

DATE: March 6, 2015

TO: House and Senate Tax Members
House Appropriations Members
Senate Finance and Claims Members

FROM: LFD Revenue Team

RE: FY 2015 General Fund Revenue Update #3

PURPOSE OF REPORT

This is the third of six monthly revenue updates throughout second half of FY 2015 designed to apprise interested members of the legislature on year-to-date general fund revenue collections, recent economic trends and the outlook for FY 2015 relative to the revenue estimate contained in HJ 2.

SUMMARY

General fund revenue collections are \$119.4 million or 9.7% ahead of FY 2014 amounts, and are currently above the overall growth estimate contained in HJ 2. The change from last month's report is primarily due to changes in individual income tax and vehicle taxes & fees.

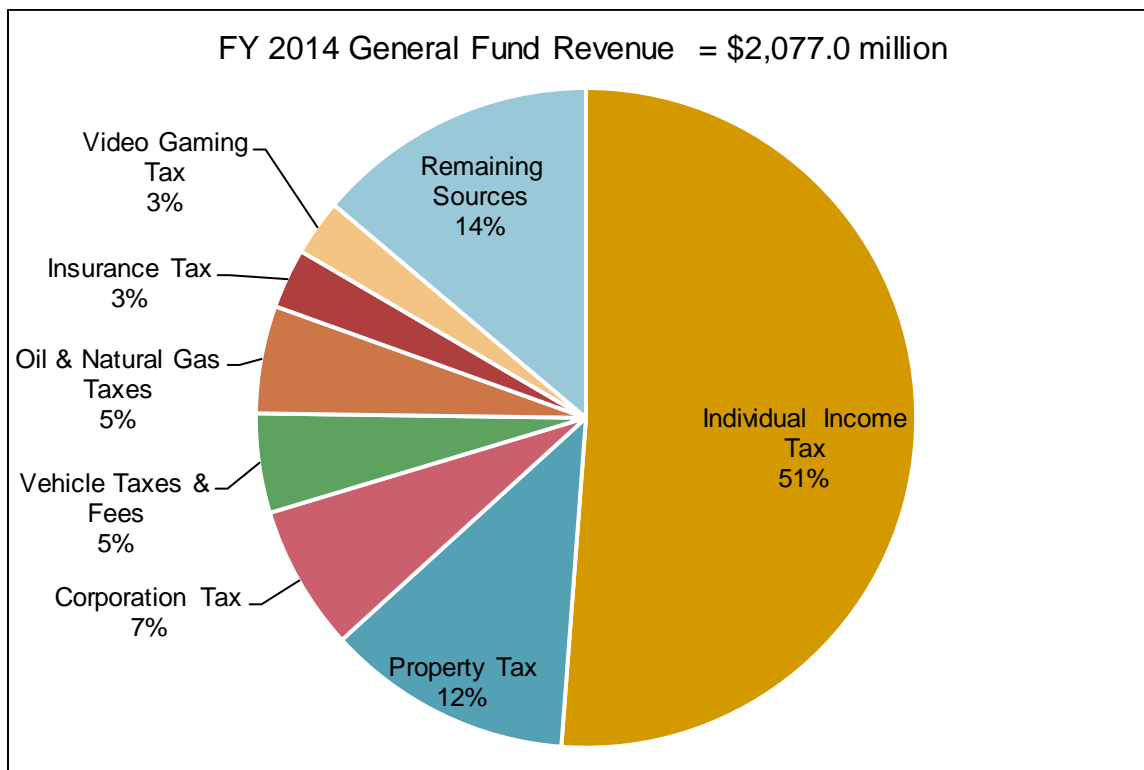
YEAR-TO-DATE GENERAL FUND REVENUE

FY 2015 general fund revenues through the end of February are \$119.4 million or 9.7% ahead of FY 2014 revenues through the same period; this increase is above the HJ 2 estimated growth of 2.7%. All major revenue sources and any other sources with significant differences will be discussed in further detail in the following sections.

General Fund Revenue Monitoring Report (\$ Millions)							
Revenue Source	Actual FY 2014	HJ 2 Est. FY 2015	HJ 2 Est. % Change	2/28/2014 FY 2014	2/28/2015 FY 2015	YTD Difference	YTD % Change
Largest Seven Sources							
Individual Income Tax	\$1,063.284	\$1,108.333	4.2%	\$746.664	\$806.899	\$60.234	8.1%
Property Tax	250.344	249.834	-0.2%	136.313	140.960	4.648	3.4%
Corporation Tax	147.548	157.683	6.9%	68.539	104.929	36.390	53.1%
Vehicle Taxes & Fees	101.088	102.290	1.2%	55.362	62.641	7.279	13.1%
Oil & Natural Gas Taxes	109.606	95.233	-13.1%	29.201	26.182	(3.020)	-10.3%
Insurance Tax	60.873	63.928	5.0%	21.191	27.982	6.792	32.0%
Video Gaming Tax	57.147	60.423	5.7%	27.980	29.537	1.556	5.6%
Other Business Taxes							
Drivers License Fee	4.051	4.397	8.6%	2.513	2.854	0.340	13.5%
Investment Licenses	7.115	7.257	2.0%	6.557	6.209	(0.347)	-5.3%
Lodging Facilities Sales Tax	17.725	19.169	8.1%	10.210	11.201	0.991	9.7%
Public Contractor's Tax	0.887	2.817	217.6%	1.609	3.640	2.031	126.2%
Railroad Car Tax	2.418	3.641	50.6%	1.690	2.842	1.152	68.2%
Rental Car Sales Tax	3.521	3.749	6.5%	2.179	2.348	0.169	7.8%
Retail Telecom Excise Tax	19.657	20.186	2.7%	9.009	8.656	(0.353)	-3.9%
Other Natural Resource Taxes							
Coal Severance Tax	14.745	15.427	4.6%	7.684	8.712	1.029	13.4%
Electrical Energy Tax	4.280	4.721	10.3%	2.016	2.561	0.545	27.1%
Metal Mines Tax	7.948	8.004	0.7%	0.510	0.390	(0.120)	-23.6%
U.S. Mineral Leasing	27.744	26.888	-3.1%	13.277	16.252	2.975	22.4%
Wholesale Energy Trans Tax	3.112	3.652	17.4%	1.470	1.948	0.478	32.6%
Other Interest Earnings							
Coal Trust Interest Earnings	21.996	20.473	-6.9%	10.926	10.833	(0.093)	-0.9%
TCA Interest Earnings	1.756	1.605	-8.6%	1.117	1.168	0.051	4.5%
Other Consumption Taxes							
Beer Tax	3.023	3.110	2.9%	1.825	1.804	(0.022)	-1.2%
Cigarette Tax	30.623	30.363	-0.8%	19.375	18.753	(0.623)	-3.2%
Liquor Excise Tax	18.418	19.086	3.6%	11.020	11.418	0.398	3.6%
Liquor Profits	10.500	10.744	2.3%	-	-	-	-
Lottery Profits	12.091	12.596	4.2%	3.068	2.555	(0.513)	-16.7%
Tobacco Tax	5.929	6.235	5.2%	3.597	3.640	0.043	1.2%
Wine Tax	2.250	2.299	2.2%	1.369	1.406	0.037	2.7%
Other Sources							
All Other Revenue	37.320	39.492	5.8%	25.343	22.897	(2.446)	-9.7%
Highway Patrol Fines	4.142	4.224	2.0%	2.325	2.249	(0.076)	-3.3%
Nursing Facilities Fee	4.961	4.859	-2.1%	2.475	2.404	(0.071)	-2.9%
Public Institution Reimbursement	17.298	17.123	-1.0%	6.775	6.763	(0.012)	-0.2%
Tobacco Settlement	3.646	3.176	-12.9%	-	-	-	-
Largest Seven Subtotal	1,789.890	1,837.724	2.7%	1,085.250	1,199.130	113.880	10.5%
Remaining Sources Subtotal	287.155	295.294	2.8%	147.939	153.503	5.564	3.8%
Grand Total	\$2,077.044	\$2,133.018	2.7%	\$1,233.189	\$1,352.632	\$119.444	9.7%

MAJOR SOURCES

In FY 2014, the largest seven revenue sources accounted for just over 86% of total general fund revenue. This section will highlight current trends with each source and further revenue detail if applicable.



Individual Income Tax: Above Estimate Primarily Due to Strong Withholding

Individual income tax collections are \$60.2 million or 8.1% above last year, and above the anticipated growth of 4.2% contained in HJ 2. Total growth was driven by withholding tax collections' continued growth of 8.1% over last year. There was a payment of \$9.3 million that was mistakenly posted to the mineral royalties withholding account that should have been posted to the oil and natural gas clearing account; this correction will be shown in the March year-to-date report. Accounting for this correction in the table below would result in mineral royalties decline of 12.8%, and total growth of \$50.9 million or 6.8% above this time last year.

Individual Income Tax (\$ Millions)				
	YTD 2015	YTD 2014	\$ Difference	% Difference
Withholding	\$558.9	\$517.2	\$41.8	8.1%
Estimated Payments	171.7	157.6	14.1	9.0%
Current Year Payments	21.3	23.8	(2.5)	-10.6%
Audit, P&I, Amended	22.9	21.1	1.7	8.3%
Refunds	(124.1)	(118.0)	(6.0)	5.1%
Refund Accrual Reversal	132.6	129.1	3.5	2.7%
Partnership Income Tax	4.7	5.0	(0.3)	-5.5%
Mineral Royalties	18.9	10.9	7.9	72.9%
Total	\$806.9	\$746.7	\$60.2	8.1%

According to the Department of Revenue, as of the end of February, the total number of individual income tax returns processed in FY 2015 is 0.7% below the level of FY 2014, the number of refunds issued is about 3.6% below the FY 2014 level, and the average refund is 0.8% below that of FY 2014.

The department is continuing a thorough review of returns that have been stopped for potential fraud. As of the end of February, there were roughly 5,100 returns with a total amount of \$3.2 million; according to the department, some of this amount would also have been stopped—both this year and last year—for routine edits, and in total shouldn't have much of an impact on year-to-date comparisons.

Property Tax: Above Estimate Due to Late Payment Last Year

Property tax collections are above last year by \$4.6 million or 3.4%, and above the decline of 0.2% anticipated in HJ 2. This has primarily to do with comparing year-to-date. This time last year there was a missing payment from Ravalli County of \$4 million, this should be corrected by next month. Total collections are still expected to decline slightly from FY 2014 due in large part to decreases in class 8 business equipment property as the result of [SB 96 \(2013 Session\)](#) as well as changes in federal forest payments.

Corporation Income Tax: Above Estimate Primarily Due to Large Audit

Corporation income tax collections through the end of February are \$36.4 million or 53.1% above last year, and above the anticipated growth of 6.9% contained in HJ 2. Much of the increase is driven by a large audit collection.

Corporation Income Tax (\$ Millions)				
Account	YTD 2015	YTD 2014	\$ Difference	% Difference
Corporation Tax	\$13.7	\$8.3	\$5.4	65.3%
Estimated Payments	72.8	64.1	8.7	13.6%
Refunds	(14.2)	(14.7)	0.5	-3.3%
Refund Accrual Reversal	8.1	5.6	2.5	44.0%
Audit, P&I, Amended	24.5	5.2	19.3	371.2%
Total	\$104.9	\$68.5	\$36.4	53.1%

Vehicle Fees & Taxes: Above Estimate

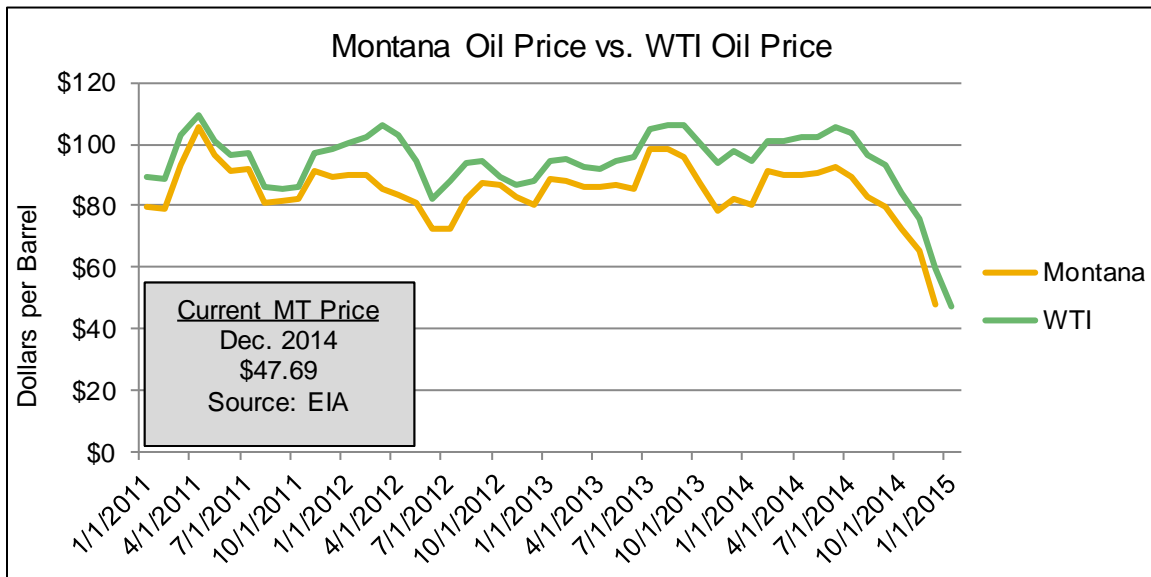
Vehicle taxes and fees through the end of February are 13.1% above collections from last year. The HJ 2 estimate assumed a growth of 1.2%. The increase was driven by extremely strong light vehicle registration growth in February.

Oil & Natural Gas Production Tax: Starting to Decline

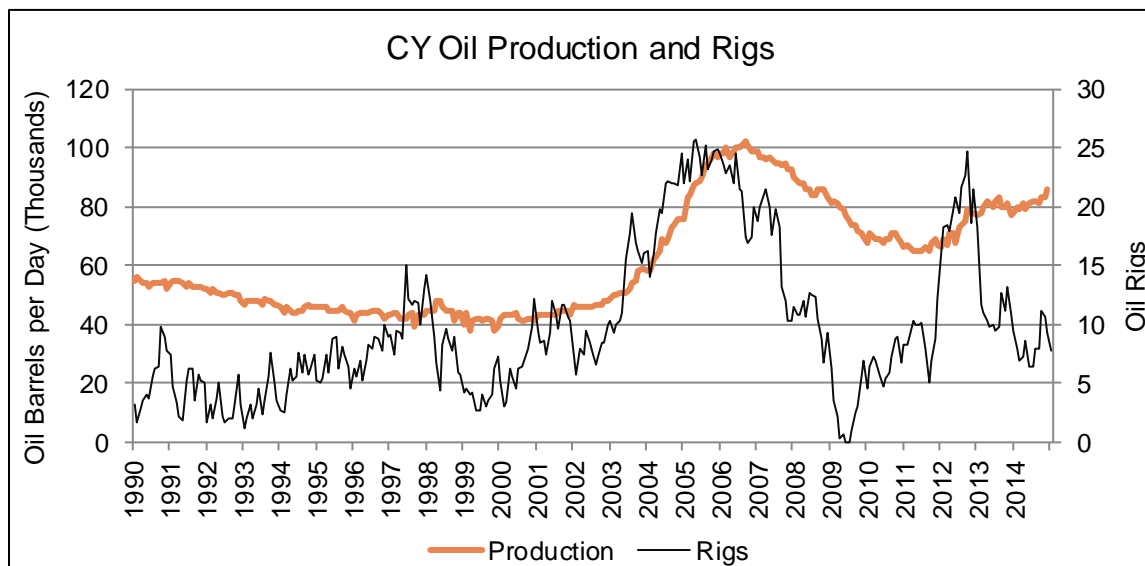
Oil and natural gas production tax collections are down \$3.0 million or 10.3% below this time last year. While this is a significant decline, this represents the first quarter of FY 2015 when oil prices first started dropping. Thus it likely represents stronger collections that are expected in subsequent FY 2015 quarters.

One issue that often comes up is the CO2 injection project at Bell Creek. While final CY 2014 numbers are not yet in, preliminary data suggests that after dropping 57 thousand barrels from CY 2012 to CY 2013, production in the Bell Creek field increased by 250 thousand barrels to 550 thousand total barrels. This is a near doubling in the Bell Creek field. The addition represents around 0.9% of the total state oil production.

Price reductions remain the big story. The following chart shows monthly average price for Montana. Although it has a two to three month lag, it clearly illustrates the relationship between WTI and Montana oil prices. During the month of February 2015, WTI has been close to \$50 a barrel.

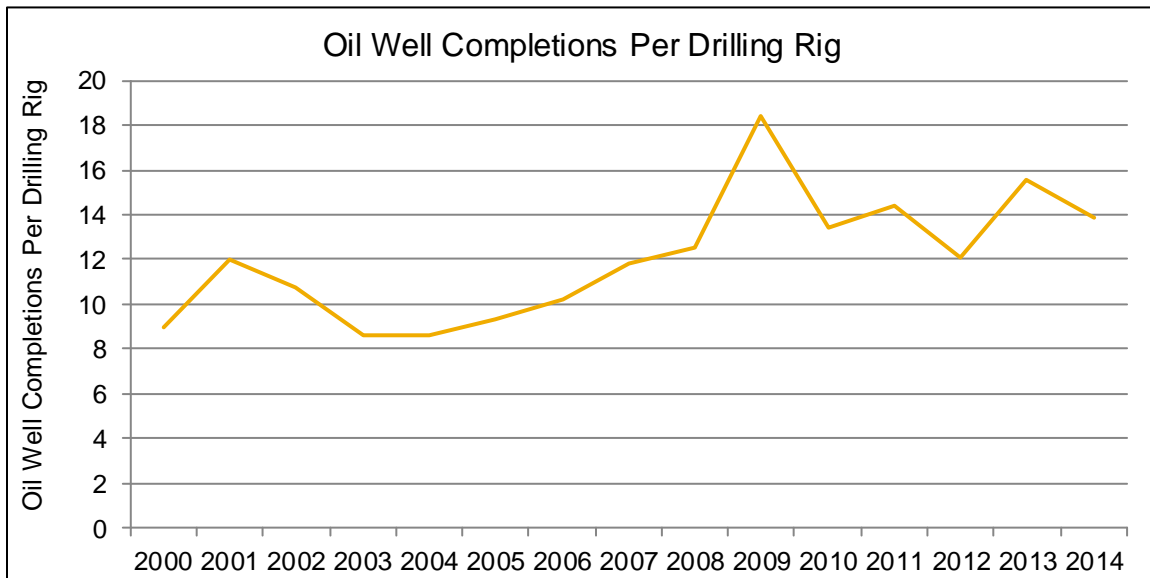


Production has remained fairly stable, with a slight uptick in the past few months. Rigs, however, continue to decline; as of the beginning of March, there were three rigs operating in the state. Rigs in the chart below are shown as monthly averages. Note that about an average of 10 rigs has resulted in a relatively stable production of around 80 thousand barrels per day since CY 2013.



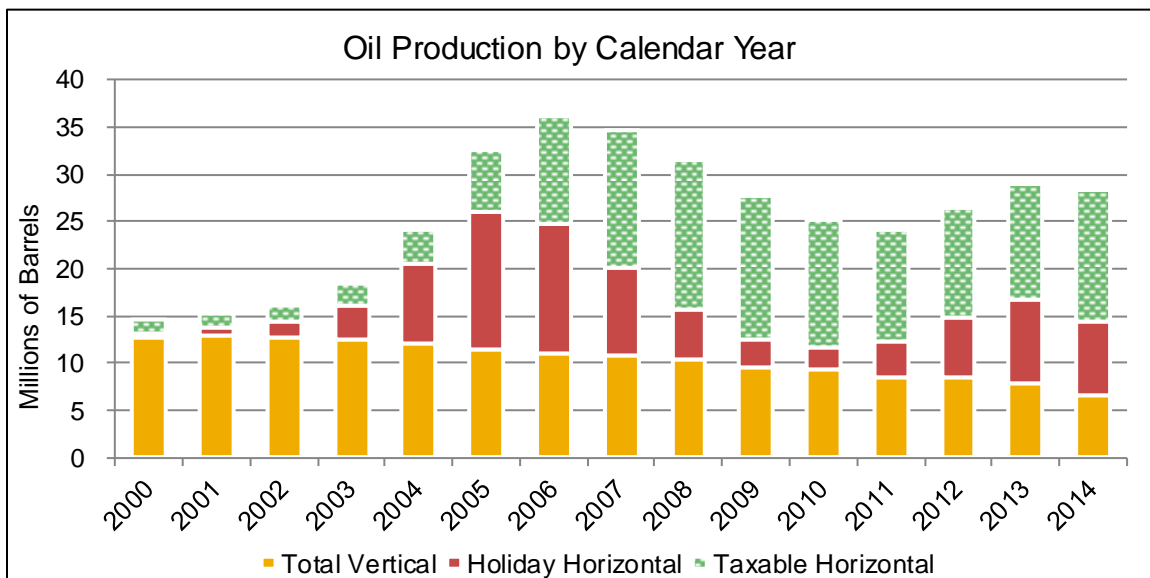
Source : Rigs-Baker Hughes / EIA

The average number of oil well completions per drilling rig has increased since 2010 as compared to the 2000-2008 period, going from around 10 well completions per rig to 14. There are a number of problems with this data as there are timing issues with the completions versus average yearly rigs; the spike in 2009 for example has more to do with the drop in rigs that year than real productivity gains. There is also the issue of other wells being drilled, such as gas wells. As Baker Hughes primarily tracks the large rigs that do the horizontal drilling and there have been very few gas wells drilled since 2011, the general increased productivity of 10 wells per rig going to 14 wells per rig seems to be a good assumption.



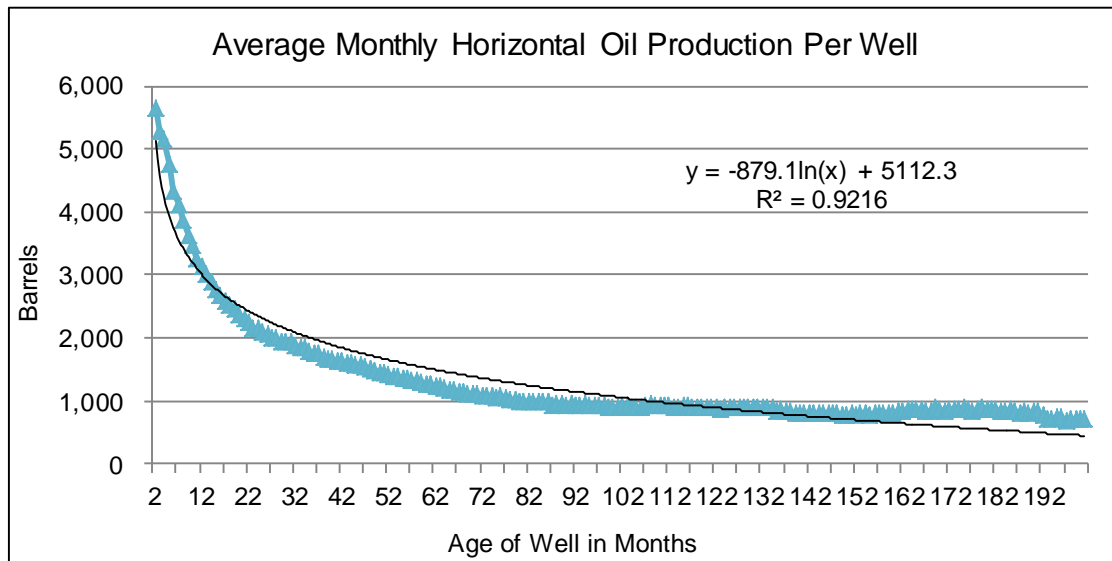
Source : Baker Hughes / MT Board of Oil and Gas

Horizontal holiday, non-holiday, and total vertical oil production is shown in the chart below. Horizontal holiday production decreased from CY 2013 to CY 2014. Vertical well oil production continues the decline that has been happening for years.



Source : MT Board of Oil and Gas

Through the first 18 months of the average well, constructed from averaging all horizontal wells, holiday production accounts for 19.95% of the total using a well life of 260 months.



The observed decline corresponds well with the fitted line which has the first 18 months representing 20% of total production, as shown in the equation below:

$$\frac{\int_1^{18} [-879.1 \ln(x) + 5112.3] dx}{\int_1^{260} [-879.1 \ln(x) + 5112.3] dx} = 20.0\%$$

Video Gaming Tax: Slightly Below Estimate

Revenue from video gambling is currently \$1.6 million or 5.6% above collections from last year. In HJ 2, FY 2015 video gambling revenue was forecast to grow by 5.7%, so this seems to be tracking well.

Insurance Tax: Above Estimate due to Last Year's Timing Issues

Current insurance tax collections are 32.0% or \$6.8 million above FY 2013 year-to-date. At this time in FY 2014, no revenue had been realized from either the HCSC buyout of BCBS or additional policies purchased in accordance with the ACA. Some of that calendar year 2013 revenue was paid in April 2014 in addition to that quarter's expected payments. That additional lump sum was around \$5.0 million; accounting for that payment would put collections almost exactly in line with the estimate.

OTHER KEY DIFFERENCES

Public Contractors' Tax: Lower-than-Estimated Growth due to Volatility

Public contractors' tax collections are \$2.0 million or 126.2% above last year, though still below the anticipated growth of 217.6% contained in HJ 2. There can be a significant time lag between the date of the contract and the reimbursement of the tax through credits or refunds, so large fluctuations in public construction projects have produced unusual future collection patterns in the past. At this time, the Department of Revenue is caught up with processing and anticipates an average time lag of 45 days.

Railroad Car Tax: Potential Timing Issue; Likely on Track with Estimate

Railroad car tax is up \$1.2 million or 68.2% compared to this time last year. There are likely some timing issues with this as it was estimated from tax bills that railroad car tax will be up 50.6% this year.

Coal Severance Tax: Strong Growth Due to Distribution Change

General fund collections for coal severance tax are \$1.0 million or 13.4% above year-to-date collections from FY 2014. The main reason for this is a distribution change that occurred at the end of the first quarter of FY 2014. The Coal Natural Resource account had been receiving 5.8% during this period in FY 2014 but only received 2.9% in FY 2015, the remainder diverted to the general fund. The year-to-date difference last month was 19.8% compared to this month's 13.4%, due to the distribution shift in the first quarter only, this year-to-date percentage difference is expected to continue to decline.

U.S. Mineral Royalties: Above Estimate, Likely Timing Issue

Through January, U.S. mineral royalties are 22.4% or \$3.0 million above last year. The HJ 2 estimate is expected to have negative growth of -3.1%. This seems to be a timing issue due to no payment being recoded in February of 2014.

All Other Revenue: Below Estimate, Due to Held Payment Last Year

Through February, all other revenue is 9.7% or \$2.4 million below last year. This is below the HJ 2 estimate of a growth of 5.8%. The decrease is due to a Ravalli County tax payment of \$4.0 million which was held in an all other revenue account in February of 2014. In next month's update this amount will not be included in the year-to-date comparison, likely bringing collections higher than this time last year.