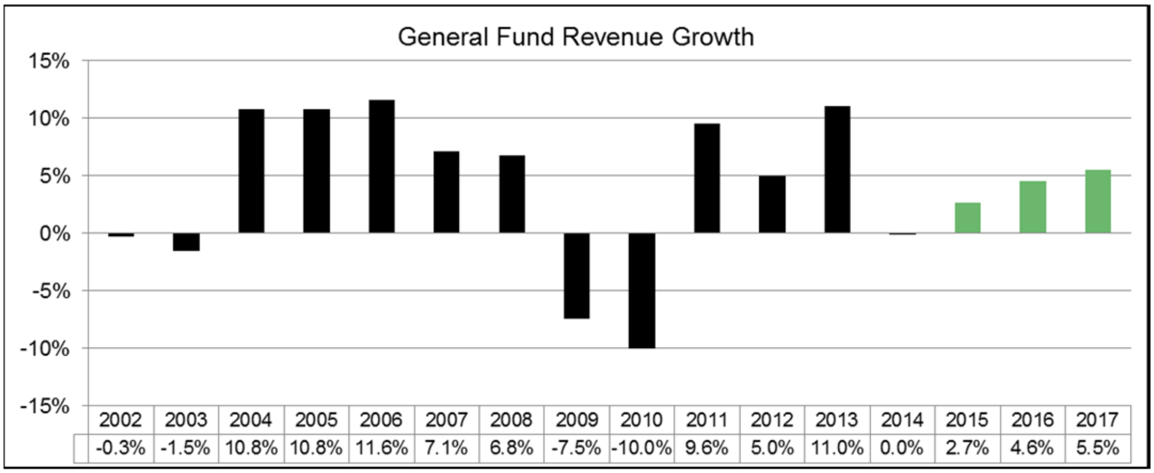
RISKS AND PRESSURES

This section builds on the previously discussed concept of managing volatility of the general fund through structural balance and ending fund balance. It includes issues of evaluating the inherent risk of the budget adopted and significant other funds' financial health. Financial pressure in other funds could put additional pressure on the general fund, decrease current services, or require additional revenue.

Revenue Volatility

General fund revenue growth has varied in the past 12 years from +11.6% to -10.0%. Revenue growth contained in HJ 2 ranges from 2.7% to 5.5%. While new statistical techniques are have been implemented to minimize the errors, not enough data exists to calculate prediction intervals from these new techniques. Previous experience is captured in the [Managing Volatility Report](#).



Fire Fund Impact on Inherent Financial Risk

The fire suppression account has an estimated FY 2015 ending fund balance of $42 million and adequate revenue flows into the fund to maintain this ending fund balance over time. This fund provides a buffer to the general fund from cost shocks due to emergency wildland fire costs. The adjacent table summarizes the anticipated average revenues and expenditures of the fund.

Biennial Average Revenues and Expenditures
Wildland Fire Suppression Fund
(in Millions)

	Biennial
Biennial average fire costs	($44.5)
Biennial allowed expenditures for forest health	(5.0)
Biennial transfers from reversions exceeding 0.5%	53.2
Biennial transfers from Governor's Emergency Statutory Appropriation	6.5
Potential average biennial growth in fund balance	$10.2

The [Managing Volatility Report](#) demonstrated that while revenue volatility is the most variable source of risk to the general fund, wildland fire is the next largest source of risk to the budget. The biennium with the greatest expenditure shock was the 2007 Biennium and accounted for 2.4% of general fund expenditures, of which 1% was attributed to fire suppression. On average, fire suppression costs account for 62% of the expenditure volatility or about 1% of biennial general fund spending. Removing this 1% risk reduces the maximum amount of ending fund balance needed to manage risk.

Expenditure Estimate Error or Supplemental

Along with the risk that revenue estimates and fire costs can cause financial stress, so can errors in expenditure estimates. Estimates are used to develop several large appropriations; when required expenditures are greater than the appropriations, a shortfall occurs and the agency must request a supplemental appropriation. Examples of expenditure estimates include caseloads for foster care, Medicaid benefits, Health Montana Kids benefits, prison populations, and student enrollment in school districts.

Pensions

The legislature passed pension funding bills in the 2013 session that included a reduction in the Guaranteed Annual Benefit Adjustment (GABA) for the Teachers' Retirement System (TRS) and Public Employees' Retirement System (PERS). Since last session, lawsuits have been filed and preliminary injunctions have been granted to at least temporarily eliminate the reductions in the GABA. The June 30, 2014 Actuarial Valuations (PERS and TRS) became available in October of 2014. In these studies, the funding levels of both large systems do not exceed the actuarial recommended funding period of 30 years even if the GABA reduction does not occur.

Pension systems in Montana still continue to have significant but declining unfunded liabilities. If the lawsuits succeed, the unfunded liability totals $3.8 billion. These unfunded liabilities are a legal liability of the state and participating local government employers. The unfunded liabilities as measured by the actuaries of the systems are shown on the right.

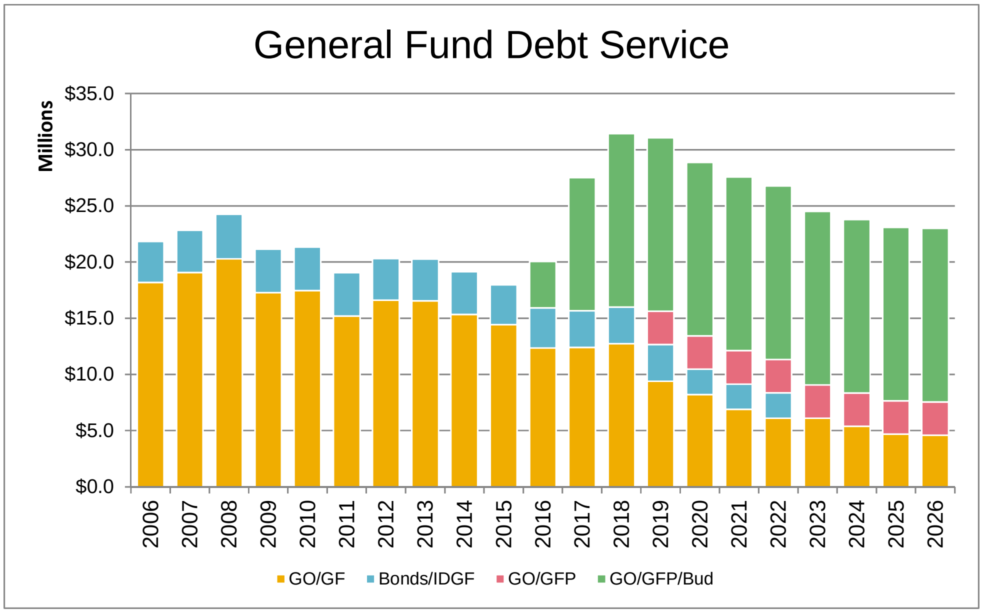
Montana Pension Systems Valuation June 30, 2014		
	Funded Ratio	Years to Amortize
Teachers Retirement System (TRS) prior GABA	65.5%	28.0
Public Employees Retirement (PERS) prior GABA	74.4%	29.3
Judges' Retirement System	155.1%	-
Highway Patrol	63.9%	30.3
Sheriffs' Retirement	81.3%	Does not amortize
Game Wardens	83.7%	Does not amortize
Municiple Police Officers	63.0%	19.6
Firefighters Unified Retirement System	71.8%	11.3
Volunteer Firefighters	82.4%	5.1

Actuarial analysis includes many assumptions that may or may not hold true in the long run. While annual valuations are a good estimate of current funding condition, if the assumptions do not hold true, the funding condition will change.

Moody's Investor Services studies and compares state liabilities. Montana ranks 20th highest out of 50 in Moody's calculated liabilities as a percent of state government revenues. A summary of the report is available at www.moodys.com or directly at this link: State pension liability levels improve in FY 2013. The full Moody's report is available in the office of the Legislative Fiscal Division.

Debt Service

Like pensions, debt is a long term liability with a payment stream. Outside of pensions, Montana's debt liability is relatively low and unless additional bonds are approved, the payment streams will decrease overtime. According to Standard and Poor's, the state of Montana ranks 48th in their ratings for long-term tax supported debt. The ranking is consistent for total and per-capita debt amounts and as a percentage of personal income and GSP. The following table illustrates current debt service and the Governor's requested budget for debt service.



- Yellow GO/GF – General obligation (GO) bonds paid by the general fund. The bond issues related to this debt service primarily funded the construction of state government buildings

- Blue Bonds/IDGF – This category includes GO bonds and special revenue bonds that are paid indirectly through the general fund. The related bond issues include state building energy conservation bonds and revenue bonds for two of the state's hospitals that offset general fund revenue through institutional reimbursements that would otherwise flow into the general fund.

- Pink GO/GFP – This category includes the projections for debt services costs on authorized but unissued bonds. Included in this category are two issues that cover the state's share of the costs of two tribal compacts, the state's share of the St. Mary's diversion structure repairs, and the remaining authority available for the Montana Heritage Center. For the purpose of this analysis, it is assumed that 20 year bonds would be issued for each of the items in the spring of FY 2017. Given the need for federal action for both the compacts and the St. Mary's project, this schedule may be ahead of actual issuance.

- Green GO/GFP/Bud – This category illustrates the Governor's 2017 biennium budget proposals for general obligation bond issues. This includes an assumption that the $185.6 million of Build Montana bonds will be issued half in October 2015 and half in October 2016. Additionally, this category includes $15.0 million of broadband infrastructure bonds that would be issued in October 2015.

In the 2017 biennium, without the executive's bonded budget proposals, the debt service paid directly and indirectly through general fund revenues is expected to average $15.8 million per year. The Build Montana and broadband infrastructure proposals in the executive budget are estimated to increase the general fund debt service by $4.1 million in FY 2016 and $11.8 million in FY 2017. It is expected that the full annual cost of the proposals will be $15.4 million per year in the future.

Other Fund Balances

Funds outside the general fund may cause pressure on the general fund or other taxes or fees. Examples of other fund pressures include:

- The Water Court state special funding is insufficient to pay for the full adjudication of water rights. The executive proposes to transfer general funds to the adjudication account to cover the shortage of approximately $4.1 million.
- The General License Account in Fish, Wildlife and Parks is under pressure for funding, the executive proposes to raise hunting and fishing fees by approximately $6.0 million per year.
- Gas Tax funds that flow into the highway restricted fund are insufficient to support the increasing cost of services, such as highway construction and maintenance and highway patrol, and for the past four years the expenditures from the highway restricted fund have exceeded the revenues going into it. There are currently no executive proposals to address this structural imbalance.

Executive Proposal

Overall, the primary methods the Governor proposes to manage risk are contained in the general fund ending fund balance and structural balance recommendations. The executive budget request includes proposals for additional bonding as shown in the above section on debt service.

The Governor is requesting supplemental appropriations for the 2015 biennium totaling $31.6 million general fund. Of this amount $13.4 million is requested to increase the fund balance for the Risk Management and Tort Defense Program.

Legislative Options

The Legislature could maintain higher or lower ending fund balance based on the legislative tolerance for the risk associated with budget volatility. Structural balance of the budget is the general recommendation for budgets. The legislature may wish to contemplate specific consideration of the CHIP FMAP discussed in the introduction relative to structural balance for the 2017 Biennium.

References

A background report on the water adjudication issues is available at the link Complete Adjudication Report or can be found at www.leg.mt.gov.

Population and Caseloads

Population increases include enrollment adjustments for the Montana University System and K-12 School Districts; prison, parole, and probation estimates; Medicaid, Healthy Montana Kids; and court caseloads. Changes in anticipated population can be reflected in the budget through a variety of ways, including statutory payments, anticipated utilization of services, and staffing and other operating costs. The following chart shows various population and caseload estimates.

Population and Caseload Increases
Comparison 2015 and 2017 Biennia

Requesting Agency	Purpose	FY 2014	FY 2015	FY 2016	FY 2017	HB 2 GF Increase from 2015 Bien. ($ Millions)	HB 2 All Fund Increase from 2015 Bien. ($ Millions)
Office of Public Instruction*	Enrollment	148,567	149,712	149,694	149,973	$51.0	$51.0
Montana University System	Resident Enrollment	29,969	29,969	29,969	29,969	35.7	35.7
Department of Corrections**	Probation and Parole	7,728	7,778	7,844	7,911	37.5	37.0
	Male Prison Beds	2,372	2,392	2,407	2,422	-	-
	Female Prison Beds	209	218	226	235	-	-
	Treatment	1,011	1,044	1,075	1,107	-	-
Dept. of Health & Human Services	Medicaid	118,888	128,623	135,090	141,387	105.2	309.4
	Foster Care/Sub Ado	4,480	4,650	4,837	5,030	4.4	6.4
Office of Public Defender**	All Court Cases	31,705	32,256	33,406	34,391	12.8	12.9
	Lower Courts	19,803	20,082	20,672	20,992	-	-

*Also includes costs associated with ANB increases, as well as annualization of other session adjustments.
**Costs are summarized due to overlap among functions and/or reorganizations.

Executive Proposal

The executive has addressed changes in anticipated population in the following ways:

- Present law adjustments are proposed in Medicaid and other human services expenditures to account for all estimated increases in population and utilization
- With the exception of the community colleges, an anticipated increase in university enrollment does not have a direct correlation to changes in the budget. Rather, for the University of Montana and Montana State University campuses, the executive is requesting various present law increases for personal services, fixed costs, and other adjustments, funded at 46% in FY 2016 and 40% in FY 2017
- The projected increases in caseload in the Office of the Public Defender are primarily reflected in requests to add positions, provide pay adjustments and/or career ladders, and increase funds for contract attorneys
- In corrections, the executive anticipates population growth, but is requesting funds that reflect an emphasis on community based efforts in an attempt to better control those populations. Therefore, the Governor is requesting additional probation and parole officers and only annualizing secure care beds at 2015 biennium contracted levels

Legislative Options

The impact on the proposed budget of these estimates is analyzed separately in each section of the budget, along with any issues or comments. LFD analysts evaluate caseloads on an individual basis and will provide alternative estimates as appropriate to subcommittee members.

Cost Pressures

Cost pressures include increases applied to current services in costs to maintain ongoing services such as personal services; fixed costs and inflation; implementing increases approved by the previous legislature; and new changes in workload and/or utilization, some of which would require legislation to reduce. Cost pressures are also due to new proposals for inflation-like items for providers of services in state government and funding shifts to fund certain present law items with state funds, such as Medicaid share and to ease tuition pressure in the Montana University System (MUS).

Statutory Cost Increases

Personal services: Some cost changes to personal services have been previously approved by the legislature, including health insurance costs that were funded for the second half of FY 2015, longevity increment adjustments, and phased-in employer cost increases for pensions.

Annualizing the FY 2015 Pay Plan Negotiated by the Governor

HB 13 (2013 Session) included an appropriation equivalent to a 3% increase each year (beginning on July 1) and an increase for insurance of 10% each calendar year. The Governor negotiated a pay plan that included a 5% increase in FY 2015, with a delayed implementation date of November 15, 2014. While the cost of the negotiated pay plan was within the HB 13 appropriation for FY 2015, it increases the annualized cost of the pay plan in the 2017 biennium.

2017 Biennium State Employee Pay Plan

State employee pay plans are generally but not always approved by the legislature. In the past ten years, pay plans have ranged from 0% to 3.6% per year for salary increases and 0% to 10% per year for insurance contribution increases. For each 1% per year, the employee pay increase would cost $12.2 million for the biennium without an increase in health insurance. A 1% per year increase in health insurance would cost $1.6 million for the biennium. A 3% per year increase in pay would cost an estimated $36.6 million and a 3% per year increase in health insurance would cost $4.8 million.

Changes in Federal Medicaid Participation

The federal medical assistance percentage (FMAP) is based on national economic factors and determines how much of Medicaid (and other medical costs) is funded by the federal government and how much by the state. Because Montana's personal income ranking has improved compared to other states, the rate Montana must pay will increase in the 2017 biennium.

2017 Provider Rate Increases

The vast majority of medical and community services administered by the Departments of Public Health and Human Services (DPHHS) and Corrections (DOC) are provided through contracts with private businesses. In some instances, the state agency is the primary or only customer for these services. As business entities or private non-profits, contractors are subject to the same economic conditions as other employers. These businesses traditionally request that the legislature consider rate increases to cover cost growth and to maintain operations.

Other Inflation Increases

Other items are inflated or deflated in the budget from FY 2015. These include statewide adjustments for fixed costs such as insurance and car rental rates, and inflation such as natural gas and electricity.

Add Back Funding for 2% Vacancy Savings Approved for the 2015 Biennium

This item is not inflation or inflation like, but is part of the Governor's recommended personal services budget, and thus included in this section. The 2013 Legislature implemented an additional vacancy savings amount equivalent to removing 2% of the cost to personal services from agency budgets for the 2015 Biennium. If this amount is reinstated into agency budgets additional costs would result in an increase in agency budgets.

Executive Proposal

The Governor has included in his proposed budget:

- o All personal services annualized costs, including the Governor's FY 2015 increase, reinstatement of the 2% additional vacancy savings reduction enacted by the 2013 Legislature, and a reduction in FTE included in 2015 biennium HB 2 boilerplate language
- o All statutory inflation on K-12 BASE Aid - $40.1 million general fund
- o A 2% per year provider rate increase for the Department of Public Health and Human Services and the Department of Corrections, as well as a direct care worker wage and Shelby prison per diem increases - $27.9 million general fund, $75.5 million total funds
- o Additional FMAP at the anticipated level - $21.6 million general fund and $5.5 million state special revenue, with a corresponding reduction in federal funds
- o Inflation/deflation on selected items and increases in fixed costs
- o A negotiated pay plan with a 10% increase in health insurance beginning on January 1, 2016 and an 8% increase on January 1, 1017, and a $0.50/ hour salary increase beginning the first pay period in October - $44.1 million general fund and $78.9 million total funds

Legislative Options

Depending on the source of the type of inflationary adjustment, the legislature may have more or fewer options for funding inflation-like items; items that have a statutory connection are the most locked in with fewer choices. These statutory items may require a statutory change, may impinge on long term commitments like school funding, or may require agencies to fund these items at the expense of other services.

Inflation and fixed cost increases are typically determined by the subcommittee that reviews those rates. Most rates are in Section A: General Government.

Provider rate increases are considered new proposals and are largely a budget policy decision of each legislature.

Services or Funding Available in the 2015 Biennium That Sunset in the 2017 Biennium

There were several items funded in the 2015 biennium either on a one-time basis, or the funding and/or statute governing the service will sunset. The 2015 Legislature may consider reinstating some of these one-time only (OTO) or sunset provisions. The following section summarizes these items.

Current Service Level

"Current service level" refers to OTO appropriations provided by the 2013 Legislature that the 2015 Legislature may be under pressure to maintain so that the level of services currently offered by the state will continue. Often these are appropriations that have been funded for several biennia. Alternatively, the legislature may have authorized the appropriation as an OTO in order to trial a new or changed program.

The most significant current service level items, along with the Governor's proposal, are shown in the following chart.

Current Service Level Compared to Executive Budget
2017 Biennium
($ Millions)

Function	Current Service Level	Executive Budget	Difference
Various Natural Resources, inc. Brucellosis and Aquatic Invasive Species	$2.7	$3.2	$0.5
Maintenance of Common Areas in State Buildings	2.3	4.2	1.9
Montana Digital Academy*	1.8	0.0	(1.8)
Economic Development in the Department of Commerce	2.8	2.8	0.0
Overtime in DPHHS funded with OTO**	2.0	2.0	0.0
Total	$11.6	$12.2	$0.6

*Executive continues base level of $2.3 million over the biennium.
**Executive includes funding for all anticipated overtime.

Sunset Items

<u>Treasure State Regional Water Program</u>

The Treasure State Regional Water Program was fully funded in the 2013 session to complete project costs for the two federally approved projects. Under current law the program is scheduled to sunset June 30, 2016. Beginning in July 1, 2016 (FY 2017), revenue that would have flowed into the Treasure State Regional Water Trust will flow into the main body of the trust, and the interest that would have gone to Treasure State Regional projects will now flow to the general fund. In FY 2017, the additional general fund revenue anticipated from this flow is $3.0 million. Federal approval is being sought for two additional projects. There is currently no funding source that would be targeted for these projects should they be approved, and the Governor has not proposed that statute be changed to continue diversion of any funds.

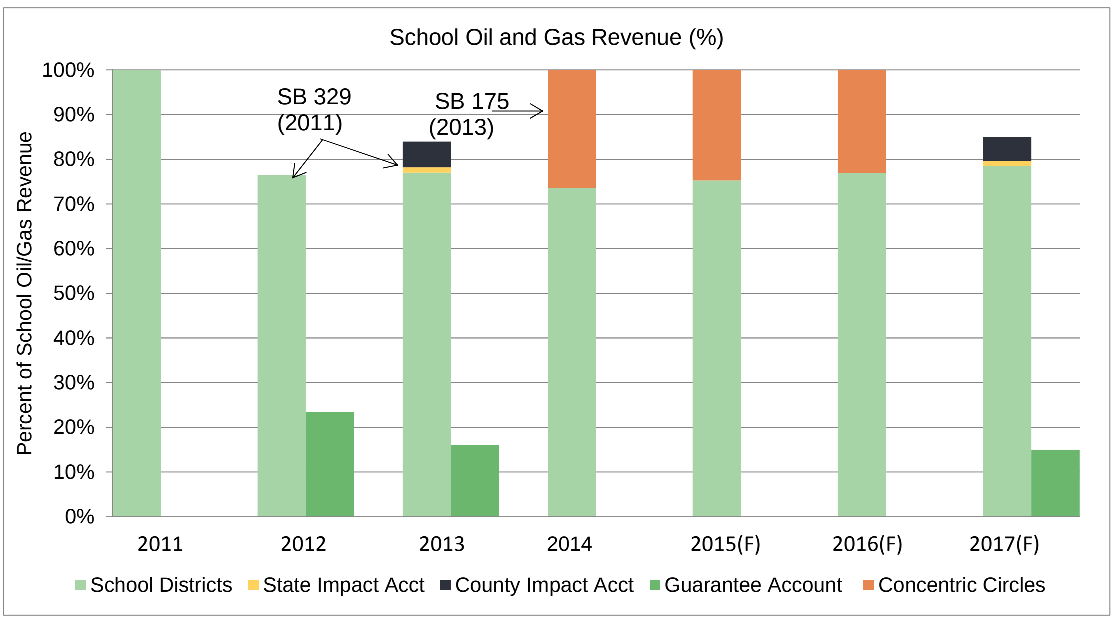
Concentric Circles

Concentric circles is part of the current method of distributing oil and natural gas production tax (ONG tax) to school districts. It essentially diverts money from school districts that have met maximum funding thresholds to nearby school districts that may be affected by oil and natural gas production. This provision sunsets after FY 2016. In FY 2017, these funds will be distributed to the guarantee account and are estimated to reduce general fund spending by $5.2 million.

The recent history of these funds can be demonstrated as follows:

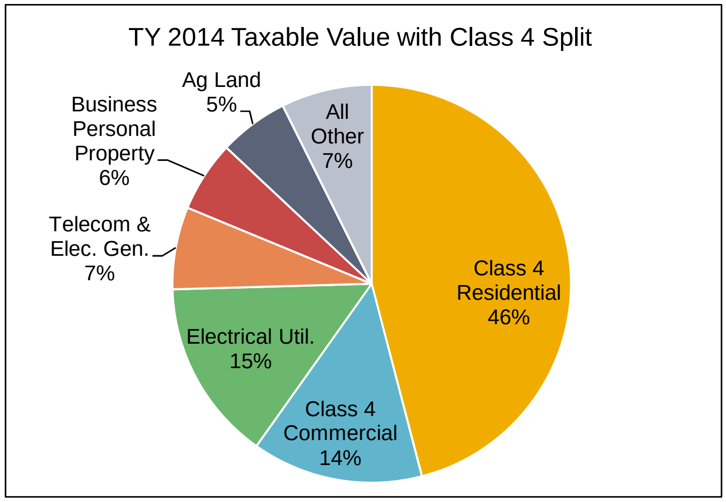
- Prior to FY 2012 school districts with oil and gas wells within their boundaries received 100% of the statutory distribution of oil and gas taxes.
- In the 2011 Session, SB 329 capped the amount of oil and gas tax revenue districts could retain to 130% of the school district's maximum budget. Revenue beyond the cap flowed as follows: (1) 5% to a state school oil and natural gas impact account; (2) 25% to a county school oil and natural gas impact fund, to provide revenue schools that were not receiving oil and gas taxes but were being affected by oil and natural gas production, and (3) 70% to the guarantee account which offsets state general fund costs.
- In the 2013 Session, SB 175 temporarily changed the allocation in order to divert a greater portion of oil and gas taxes, above school district thresholds, to nearby school districts that have not yet met the thresholds. This provision sunsets after FY 2016 at which time the distribution returns to be similar to the provisions provided by SB 329 in FY 2013.

The chart below displays how that money is allocated on a percentage basis in order to see the effects of the distribution. It is anticipated that school districts impacted by the sunset may request a change to current law so that these funds return these districts.



Property Reappraisal Mitigation

Agricultural land (Class 3), timber land (Class 10), and residential and commercial land (Class 4) values are reappraised every six years; all other property classes are reappraised annually. Large increases in property valuation that may occur over a six year reappraisal cycle can put pressure on the legislature to mitigate the tax effects of the valuation increases.



Statewide mitigation of property values is often used to keep the total property tax class revenue neutral while property values increase. When revenue estimates were produced for the 2017 Biennium Outlook, there was only very preliminary reappraisal data which suggested reappraisal effects of around $6.2 million for Class 3 and 4 in FY 2016. It is important to note that reductions in taxable value are phased out completely in the first year. However, increases in taxable value are phased in over a six year period.

Due to Class 3, Class 4, and Class 10 all dropping in taxable value the first year, the reappraisal is expected to decrease state-wide tax collections by $8.5 million in FY 2016 and $6.5 million in FY 2017 as compared to no reappraisal. It is unusual that property drops in value, but this will likely put less pressure on mitigation efforts than in past reappraisal cycles.

Executive Proposal

The executive currently has no cost associated with the reappraisal mitigation proposal.

Legislative Options

Reappraisal mitigation can be in different forms; some examples include HB 658 which mitigated reappraisal during the 2009 session, as well as other mitigation proposals from the 2009 session, and SB 461 which mitigated reappraisal in the 2003 session.

References

Department of Revenue 2014 Property Reappraisal Presentation to RTIC

Previous Issues Anticipated to be Discussed Again

Local Government Infrastructure

During the 2013 Session local government infrastructure was a significant issue with several funding bills. The legislature passed one of these infrastructure bills: HB 218, which was vetoed by the Governor. In the interim, the Legislative Finance Committee has considered various components that could be used in a program that would fund local infrastructure based on need and community ability to pay.

Executive Proposal

Gov. Bullock proposes HB 5 (commonly referred to as the Build Montana Act), which includes proposed expenditures for eastern Montana infrastructure. The Governor proposes expending over $300 million using both cash and bond proceeds for the entire Build Montana Act. The portion of the bill focused on this issue is $45 million in grants to Eastern Montana communities impacted by oil and gas development.

Legislative Options

The Legislative Finance Committee studied options for statewide infrastructure funding for local governments. The following linked reports summarize the options evaluated and are also available at www.leg.mt.gov/css/fiscal:

- Local Government Economic Impacts Defined
- Measurement Criteria

References

HB 218 (2013 Session)
Governor Bullock's 2016-2017 Budget Highlights (Orange Book)

Water Compacts

During the 2013 Session, the Confederated Salish and Kootenai Tribes water compact did not pass the legislature. The 2013 Session's state cost to this compact was $55 million and relied on funding from bonds which required a 2/3 vote.

Executive Proposal

At the time of this writing, no water compact legislation was included in the Governor's budget.

Legislative Options

The legislature could choose to pass or not pass the water compacts. Funding for the compacts could come from a one-time appropriation, a payment stream into an escrow account, or bonding.

References

HB 629 (2013 Session)
Technical review of proposed CSKT water rights settlement for the Water Policy Interim Committee

Medicaid Expansion

In the 2013 Session, the Governor proposed expanding the population eligible for Medicaid as allowed by the Federal Affordable Care Act. This proposal did not pass the legislature.

Executive Proposal

The Governor has proposed LC631 (commonly referred to as Healthy Montana Act), which proposes to expand Medicaid coverage to approximately 70,000 Montanans.

Legislative Options

Many options exist for expanding Medicaid and several options were considered last session including those listed under references.

References

Links to primary 2013 Session bills:

- HB 458 – Rep Noonan
- HB 590 – Rep Hunter (Governor's proposal)
- SB 393 – Sen Kaufmann
- SB 395 – Sen Wanzenried

Individual Income Tax Simplification

Several individual income tax simplification bills were introduced and debated in the 2013 Session. SB 282 (2013 Session) made it through the legislative process; however, it was ultimately vetoed by the governor. There appears to be a continued high level of interest in simplifying Montana's individual income tax structure.

Executive Proposal

The executive did not propose an income tax simplification bill.

Legislative Options

There have been a variety of approaches to simplification. These approaches usually involve some combination of eliminating various additions, reductions, deductions and credits; changing the income starting point; allowing for joint taxpayer income brackets; and adjusting the rates. Complicating factors may arise by requiring certain outcomes, such as overall revenue neutrality or minimal tax shifting between taxpayers.

References

2013 Session simplification bills:

- HB 532 – Rep. Hollandsworth
- HB 581 – Rep. Hansen
- SB 282 – Sen. Tutvedt

2013 Session Quick Notes: summary document of key elements of the bills

- HB 532 Quick Note
- HB 581 Quick Note
- SB 282 Quick Note