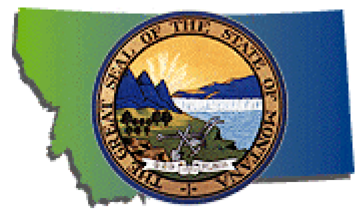
Other Budget Issues



INTRODUCTION

This chapter provides a discussion of a number of budget issues that are not described in any detail elsewhere in this volume. The issues are varied and have been discussed in various venues over recent years. It is, however, desirable to keep these issues in the forefront because of their potential impact in future fiscal deliberations of the legislature.

The issues that are included in this chapter are the following and are discussed in more detail in the pages that follow:

- Post-Session: What Happens if Revenues Fall?
- Structural Balance
- Measurable Performance Indicators
- Montana State Fund "Old Fund" Liability
- Pending Lawsuits
- Pension Plan Unfunded Liability
- Other Major Funds
    - Highway State Special Revenue Account
    - Resource Indemnity Trust

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, forecasts must be prepared almost three years in advance. During this period of economic uncertainty, it is likely that the budget outlook for the 2011 biennium could vary widely from month to month. To provide a perspective, every one percent change in revenues amounts to approximately $36 to $37 million for the biennium. A ten percent downturn in revenues would be close to $360 to $370 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 ten percent are required to maintain fiscal solvency, then the Governor would be obligated to call a special legislative session to address the fiscal conditions.

The legislature adjourned with a projected fund balance of $282.4 million. The executive had recommended that there be a fund balance in excess of $250 million to provide a cushion because of the uncertainty of the economy and the instability of the revenue picture. The legislature concurred. If revenues drop further during the interim, the fund balance does offer some protection. Of course, it depends on the extent to which revenues decline. Using the excess balance in the event of a revenue downturn signals a few policy issues relevant to budgeting for a higher ending fund balance. First, using an ending fund balance in the advent 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 six months 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 an ending fund balance should the legislature have left? As mentioned above, a 10 percent decline in revenues for the biennium would be in the range of $360 to $370 million. Even the $282.4 million ending balance would not be adequate in that case. (Note also that the projected ending fund balance cannot drop below about $37 million.) If the budgeted ending fund balance is not adequate to maintain solvency, then the provisions delineated in MCA 17-7-140 may be triggered and, if that is not enough, a special session may be needed.

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 2009 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 2010 and 2011.

Total general fund revenues exceeded total expenditures for 6 of the past 9 years from 2000 to 2008 (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 unprecedented revenue shortfall in the 2003 biennium intensified the imbalance heading into the 2005 biennium.

Figure 1

General Fund Structural Balance
Figures in Millions

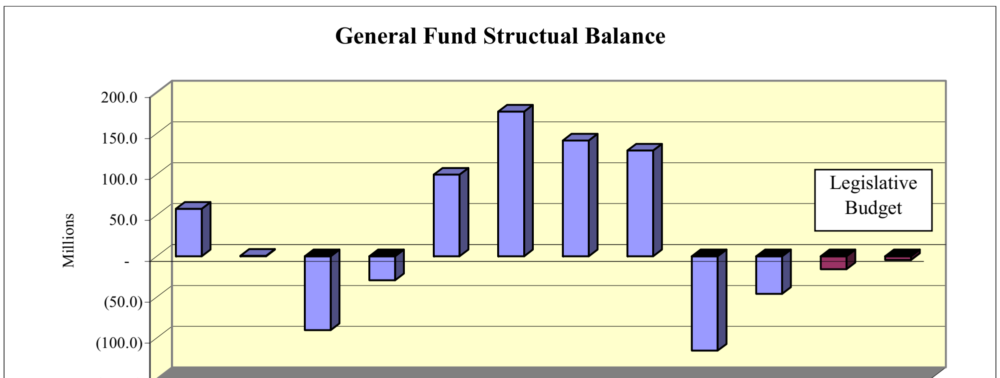
		End. Fund Balance	Yearly Adjustments	Yearly Revenue	Yearly Disburse		Yearly Sur./(Def.)	Biennial Revenue	Biennial Disburse	Biennial Sur./(Def.)
A	2000	$176.000	$8.287	$1,163.638	$1,105.599		$58.039			
A	2001	172.897	(3.637)	1,269.472	1,268.938		0.534	2,433.110	2,374.537	58.573
A	2002	81.316	(1.391)	1,265.713	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	437.676	9.640	1,953.540	2,069.045		(115.505)			
F	2009	390.392	(1.453)	1,844.604	1,890.435		(45.831)	3,798.144	3,959.480	(161.336)
F	2010	312.668	0.000	1,769.293	1,785.315	*	(16.022)			
F	2011	282.415	0.000	1,826.264	1,830.667	*	(4.403)	3,595.557	3,615.982	(20.425)

* Legislative Budget On-going 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, it is projected to end the 2009 biennium 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 ended the session with a proposed biennial budget that is within about $4.4 million of being structurally balanced for the FY 2011. But as Figure 1 portrays, a structural imbalance exists for both years of the 2011 biennium, with anticipated revenues as projected by the LFD at $20.4 million below on-going expenditures in the legislatively approved budget. Figure 2 shows the same information in a graphic form.

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 potential for 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.

Figure 2



	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Balance	58.0	0.6	(90.2)	(29.4)	99.6	176.9	141.5	129.1	(115.5)	(45.8)	(16.0)	(4.4)

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 2011 biennium pay plan, which delay implementation until mid-year, will require additional funding in the 2013 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

General Fund - Conclusion

From a short-term view point of assessing structural balance related to matching on-going revenues with on-going expenditures, the legislative budget for the 2011 biennium is structural balanced. Reviewing each fiscal year individually, there is a structural imbalance in FY 2010 of $16.0 million and $4.4 million in FY 2011. 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.

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. This fund is in a chronic state of structural imbalance due to an inelastic revenue source and inflationary construction costs. While the highways account is structurally balanced through the 2011 biennium, it is only because recent structural stabilization has been attained by maximizing recovery of indirect costs from the administration of the federal-aid highway program and use of indirect cost revenue to shore up the account revenues. The balance allows for all anticipated federal funds to be matched through the 2011 biennium. 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.

MEASUREABLE PERFORMANCE INDICATORS

State law requires that the executive budget include goals and objectives for each program and that the goals and objectives include "…sufficient specific information and quantifiable information to enable the legislature to formulate an appropriations policy regarding the agency and its program and to allow a determination, at some future date, of whether the agency has succeeded in attaining its goals and objectives."

During the subcommittee hearings process, the legislature examined the goals and objectives submitted for each program. This was done in varying degrees in the five sub-committees. On the whole, the information was utilized to obtain an understanding of the programs' operational issues, determine if progress was being made, discuss allocation of resources, and require follow up activities.

The legislature requested performance measurement activities be performed in three different ways: 1) a recommendation to the Legislative Finance Committee (LFC); 2) statutory requirements specified in HB 676; and 3) joint resolutions. The fiscal report provides details of the requests in the "Agency Discussion" section. For example, on page D-91, the Judicial Branch, Law Enforcement, and Justice subcommittee recommends a number of items for review by the LFC in order to determine if adequate goals and objectives are set and measured within the Department of Corrections. In situations where the subcommittees made such recommendations, those items are recorded under *Recommendations to the Legislative Finance Committee* at the agency level in this report.

The other method used to record requests for reports was via statutory changes in HB 676, which includes the following requirements:

- 17-7-11, MCA requires the Department of Public Health and Human Services to utilize a work plan, with goals, milestones, and measures to identify potential ongoing reductions of state spending within the agency and provide regular project updates to the LFC
- 47-1-201, MCA requires the Office of the Public Defender to report caseload and reimbursement data to the LFC to enable discussions regarding the adequacy of state appropriations for this program
- Title 61, chapter 2 was updated to include requirements of the Department of Transportation to report progress on the disbursement of the emergency medical services grants to the LFC and to the Children, Families, Health and Human Services interim committee

Early in the 2011 interim, the LFC will make a determination regarding the inclusion of monitoring of performance related activities in the committee's work plan. In addition, the legislature adopted two resolutions to address shared goals and accountability measures for education that could be used by legislators, the education community, and the public to determine progress toward educational goals. They are:

- HJR 6, which directs the Superintendent of Public Instruction and Board of Public Education in consultation with the Education and Local Government Interim Committee to develop shared goals and accountability measures for K-12
- SJR 8, which directs the Board of Regents, Commissioner of Higher Education, Superintendent of Public Instruction, and Board of Public Education, in consultation with the Education and Local Government Interim Committee, to develop shared goals and accountability measures for K-20, including the affordability and availability of distance learning, reduction in the remediation rate of students entering college, and improvement of the dual enrollment process.

The staff of the Legislative Fiscal Division will be monitoring the implementation of both resolutions. These resolutions are discussed further in the Office of Public Instruction agency discussion in Volume 4, page E-5.

MONTANA STATE FUND "OLD FUND" LIABILITY

The Montana State Fund provides Montana employers with an option for workers' compensation and occupational disease insurance. Prior to 1990 workers' compensation experienced significant liabilities. The legislature restructured the state fund, and separated state fund liabilities between claims occurring before July 1, 1990 and claims occurring on or after that date. Funds relating to claims prior to July 1, 1990 are referred to as "Old Fund" and those on or after as "New Fund".

Statutes require that in any fiscal year where claims for injuries from accidents occurring before July 1, 1990 (Old Fund) are not adequately funded, the funds must be transferred from the general fund. As of June 30, 2008 estimated liabilities exceeded assets by $36.5 million. At this time, the Old Fund is projected to have sufficient invested assets to meet its obligations until FY 2011, when an estimated $760,317 general fund would be needed to offset this shortfall. In FY 2012, the cost of the shortfall to the general fund is estimated to be $8.0 million. It should be noted that these estimates were calculated using financial information as of June 30, 2008, prior to the economic recession, which could affect the amount of the estimated general fund liability and the timing of the required transfer. As discussed in the "Pending Lawsuit" narrative, cases currently in the courts may affect both the amount of the liability and how long the fund has sufficient assets to meet its obligations.

The 2009 Legislature considered in SB 224 the transfer of $30 million from the general fund to the Old Fund in the 2011 biennium. However, the bill did not pass. Currently, HB 2 does not appropriate funds for the transfer of general fund for FY 2011. The Legislative Fiscal Division includes this transfer in its estimates of nonbudgeted transfers of general fund used to estimate the state's general fund balance.

PENDING LAWSUITS

K-12 LAWSUIT

The Supreme Court is being asked to overturn a decision by a district court that requires payment by PPL Montana of rents on riverbeds. The riverbeds of Montana have been determined by the district court to be part of the permanent school trust lands of Montana and as such any income derived from the use of the riverbeds would be considered part of the trust lands income to be distributed as required by law. The constitution requires 95 percent of all rent received from the leasing of school lands be equitably apportioned each year to public elementary and secondary school districts. The remaining 5 percent is added to the public school trust fund.

District Court Judge Honzel determined that the use of state school trust navigable riverbed lands for power generation subjected PPL Montana, LLC to the payment of these rents. The decision determines that the state school trust is due $34.7 million from PPL, Montana for "the rental of state land used for a power site" for the years 2000 through 2006 and $6.2 million for 2007. The amounts included in the decision are for rent only. The district court did not allow for interest on the payments as requested by the state.

In a similar case, Avista Corporation negotiated a settlement with the state for its use of state school trust navigable riverbed lands. The $4.0 million rental payment was deposited into the guarantee account and the public school trust fund as required in the constitution. It should be noted that funding in the guarantee account is used to offset state general fund support for schools.

The land board considers the PPL payments to be compensatory damages rather than rent. On December 15, 2008, the land board determined it would place the rental payments of $40.9 million into the Common School Land Banking Trust Account rather than, as required by the constitution, 5 percent to the public school trust fund and 95 percent to public schools. Further, the land board approved placing into the same account any interest earned while the appeal filed by PPL is pending. PPL has appealed the district court decision to the Montana Supreme Court.

The 2009 Legislature passed SB 507, a bill to revise and clarify the laws related to the treatment of navigable rivers. The legislation requires that the full market value collected for a lease, license, or easement of navigable riverbeds must be deposited in the appropriate trust fund established for receipt of income from the land over which an authorized use is granted. In the case of permanent school trust lands this would be the public school trust fund. HB 152 of the 2009 session specifically requires that rental income from power site leases be deposited into the school facility and technology account. As HB 152 is specific it will control the deposit of power site leases paid for the use of navigable riverbeds.

STATE FUND

As discussed previously, the state fund "Old Fund" projected shortfall is $36.5 million. In addition, two court cases brought against the Montana State Fund (MSF) may increase the general fund liability in the Old Fund by as much as $117.9 million.

- *Satterlee* challenges the constitutionality of terminating permanent total disability and rehabilitation benefits when a claimant receives or becomes eligible to receive full Social Security retirement benefits or an alternative to that plan. A Montana Workers' Compensation Court judge ruled in favor of the respondents/insurers (including Montana State Fund) in December 2005. A request for reconsideration of the case was denied by the Montana Workers' Compensation Court. The case was appealed by the plaintiffs to the Montana Supreme Court. On December 11, 2008 the Montana Supreme Court issued an order dismissing *Satterlee* without prejudice as two constitutional issues remained for ruling on by the lower court. The Workers' Compensation Court ruled in MSF's favor on both issues. On July 1, 2008 *Satterlee* again appealed the decisions to the Montana Supreme Court. The potential estimated benefit costs for non-settled permanent total disability claims, if the statute is ultimately held to be unconstitutional and to apply retroactively, is between $93 and $116 million for the Old Fund.

- A second lawsuit, *Quick,* requests retroactive and future domiciliary care benefits for a claimant. The case is on appeal to the Montana Supreme Court. Should the Montana Supreme Court reverse the lower court decision and award retroactive domiciliary care prior to February 1, 2007, the potential estimated benefit costs are $1.9 million.

PENSION PLANS UNFUNDED LIABILITY

One of the key fiscal issues in front of the legislature over the past few 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 earning 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. At the end of FY 2008, and after 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.

BACKGROUND

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.

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 the end of September of each year. Figure 1 summarizes key points of actuarial valuations for the year ending June 30, 2008, and provides a comparison to the previous two valuations (2006 and 2007). The first four plans are those pension plans that were the focus of attention over the past few sessions as they were considered "actuarially unsound."

The key item to focus on in the FY 2008 data is the "Years to Amortize Unfunded Liability" which is highlighted. 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 figure shows, the Teachers' Retirement System is the only plan that exceeds the 30 year amortization, partly due to the reduced investment earnings and partly due to a change in actuarial assumptions approved by its board.

Figure 3

Pension Plan Unfunded Actuarial Liability
2008 Actuarial Valuation versus 2006 & 2007 Actuarial Valuations
(Dollars in Millions)

	TRS	PERS-DB	SRS	GWPORS	HPORS	MPORS	FURS	JRS	VFCA
2006 Valuation (as of 6/30/2006)									
Actuarial Liability	$3,608.9	$3,919.3	$171.8	$64.2	$112.0	$291.1	$255.5	$37.2	$31.9
Assets	2,745.8	3,459.1	163.0	58.8	87.2	175.9	167.3	51.8	23.2
Unfunded Liability (Surplus)	$863.1	$460.2	$8.8	$5.4	$24.8	$115.2	$88.2	($14.6)	$8.7
Funded Ratio	76.1%	88.3%	94.9%	91.6%	77.9%	60.4%	65.5%	139.2%	72.7%
Years to Amortize Unfunded Liability	**Does not amortize**	**Does not amortize**	**Does not amortize**	**32.4 yrs**	**18 yrs**	**21.4 yrs**	**15.5 yrs**	**n/a**	**9.6 yrs**
2007 Valuation (as of 6/30/2007)									
Actuarial Liability	$3,775.1	$4,201.2	$189.0	$73.0	$128.3	$310.4	$269.4	$36.9	$31.6
Assets	3,006.2	3,825.2	183.9	68.8	95.8	198.3	188.5	57.8	25.9
Unfunded Liability (Surplus)	$768.9	$376.0	$5.1	$4.2	$32.5	$112.1	$80.9	($20.9)	$5.7
Funded Ratio	79.6%	91.1%	97.3%	94.2%	74.7%	63.9%	70.0%	156.6%	82.0%
Years to Amortize Unfunded Liability [b]	**28.6 yrs**	**21.9 yrs**	**19.6 yrs**	**11.3 yrs**	**19.1 yrs**	**20.5 yrs**	**12.9 yrs**	**n/a**	**5.1 yrs**
Total Contribution Rate	16.730%	13.895%	19.070%	19.560%	45.380%	52.780%	57.660%	32.810%	[a]
Normal Cost Rate	10.400%	12.220%	19.460%	18.670%	22.310%	26.450%	26.050%	25.190%	
Available for Amortization	6.330%	1.675%	-0.390%	0.890%	23.070%	26.330%	31.610%	7.620%	
Avail. For Amort. FY 2010 [b]	6.710%	1.810%	-0.100%						
2008 Valuation (as of 6/30/2008)									
Actuarial Liability	$3,953.7	$4,504.7	$204.5	$83.4	$134.7	$327.5	$287.2	$39.4	$32.7
Assets	3,159.1	4,065.3	199.4	77.5	101.5	212.3	206.1	62.0	27.5
Unfunded Liability (Surplus)	$794.6	$439.4	$5.1	$5.9	$33.2	$115.2	$81.1	($22.6)	$5.2
Funded Ratio	79.9%	90.2%	97.5%	92.9%	75.4%	64.8%	71.8%	157.4%	84.1%
Years to Amortize Unfunded Liability [b]	**31.3 yrs**	**24.8 yrs**	**16.3 yrs**	**13.0 yrs**	**17.4 yrs**	**18.6 yrs**	**11.3 yrs**	**n/a**	**5.0 yrs**
Net Statutory Funding Rate	16.730%	13.895%	19.070%	19.560%	45.380%	52.780%	57.660%	32.810%	[a]
Normal Cost Rate	10.870%	12.130%	19.240%	18.540%	22.250%	26.650%	26.150%	25.120%	
Available for Amortization	5.860%	1.765%	-0.170%	1.020%	23.130%	26.130%	31.510%	7.690%	
Avail. For Amort. FY 2010 [b]	6.240%	1.900%	0.120%						

Notes [a] Contibutions are not expressed as a percent of wages but rather are a portion of the fire insurance premiums collected by the state.
[b] Contributions by employer increase 0.38% for TRS, 0.135% for PERS and 0.29% for SRS on July 1, 2009, resulting in an increased amount available for amortization. The number of years shown to amortize the unfunded liability takes these increases in employer contribution into account.

Key
TRS - Teachers' Retirement System
PERS - Public Employees' Retirement System
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

There are two points to be noted. First, although this data does not look as bad as one might expect given the recent economic events, 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 2008 are not totally realized in this current valuation, but rather are spread out over a four year period. Second, the most recent valuation does not take into account the impact of economic events since June 30, 2008, where retirement investments have seen some extraordinary volatility. As of this writing (May 2009), the retirement plans have recovered somewhat, but have a very long way to go.

The next scheduled valuations will occur after June 30, 2009 and will not be available until around October 1. How the equity markets and other investments will perform before the end of FY 2009 is unknown, but it is how they perform that will determine the soundness or unsoundness of the retirement plans in the next valuation, assuming that the actuarial assumptions remain relatively unchanged. The expectation is that the June 30, 2009 valuations will not paint a pretty picture. Teachers' Retirement will likely be actuarially unsound for its second consecutive valuation which will result in its board pursuing legislative remedies in accordance with its own policy. Other retirement systems (not necessarily all) will likely have their first negative valuation and could have a second consecutive negative valuation before the 2011 session convenes. How quickly the economy can recover and whether the equity markets can recover the asset value in the funds will determine future valuations and actuarial soundness.

TOTAL UNFUNDED LIABILITY

The net unfunded liability of the nine defined benefits pension plans as of June 30, 2008 is $1.5 billion. Just five months later, a rough calculation of the change since June 30 suggested that the unfunded actuarial liability may have doubled. The collective funded ratio, which was about 85 percent at June 30, could be in the neighborhood of 68 percent in December. The changes are dramatic but do not consider the actuarial assumptions of "smoothing" which refers the practice of spreading of gains and losses over a four year period. Still, there was an unsettling drop in asset value in just a couple of month's time.

ACTIONS OF THE SIXTY-FIRST LEGISLATURE REGARDING PENSION PLANS

Although Governor proposed using $43.0 million general fund, freed up by increased federal funds made available for Medicaid funding by the American Recovery and Reinvestment Act, to shore up the Teachers' Retirement Fund, the legislature did not agree that this was appropriate spending of funds intended to stimulate a struggling economy. In the 2009 session, no additional funding was provided to the retirement systems. The legislature did pass legislation related to pension plans, most of which are "housekeeping" in nature. Only a couple of statutory changes to address the issues of unfunded liabilities passed the 2009 session:

- HB 34 will help reduce future unfunded liabilities created when a retiree's benefits are terminated and then recalculated based on the higher salary and service earned following a period of reemployment as an active member of the TRS. It will also provide additional funding for the TRS starting July 1, 2013, to help offset the adverse affect of retirees returning to work in part-time non-contributing positions in place of active contributing positions.

- HB 659 directs the State Administration and Veterans' Affairs Interim Committee to examine and recommend to the 62nd Legislature funding and benefits changes in the statewide public employees' retirement systems and, with respect to the teachers' retirement system, the committee is directed to develop legislation to implement a redesign of the teachers' retirement system.

WHAT IS IN STORE FOR THE SIXTY-SECOND LEGISLATURE?

As of this report, by definition and based upon the most recent actuarial valuation, all but one of the pension plans is actuarially sound. In addition, the actuarial soundness of these plans is based upon assumptions that measure the long-term trends of various factors, with investment returns being a key one that may significantly impact the picture. When the legislature convenes in January 2011, hopefully the picture with regard to investment returns will be clearer.

Historic economic cycles and the logic of actuarial valuations might suggest that time will resolve the pension plan unfunded liabilities to the degree needed for actuarial soundness. However, this time may be different as it does not appear that the economy is poised to recover quickly or even to the extent in a number of years that would bring the unfunded liabilities into line with the 30-year amortization requirement. Retirement fund experts suggest that, more than likely, additional funding and reductions in liabilities (to the extent that liabilities can be reduced) will also be required. The Montana Constitution requires that retirement systems be funded on an actuarial sound basis. The retirement boards have a policy that provides that after two consecutive "negative" valuation reports, the boards are obligated to pursue legislative remedies. The questions then become: How long might a recovery take and at what point is the legislature obligated to take some action? The answers to those questions will not likely be evident in the near future.

Further, the contributions to the pension plans are sufficient to cover the normal costs of the plans, that being the actuarial cost to fund the benefits provided by the system and administration were the funding to begin at date of hire. What will not be known until the next actuarial valuation is the degree to which investment losses have increased the unfunded actuarial liabilities, and the cost to amortize those unfunded actuarial liabilities within the 30-year threshold. In addition, the retirement systems are planning to conduct "experience studies" in the coming year, which might result in changes to the actuarial assumptions. Although changes to assumptions would theoretically reflect "reality" for the indicators of actuarial soundness of the plans, it is conceivable that given the events of the past year that unfunded actuarial liabilities might increase.

OTHER MAJOR FUNDS

HIGHWAYS STATE SPECIAL REVENUE ACCOUNT

Figure 4 summarizes the projections of working capital for the highways state special revenue account. This account is comprised of two funds and funds the Department of Transportation highway planning, construction, and maintenance activities; highway safety enforcement activities in the Department of Justice; road maintenance functions in state parks; capital projects related to highways infrastructure; and grants to emergency medical services providers. The two funds that make up the account are the constitutionally restricted and the nonrestricted state special revenue funds, which each have different statutory sources and uses. The highways state special revenue account has been chronically structurally imbalanced, and previously the level of revenue growth could not sustain the level of expenditure growth needed to support the services provided. For the 2011 biennium revenues are expected to exceed expenditures. The projections show expected revenues would exceed appropriations for the 2011 biennium by $34.3 million and the account would end the 2011 biennium with a balance of $47.4 million. The recent structural stabilization has been attained by maximizing recovery of indirect costs from the administration of the federal-aid highway program and use of indirect cost revenue to shore up the account revenues. The balance allows for all anticipated federal funds to be matched through the 2011 biennium. A detailed working capital analysis for the highways state special revenue account is provided in the Department of Transportation agency discussion in Volume 4, page C-76.

Figure 4

Working Capital Analysis - Highways State Special Revenue
Fiscal Years 2008 - 2011
(in Millions)

Description	FY 2008 Actual	FY 2009 Approp.	FY 2010 Budget	FY 2011 Budget
Beginning Working Capital Balance	$24.1	$41.3	$15.4	$27.4
Revenues	292.0	277.5	292.5	295.3
Available Working Capital	316.1	318.7	307.9	322.7
Authorized Expenditures	274.4	303.4	280.5	279.8
Adjustments	(0.5)	0.0	0.0	0.0
Ending Working Capital Balance	**$41.3**	**$15.4**	**$27.4**	**$42.8**
Variance - Revenues less Expenditures	$17.6	($25.9)	$12.0	$15.5

RESOURCE INDEMNITY TRUST AND RELATED FUNDS

The Resource Indemnity Trust (RIT) and related accounts provide support to the natural resource agencies for a variety of purposes. The Department of Environmental Quality is the largest recipient of RIT funds. Due to the decline in RIT interest from the economic downturn and increased costs due to inflation and pay plan, the legislature transferred funds to and reduced appropriations from the natural resources operations fund. Figure 1 illustrates the condition of the RIT related funds.

Major changes include:

- Revision of the deposit schedule to the environmental contingency fund from $175,000 annually to $175,000 at the beginning of each biennium
- Elimination of support to the Central Services Division within the Department of Natural Resources and Conservation and the Natural Resources Information System (NRIS) at the State Library
- Reductions to the Permitting and Compliance Division within the Department of Environmental Quality of $50,000 in FY 2011 to aid in balancing the natural resources operating fund

Biennial transfers include:

- $2.4 million per statute from the orphan share to the Zortman/Landusky water treatment trust
- $2.1 million from the water adjudication fund to the natural resources operations fund to support the water court
- $0.6 million from the environmental quality protection fund and $0.3 million from the junk vehicle fund to the natural resource operations fund to cover funding shortfalls

Biennial appropriations include:

- $11.6 million to operate the state superfund program, of which $7.5 million is reimbursement from liable parties
- $9.6 million to cover the state's share of the cleanup costs of the KRY state superfund site
- $8.6 million for agency operational support including:
    - $2.1 million for the Water Court
    - $4.2 million for the Department of Environmental Quality
    - $2.0 million for the Department of Natural Resources and Conservation
    - $0.3 for the Montana Bureau of Mines and Geology

The legislature did not over-appropriate any fund based on available revenue estimates. All projected balances could change based on the amount of the appropriations expended and the actual revenues.

Figure 5

2011 Biennium
Resource Indemnity Funding

Related Funds	02010 Oil & Gas	02022 Future Fish	02070 HazWas	02107 ECA	02162 EQPF	02216 Wa Sto	02289 GRW	02472 Orphan Share	02576 Operations
Beginning FY 2009 Fund Balance	$312,433	$1,113,055	$429,779	639,501	$2,987,113	$1,420,433	$0	$10,632,358	$4,192,776
RIT Interest		$500,000	$287,040	175,000	$99,360	$0	$300,000		$717,600
interest									
STIP	10,000		10,000	15,000					
RIGWA			293,711		293,711	150,000	366,000		
Metal Mines Tax									832,000
Oil and Gas Tax								3,140,398	1,522,936
Other Income	67,000				3,750,000				
FY 2009 Total Revenues & Fund Balance	$389,433	$1,613,008	$1,020,530	$829,501	$7,130,184	$1,570,433	$666,000	$13,772,756	$7,265,312
FY 2009 Appropriations	(174,194)	(1,613,008)	(494,755)	0	(3,008,135)	(520,628)	(666,000)	(19,118)	(5,324,833)
FY 2009 Budget Amendment									(992,037)
Transfers	25,000							(3,025,000)	
Reserved for Capital Appropriations									
Grant Reversion									
Projected Fund Balance Ending FY 2009	$240,239	$0	$525,775	$829,501	$4,122,049	$1,049,805	$0	$10,728,638	$948,442
Revenues for 2011 Biennium									
RIT Interest - Direct	50,000	1,000,000	431,340	175,000	595,310	500,000	600,000	-	1,078,350
RIGWA			820,422		820,422		732,000		
Anticipated reversions									350,000
Short Term Investment Pool - Interest	20,000		20,000		70,000	35,000			
Admin Fees						120,000			6,000
Metal Mines Tax									802,000
Oil and Gas Tax								4,949,187	2,400,108
Agency Generated Revenues	100,000				7,500,000				
Transfers - From Water Adjudication Account									2,064,139
Transfers - Other					(600,000)			(2,400,000)	900,000
Fiscal Note - SB 62 / HB 678									226,843
Projected Fund Balance Beginning FY 2010	$410,239	$1,000,000	$1,797,537	$1,004,501	$13,107,781	$1,704,805	$1,332,000	$13,277,825	$8,775,882
Appropriations for 2011 Biennium									
RRGL and RDGP Programs									
UM-Bureau of Mines							(1,332,000)		(351,772)
DNRC - Conservation and Resource Devel. Division									(1,362,397)
DNRC - Water Resources Division						(535,000)			(451,687)
DNRC - Board of Oil & Gas	(200,000)								
DNRC - Forestry/Trust Lands								(9,600,000)	(199,762)
DEQ - Central Management									(117,114)
DEQ - Planning, Prevention & Assistance			(182,178)						
DEQ - Enforcement									(10,260)
DEQ - Remediation			(42,873)		(11,600,998)			(28,851)	
DEQ - Permitting & Compliance			(872,858)						(4,055,739)
Future Fisheries		(1,000,000)							
Judiciary-Water Court									(2,082,508)
Governor's Office - Emergency Authority				(1,004,501)					
Total Appropriations	($200,000)	($1,000,000)	($1,097,909)	($1,004,501)	($11,600,998)	($535,000)	($1,332,000)	($9,628,851)	($8,631,239)
Projected Ending Fund Balance	$210,239	$0	$699,628	$0	$1,506,783	$1,169,805	$0	$3,648,974	$144,643