

DATE: March 7, 2016

TO: Revenue & Transportation Interim Committee Members
House and Senate Tax Members
House Appropriations Members
Senate Finance and Claims Members

FROM: LFD Revenue Team

RE: FY 2016 General Fund Revenue Update #3

PURPOSE OF REPORT

This report is the third of six monthly revenue updates throughout the second half of FY 2016 designed to apprise interested members of the legislature on year-to-date general fund revenue collections, recent economic trends and the outlook for FY 2016 relative to the official revenue estimate contained in HJ 2. As requested by the Revenue & Transportation Interim Committee, these reports now include a section of leading economic indicators.

SUMMARY

General fund revenue collections are \$26.5 million or 2.0% less than FY 2015 amounts through February, and are currently below the overall growth estimate of 2.9% contained in HJ 2. The decline in revenue is somewhat inflated due to a posting error of \$9.3 million made in February 2015 which was subsequently reversed the following month. Adjusting for the error produces a year-to-date decline of \$17.2 million or 1.3%.

Current revenue trends calculated by using year-to-date median collections compared to historical collection patterns (see page 3) indicate total general fund collections of \$2,175 million or about \$90 million less than the HJ 2 estimate. If a similar \$90 million shortage occurs in FY 2017, the ending fund balance would still be sufficient and the [17-7-140 \(3\), MCA](#) "trigger" would not occur as the fund balance would have to fall below \$118 million. In order to reach the trigger, the estimated biennial shortfall would need to be more than \$239 million (\$357 million anticipated ending fund balance less \$118 million required ending fund balance).

Items to watch for in future updates include oil & natural gas tax revenue, and individual income current year and quarterly estimated tax payments, which may change with a potentially changing outlook on capital gains income.

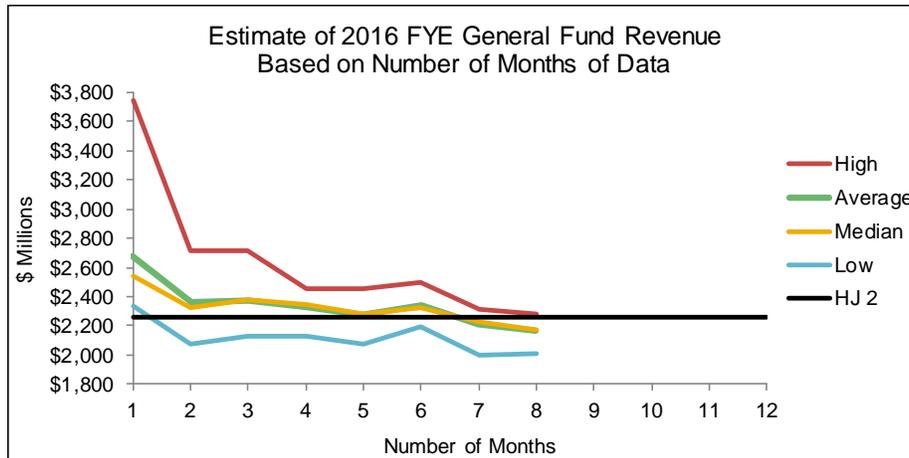
YEAR-TO-DATE GENERAL FUND REVENUE

FY 2016 general fund revenues through the end of February are \$26.5 million or 2.0% less than FY 2015 revenues through the same period; this decrease is below the HJ 2 estimated growth of 2.9%. All major revenue sources and any other sources with significant differences will be discussed in further detail in the next section.

General Fund Revenue Monitoring Report							
(\$ Millions)							
Revenue Source	Actual FY 2015	HJ 2 Est. FY 2016	HJ 2 Est. % Change	2/28/2015 FY 2015	2/29/2016 FY 2016	YTD Difference	YTD % Change
Largest Seven Sources							
Individual Income Tax	\$1,175.745	\$1,229.616	4.6%	\$806.899	\$833.227	\$26.328	3.3%
Property Tax	247.881	253.799	2.4%	140.960	143.816	2.855	2.0%
Corporation Tax	172.729	179.898	4.2%	104.929	76.319	(28.610)	-27.3%
Vehicle Taxes & Fees	106.382	106.199	-0.2%	62.641	59.638	(3.002)	-4.8%
Oil & Natural Gas Taxes	73.184	59.250	-19.0%	26.182	11.260	(14.922)	-57.0%
Insurance Tax	66.582	72.279	8.6%	27.982	31.397	3.415	12.2%
Video Gaming Tax	59.799	62.007	3.7%	29.537	30.050	0.514	1.7%
Other Business Taxes							
Drivers License Fee	4.811	4.081	-15.2%	2.854	2.877	0.024	0.8%
Investment Licenses	6.773	7.412	9.4%	6.209	6.631	0.422	6.8%
Lodging Facilities Sales Tax	19.697	21.872	11.0%	11.201	13.044	1.843	16.5%
Public Contractor's Tax	3.257	3.560	9.3%	3.640	2.524	(1.116)	-30.7%
Railroad Car Tax	3.706	3.741	0.9%	2.842	3.111	0.269	9.5%
Rental Car Sales Tax	3.907	3.486	-10.8%	2.348	2.700	0.352	15.0%
Retail Telecom Excise Tax	18.257	18.999	4.1%	8.656	8.569	(0.086)	-1.0%
Other Natural Resource Taxes							
Coal Severance Tax	16.063	14.434	-10.1%	8.712	7.506	(1.206)	-13.8%
Electrical Energy Tax	5.133	4.580	-10.8%	2.561	2.374	(0.187)	-7.3%
Metal Mines Tax	8.320	8.311	-0.1%	0.390	0.241	(0.149)	-38.2%
U.S. Mineral Leasing	26.960	24.069	-10.7%	16.252	11.854	(4.398)	-27.1%
Wholesale Energy Trans Tax	3.795	3.595	-5.3%	1.948	1.832	(0.116)	-6.0%
Other Interest Earnings							
Coal Trust Interest Earnings	21.168	19.805	-6.4%	10.833	10.152	(0.681)	-6.3%
TCA Interest Earnings	2.164	8.527	294.0%	1.147	1.954	0.807	70.4%
Other Consumption Taxes							
Beer Tax	3.034	3.129	3.1%	1.804	1.766	(0.038)	-2.1%
Cigarette Tax	29.604	31.036	4.8%	18.753	19.476	0.723	3.9%
Liquor Excise Tax	19.257	19.521	1.4%	11.418	11.558	0.140	1.2%
Liquor Profits	11.000	11.021	0.2%	-	-	-	-
Lottery Profits	12.363	11.031	-10.8%	2.555	2.417	(0.138)	-5.4%
Tobacco Tax	6.056	6.396	5.6%	3.640	3.631	(0.009)	-0.3%
Wine Tax	2.307	2.363	2.4%	1.406	1.426	0.020	1.4%
Other Sources							
All Other Revenue	40.822	40.060	-1.9%	22.919	18.408	(4.510)	-19.7%
Highway Patrol Fines	4.042	4.349	7.6%	2.249	2.282	0.033	1.5%
Nursing Facilities Fee	4.810	4.756	-1.1%	2.404	2.395	(0.009)	-0.4%
Public Institution Reimbursement	16.819	16.606	-1.3%	6.763	1.677	(5.086)	-75.2%
Tobacco Settlement	3.225	3.145	-2.5%	-	0.023	0.023	-
Largest Seven Subtotal	1,902.301	1,963.049	3.2%	1,199.130	1,185.707	(13.423)	-1.1%
Remaining Sources Subtotal	297.352	299.883	0.9%	153.503	140.428	(13.075)	-8.5%
Grand Total	\$2,199.653	\$2,262.932	2.9%	\$1,352.632	\$1,326.135	(\$26.498)	-2.0%

Year-to-Date Relative to Historical Collection Patterns

As the fiscal year progresses, the accruing data allows for a closer estimate of final collections based on historical collection patterns. Potential total general fund collections for FY 2016 are calculated using various year-to-date percentages—minimum, maximum, median and average—since FY 2002. The results are shown in the graph below. Based on collections through the end of February, the difference between the high and low is less than \$300 million, with the average and median values below the HJ 2 estimate.



Potential total general fund collections range from a low of \$2,007 million to a high of \$2,284 million, with a median value of \$2,175 million and an average value of \$2,164 million. The FY 2016 forecast for total general fund in HJ 2 is \$2,263 million.

Important Considerations

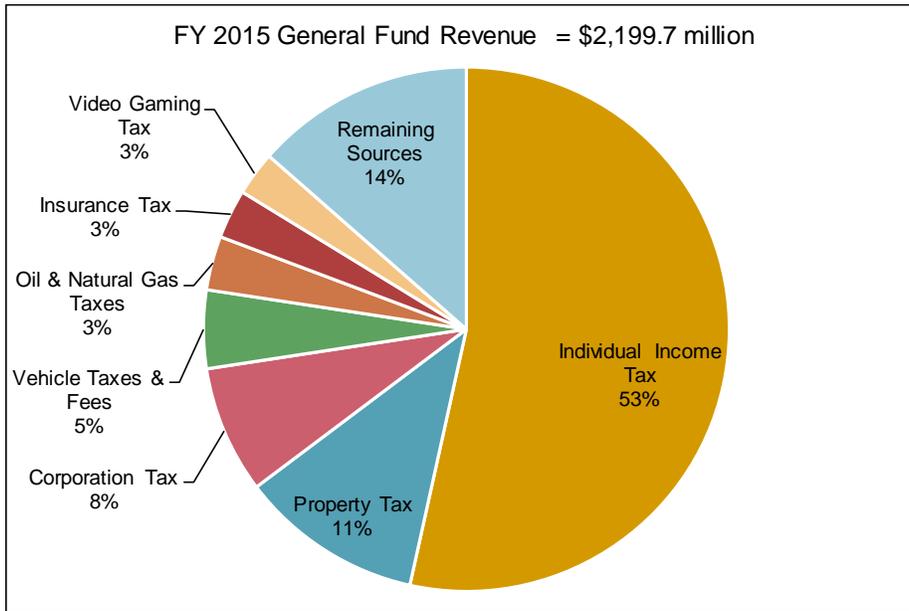
The economy is strong and the decline in revenue is not due to the current economy. Wages are growing as anticipated at about 5% and withholding is above last year by 3.4%. The declines in anticipated revenues are due to lower natural resource taxes related to drops in price and interest earnings that are lower than anticipated in HJ 2.

Additional risk in FY 2016 could come from income tax revenue. CY 2014 capital gains income was relatively high and resulted in higher tax revenue in FY 2015. It is unknown how CY 2014 capital gains realizations may have impacted CY 2015 capital gains income and FY 2016 tax revenue. Potential options include the following:

- The recent average trend of growth over the past several years will continue and capital gains will be strong, potentially stronger than CY 2014
- The flat stock market in CY 2015 will provide opportunity for taxpayers to offset gains made in CY 2014 with losses in CY 2015 and reduce tax liability

MAJOR SOURCES

In FY 2015, the largest seven revenue sources accounted for just over 86% of total general fund revenue. This section will highlight current trends with each source and further revenue detail if applicable.

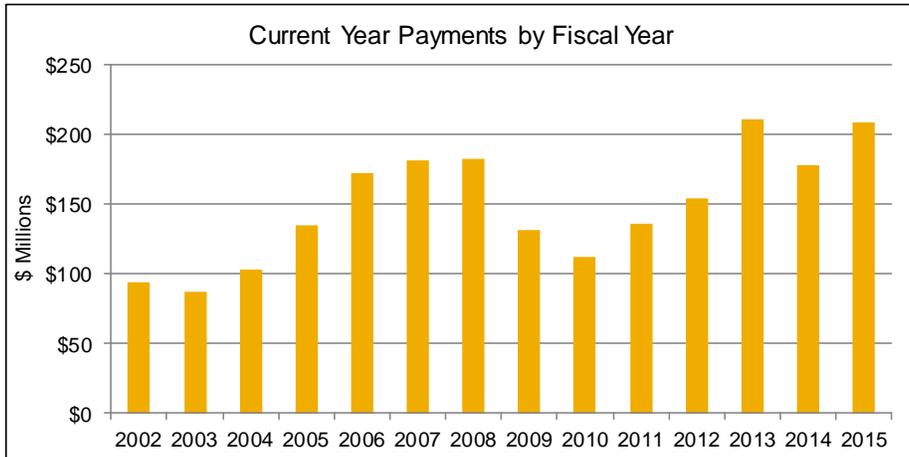


Individual Income Tax: On Track with HJ 2 after Adjusting for FY 2015 Posting Error

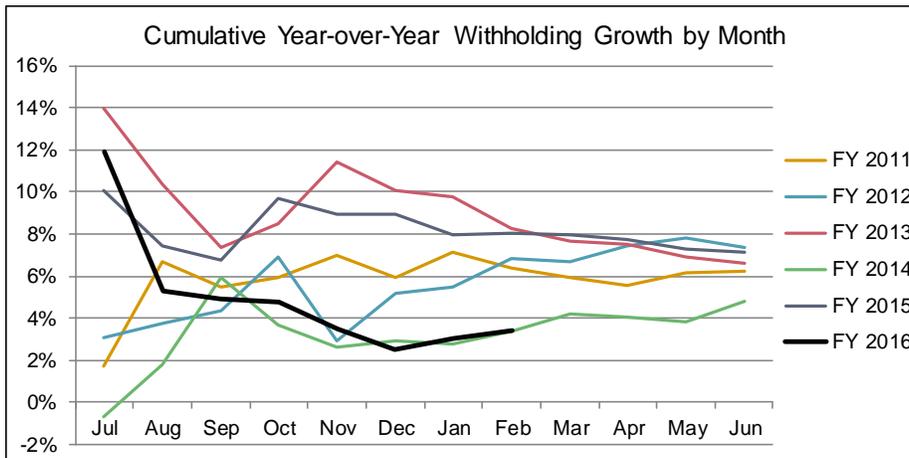
Individual income tax collections are \$26.3 million or 3.3% above last year, which is below the anticipated growth of 4.6% contained in HJ 2. In February 2015, there was a payment of \$9.3 million that was mistakenly posted to the mineral royalties withholding account that should have been posted to the oil and natural gas clearing account; the correction will be shown in the March year-to-date report. Accounting for the error in the table below would result in a mineral royalties decline of 46.1%, and total growth of \$35.6 million or 4.5% above this time last year.

Individual Income Tax				
(\$ Millions)				
	YTD 2016	YTD 2015	\$ Difference	% Difference
Withholding	\$578.1	\$558.9	\$19.2	3.4%
Estimated Payments	182.2	171.7	10.4	6.1%
Current Year Payments	26.0	21.3	4.7	22.2%
Audit, P&I, Amended	31.9	22.9	9.1	39.6%
Refunds	(136.9)	(124.1)	(12.9)	10.4%
Refund Accrual Reversal	140.0	132.6	7.4	5.6%
Partnership Income Tax	6.8	4.7	2.1	45.0%
Mineral Royalties	5.2	18.9	(13.7)	-72.7%
Total	\$833.2	\$806.9	\$26.3	3.3%

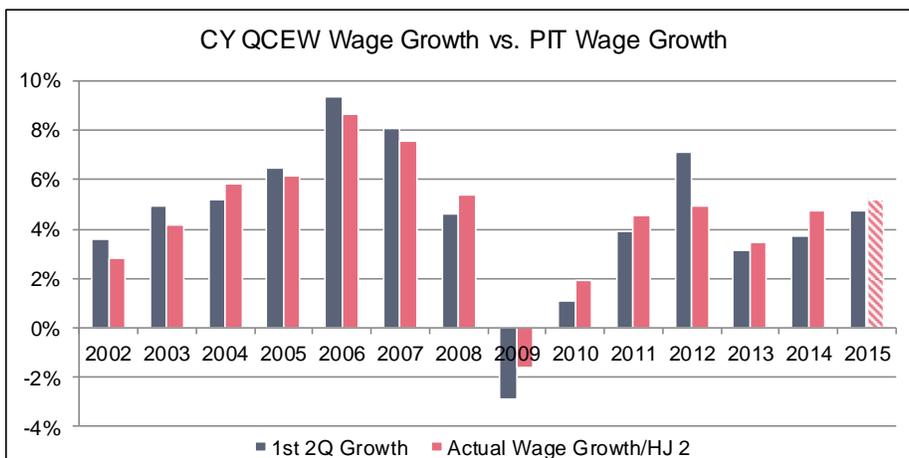
The increase in current year payments reflect the tax due by tax year 2014 extension filers, rather than that of 2015 filers. Current year payments have fluctuated in recent years, perhaps in response to taxpayers' capital gains realizations of the prior tax year. For example, FY 2013 payments were high primarily due to the increased capital gains realizations at the end of CY 2012 as taxpayers responded to the potentially higher federal capital gains tax rates of the "fiscal cliff." About three-quarters of total current year payments are received in April. The chart on the next page shows current year payments since FY 2002.



Withholding shows weak growth when compared to FY 2015 collections; however, as shown in the following chart, withholding growth tends to be relatively volatile in the first half of the year. By February, the year-over-year growth seems to stabilize, along with potential assessments of overall FY 2016 withholding growth.



Although withholding comes primarily from wage income, change in withholding may also reflect taxpayers' changing expectation of other income sources such as retirement income and possibly capital gains. The current slower growth in withholding appears to be due to factors other than wage growth; as shown in the chart below, wage growth in the first half of 2015 was nearly 5%.



Property Tax: In Line with Estimate

Property tax collections are above last year by \$2.9 million or 2.0%, and currently below the HJ 2 estimated growth of 2.4%. Final collections will likely come in close to HJ 2 estimates, perhaps slightly above due to strong growth in Class 9 pipeline property.

Corporation Income Tax: Below Estimate

Corporation income tax collections through the end of February are \$28.6 million or 27.3% below last year, and below the anticipated increase of 4.2% contained in HJ 2. The year-over-year decrease is primarily due to a large one-time audit that occurred in FY 2015. HJ 2 assumed a \$25 million revenue shift from FY 2015 to FY 2016 due taxpayer behavior. The shift appeared to have not materialized in FY 2015; therefore, the additional revenue is unlikely to appear in FY 2016.

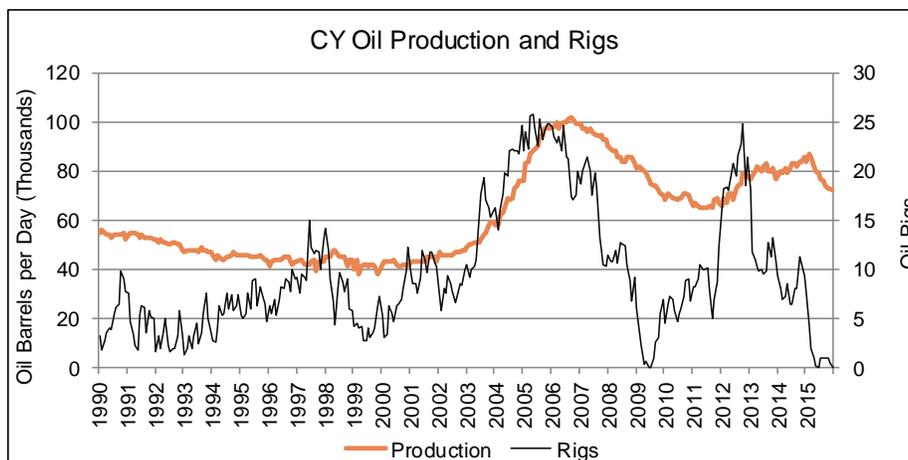
Corporation Income Tax (\$ Millions)				
Account	YTD 2016	YTD 2015	\$ Difference	% Difference
Corporation Tax	\$11.0	\$13.7	(\$2.7)	-19.7%
Estimated Payments	69.1	72.8	(3.7)	-5.1%
Refunds	(13.2)	(14.2)	1.0	-6.7%
Refund Accrual Reversal	4.3	8.1	(3.8)	-47.0%
Audit, P&I, Amended	5.1	24.5	(19.3)	-79.0%
Total	\$76.3	\$104.9	(\$28.6)	-27.3%

Vehicle Fees & Taxes: Currently Below Estimate

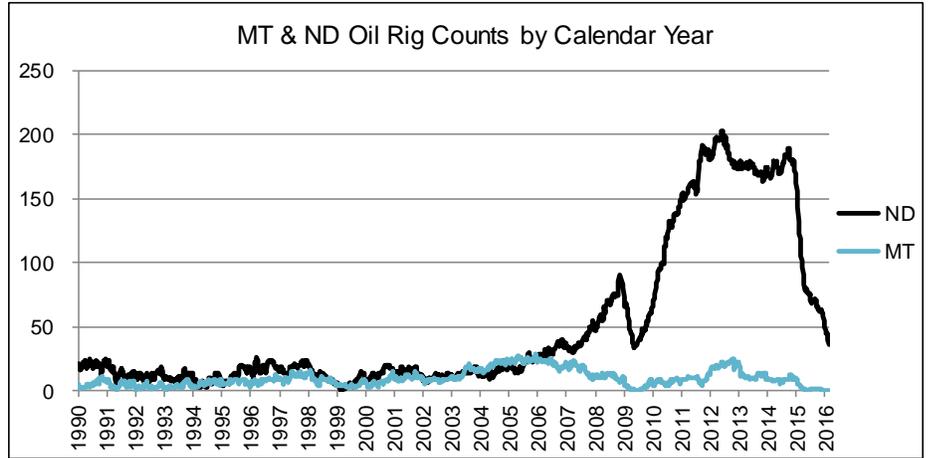
Through February of FY 2016, vehicle taxes and fees are 4.8% or \$3.0 million below collections last year at this time. The year-over-year decline is due to uncharacteristically high light vehicle registrations in February of FY 2015. Until February, year-to-date collections had been approximately 10% higher than FY 2015 collections. If that trend continues following February, collections are likely to end up near the HJ 2 estimate which assumed a decline of 0.2%.

Oil & Natural Gas Production Tax: Below Estimate

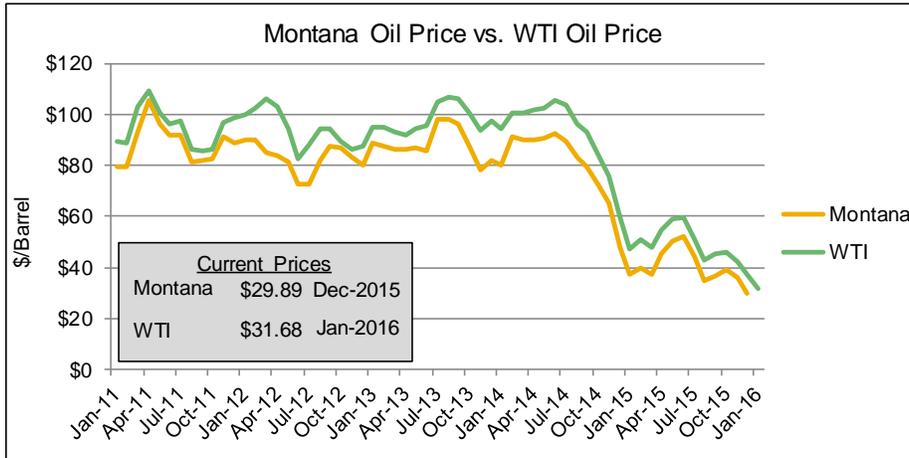
With first quarter collections posted, oil and natural gas tax is below last year 57.0% or \$14.9 million, and below the HJ 2 anticipated decline of 19.0%. The dollar difference will continue to increase but the percentage difference should move somewhat closer to HJ 2 as the first quarter compares to the first quarter of FY 2015, which was the strongest quarter that year. Production continues to decline as shown in the following chart, and there has only been at most one rig operating in the state since March of 2015.



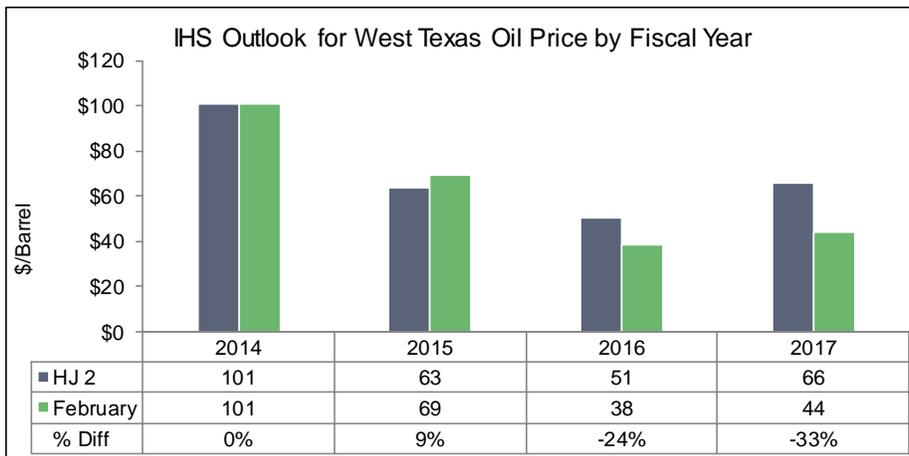
The impact of the oil industry response to lower prices has been even more pronounced in North Dakota, as illustrated in the adjacent chart.



The decline in price is the primary driver in the reduced revenue collections. The following chart compares the monthly average price for Montana oil with the WTI price. There is a two-to-three month lag in available monthly price data.



Current West Texas Intermediate (WTI) oil price is below the estimate contained in HJ 2, and the most recent outlook from IHS suggests that the lower prices will continue throughout the remainder of the 2017 biennium. The chart below shows the WTI price contained in HJ 2 and the outlook for WTI from the IHS February 2016 forecast.



Video Gaming Tax: Slightly Below HJ 2

Revenue from video gambling is currently \$0.5 million or 1.7% above collections from last year at this time. In HJ 2, FY 2016 video gambling revenue was forecast to grow by 3.7%. The slower-than-expected growth may be due to a switch in gambling behavior from gaming machines to the lottery in the month of January, a result of the unusually high jackpot. Prior to the January payment, this source had been tracking higher than 3.7% growth. The April payment may provide more information on the decreased growth.

Insurance Tax: Faster-than-Expected Growth

Current insurance tax collections are 12.2% or \$3.4 million above FY 2015 year-to-date. HJ 2 anticipates growth of 8.6% at fiscal year end. The current volatility of this source comes from the continued take-up of the Affordable Care Act including increasing participation on the exchange, hard-to-predict changes in health insurance premiums year-over-year, and timing of payments.

OTHER KEY DIFFERENCES

Lodging Facilities Sales Tax: Above Estimate Due to Online Travel Companies' Remittances

Lodging facilities sales tax collections are \$1.8 million or 16.5% above last year, and above the anticipated growth of 11.0% contained in HJ 2. The growth is driven by \$1.1 million in payments made in November by online travel companies as a result of litigation with DOR. Going forward, the online travel companies are anticipated to remit about \$0.1 million per quarter. The litigation also impacted rental car sales taxes, with an additional \$0.3 million in payments by the online travel companies.

Public Contractors' Tax: Below Estimate Primarily due to Timing

Public contractors' tax collections are \$1.1 million or 30.7% lower than last year, and below the anticipated growth 9.3% contained in HJ 2. A large refund was process in February that had been processed in January of the prior year; staff at DOR anticipates total refunds to end up in line with historical trends.

Coal Severance Tax: Below Estimate Due to Lower Production

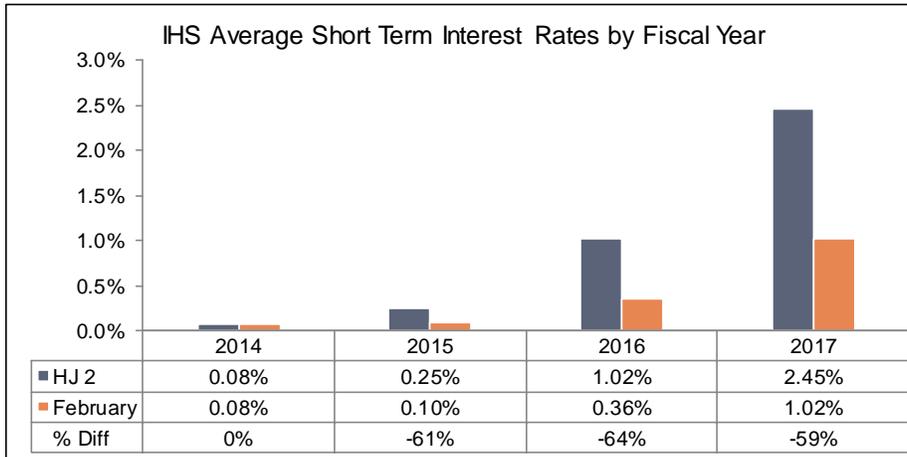
Coal severance tax revenue is \$1.2 million or 13.8% below year-to-date collections in FY 2015, and below the HJ 2 estimated decline of 10.1%. General fund collections were expected to decrease primarily due to [HB 228](#) shifting coal distribution from the general fund to the coal board account; however, total coal collections were expected to stay flat. Production is down somewhat however, accounting for the decline.

U.S. Mineral Royalties: Below Estimate, Likely Due to Oil

U.S. mineral royalties are down year-to-date 27.1% or \$4.4 million, and below the HJ 2 forecast decrease of 10.7%. While total U.S. mineral royalties were expected to decrease, the larger-than-expected decrease is most likely due to oil royalties being lower than expected. The U.S. Department of the Interior's Office of Natural Resources Revenue releases the royalty payment category breakdowns at the end of the federal fiscal year, so detailed information by revenue type will not be available until November 2016.

TCA Interest Earnings: Below Estimate Due to Lower Interest Rates

To date, TCA interest earnings are trending below the estimate contained in HJ due to continued low interest rates. The differences in the projections for short-term interest rates in HJ 2 compared to IHS February 2016 forecasts can be seen in the following chart, with the lowered expectations for interest rates continuing throughout the 2017 biennium.



All Other Revenue: Below Estimate Due to SB 405 Premiums

To date, all other revenue collections are 19.7% or \$4.5 million below last year's collections, primarily due to a decrease in abandoned property collections. In HJ 2, collections were expected to decrease by 1.9%. In addition, the official estimate included nearly \$3.0 million in premium collections from [SB 405](#), which have not been collected yet.

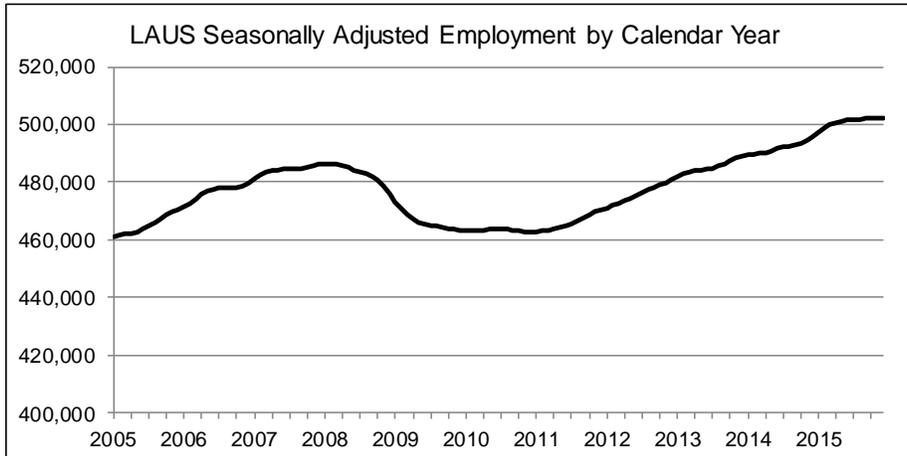
Public Institution Reimbursements: Below Estimate

Public institution reimbursements are currently 75.2% or \$5.1 million behind last fiscal year. Part of this is likely due to the historically erratic of these collections, but there are some explainable irregularities this year. Part of [SB 411](#) specified that in FY 2017 some of the revenues from this source be withheld from the general fund to pay off bonding associated with MDC. Instead, DPHHS withheld those funds this year and are paying the bond in FY 2016. Some of the funds currently withheld are anticipated to be deposited back into the general fund for FY 2016. The impact of moving this payment to FY 2016 will net to zero for the biennium.

LEADING ECONOMIC INDICATORS

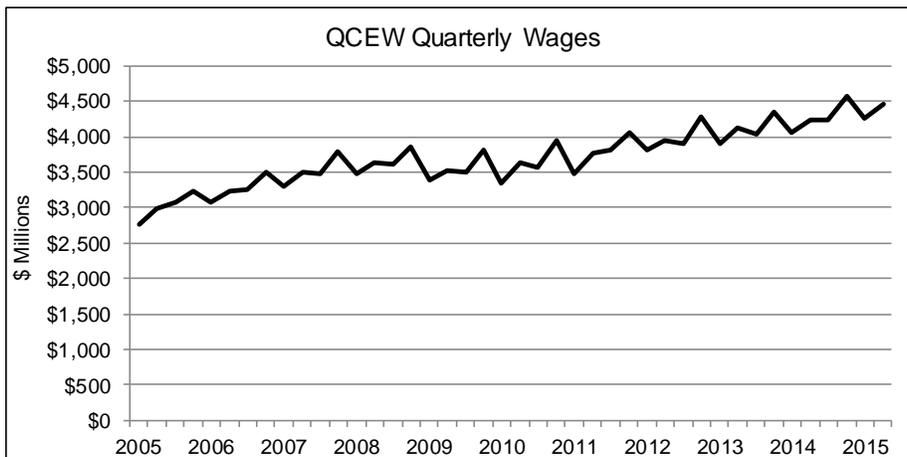
Employment

The [Local Area Unemployment Statistics](#) (LAUS) program from the federal Bureau of Labor Statistics (BLS) provides a monthly estimate of an area's labor force, employment, unemployment, and unemployment rate. Data is taken from surveys and unemployment claims recorded during the monthly reference week, which is usually the week including the 12th day of each month. Statistics are an estimate of persons by place of residence, not jobs or where a person works. In order to be considered unemployed an individual must have had no employment during the reference week, been available for work, and have made an effort to find employment for four weeks leading up to the reference week. The chart below shows seasonally adjusted LAUS employment since CY 2005.



Wages

Industry employment and wage data is collected through the [Quarterly Census of Employment and Wages](#) (QCEW) program from the BLS. The primary sources for the QCEW are the reports submitted by employers to the Montana Unemployment Insurance program. Employment data represents the number of workers on the payroll during the pay period including the 12th day of the month. Total wages include gross wages and salaries, bonuses, profit sharing, commissions, severance pay, and limited tips. Total wages are reported in quarter paid and not earned. The chart below shows QCEW total wages by quarter since CY 2005.

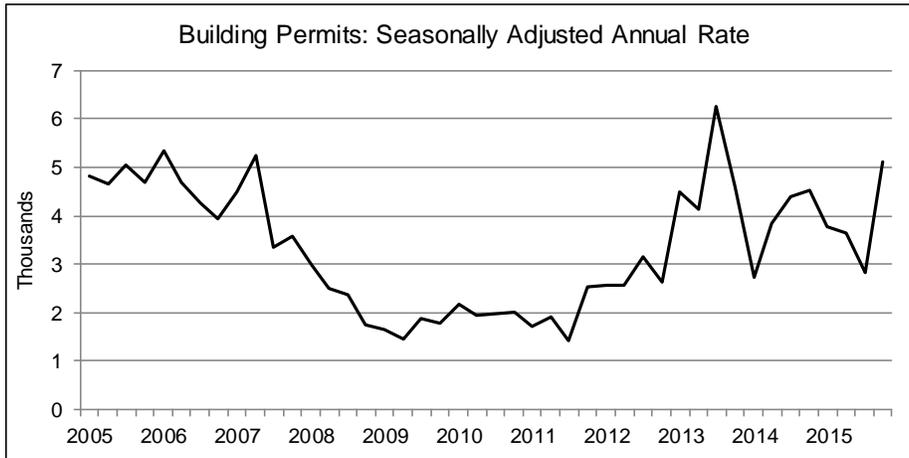


Building Permits

The [Building Permits Survey](#) by the U.S. Census Bureau provides data on the number of new housing units authorized by building permits. Building permits data are collected from individual permit offices, most of

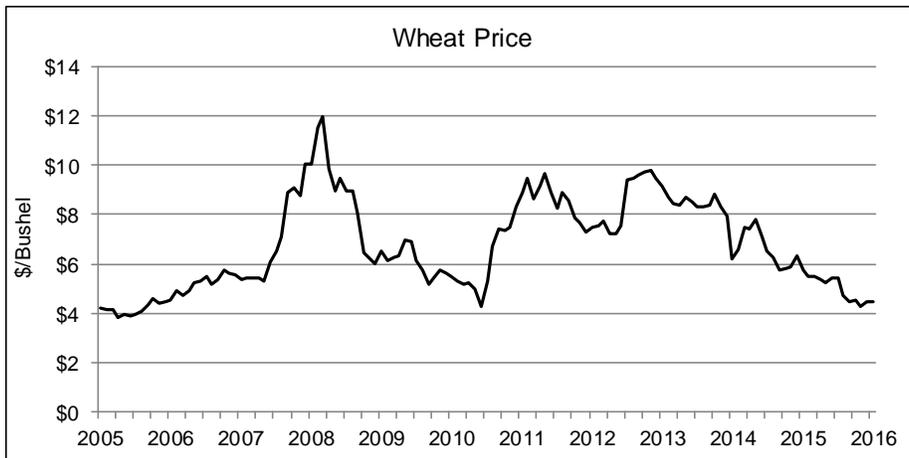
which are municipalities; the remainder are counties, townships, or towns. From local area data, estimates are tabulated for counties, states, metropolitan areas and other regions. The reliability of this data may be limited for Montana, as some counties do not require building permits. Unfortunately, data for other sources such as water and sewer hookups that may more accurately reflect new construction is not available as a database, and too much time would be required to compile the data into a useful format.

The Census Bureau building permits data is available online, but is not compiled into a useful database. Fortunately, the historical data has been assembled by IHS, and is shown in the chart below.

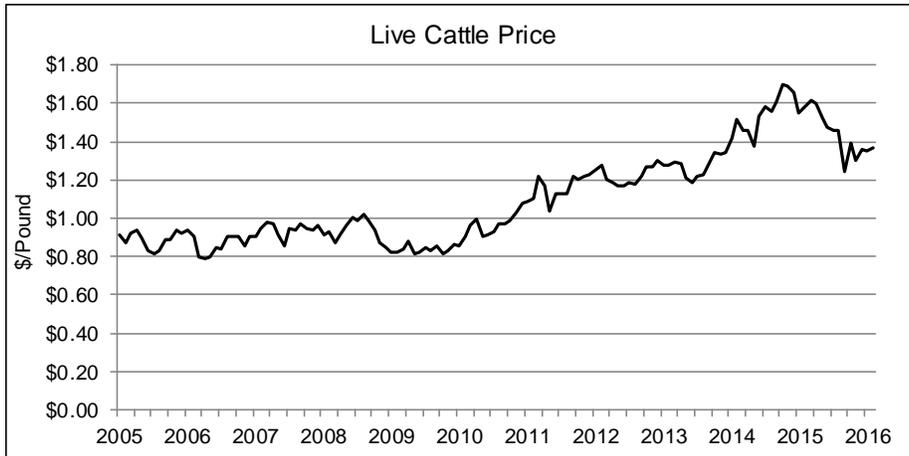


Agricultural Prices

Historical wheat prices are based on hard red winter wheat from the USDA Market News as compiled by [index mundi](#).



Historical live cattle prices are compiled from investing.com.



Drilling Permits

Drilling permits data obtained from the [Montana Board of Oil & Gas](http://montana.gov) are shown in the chart below. Due to a pre-regulatory period prior to the 1950s, the chart includes primarily drilled wells for those years as permits were not required. It is important to note that not all permits result in completed wells. As shown below, 2015 had the lowest number of permits since 1919.

