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 Fund Unfunded Liability
- Other Major Funds
    - Highway Special Revenue Account
    - Resource Indemnity Trust
- Senate Bill 426
- Changes in General Fund Balance

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 17-7-140, MCA 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.

The legislature adjourned with a projected fund balance of $150.4 million. The executive budget proposal submitted to the legislature December 15, 2010 included a fund balance of $238.5 million. The legislative budget fund balance is not far from that. If revenues drop 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 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 nearly $360 million. Even the $150.4 million 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 17-7-140, MCA 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 ongoing expenditures with ongoing revenues. If revenues equal or exceed expenditures, then structural balance is achieved for the short-term. If expenditures exceed revenues, then structural imbalance occurs. With adjustments for one-time revenues and expenditures, the ending structural balance for the 2013 biennium is $25 million negative.

Future Structural Balance

The simple assessment of structural balance as matching ongoing revenues to ongoing expenditures, while useful to ensure short-term sustainability, may not be a good measure of long-term sustainability. Issues such as the potential for revenues exceeding estimates or an upside risk (this would improve structural balance) or considerations of future funding pressures (such as pension liabilities, K-12 funding requirements or human services case loads) require more in-depth analysis than is used in the current calculation of structural balance. For a forward looking analysis of budget pressure see pages 8 through 12 in this Volume 1 Overview. The following summarizes future budget risks.

Future Budget Risks

In every biennium, the following pressures can impact future structural balance of the general fund:

- Expenditure growth for higher costs for current services, as is common with caseload driven entitlement programs such as Medicaid or increases in prison populations supervised by the Department of Corrections
- Realization of any delayed implementation of the pay plan, which is not a factor in this biennium
- Growth in services arising from expansions in services provided
- Growth or reductions in services arising from known demographic or other economic changes, such as the cost of an aging population
- For any increase in annual expenditures, there must be ongoing revenue with which to fund it. In order to attain or maintain a structural balance, annual revenue growth must equal or exceed expenditure growth.

Going into the next biennium, the beginning point would be the structural balance of FY 2013 or $25 million per year negative. In addition there are several ways in which structural balance will be impacted in the 2015 biennia, including:

- The base revenues will likely be higher than anticipated by $50 to $80 million per year positive
- Healthy Montana Kids initiative will reduce general fund revenue by $11 million per year.
- General fund only liabilities associated with the pension systems are over $40 million per year

- Other spending pressures for the 2015 biennium are $25 to $35 million per year of additional cost. For more details of these costs, please see pages 8 through 12 in this Volume 1 Overview

General Fund - Conclusion

The structural balance for the 2013 biennium, based on HJR 2 estimates, without consideration for retirements or other pressures, and including final impacts of legislation and Governor vetoes, was negative $25.0 million. As shown above, looking in to the 2015 biennium and beyond the picture becomes more complicated.

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. A number of functions of state government are funded from accounts that receive their income from dedicated taxes and fees. The impact on two major state special revenue funds illustrates issues with structural balance in two different program areas.

First is the health and Medicaid initiatives account established by voter initiative that raised taxes on cigarettes and other forms of tobacco to benefit Medicaid, Healthy Montana Kids, Big Sky Rx, and the Insure Montana program. The fund is not structurally balanced as annual appropriations ($49.6 million in FY 2013) exceed annual revenues ($36.1 million in FY 2013). If all appropriation authority is expended, the ending fund balance of $10.9 million may not be sufficient for FY 2014 and beyond. During the 2013 legislative session, the legislature will need to find other revenue to support these functions or reduce services funded from the account.

Second is the highway special revenue account, which funds highway construction and maintenance and safety related costs. This fund normally appears in a chronic state of structural imbalance due to an inelastic revenue source and inflationary construction costs. The structural stabilization has been attained by maximizing recovery of indirect costs from the administration of the federal-aid highway program, use of indirect cost revenue to shore up the account revenues, and managing the program within available revenues. The balance allows for all anticipated federal funds to be matched through the 2013 biennium.

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 for the 2011 biennium that were monitored by the Legislative Finance Committee and agency proposed goals for the 2013 biennium. 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.

Members of the joint subcommittees recorded the requests for interim performance measurement in SJ 26. This resolution lists several programs for recommendation by the Legislative Finance Committee (LFC) to legislative interim committees for monitoring and directly to the Environmental Quality Council (EQC) as assigned, and records other monitoring that was discussed and considered by the legislature. This resolution includes the following for recommendation by the LFC to interim committees:

- The Court Help Program and the Water Court in the Judicial Branch
- Vehicle insurance verification system and the Motor Vehicle Division in the Department of Justice
- Average daily population of secure assisted living beds in the Department of Corrections
- General operations and budget issues within the Office of the Public Defender (also in HB 613)
- Department of Public Health and Human Services:
    - Implementation of broad-based budget reductions and the effect on operations
    - Implementation of Healthy Montana Kids
    - Evaluation of the impacts of the economy and recession on workload and programs
    - Implementation of components of federal health insurance reform including
    - Integration of Medicaid eligibility determination in the health insurance exchange design
    - Evaluation of the potential for a single system to determine Medicaid eligibility
    - Outlining components and cost of Medicaid eligibility expansion for consideration by the 2013 Legislature
    - Implementation of the broad-based budget and personal services reductions and related effects on the Human and Community Services Division
    - Caseload growth in SNAP, Medicaid, TANF, LIEAP, and child care and the number of children entering and exiting foster care

  - Impact of the implementation of the components of federal health insurance reform on the Technology Services Division
- Office of Public Instruction:
  Implementing state actions to create a culture of effective data use and to improve student performance
  - Goals and objectives on K-12, higher education, and P-20, including the role and mission of the
  Education and Local Government Interim Committee
- The Preservation Review Board on the status and maintenance needs of agency heritage properties as required in SB 3

The resolution includes the following recommendations for interim monitoring by the EQC:
- The migratory bird, upland game bird and brucellosis surveillance in elk managed by the Department of Fish Wildlife and Parks
- Progress of remediation of the KRY clean-up site and petroleum tank closures within the Department of Environmental Quality (also in HB 613)

The resolution also lists several program areas discussed by appropriations subcommittees in the context of performance monitoring but for which a formal recommendation to monitor in the interim was not made. This list includes children’s mental health providers, autism waiver services, impact of the Patient Protection and Affordable Care Act on the state employee group health plan, increased use in electronic fund transfers, the imaging project within the Department of Revenue, and activities related to controlling aquatic nuisance species by the Department of Agriculture.

In addition, two pieces of legislation direct the legislature to engage in research related to the use of performance based or priority based budgeting. They are:
- SJ 28 – Requests that the Legislative Counsel designate the Education and Local Government committee to study the potential for utilization of performance based budget to design a performance-based funding formula or structure for K-12 education for use in this state that recognizes and accommodates Montana's historical commitment to local control, highly qualified educators, high student achievement, and continual improvement in education outcomes.
- HB 642 – Creates a select committee on efficiency in government. This committee is charged with evaluating priority based budgeting systems, performance measurement, and other efficiency and effectiveness measures used in other states. The bill requires the research to be compared, contrasted and documented with the base budgeting system currently in use. The bill requires the committee to focus its attention on three key areas: information technology, health care, and natural resources development.

Early in the 2013 interim, the LFC and the other interim committees will make determinations regarding the inclusion of monitoring of performance related activities in committee work plans. The staff of the Legislative Fiscal Division will be assisting with the monitoring activities of the LFC, working with branch colleagues on the monitoring assigned to other committees, and taking an active role in the execution of the work plan associated with HB 642.

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 the end of FY 2011. 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 are authorized by statute and are included in the LFD general fund balance projections of ending fund balance.

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 Office of the Solicitor General filed an amicus brief on May 20, 2010 entering the opinion that the request to hear the case should be denied. On June 20, 2011 the U.S. Supreme Court granted PPL's petition, limiting arguments to the test of determining navigability of the rivers in question.

The 2011 Legislature passed SB 410, which requires the deposit of the funds to the public land trust acquisition account to acquire higher producing lands for the purpose of public school funding. This bill also requires that the purchases be offset by selling lower producing lands. Revenue from the sale of the lower producing lands is to be deposited to the public land permanent fund. Interest income from the public land permanent fund would be distributed to the K-12 guarantee account for support of schools. HB 2 contains a language appropriation to provide the authority to expend up to $60.9 million for this purpose.

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.

PENSION PLANS UNFUNDED LIABILITY

Over the past decade, one of the key fiscal issues in front of the legislature 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. The severe market downturn in FY 2009 resulted in actuarial valuations that reported four defined benefits plans as actuarially unsound at the end of FY 2009 and FY 2010.

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 be sufficient to amortize any projected unfunded liability within 30 years.

MOST RECENT ACTUARIAL VALUATION

An actuarial valuation is required, by statute, 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 years ending June 30, 2010 and 2009. The first four plans are those pension plans that were the focus of attention over the past five sessions as they were considered "actuarially unsound" during three of those sessions.

The key item to focus on in the FY 2010 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, four plans (TRS, PERS, GWPORS, and SRS) are actuarially unsound in the actuarial valuation for both years.

Figure 1

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

There is a key point to be noted. 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 2009 are not totally realized in this current valuation, but rather are spread out over a four year period. In fact, there are two more years of losses from FY 2009 that will be realized in 2011 and 2012. Similarly, the portions of gains of FY 2008, FY 2010, and FY 2011 still need to be recognized. As of this writing (May 2011), the retirement plans have recovered somewhat, but still have a long way to go.

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 will perform before the end of FY 2011 is unknown, but it is how they perform that will primarily determine the degree of actuarial soundness or unsoundness of the retirement plans in the next valuation, assuming experience is substantially in keeping with the actuarial assumptions. The expectation is that the June 30, 2011 valuations for the four plans will remain "unsound" and one more plan (HPORS) will become actuarially unsound as the FY 2009 losses are further recognized.

It remains to be seen how quickly the economy can recover, and whether the recovery will be strong enough for the equity markets to replace any significant amount of the lost asset value in the funds. However, the expectation is that, long term, even a very positive economic recovery will not be sufficient to recover all of the lost asset value, and corrective action to increase contribution rates or reduce benefits will be necessary to return the plans to actuarial soundness. The cumulative effects of these market factors and any plan adjustments will ultimately determine the actuarial soundness of the systems.

TOTAL UNFUNDED LIABILITY

The net unfunded liability of the nine defined benefit pension plans as of June 30, 2010, was $3.3 billion. The collective funded ratio was 70%.

ACTIONS OF THE SIXTY-SECOND LEGISLATURE REGARDING PENSION PLANS

The Governor's budget proposal, submitted to the legislature in December 2010, did not include any proposal addressing the unfunded liability of the pension plans. Regardless, more than a couple of dozen bills were considered by the legislature during the 2011 session. Those that passed were largely "housekeeping" in nature and do little to increase assets or decrease liabilities of the retirement systems. The few that actually impact the actuarial soundness and take a step in the right direction are listed below:

- HB 116 contains two changes that impact on the funding of the Teachers' Retirement System: 1) charging actuarial rate of interest of purchases of service, and 2) true actuarial reductions for early retirement. According to the fiscal note, these changes will reduce the unfunded liabilities by $6.8 million and the amortization period by 2.3 years. (While the State Administration and Veterans' Affairs Interim Committee (SAVA) was charged during the last interim with evaluating the teachers' retirement system, and proposing plan design changes to improve the funding status of the system, the proposed legislation offered by SAVA in the 2011 Session, SB 54, did not pass.)
- HB 122 makes changes to the Public Employee Retirement System that, in the long term, will have a positive impact on the pension plan by reducing the normal cost resulting in an increased amount of required contributions available to pay down the unfunded liability. The changes, for new hires beginning July 1, 2011 are: 1) an increase in the number of years of compensation used to calculate the highest average monthly compensation from 3 years to 5 years; 2) an increase in the members contribution rate from 6.9% to 7.9%; 3) an increase in the ages for full retirement from 60 to 65 and for early retirement from 50 to 55; 4) a reduction in the multiplier used to calculate benefits; and 5) elimination of early retirement based upon membership service. HB 122 also incorporates true actuarial reductions for early retirement.
- HB 134 changes the time period used by the Game Warden and Peace Officers' Retirement System to calculate the highest average compensation used to calculate benefits upon retirement. The time period is changed from 3 years to 5 years for new hires. According to the fiscal note, the short term impact is negligible, but in the long term, the change will have a positive impact on the fiscal status.

- HB 135 changes the time period used by the Sheriffs' Retirement System to calculate the highest average compensation used to calculate benefits upon retirement. The time period is changed from 3 years to 5 years for new hires. According to the fiscal note, the short term impact is negligible, but in the long term, the change will have a positive impact on the fiscal status.

There were a couple of bills that could have positively impacted the pension situation but, in the end, were not enacted:

- SB 113 would have funds from the pension reserve accounts of school districts to the Teachers' Retirement Fund to help, in a small way, to shore up the funds. This bill passed the Senate but died in the House State Administration committee.
- SB 54 would have created a "hybrid" plan for new hires under the Teachers' Retirement System. This would not have significantly impacted the unfunded liability of the TRS plan in the short term but would have had an impact in the long-term. SB 54 passed both houses of the legislature but was vetoed by the Governor.

WHAT WILL THE SIXTY-THIRD LEGISLATURE FACE?

As of this report, by definition and based upon the most recent actuarial valuation, four plans are actuarially unsound. 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 2013, hopefully the picture with regard to investment returns will be clearer.

Legislative staff has attempted to keep the pension issues in the forefront for the legislature because of its potential budgetary impacts for future legislatures. Pension benefits are a financial obligation of state and local governments, and of school districts. At some point in time, these obligations will need to be addressed. As discussed earlier in this section, the losses to pension funds that occurred in 2008 and 2009 seriously reduced the asset value of the pension plans. Although investment returns have restored some of the losses, they have only begun to close the gap between the pension obligations and the assets available to meet them. The following two charts (Figures 2 and 3) demonstrate that "gap" for the largest of the pension system, PERS and TRS.

Figure 2

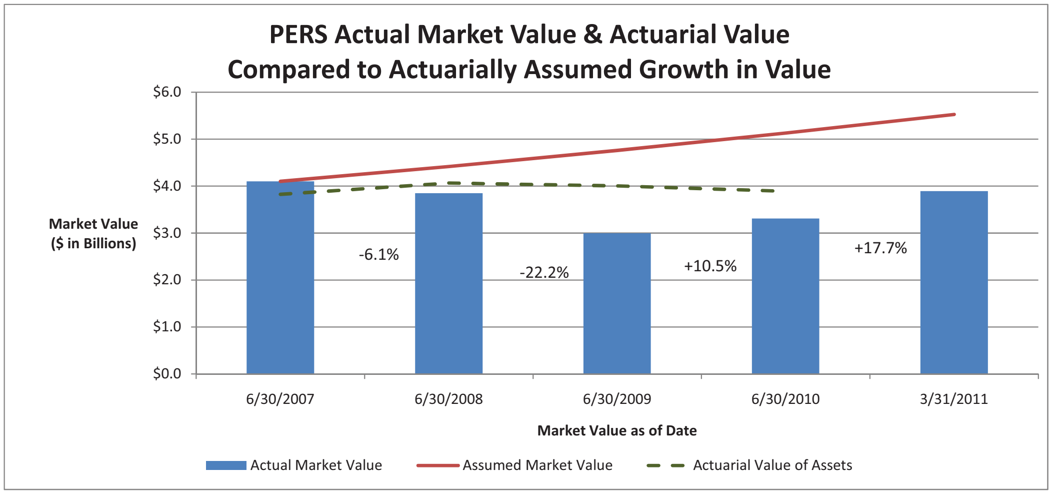
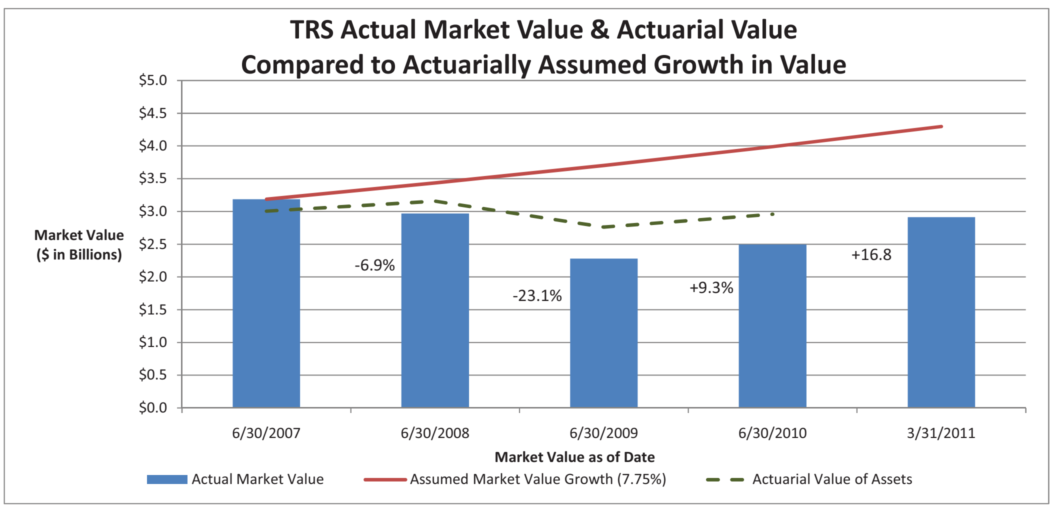


Figure 3



The reader must understand that the representations above stray from the usual actuarial analysis simply to make a point. Actuarial valuations incorporate many assumptions to reach a conclusion while this analysis focuses on the asset value of the pension funds.

The bars in the chart are the actual market value of each fund as reported by the Board of Investments. The solid line represents the value of assets if it had grown at 7.75% each year as is assumed for investment returns in the actuarial valuations. The dotted line is the actuarial value of assets (not available for 2011 until the valuation is complete about October 1) as reported in the actuarial valuations for the indicated years. The point of these two charts is to demonstrate how unrealistic it might be to assume that investment earnings can close the gap. FY 2007 is last year that both plans were actuarially sound. PERS was still sound in FY 2008. As is shown, FY 2009 saw reductions in fund assets of 22% and 23%. Since then, returns have exceeded the 7.75% actuarial assumption, but the gap has changed little. It will take significant investment returns over a long time period of time to close the gap and this assumes that the equity markets do not experience another downturn for many years. The markets are typically subject to business cycles that all but guarantee an economic downturn every several years. As of this writing, the equity markets continue to be volatile from weak signals from the economy.

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 with the needed investment returns to 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. Each retirement board has a policy that provides that after two consecutive “negative” valuation reports, the board is 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?

OTHER MAJOR FUNDS

HIGHWAY STATE SPECIAL REVENUE ACCOUNT PROJECTIONS

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 each of which funds, 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. However, projections show appropriations for the 2013 biennium exceed expected revenues by $47.4 million and the account would end the 2013 biennium with a balance of $25.2 million, which should provide sufficient cash flow for operations during the 2013 biennium. Furthermore, with $30.4 million of the appropriations designated as one time only, the risks into the 2015 biennium from the 2013 biennium imbalance are reduced significantly. A detailed working capital analysis for the highways state special revenue account is provided in the Department of Transportation agency discussion in Volume 4, beginning on page C-64.

Figure 4

Working Capital Analysis - Highways State Special Revenue
Fiscal Years 2010 - 2013
(in Millions)

Description	FY 2010 Actual	FY 2011 Approp.	FY 2012 Budget	FY 2013 Budget
Beginning Working Capital Balance	$66.5	$100.8	$72.6	$45.1
Revenues	289.3	286.2	288.7	292.3
Available Working Capital	252.0	314.4	316.2	312.3
Authorized Expenditures	37.3	(28.2)	(27.5)	(19.9)
Adjustments	(3.0)	0.0	0.0	0.0
Ending Working Capital Balance	$100.8	$72.6	$45.1	$25.2

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, the legislature reduced appropriations from the natural resources operations fund. The legislature also transferred $4.4 million from the orphan share fund to the guarantee account.

Figure 5 illustrates the condition of the RIT related funds.
Major changes include the following:

- Deposits of RIT interest will not be made to the oil and gas fund and the environmental contingency account due to the current fund balance and statutory restrictions
- An allocation of $5.85 million was made in HB 5 to fund a portion of the state's share of the cleanup at the KRY site

Biennial transfers include:

- $2.4 million per statute from the orphan share to the Zortman/Landusky water treatment trust
- $4.4 million from the orphan share to the state guarantee account due to passage and approval of HB 604

Biennial appropriations include:

- $8.6 million to operate the state superfund program, of which $4.3 million is reimbursement from liable parties
- $8.6 million for agency operational support including:
- $2.1 million for the Water Court
- $4.0 million for the Department of Environmental Quality
- $2.2 million for the Department of Natural Resources and Conservation
- $0.3 for the Montana Bureau of Mines and Geology

No funds are over-appropriated based on available revenue estimates. All projected balances could change based on the amount of the appropriations expended and the actual revenues.

Figure 5

Resource Indemnity Funding - 2013 Biennium									
Related Funds	02010 Oil & Gas	02022 Future Fish	02070 HazWas	02107 ECA	02162 EQPF	02216 Wa Sto	02289 GRW	02472 Orphan Share	02576 Operations
Projected Fund Balance Ending FY 2011	$180,289	$0	$81,145	$858,956	$1,531,718	$342,927	$0	$3,751,678	$881,572
Revenues for 2013 Biennium	31,400	1,000,000	923,432	2,500	7,147,262	550,000	1,332,000	5,426,171	7,748,783
Projected Fund Balance Beginning FY 2012	$211,689	$1,000,000	$1,004,577	$861,456	$8,678,980	$892,927	$1,332,000	$9,177,849	$8,630,355
Appropriations for 2013 Biennium									
UM-Bureau of Mines							(1,332,000)		(351,772)
DNRC	(200,000)					0			(2,254,042)
DEQ			(944,928)		(8,638,190)			(1,527,847)	(3,958,735)
DEQ HB 5								(5,850,000)	
Future Fisheries		(1,000,000)							
Judiciary-Water Court									(2,038,668)
Governor's Office - Emergency Authority*				(861,456)					
Total Appropriations	($200,000)	($1,000,000)	($944,928)	($861,456)	($8,638,190)	$0	($1,332,000)	($7,377,847)	($8,603,217)
Ending Fund Balance	$11,689	$0	$59,649	$0	$40,790	$892,927	$0	$1,800,002	$27,138

SB 426 Referendum for Tax Relief

Based on Excess Ending Fund Balance

Senate Bill 426 sponsored by Senator Balyeat was enacted by the Sixty-second Legislature. This legislation created the "Treasure State Taxpayer Dividend Program" with the provision the act is submitted to the qualified electors on the November 2012 ballot. This legislation is designed to refund surplus state government fund balance through an income tax credit mechanism. If approved by the electors, the legislation would be applicable to fiscal years ending on June 30, 2013 and beyond.

The Department of Administration is required to certify to the budget director, by August 1 of each year, the amount of the unaudited general fund balance for the previous fiscal year. If this balance exceeds the budgeted balance by 125%, then tax credits for individual income and property taxes paid are allowed to be claimed on subsequent tax return filings. It should be noted, however, that the excess balance must be at least \$5.0 million otherwise no tax credits are allowed. The legislation also specifies that one-half of the excess balance must be distributed "in the form of individual income tax credits related to property taxes paid on the taxpayer's principal residence and related to the taxpayer's individual income tax paid." The remaining one-half of the excess balance remains in the general fund ending fund balance.

The legislation defines the procedures to be used by the Department of Revenue to determine how much of the excess fund balance is to be used for residential property tax and individual income tax relief. This calculation is based on the ratio of the total amount to be refunded divided by the sum of total residential property and total individual income taxes. For example, if residential property tax collections were \$600 million and individual income tax collections were \$800 million and the amount to be refunded was \$50 million, then residential property and individual income taxpayers would be allowed to claim an income tax credit in the subsequent year equivalent to 3.57% of their residential property and individual income taxes paid in the previous year. This tax credit is a refundable tax credit that applies to only the subsequent tax return filed. Any potential future tax credits are determined annually based on whether there are excess fund balances above the projected amounts.

Changes In General Fund Balance

Figure 6 shows the ending general fund balance and yearly revenues and disbursements by fiscal year. The amounts shown for the period FY 2011 through FY 2013 are forecasts. The other years shown represent actual amounts for each item. As shown in the figure, the adopted legislative budget reduces the fund balance from $314.9 million to $150.4 million by the end of the 2013 biennium. The figure also shows that general fund spending exceeds anticipated revenue by approximately $38.5 million for each year of the 2013 biennium. These amounts have not been adjusted for one-time only revenues and disbursements.

Figure 6

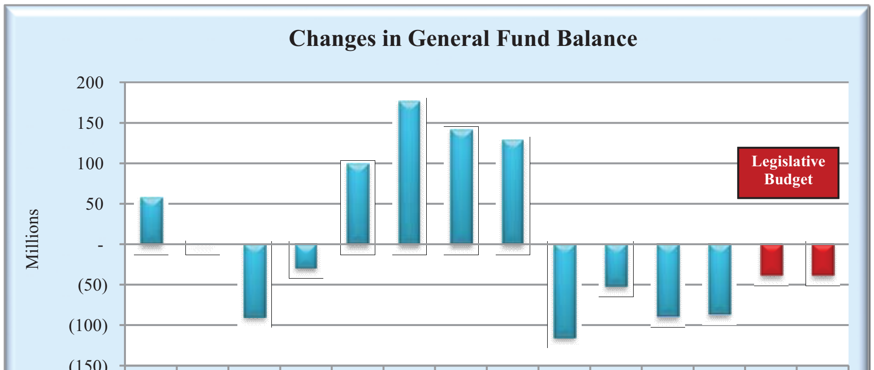
Changes in General Fund Balance
Figures in Millions

		End. Fund Balance	Yearly Adjustments	Yearly Revenue	Yearly Disburse		Yearly 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
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)
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
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
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)
A	2010	314.881	8.112	1,627.145	1,716.710		(89.565)
F	2011	227.339	(0.466)	1,706.654	1,793.730	*	(87.076)
F	2012	188.910	0.000	1,785.623	1,824.052	*	(38.429)
F	2013	150.382	0.000	1,853.138	1,891.666	*	(38.528)

* Legislative Budget Revenue and Expenditure Budget

Figure 7 shows the year over year change in the general fund balance. The figure illustrates how spending was less than revenues during the period FY 2004 through 2007. Beginning in FY 2008, general fund spending has exceeded available revenue. As with Figure 6, the amounts shown in Figure 7 have not been adjusted for one-time only revenues and disbursements.

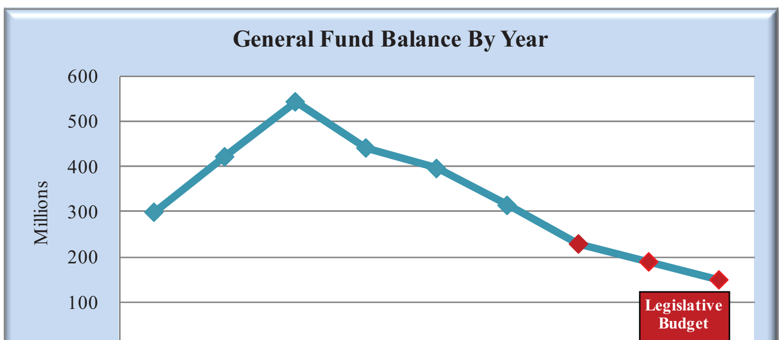
Figure 7



	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	-87.0	-38.5	-38.6

Figure 8 shows the actual and projected ending fund balance by fiscal year. Since FY 2007, the ending general fund balance has declined at a rather steep rate. The ending balance peaked at $543.5 million at the end of FY 2007 and is projected to end the 2013 biennium at $150.5 million. The decline in ending fund balance illustrates that all general fund spending (one-time and ongoing) has exceeded all revenues. As spending exceeds revenue, the ending balance is used to continue a higher level of spending. Budgets for future biennia are not projected to have a large balance to support general fund spending. General fund spending will be required to be within the anticipated revenue growth.

Figure 8



	2005	2006	2007	2008	2009	2010	2011	2012	2013
Amount	$299.8	$422.2	$543.5	$441.5	$396.3	$314.9	$227.3	$188.9	$150.4
Revised									