There is a smaller, but not insignificant spending risk resulting from this development. Costs in the areas of public safety, Health and Human Services including the state share of the cost of the benefits, K-12 schools, natural resource agencies, and other costs may be under spending pressure. As development expands, increased demands for services and the cost for providing those services will grow. Please see Natural Resource Development section for more information.

At this time, some level of increased development, primarily in North Dakota and its spill over into Montana has been captured in this forecast. Expanded oil drilling and fracking development in Montana has just begun in the past 6 to 9 months. Quarterly oil production in Montana has been on a decline since mid 2006 and has seen few quarters of increase over that time period. Production increased 7.4% quarter over quarter the last calendar quarter of 2011 and may be a sign of ongoing increased production. Revenue impacts typically lag 6 to 24 months after the economic activity so it is unlikely that these impacts are seen in the revenues at this time.

Additional research is needed to refine what level of revenue growth Montana might expect from this additional development.



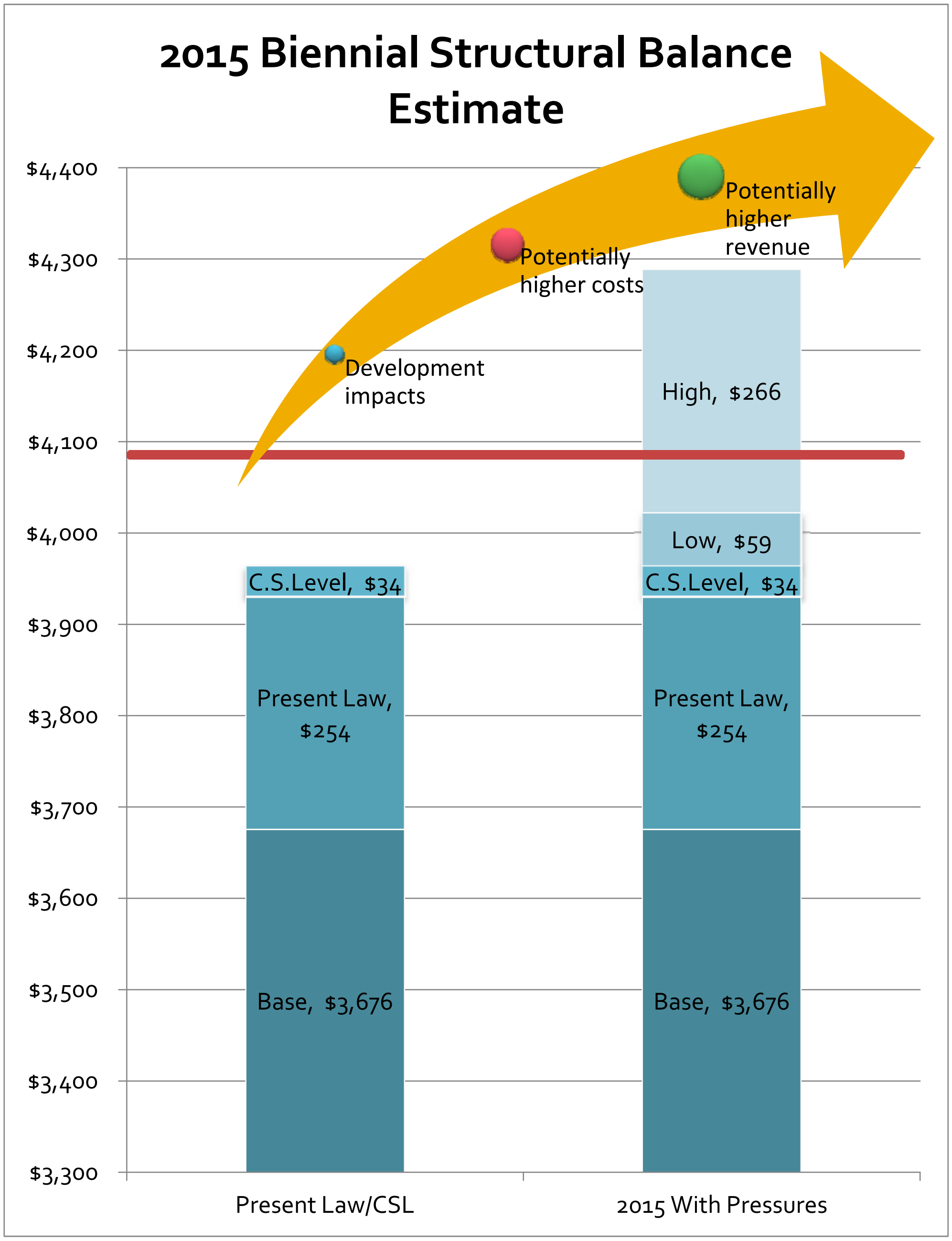
The graphic illustrates the current analysis of points 1 through 4 above.

OTHER SPENDING PRESSURES

In order to give perspective on the range of possible costs, estimates for other spending pressures were included. An estimate for a pay increase and a provider rate increase of 1% for the low estimate and 3% for the high estimate are included in the second bar. The low estimate for funding the gap in pensions is a 50/50 split between employer and employee shown in Scenario 2 of Appendix D. The high estimate includes using only general fund to close the pension funding gap and is described in Scenario 3 of Appendix D.

Other Spending Pressure Range		
In millions		
Item	Low	High
Provider Rates	$12	$36
Pay plan	$15	$45
Pensions	$32	$244
Totals	$59	$325

The next graphic illustrates point 5 and the uncertainties associated with the natural resource development in Montana and North Dakota.



ECONOMIC OVERVIEW

The general outlook for the U.S. and Montana economies for the next three years as per the May 2012 report from IHS Global Insight is as follows:

U.S. ECONOMY

Another Summer Slowdown

The clear downshift in employment growth during March and April has raised the question of whether this year will see a marked summer slowdown in the recovery, similar to 2011. IHS Global Insight’s view is that the underlying path of growth was never that robust to begin with—as illustrated by the 2.2% growth rate in GDP during the first quarter. Employment gains around 250,000 per month over the three months through February, partly helped by the unseasonably warm weather, was inconsistent with the growth picture. It now seems that job growth is decelerating to meet GDP growth, rather than GDP picking up to meet employment. But since IHS Global Insight had never bought into the view that the recovery was "taking off," the employment slowdown does not change its outlook. Our GDP growth forecasts were already cautious, and IHS Global Insight sees no extra reasons for pessimism yet, so we remain at 2.2% for 2012 and 2.4% for 2013

Multiple Shocks Hit in 2011

In 2011, the economy was hit by multiple shocks—the surge in oil prices resulting from the Arab spring; the shock to global supply chains, especially automotive, from the Japanese earthquake and tsunami; the deteriorating Eurozone sovereign-debt crisis; and the brush with US sovereign-debt default caused by the prolonged deadlock over raising the debt ceiling.

Risks Still Abound in 2012, Although No Similar-Sized Shocks Yet

This year, there are plenty of downside risks, but the economy has not yet had shocks comparable in impact to those in 2011. Oil prices have moved up again, but not enough to move gasoline prices to new highs. We have had no natural disaster of the order of Japan's last year. In the Eurozone, the sovereign-debt crisis and the Eurozone recession are both deepening, but markets are now more confident that the crisis will not morph into a global banking-sector meltdown, largely because of aggressive liquidity injections by the European Central Bank. At home, the United States still faces huge fiscal uncertainty, as key tax and spending deadlines loom on January 1, 2013, along with another contested increase in the debt ceiling at around the same time. The uncertainty will not be resolved until after the elections, and is a potential major dampener on activity during the second half of the year.

Some Fundamentals Look Better

The US economy is one more year advanced in some key adjustments than it was in 2011. One more year of deleveraging is now behind us, and one more year of pent-up demand has built up, some of which is now translating into stronger demand, notably in the vehicles sector. We also have one more year's worth of housing adjustment behind us, which is bringing down vacancy rates in both the rental and the homeowner markets, setting the stage for a future recovery in housing activity.

Gross Domestic Product (GDP) Growth Outlook Remains Just Above 2% for the Rest of 2012

IHS Global Insight does not expect inventory accumulation to keep boosting growth, as it did in the fourth and first quarters, but thinks that the slowdown in business fixed investment (which actually fell in the first quarter) is just temporary, and that spending will rebound in the current quarter. And although the long-term path of real federal spending remains downward, IHS Global Insight now expect some bounce in defense spending after two successive quarters of steep declines. Consumer spending is likely to remain on a modest upward trajectory, running at just above 2% growth, like GDP, fueled by monthly employment gains in the 150,000–200,000 range.

Quantitative Easing Possible, But Unlikely

The Federal Reserve is in a "wait-and-see" mode right now. Given softer recent data, talk that the Fed might change its guidance on the likely path of interest rates any time soon has died away, even though the majority at the Fed expects rates to rise before the end-2014 guidance date. But for the Fed to take any more action—whether full-fledged quantitative easing or another twist-type operation—we would need to see bigger setbacks to the outlook.

The Federal Reserve on January 1, 2013

For the past couple of weeks, Federal Reserve chairman Ben Bernanke has been sounding the alarm—in speeches and testimony to lawmakers—over the "fiscal cliff" that the country faces at the end of this year. Bernanke has even elevated it to a risk on a par with the Eurozone crisis. He is correct to do so. Come January 1, the Bush tax cuts, payroll tax cuts, and emergency unemployment benefits expire, while $1.2 trillion in sequestration spending cuts kick in. Together, this would amount to a half-trillion-dollar drag on the economy and could cost the economy 4.2 percentage points of real GDP growth in the first quarter of 2013. But do not expect the Fed to fill this economic crater by moving on QE III. The Fed has been clear that it is prepared to respond to negative shocks to employment and inflation. It is deeply reluctant (perhaps unwilling), however, to respond to a slow-moving, predictable, and completely avoidable failure of government policy. What's more, it is highly unlikely that the Fed at this point could even lower interest rates enough to offset the hit to growth. Bernanke has stated that "there is absolutely no chance that the Federal Reserve would be able to have the ability whatsoever to offset that effect on the economy." So the door to QE III remains open should the economy falter, but not if a major lapse in fiscal policy is the culprit.

IHS Global Insight Key Forecast Assumptions for the U.S.

Fiscal Policy: Discretionary Spending

IHS Global Insight assumes that real nondefense federal government spending on goods and services falls 1.5% in calendar 2012 and 2.7% in 2013 as budget cuts bite. IHS Global Insight assumes that real defense spending falls 2.8% in 2012 and 3.1% in 2013, reflecting a combination of budget cuts and overseas contingency operations winding down.

Fiscal Policy: Expiring Stimulus

IHS Global Insight assumes that the 2% payroll tax cut and emergency unemployment insurance benefits are extended for 2013, and then phased out over several years, rather than disappearing overnight.

Fiscal Policy: Automatic Spending Cuts and the Bush Tax Cuts

IHS Global Insight does not expect the automatic spending cuts now scheduled to begin in January 2013 to take effect. It assumes that the lame-duck Congress will delay the cuts, giving time for the new Congress and president to produce a package of spending cuts and tax increases, mostly sparing discretionary spending since the cuts there are already aggressive. It has assumed a combination of cuts in Medicare, Medicaid, and Social Security and increases in income tax rates. The measures mostly begin in January 2014; we assume that the Bush tax cuts are extended for 2013.

Oil Prices Assumed to Stay High

Oil prices have eased in recent days as the deepening Eurozone crisis has undermined demand expectations. The IHS Global Insight baseline forecast assumes that demand expectations stabilize and that supply risks return to the fore, nudging oil prices higher again. It expects the refiners' acquisition cost for crude oil, which averaged

$102/barrel in 2011, to average $112/barrel in 2012. This corresponds to an average price for Brent oil of roughly $120/barrel in 2012.

Federal Reserve to Hold Rates Near Zero Until Late 2014

The Fed has said that it expects to keep its federal funds target in the 0.00–0.25% range until at least late 2014. We anticipate that it will wait until November 2014. We assume no further quantitative easing and no further "twist" operations beyond mid-2012.

Dollar to Gain on the Euro

The Eurozone economy will almost certainly tip into recession during the fourth quarter of 2012, and the sovereign-debt crisis has further to run. As a result, IHS Global Insight expects the euro to weaken to $1.28 by the end of 2012 (LFD note; as of June 1 it is $1.24). IHS Global Insight still sees the dollar’s long-run trend as downward, but against emerging-market currencies rather than major currencies. We expect a gradual appreciation of the Chinese renminbi, amounting to 3.0% in 2012 (year-end to year-end), after 4.6% in 2011.

Global Growth Slowing

IHS Global Insight expects GDP growth in the United States’ major-currency trading partners to weaken to 1.0% in 2012, from 1.7% in 2011. This mainly reflects a recession in the Eurozone, where we expect GDP to contract 0.6%. GDP growth for other important trading partners is projected to slow to 4.3% in 2012, from 5.3% in 2011.

MONTANA OUTLOOK

Recovery on Track, Slightly Behind the Country

Employment will regain pre-recession levels around the end of 2014, slightly ahead of the country. Montana's employment growth will run at a slightly slower pace than the nation’s during 2011–17, at 1.4%. Real income growth will be slightly behind the nation at an annualized rate of 4.3% by 2017. Real output growth will be slightly lower than the nation as well, growing at an annualized rate of 2.3% by 2017.

Note that IHS Global Insight is in the process of reevaluating the Bakken and other natural resource development in Montana and North Dakota. These assumptions may change with this reevaluation.

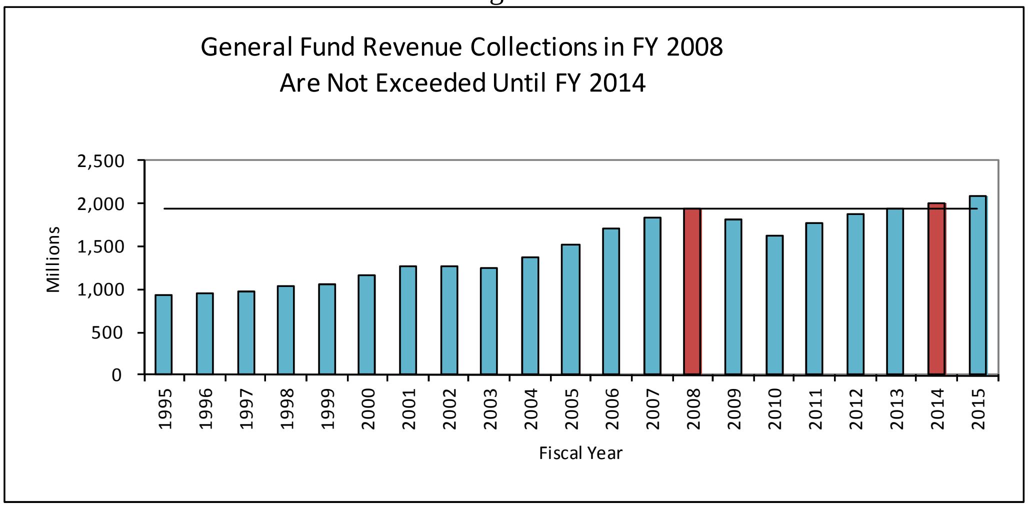
State Rankings

Montana State Rankings					
Concept	Date	Value	Growth	Rank by	Rank
Total Non-Farm Employment	2012	427,810	0.36%	Growth	49
	2013	434,200	1.49%		24
	2014	442,300	1.87%		14
	2015	450,620	1.88%		21
Unemployment Rate	2012	6.05%		Value	40
	2013	5.63%			40
	2014	5.27%			40
	2015	4.98%			39
Single Family Housing Starts	2012	894	-31.01%	Growth	51
	2013	1,180	32.08%		28
	2014	2,003	69.49%		4
	2015	2,530	26.50%		6
Gross State Product ($ millions)	2012	$37,713	2.53%	Growth	46
	2013	$39,032	3.50%		34
	2014	$40,931	4.87%		30
	2015	$42,888	4.78%		38
Wage & Salary Disbursements ($ millions)	2012	$16,946	4.73%	Growth	17
	2013	$17,638	4.09%		23
	2014	$18,468	4.71%		15
	2015	$19,408	5.09%		12

REVENUE ASSUMPTIONS

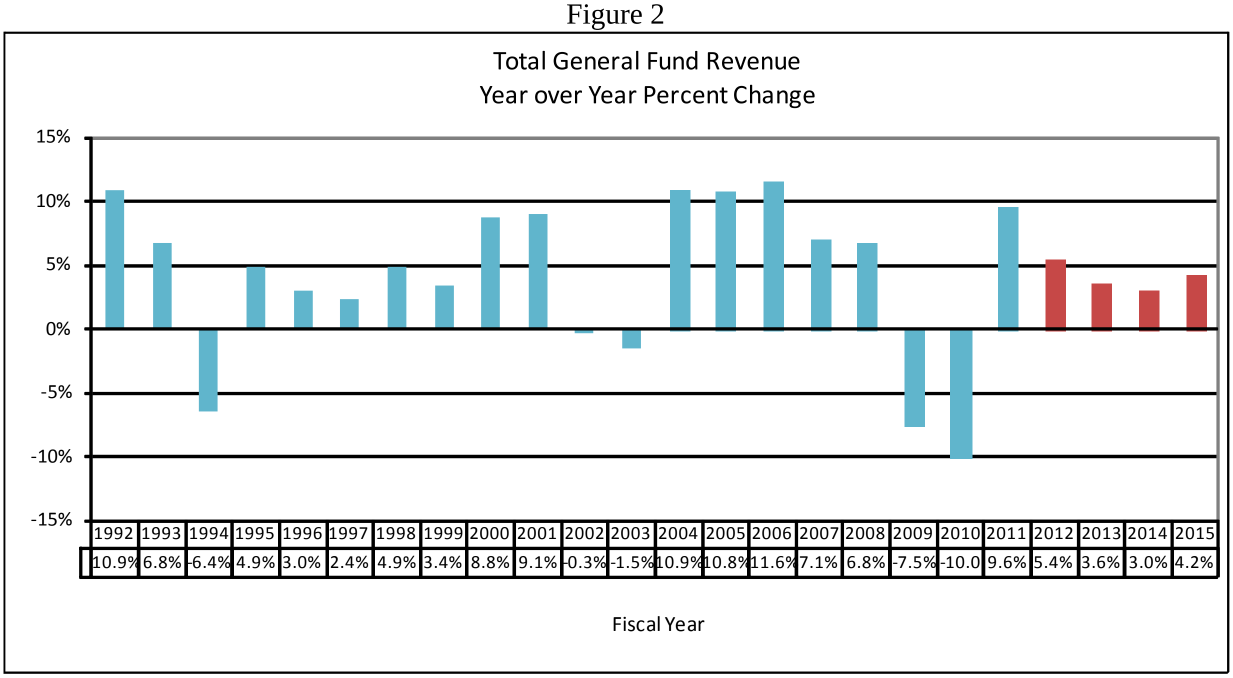
Major revenue contributors to the state general fund (and interrelated state special funds) are experiencing significant improvements from FY 2010 levels. These increases are expected to continue through FY 2015. As shown in Figure 1, general fund revenue collections peaked in FY 2008, but declined significantly in FY 2009 and FY 2010. General fund revenues began a recovery in FY 2011 and are expected to be within $10 million of the peak in FY 2013 and exceed the peak level by FY 2014.

Figure 1



The economic conditions that have prevailed since late 2008 in the state, nation, and world economies caused state revenues to plummet in FY 2009 and FY 2010. Revenues began to recover in FY 2011 and are expected to continue a growth pattern as shown below.

Figure 2



1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
10.9%	6.8%	-6.4%	4.9%	3.0%	2.4%	4.9%	3.4%	8.8%	9.1%	-0.3%	-1.5%	10.9%	10.8%	11.6%	7.1%	6.8%	-7.5%	-10.0	9.6%	5.4%	3.6%	3.0%	4.2%

As shown in Figure 2, general fund revenues declined by 7.5% in FY 2009 and an additional 10.0% in FY 2010. Such unprecedented back to back declines have not occurred for over four decades. The only period when two consecutive years of decline occurred was in FY 2002 and 2003, but at a modest 0.3 and 1.5%, respectively.

As shown in Figure 2, general fund revenues began to recover in FY 2011 with a growth of 9.6%. Continued general fund revenue growth is expected in FY 2012 through FY 2015, but at a more modest rate than observed from FY 2004 through FY 2008. These estimates are based on the IHS economic forecasts previously discussed. The economic forecasts as prepared by IHS reflect an economic recovery that will continue to be slow and gradual throughout the forecast period. In Appendix B, the LFD general fund revenue estimates for the six major sources are discussed.

THE LFD GENERAL FUND REVENUE OUTLOOK

The LFD general fund revenue estimates for the six major revenue sources are shown in Figure 3. The economic forecasts as prepared by IHS have been incorporated into these estimates when appropriate. Revised estimates for FY 2012 and FY 2013 are shown as well as estimates for FY 2014 and FY 2015. The revised estimates for the 2013 biennium are $186 million or 5.1% more than the HJ 2 estimates prepared by the 62nd Legislature.

Figure 3

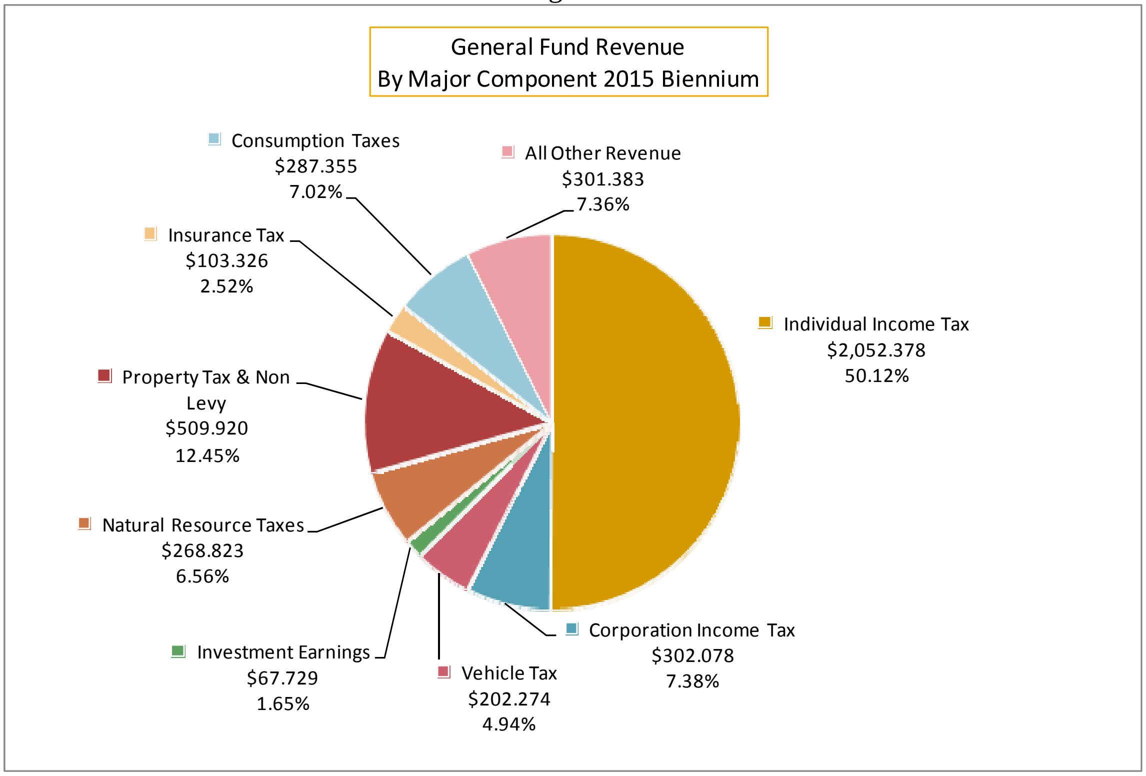
LFD Revenue Estimate Outlook - General Fund

Figures in Millions

	Actual FY 2011	Estimated FY 2012	Estimated FY 2013	Estimated FY 2014	Estimated FY 2015	2013 Biennium	2015 Biennium	Biennial $ Change	Biennial % Change
Individual Income Tax	$816.090	$902.179	$949.650	$994.589	$1,057.789	$1,851.829	$2,052.378	$200.549	10.83%
Property Tax	229.352	238.320	241.285	251.162	258.758	479.605	509.920	30.315	6.32%
Corporation Income Tax	119.044	133.280	144.645	150.929	151.149	277.925	302.078	24.153	8.69%
Vehicle Tax and Fees	100.576	100.208	100.420	100.818	101.456	200.628	202.274	1.646	0.82%
Oil and Gas Production Tax	99.764	103.669	106.249	112.528	113.955	209.918	226.482	16.565	7.89%
Insurance Tax	57.964	58.586	59.905	50.630	52.695	118.492	103.326	(15.166)	-12.80%
Remaining Sources	359.768	342.601	343.979	344.515	354.293	686.580	698.808	12.228	1.78%
Total	$1,782.558	$1,878.843	$1,946.133	$2,005.171	$2,090.095	$3,824.976	$4,095.266	$270.290	7.07%

Figure 4 shows the LFD revenue estimates for the 2015 biennium by the major revenue components. As shown, individual and corporation income taxes account for over 57.5% of the total anticipated revenues while property and vehicle taxes account for over 17% of the anticipated income. All together, individual, corporation, property, vehicle, natural resource, and insurance taxes are estimated to be 84.0% the total estimated revenues in the 2015 biennium.

Figure 4



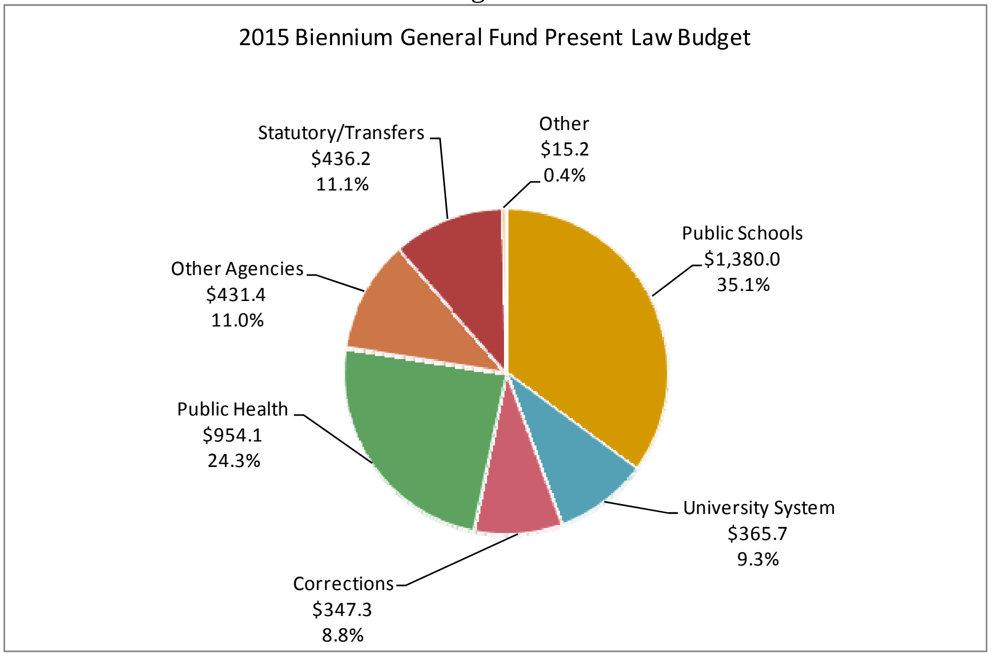
LFD Forecast for Major General Fund Revenue Sources

Appendix B presents the details on six of the major general fund revenue sources that comprise 82.8% of the total general fund revenue for the 2013 biennium and 84% for the 2015 biennium. The LFD has revised assumptions for all of these sources in addition to all remaining sources. These revisions for the major sources are reflected in the information in Appendix B.

SUMMARY OF EXPENDITURES

General fund expenditures in the 2015 biennium are projected to total $3.93 billion. Figure 5 shows expenditure projections for the 2015 biennium for current service levels by function. Note that this chart excludes carryover, the feed bill, and potential appropriations for the pension issues discussed in Appendix D.

Figure 5



As shown in Figure 5, 77.5% of all projected general fund expenditures are made in three areas:

- Education, consisting of both the Office of Public Instruction (K-12 education) and the Commissioner of Higher Education – 44.4%
- Department of Health and Human Services (DPHHS) – 24.3%
- Corrections 8.8%.

Statutory appropriations, which are controlled by statute and not routinely examined by the legislature, along with transfers from the general fund, are over 10% of all general fund expenditures. Statutory appropriations and transfers are dominated by two types of expenditures:

- Entitlement share payments to local governments
- Payments for local fire, police, and teacher retirement costs

The following discussion details the assumptions used in the above calculations.

ASSUMPTIONS FOR EXPENDITURES

A number of assumptions were used to derive the current level of service for expenditures. "Current service level" is defined as that level of funding necessary to maintain the services provided in FY 2013 that are not funded with present law. It consists of two components:

1) Those expenditures used to fund functions of state government designated as ongoing by the legislature. These expenditures are considered "present law" and will be included in the base used to build the 2015 budget.
2) Certain expenditures designated as one-time-only (OTO) by the legislature that fund current services. These expenditures will not be included in the budget base for the 2015 biennium, but would result in a loss of services if they are not funded. The legislature will likely be under pressure to continue many if not all of these services.

In addition employer contributions necessary to achieve 30 year actuarial soundness in the state employee and teacher's retirement systems are included in the calculations and discussed.

MAJOR PRESENT LAW ADJUSTMENTS

A number of different types of adjustments were made to expenditures to derive current service level costs for the 2015 biennium.

General Increases/Decreases

- Minor inflation was added for:
  - A small adjustment for increases in personal services due to an increase in the number of working hours over the FY 2013 level
  - A slight increase for certain fixed costs
  - No other inflation except for statutorily required additions in K-12 education (see below)
  - As a result of the Libby asbestos settlement, the reserve balance in the Tort Claims Division of the Department of Administration was depleted and must be replenished. This analysis assumes the replenishment will be amortized over five years and be funded through the tort claims fixed cost. The general fund share is $2.258 million each year of the 2015 biennium
- Two funding switches were made:
  - $2.5 million for a temporary shift from general fund to TANF block grant as authorized by the legislature
  - $2.9 million each year to replace general fund in student assistance that had been temporarily switched for one-time student loan fund balance

Caseload Increases

Costs were adjusted for projected caseload changes in a number of areas.

- Human services – Medicaid, foster care, and subsidized adoption service utilization growth and enrollment changes - $58.1 million
- Corrections – Overall populations are anticipated to be lower than had been anticipated for the 2013 biennium budget. However, growth in secure care and alternative to prison placements will continue to stress capacities, especially in the female secure care facilities. The projections assumes the department will be able to maintain a ratio of about 80 percent community to 20 percent secure care supervision
- K-12 Education –A slight decline of 0.4% in FY 2014 and 0.1% in FY 2015 in budgeted average number belonging (ANB), as well as statutorily required inflation and Base Aid payments - $42.9 million. This total assumes supplemental appropriations in the 2013 biennium totaling $33.7 million for additions due to the veto of HB 316 and the recent consent decree on inflationary adjustments, without which the total is $76.6 million
- Higher Education – No enrollment increases are included as enrollment has leveled and is projected to continue to show low growth

Appendix C provides a more detailed discussion of these areas.

CURRENT SERVICES FUNDED WITH OTO APPROPRIATIONS

A number of OTO expenditures that fund current services and for which the legislature is likely to be under pressure to fund were included. The following are the major adjustments made.

- Montana University System (MUS) - In addition to base funding, the 2011 Legislature appropriated $9.2 million of additional general fund in the 2013 biennium on a one-time-only basis for the state funding allocated to the MUS educational units. These funds were used for the general operations of the educational units and helped mitigate what would have been higher tuition rates had the funding not been provided. If the same level of service is to be offered in the 2015 biennium, the general fund or additional tuition will be needed.

  The 2011 Legislature also appropriated $3.5 million of general fund in the 2013 biennium on a one-time-only basis for research costs at the MUS education units. These funds were used to provide non-federal matching funds for multi-year, competitive federal grants awarded to Montana and matching funds for private donations to the research programs in the MUS. To continue receiving the federal research grants, the MUS will need to match the grants with $2.6 million from non-federal sources, such as state general fund or institutional funds

- DPHHS and the State Auditor – The Health and Medicaid Initiative account, which is utilized by both DPHHS and the Office of the State Auditor for a variety of functions, will not have sufficient funds to support all ongoing programs funded from this account in the 2013 biennium. A total of $1.4 million in FY 2014 and $15.5 million in FY 2015 is included to replace these funds with general fund.
- Department of Commerce - Economic Development – The legislature for the past several sessions has funded several economic development programs with OTO funding. Because of the OTO designation, the amounts are not included in present law. They are included here due to the long-term nature of the funding - $1.925 million each year

OTHER SPENDING PRESSURES

In addition to the present law and current service level adjustments discussed above, the legislature will also be facing a number of other funding pressures in the 2015 biennium. Among the most significant are:

- State pensions
- State employee pay plan
- Provider rate increases

Pensions – The pension systems for state and local employees and teachers are not fiscally sound. The cost to the general fund of long-term solutions would depend upon the options chosen. Among those options are the following, which are addressed in more detail in the "Examination of Pension Challenges" report. This is not a complete list of options available to the legislature.

- Entire funding from employer contributions: $63.1 million
- Half of entire funding from employer contributions: $36.6 million
- General fund payment: $244 million

State Employee Pay Plan - There has not been a general state employee pay plan increase for the last two biennia. If the legislature were to fund a pay plan, each 1.0% increase in salary would cost about $5 million per year, with a total biennial cost of about $15 million. Correspondingly a 3% per year increase in salary would cost about $45 million in the biennium.

Provider Rate Increases – Providers have had limited increases in previous biennia. Each 1% increase in provider rates in the Department of Public Health and Human Services and the Department of Corrections would cost about $4 million per year, or a biennial cost of about $12 million. Correspondingly a 3% increase in provider rates would cost about $36 million.

NOT INCLUDED IN THE CALCULATION

A number of other issues the legislature will likely address are not included in the calculations. Therefore, any additional costs for these items will reduce the ending fund balance.

- State employee health insurance increases.
- Any employee pay adjustments made in FY 2012 by agencies under broadband statutes. Certain agencies have made adjustments that will be included in the adjusted base for the 2015 biennium. However, other agencies are still in the process of examining potential increases and the picture is therefore incomplete at this time. A report will be provided at the September LFC meeting when further information is available
- Any potential lawsuit settlement costs (see “Potential Lawsuits” later in this report)
- Potential costs to implement “Common Core” or “Chapter 55” accreditation standards revisions by the Board of Public Education (see “K-12 Education” in Appendix C)
- Inflationary adjustments for provider rates, rents, food, fuel, or other contracts. Rents and leases for state buildings were lowered in the previous biennium on a temporary basis and will potentially increase, and fuel costs have been volatile. No general inflation on other costs was included, including potential increases due to increased activity in Eastern Montana (see “Natural Resource Development” later in this report)
- New proposals. While new proposals have been very limited in the last two biennia due to fiscal constraints, there are traditionally some new proposals each biennium to add spending. Therefore, additional requests can be assumed but cannot be estimated

For a further discussion of adjustments made by functional area, see Appendix C.

FY 2013 SUPPLEMENTAL APPROPRIATIONS

K-12 Education

There will be two K-12 supplementals for OPI in FY 2013, a Base Aid supplemental and a block grant supplemental. The legislature in FY 2011 passed a state general fund budget for K-12 that anticipated that HB 316 would be passed and approved by the Governor. HB 316 paid for a portion of Base Aid from the guarantee account. The revenue for this payment in HB 316 came from moving the deposit of US mineral royalties from the general fund to the guarantee account. The Governor vetoed HB 316, US royalties stayed in the general fund, and the guarantee account didn’t have enough revenue to pay for its assumed share of Base Aid.

The expected Base Aid supplemental in FY 2013 due to the veto of HB 316 was expected to total $53.4 million when HB 316 was vetoed. As a result of greater than expected oil and gas bonus payment revenue in the guarantee account, and in spite of a Base Aid cost increase of $4.6 million in FY 2013 as a result of the district court’s consent decree raising the FY 2013 entitlement increase to 2.43%, the Base Aid supplemental in FY 2013 is now expected to be approximately $30.0 million.

A second supplemental will take place in FY 2013 because of greater than expected reimbursement costs associated with SB 372. The FY 2013 block grant reimbursements associated with SB 372 will be $3.7 million higher than were anticipated during the 2011 legislative session.

Breach of Contract Settlement

The state recently settled a lawsuit for $3.0 million on the Nob Hill development. Because it is a breach of contract settlement, the state’s insurance policy does not cover the cost. This analysis assumes the cost will be paid through a general fund supplemental appropriation.

Pressure Points

Two additional areas are showing expenditure pressures that may result in a supplemental appropriation request: 1) Department of Corrections primarily due to additional medical costs; and 2) the Office of the Public Defender primarily due to spikes in caseload. In addition, the Department of Corrections was the subject of an unfair labor standards ruling that will increase personal services costs, which also impacts employees of the Office of the Public Defender.

While neither is listed as an area of likely supplemental appropriation, both will continue to be closely monitored by staff.

2015 BIENNIUM SUPPLEMENTAL APPROPRIATIONS

The only supplemental assumed for the 2015 biennium is for the state share of fire costs not covered by the Governor's emergency fund.

- $14.7 million for potential fire costs. The fire suppression fund will be depleted in the 2013 biennium. Therefore, all state share costs must be paid from the general fund through either a direct appropriation to DNRC or, for qualifying expenses, with the Governor's emergency appropriation. For purposes of this report the amount included is the difference between the rolling 7-year average state share cost of $14.6 million each year and an assumed utilization of $14.5 million of the Governor's $16.5 million emergency appropriation

POTENTIAL IMPACT FROM LAWSUITS

TREASURE STATE TAXPAYERS' DIVIDEND PROGRAM

SB 426 proposes the creation of a Treasure State Taxpayers Dividend Program, if approved by voters at the November 6, 2012 election. The dividend program would provide a refund of a portion of the state's ending general fund balance if that balance reaches a certain threshold.

Under SB 426, the Department of Administration must certify to the budget director, by August 1 of each year, the amount of unaudited general fund balance for the prior fiscal year. SB 426 creates a refundable credit that would be calculated as one-half of the amount by which the actual ending general fund balance exceeds 125% of the budgeted ending general fund balance, provided that amount is at least $5 million, and provided that the second tax rate cut in SB 372 (2011 Session) has been in effect for at least one year.

SB 372 creates two business equipment tax cuts. The first cuts property taxes on business equipment on January 1, 2012. Owners of property valued at $2 million or less will be subject to a tax rate of 2%, a cut from the previous 3% tax rate. A second tax cut may take place no sooner than January 1, 2014 if the prior fiscal year's state income tax and state corporate tax receipt growth exceeds 4%. Owners of property valued at $3 million or less will be subject to a tax rate of 1.5% if the second tax cut becomes effective on January 1, 2014.

If the second tax cut becomes effective on January 1, 2014, it will have been in existence for one year on January 1, 2015, after which the Treasure State Taxpayers Dividend Program (if approved in November) may be implemented. <u>This means the earliest income tax year that individual taxpayers will receive the income tax credit is Tax Year 2015 or FY 2016.</u>

TERRY BLANTON VS. DPHHS

This class action lawsuit seeks payment from DPHHS of money wrongfully collected from third-party settlements or recoveries from Medicaid recipients to offset the cost of services they received. The suit also seeks interest, court costs, attorney fees, and declaratory and injunctive relief. In April 2010, the Montana Twentieth Judicial District Court, Lake County granted partial summary judgment on certain issues – primarily liability issues. The Montana Supreme Court issued a decision on May 24, 2011, upholding several of the district court rulings, reversing several others, and remanded the case to district court.

DPHHS is currently involved in settlement discussions with the plaintiffs and appear to be near a final agreement. The court has yet to review the settlement. DPHHS has identified members of the class affected by the lawsuit and made a preliminary cost estimate under the settlement agreement. LFD staff has requested information regarding potential settlement amounts.

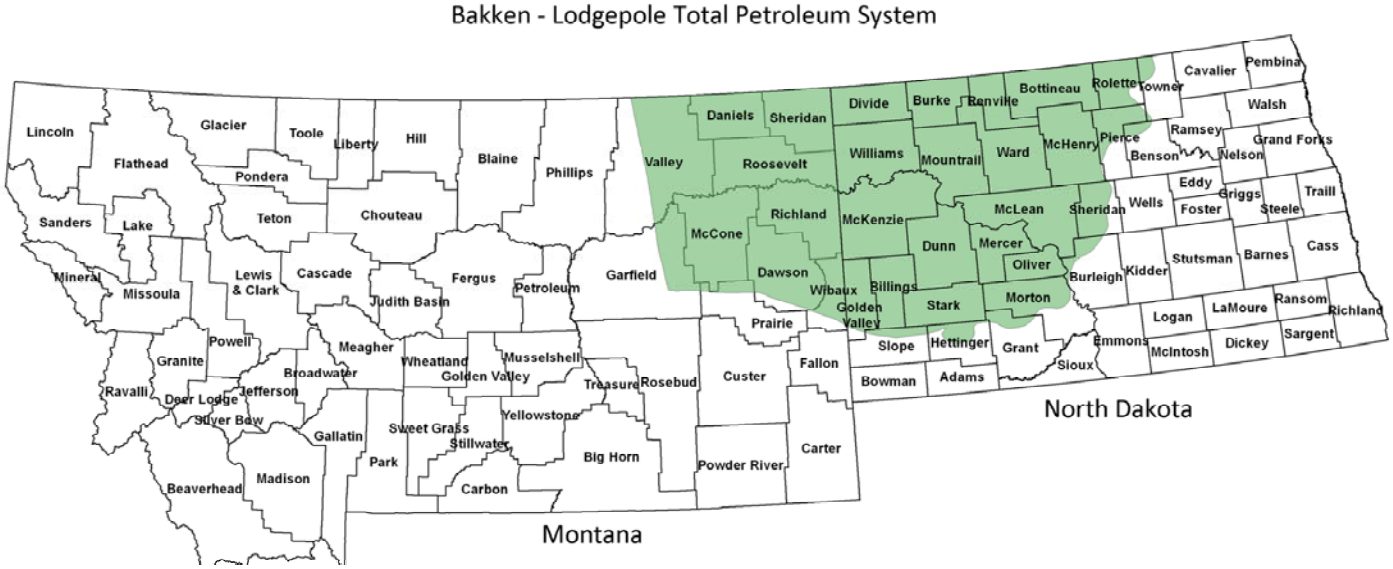
MEA-MFT VS. STATE

The MPEA, the MEA-MFT and American Federation of State, County and Municipal Employees Council No. 9 filed an unfair labor practices (ULP) complaint against the state of Montana in May 2011. The employee unions argued the state of Montana (via the Executive Branch) fairly negotiated a proposed collective bargaining agreement with the public employee's labor unions for a pay increase for public employees. However the unions' argument purports, the state (via the Legislature) did not bargain in good faith by rejecting the agreement. The Legislature countered that it fully considered and debated the bill for a public employee pay raise, but ultimately determined that it would not ratify the pay raise. The Board of Personnel Appeals' (the Board) hearing officer recommended that the Legislature is not considered a "public employer" under collective bargaining law for purposes of determining labor disputes. In May 2012 the Board adopted the decision of the hearings officer, finding that the state's obligation to negotiate in good faith ends with submittal of the proposed collective bargaining agreement to the Legislature. The unions have the option of appealing to a district court. There is not a financial component to this lawsuit as neither the Board nor a District Court has the ability to order the Legislature to provide a pay increase to employees.

NATURAL RESOURCE DEVELOPMENT

There is significant press and attention being paid to the development and extraction of oil from the Bakken formation. This formation includes a portion of eastern Montana, western North Dakota, and into Canada. The Figure on the following page shows this formation is large. New drilling technology and the price of oil has provided a new frontier for oil exploration and development from this area. Without the technology called "fracking", it is unlikely oil in these types of formations would be recovered.

Bakken - Lodgepole Total Petroleum System



To assess the revenue potential of the exploration and development of oil from the Bakken and other similar formations in Montana is not something that can be done easily. Economic data observed in North Dakota may aid in understating impacts that may occur in Montana as development occurs. Key factors to consider when evaluating at these numbers is that Montana's anticipated resource is not as great as North Dakota's and

Montana's beginning population and gross state product start at a higher base than in North Dakota so the relative growth should be less. Figure 2 shows some of the economic statistics observed in North Dakota since oil production began to accelerate there.

ECONOMICS

Comparison of Montana versus North Dakota
Various Economic Statistics

Category	Montana 2006	Montana 2010/2011	Montana Change	North Dakota 2006	North Dakota 2010/2011	North Dakota Change
Oil Production	36,195,677	24,149,583	-33.3%	39,943,108	152,904,590	282.8%
Gross State Product (Millions) *	$32,256	$36,067	11.8%	$26,068	$34,685	33.1%
Total Personal Income (Thousands)	$ 30,447,102	$ 36,507,395	19.9%	$21,375,002	$31,287,765	46.4%
Total Population	952,692	998,199	4.8%	649,422	683,932	5.3%
Nonfarm Employment *	594,109	594,831	0.1%	442,152	471,307	6.6%
Wage & Salary Income (Millions)	$14,023	$16,180	15.4%	$11,537	$16,918	46.6%
Federal Taxes Paid (Thousands) *	$2,246,486	$2,092,934	-6.8%	$1,627,389	$1,944,981	19.5%
Oil Production Taxes	$155,985,174	$203,495,078	30.5%	$180,533,360	$1,296,105,973	617.9%

* Data in the 2010/2011 column is for 2010

POTENTIAL SPENDING IMPACTS

Resource development, particularly in Eastern Montana, has resulted in numerous spending pressures for local governments, and will continue to have a greater and greater significance on both local and state functions as more production moves into Montana.

The following compares various statistics from North Dakota, where impacts are already being felt, to Montana over a similar period of time for several areas of state government. The purpose is to show where North Dakota has already been experiencing impacts that will likely move to Montana. This list is not all inclusive of functional areas that are being or will likely be impacted. The second part of the table compares North Dakota expenditures on transfers and assistance to political subdivisions in the 2007 biennium to the current biennium.

Comparison of Change North Dakota to Montana Selected Governmental Function FY 2007 through FY 2011 Expenditures in Millions						
	North Dakota			Montana		
Function	2007	2011	Change	2007	2011	Change
General Fund Expenditures*	$2,000.5	$3,296.6	64.8%	$3,283.2	$3,455.6	5.3%
Total State FTE**	8,438	8,970	6.3%	11,124	12,267	10.3%
K-12 Enrollment	95,600	94,729	-0.9%	144,736	141,102	-2.5%
Higher Education Enrollment	35,075	39,193	11.7%	35,292	40,961	16.1%
Medicaid Costs	$798.1	$1,115.6	39.8%	$732.0	$971.0	32.7%
FMAP Rate	64.7%	60.4%	-6.6%	69.3%	66.9%	-3.5%
Corrections Populations***	1,444	1,581	9.5%	3,178	3,410	7.3%
General Funds Transfers	154.7	489.7	216.5%	-	-	-
All Funds Assistance to Political Subdivisions	1,087.0	1,843.8	69.6%	-	-	-
All Funds Local Assistance	-	-	-	1,806.7	2,083.0	15.3%
General fund Local Assistance	-	-	-	1,377.4	1,458.5	5.9%

*North Dakota expenditures increase a further 23.4% from the 2011 to the 2013 biennium
**2007 Biennium to 2011 Biennium
***North Dakota 2009 biennium to 2013 biennium
****North Dakota 2013 totals $608.1 million transfers (293.1% increase over 2007 biennium) and $2,333.0 Assistance to Political Subdivisions (114.6% increase over 2007 biennium).
North Dakota source: North Dakota Legislative Council 2011 North Dakota Finance Facts

POTENTIAL REVENUE IMPACTS

In addition to the Bakken described above, Montana's natural resources include coal, oil (outside of the Bakken), natural gas, metals, and timber. Although Montana governments have benefitted from the extraction of these commodities in the past, the potential for significant revenue growth in the future is immense. Montana has the largest coal reserves of any state as well as about one-third of the Bakken formation. Both of these commodities, if extracted, could have the potential to enhance Montana's revenue base far beyond what has been realized in the past. There are numerous policy issues that will be discussed in the future including environmental impacts, transportation issues, tax policies, state and federal regulations, and infrastructure impacts on Montana's communities.

The figure on the following page puts into perspective how natural resource development may impact Montana's revenue base in the future.

Natural Resource Development Revenue Grid	
Direct Taxes	
Oil and Gas Production Tax	Tax on the gross value of the production.
State Royalties on State Lands	State royalty payments if the production occurs on state lands.
State Lease Payments on State Lands	State lease payments if the production occurs on state lands.
State Bonus Payments on State Lands	State bonus payments if the production occurs on state lands.
Federal Royalties on Federal Lands	Federal royalty payments if the production occurs on Federal lands.
Federal Lease Payments on Federal Lands	Federal lease payments if the production occurs on Federal lands.
Federal Bonus Payments on Federal Lands	Federal bonus payments if the production occurs on Federal lands.
Individual Income Tax on Royalty Income	Individual income taxes on royalty income.
Corporation License Tax on Profits	Corporation license tax on corporations producing the oil and the those sectors providing services to the industry.
Property Tax on Business Equipment	Property tax on business equipment .
Indirect Taxes	
Corporation License Tax	Increased populations and higher disposable income may lead to increased retail sales at large retail establishments, thus resulting in higher corporation licence tax.
Individual Income Tax	Increased populations and higher disposable income may lead to increased retail sales at small business establishments, which are likely organized as S-corps or LLCs; therefore, higher revenues would produce higher individual income tax.
Drivers' License Fee	With increased employment, drivers' license fees increase.
Insurance Premiums Tax	Additional insurance premiums written primarily for vehicles and housing.
Vehicle Fee/Tax	Increased employment may lead to more vehicles; increased disposable income may result in more vehicle upgrades
Beer Tax	Increased populations and higher disposable income may lead to increased consumption.
Cigarette Tax	Increased populations may lead to increased consumption.
Rental Car Tax	Lack of available housing in eastern Montana may result in increased weekend travel to home sites, which could in turn lead to an increase in Rental Car Tax.
Lodging Tax	Lack of available housing in eastern Montana is likely to lead to an increase in Lodging Tax.
Telecommunications Tax	Increased populations and higher disposable income may lead to increased consumption.
Tobacco Tax	Increased populations and higher disposable income may lead to increased gaming.
Video Gaming Tax	Increased populations and higher disposable income may lead to increased gaming.
Wine Tax	Increased populations and higher disposable income may lead to increased consumption.
Highway Patrol Fines	Increased traffic and traffic congestion may lead to a larger number of traffic fines.
Liquor Tax & Profits	Increased populations and higher disposable income may lead to increased consumption.
Lottery Profits	Increased populations and higher disposable income may lead to increased gaming.

APPENDIX A

MAJOR ECONOMIC ASSUMPTIONS

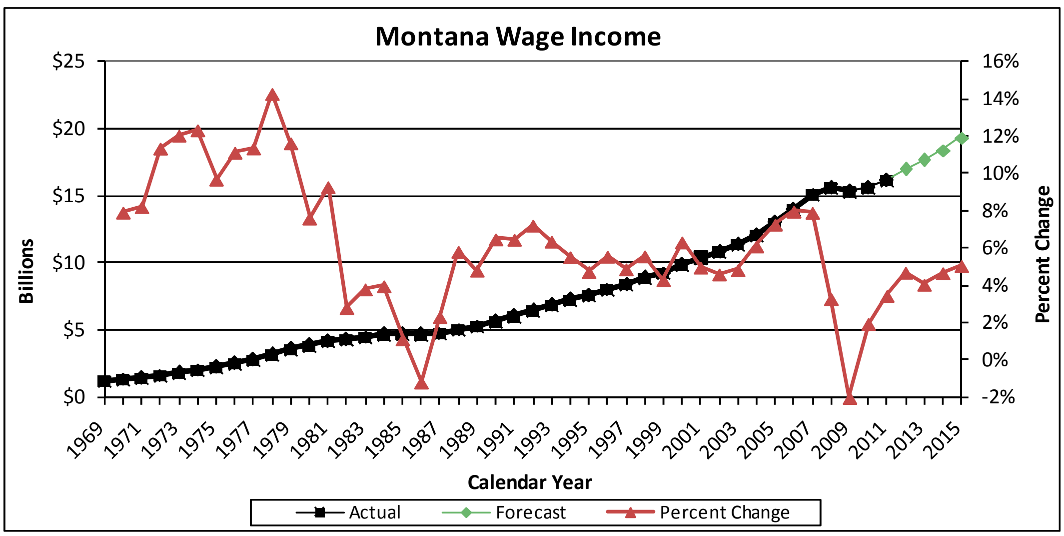
The revenue forecasts of the major sources in this report are based on the most recent data available from IHS Global Insight (HIS report for May 2012).

Economic Indicators

The major economic assumptions—individual income, interest rates, corporation indicators, and energy prices—used to forecast the state's general fund revenue for FY 2012 – FY 2015 are discussed in detail in the following subsections.

Individual Income

The total of all income sources listed on the Montana individual income tax form is referred to as Montana total income. The Department of Revenue tracks income from 11 different components, including wages, interest, dividends, business, capital gains, supplemental, rental, farm, social security, IRA and pension, and other incomes. Montana total income is the single most important variable to consider in the revenue estimation process.



Of the 11 income items, wage and salary income provides the largest portion of Montana total income. Since 1990, wage and salary income has contributed an annual average of 65.1% of total income. In 2010, it contributed 65.2%, or $13.4 billion. The average annual growth in Montana wages and salaries was 5.3% between 1990 and 2010. Wage growth exceeding this average occurred in the early 1990s and again in 2004-2007. During these periods, both inflation and employment growth was relatively high. However, the growth of wages declined sharply to rates of -2.0% and 2.0% in 2009 and 2010 respectively.

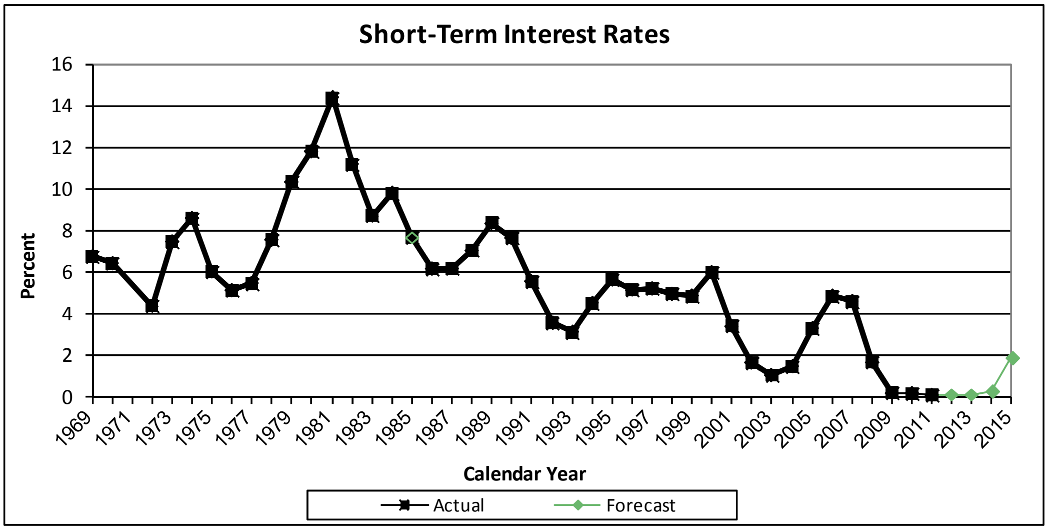
As shown above, wages are expected to assume a slower rate of growth in the forecast period with growth of about 4.7% in 2012. 4.1% in 2013, 4.7% in 2014 and 5.1% in 2015.

Interest Rates

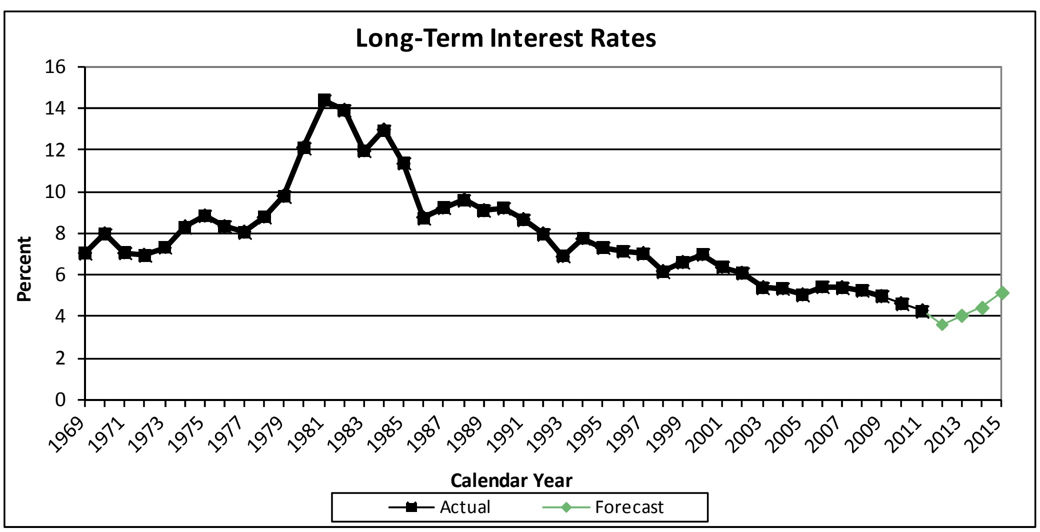
The federal funds rate set by the Federal Reserve continues to be at an historical minimum. Low interest rates may stimulate economic activity which potentially increases wage and salary and business income. On the other hand, Montana's earnings from trust funds and excess investable cash decrease fairly quickly at reduced interest rates. Investment income reported for income tax purposes also declines, although this impact can be delayed.

A large portion of Montana's revenues is derived from investment earnings from trust accounts and daily invested cash. Interest rates also affect the amount of investment income that is reported on individual income tax returns. As such, interest rates are a significant assumption when estimating future state revenues.

In addition to the state revenue impact, interest rates are fundamental in understanding the climate in which consumers and businesses are likely to make investments and large purchases. While low interest rates produce less revenue for Montana's trust and interest holdings, higher income tax earnings might be expected as construction and sales activities increase.

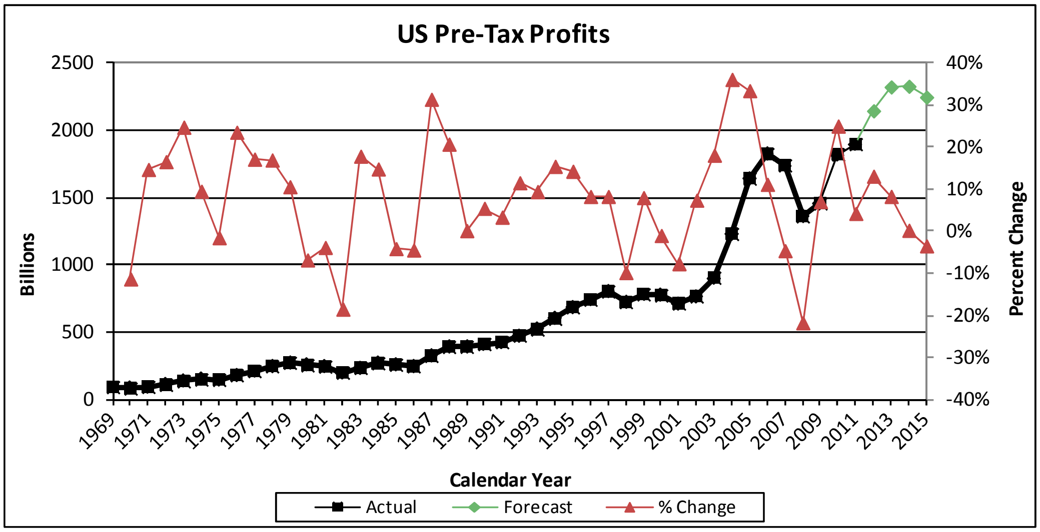


Both long and short-term interest rates are used in determining future revenues. Short-term rates are an average of 3-month corporate paper and 3 and 6-month T-bills. Long-term rates are an average of Corporate Aaa and Baa bonds, 10-year T bonds, and 30-year T bonds. Fiscal year short-term interest rates reached a unprecedented low rates of 0.1% in 2011. Rates are expected to remain below 0.5% through 2014, then increase to nearly 2% in 2015. Long-term rates are expected to be at a historical minimum in 2012 of 3.6%, then increasing to 4.0% in 2013, 4.4% in 2014, and 5.2% in 2015.



Corporation Indicators

The profitability of corporate America is an important factor in estimating revenues. Corporate profitability affects both corporation license tax and individual income tax estimates. When corporations are profitable nationally, there is an expectation that corporations will be profitable in Montana. Additionally, greater corporate profitability is largely responsible for the amount of dividends corporations pay to stockholders as well as the value of equity investments.

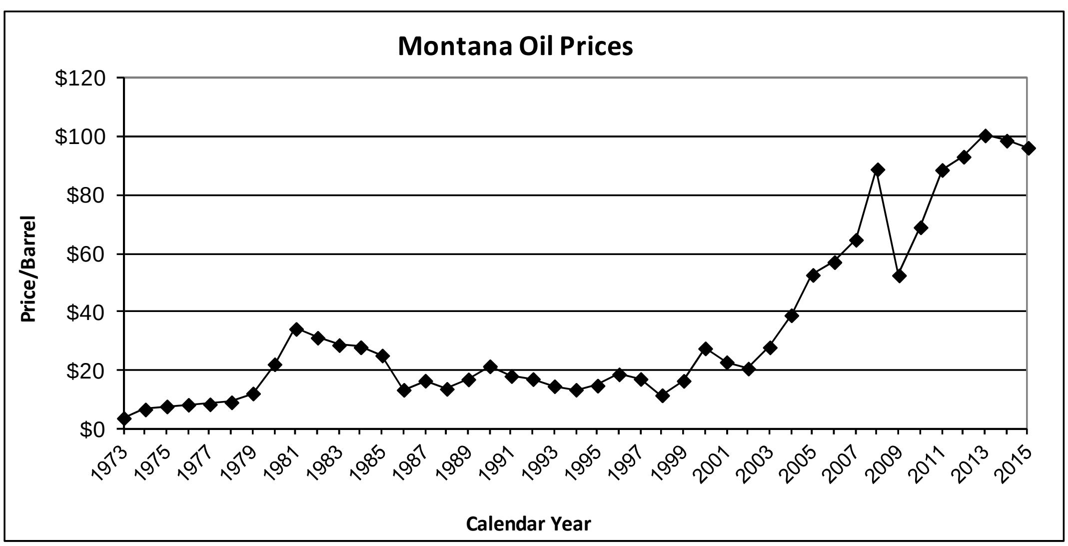


During the most recent years, the reduction of corporate profits has translated to lower corporate license tax collections. According to IHS, between 1990 and 1997, U.S. corporation pre-tax profits increased by an annual average of 10.3%. However, from 1997 through 2001, profits decreased by an average of 3.0%, the greatest decrease of 8.5% occurring in 2001. During 2007 and 2008, corporate profitability decreased at an average annual rate of 13.2%. During the forecast period, corporation profits are expected to grow at an average rate of 4.5% annually.

Energy Prices

Oil

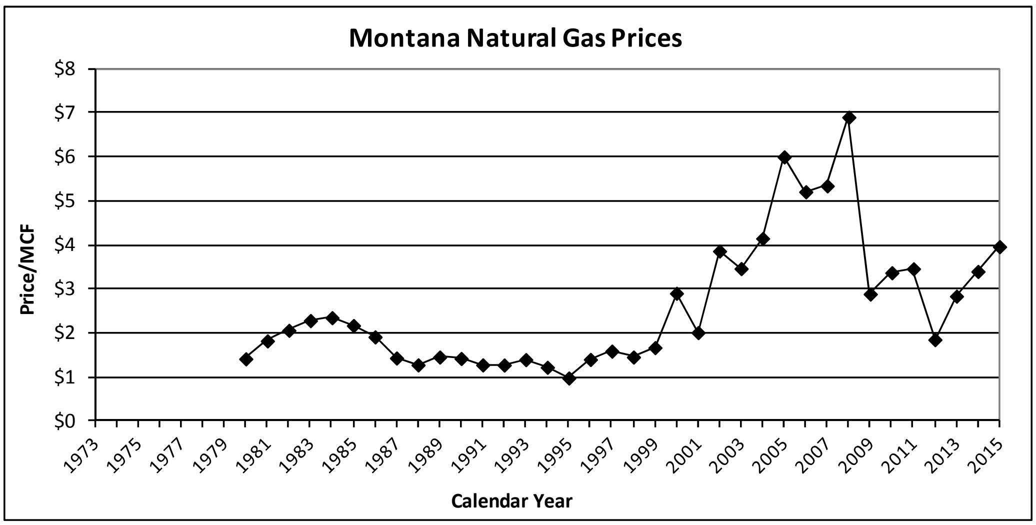
Energy prices have been volatile over the past decade, with changes in both supply and demand combining to cause dramatic price variations. For example, West Texas Intermediate (WTI) spot oil prices averaged $25.96 per barrel in 2001 and increased every year through 2008. In 2009, the WTI price dropped by 38.1% to $61.69 per barrel, then increased again to an estimated $99.07 per barrel in 2011. IHS forecasts WTI oil prices to increase to $104.76 in 2012, $112.94 in 2013, $110.94 in 2014, and $108.21 in 2015. While Montana prices are considerably lower than the WTI price, they are expected to follow a similar trend.



After a period of decline in oil production, from a peak in 1974 of 34 million barrels to a trough in 1999 of 15 million barrels, the discovery of new oil fields and advances in technologies increased oil production in Montana. New drilling activity increased 75% in 2003, and increased nearly the same amount in 2004. In 2006, the new production hit a peak, with production of over 36 million barrels. Since 2006, oil production has declined, but that trend is not expected to continue through 2015 as drilling has started to increase and is anticipated to continue to increase. Montana oil production is expected to increase to 27.3 million barrels in 2013, 28.5 million barrels in 2014, and 30.0 million barrels in 2015.

Natural Gas

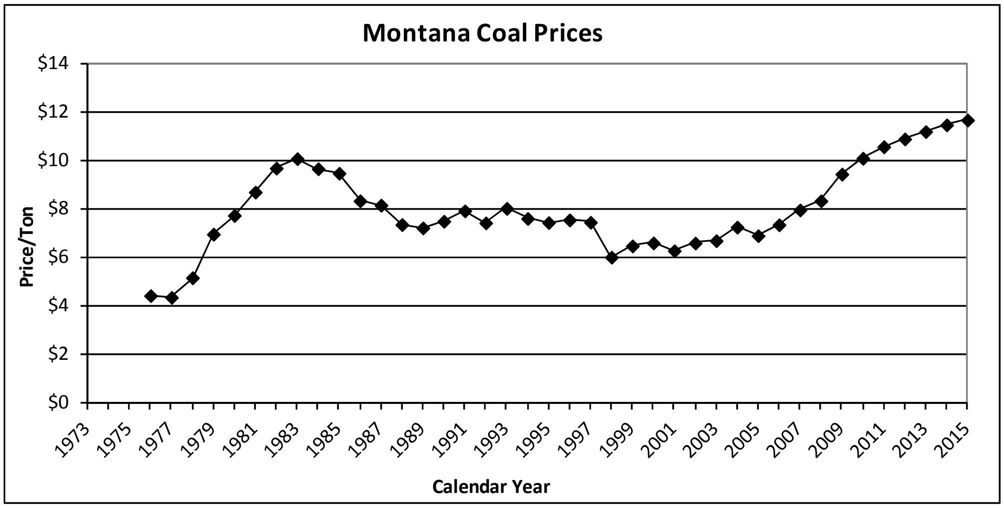
Natural gas prices at the wellhead in the U.S. reached as high as $8.84 per MCF in 2008, but the prices have declined significantly since then. The average price in 2012 is expected to be $2.36 per MCF. IHS is forecasting average well head natural gas prices at $3.67 in 2013, $4.33 in 2014, and $5.01 in 2015. While Montana wellhead prices are usually lower than the US average well head price, Montana prices are expected to follow a similar trend.



Natural gas production in Montana almost tripled between 1981 and 2007, from 40 million MCF to 119 million MCF. Production has increased around 70% since 2000. As in the oil market, new drilling activity was up substantially in 2003 and 2004, but production has declined since 2008 and that trend is expected through 2015. Montana natural gas production is expected to be 69.9 million MCF in 2013, 60.1 million MCF in 2014, and 51.5 million MCF in 2015.

Coal

The Montana price for coal remained relatively constant between 1998 and 2006, but has increased since 2006 and is expected to continue increasing over the 2015 biennium as demand for coal grows.



Western U.S. coal production, which has grown steadily since 1970, is expected to continue to increase through 2015. Strong growth, combined with limited improvement in coal mining productivity, is expected to result in average mine mouth price increases of 2.5% annually from 2013 through 2015.

Production is expected to be 42.2 million tons in FY 2013, 41.1 million tons in FY 2014, and 40.6 million tons in FY 2015.

APPENDIX B

ESTIMATES OF MAJOR TAX TYPES

Individual Income Tax

Background

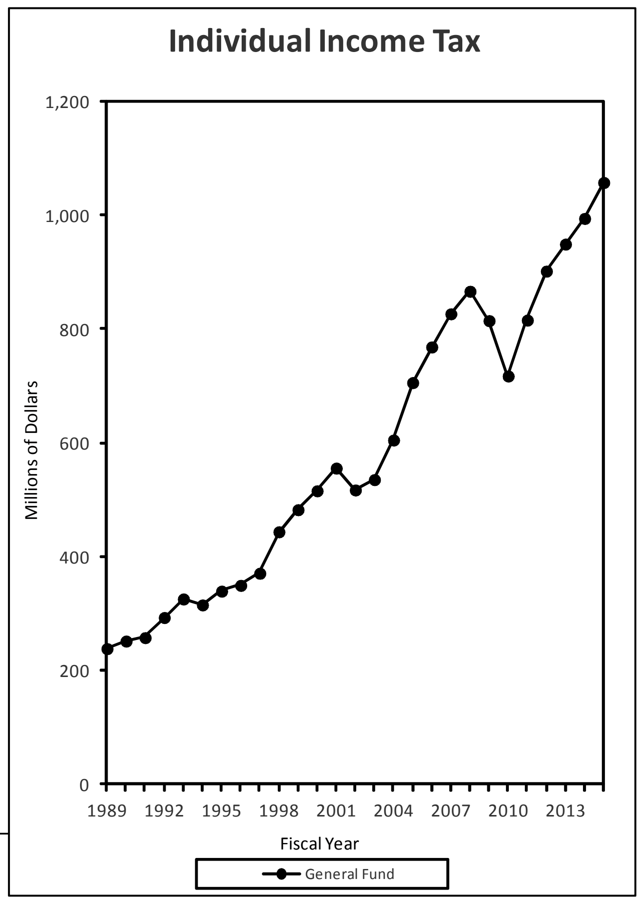
The tax is levied against taxable income, which is defined as Montana personal income adjusted for exemptions and deductions. Once tax liability is determined, the amount of tax due is computed by subtracting allowable credits. Tax rates vary from 1.0% to 6.9%, depending on the level of taxable income. Tax brackets, personal exemption amounts, and the standard deduction are adjusted for inflation each year. SB 407, enacted by the 2003 Legislature, created a new capital gains income tax credit. As a result, the tax rate on capital gains income was less than the tax rate on ordinary income by 1% in tax years 2005 and 2006, and by 2% in tax year 2007 and beyond.

% of Total General Fund Revenue

FY 2004 – 43.82%	FY 2007 – 45.04%	FY 2010 – 44.12%
FY 2005 – 46.13%	FY 2008 – 44.17%	FY 2011 – 45.78%
FY 2006 – 45.01%	FY 2009 – 45.09%	

Revenue Forecast

	Fiscal Year	General Fund Collections Millions	GF Percent Change
A	1989	238.963596	Not App.
A	1990	252.230465	5.55%
A	1991	258.216424	2.37%
A	1992	293.564151	13.69%
A	1993	326.187735	11.11%
A	1994	315.677433	-3.22%
A	1995	339.939156	7.69%
A	1996	350.161013	3.01%
A	1997	371.275410	6.03%
A	1998	444.160729	19.63%
A	1999	483.031571	8.75%
A	2000	516.261912	6.88%
A	2001	556.014554	7.70%
A	2002	517.567691	-6.91%
A	2003	535.830664	3.53%
A	2004	605.348420	12.97%
A	2005	706.234579	16.67%
A	2006	768.922343	8.88%
A	2007	827.145498	7.57%
A	2008	866.658538	4.78%
A	2009	815.138193	-5.94%
A	2010	717.834371	-11.94%
A	2011	816.089973	13.69%
F	2012	902.179000	10.55%
F	2013	949.650000	5.26%
F	2014	994.589000	4.73%
F	2015	1,057.789000	6.35%



Property Tax

Background

Montana law requires counties to levy a county equalization levy of 55 mills, a state equalization levy of 40 mills, and 6 mills for the university system against all taxable value in each county. A mill levy of 1.5 mills is also applied against all property in the five counties with a vo-tech college. Taxable value is defined as the market value of statutorily defined property times a statutory tax rate. Property valued at market value includes personal property, utility property, railroad and airline property, and mineral net and gross proceeds. The assessed value of residential and commercial real estate is the market value phased in over the reappraisal cycle. Agricultural land and timberland are valued on a productivity basis and their values are also phased in over the reappraisal cycle. The last reappraisal cycle took effect January 1, 2009.

Beginning January 1, 2009, residential and commercial property as well as agricultural land and timberland reflect the impact of the new reappraisal on assessed values. The current reappraisal cycle is 6 years, during which increases in property values are phased in by 1/6th per year.

In addition to the tax on property, this revenue component includes collections from "non-levy" sources that are distributed on the basis of mills levied by taxing jurisdictions. These non-levy sources include the state share of coal gross proceeds taxes, federal forest revenues, and other smaller revenue sources.

This source also includes the state's share of protested taxes paid by centrally assessed companies. Fifty percent of taxes paid under protest by centrally assessed firms are deposited in the general fund and the rest are deposited in a state special account. Should the state fail in it defense of the taxation of these companies, the protested taxes must be returned to the taxpayer. If the state prevails in the case, the money in the state special account is transferred to the general fund.

SB 372 Business Equipment Tax

One bill, SB 372, and one event at the federal level, will impact property tax revenue in the 2015 biennium. Taxable value for Class 8 business equipment will be impacted by two tax rate cuts enacted in SB 372. The first tax rate cut in SB 372 cuts property taxes on business equipment on January 1, 2012. Owners of property valued at $2 million or less will be subject to a tax rate of 2%, a cut from the previous 3% tax rate. A second tax cut may take place no sooner than January 1, 2014 if the prior fiscal year's state income tax and state corporate tax receipt growth exceeds 4%. Owners of property valued at $3 million or less will be subject to a tax rate of 1.5% if the second tax cut becomes effective on January 1, 2014.

The first tax cut will reduce class 8 taxable value around $30 million in tax year 2012. This will result in state revenue losses to the 95 mills and 1.5 mills of approximately $2.9 million per year. This analysis assumes that the second tax cut will take place on January 1, 2014. This is expected to reduce class 8 taxable value statewide another $23 million, reducing revenue to the 95 mills and the 1.5 mills by an additional $2.2 million.

Federal Forest Revenue

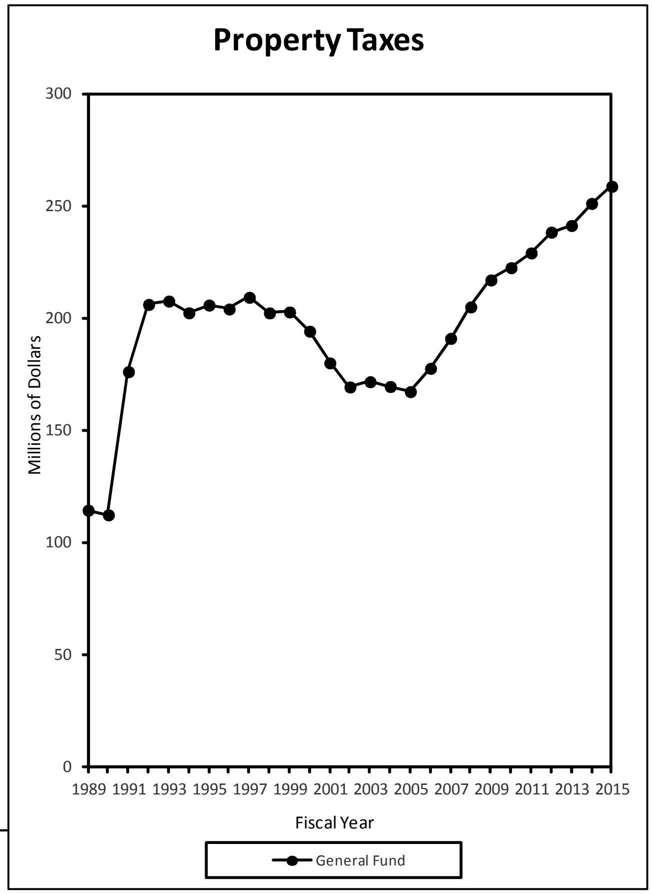
The impact of the non-renewal of the federal Secure Rural Schools Act which was given a temporary continuance through FY 2012, will impact property tax revenues in FY 2013 and the 2015 biennium. Without the reauthorization of this Act, the revenue from federal forest lands is expected to drop to around $600,000 per year, a loss of around $3.8 million per year. A one-year extension passed the US Senate, but has yet to be approved by the US House or signed by the President.

% of Total General Fund Revenue

FY 2004 – 12.27 %	FY 2007 – 10.74%	FY 2010 – 13.68%
FY 2005 – 10.93%	FY 2008 – 11.53%	FY 2011 – 12.87%
FY 2006 – 10.40%	FY 2009 – 12.01%	

Revenue Forecast

	Fiscal Year	General Fund Collections Millions	GF Percent Change
A	1989	114.444609	Not App.
A	1990	112.374543	-1.81%
A	1991	176.154583	56.76%
A	1992	206.138029	17.02%
A	1993	207.646372	0.73%
A	1994	202.381945	-2.54%
A	1995	205.842671	1.71%
A	1996	204.082588	-0.86%
A	1997	209.284365	2.55%
A	1998	202.350380	-3.31%
A	1999	202.774979	0.21%
A	2000	194.196158	-4.23%
A	2001	180.050247	-7.28%
A	2002	169.339388	-5.95%
A	2003	171.679862	1.38%
A	2004	169.530994	-1.25%
A	2005	167.270350	-1.33%
A	2006	177.639199	6.20%
A	2007	190.981939	7.51%
A	2008	205.043751	7.36%
A	2009	217.042057	5.85%
A	2010	222.509767	2.52%
A	2011	229.084000	2.95%
F	2012	238.320000	4.03%
F	2013	241.285000	1.24%
F	2014	251.162000	4.09%
F	2015	258.758000	3.02%



Corporation License Tax

Background

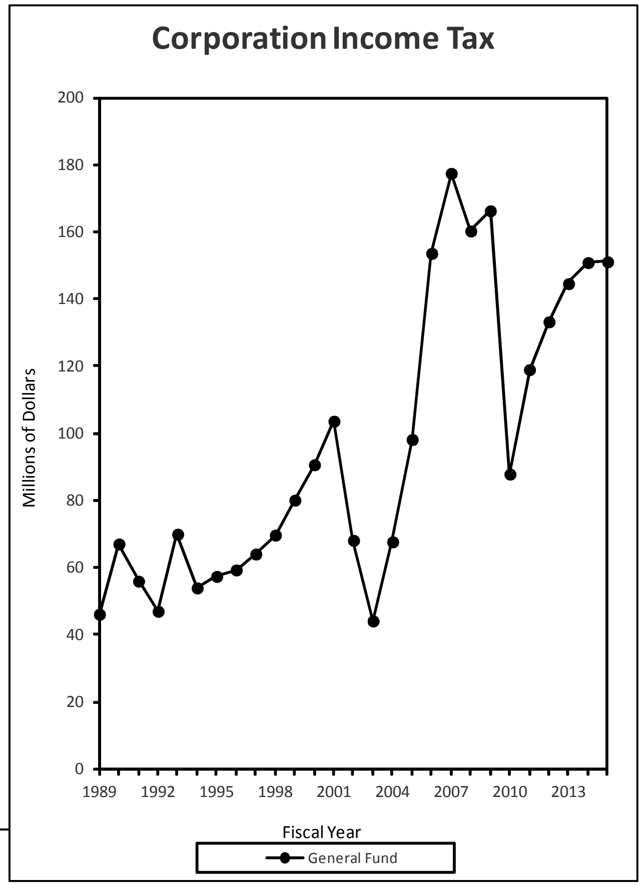
The corporation income tax is a license fee levied against a corporation's net income earned in Montana. The corporation income tax is imposed on corporations that, for reasons of jurisdiction, are not taxable under a license tax. Factors that affect corporation income tax receipts include tax credits and the audit efforts by the Department of Revenue. As with individual income tax, all tax liability is adjusted for allowable credits. The tax rate is 6.75%, except for corporations making a "water's edge" election (see 15-31-322, MCA), who pay a 7.0% tax on their net income.

% of Total General Fund Revenue

FY 2004 – 4.90%	FY 2007 – 9.67%	FY 2010 – 5.40%
FY 2005 – 6.42%	FY 2008 – 8.17%	FY 2011 – 6.68%
FY 2006 – 9.00%	FY 2009 – 9.20%	

Revenue Forecast

	Fiscal Year	General Fund Collections Millions	GF Percent Change
A	1989	46.152627	Not App.
A	1990	67.087905	45.36%
A	1991	56.006784	-16.52%
A	1992	47.027797	-16.03%
A	1993	70.003987	48.86%
A	1994	53.996713	-22.87%
A	1995	57.425136	6.35%
A	1996	59.336677	3.33%
A	1997	64.078549	7.99%
A	1998	69.724680	8.81%
A	1999	80.142416	14.94%
A	2000	90.682672	13.15%
A	2001	103.670487	14.32%
A	2002	68.173253	-34.24%
A	2003	44.137518	-35.26%
A	2004	67.722940	53.44%
A	2005	98.213716	45.02%
A	2006	153.675068	56.47%
A	2007	177.503707	15.51%
A	2008	160.341786	-9.67%
A	2009	166.354514	3.75%
A	2010	87.900911	-47.16%
A	2011	119.043890	35.43%
F	2012	133.280000	11.96%
F	2013	144.645000	8.53%
F	2014	150.929000	4.34%
F	2015	151.149000	0.15%



Vehicle Tax

Background

Light vehicles, motorcycles and quadricycles, snowmobiles, buses, trucks, truck tractors having a manufacturer's rated capacity of more than 1 ton, motor homes, and certain trailers and travel trailers are taxed under a fee schedule that varies by age and weight.

Before January 1, 2001, light vehicles were taxed on an ad valorem basis. As a result of Referendum (LR) 115 (HB 540), passed by the electorate in November 2000, light vehicles pay a fee-in-lieu of tax (FILT). The fee is $195 for light vehicles of age between zero and four years, $65 for vehicles between five and ten years of age, and $6 for vehicles over ten years old. Owners of vehicles greater than ten years old may pay $87.50 (plus other applicable fees) for a permanent registration.

Effective January 1, 2003, the fee schedule on heavy trucks is reduced by one-sixth for calendar 2003, by one-third for calendar 2004 and by one-half for calendar 2005. These changes were enacted by HB 247 in the 2003 legislative session. The fee schedule for truck varies by age and weight capacity.

Effective January 1, 2004, the fees-in-lieu-of-tax on motorcycles and quadricycles, trailers and travel trailers, snowmobiles, watercraft, off-highway vehicles are one-time payments, except upon change of ownership. These one-time fees in calendar 2004 doubled in calendar 2005 and thereafter.

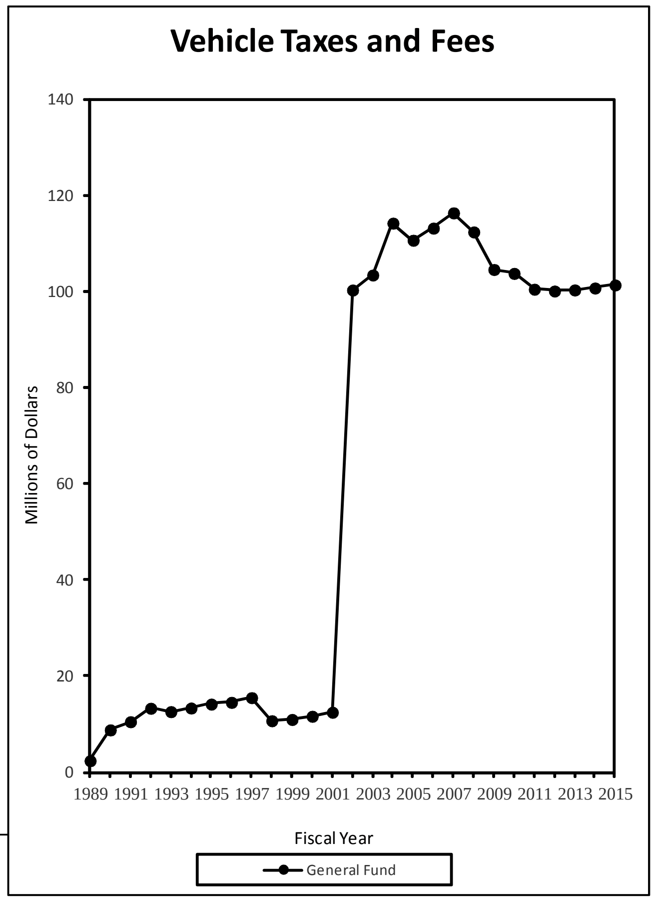
Due to changes enacted by HB 671 and SB 285 by the 2005 Legislature, registration fee revenue reported by counties on the county collection report are now being recorded as vehicle taxes. Therefore, revenue shown for this source shows a large increase in FY 2006 from FY 2005, but revenue decreases by a like amount in the "Motor Vehicle Fee" revenue source.

<u>% of Total General Fund Revenue:</u>

FY 2004 – 6.05%	FY 2007 – 5.51%	FY 2010 – 5.50%
FY 2005 – 5.23%	FY 2008 – 5.26%	FY 2011 – 4.81%
FY 2006 – 5.39%	FY 2009 – 4.94%	

<u>Revenue Forecast</u>

	Fiscal Year	General Fund Collections Millions	GF Percent Change
A	1989	2.471472	Not App.
A	1990	8.869602	258.88%
A	1991	10.582218	19.31%
A	1992	13.378654	26.43%
A	1993	12.670105	-5.30%
A	1994	13.424539	5.95%
A	1995	14.238226	6.06%
A	1996	14.605759	2.58%
A	1997	15.588374	6.73%
A	1998	10.778306	-30.86%
A	1999	11.053035	2.55%
A	2000	11.715716	6.00%
A	2001	12.548251	7.11%
A	2002	100.398624	700.10%
A	2003	103.537563	3.13%
A	2004	114.330455	10.42%
A	2005	110.771948	-3.11%
A	2006	113.292384	2.28%
A	2007	116.471506	2.81%
A	2008	112.487931	-3.42%
A	2009	104.679977	-6.94%
A	2010	103.861549	-0.78%
A	2011	100.576655	-3.16%
F	2012	100.208000	-0.37%
F	2013	100.420000	0.21%
F	2014	100.818000	0.40%
F	2015	101.456000	0.63%



Oil and Natural Gas Production Tax

Background

The oil and natural gas production tax is imposed on the production of petroleum and natural gas in the state. Gross taxable value of oil and natural gas production is based on the type of well and type of production. A portion of the revenue from the tax may be returned to Indian tribes per agreements between the Department of Revenue and the tribes.

The oil and natural gas production tax has numerous tax rates depending on several factors. These factors include whether the oil or gas is produced from a stripper well, a stripper incentive well, from a well initially drilled before 1999 or after, from a well newly drilled within the last year or 18 months, and whether the interest being taxed is the working interest or the royalty interest. The Board of Oil and Gas Conservation imposes an additional privilege and license (P & L) tax on all oil and natural gas tax rates. Starting October 2006 as set by the Board, the P&L tax rate is 0.09%. Based on this rate, HB 758 enacted by the 2005 Legislature allows an additional tax rate of 0.17% to generate revenue for local impacts for local governments. The two taxes may not exceed 0.3%. The following table shows tax rate percentages for each type of pre-1999 oil and post-1999 oil, excluding the P & L tax and the new Local Impact tax.

The quarterly tax rates on stripper production and on incremental production are lower than that for regular production unless the price of West Texas Intermediate averages above $30 for the quarter. Similarly, the quarterly tax rate for stripper well exemption production (1-3 barrels a day) is lower than that for regular production unless the price of West Texas Intermediate averages above $38 for the quarter.

Oil Tax Rates 15-36-304(5), MCA	
Working Interest	
Primary recovery production	
First 12 months of qualifying production	0.5%
After 12 months:	
pre-1999 wells	12.5%
post-1999 wells	9.0%
Stripper oil production (>3 and < 15 barrels/day if oil<$30)	
1 through 10 barrels a day production	5.5%
>10 through 14 barrels a day production	9.0%
Stripper oil production (>3 and < 15 barrels/day if oil>=$30)	*
Stripper wells (3 barrels or less/day)	
Stripper well exemption production (if oil <$38)	0.5%
Stripper well bonus production (if oil >=$38)	6.0%
Horizontally completed well production	
First 18 months of qualifying production	0.5%
After 18 months	
pre-1999 wells	12.5%
post-1999 wells	9.0%
Incremental production (if oil <$30/barrel)	
New or expanded secondary recovery production	8.5%
New or expanded tertiary production	5.8%
Incremental production (if oil >=$30/barrel)	
Pre-1999 wells	12.5%
Post-1999 wells	9.0%
Horizontally recompleted well	
First 18 months	5.5%
After 18 months	
pre-1999 wells	12.5%
post-1999 wells	9.0%
Nonworking Interest	14.8%
* No stripper tax rate. Taxed at primary recovery rates. See 15-36-303(22a)	

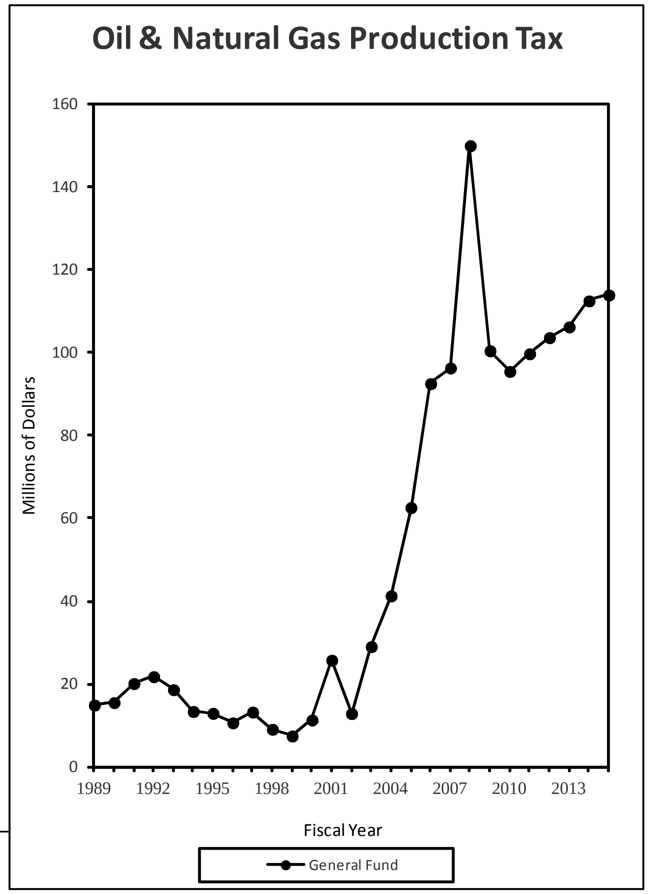
% of Total General Fund Revenue

FY 2004 – 2.99%	FY 2007 – 5.25%
FY 2010 – 5.87%	FY 2005 – 4.09%
FY 2008 – 7.64%	FY 2011 – 5.60%
FY 2006 – 5.42%	FY 2009 – 5.56%

Natural Gas Tax Rates 15-36-304(2), MCA		
Working Interest		
Qualified production		
First 12 months		0.5%
After 12 months		
	pre-1999 wells	14.8%
	post-1999 wells	9.0%
Stripper natural gas pre-1999 wells		11.0%
Horizontally completed well production		
First 18 months of qualifying production		0.5%
After 18 months		9.0%
Nonworking Interest		14.8%

Revenue Forecast

	Fiscal Year	General Fund Collections Millions	GF Percent Change
A	1989	14.959251	Not App.
A	1990	15.567426	4.07%
A	1991	20.163269	29.52%
A	1992	21.822893	8.23%
A	1993	18.676586	-14.42%
A	1994	13.403408	-28.23%
A	1995	12.963887	-3.28%
A	1996	10.665986	-17.73%
A	1997	13.283093	24.54%
A	1998	9.120152	-31.34%
A	1999	7.505617	-17.70%
A	2000	11.362741	51.39%
A	2001	25.791723	126.99%
A	2002	12.902439	-49.97%
A	2003	29.086038	125.43%
A	2004	41.323718	42.07%
A	2005	62.625939	51.55%
A	2006	92.562800	47.80%
A	2007	96.334992	4.08%
A	2008	149.993826	55.70%
A	2009	100.490971	-33.00%
A	2010	95.490812	-4.98%
A	2011	99.763712	4.47%
F	2012	103.669000	3.91%
F	2013	106.249000	2.49%
F	2014	112.528000	5.91%
F	2015	113.955000	1.27%



Insurance Tax

Background

The insurance premiums tax is levied on the net premiums or gross underwriting profit for each insurance company operating in Montana. Gross underwriting profit is essentially insurance premium income. In addition, various insurance and license fees are also collected.

The current tax rate is 2.75% of net premiums (including cancellation and return premiums) on policies sold in Montana. In addition to this tax, there is a 2.5% tax on the fire portion of net premiums for selected risks. Beginning FY 2008 with the enactment of HB 278 (2007 session), for each Montana resident insured under any individual or group disability or health insurance policy, all insurers are required to pay $1.00 to the State Insurance Commissioner. The fee had been scheduled to be reduced to $0.70, but the legislation extended the $1.00 fee indefinitely. This fee is deposited to the state special revenue fund and used to fund the statewide genetics program established in statute (50-19-211, MCA). Senate Bill 132 (passed by the 1999 legislature) eliminated many disparate fees on insurance companies, which had partially been deposited into the general fund, and replaced them with a single company annual fee of $1,900. Revenue from this fee is deposited to the state special revenue fund for administration of insurance activities.

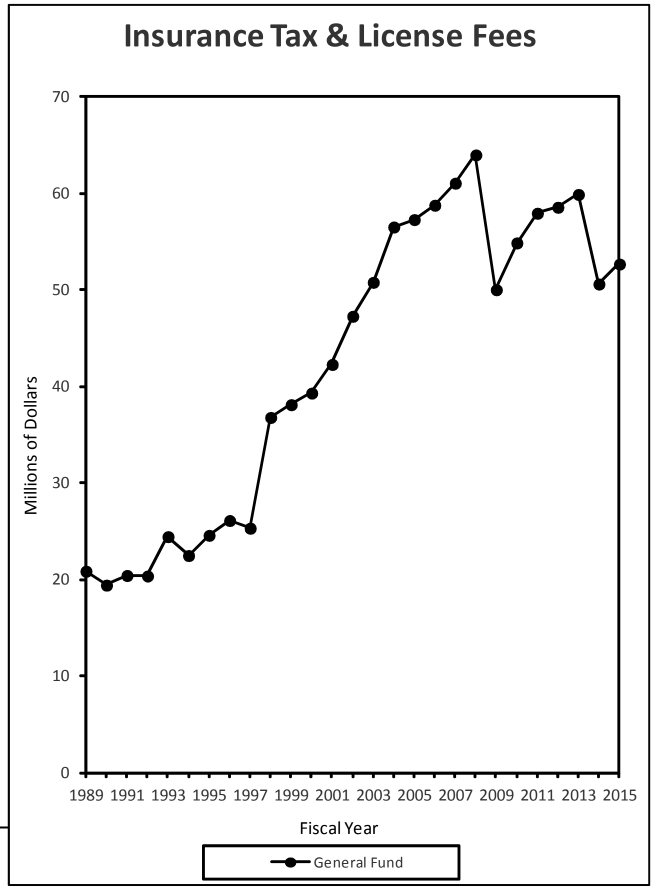
Captive insurance companies are taxed 0.4% on the first $20 million of net direct premiums and 0.3% on each subsequent dollar collected. The annual $5,000 minimum tax is prorated based on the quarter in which the company is first licensed.

<u>% of Total General Fund Revenue</u>

FY 2004 – 4.11%	FY 2007 – 3.33%	FY 2010 – 3.37%
FY 2005 – 3.74%	FY 2008 – 3.26%	FY 2011 – 3.25%
FY 2006 – 3.44%	FY 2009 – 2.77%	

<u>Revenue Forecast</u>

	Fiscal Year	General Fund Collections Millions	GF Percent Change
A	1989	20.882814	Not App.
A	1990	19.446368	-6.88%
A	1991	20.438058	5.10%
A	1992	20.387391	-0.25%
A	1993	24.463587	19.99%
A	1994	22.510848	-7.98%
A	1995	24.600092	9.28%
A	1996	26.132824	6.23%
A	1997	25.341540	-3.03%
A	1998	36.813041	45.27%
A	1999	38.137472	3.60%
A	2000	39.333537	3.14%
A	2001	42.297647	7.54%
A	2002	47.290738	11.80%
A	2003	50.809600	7.44%
A	2004	56.532929	11.26%
A	2005	57.308425	1.37%
A	2006	58.794762	2.59%
A	2007	61.074266	3.88%
A	2008	64.003987	4.80%
A	2009	50.038468	-21.82%
A	2010	54.892354	9.70%
A	2011	57.963581	5.59%
F	2012	58.586000	1.07%
F	2013	59.906000	2.25%
F	2014	50.631000	-15.48%
F	2015	52.696000	4.08%



All Remaining General Fund Revenue

The remaining general fund revenue sources constitute 17.2% of the 2013 biennium total and 16.0% of the 2015 biennium total.

APPENDIX C

MAJOR GENERAL FUND EXPENDITURE ASSUMPTIONS BY FUNCTIONAL AREA

The following provides a more detailed discussion of all adjustments made for K-12 and higher education, human services, and corrections.

K-12 Education

General fund for K-12 education would increase $42.9 million compared to the 2013 biennium, assuming a supplemental appropriation of $33.7 million in that biennium. If the supplemental is not included in the 2013 biennium, the increase is $76.6 million.

Student enrollment in K-12 in the 2015 biennium is expected to bottom out and begin increasing. Budgeted ANB, a function of enrollment and three-year averaging, will slightly decline by 0.4% in FY 2014 and by 0.1% in FY 2015.

Present law inflation applied to the basic and per-ANB entitlements is expected to be 0.89% in FY 2014 and 2.3% in FY 2015, based on Global Insight's forecast of the CPI-U index. This will increase the state's payment for Base Aid by $5.1 million in FY 2014 and $18.3 million in FY 2015.

The FY 2013 level of K-12 entitlements from which inflation during the 2015 biennium will be applied is consistent with an FY 2013 increase in entitlements of 2.43%. The veto of HB 316 required that the increase in entitlements in FY 2013 be only 1.6%. A recent consent decree by a Helena district judge requires that the increase for FY 2013 be set at 2.43%. For the purposes of this analysis, the level of entitlements in FY 2013 as required by the consent decree is considered present law and is the base from which the 2015 biennium K-12 entitlements are measured.

In addition to ANB changes and inflation of entitlements, general fund Base Aid costs in the 2015 biennium will also increase because of less assumed revenue to pay for Base Aid from the guarantee account. This is expected to increase general fund Base Aid costs by $23.7 million in FY 2014 and by $25.9 million in FY 2015.

The guarantee account has a new major source of revenue beginning in FY 2012. SB 329 enacted by the 2011 Legislature says that school districts may only receive oil and gas revenue up to 130% of their general fund budgets. Any excess above that amount is retained by the state and is deposited 100% in the guarantee account in FY 2012. Beginning in FY 2013 and beyond, 70% of the excess oil and gas revenue will be deposited in the guarantee account, 5% in a state impact account and 25% in a local impact account. The amount that is expected to be deposited in the guarantee account will be approximately $12.0 million per year in the 2015 biennium.

Two bills will have impacts on general fund Base Aid in the 2015 biennium. SB 372 will cut tax rates for small business owners on January 1, 2012 and a second time on January 1, 2014, subject to a revenue trigger. SB 372 will reimburse school districts for the loss in revenue in FY 2014 and FY 2015 and beyond. These reimbursement block grants will amount to $7.3 million more than were appropriated in FY 2013.

In addition, SB 372 block grants will result in state Guaranteed Tax Base Aid (GTB) savings of $4.7 million in the 2015 biennium. A second bill, SB 329, requiring that districts' budget an increasing share of their prior year oil and gas revenues in the district general fund, will result in minor GTB savings in the 2015 biennium.

The analysis does not include an adjustment for the change in accreditation standards included in either "Common Core" or "Chapter 55". Under statute the LFD is charged with analyzing potential costs. If these costs are determined to be significant[1], the Board of Public Education must delay implementation and request that the legislature fund the increased costs prior to implementation. Both analyses will be completed by the fall. Implementation of common core was delayed until July 2012

Higher Education

Present law adjustments for the Montana University System (MUS) funded by general fund include the same adjustments made for all other state agencies, including an adjustment to reflect an increase in the number of hours in each fiscal year, and agency fixed cost adjustments at the educational units and educational agencies. These costs must be projected and added separately in the present law budget projection for the postsecondary education institutions because the state appropriation for these entities is to the Board of Regents, and then reallocated by the board to the educational institutions. The total amount of these types of adjustments is $1.4 million for the 2015 biennium.

The present law budget projection includes $2.88 million general fund each year for the Student Assistance Program that is not technically present law. However, the costs are included in the present law budget projection because they are costs that have historically been funded from general fund but were funded by the 2011 Legislature with one-time funding in HB2 from the federal guaranteed student loan account fund balance.

Revenue from the statewide six-mill levy for the Montana University System is projected to increase in the 2015 biennium compared to the 2013 biennium, including the impacts of SB 372. Other things being equal, this projected increase in the six-mill levy will reduce the amount of general fund needed to fund the lump sum appropriation for the educational units. The 2015 biennium budget projection reflects a $3.48 million general fund reduction due to the projected increase in the six-mill levy.

The analysis does not include an enrollment increase. Enrollment has been leveling and projections continue this trend.

A present law adjustment of $3.67 million general fund is also included in the 2015 biennium budget projection for the community colleges. However, because the community college funding formula relies upon actual base year expenditures and student enrollment to project the state appropriation, the adjustment estimated in this report for the 2015 biennium should be considered preliminary. Actual expenditures should be available at the end of FY 2012 and a revised estimate will be prepared in the fall.

Human Services (DPHHS)

The 2015 biennium budget for the Department of Public Health and Human Services is $124.6 million general fund greater than the 2013 biennium appropriation, which includes $110.9 million in present law adjustments and $17.1 million in new proposals due to cost shifts to the general fund from special revenue shortfalls

The major increases (present law and new proposal) are:

- $50.5 million for Medicaid services enrollment and service utilization increases
- $18.6 million to cover the full expenditure of the Medicaid hold harmless reserve account, created to retain a portion of the enhanced federal Medicaid match rate authorized under the American Recovery and Reinvestment Act of 2009
- $14.2 million for the increase in the state match rate (mostly the percent of Medicaid funded by the federal government –FMAP) for Medicaid and foster care services
- $13.6 million to offset the loss of health and Medicaid initiatives state special revenue that supports Medicaid programs, Big Sky Rx, and the Healthy Montana Kids program (included in the correct service level) noted as CSL

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[1] Defined in 20-7-101 MCA as "an amount that cannot be readily absorbed in the budget of an existing school district program."

- $2.5 million to back fill the funding shift from general fund to the TANF block grant authorized in HB 613, passed by the 2011 Legislature

Medicaid Forecast

LFD staff produced a comprehensive Medicaid forecast to independently estimate 2015 biennium cost increases for the Big Picture report. The forecast process, methodology, and funding assumptions were discussed with the LFC Subcommittee on Medicaid Estimates in late May. Subcommittee members concurred with refinements to the forecast that LFD staff identified and discussed with the subcommittee.

This preliminary forecast does not include the effect of the Medicaid expansion authorized in the Patient Protection and Affordable Care Act of 2010. The comparison of the LFD forecast for the 2013 biennium compared to the 2015 biennium shows:

- A total funds increase of $204.2 million from the 2013 to the 2015 biennium.
- A general fund biennial increase of $110.2 million due primarily to:
    - $58.0 million in service utilization growth and enrollment changes
    - $13.9 million for increases in the state Medicaid match rate
    - $28.2 million of shift from state special revenue account shortfalls[2]

Corrections

The 2015 biennium projections for adult offender populations under the supervision of the Department of Corrections decrease general fund expenditures by $2.8 million when compared to the 2013 biennium budget. The estimates represent more than 500 fewer overall placements than were anticipated in the 2013 biennium budget. Growth of 5.5% in female secure care and 1.9% in male secure care will stress capacities in secure care facilities. Medical and pharmaceutical cost growth of $6.0 million to care for the inmate populations will more than offset the lower than anticipated offender populations.

[2] The primary revenue shortfalls are the full expenditure of the Medicaid hold harmless/reserve account and the health and Medicaid initiatives account. The hold harmless account revenue was derived from setting aside the general fund savings from a small portion of the enhanced federal Medicaid match rate authorized in the American Recovery and Reinvestment Act of 2009 (ARRA). This amount could be set aside in a reserve account, which was earmarked to fund Medicaid services after June 30, 2011. The account will be fully expended by the end of FY 2013. The health and Medicaid initiatives account was established by voter initiative and funded with an increase in tobacco and cigarette taxes ($1 per pack). Initially the account built up significant reserves as programs ramped up. However, the FY 2013 appropriation level exceeds annual income and interest revenue by $13.0 million. This account funds Medicaid services, Healthy Montana Kids, Insure Montana, and Big Sky Rx. Ongoing revenues are insufficient to fund ongoing services funded from the account. The amount listed is the proportional reduction allocated to all Medicaid services.

APPENDIX D

FUNDING ANALYSIS OF PENSION SYSTEMS

Funding requirements the five scenarios vary significantly in complexity. Scenarios 1 and 2 impact all levels of government funding and are relatively complex from a funding perspective. Scenario 3 relies only on state general fund and is a relatively simple funding plan. Scenario 4 does not assume any government funding; therefore, no analysis is present in this section of the report. Finally, scenario 5, defined contribution plan, has an unknown funding impact since no additional funding has been assumed at this time. Scenario 5 will require additional funding to pay for the unfunded liability remaining in the pension systems, but is only discussed in general in this section.

The majority of this section focuses on scenarios 1 and 2 due to the complexity of government funding.

1) Meet the actuarial required contribution[3] (ARC) funding with employer contributions; and
2) Provide one-half the required ARC[5] funding with employer contributions.

In addition, the funding implications for the defined contribution plan or scenario 5.

The complexity associated with addressing the ARC through employer contributions varies for the different levels of government. The impacts on four levels of government are summarized in this section. They are:

- State agencies
- Local governments, including the community colleges
- School districts
- The Montana University System (MUS)

Scenarios 1 and 2 Funding Requirements

Note that the analysis in this section is based on the assumption that the ARC as shown in the actuarial valuations is based only on the defined benefit members of each system. This assumption appears valid based on how the actuarial valuation tables are presented. Under this assumption, the FY 2014 ARC costs in the following tables have been uniformly reduced to eliminate the impacts of participants in the deferred compensation retirement system. This methodology results in small inaccuracies in the allocation of cost increases among the various funding sources for state agencies. Discussion with the actuaries is needed to confirm the accuracy of this assumption.

The following figure shows the projected increases in employer contributions for each of the impacted retirement plans that would be required to fully fund the ARC shortfall[5], as discussed in the December 2011 LFD "Financial Analysis of Pensions" report.

[3] Actuarial required contribution (ARC) as discussed in this report represents the amount needed on an annual basis stated in term of a percent of payroll to fund estimated benefit accrual for current employees/retirees and pay down the unfunded liabilities over 30 years. The shortfall or gap in the ARC is the difference between current contribution levels and the amount needed to meet the ARC. Note that this ARC definition is based on current GASB guidelines as adopted by the pension boards. The GASB definitions are changing, but do not necessarily impact pension board funding policy.

Estimated Required Additional funding meet the ARC gap[5] By Retirement Plan FY 2014		
Plan	Increase	Source of Estimate
Teachers Retirement System (TRS)	4.63%	Actuarially Estimated
Public Employees Retirement System (PERS)	5.45%	FY 2011 Actuarial Valuation
Sheriffs Retirement System (SRS)	4.33%	FY 2011 Actuarial Valuation
Game Wardens Retirement System	2.82%	FY 2011 Actuarial Valuation
Highway Patrol Retirement System	2.38%	FY 2011 Actuarial Valuation
MUS Optional Retirement Plan (ORP)	3.82%	TRS Estimate

The breakdown of the funding requirements is estimated, based on covered payroll, as the following:

Total Allocation of Costs to Fund ARC Shortfall in FY 2014
Entire or One-Half Employer Contribution
In Millions

	Entire Employer						
Entitiy	General Fund	SSR	Federal	Local/Other*	Proprietary	Current Unrestricted	Total
State Agencies	$13.9	$10.9	$6.9	$0.0	$1.4	$0.0	$33.1
Local Governments/Community Colleges**	0.0	0.0	0.0	26.0	0.0	0.0	26.0
School Districts	11.1	0.0	5.3	28.5	0.0	0.0	44.9
Montana University System*	5.7	0.0	0.0	0.0	0.0	6.2	11.9
Total	$30.7	$10.9	$12.2	$54.5	$1.4	$6.2	$115.9

	One-Half Employer						
Entitiy	General Fund	SSR	Federal	Local/Other	Proprietary	Current Unrestricted	Total
State Agencies	$7.0	$5.5	$3.5	$0.0	$0.7	$0.0	$16.6
Local Governments/Community Colleges	0.0	0.0	0.0	13.0	0.0	0.0	13.0
School Districts	5.6	0.0	2.7	14.3	0.0	0.0	22.5
Montana University System*	2.9	0.0	0.0	0.0	0.0	3.1	6.0
Total	$15.4	$5.5	$6.1	$27.2	$0.7	$3.1	$58.0

*Does not include funding from non-current unrestricted funds such as research grants and auxilliary funds totaling $5.2 million for entire employer contributoin and $2.6 million for half.
**Community colleges include $11,641 in general fund for the state's PERS and TRS subsidy.
Note: The FY 2014 ARCshortfall costs have been uniformly reduced to eliminate the impacts of participants in the deferred compensation retirement system. The methodology results in small inaccuracies in the cost increases in the allocation of costs among the various funding sources for state government agencies.

State Agencies

The figure to the right shows the approximate breakdown of costs to state government agencies to fund all or one-half of the ARC with employer contributions.

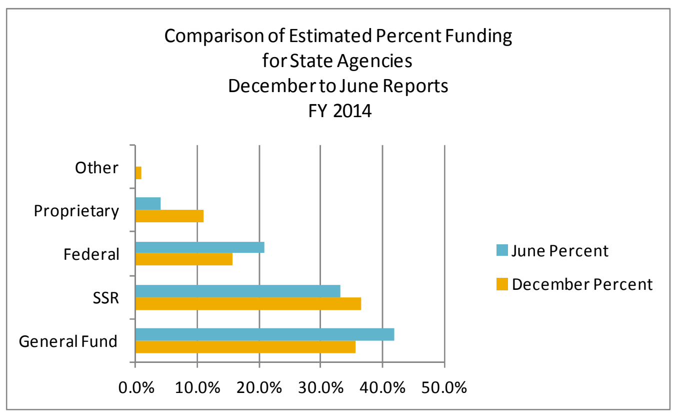
State Agencies Allocation of Costs Funding ARC gap with Employer Contributions FY 2014 In Millions		
Source	Entire Employer	One-Half Employer
General Fund	$13.90	$6.95
State Special Revenue	10.90	5.45
Federal Revenue	6.90	3.45
Proprietary	1.40	0.70
Other*	0.00	0.00
Total	$33.1	$16.6

*Includes a small amount of current unrestricted funds in the Commissioner of Higher Education.
Note: The FY 2014 ARC costs have been uniformly reduced to eliminate the impacts of participants in the deferred compensation retirement system. The methodology results in small inaccuracies in the cost increases in the allocation of costs among the various funding sources.

The breakdown of costs in the December 2011 report, which was based on expenditures in FY 2011, differs in from this analysis for a number of reasons.

- Some state special revenue and/or proprietary funds automatically interact with general fund. Therefore, the increase in funding is shown as coming directly from the general fund. Among the funds in this category are:
  - Lottery proceeds – fund balance reverts to the general fund
  - Liquor revenues – fund balance reverts to the general fund
  - Trust Lands Management Division in the Department of Natural Resources and Conservation – funds deposited to this account are distributable revenue derived from state trust lands, the remainder of which is used in large part to offset general fund in K-12 education and certain state institutions, as well as debt service in the MUS, as directed by statute
  - Insurance and security fee accounts in the Office of the State Auditor – fund balance reverts to the general fund
  - Earmarked alcohol funds – funds are a direct replacement of general fund in several programs
- Certain types of proprietary funds are funded through assessments on other sources of funding either within a single agency or across state government. Therefore, these costs were allocated among those sources, since any increase in those proprietary funds would be funded through additional charges to the other funding sources

The graphic illustrates the approximate change in funding percentages from the December 2011 LFC pension report[4] to the new estimated allocations. In this more detailed analysis, general fund absorbs the additional costs of those funds listed above that interact directly with general fund, and general fund, state special revenue, and federal funds absorb the additional costs of certain proprietary funds.



State Special Revenue (SSR)

The next figure shows the largest state special revenue sources for pension costs. Please note that there are over 250 SSR funds that funded pension contributions in FY 2011. This analysis did not examine each one. However, numerous functions of state government depend in whole or in large part on SSRs for funding, and the actual impact of an increase in employer contribution would vary significantly from function to function.

In determining the final result of the increase in costs to state agencies, an SSR fund may not be able to absorb the entire increase within current expenditures and/or revenue sources. Consequently, additional costs would result in either:

3) Increases in charges to current payers;
4) Reductions in some aspect of operations; and/or
5) Replacement of all or a portion with some other revenue source, including general fund.

[4] http://leg.mt.gov/css/fiscal/LFC-Pensions.asp

In addition, while other funds may be able to absorb this increase within current revenues, there would be an impact on either operations or some other factor.

The following figure shows the largest state special revenue sources. The following highlights the largest.

- Highways special revenue, which is used both for direct expenditures on maintenance and limited construction and as match for federal funds, could absorb the cost and allow the fund to remain within current revenues. However, any additional costs would mean less available for matching federal funds
- The general license account would also be able to absorb the increase. The Department of Fish, Wildlife and Parks (FWP) times its fee adjustments to collect more revenue than expended in the first several years and then draw down the resulting fund balance before requesting a fee increase from the legislature. This increase would hasten the time period for an adjustment in fees but it is not known by how much, as many other factors would influence that decision
- Trust Lands Management Division funding could absorb the increase. However, because funds not used for this purpose primarily offset general fund in K-12 education (with additional offsets in certain state institutions and the MUS), there would be a direct impact on general fund
- The employment security account funds a number of functions in the Department of Labor and Industry. The fund could likely absorb the increase, but would possibly impact the timing of a planned large information system replacement

Major State Special Revenue Sources of Pension Funding
Estimated FY 2014 Costs with Additional Employer Contribution
In Millions**

Source	Entire Employer	One-Half Employer
Highways Special Revenue	$4.77	$2.38
General License (FWP)	1.08	0.54
Trust Lands Management Division* (DNRC)	0.46	0.23
Employment Security Account (DOLI)	0.39	0.20
Workers' Comp Regulation (DOLI)	0.18	0.09
Insurance Fee Account	0.17	0.09
State Parks Miscellaneous (FWP)	0.17	0.08
Building Codes	0.15	0.08
Air Quality Operating Fees (DEQ)	0.14	0.07
Earmarked Alcohol Funds*	0.14	0.07
Natural Resouces Operations	0.14	0.07
Public Service Commission	0.13	0.06
Water Adjudication (DNRC)	0.12	0.06
Livestock Per Capita (DOLI)	0.12	0.06

*Direct general fund impact.
**Includes contributions for defined contribution plans.

Federal Revenue

In FY 2011, federal funds provided almost 14% of total non-MUS pension contributions of state agencies[5]. The following figure shows the largest funding sources.

Key issues in examining federal funds for potential impact are:

6) Is the amount received by the state a set grant amount, or is the amount based upon some other factor such as a percent of total expenditures that will automatically change as state costs change?
7) Have federal funds been sufficient to fund current operations, and have the federal funds been keeping up with other program cost increases?
8) What is the short and long-term outlook for receipt of the funds?

Major Federal Sources of Pension Funding
Estimated FY 2014 Costs with Additional Employer Contribution
In Millions*

Source	Entire Employer	One-Half Employer
Highway Trust Fund	$1.71	$0.86
DPPHS Indirect Activity Program 2	0.39	0.20
Federal Fish and Wildlife Grants	0.41	0.20
Unemployment Administration	0.67	0.34
DPHHS Indirect Activity Program 3	0.35	0.18
DPHHS Child Support	0.26	0.13
Public Instruction (K-12 Education)	0.28	0.14
National Guard	0.25	0.13
Wagner Peyser (Labor and Industry)	0.21	0.10
EPA	0.17	0.09
Medicaid Administration	0.17	0.08
Miscellaneous Federal Funds FWP	0.18	0.09
Employment Training Grants	0.15	0.08

*Includes contributions for defined contribution plans.

[5] The reason for the large discrepancy from total federal funding of state government (about 41% in the 2013 biennium) is because most federal funding is for Medicaid benefits that have no direct personal services funding and for transportation funding, which is primarily expended through contracts.

This analysis does not analyze each federal funding source to determine whether there are serious issues as to availability of funds to absorb an additional pension cost. However, there are several general issue points that will impact numerous agencies. The issue that must be examined on a case-by-case basis is whether, and to what degree, there will be pressure to either reduce service levels or to replace federal funds with general fund or some other state source to maintain service levels.

- The federal highways funding is essentially a set amount. As costs of each project rise due to any increases in personal services, it leaves less money for other projects. The amount of the increase for pensions would be extremely small compared to the total
- DPHHS indirect activity is a charge made to various funding sources within the department. For those charges to Medicaid administration, the funding source will keep up with increased costs as the amount provided is based on a set percentage of allowed expenditures. However, many grants and other federal funding sources in DPHHS are set grant amounts
- Many other federal funding sources are fixed amounts, and therefore the question of whether they can absorb additional personal services costs is questionable and would have to be examined on a case by case basis. In addition, deficit reduction actions on the federal level mean that many federal funds will in fact be reduced from previously anticipated levels, giving rise to further doubt whether the sources would be sufficient and the potential impact on operations

Local Governments

The ARC shortfall rates applicable to local governments and total associated costs are in the figure on the right. This analysis separates political subdivisions from the county data as provided in the December pension report to provide a more accurate cost related to county governments. The cost increases for FY 2014 are based on FY 2011 PERS wage data (excluding participant wages for the defined contribution plan) and are increased by wage growth of 4.25%. Cost increases attributable to political subdivisions will be discussed following the city/town and county analysis.

ARC Increase and Costs

	ARC Increase	FY 2014 ARC Cost
City/Town PERS	5.45%	$7,159,487
County PERS	5.45%	12,650,897
County SRS	4.30%	2,642,628
Political Subdivisions	5.45%	2,507,641
Total		$24,960,654

Note: The FY 2014 ARC costs have been uniformly reduced to eliminate the impacts of participants in the deffered compensation retirement system.

The figure on the following page illustrates the impact to city/town and county governments of increased employer contributions to fund the ARC shortfall for PERS and the Sheriff's Retirement System (SRS). Extrapolating the cost of the ARC to each of these entities based on the 2011 wages, the costs to cities/towns in FY 2014 would be about $7.2 million and the new costs to counties, including the increased costs related to the SRS, would be about $15.3 million in FY 2014. If the costs of the ARC were funded partially (50%) with increased employee contributions, costs to the local governments would amount to approximately $3.6 million for city/towns and the $7.7 million for county governments.

Local governments would have the option of financing the increase with some combination of increased service fees, property tax levies, and/or absorbing the additional cost within existing resources.

- Increased service costs – While there is variation among local governments, as much as 50% of public employee personal service costs in city/town and county governments are funded through service fees, such as water, sewer, and solid waste fees. Such fees may need to be increased to accommodate the increased costs of funding the ARC.
- Property tax increases - If the ARC shortfall[13] was entirely funded with property taxes, by FY 2014 the property taxes for cities/towns would increase by 5.12% and counties by 4.76% when compared to property taxes levied in FY 2011. This analysis is based on averages, so the costs to each community will be different. However, local governments are limited to property tax increases of one-half of the average prior three years' rate of inflation without a vote of the people per 15-10-420, MCA. In FY 2013, local governments will be limited to property tax increases of 1.2%. Under this provision, local governments might need to take property tax increases to the voters for any pension cost increases in excess of the limit.

- o Local governments may be able to absorb some increased cost.

If the cities and counties were unable to absorb the increased costs of meeting the ARC[6] and property taxes are not approved to offset the cost increase, then it is likely that local governments would reduce the public employee workforce.

[6] Actuarial required contribution (ARC) as discussed in this report represents the amount needed on an annual basis stated in term of a percent of payroll to fund estimated benefit accrual for current employees/retirees and pay down the unfunded liabilities over 30 years. The shortfall or gap in the ARC is the difference between current contribution levels and the amount needed to meet the ARC. Note that this ARC definition is based on current GASB guidelines as adopted by the pension boards. The GASB definitions are changing, but do not necessarily impact pension board funding policy.

Local Government Costs to Fund the Arc

Estimated Cost Increase for FY 2014 Compared to Property Taxes Levied in FY 2011

	Total Change in Contributions				FY 2011 Property Tax Increase to Fund Entire ARC	
County Name	City	County	Sheriffs	Total County	City	Total County
Beaverhead	$37,514	$127,543	$22,834	$150,377	4.75%	5.45%
Big Horn	60,556	206,390	37,308	243,698	17.12%	13.02%
Blaine	43,769	129,679	19,739	149,418	9.07%	6.64%
Broadwater	16,160	75,023	32,895	107,918	12.94%	5.24%
Carbon	55,818	141,353	22,280	163,633	5.76%	4.07%
Carter	2,798	37,093	7,099	44,192	4.14%	3.20%
Cascade	933,559	721,995	194,484	916,478	7.00%	5.38%
Chouteau	28,964	109,543	22,159	131,702	5.34%	4.19%
Custer	118,045	123,259	22,882	146,141	8.69%	4.95%
Daniels	11,254	45,120	6,533	51,654	*	3.76%
Dawson	77,907	179,058	80,036	259,094	6.76%	8.25%
Deer Lodge	0	160,740	8,342	169,082	0.00%	7.46%
Fallon	28,562	144,419	14,425	158,844	6.83%	4.24%
Fergus	80,019	137,320	26,486	163,805	5.62%	5.15%
Flathead	640,151	914,718	230,760	1,145,478	6.40%	3.70%
Gallatin	793,920	781,660	217,587	999,247	4.77%	4.25%
Garfield	0	49,035	3,395	52,430	0.00%	3.96%
Glacier	63,069	140,570	34,025	174,595	11.62%	3.40%
Golden Valley	1,208	12,876	3,025	15,900	4.40%	2.57%
Granite	14,351	57,843	12,340	70,182	7.08%	3.38%
Hill	128,711	180,981	39,580	220,560	8.05%	4.48%
Jefferson	14,559	172,481	42,994	215,475	5.32%	5.18%
Judith Basin	2,518	42,135	7,695	49,830	4.96%	3.87%
Lake	8,277	259,025	87,921	346,946	0.52%	3.25%
Lewis & Clark	591,016	822,494	176,837	999,330	6.51%	4.64%
Liberty	12,872	59,255	9,591	68,846	12.11%	4.27%
Lincoln	82,980	254,880	66,404	321,284	13.33%	7.75%
Madison	27,336	303,242	30,284	333,526	6.32%	4.43%
McCone	5,841	50,602	7,470	58,071	3.94%	3.65%
Meagher	7,587	44,283	8,505	52,789	5.62%	3.54%
Mineral	12,117	68,680	15,138	83,818	5.70%	5.22%
Missoula	612,721	1,460,714	294,270	1,754,984	2.49%	5.85%
Musselshell	20,571	67,102	18,133	85,235	9.36%	4.26%
Park	138,805	160,858	48,359	209,217	6.06%	5.16%
Petroleum	2,650	11,230	1,834	13,064	10.49%	6.46%
Phillips	27,384	93,099	17,271	110,370	9.32%	9.56%
Pondera	47,725	75,132	24,211	99,343	12.64%	3.96%
Powder River	8,159	119,532	7,116	126,648	14.84%	9.08%
Powell	26,351	79,078	19,520	98,598	7.54%	4.96%
Prairie	5,551	36,872	5,108	41,980	6.69%	4.76%
Ravalli	97,232	352,088	104,527	456,616	4.63%	4.68%
Richland	78,206	279,564	45,896	325,461	12.75%	6.98%
Roosevelt	68,177	170,947	25,840	196,787	13.32%	4.55%
Rosebud	96,629	145,120	40,404	185,523	0.83%	6.44%
Sanders	35,867	151,930	29,192	181,122	6.73%	5.25%
Sheridan	20,196	127,642	15,547	143,189	4.94%	9.68%
Silver Bow	0	926,337	42,114	968,451	0.00%	4.91%
Stillwater	32,289	129,385	16,237	145,623	4.20%	3.94%
Sweet Grass	15,648	199,061	13,400	212,461	5.53%	7.59%
Teton	26,004	142,842	18,846	161,688	6.77%	7.33%
Toole	47,566	337,293	34,486	371,779	5.69%	13.97%
Treasure	0	23,338	2,454	25,792	0.00%	4.21%
Valley	52,188	124,938	22,970	147,907	5.91%	4.68%
Wheatland	9,706	33,297	14,608	47,905	7.92%	2.70%
Wibaux	5,178	49,072	5,544	54,615	10.26%	9.49%
Yellowstone	1,783,246	801,134	263,688	1,064,822	6.05%	2.78%
Grand Total	$7,159,487	$12,650,897	$2,642,628	$15,293,525	5.12%	4.76%

NOTE: Property Tax Increase is based on dollar changes resulting from the total change in contributions.

*Property tax values for the city/towns in Daniels County were not available at the time of this report.

Political Subdivisions

As defined in Title 2, Chapter 7, part 501, MCA, local governments are allowed to form political subdivisions for special activities. In FY 2011, 110 political subdivisions from 36 counties participated in PERS and have ownership in the unfunded liability. These entities include airport authorities, water/sewer/irrigation districts, and conservation districts, just to name a few. In the figure to the left, political subdivisions are presented by county, but the unfunded liability associated with these entities is not a direct obligation of the county. By FY 2014, the ARC costs are expected to be approximately $2.5 million. Fee based political subdivisions (airports, water, sewer, solid waste) may increase fees and service charges to cover pension costs and with the approval of county commissioners and the voters the entities could levy mills to fund the increased cost. However, if mills are levied, the increases would fall under the property tax increase limitation provisions of 15-10-420, MCA. If the entities are not able to absorb increased costs, service reductions would be required.

FY 2014 Political Subdivision Costs to Fund the Arc
Based on FY 2011 Wages

County Name	Amount
Blaine	$1,664
Cascade	124,460
Chouteau	651
Custer	1,726
Dawson	9,328
Deer Lodge	18,560
Fallon	17,814
Fergus	1,324
Flathead	249,574
Gallatin	134,635
Glacier	2,034
Granite	108,859
Hill	4,128
Judith Basin	687
Lake	14,894
Lewis & Clark	173,738
Liberty	1,537
Lincoln	4,034
Madison	852
Missoula	304,031
Musselshell	583
Park	17,837
Petroleum	3,851
Phillips	21,500
Pondera	35,972
Powell	26,387
Prairie	48,277
Ravalli	24,857
Richland	27,616
Roosevelt	16,770
Sanders	1,704
Sheridan	649
Silver Bow	144,087
Teton	56,819
Treasure	1,361
Valley	13,921
Wheatland	640
Yellowstone	890,278
Grand Total	$2,507,641

Community Colleges

The estimated cost to fund the entire ARC shortfall for the three community colleges located at Glendive, Miles City, and Kalispell is $1.0 million for FY 2014. With the exception of a statutory general fund subsidy of 0.10% for PERS and 2.49% for TRS of covered payroll, each of the community colleges has a mandatory retirement levy that pays for the employer contributions from the current unrestricted portion. The analysis assumes no change in the state subsidy, although the legislature could choose to increase it. The figure below shows the impact on the community college levy if the entire shortfall was funded from that source.

Estimated Mills to Fund 100% Employer Contribution
Community Colleges
FY 2014

Function	Dawson	Flathead	Miles City
ARC Amount	$148,944	$713,750	$166,048
Community College District 2011 Mill Values	16,229	238,940	16,009
Estimated Mills to Fund ARC Shortfall	9.700	3.195	10.711

By County Impact on Property Tax Mils of Increasing
Employer Contributions to TRS and School-Based PERS
Based on FY 2011 Property Tax Data & FY 2011 Contributions

County	Local TRS Contrib.	Local PERS Contrib.	Totals Mils	Net Taxable Value	Inc. Emp. Contrib.	Mils Req.	% Total Mils
Beaverhead	$310,283	$50,241	$538	$18,194,007	$231,723	12.74	2.37%
Big Horn	537,506	121,499	383	24,579,364	399,580	16.26	4.24%
Blaine	307,836	63,073	500	13,115,420	229,271	17.48	3.50%
Broadwater	123,603	16,366	478	12,557,866	86,408	6.88	1.44%
Carbon	494,446	88,803	481	33,864,106	365,523	10.79	2.25%
Carter	51,748	16,857	359	8,515,285	44,786	5.26	1.47%
Cascade	2,149,969	388,156	597	127,613,147	1,567,644	12.28	2.06%
Chouteau	233,518	65,617	560	20,978,920	193,222	9.21	1.64%
Custer	304,664	32,101	719	15,303,726	207,024	13.53	1.88%
Daniels	86,801	23,266	612	5,601,821	72,447	12.93	2.11%
Dawson	390,387	53,594	664	17,257,428	265,312	15.37	2.32%
Deer Lodge	165,393	25,791	582	11,579,290	123,183	10.64	1.83%
Fallon	246,267	50,156	269	25,673,421	190,441	7.42	2.75%
Fergus	479,892	110,644	570	26,006,159	372,167	14.31	2.51%
Flathead	3,892,748	475,426	548	222,869,620	2,746,252	12.32	2.25%
Gallatin	3,568,344	624,967	537	231,512,819	2,547,196	11.00	2.05%
Garfield	57,785	29,099	519	5,367,368	59,138	11.02	2.12%
Glacier	468,616	109,409	630	22,191,765	359,720	16.21	2.57%
Golden Valley	75,245	13,305	460	5,240,410	54,783	10.45	2.27%
Granite	165,596	21,779	528	10,179,643	109,392	10.75	2.04%
Hill	582,117	192,496	524	30,155,927	491,498	16.30	3.11%
Jefferson	408,436	63,126	559	22,630,865	285,518	12.62	2.26%
Judith Basin	127,591	31,055	427	11,304,039	103,972	9.20	2.15%
Lake	1,133,122	189,080	443	67,643,519	805,034	11.90	2.69%
Lewis & Clark	2,290,919	280,758	685	113,247,370	1,429,416	12.62	1.84%
Liberty	88,779	15,403	499	6,958,282	73,601	10.58	2.12%
Lincoln	438,203	54,895	491	31,148,168	267,613	8.59	1.75%
Madison	344,288	78,885	370	71,238,795	259,567	3.64	0.99%
McCone	99,068	14,011	530	7,260,327	75,036	10.34	1.95%
Meagher	85,793	16,159	474	7,728,304	69,581	9.00	1.90%
Mineral	110,675	13,942	621	9,069,452	71,568	7.89	1.27%
Missoula	3,620,549	510,379	696	191,906,342	2,311,706	12.05	1.73%
Musselshell	170,978	42,706	557	10,487,935	136,238	12.99	2.33%
Park	727,301	123,385	516	37,514,573	482,727	12.87	2.50%
Petroleum	28,626	5,004	505	1,635,744	14,867	9.09	1.80%
Phillips	271,236	56,768	392	16,814,958	217,684	12.95	3.31%
Pondera	270,224	39,829	617	13,238,270	173,308	13.09	2.12%
Powder River	222,695	11,494	608	4,677,281	122,751	26.24	4.32%
Powell	148,715	47,678	464	13,298,377	125,197	9.41	2.03%
Prairie	51,790	12,401	581	3,500,480	41,098	11.74	2.02%
Ravalli	973,854	141,247	485	76,673,023	657,630	8.58	1.77%
Richland	540,200	122,415	360	32,003,105	455,355	14.23	3.95%
Roosevelt	497,957	109,279	538	23,725,702	388,881	16.39	3.05%
Rosebud	802,402	189,925	247	95,326,442	610,598	6.41	2.59%
Sanders	530,541	87,320	419	33,293,690	357,594	10.74	2.56%
Sheridan	227,939	57,624	509	10,360,611	185,271	17.88	3.51%
Silver Bow	813,922	146,146	735	49,086,272	537,503	10.95	1.49%
Stillwater	534,633	241,754	448	27,648,945	513,394	18.57	4.15%
Sweet Grass	267,698	31,958	463	13,484,226	142,866	10.60	2.29%
Teton	292,420	45,056	562	15,732,534	211,309	13.43	2.39%
Toole	274,345	59,252	480	18,911,919	218,994	11.58	2.41%
Treasure	47,229	0	459	3,945,047	26,296	6.67	1.45%
Valley	453,470	110,252	522	23,743,249	348,493	14.68	2.81%
Wheatland	141,004	18,611	419	13,341,396	92,388	6.92	1.65%
Wibaux	64,792	11,744	411	3,692,447	50,199	13.60	3.31%
Yellowstone	6,198,830.56	749,586.20	600.57	283,362,738.00	3,587,014.12	12.66	0.02
Total/Average	$37,992,984	$6,301,768	513.39	$2,253,991,939	$26,166,978	11.61	2.26%

School Districts

As shown in the next figure, the estimated increase in costs to school districts of an increase in PERS and TRS is $44.9 million in FY 2014. Retirement costs in school districts are funded from three main sources:

1) Federal funds (about 11.9% of the total)
2) County mill levies with guaranteed tax base (GTB) from the state
3) Direct statutory appropriation of 0.37% and 2.49% of covered payroll for PERS and TRS, respectively

Costs to School Districts to Fund the ARC Shortfall
Employer Contributions, Only
In Millions

Fund Source	FY 2014	FY 2015
General Fund	$11.1	$11.6
Federal Fund	5.3	5.6
County Levies	28.5	29.7
Total	$44.9	$46.9

For purposes of this report, no increase in the statutory appropriation was assumed. However, the legislature could change the statutory appropriation to provide more direct general fund for this purpose.

If school levies are used to fund the entirety of the increase in employer contributions, with a continuation of the statutory state GTB payment, the allocation of the total is on the previous page.

Montana University System

The total additional pension contribution for the Montana University System is approximately $36.2 million for the 2015 biennium.

This total is approximately $2.0 million less than the December 2011 estimate. The December 2011 estimate assumed higher compensation growth in FY 2012 and FY 2013 than what the MUS has estimated will actually occur. This resulted in higher estimated salaries, and therefore higher estimated retirement contribution costs.

Of the additional $36.2 million, approximately 70% of the cost, or $25.5 million, is in the current unrestricted fund, which is the fund in the university system where the state general fund, tuition revenue, and six mill levy are deposited and expended.

- Funding this additional cost would likely be from either the state general fund or tuition rate increases, as the six mill levy is entirely determined by the collections
- If the general fund were to contribute 47% of the total current unrestricted fund, which is the percentage used by the 2011 Legislature, the general fund total would be $12.1 million over the biennium
- If tuition rates were to fund the entire current unrestricted portion of the increase, rates at the university units would need to increase approximately 4.0% each year of the 2015 biennium to generate sufficient additional revenue to cover the potential cost increase. The increase if tuition funded 53% of the total would require a 2.1% increase each year

Section 19-21-101, MCA authorizes the Board of Regents to establish a defined contribution plan for faculty and professional staff hired under a Board of Regents contract. This plan is known as the MUS Optional Retirement Plan (ORP). All new faculty and professional staff hired are now required to belong to the defined contribution plan. However, at the time the plan was implemented in the late 1980's, employees in these positions were allowed to choose to stay in the defined benefit retirement systems (originally just TRS) or switch to the ORP plan. In order to compensate TRS and later PERS for those employees that switched to ORP, the MUS pays a "supplemental contribution" to TRS and PERS of 4.72% and 2.68%, respectively. These employer contribution rates are assumed to increase for the ARC shortfall discussed in this report.

Scenario 3: State General Fund

Scenario 3 would require an annual and growing payment from the state general fund to the pension systems for 30 years. This could be a direct payment from the general fund or a revenue diversion from specific potentially growing revenue source. This idea was proposed in HB 632 from the 2011 session - -"Use spendable portion of coal severance tax to pay down UAL in PERS, TRS, SRS, GWPORS". The ongoing amount of general fund required by this scenario would be approximately $118 million in FY 2014 and $126 million in FY 2015. Alternatives could include one-time payments to complement general fund or other ongoing sources.

Scenario 4: Reduction in GABA

Scenario 4, a reduction in GABA, would have no impact on state or local funding since all of the impact would fall to employees and retirees.

Scenario 5: Defined Contribution Plan

If the legislature opts to close the defined benefit plan to new members and have new employees enter a defined contribution plan, the need to fund the unfunded liability in the defined benefit plans will continue. Employer contribution rate increases described in scenarios 1 and 2 would be an option for funding the current unfunded liability.

If the legislature chooses to provide additional funding to address the unfunded liability through employer contributions the impacts would be proportional to those impacts shown in scenarios 1 and 2. For example, if the legislature chose to fund PERS unfunded liability with a 10% employer contribution rate increase, the impacts could be estimated by considering the impacts shown in Scenario 1 divided by 5.45%, the ARC gap increase calculated by the actuaries (shown on page 41), and multiplied by 10%.

Without knowing the specific recommendations of the legislature for funding the unfunded liability the precise funding requirements are unknown. Any specific recommendation can be calculated at the time of the proposal.

APPENDIX E

GENERAL FUND STATUTORY APPROPRIATIONS

The legislature has authorized 30 general fund statutory appropriations for various purposes.

Twelve statutory appropriations transfer money to state and local retirement funds. The amount of these appropriations is estimated to be $98.4 million in the 2013 biennium and $106.2 million in the 2015 biennium.

Four statutory appropriations provide funding for various economic development projects. The cost in the 2013 biennium is estimated to be $6.1 million and $12.1 million for the 2015 biennium. The latter biennium costs are greater due to legislation that restores the appropriations to the original fiscal 2010 amounts.

There are 14 other various statutory appropriations that fund county attorney salaries, emergencies, local governments, Board of Investment banking charges, debt service payments, and others. The largest of these are the amounts appropriated to local governments, estimated to be $212.3 million in the 2013 biennium and $234.9 in the 2015 biennium. Payments to local governments in these biennia have increased due to enactment of SB 372 by the 2011 Legislature. The legislation reduces taxation of class eight properties and provides reimbursement for lost revenue at the local level through additional payments to local governments. HB 495 enacted by the 2011 Legislature changed the methodology for calculating the growth in the amount of base payments to local governments beginning FY 2014. The calculation incorporates revenue collections from various sources over the previous three and two year periods.

GENERAL FUND NON-BUDGETED TRANSFER

The legislature has authorized 16 on-going transfers of general fund for various purposes. The amount of these transfers is estimated to be $32.4 million in the 2013 biennium and $22.9 million in the 2015 biennium. The largest of these transfers is to address the shortfall in the old state fund estimated to be $21.5 million in the 2013 biennium and $11.1 million in the 2015 biennium.

General Fund Statutory Appropriations
In Millions

	FY2012	FY2013	FY2014	FY2015
Retirement	$48.198	$50.218	$52.093	$54.092
Economic Development	3.065	3.065	6.065	6.065
Local Assistance	102.738	115.255	113.988	127.500
Other	31.442	27.500	27.575	25.937
Total	$185.443	$196.038	$199.720	$213.594

General Fund Transfers
In Millions

	FY2012	FY2013	FY2014	FY2015
Vehicle/Other Transfers	$4.761	$4.778	$5.094	$5.150
Local Assistance	$0.427	$0.708	$0.600	$0.816
Other Transfers	11.432	10.247	6.131	5.117
Total:	$16.620	$15.734	$11.826	$11.082