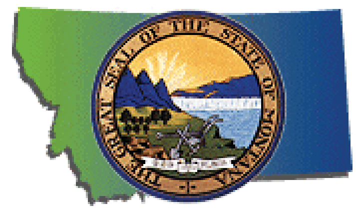
Major Issues Facing the Legislature



This chapter provides a discussion of a number of budget issues that are not described in any detail elsewhere in this volume. These issues are listed below and discussed further in the pages that follow.

- Structural Balance
- Post-Session – What Happens if Revenues Fall?
- Fund Balance Adequacy
- Pay Plan - Issues
- Montana State Fund “Old Fund” Liability
- Pending Lawsuits
  - PPL v Montana
  - Lucas Ranch, Montana Farm Bureau and Montana Taxpayers Assoc v Montana Department of Revenue
  - South Point
  - Libby Asbestos
- Wildfire Funding
- Long-Term Stability of the General Fund
- Pension Plans Unfunded Liability
- Transfers to the General Fund from Other Funds
- Present Law Analysis

STRUCTURAL BALANCE

GENERAL FUND

Structural balance refers to the balancing of on-going expenditures with on-going revenues. If revenues equal or exceed expenditures, then structural balance is achieved for the short-term. If expenditures exceed revenues, then structural imbalance occurs. Figure 1 shows historical data for both revenues and expenditures since FY 2000. It should be noted that the data for FY 2000 through 2011 represent total revenues and expenditures and have not been adjusted to reflect "on-going" amounts. Since this type of categorization has not been maintained on a historical basis, the only on-going amounts shown in Figure 1 are for FY 2012 and 2013.

Total general fund revenues exceeded total expenditures for 6 of the past 11 years from 2000 through 2010 (see Figures 1 and 2). In the mid- to late-1990's, the legislature placed a concentrated effort on achieving structural balance and made significant progress, reaching a sizable positive balance in FY 2000. It should be noted that during this time, Montana, as well as other states, were reaping the benefits of an information technology boom and the significant increase in individual income taxes due to capital gains income. The pendulum, however, shifted the other way beginning in FY 2001, where revenues were slightly above expenditures. The revenue shortfall in the 2003 biennium intensified the imbalance heading into the 2005 biennium. However, for the 2005 and 2007 biennia, structural balance was achieved.

Figure 1

General Fund Structural Balance
Figures in Millions

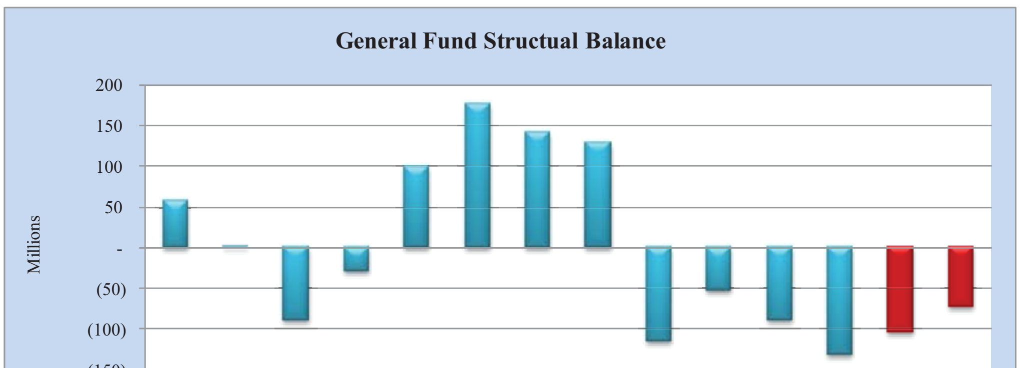
		End. Fund Balance	Yearly Adjustments	Yearly Revenue	Yearly Disburse		Yearly Sur./(Def.)	Biennial Revenue	Biennial Disburse	Biennial Sur./(Def.)
A	2000	$176.000	$8.287	$1,163.638	$1,105.599		$58.039			
A	2001	172.897	(3.637)	1,269.472	1,268.938		0.534	2,433.110	2,374.537	58.573
A	2002	81.316	(1.391)	1,265.713	1,355.903		(90.190)			
A	2003	43.065	(8.805)	1,246.381	1,275.827		(29.446)	2,512.094	2,631.730	(119.636)
A	2004	132.873	(9.719)	1,381.565	1,282.038		99.527			
A	2005	299.792	(10.010)	1,530.949	1,354.020		176.929	2,912.514	2,636.058	276.456
A	2006	422.209	(19.010)	1,708.166	1,566.739		141.427			
A	2007	543.541	(7.767)	1,829.872	1,700.773		129.099	3,538.038	3,267.512	270.526
A	2008	441.505	13.469	1,953.540	2,069.045		(115.505)			
A	2009	396.335	6.836	1,807.968	1,859.974		(52.006)	3,761.508	3,929.019	(167.511)
A	2010	314.881	8.111	1,627.145	1,716.710		(89.565)			
A	2011	183.264	(0.466)	1,672.133	1,803.284		(131.151)	3,299.278	3,519.994	(220.716)
A	2012	31.830	(47.001)	1,753.767	1,858.200	*	(104.433)			
A	2013	(59.887)	(17.950)	1,825.963	1,899.730	*	(73.767)	3,579.730	3,757.930	(178.200)

* Executive Budget On-going Expenditure Proposals

Historically, the legislature has faced the ever-present difficulty of holding down budget growth when confronted with double-digit growth in correction costs, increased human service demands, and pressures for increased education funding. The 2007 Legislature enacted a structurally balance budget, but as Figure 1 shows, the 2009 biennium ended with a structural imbalance. Again, this is because the data shown for the 2009 biennium reflects total revenues and expenditures and has not been adjusted to show on-going amounts. The 2009 Legislature enacted a budget that showed a slight imbalance but as is shown above, the 2011 biennium is projected to have a significant imbalance.

Figure 2 shows that the anticipated revenues as projected by the Revenue and Transportation Interim Committee are $73.7 million below on-going expenditures in the executive budget proposal for the 2013 biennium. Further, the simple assessment of structural balance as matching on-going revenues to on-going expenditures, while useful to ensure short-term sustainability, is not a good measure of long-term sustainability. Issues such as the likely reduction in federal fund support (due to federal action to reduce a huge deficit) or considerations of future funding pressures (such as the cost of an aging population or the reversal of declining school populations) require more in-depth analysis than is used in the current calculation of structural balance. These issues are discussed in more detail in an assessment of longer term sustainability of the general fund, beginning on page 107 of this volume.

Figure 2



	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Balance	58.0	0.6	-90.2	-29.4	99.6	176.9	141.5	129.1	-115.5	-52.0	-89.6	-131.2	-104.4	-73.7

EXPENDITURE PROPOSALS

There are several ways in which structural balance can be adversely impacted in subsequent biennia, on the expenditure side:

- Expanded expenditure growth, as is common with caseload driven entitlement programs such as Medicaid, can adversely impact structural balance
- Realization of delayed implementation of expenditures. Annualization of the 2013 biennium pay plan, which delays implementation until mid-year, will require additional funding in the 2015 biennium
- Growth in services arising from expansions in such programs as Medicaid or from increases in prisoner populations supervised by the Department of Corrections. For any increase in annual expenditures, there must be on-going revenue with which to fund it. In order to attain or maintain a structural balance, annual revenue growth must equal or exceed expenditure growth

- Growth in services arising from known demographic or other economic changes, such as the cost of an aging population

REVENUE PROPOSALS

- Implementing tax policy changes with delayed effective dates or phased in tax policy changes
- Transferring funds from other accounts that will not be available in subsequent biennia
- Implementing tax policies that provide inadequate funding in subsequent biennia

GENERAL FUND - CONCLUSION

From a short-term view point of assessing structural balance related to matching on-going revenues with on-going expenditures, the executive budget for the 2013 biennium is structural imbalanced. Reviewing each fiscal year individually, there is a structural imbalance in FY 2012 of $104.4 million and a structural imbalance of $73.7 million in FY 2013. Achieving long-term sustainability requires a more in-depth assessment and is a significant policy issue the legislature should address in order to make the budget process less problematic for both the legislative and executive branches in subsequent biennia. See the discussion of sustainability on page 108 of this volume.

OTHER FUNDS

In addition to issues of structural balance in the general fund, there are issues of structural balance in some of the state special revenue accounts included in the executive budget. A number of functions of state government are funded from accounts that receive their income from dedicated taxes and fees. One example is the highway special revenue account, which funds highway construction and maintenance and safety related costs. For the 2013 biennium, budgeted expenditures are nearly $40.0 million higher than projected revenues. A key contributor is a four-fold increase proposed for the 100% state funded construction program. Unknown risks are how much state funds will be needed to match federal funds and maintain state highways in the future. These are serious questions of long-term sustainability. In other parts of the executive budget, the legislature will find instances in which the executive has proposed expenditures that exceed revenue. By budgeting from these accounts at expenditure levels that exceed on-going revenues, the executive draws down the fund balance and creates program expenditure levels that cannot be sustained. Therefore, future legislatures would be faced with reducing program expenditure levels or increasing revenue. In agency sections of the Legislative Budget Analysis, staff has identified those instances in which expenditures from an account exceed anticipated on-going revenues.

POST SESSION – WHAT HAPPENS IF REVENUES FALL?

Budgeting is not an exact science and requires a significant amount of economic and budgetary forecasting. Since Montana adopts a budget on a biennial basis, numerous forecasts must be prepared almost three years in advance. During this period of economic uncertainty, it is likely that the budget outlook for the 2013 biennium could vary widely from month to month. To provide a perspective, every 1% change in revenues amounts to approximately $36 million for the biennium. A 10% downturn in revenues would be close to $360 million for the biennium, equivalent to the entire Department of Corrections general fund biennial budget.

What happens if revenues fall after the legislature adjourns? This question cannot be answered without knowing the policy issue of an ending fund balance. If the legislature adjourns with a minimal ending fund balance (about $50 million), then MCA 17-7-140 provides statutory guidelines to the executive in the event of a revenue shortfall. In essence, this section of law requires the executive to submit a "reduction in spending plan" to the Legislative Finance Committee (LFC) prior to implementing reductions in spending. The LFC, after receipt of this plan, may submit recommendations to the executive prior to the executive implementing spending reductions. If spending reductions of more than 10% are required to maintain fiscal solvency, then the Governor would be obligated to call a special legislative session to address the fiscal conditions.

If the legislature adjourns with a higher projected ending fund balance (executive recommends $238.5 million), then the excess balance would be used in the event of a revenue downturn. There are policy issues relevant to budgeting for a higher ending fund balance. First, using an ending fund balance in the event of a revenue shortfall does not provide the legislature the opportunity to re-prioritize spending during a period of declining revenues. Today's priorities may not be the same two years from now. Second, using the ending fund balance for on-going programs could create a structural imbalance that could not be addressed until the next legislative session. This may limit the options available to the next legislature to address the fiscal imbalance. Third, if the revenue decline is longer term (beyond the biennium), then the utilization of an ending fund balance is not a prudent fiscal policy. This is merely a policy to "get you through the biennium". And finally, how high should the ending fund balance be? As mentioned above, a 10% decline in revenues for the biennium would be about $360 million. Even the executive's proposed ending balance would not be adequate in that case. If the budgeted ending fund balance is not adequate to maintain solvency, then the provisions delineated in MCA 17-7-140 would be required.

The legislature may want to consider their involvement in the development of fiscal policies in the event of a revenue shortfall. As discussed above, the existence of an unrestricted large fund balance reserve leaves the Governor much flexibility in determining a response to a revenue shortfall without calling the legislature into special session. Options to consider might include setting aside a portion of the projected fund reserve into a rainy day fund or other restricted category that would require legislative action to access the funds.

FUND BALANCE ADEQUACY/RESERVE

Attaining general fund budget stability means more than setting appropriations equal to anticipated revenues, with a positive ending fund balance serving as a safety net. The adequacy of the state general fund balance can signify the difference between whether or not the state is forced to confront the unpleasant consequences of fiscal instability. The legislature needs to be aware of the tenuous nature of the projections and keep in mind the need to maintain an adequate reserve.

BACKGROUND

Montanans are all too familiar with the consequences of general fund balance inadequacy. In the late 1980's and early 1990's, the state general fund experienced a chronic deficit between revenues and disbursements. Much of the growth in the disbursement rate is a result of natural growth in expenditures due to inflation and/or caseload and enrollment increases, as well as supplemental spending for such contingencies as fire suppression. Revenue growth in the state has not always kept pace with expenditure growth. During the 2003 biennium and again in FY 2009 and 2011 bienniium, actual revenue growth was well below forecasts, primarily because of reduced income tax collection and lower interest rates, largely due to circumstances that could not be predicted when the budgets was being approved. The legislature adjourned from the 2001 regular session with a projected 2003 biennium general fund ending balance of $54 million (2.3% of biennial appropriations). By the end of the first fiscal year, revenue collections for the biennium were $153 million below legislative estimates. Even after the Governor directed statutory spending reductions of $23 million, a special session was necessary to achieve an acceptable ending fund balance reserve through an additional $59 million in budget balancing actions. Revenues still remained unstable as the Fifty-eighth Legislature imposed additional reductions as it shaped the 2005 biennium budget, ending the session with a projected fund balance of $46.2 million or 1.7%. As the economy bounced back in the 2005 and 2007 biennia, Montana witnessed extraordinary revenue growth, with a record fund balance approaching $1 billion projected through the 2009 biennium. The Governor's proposed budget for the 2009 biennium coupled with the 2007 Legislature's actions through appropriation and tax relief measures, resulted in a projected 2009 biennium ending fund balance of $184 million. A 2007 special session to address wildfire costs reduced that amount to $125 million. The 2009 Legislature ended the session with a $282 million fund balance. Less than a year later, the Governor was implementing statutory spending reductions again. The past decade has been an extremely volatile financial time.

ADDRESSING FUND BALANCE ADEQUACY

Recognizing that budgetary imbalances and revenue swings can occur, the state can either take a reactive or a proactive approach. During the 1993, 1995, 2003 and 2009 biennia, the state held special legislative sessions to deal with general fund shortfalls or specific budget needs such as fire costs. Although special sessions allow lawmakers the ability to address issues relative to revenues and expenditures, special sessions can cost the taxpayers more than $50,000 per day. The need for special sessions is also closely scrutinized by the national agencies that rate the state's debt. Rating agencies also use a state's general fund balance as a percent of revenues as a key financial indicator for credit analysis.

Again from a reactive stance, budgetary fluctuation can be temporarily resolved through spending reductions. In accordance with 17-7-140, MCA, the Governor can authorize spending reductions: "...in an amount that ensures that the projected ending general fund balance for the biennium will be at least 1% of all general fund appropriations during the biennium." Essentially, the executive branch assumes control of the budget decision-making process by implementing and prioritizing spending reductions. Further, budgetary imbalances can be addressed only from one side of the equation -- expenditures. This means that legislative priorities could potentially get lost in the process.

Because of the cost and disadvantages of taking a reactive approach to budget imbalances, a more effective method may be to approach these issues proactively through provision of adequate fund balance reserves. National fiscal experts such as the National Conference of State Legislatures (NCSL) recommend a reserve fund balance of 3% to 5% of total appropriations or revenues. A recent report by NCSL[3] stated that "a reserve of 5% of budgeted expenditures is a conventional standard of adequacy, although what is appropriate for each state will depend on circumstances." Because Montana's budget is implemented on a biennial basis -- resulting in considerably more risk than an annual budgeting process -- the 3% to 5% should be applied to biennial totals. For Montana, with projected total general fund revenues of $3.6 billion, a minimum 3% reserve equates to a $108 million ending fund balance and 5% translates to $180 million. The revenue volatility of recent years might suggest that an even higher reserve would be more prudent.

The provision of an adequate general fund balance is essential to achieving a sound financial foundation. The level of fund balance reserves must be sufficient to offset the volatility of revenues and the potential for unforeseen expenditure increases, both of which are prevalent in recent years and in current budget proposals. It is even more important since Montana is one of only three states that do not have a rainy day fund provision (although the legislature is expected to consider one or more "rainy day fund" bills this session). To this end, the legislature will again need to determine what amount of ending fund balance is sufficient to ensure budget stability.

Executive Recommendation

The executive budget balance sheet as revised on December 15 shows an ending fund balance of approximately $238.5 million, or 6.6% of the executive revenue estimate. The original executive budget recommended a fund balance of $129 million with a minimum ending fund balance of $125 million.

[3] National Conference of State Legislatures, *NCSL Fiscal Brief: State Balanced Budget Provisions*, October 2010.

PAY PLAN - ISSUES

The Governor has allocated $19.1 million general fund and $13.2 million other funds ($32.3 million total) in the 2013 biennium for a state employee pay plan. The pay plan consists of an across the board increase of 1% effective on January 1, 2012 (midway through FY 2012) and a further 3% effective January 1, 2013. The Governor also proposes $4.0 million general fund and $3.0 million other funds ($7.0 million total) as a biennial contingency fund for agencies unable to meet their personal services funding levels, and $75,000 in training funds. There is no proposed increase in the state contribution for health insurance.

The following figure shows the total pay plan each year by branch of government.

Governor's Proposed Pay Plan, by Year and Recipient
2013 Biennium

	-- FY 2012 --			-- FY 2013 --			-- 2013 Biennium --		
Entity	General Fund	Other Funds	Total Funds	General Fund	Other Funds	Total Funds	General Fund	Other Funds	Total Funds
				--- On-going ---					
Pay Plan Increase									
Consumer Counsel	$0	$2,601	$2,601	$0	$13,124	$13,124	$0	$15,725	$15,725
Legislative Branch	41,564	7,024	48,588	207,912	35,323	243,235	249,476	42,347	291,823
Judicial Branch	128,242	6,688	134,930	647,161	37,938	685,099	775,403	44,626	820,029
Executive Branch	1,143,558	1,653,520	2,797,078	5,763,057	8,317,748	14,080,805	6,906,615	9,971,268	16,877,883
University System	1,176,391	14,817	1,191,208	5,917,817	74,686	5,992,503	7,094,208	89,503	7,183,711
Subtotal	$2,489,755	$1,684,650	$4,174,405	$12,535,947	$8,478,819	$21,014,766	$15,025,702	$10,163,469	$25,189,171
Training Allowance*	75,000	0	75,000	0	0	0	75,000	0	75,000
Personal Services Contingency*	4,000,000	3,000,000	7,000,000	0	0	0	4,000,000	3,000,000	7,000,000
Total	$6,564,755	$4,684,650	$11,249,405	$12,535,947	$8,478,819	$21,014,766	$19,100,702	$13,163,469	$32,264,171

*Biennial appropriations

The following shows the biennial amount, by funding source and component.

Proposed Executive Pay Plan by Component
2013 Biennium

Component	General Fund	State Special	Federal	Proprietary	Total Funds
			--- 2013 Biennium ---		
Pay Increase	$15,025,702	$6,094,869	$3,922,825	$145,775	$25,189,171
Training	75,000	0	0	0	75,000
Personal Services Contingency**	4,000,000	2,400,000	500,000	100,000	7,000,000
Total	$19,100,702	$8,494,869	$4,422,825	$245,775	$32,264,171

*Does not include non-appropriated university funds or proprietary funds.
**The contingency is proposed by "general fund" and "other funds". Table is an extrapolation of funding for the other components and does not represent the executive allocation.

LFD COMMENT

What Personal Services Goals is the Governor Addressing?

There are a number of potential goals for any pay plan:

Maintenance or increase of purchasing power through one or both of two means:

Inflationary adjustments to salaries

Increase in benefits to meet rising medical and other benefits costs

Attempts to recruit and/or retain qualified employees throughout state government, which is generally addressed through such measures as:

Adherence or regular movement to market salaries

Opportunities for career path advancement within and among job descriptions

Special allowance for difficult to hire/recruit positions

Longevity adjustments for continued service

Statewide compensation equity among and within agencies for like work, the evidence for which is lack of a wide discrepancy in salaries as a percent of market (both experienced and starting positions), and similar movement to market over time for similar positions

The Governor has proposed a pay plan that provides an across-the-board pay increase for all state employees. Therefore, the primary goal appears to be to maintain or increase purchasing power. No proposals were submitted to maintain purchasing power for health insurance, to move salaries generally or for specific skills to market compensation, or any other measures to increase equity or the ability of agencies to recruit and retain either generally or for hard to fill positions.

Salary Adjustment

LFD COMMENT

Salaries to Inflation

According to the Mercer and Culpepper surveys of compensation in the U.S., the average salary increase was 3.2% in 2009 and 2.7% in 2010, and was expected to be 2.9% in FY 2011, when state employee salaries were frozen. So, even though unemployment increased, those who were working generally received salary increases. Consequently, not only did/will state employees lose purchasing power against inflation in those years, but will also lose overall salary to market ratio, with high demand positions likely losing a greater share.

The Governor has addressed maintenance of some portion of purchasing power in the provision of a salary increase. As stated, the Governor did not propose any funds to address equity issues in or among agencies or targeted movement to market.

In examining the Governor's pay plan there are a number of factors to keep in mind.

- State employee salaries have not been increased since FY 2009, although employees making less than $45,000 received a one-time biennial payment of $450 in the 2011 biennium that was not continued in the 2013 biennium. General inflation (consumer price index – CPI) is expected to increase by about 1.9% in FY 2012 and a further 2.0% in FY 2013 (please note that medical inflation is a portion of this increase). Coupled with the lack of increase in the 2011 biennium, state employees will continue to lose ground against inflation in the 2013 biennium under the Governor's proposal
- Any advances to market must be done internally within the agency outside of the pay plan funding if the Governor's pay plan does not include a component that addresses salary progression. This has two impacts:
  - Agencies with fewer resources will be at both an actual and competitive disadvantage to agencies that have more available resources
  - A larger and larger share of personal services adjustments will continue to be made outside of the pay plan and therefore outside of direct appropriation by the legislature
- Agencies generally report that the number of applicants has increased, along with a corresponding increase in minimally qualified candidates, likely due in part to the economy. Improvements in the economy could have a negative impact on turnover and ability to hire at current salary rates

LFD ISSUE

Future Costs

As stated, the pay increase proposed by the Governor would take effect on January 1 of each fiscal year. Consequently, costs of the pay plan will be significantly higher than the $15.1 million general fund biennial cost in HB 13.

Prior pay plans have taken effect on October 1. So, January 1 is the latest any pay increases have been proposed. The movement effectively reduces the costs in the 2013 biennium, while increasing costs into the 2015 biennium. The estimated cost in the 2015 biennium to maintain this pay plan is almost $40 million general fund.

Health Care

As stated, the Governor's pay plan proposal does not include any funding for increased health care costs. The issue of whether state employees will see an increase in deductibles or other out-of-pocket medical costs is not clear at this point. The Health Care and Benefits Division in the Department of Administration has not requested an increase in the per employee contribution in the 2013 biennium. However, group health plan medical, dental, and pharmacy costs are anticipated to increase from 8% to 10% per year. Reserve levels are within 10% of the top of the reserve level benchmark.

In addition, it is not clear what impact health care reform will have on costs. The plan is voluntarily offering a requirement of health care reform prior to the implementation date by offering coverage to children of covered members until they are 26 years old. At the same time, costs could be lowered due to shifting of some children to Healthy Montana Kids and the availability of certain grant funds.

LFD COMMENT

Integration of Pay Plan and Budgeting Discussions

Personal services is the single largest expenditure for most agencies, as most agencies directly provide services through the efforts of those employees. Consequently, issues pertaining to personal services and their adequacy to meet certain goals of state government take on a high importance. The size and character of any pay plan is an important component in addressing those issues. Given its size and importance, the pay plan discussion should be integrated with other budgeting policy decisions of the legislature.

The Governor proposes an overall budget that essentially keeps operating expenses flat, and includes an ongoing reduction in personal services, with little to no change in expectations as to the provision of government services. Therefore, under the Governor's budget state government is to continue providing the same services with stagnant or reduced resources. The ability of state agencies to recruit and retain a qualified workforce has been an ongoing issue for several years, particularly in light of the aging state workforce and recent stagnant pay, and takes on an added significance given the Governor's budget recommendation. Salary and benefits, particularly in relation to competition with the private sector or others, play an important part in agencies' ability to recruit and retain qualified workers. Therefore, any discussion of the policy behind the pay plan should be discussed in tandem with issues of what state government is expected to do in the 2013 biennium and the challenges faced in doing so.

The legislature may wish to expand the discussion of any pay plan proposal to include the broader goals the pay plan is designed to address, and how success of the pay plan in furthering those goals will be measured. As a part of this discussion, the legislature may wish to articulate specific reporting requirements on recruitment and retention issues and have the Department of Administration report to the Legislative Finance Committee and any other appropriate interim committees during the interim.

LFD COMMENT

Aging Workforce and Turnover

State government has for several years been facing a major brain drain across all agencies as the state's aging workforce prepares to retire. While the economic conditions may have slowed or delayed the most significant turnover, a number of agencies report high percentages of its workforce eligible for full retirement now or in the next biennium. These workers will have to be replaced.

In addition, various factors will influence turnover and the ability of state agencies to replace workers and the cost of doing so, especially in certain high demand professions. Workers of the baby-boom generation placed a higher value on job stability and loyalty. Benefit packages are therefore a more powerful incentive to stay in a job. According to numerous sources younger workers no longer value as highly the kind of stability in employment that can be partially addressed through benefits such as pension plans, but rather in skills acquisition, salary, and life balance.

LFD COMMENT CONT.

Surveys consistently show that state employees are generally paid a lower salary than similar workers in the private sector, but generally get better benefits. As stated, younger workers who will replace the current generation are not as motivated by factors that benefits are designed in part to address. As a consequence, even if the competitive advantage in benefits can be maintained, the state will have difficulty competing for workers in the future.

The legislature may wish to discuss with the executive long-term strategies for addressing the aging workforce and ongoing brain drain; and hiring, retaining, and motivating younger workers.

MONTANA STATE FUND "OLD FUND" LIABILITY

Statutes require that in any fiscal year when the Montana State Fund (MSF) is not adequately funded to pay claims arising from accidents that occurred before July 1, 1990, the funds to pay these Old Fund claims must be transferred from the general fund. As of June 30, 2010 estimated liabilities exceeded assets by $60.8 million. At this time, the Old Fund is projected to have sufficient invested assets to meet its obligations until sometime in FY 2011, when up to $2.1 million in general fund will need to be transferred to MSF. The general fund costs of benefits, claims, and administration in the 2013 biennium are estimated to be $18.1 million, comprised of $11.2 million in FY 2012, and $6.9 million in FY 2013.

General fund transfers required by statute are not included as part of the appropriation decisions of the legislature. Transfers are considered as part of the LFD general fund balance projections.

PENDING LAWSUITS

UPDATE ON PPL V MONTANA

In PPL Montana, LLC v. State, 2010 MT 64, the Montana Supreme Court determined that title to the riverbeds of the Missouri, Clark Fork, and Madison Rivers passed to Montana when it became a state in 1889. However, the Court also reversed the District Court's conclusion that the riverbeds are "school trust lands" and instead held that they are public trust lands under Article X, Section 11. The state and the Board of Land Commissioners (Land Board) have a fiduciary responsibility to manage the land for the benefit of the public. As part of the decision, the Court upheld the District Court's methodology of calculating damages, and PPL was ordered to pay approximately $41 million (plus interest) in compensatory damages to the state for improper use of the streambed. PPL subsequently filed a petition with the US Supreme Court, asking it to hear the case. On November 1, 2010, the US Supreme Court referred the case for comment to the US Solicitor General. The case remains at the Office of the Solicitor General at this time.

When the Montana Supreme Court ordered PPL to pay compensatory damages, DNRC concluded, and subsequently the Land Board agreed, that the compensatory damages should be used for the support of education for common schools, that the compensatory damages are to make the public land trust "whole" for the unlawful use of state land, and in purchasing land with the compensatory damages the trust receives assets to make it "whole". The board further concluded that the compensatory damages were from non-state, non-federal money and therefore legislative appropriation was not necessary for the expenditure of the funds.

Staff of the Legislative Fiscal Division (LFD) alerted the Legislative Finance Committee of the executive's plan, including the disagreement of treating the revenues as non-state, non-federal funds. The committee asked legislative legal counsel to research the issue, who concluded an appropriation was necessary and the funds could be used to support a variety of beneficiaries, including the common schools. The committee established a subcommittee to examine legislative options to address the action of the board. The subcommittee met with staffers of each land board member, and other interested parties. The subcommittee provided the LFC with the conclusion that the board and legislative staff had different legal interpretations and neither party was willing to change positions.

Since the case is at the US Solicitor General the need for resolution is not as immediate. It is undeterminable as to when the Solicitor General will provide comments to the US Supreme Court. This provides time for the legislature to determine public policy regarding the disposition of this type of settlement. A number of bill drafts have already been submitted to address the issue. Those drafts include distributing the funds to the guarantee fund for schools to use immediately, allowing a portion of the funds to be used to purchase land to increase the trust resource base, and deposit to the land banking fund. The legislature could also consider allocating the damages among all beneficiaries, including the K-12 Public Schools, units of the Montana University System, Pine Hills, School for the Deaf and Blind, Veterans Home, and Public Buildings.

Lucas Ranch, Montana Farm Bureau and Montana Taxpayers Assoc v Montana Department of Revenue

On February 12, 2010, petitioners Charles B. Lucas, Lucas Ranch, Inc., Montana Farm Bureau Federation (MFBF), and the Montana Taxpayers' Association (MTA) filed a petition for declaratory judgment and a writ of mandate against the Montana Department of Revenue (Department). The petition alleged that the Department failed to correctly calculate the phase-in amounts for agricultural properties that resulted in erroneous taxable values for Lucas, Lucas Ranch, and "all similarly situated agricultural landowners in Montana."

As a remedy, the petition requested the court to "immediately reassess the erroneously phased-in taxable values for all agricultural land in the state, and recertify its corrected values to the taxing jurisdictions." Alternatively, the petition alleged that the Department was violating "the affected taxpayers' rights under the equal protection clauses of the federal and Montana constitutions, as well as the Department's statutory and constitutional obligation to equalize taxable values throughout Montana." As the alternative remedy, the petition requested the court to issue a writ "ordering the Department to carry out its constitutional and statutory obligations . . . for tax year 2009 and the remaining years of the current reappraisal cycle."

On or around March 29, 2010, the Department submitted a responsive answer to the District Court. The Department generally denied most of the allegations in the petition, but it admitted that "it has publicly indicated that it will correct for tax year 2009 the [value before reappraisal (VBR)] for taxpayers that experienced productivity-only changes if those taxpayers filed timely AB-26s, or appeals for tax year 2009 and; that the Department would correct all other affected taxpayers in tax year 2010." Moreover, the Department alleged that: (1) MFBF and MTA do not have standing to assert an action before the court;(2) the action is moot, as the Department has acknowledged that it incorrectly established VBR for properties that experienced a productivity-only change and it is correcting the error for all affected taxpayers; and (3) the parties have failed to exhaust their administrative remedies.

The matter stands there and it is unknown when the court might rule. If the plaintiffs are successful, it is unknown whether payments made in prior years to the state and local jurisdictions will have to be refunded.

SOUTH POINT

The State of Montana is listed as a defendant in a lawsuit over the state's cancellation of three 30-year lease contracts for a building in Helena. Under the signed leases, employees from the Department of Public Health and Human Services, Department of Corrections, and Board of Crime Control would have been housed in the yet to be constructed building. The developer for the building has sued the state for reimbursement of costs incurred after signing of the leases and their cancellation. The developer is also seeking compensation for lost profits associated with the building lease. The lawsuit represents a potential liability to the state of in excess of $3.5 million if judgment is made against the state. The lawsuit is currently in the discovery phase.

LIBBY ASBESTOS

The State of Montana is listed as a defendant in a lawsuit involving asbestos damages resulting from asbestos mining in Libby. The lawsuit involves thousands of parties under a class action lawsuit. The complexity of the case and long-term activities of similar lawsuits in other states with little resolution make estimating the risk and financial impacts problematic.

WILDFIRE FUNDING

Fire costs are based on estimated fire costs and costs that have already been paid. Fire costs are not settled until all reimbursement has been received and all bills have been paid. As of September 20, 2010 state fire costs were $1.9 million as described in Figure 3. State fire costs are paid from the fire suppression fund.

The impact of FY 2011 costs leaves an estimated balance of $22.5 million as detailed in Figure 4 below. The Legislative Fiscal Division calculates average fire costs by utilizing the last seven years of data and removing the

Figure 3

State of Montana
Estimated Fire Expenditures - Summary Level

Part 1: Fire Protection Costs:		
FY 2010	$5,811,359	
FY 2011	2,297,285	
Biennial Cost		8,108,644
Part 2: Reimbursements:		
FY 2010	849,640	
FY 2011	357,399	
Received and Anticipated Reimbursements		1,207,039
Estimated Biennial State Fire Costs		$6,901,605

Figure 4

Fire Suppression Fund *in Millions*	
FY 2010 Beginning Balance	$29.4
Estimated Fire Costs	6.9
Estimated Funds Remaining	$22.5

high and low year. Due to the relatively low costs of the last three fire seasons and the loss of a high year (FY 2004) from the data the average state cost of fire suppression has fallen. The average annual state fire cost is now $11.9 million, down from $18.3 million. Figure 5 illustrates the average fire costs.

Figure 5

Average Cost of Fire Suppression			
Fiscal Year	Total Costs	eimbursemen	State Costs
2005	$3,969,096	$989,945	$2,979,151
2006	8,302,312	3,240,042	5,062,270
2007	61,000,318	21,290,928	39,709,390
2008	81,544,805	31,544,805	50,000,000
2009	10,082,885	3,085,409	6,997,476
2010	5,811,539	849,640	4,961,898
2011	2,297,285	357,399	1,939,886
7 year total	$173,008,240	$61,358,168	$111,650,071
7 year average	$24,715,463	$8,765,453	$15,950,010
	$89,166,150	$29,455,964	$59,710,185
5 year adjusted	$17,833,230	$5,891,193	$11,942,037

The Governor proposes a transfer of $20.0 million from the fire suppression fund to the general fund. However, this transfer does not come without risk to the state.

The fire suppression fund was established by the legislature in special session in September 2007 from a transfer of general fund. Prior to the establishment of this fund, the Department of Natural Resources and Conservation (DNRC) utilized general fund authority appropriated primarily for agency operations to pay bills as they became due until the legislature could provide supplemental funding in the next legislative session. This meant that the department was in danger of not having enough general fund authority, particularly if the fire season was early and/or severe, which could potentially requiring a special session to provide additional funding as was the case in FY 2007. Even if the department was able to find enough general fund authority, to operate until the legislature convened it often required an emergency appropriation in the early days of session to allow the department to continue to operate.

While transfer of the fund balance would provide one-time relief to the general fund, it would once again require DNRC to finance any fire costs until the legislature could act. While the last three years have been mild fire seasons, as shown in the Figure 3, Montana has had severe fire seasons, and overall the costs to fight fires has been increasing.

The Governor is proposing to fund the fire suppression fund in future biennia by transferring any unexpended fund balance in the Governor's emergency fund to the fire suppression fund at the end of each biennium. However, if DNRC must access the fund to fight fires, there may not be any unexpended funds to transfer. For a further discussion, see 128 in this volume.

LONG-TERM STABILITY OF THE GENERAL FUND

INTRODUCTION

The state general fund is the primary account that funds a significant portion of the general operations of state government. Since this fund is critical to the operations of state government, its long-term stability is an issue that must be examined for development of sound fiscal policies. This section of the document discusses three key issues relevant to the 2013 legislative session and the necessary planning for subsequent sessions. The issues addressed are: 1) revenue stability; 2) reliance on federal funds; and 3) funding demands.

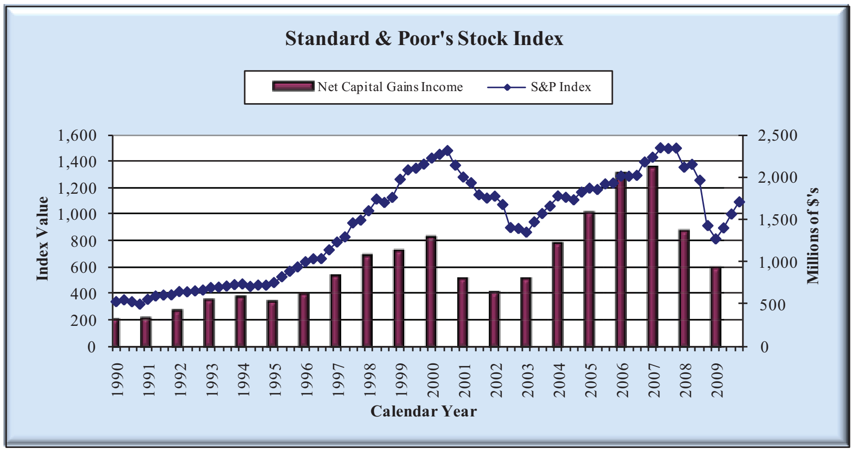
REVENUE STABILITY

There are three major components of general fund revenues that have contributed to increased revenue collections in recent years: capital gains income, oil and gas price and production, and corporate profitability. Reliance on capital gains upswings is the "poster child" of over-reliance on the income growth, and expanding government services based on unsound fiscal policy.

CAPITAL GAINS

The 1990's were generally good years for Montana's economy. With a few exceptions, Montana experienced above average employment and wage levels that translated into strong tax revenue growth. This revenue growth was further enhanced by the significant increase in the equity markets and the resulting growth in capital gains income. During calendar 2002 and 2003, however, the state's financial picture blurred as the effects of a national economic recession, terrorism threats, and mid-east tensions played havoc on the US economy. Although Montana's economic base remained relatively stable during this period, state general fund revenues plummeted. This inconsistency was due to the precipitous fall in equity markets, low interest rates, and reduced corporate profits. All of these factors contributed to the 2002/2003 budget crisis while the state's economy continued to outperform the national economy.

Figure 1

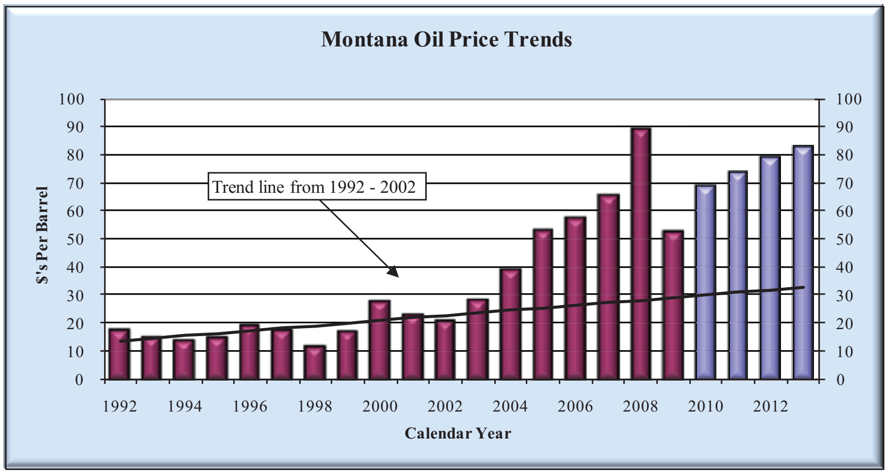


As Montana moves forward into the next century, there are valuable lessons that can be extracted from the financial experiences of the 1990's. For example, as the information technology age was exploding during the nineties, the equity markets were experiencing phenomenal growth rates. As shown in Figure 1, the S&P stock index reached a high of almost 1,500 in calendar 2000 and then declined abruptly until 2003 when the index dropped to about 850. Figure 1 also shows the corresponding trend in net capital gains realizations as reported on Montana's tax returns. As the figure shows, the trends in reported net capital gains income is highly correlated to the S&P index. This would indicate that state tax revenues experienced significant growth from the mid to late nineties due to the information technology investment euphoria. In the meantime, while this growth scenario was occurring, state general fund expenditures were increased along with passage of significant tax relief measures. The actions of the legislature, in essence, expanded the expenditure base and reduced the tax base based on the assumption that strong revenue growth would continue indefinitely. Obviously, the budget crisis of 2002/2003 refuted this supposition. For the calendar period 2005 -2008, an ominously similar pattern developed, clearly shown in Figure 1. Reliance on continued levels of capital gains income lead to another fiscal crisis. A careful assessment of the long-term stability of these levels of income is warranted. As shown in Figure 1, capital gains income plummeted in 2008 and 2009, which translated to a devasting decline in tax revenue during FY 2009 and FY 2010.

OIL AND GAS PRODUCTION

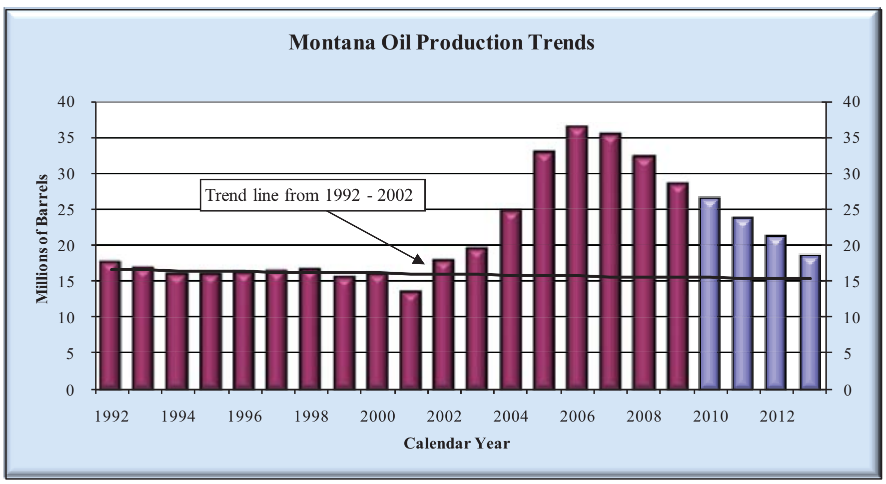
Again for the calendar period 2005-2008 , a similar situation has developed in the oil and gas production component of state revenues. Montana's oil and natural gas revenues have increased significantly when compared to previous biennia. The issue is whether these increased revenues are "on-going" or are a short-term "blip" (similar to net capital gains income) that may fade in the future.

Figure 2



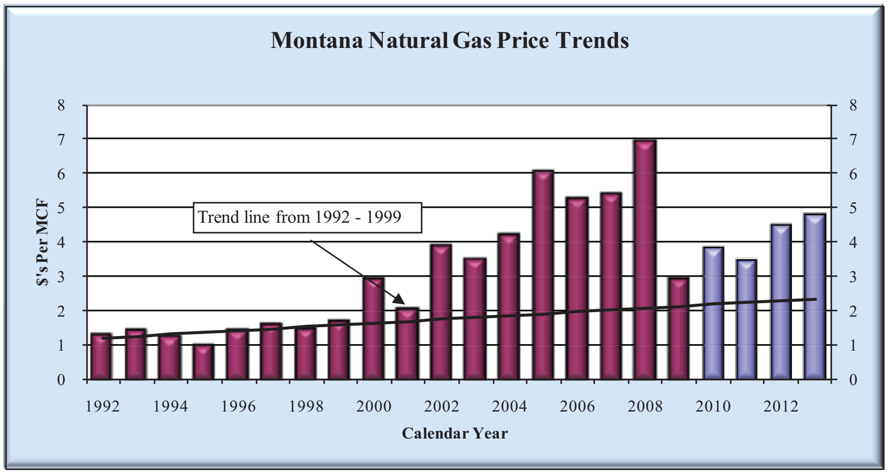
]

Figure 3



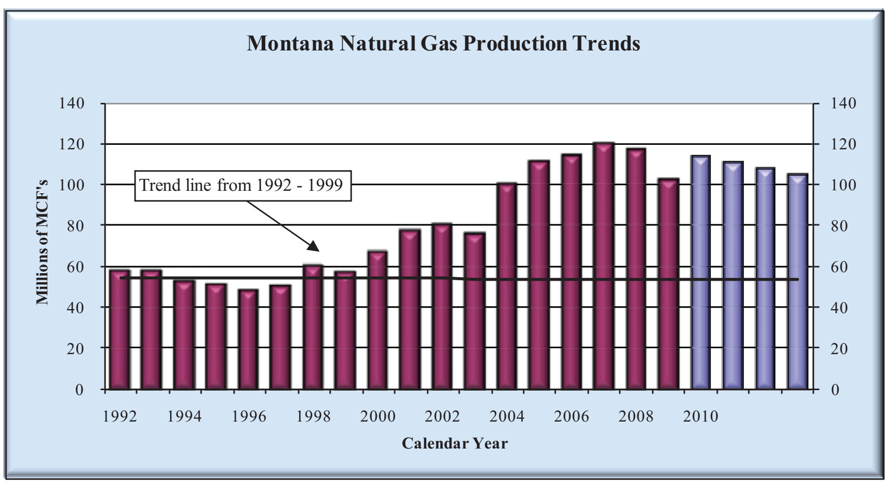
Figures 2, 3, 4 and 5 show the trends in Montana's price and production for oil and natural gas. The data shown for calendar 1992 through 2009 are actual information extracted from the Department of Revenue's computer system, GenTax. The estimates shown for the calendar period 2011 through 2013 are based on assumptions prepared by the Legislative Fiscal Division (LFD). In addition to the actual and estimated amounts, the figures also show a trend line based on the calendar years indicated in the annotations. These trends are based on a common statistical technique that minimizes the differences between the trend estimate and the actual amount. The trend lines are extrapolated into the future to indicate what the "trend" would be under a status quo situation.

Figure 4



As shown in the figures, both oil and natural gas prices have increased dramatically through calendar 2008. The increase in oil prices is primarily in response to strong world demand and limited supplies.

Figure 5



Based on October 2010 forecasts by IHS Global Insight, the LFD has developed its recommended assumptions for both oil and natural gas prices. As shown in the figures, it is quite apparent that the price assumptions recommended by LFD are expected to increase in calendar 2010 and are expected to grow each year thereafter. Natural gas prices are expected to decline slightly in calendar 2011.

It is clear from the price and production data shown in the figures that oil and gas tax revenues for calendar 2005-2008 have been considerably higher than the trend line would have produced. If the LFD recommended price and production assumptions are correct, state revenues will fall during the next biennium as compared to the current biennium. The issue then becomes what will be the level of "on-going" revenue from oil and gas productions taxes. The question for the legislature is what a reasonable oil and gas price assumption is that will not create a boom or bust cycle into the future. One way to accomplish this goal would be to establish a revenue cap based on reasonable trends in price and production. Any collections above the trend amount would be diverted to a rainy day or trust fund to be used during unusual downturns.

CORPORATE INCOME

Corporate income taxes have traditionally been an extremely volatile source of revenue, directly tied to the national and world economic conditions and its erratic fluctuation. While corporate taxes declined during FY 2009 and FY 2010, this tax source is expected to increase during the 2013 biennium. Again, the issue for the legislature is to assess the long-term trend of this source and how sustainable these revenues will be into the future. A significant portion of previous growth in corporate income taxes was "fueled" by the natural resource industry. Lower oil and gas prices, compared to peak levels, however, are expected to reduce corporate profitability growth and the associated corporation tax payments. This is just one more example of a revenue source that can be quite volatile, which makes the long-term stability of general fund revenues questionable.

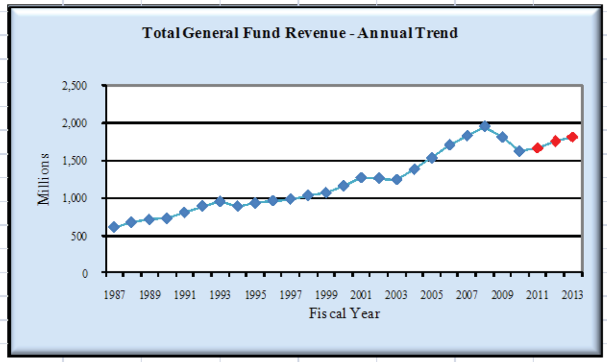
REVENUE STABILITY-SUMMARY

As shown in Figure 6, total general fund revenues have increased substantially during the period fiscal 2004 through 2008 and then declined dramatically during FY 2009 and 2010. Anticipated revenues are expected to begin a recovery starting in FY 2011.

Figure 6

General Fund Revenue Trends
Historical Collections and Legislative Estimates

	Fiscal Year	General Fund Collections Millions	Year to Year Change Millions	GF Percent Change
A	1987	609.742		
A	1988	676.718	66.976	10.98%
A	1989	711.968	35.250	5.21%
A	1990	730.351	18.383	2.58%
A	1991	805.288	74.937	10.26%
A	1992	892.727	87.439	10.86%
A	1993	953.063	60.336	6.76%
A	1994	891.859	(61.204)	-6.42%
A	1995	935.348	43.489	4.88%
A	1996	963.193	27.845	2.98%
A	1997	986.570	23.377	2.43%
A	1998	1,034.382	47.812	4.85%
A	1999	1,069.982	35.599	3.44%
A	2000	1,163.638	93.657	8.75%
A	2001	1,269.472	105.834	9.10%
A	2002	1,265.713	(3.759)	-0.30%
A	2003	1,246.381	(19.332)	-1.53%
A	2004	1,381.565	135.183	10.85%
A	2005	1,530.949	149.384	10.81%
A	2006	1,708.166	177.217	11.58%
A	2007	1,829.872	121.706	7.12%
A	2008	1,953.540	123.668	6.76%
A	2009	1,807.968	(145.572)	-7.45%
A	2010	1,627.145	(180.823)	-10.00%
F	2011	1,672.133	44.988	2.76%
F	2012	1,753.767	81.634	4.88%
F	2013	1,825.963	72.196	4.12%



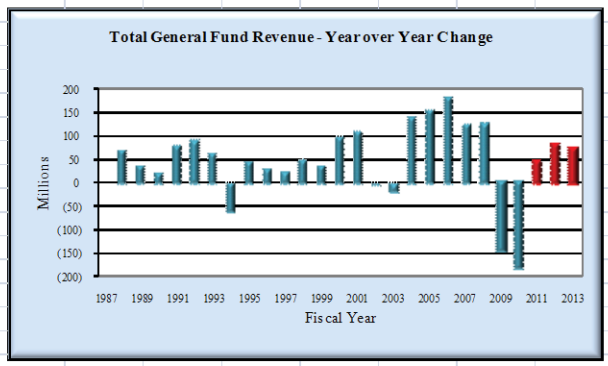


Figure 6 also shows the change in revenue collections from year to year. The disturbing trend is the downturn in revenue collections observed at six to eight year intervals. As shown in the figure, this downturn occurred in FY 2009 and 2010, earlier than the seven to eight year cycle observed historically.

The downturn in revenues during FY 2002/2003 illustrates the sensitivity of Montana's revenue stream to world events and investment opportunities. It also underscores the potential inaccuracies in the revenue estimates if the occurrences of these types of events are not known or are mistimed. Economic upturns or downturns are rarely accurately projected, nor can disasters or certain world developments be anticipated. To quantify current collection patterns, the increased revenue collection from fiscal 2003 to 2008 was primarily due to three general fund revenue sources: individual income, corporation income, and oil and gas production taxes. Together, these three sources of revenue contributed about $568 million of the total increase, which represents over 80 percent of the total. Conversely, the decline in revenue from FY 2008 to FY 2010 was $275.8 million. These three sources contributed over 85% of the total decline. The various assumptions used to estimate these revenue sources will have a substantial impact on total estimated general fund revenues in the future. If only a few of the key assumptions miss the mark, estimates may vary widely from actual collections.

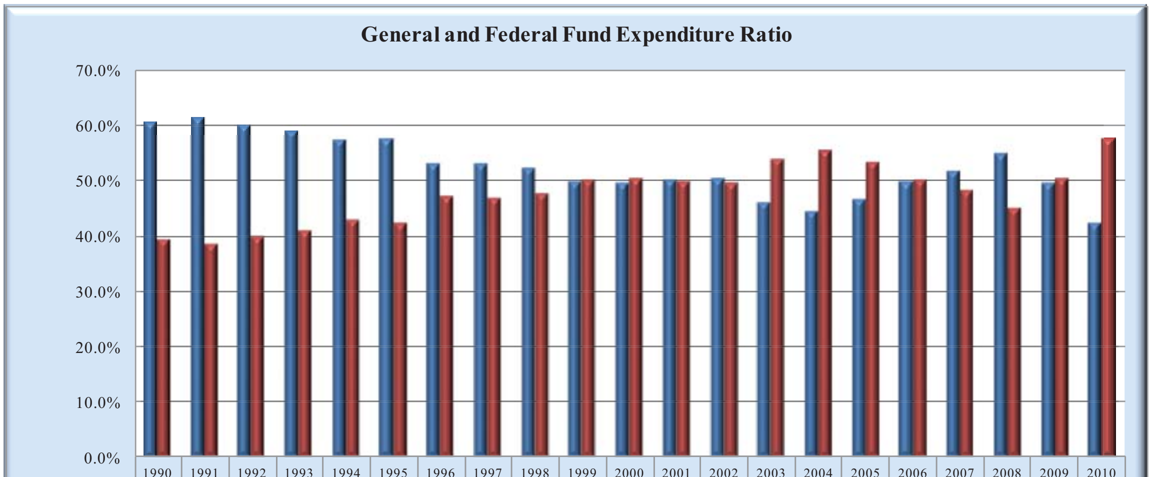
RELIANCE ON FEDERAL FUNDS

General fund expenditures have increased on average about 4.7% per year from fiscal 1990 to 2010. Correspondingly, federal funds expended have increased about 8.6% per year during this same period. In both funds, however, there have been some budgetary changes that skew these percentages. For example, HB124 (local government entitlement legislation) diverted some local government revenues to the state treasury in return for a state general fund entitlement appropriation to local governments. This change increased general fund revenues by approximately the same amount of increased general fund expenditures. During the 2003 biennium, the state food stamp program was included in the budgeting process. Prior to this time, this program was considered "off budget" and was not included as a federal fund expenditure.

Regardless of these changes, the fact remains that federal funds were a smaller portion of the total state budget until about FY 2002. Beginning in FY 2003, this trend was reversed wherein general fund was a smaller portion of the total state budget. Beginning in FY 2007, general fund was once again a larger portion of the total budget. Federal funds were more significant in FY 2010 because of federal stimulus dollars Montana received under the American Recovery and Reinvestment Act.

As shown in Figure 7, general fund expenditures represented over 60% of the combined general and federal fund expenditures in FY 1990. By FY 1999, the percentage split was about equal. By FY 2004, however, federal funds represented over 55% of the combined spending to about 44% from the general fund. Interestingly, the federal funds percentage has dropped to about 45% in FY 2008. Total federal funds expended in FY 2008 were \$1.700 billion compared to \$2.069 billion general fund, for a difference of \$369 million. This shift in percentages was due to the unusually high amounts of one-time only disbursements in FY 2008. If Montana was to lose a portion of these federal funds, the impact on the services provided to the citizens would be significantly reduced. To maintain the same level of services would require a substantial change in state tax policy.

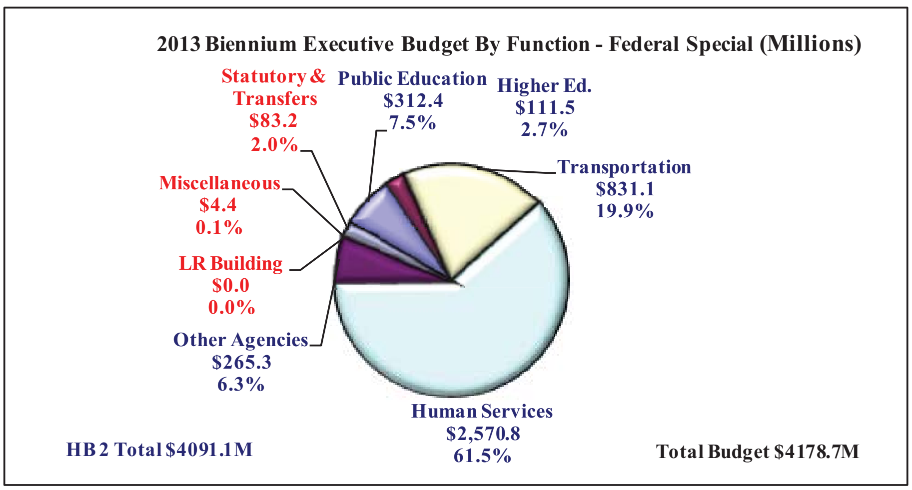
Figure 7



	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
General Fund	60.7%	61.5%	60.0%	58.9%	57.3%	57.6%	53.0%	53.2%	52.3%	49.8%	49.6%	50.1%	50.4%	46.2%	44.5%	46.7%	49.9%	51.8%	54.9%	49.6%	42.4%
Federal Fund	39.3%	38.5%	40.0%	41.1%	42.7%	42.4%	47.0%	46.8%	47.7%	50.2%	50.4%	49.9%	49.6%	53.8%	55.5%	53.3%	50.1%	48.2%	45.1%	50.4%	57.6%

Figure 8 shows the 2013 biennium executive budget recommendation for federal special revenue funds. As the figure shows, public health and transportation services consume over 81% of the federal funds recommended in the executive budget. A potential reduction in federal funding would have a significant impact to these state functions.

Figure 8



RELIANCE ON FEDERAL FUNDS - SUMMARY

With huge federal deficits, federal funding freezes or reductions is a real possibility, not only in the near-term but also in the long-term. The current economic crisis has impacted federal revenues and will continue to have substantial impacts well into the future. The

62nd Legislature may want to consider developing a long-range plan in the event of a reduction in federal funds.

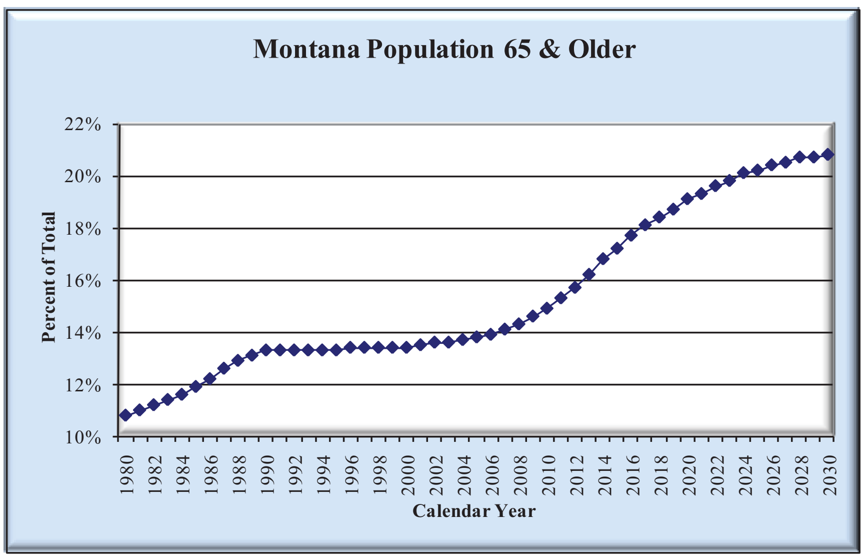
FUNDING DEMANDS

Businesses as well as government constantly experience the changing and competing demands for available dollars. Whether a business is contemplating expansion or technology enhancements, state government experiences the same type of needs and priorities in order to continue services to the citizenry of the state.

Aging Population

One of the most significant events that is beginning to surface in Montana is the projected increase in the aging population. Between 2002 and 2025, Montana's population 65 and older is expected to increase from 13.6% of the total population to 20.2%, or a change in older residents of almost 100,000. As shown in Figure 9, Montana experienced rapid growth in this age cohort from calendar 1980 to 1990.

Figure 9



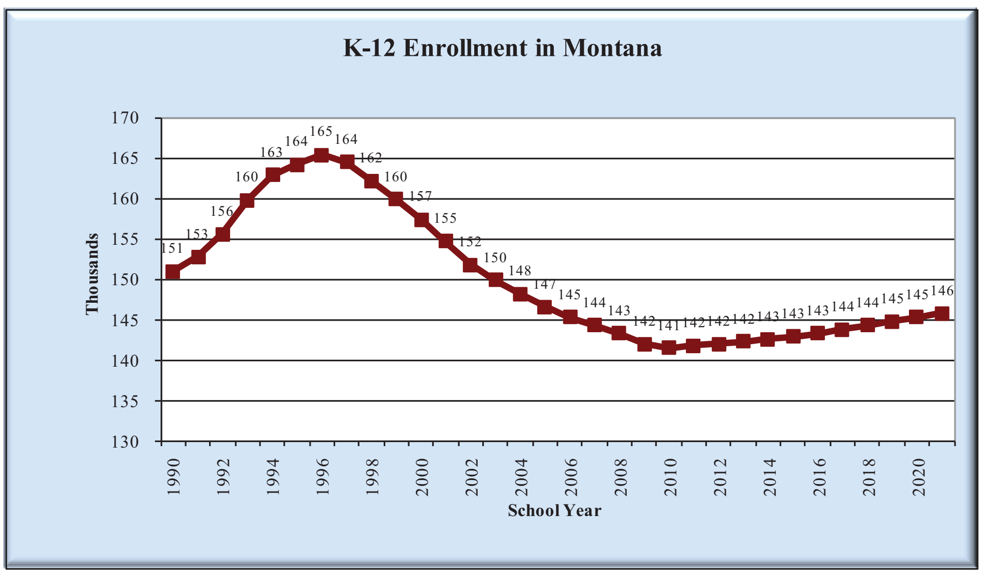
Starting in calendar 1991 and through 2002, this trend waned, with the percentage of residents in this age bracket remaining quite constant. From calendar 2002 to 2025 this trend is once again changing, showing a significant percentage of Montana's total population in the 65 and older age range. If these projections are correct, by calendar 2025, one out of every five Montanan's will be at least 65 years old.

The primary cause of this rising population change is the maturing of the baby-boomer generation, born between 1946 and 1965. Montana, like other state and local governments, will need to address the issues relative to changing demographics. As Montana's population ages, issues relative to an economy that will be required to support these changes and the implications for medical and long-term care costs must be addressed.

With a growing elderly population, the legislature will need to address how the working-age population can support a significantly older population. In addition to the associated costs of caring for the elderly, the level of income these individuals have, and ultimately how much they will pay in taxes could have a substantial impact on state government finances. Given the expected dramatic changes in the age structure of this state's population, these issues and how they may be addressed in the future are imperative.

During the 2007-08 interim, the RTIC and the LFC formed a subcommittee to discuss the fiscal implications of an aging population and other demographics on state revenues and expenditures. Their work resulted in a study proposal which was brought to the legislature via HB 81. This legislation created an interim committee to conduct a study of the potential long-term effects of demographic, economic, social, and other trends in Montana. State and local governmental programs and services, and state and local revenue systems would have been studied. The legislature did not pass this legislation.

Figure 10



School Enrollment

In addition to our aging population, Montana has experienced a significant change in enrollment in our elementary and secondary public schools. As shown in Figure 10, Montana's total enrollment was in excess of 165,000 children in school year 1996. From this time forward, total enrollment declined to about 141,000 students by school year 2010. Beyond 2010 enrollment is estimated to increase, but at a fairly moderate rate. The significance of this change is the costs associated with funding the current public school system. Under current law, state expenditures for public schools are primarily driven by the enrollment in each district. If enrollment declines, then the cost to fund education correspondingly declines.

If the current public school funding formula continues to be enrollment driven, the cost of funding the public school system will begin to accelerate when the current enrollment trends reverse direction beginning in school year 2014. At an average cost of about $3,900 per enrollee per year, small changes in enrollment can turn into significant funding increases in the future.

Funding Demands - Summary

Changes in population demographics related to an aging population and a reversal of the decline in school enrollments are just two examples of funding demands. The chronic demands for increased human services, corrections and pension funding are well known, and there are other troubling signs that funding demands could exacerbate the long-term stability of the general fund.

CONCLUSIONS

Ensuring that the general fund is structurally balanced, i.e., that on-going revenues meet or exceed on-going expenditures for the next biennium, provides a simplistic short-term assessment of sustainability of the general fund. However, it does not take into consideration the long-term stability of the funds or whether long-term trend assumptions are based on sound fiscal policies. This section discussed three key issues related to long-term stability that may point to tougher times ahead. With regard to revenue stability, individual income taxes, oil and gas production taxes, and corporate income taxes accounted for 84% of revenue decline in the past two fiscal years. Further reliance on these revenues into the future should warrant careful scrutiny and long-term planning. Regarding funding demands, shifting demographics related to aging population and school enrollment, as well as challenging chronic growth patterns with corrections and human services, signal yet another reason for concern with long range stability of the general fund. Collectively, these sample issues bring into question the sustainability of an executive budget proposal that is "structurally imbalanced" from a simplistic short-term perspective, which may lead to further budget shortfalls in the not-too-distant future.

LFD ISSUE

While revenue estimates and spending proposals in the executive budget may be based on the best information available, particularly with regard to future sustainability, if only a few key assumptions miss the mark, it could lead to further budget shortfalls in the long-term. The legislature should carefully consider the issues surrounding the sustainability of the proposed executive budget, and determine the level of risk that is acceptable in consideration of the vulnerability of any economic forecasting assumptions. For the longer-term, an in-depth analysis of the long-term stability of the general fund would require a fairly extensive analysis, but may be prudent given the serious impacts of over-extending based on erroneous assumptions.

The legislature may wish to consider an interim study bill that would study the long-term stability of the general fund. Much could be learned from examining the fiscal policies on which the current general fund structure is based.

Based on this outlook, it could be argued that a significant amount of additional revenue received during the period FY 2004 through FY 2008 should have been considered "one-time" and should not have been expended for on-going programs. If this hypothesis is correct, the 62nd Legislature should consider creating a "rainy day fund" that is designed to capture additional revenue above a defined cap. Given the tenuous nature of some assumptions regarding the long-term sustainability of general fund, a rainy-day fund would provide a cushion to get through the down-side of economic cycles.

PENSION PLANS UNFUNDED LIABILITY

Does the legislature need to take action in the 2011 session?

One of the key fiscal issues in front of the legislature over the past four biennia has been the unfunded actuarial liability (UAL) of the state pension plans. In two different sessions (the December 2005 special session and the 2007 special session) the legislature approved cash contributions totaling $175 million to reduce unfunded liabilities and shore up plan assets that had been impacted by reduced equity market values and a downturn in investment earnings generally. In FY 2007, the equity markets regained value and at the end of June 2007, all of the pension plans were actuarially sound as defined in state statute (discussed below). At the end of FY 2008, the equity markets dropped in value in the last month of the year, all but one of the plans still met the criteria of being actuarially sound. Only the Teachers' Retirement System was determined to be actuarial unsound. In FY 2009, the bottom fell out of the equity markets and pension asset values tumbled, showing losses of about 22%. As of the year ended June 30, 2009 and again as of June 30, 2010, four of the nine pension plans had "negative" actuarial valuation reports. About half of the loss in asset value has not yet been recognized in determining the unfunded actuarial liability. Similarly, only about one-quarter of the gains of FY 2010 have been recognized.

Does the legislature need to take action in the 2011 session? If no action is taken or if there is not a continued and dramatic recovery of the equity markets, future legislatures will be faced with significant issues concerning the long-term health of the retirement systems. These fiscal issues are a part of the entire budget debate because the fiscal health of the retirement system is an important component of state and local government fiscal stability.

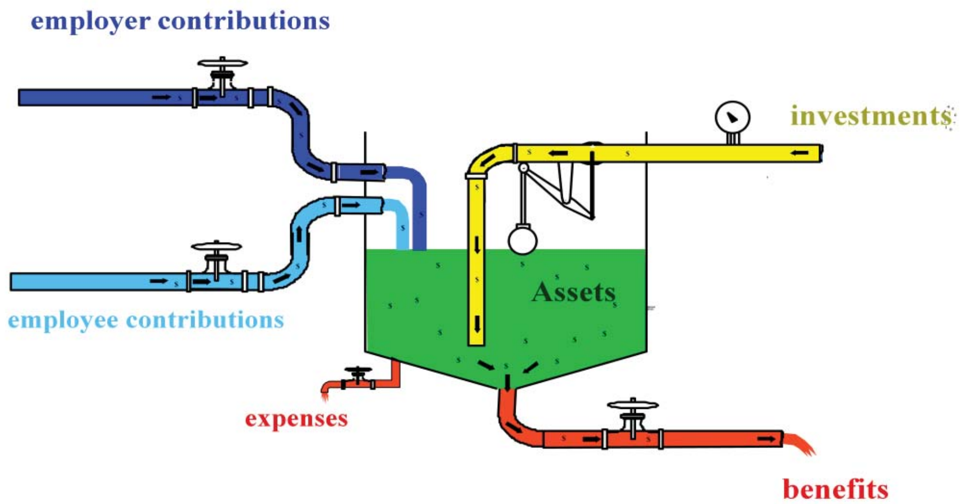
There are three parts to this discussion. The first focuses on the actuarial valuations of each plan as the tool that reports whether or not a retirement plan is actuarially sound. This is an important discussion because of its relevance to a constitutional requirement. The second part focuses on the "annual required contribution" (ARC) of the pension plans, which are an indication of the long-term health of the pension plans. The third part discusses other risks to consider. The fourth part discusses the legislation that is anticipated for the 2011 Session.

BACKGROUND

This section discusses some key concepts concerning pension systems.

How Pension Systems Work

The following is a simple schematic of a pension system. Employer and employee contributions and investment earnings flow in, and retirement benefits and administrative expenses flow out.



What this schematic does not show is that fluctuations in the equity markets can cause the asset values to increase or decrease. In other words, the investments pipe can flow both ways, depending on the markets. For the most part, the employer and employee contributions are a percentage of employee payroll. However, as mentioned earlier, on a couple of occasions, the legislature approved a direct cash infusion to shore up pension assets. The workings of this simple schematic become more complex when discussions turn to actuarial valuations.

Actuarial Valuation

An actuarial valuation is an analysis of the expected liabilities or retirement payments that will be owed in the future compared to the value of funds (assets) held by the fund and expected contributions and investment earnings into the future.

Actuarial Value of Assets

The actuarial value of assets differs from market value in one way. Actuarial value includes a technique of "smoothing" that spreads gains and losses of the pension plans investments over a 4-year period rather than recognizing a gain or loss in the year it occurs. Market value is the amount of money that could be acquired if the asset were exchanged on the open market. The smoothing method simply attempts to account for fluctuation in the investment market.

Actuarial Liability

The actuarial liability of a pension plan is the amount that is projected to be needed to pay obligations in the future. It can be likened to a mortgage amount, although unlike a mortgage, the pension liability is determined annually (by the actuarial valuation) based upon what is currently known about the pension fund and what is assumed for the future. Theoretically, like a mortgage, the amount owed for future benefits should be paid for in a specified time by the contributions and investment earnings that are collected or expected to be collected. If the actuarial liabilities exceed the actuarial value of assets of the pension fund, then there is an **unfunded actuarial liability**. In other words, unfunded actuarial liability is the present value of benefits earned to date not covered by the current plan assets, or in the mortgage analogy, the mortgage cannot be paid off with the current level of payment.

Actuarially Sound

Article VIII of the State Constitution states that "public retirement systems shall be funded on an actuarially sound basis." State law defines actuarial soundness by stating that the "unfunded liability contribution rate…must be calculated as the level percentage of current and future defined benefit plan members' salaries that will amortize the unfunded actuarial liabilities of the retirement plan over a reasonable period of time, not to exceed 30 years, as determined by the board." In other words, the contribution rate for a particular plan must exceed the level needed to cover the normal costs of benefits and administration for the retirees and be sufficient, when amortized, to cover the unfunded liability within 30 years (i.e., pay off like a mortgage over 30 years).

MOST RECENT ACTUARIAL VALUATIONS

An actuarial valuation, by statute, is required annually for each plan. The valuations are prepared after the end of the fiscal year and are available to the respective retirement boards around October 1 of each year. The following figure summarizes key points of actuarial valuations for the year ending June 30, 2010 and 2009. The four plans that are shaded are those pension plans that were the focus of attention over most of the past decade as they were considered "actuarially unsound" much of that time.

The key item to focus on in the FY 2010 data is the "Years to Amortize Unfunded Liability." This is an important indicator because the definition of "actuarial soundness" is tied to the pension plan ability to pay down its unfunded liability within a 30 year period. As the following figure shows, the four pension plans exceed the 30-year amortization.

There are two points that need to be noted. First is that this data does not include all of the losses that occurred in FY 2009 or all of the gains that occurred in FY 2010. The valuation process applies a technique called "smoothing" that spreads gains and losses out over a period of time. Therefore, losses that occurred in FY 2009 are not totally realized in this current valuation, but rather are spread out over a four-year period. Second, actuarial valuations are snapshots as of June 30. The current valuation does not take into account the impact of economic events since June 30, 2010, where retirement investments have experienced some recovery.

Pension Plan Unfunded Actuarial Liability
2010 Actuarial Valuation versus 2009 Actuarial Valuation
(Dollars in Millions)

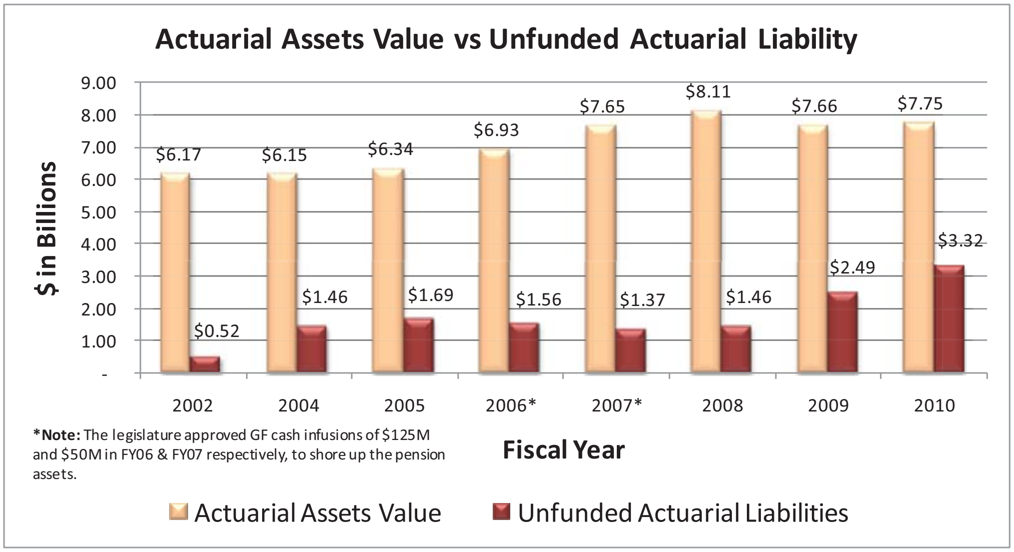
	TRS	PERS-DB	SRS	GWPORS	HPORS	MPORS	FURS	JRS	VFCA
2010 Valuation (as of 6/30/2010)									
Actuarial Accrued Liability (AAL)	$4,518.2	$5,241.8	$246.7	$113.9	$151.2	$380.4	$335.5	$42.5	$34.5
Actuarial Value of Assets (AVA)	2,956.6	3,889.9	200.7	85.2	97.2	217.5	213.8	61.3	26.6
Unfunded Actuarial Liability/(Surplus)	$1,561.6	$1,351.9	$46.0	$28.7	$54.0	$162.8	$121.7	($18.8)	$7.9
Funded Ratio (AVA/AAL)	65.4%	74.2%	81.4%	74.8%	64.3%	57.2%	63.7%	144.1%	77.0%
Years to Amortize Unfunded Liability	49.5 yrs	Does not amortize	Does not amortize	Does not amortize	26.3 yrs	19.9 yrs	13.8 yrs	0 yrs	n/a
	TRS	PERS-DB	SRS	GWPORS	HPORS	MPORS	FURS	JRS	VFCA
2009 Valuation (as of 6/30/2009)									
Actuarial Accrued Liability (AAL)	$4,173.8	$4,792.8	$223.9	$92.2	$137.8	$345.3	$306.2	$41.8	$33.5
Actuarial Value of Assets (AVA)	2,762.2	4,002.2	200.7	81.2	99.6	214.3	209.8	61.9	27.2
Unfunded Actuarial Liability/(Surplus)	$1,411.6	$790.6	$23.2	$11.0	$38.2	$131.0	$96.4	($20.1)	$6.3
Funded Ratio (AVA/AAL)	66.2%	83.5%	89.6%	88.1%	72.3%	62.1%	68.5%	147.9%	81.2%
Years to Amortize Unfunded Liability	Does not amortize	Does not amortize	Does not amortize	Does not amortize	21.5 yrs	22.1 yrs	12.7 yrs	0 yrs	6.9 yrs

Key
TRS - Teachers' Retirement System
PERS-DB - Public Employees' Retirement System - Defined Benefits
SRS - Sheriffs' Retirement System
GWPORS - Game Wardens and Peace Officers' Retirement System
HPORS - Highway Patrol Officers' Retirement System
MPORS - Municipal Police Officers' Retirement System
FURS - Firefighters' Unified Reirement System
JRS - Judges' Retirement System
VFCA - Volunteer Firefighters' Compensation Act

The next scheduled valuations will occur after June 30, 2011 and will not be available until around October 1. How the equity markets and other investments perform before the end of FY 2011 is unknown, but it is how they perform that will determine the relative soundness or unsoundness of the retirement plans in the next valuation, assuming that the actuarial assumptions remain relatively unchanged. The assumptions used in the valuation are subject to review, and in fact, some changes occurred prior to the 2010 valuation.

Total Unfunded Actuarial Liability

The net unfunded liability of the nine defined benefit pension plans collectively increased from $2.5 billion in 2009 to $3.3 billion in 2010. The collective funded ratio, which was about 75.5%, dropped to 70% percent. A look at the unfunded actuarial liability for the past decade adds more significance to the magnitude of these numbers. As the chart below shows, the unfunded liability has increased six-fold since FY 2002 while the actuarial assets increased 25%.



There are two primary reasons for the increase in the UAL in the 2010 valuation: 1) For all nine pension plans, they are in the second year of the 4-year smoothing cycle for the losses that occurred in FY 2009 investment returns. The downturn was so significant that even with "smoothing," the impact in each valuation is dramatic. 2) For the eight plans under the Public Employees Retirement Board, the assumption for investment returns for the FY 2010 actuarial valuation was reduced from 8 percent to 7.75 percent. The seemingly small change, when applied to pension plan values and spread over the 30-year amortization period, also has a dramatic impact.

ANNUAL REQUIRED CONTRIBUTION

However, the above does not tell the whole story. The actuaries also provide estimates of what the "annual required contribution (ARC)" should be to ensure that the actuarial unfunded liability can be amortized within the 30-year threshold. The ARC is a determination based upon the assumptions that are used in the actuarial valuation. Accounting standards require its calculation but it is not typically used to determine funding. It does, however, provide a link between the valuation statement that "the unfunded liabilities of a given plan does not amortized in 30 years" and the obvious question of "what will it take to get there?" While a contribution increase is not the only answer, calculating the cost of the ARC does place a value on the problem.

The following figure shows the difference between the statutory employer contribution rate and the estimated ARC. The difference or shortage would translate to the increase in contributions needed to ensure that the unfunded liabilities of the pension plans can be amortized within 30 years.

When the ARC rate is applied to the projected wage data of state and local government employees and teachers for the FY 2012 and FY 2013, the estimated state general fund impact is $31 million for FY 2012 and $37 million for FY 2013.

Pension Plan Unfunded Liabilities Annual Required Contribution (ARC)
ARC Rate versus Current Statutory Rate

Fiscal Year	TRS	PERS	SRS	GWPORS	HPORS
Statutory Employer Rates					
2012	9.96%	7.17%	10.12%	9.00%	36.33%
2013	9.96%	7.17%	10.12%	9.00%	36.33%
2014	9.96%	7.17%	10.12%	9.00%	36.33%
2015	9.96%	7.17%	10.12%	9.00%	36.33%
Annual Required Contributions (ARC) Rate to Attain 30-Year Amortization					
2012	12.16%	15.33%	17.07%	13.90%	41.37%
2013	14.18%	15.39%	17.07%	13.87%	40.79%
2014	15.13%	15.61%	17.23%	13.92%	40.54%
2015	15.13%	15.84%	17.39%	13.99%	40.28%
Rate Shortage					
2012	2.20%	8.16%	6.95%	4.90%	5.04%
2013	4.22%	8.22%	6.95%	4.87%	4.46%
2014	5.17%	8.44%	7.11%	4.92%	4.21%
2015	5.17%	8.67%	7.27%	4.99%	3.95%

Data Source: June 30, 2010 actuarial valuations - for TRS 2014-15, LFD analysis uses the ARC determined for FYE 2012 from market value as proxy for unavailable data.

This calculation also includes a potential adjustment to the contribution rates of the university system's Optional Retirement Plan, specifically the portion that the employer must pay to TRS to pay down unfunded liabilities (future costs) resulting from TRS members being in the ORP plan rather that the TRS plan. A recent study suggests that 3.82% be added to the current supplemental rate of 4.72%.

What the Data Shows

Using the estimated ARC rates discussed above, the total impact is $296 million for the 2013 biennium, including impact on the state general fund, other state funds (state special, federal, etc.), local governments, and schools.

The figure below shows the potential impact for the next two biennia.

Potential Pension Cost Increases
FY 2012 - FY 2015 (Dollars in Millions)

	FY 2012	FY 2013	FY 2014	FY 2015
State Costs				
General Fund	$ 31	$ 37	$ 41	$ 44
Other Funds	48	53	58	62
Local Schools	18	29	36	37
Local Government	39	40	43	46
	$ 136	$ 160	$ 178	$ 189

The analysis assumes that local governments and schools would be responsible for their costs except where the guaranteed tax base (GTB) comes into play. GTB costs are shown in the figure as part of the state general fund costs. In addition, the general fund estimated costs include estimates of the portion of university system current unrestricted funds that would come from the general fund. It also includes a portion of the proprietary funds that translate to general funds when agencies are billed for internal service fund services such as information technology services. The estimated cost to the general fund in the 2013 biennium is $68 million. The cost to other state funds would be $101 million.

Local Schools

Each county has high school and elementary county retirement accounts for employees employed by school districts. These accounts collect revenue to pay for the employer contributions to the TRS and PERS on behalf of school employees. It also collects revenue to pay for the Social Security, Medicare and unemployment insurance on behalf of school district employees. Each school district reports its retirement, Social Security, Medicare and unemployment insurance requirements to the county superintendent. The county superintendent sums these requirements for districts within the county. The state by law pays a portion of the contribution and the counties pay the remainder. For instance, for TRS, the state contributions into TRS for FY 2010 and FY 2011 are 2.38% of wages plus 0.11% of wages for a total of 2.49%[4]. The counties pay 7.47% of wages. The figure shows that the cost to schools overall would be $47 million for the 2013 biennium and $73 million in the 2015 biennium.

The county has three main sources of revenue to pay for the increased retirement costs: Non-levy revenue (such as oil and gas revenue, coal gross proceeds, interest earnings), property taxes, and, if eligible, state GTB payments. A county is eligible for state GTB payments if its taxable value per pupil is below 121% of the statewide average taxable value per pupil. Once a county has received the revenue to pay for the required contributions for the school districts within its boundary, it sends the revenue to each school district that then pays the contributions, as well as social security, Medicare and unemployment insurance. If local contribution rates increase and the state does not increase its share, then the retirement revenue requirements for counties will also increase. Some counties may have enough revenue from non-levy sources so that property taxes and state GTB will not increase. In the absence of sufficient non-levy revenue or an increased state supplemental contribution as discussed above, when local contribution rates increase, a county must raise the additional local revenue through property taxes and GTB.

Local Government

MCA 15-10-420 limits the increase from year to year of a local government's revenue from property taxes to one-half the rate of inflation averaged over the prior three years without a vote. This applies to county governments and city governments, but not to school districts, and the county retirement account discussed above is considered to be exempt from 15-10-420, MCA.

The result from applying the potential ARC rates as future contribution rates to local government jurisdictions are shown in the figure above for FY 2012 through FY 2015. The analysis shows the cost to local government would be $79 million for the 2013 biennium, which might result in property tax increases if room exists under the limit, or the reduction of current service levels in order for counties or municipalities to cover the increased costs. The estimated $79 million is about 3% of total county and municipality 2-year spending statewide. For the 2015 biennium, the estimated cost of $89 million would also fall into the 3% to 3.5% range.

[4] The contributions by the state are transferred from the state general fund to the Teachers' Retirement Fund in a statutory appropriation (19-20-607, MCA). The 2.38% state supplemental rate was added by HB 63 of the 2007 session to address the unfunded liability and the 0.11% was added in HB 72 of the 1999 session to fund the guaranteed annual benefit amount (GABA) of 1.5% for TRS. There is a similar state contribution by statutory appropriation to the Public Employees Retirement fund on behalf of local government and schools (19-3-319, MCA) to address the unfunded liability (HB 131 of 2007 session).

FURTHER RISKS

There are other considerations to keep in mind regarding pension plans:

- The analysis discussed above is based upon the pension plan actuarial valuations as of June 30, 2010. Although the equity markets have made big gains over the past two years, they continue to experience volatility. In addition, there are still two more years in which the losses of FY 2009 will be recognized. What the next valuations will show at the end of the current fiscal year is unknown. Without strong investment returns and/or some other action, the expectation is that at least four pension plans will still not be actuarially sound.
- In the Teachers' Retirement System 2010 Actuarial Valuation, the plans actuary shows that without some corrective action, projections cash flow will trend downward beginning in FY 2012, turning into a negative cash flow around FY 2021 or FY 2022. A negative cash flow means that payments out of the pension fund would exceed the contributions and investment income coming into the fund. The same is likely for the Public Employees' Retirement System (but the analysis is not available). If cash flow goes negative and stays negative, it is just a matter of time before the fund runs out of money.
- The fiscal health of public pension plans is looked at by bond rating agencies. If the state does not have a viable action plan for fixing an underfunded pension plan, bond ratings may suffer.

IS LEGISLATIVE ACTION NEEDED?

By definition and based upon the most recent actuarial valuation, four of the public pension funds are not actuarial sound. In addition, the actuarial soundness of these plans are based upon assumptions that measure the long-term trends of various factors, with investment returns certainly being a key one. When the legislature convenes in January, there will still be six months remaining in FY 2011 and the session will end 5-months prior to the availability of the FY 2011 valuation. Historic economic cycles and the logic of actuarial valuations would suggest that time might resolve the pension plan unfunded liabilities to the degree needed for actuarial soundness, but the downturn of the equity markets in FY 2009 were unprecedented in recent history. Even the retirement boards have a policy that provides that after two consecutive "negative" valuation reports, the boards are obligated to pursue legislative remedies. The question then becomes: How long might a recovery take? The answer to that question will not likely be evident in the near future. In fact, economic experts are forecasting a slow recovery. To whatever extent the economy recovers, it may not be enough to add needed stability to the pension plans.

The retirement boards have a policy that provides that after two consecutive "negative" valuation reports, the boards are obligated to pursue legislative remedies. In addition, 2011 Legislature can expect to see recommendations from the State Administration and Veterans' Affairs Interim Committee (SAVA), the retirement boards, various stakeholders, and others intended to enhance and stabilize the respective plans. The proposals will vary. Many are directed at new hires, some would raise employer contribution rates for the plans and change benefit calculations, and the SAVA committee is proposing two plans for newly hired teachers that reduce the state's funding risks, and there are a couple of "housekeeping" bills. There appear to be many bills in the works to address pension plan issues. Many have little to offer the issue of unfunded liability but can offer some long-term solutions to those issues. A few might have the potential to reduce the unfunded liability but may see court challenges if enacted.

TRANSFERS TO THE GENERAL FUND FROM OTHER FUNDS

There are several proposals in the executive budget to transfer moneys to the general fund as part of the solution to solve budget gap. These transfers total $95.2 million for the general fund. The following provides information regarding the impacts of the transfers:

HB 5 – LONG-RANGE PLANNING PROGRAM

The Governor recommends the reduction or elimination of certain Long-Range Building Program (LRBP) projects and the transfer of $11.7 million of LRBP capital project funds to the general fund. The planned LRBP project reductions/eliminations include:

- The Receiving Hospital Renovation at MT State Hospital ($4.5 million)
- The Expansion of Food Services at Montana State Prison ($1.2 million)
- the New Building for Youth Transition Center, Great Falls ($1.3 million)
- A new Office of Public Assistance, Wolf Point ($2.2 million)
- Statewide Facilities Planning ($0.4 million)
- Infrastructure Repairs at the State Capitol, Helena ($0.5 million)
- Auto Tech Center Design at MSU-Northern ($0.6 million)
- LRBP Additional Capital Project Fund transfer, without accompanying project reduction ($1.0 million)

For more information on the transfer of funds see Vol. 7, page F-8 of the Legislative Budget Analysis.

HB 10 – LONG-RANG INFORMATION TECHNOLOGY PROJECTS

The Governor recommends the reduction or elimination of certain Long-Range Information Technology Program (LRITP) projects. The planned LRITP project reductions and transfers to the general fund amount to $10.7 million and include:

- The Montana Automated Child Welfare Information System (MACWIS) (Child and Adult Protective Services, CAPS) Project ($10.3 million)
- The Judicial Branch Information Technology Project ($0.3 million)
- The Efficiency through Imaging, Department of Revenue (DOR) ($0.1 million).

For more information on the transfer of funds see Vol. 7, page F-16 of the Legislative Budget Analysis.

HB 11 – TSEP AND REGIONAL WATER TRANSFER

The executive proposes two transfers from the Treasure State Endowment Programs (TSEP) to the general fund in HB 11. The first proposed transfer is from the TSEP interest earnings from the local government water infrastructure grant program state special revenue fund ($17.6 million). If the legislature agrees with this transfer, there will not be any funds available for TSEP local government infrastructure grants in the 2013 biennium. The second transfer, $4.8 million, is from the TSEP regional water program. These funds are used to match federal dollars for large regional water projects. If the legislature agrees with this transfer, there will not be any state funds available for projects in the 2013 biennium. For more information on the transfer of funds see Volume 7, pages F-19 through F-25 of the Legislative Budget Analysis.

BIG SKY ECONOMIC DEVELOPMENT

Interest from coal tax revenue deposited to the Big Sky Economic Development Fund is transferred to a state special revenue account. Money in the account is statutorily appropriated to the Department of Commerce for administration with the 75% distributed to local governments and tribal governments to be used for job creation effort, and 25% distributed to certified regional development corporations, economic development organizations that are located in a county that is not part of a certified regional development corporation, and tribal governments.

In HB 140, the executive proposes to divert $2.89 million of earnings in the 2013 biennium and deposit the money in the general fund. Because of the diversion, the amount of funds available to local and tribal governments and regional development corporations will be reduced by 50% for two years.

FIRE SUPPRESSION FUND TRANSFER

The Governor is proposing to transfer $20.0 million from the fire suppression fund to the general fund to assist with the current general fund shortage. However, this transfer does not come without risk to the state. This is discussed in more detail in this section under the heading for Fire Suppression Funding on page 105.

SCHOOL FACILITY

The executive budget includes two proposals decreasing funds that are set aside for school facility upgrades through the Quality School Facilities Grant Program (QSFP). The reductions of funds will indirectly impact the general fund, as increased funds will be available for school funding through the state guarantee account.

The first proposal would delay the start of the flow of the streambed rents for a biennium. Under current law, the flow of revenue is set to begin January 1, 2012 and is expected to bring $8.6 million in revenue to the QSFP fund during the 2013 biennium. The proposal would allow the funds to flow into the state guarantee account for the 2013 biennium. While the LFD anticipates the biennial reduction of QSFP funds at $8.6 million, the "transfer" is shown on the executive balance sheet at $10.0 million per year. The reason for the difference between the two offices is that the executive has included an amount in anticipation of the state winning the lawsuit with Pennsylvania Power and Lighting (PPL). In the suit, PPL is arguing against the state's right to charge rent against the sections of streambed that the company occupies. As the matter is still in litigation, there is a possibility that these funds may not materialize. If the company is successful, the state will not receive rents from PPL and the projected $8.6 million, which is currently paid by other utility firms, could also be in jeopardy. If the funds do not materialize, the general fund will be required to support the K-12 education at a higher level.

The second proposal is a funding switch of the debt service currently paid from the state guarantee account to the QSFP fund. This funding switch is expected to equal $17.2 million in the 2013 biennium. For more information on the transfer of funds see Vol. 7, pages F-47 of the Legislative Budget Analysis.

HEALTH CARE AND BENEFITS DIVISION TRANSFER

The executive budget includes a $0.1 million transfer to the general fund from the workers' compensation agency assistance state special revenue account. The Workers' Compensation Management Program (Department of Administration) negotiated a retention return clause in state policies that requires reimbursements from the State Fund if workers' compensation losses are lower than premiums paid by state agencies. The second year this contract provision was in force, the state received $1.6 in retention return funds and the Workers' Compensation Management Program received an appropriation in HB 2 for $500,000 of the refund. The program used funds to help jump start agency work safety programs and to purchase ergonomic equipment to prevent workplace injuries. The executive budget transfers excess funds from the account to the general fund.

NATURAL RESOURCE DAMAGE PROGRAM TRANSFER

Included in the executive budget is a transfer of $1.3 million from the natural resources damage (NRD) program funds obtained through the ARCO settlement to the general fund. This transfer is to repay the general fund for start up costs that were provided to the NRD program. The consent decree allowed for state costs of litigation to be reimbursed.

COAL BED METHANE ACCT

The executive is proposing a one-time transfer of $6.0 million from the coal bed methane (CBM) fund to the general fund. The CBM fund was established to provide compensation to landowners and water right holders for damages attributable to coal bed methane development. This transfer along with the executive budget request will decrease the fund balance to approximately $3.0 million for the 2013 biennium. The risk of the transfer is that if a large number of claims for damages is filed, the state will not have sufficient funds to cover the payments. The $3.0 million would cover approximately 60 claims at the $50,000 per claim limit. In FY 2010, there were no claims submitted for payment.

PRESENT LAW ANALYSIS

Figure 1

2013 Biennium Present Law Budget - General Fund							
Figures in Millions							
	Actual FY 2010	Estimated FY 2011	Estimated FY 2012	Estimated FY 2013	2011 Biennium	2013 Biennium	Biennial $ Change
Beginning Fund Balance	$396.334	$314.880	$183.263	$31.829	$396.334	$183.263	($213.071)
Revenue							
RTIC Revenue Estimate	1,627.145	1,672.133	1,753.767	1,825.963	3,299.277	3,579.731	280.453
Total Funds Available	$2,023.478	$1,987.013	$1,937.030	$1,857.792	$3,695.611	$3,762.993	$67.383
Disbursements							
General Appropriations - HB2	1,575.921	1,533.314	1,701.756	1,704.751	3,109.235	3,406.507	297.272
Statutory Appropriations	169.872	180.683	189.618	197.180	350.555	386.798	36.243
Transfers	88.877	49.144	16.741	12.426	138.021	29.167	(108.854)
Other Appropriations	-	139.737	-	-	139.737	-	(139.737)
Supplementals	-	2.851	-	-	2.851	-	(2.851)
Feed Bill	-	9.818	2.469	10.009	9.818	12.478	2.660
Reversions	(117.960)	(112.263)	(5.383)	(6.686)	(230.223)	(12.069)	218.154
Total Disbursements	$1,716.710	$1,803.284	$1,905.201	$1,917.680	$3,519.994	$3,822.881	$302.887
Fund Balance Adjustments	8.112	(0.466)	-	-	7.646	-	(7.646)
Ending Fund Balance	$314.880	$183.263	$31.829	($59.888)	$183.263	($59.888)	($243.150)
Structural Balance Calculation			($151.434)	($91.717)			
Fiscal Policies Required to Achieve $100 Million Balance				($159.888)			

Figure 1 shows the projected general fund present law balance for the 2013 biennium. Amounts shown include the revenue estimates as adopted by RTIC on November 19, 2010, and the cost of operating state government based on "present law" requirements. These disbursement amounts are as proposed in the executive budget. The present law amounts shown for both anticipated revenues and expenditures do not include any new proposals or initiatives recommended by the executive. As Figure 1 shows, the 2013 biennium ending general fund balance is projected to be a negative $60.0 million before any new proposals or initiatives are considered. This balance indicates the state cannot maintain the existing present law services without a reduction in services or revenue enhancements.

Figure 2

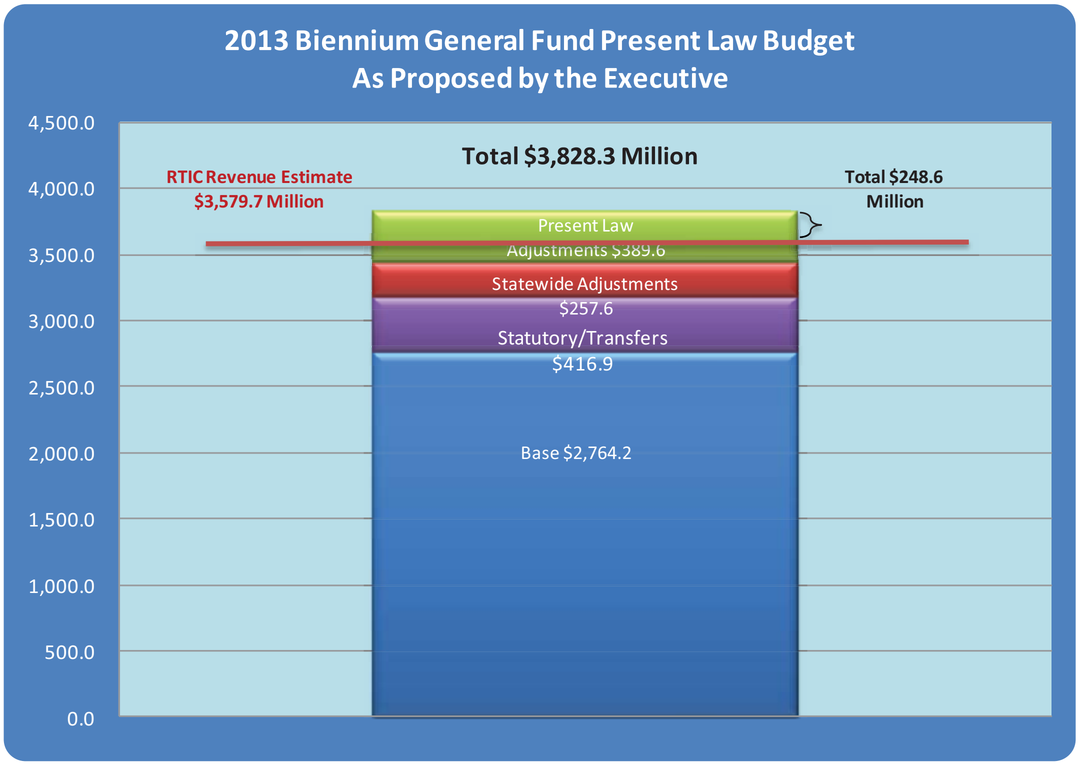
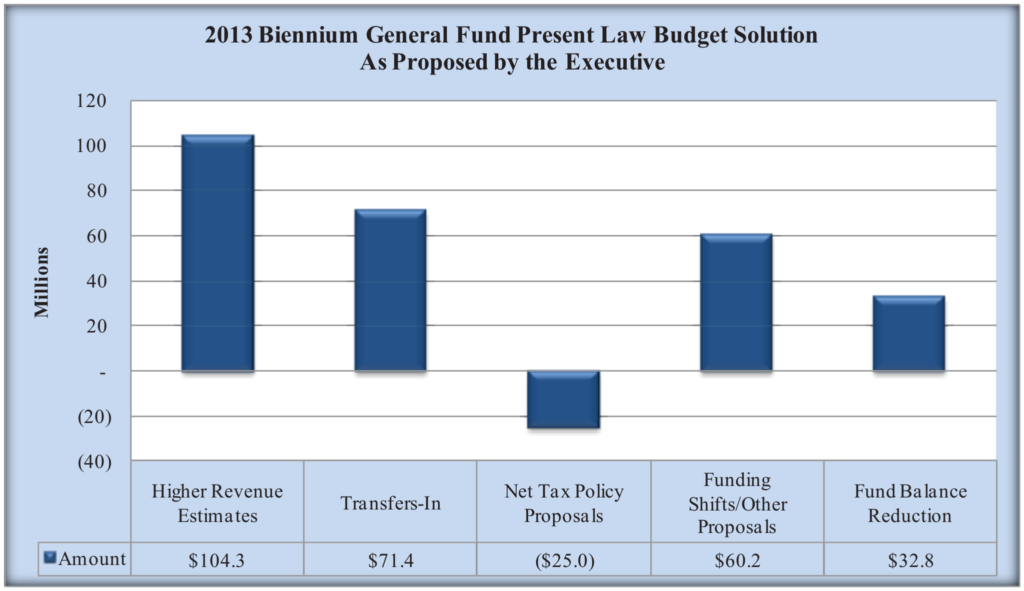


Figure 2 shows the projected general fund gap between RTIC anticipated revenues versus the present law expenditure costs. As shown in the figure, the budgetary gap between anticipated revenues and present law costs is $243.2 million. The amount does not include any of the recommended solutions of the executive nor does it include the "current service level" or pension funding issues. See discussion in the overview.

Figure 3 shows the present law budget solution as proposed by the executive. As shown in the figure, the executive proposal relies on higher revenue estimates, fund transfers, funding shifts, and a fund balance reduction to balance the present law budget. From a structural balance perspective, the transfers and fund balance reduction continue the budget gap issue for the 2015 biennium. The net tax policy proposals exacerbate the budgetary gap for the 2013 biennium. It also should be noted that an additional $48 million will be required in the 2015 biennium to continue the tax policy proposals as well as the funding shifts proposed by the executive. These type of delayed impacts would increase a significant budgetary gap issue for the 2013 Legislature.

Figure 3


2013 Biennium General Fund Present Law Budget Solution
As Proposed by the Executive
Millions
120
100
80
60
40
20
-
(20)
(40)
Higher Revenue Estimates
Transfers-In
Net Tax Policy Proposals
Funding Shifts/Other Proposals
Fund Balance Reduction
Amount
$104.3
$71.4
($25.0)
$60.2
$32.8