2017 BIENNIUM OUTLOOK
FOR THE GENERAL FUND BUDGET

A Report Prepared for the

Legislative Finance Committee

By

Legislative Fiscal Division

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LFD
MONTANA LEGISLATIVE FISCAL DIVISION

INTRODUCTION

The purpose of this report is to provide perspectives on the upcoming 2017 biennium budget. The report provides the current outlook for ongoing general fund revenues and expenditures to project the general fund structural balance the legislature will have available for the 2017 biennium. The report includes a summary of findings, with further elaboration on:

- Anticipated ongoing general fund revenues
- Ongoing general fund present law expenditure requirements, including budget risks
- Budget pressures

RISKS AND PRESSURES

The report contains a discussion of various risks and pressures that are not a part of present law but could impact spending or revenues. Present law is defined in statute as that level of funding needed under present law to maintain operations and services at the level authorized by the previous legislature.

"Risks" are defined as those factors that could render the projected present law different from actual present law in the next legislative session. For example, estimates of Medicaid costs and corrections populations are included in the present law estimate. Changes in any of these factors from the parameters used in the estimate will result in a different actual present law than the projected.

"Pressures" are defined as those factors that are not within the statutory definition of present law and so are not included in the estimate but that the legislature is likely to be under pressure to fund.

ANALYSIS OF FINDINGS

This report concentrates on the general fund, as it is the primary source used by the legislature to make funding decisions for general government services, such as education, health and human services and public safety. General fund structural balance and ending fund balance (to include any rainy day fund) are also generally used to determine the fiscal soundness of the state. For background information on these two measures, please see Appendix A: Managing Budget Volatility on page 26.

STRUCTURAL BALANCE

Structural balance compares the anticipated ongoing revenues and ongoing expenditures to determine whether ongoing revenues are sufficient to continue to fund the legislatively authorized ongoing functions of state government. The estimate of the 2017 biennium general fund structural balance is positive, meaning that the current outlook for general fund revenue exceeds the anticipated present law expenditure requirements for the budget.

The following chart is divided into two parts and is a visual representation of projected general fund structural balance in the 2017 biennium. The left side of the chart shows:

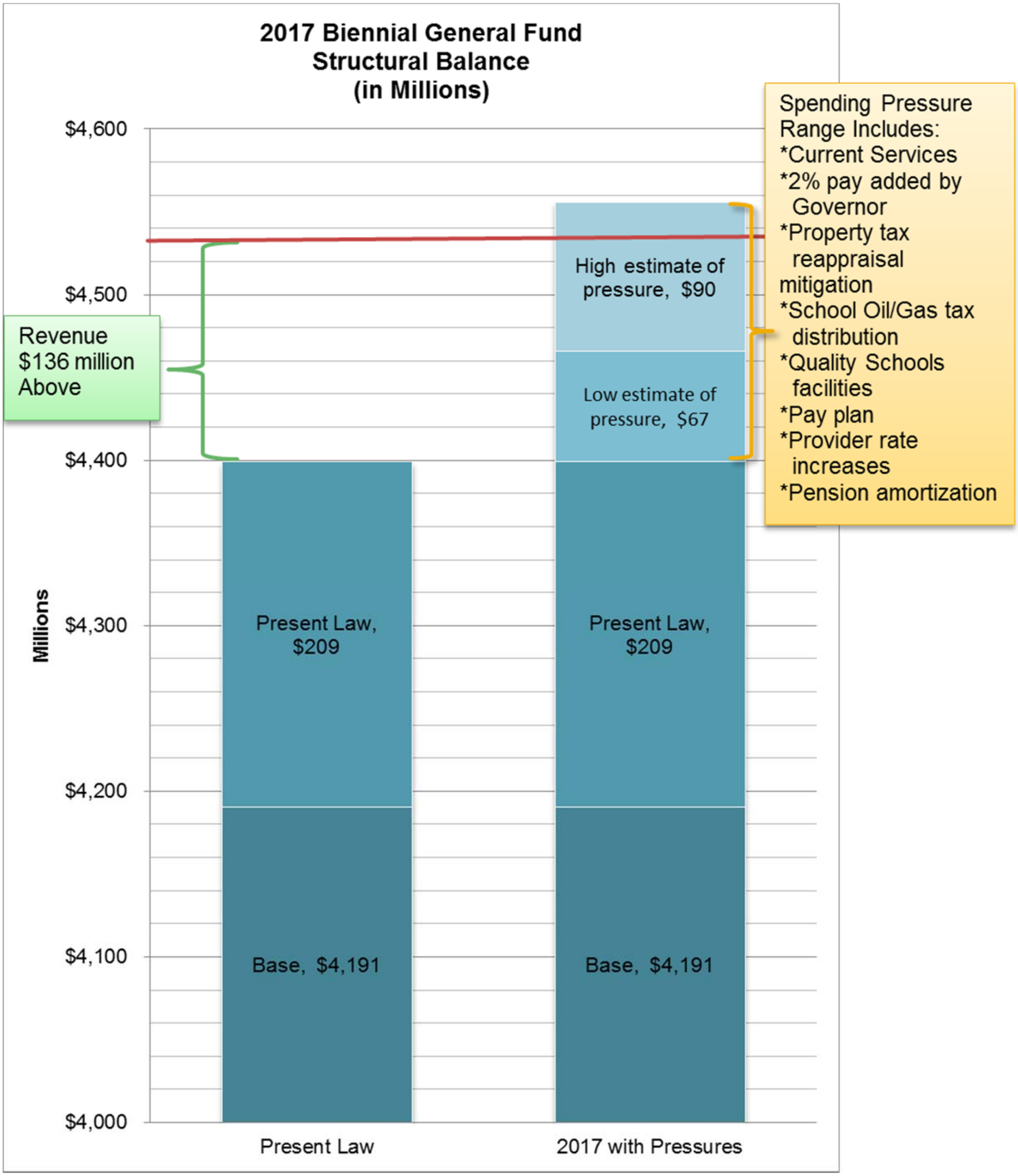
- Anticipated ongoing revenues, of the $4,526 million represented by the red line across the top of the chart
- The 2015 biennium ongoing appropriation base used as the starting point for the 2017 biennium budget
- Projected general fund present law adjustments to the base

The chart assumes:

- General fund revenue growth of 5.3% in the 2015 biennium and 9.1% in the 2017 biennium
- Present law expenditure growth of 5.0% from the 2015 biennium base to the 2017 biennium

As shown, anticipated ongoing spending is below projections of ongoing revenue. The projected revenue and spending trends would result in a structural balance of $136 million for the 2015 biennia, meaning that ongoing revenues are greater than assumed spending by $136 million or 3.0% of anticipated biennial revenue.

The right side of the chart shows the projected present law, but also adds various budget pressures the 2017 legislature is likely to face, including state employee pay plan, provider rate increases, and several other factors. It includes a range of possible funding scenarios, which are discussed later in the report.



Note for ease of understanding this chart, the revenue pressure related to property tax reappraisal mitigation is shown as an expenditure increase.

2015 Biennium Ending Fund Balance

In addition to a positive structural balance in the 2017 biennium, a higher than anticipated 2015 biennium ending fund balance is expected. The final anticipated ending fund balance at the end of the 2013 Legislative Session was $298 million. If the expenditures and revenues anticipated in this report hold true, the 2015 biennium ending fund balance will be $16 million higher than anticipated or $314 million.[1] For further information on the balance sheet, please review the 2015 Biennuim Budget Update.

Revenues

General fund revenue in FY 2013 was $82 million higher than anticipated in SJ 2 adjusted for revenue legislation. The current outlook for revenue in the 2015 biennium is $34.5 million or 0.8% less than anticipated in SJ 2 adjusted for revenue legislation. Revenues in the 2017 biennium are anticipated to grow by 9.1% or $377 million. More information regarding revenue estimates can be found on page 7.

Present Law

Anticipated present law expenditure requirements growth is slower than has been seen in recent biennia. The total dollar growth for present law in the 2015 Biennium Outlook report was $254 million, while the comparable value in the 2017 Biennium Outlook is $209 million. The two primary reasons for this lower growth are:

1. $58 million of the reduced general fund requirement is due to the 23% increase in the federal match rate for the Children's Health Insurance Program (CHIP) and additional state special revenue anticipated in the primary CHIP funding stream. Beginning in October of 2015, the federal government will pay an additional 23% of the cost of the state CHIP program, which offsets state funds. It is assumed that all 23% and the additional revenue can be used to offset general fund expenditures. Please see Appendix D page 33 for more details
2. In the 2017 biennium there will be less need to backfill revenue sources. The largest backfill in the 2015 biennium was for K-12 schools to replace guarantee account funds. On a biennial expenditure basis this replacement is forecast to be $57 million in the 2015 biennium and $17 million in the 2017 biennium.
3. Partially offsetting these reductions are higher growth levels in other areas of the budget as described below.

Of the $209 million of present law adjustments the largest increases include:

- $88.1 million annualizing the FY 2015 costs (the difference between FY 2015 and FY 2014) into the next biennium
- $71 million of Medicaid and CHIP caseload and utilization increases and $13 million in additional Medicaid FMAP costs (note that is significantly offset with the $58 million in higher revenue stream and lower CHIP federal match mentioned in 1 above)
- $87 million in school BASE aid and other present law school funding adjustments
- $6.5 million to replace the additional 2% vacancy savings adopted by the 2013 Legislature

The present law definition as applied above does not include all costs that could be considered needed to maintain current services and other spending pressures to be considered by the next legislature. These pressures are outlined in the next section and receive further attention in the Other Budget Pressures section on page 20.

[1] Note that the ending fund balance included in the June 2015 Biennium Budget Update Report is $35.1 million higher than the ending fund balance in this report. The difference is because the budget status includes the official SJ2 revenue estimate, while this report updates those amounts with the current outlook for the 2015 biennia.

RISKS AND PRESSURES

The report contains a discussion of various risks and pressures that are not a part of present law but could impact spending. The following section summarizes those risks and pressures.

Risks

Risks highlighted in the report include potential changes in human services caseload/utilization, corrections populations, and other factors. Each of the risks is incorporated within the relevant discussion in the "Revenue" and "Expenditure" sections that follow. Initiatives that could gain signatures and be passed by the electorate are included in the "Initiatives Risk" section on page 25.

Pressures

There are a number of areas where anticipated expenditures are not included in present law but where the legislature is likely to face pressure to increase spending. Each area is discussed in more detail in the "Other Budget Pressures" section on page 20 and is briefly described here. This list is not comprehensive of all items that will come before the legislature and it focuses on items that impact structural balance, are ongoing in nature, and fund current operations of state government. Items that tend to be one time investments such as any replacement for HB 218 (local government infrastructure) or state infrastructure investments are not included.

The table at the end of the list recaps each item and describes how much is included in the low estimate of pressure and a higher estimate of pressure that could be considered.

- Certain One-Time-Only Spending – The legislature made a number of appropriations one-time-only (OTO) that have either been funded for several biennia or that were for functions that could be considered ongoing. In this biennium $15 million of anticipated expenditures fall into this category, while $34 million appeared in this category last biennium.
- 2% Additional Pay Plan Negotiated by the Governor - While HB 13 contained funding for a 3% per year increase in state employee pay, the Governor negotiated a pay increase of 3% with the unions at the beginning of FY 2014 and 5% later in FY 2015. The difference between the legislatively budgeted pay plan and the implemented executive pay plan is not included in the present law analysis. The additional 2% pay increase is anticipated to cost $10.8 million in the 2017 biennium
- Property Tax Reappraisal Mitigation - Statewide mitigation of property values is often used to keep the total property tax class revenue neutral while property values increase. Mitigation that addresses both the strong Class 3 growth and the more moderate Class 4 growth, using preliminary numbers, could cause a $6.2 million reduction in income to the general fund. Alternatively, due to the modest increases in Class 4 property, if only Class 3 was mitigated, a reduction in $4.5 million to the general fund could occur. These reductions in income as compared to present law are shown as expenditures on the structural balance chart
- Oil and Gas Revenues to School Districts, also known as Concentric Circles (SB 175) – Replacement of funding to school districts is estimated to cost $5.8 million in FY 2017. See page 22 for more details
- Quality Schools School Facilities - Quality schools revenues are not sufficient to fund current programs in future biennia. If these programs were fully funded, the shortfall is estimated to be $14 million in the 2017 biennium. See page 23 for more information
- State Employee Pay Plan – The legislature could be approached with a pay plan for the 2017 biennium. A 1% pay plan, including funding for the Montana University System (MUS) at current funding ratios, is approximately $12.2 million general fund without an adjustment to the state contribution to health insurance. A 1% increase in health insurance is anticipated to cost $1.6 million general fund
- In addition to the cost of a pay plan, if the legislature desires to limit tuition increases, additional funding may be requested to fund the full resident student share of the MUS pay plan. The additional funding at 1% pay plan and insurance would be an additional $5 million general fund in the biennium and at a 3% pay plan would be $15 million general fund in the biennium
- Provider Rate Increases - The vast majority of medical and community services administered by the Departments of Public Health and Human Services (DPHHS) and Corrections (DOC) are provided

through contracts with private businesses or non-profits generally called providers. A 1% per year increase in provider rates is estimated to cost the general fund $12.5 million, similarly a 3% per year increase is estimated to cost $37.5 million

- Pension Liabilities: Current legal challenges and other circumstances add expenditure pressure to continue to meet the actuarial recommended 30 year amortization period. The anticipated cost to meet this actuarial recommendation is $11 million for the Public Employees' Retirement System. Please see page 24 for more information

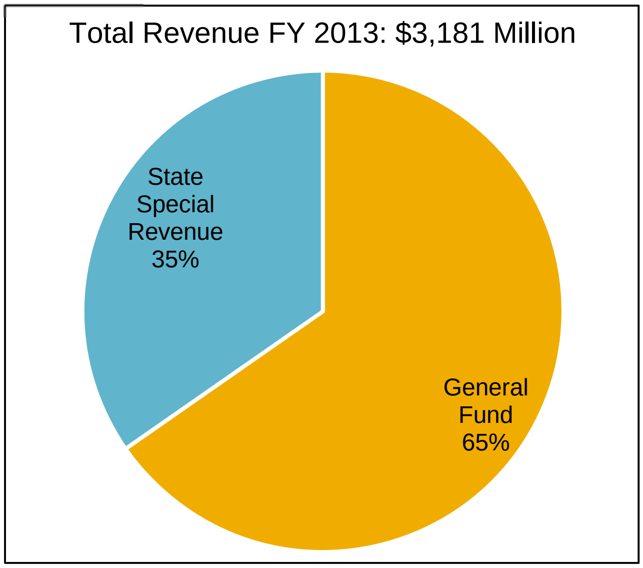
Summary of Ongoing Biennial General Fund Pressures

(In Millions)

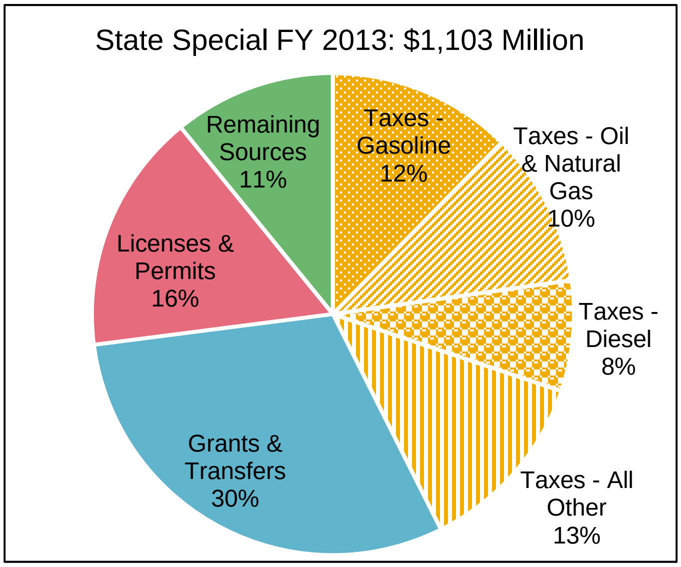
Pressure	Assumptions	Low Estimate	High Estimate	Total
Current Service Level	Full amount in low estimate	$15.1	-	$ 15.1
Governor's additional 2% pay	Full amount in low estimate	10.8	-	10.8
Reappraisal Mitigation	Low is class 3 mitigation only	4.5	1.7	6.2
School District Oil and Gas Distribution	Low assumptions is half	2.9	2.9	5.8
Quality Schools	Low assumptions is half	7.0	7.0	14.0
Pay Plan	1% per year in Low, 3% in High	13.8	27.6	41.4
Provider Rate Increase	1% per year in Low, 3% in High	12.5	25.0	37.5
MUS tuition mitigation	None in Low, all in High	-	15.0	15.0
Pensions	None in Low, all in High	-	11.0	11.0
Potential pressures described in 2017 Outlook		**$ 66.6**	**$ 90.2**	**$ 156.8**

REVENUE

Most general taxes are deposited in the state general fund. The general fund is used for most broad purposes of state government; education, health, and corrections are the predominant uses of this fund. State special fund revenues are raised and used for specific purposes. For example the state levies a gas tax that is dedicated for use on state roads and highways. Details of all general fund and most major state special fund revenue distributions and allocations are contained in the Legislative Fiscal Division's [June 2013 Revenue Report](#).



GENERAL FUND AND OTHER STATE REVENUE SOURCES



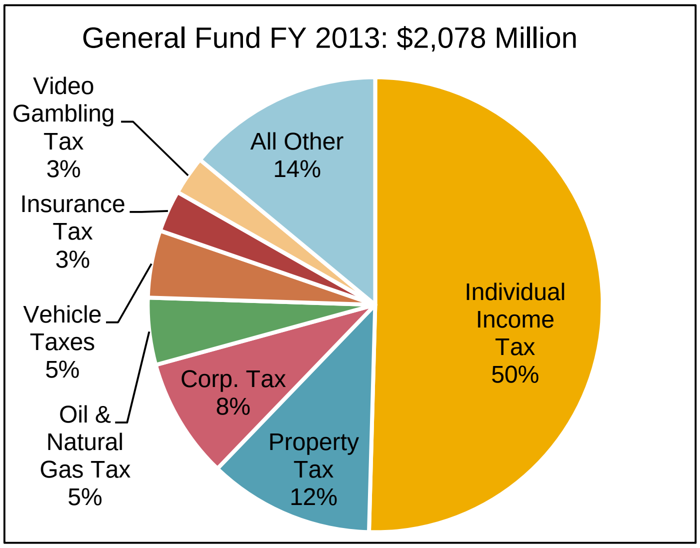
Most of the focus during session tends to be on the state general fund which accounted for 65% of FY 2013 total state revenue. Note that trusts or direct services funds such as unemployment insurance and workers' compensation insurance are not included in the adjacent chart. In addition, there is limited double counting as some sources of revenues are transferred between funds.

Large sources of state special revenue include the gasoline and diesel taxes, and oil and natural gas production tax. In FY 2013, the various taxes accounted for 43% of total state special revenue. Grants and transfers were the next largest contributor, amounting to 30% of state special revenue.

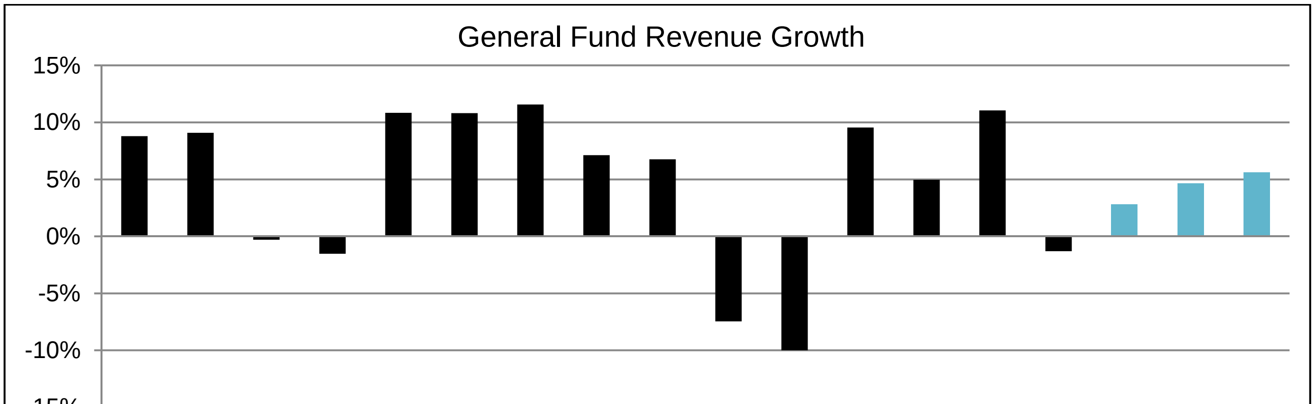
The largest seven sources of general revenue are individual income tax, property tax, corporation income tax, oil and natural gas taxes, vehicle taxes, insurance tax, and video gambling tax. In FY 2013, these sources accounted for 86% of total general fund revenue.

In the past several years, the general fund revenue has been relatively volatile as revenues fell nearly 17% from $1,954 million in FY 2008. In FY 2013, revenues increased by 11%—perhaps in response the federal tax uncertainty "Fiscal Cliff" at the end of calendar year 2012.

The chart on the next page shows the annual percent change in revenue, with actual values shown in black and outlook values shown in light



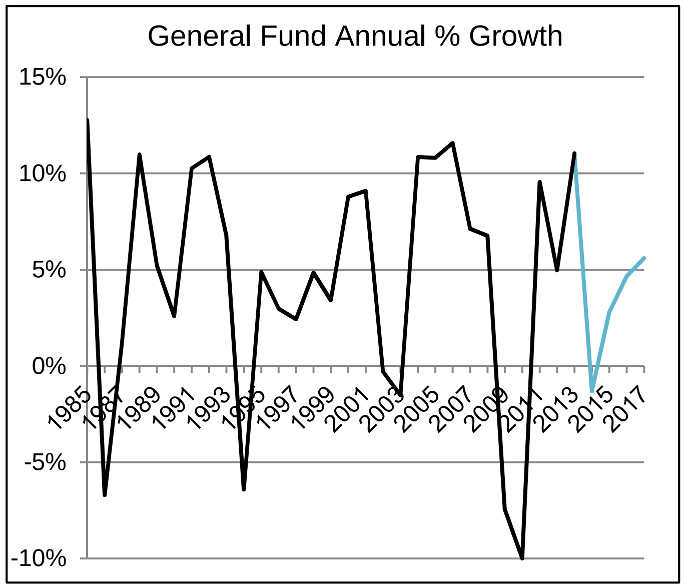
blue. The outlook for annual growth in general fund revenue for FY 2014 is -1.3%, FY 2015 is 2.8%, for FY 2016 is 4.7% and for FY 2017 is 5.6%. The outlook's projected revenue decline in FY 2014 primarily reflects the assumption of income shifting from FY 2014 to FY 2013 due to the federal "Fiscal Cliff."



2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
8.8%	9.1%	-0.3	-1.5	10.8	10.8	11.6	7.1%	6.8%	-7.5	-10.	9.6%	5.0%	11.0	-1.3	2.8%	4.7%	5.6%

Risk: Historical general fund revenue has been relatively volatile from year to year as the adjacent graph depicts. Corporation income tax, and oil and natural gas production tax are quite volatile in relative terms, while small percentage swings in the largest source—individual income tax—can produce significant changes to overall general fund revenue collections.

Another area of potential risk for this outlook is interest rates: although the past several years have seen almost zero rates of return on short-term investments, the current outlook assumes a return to normal rates. If realized, this increase would have an especially pronounced impact on treasury cash account earnings.

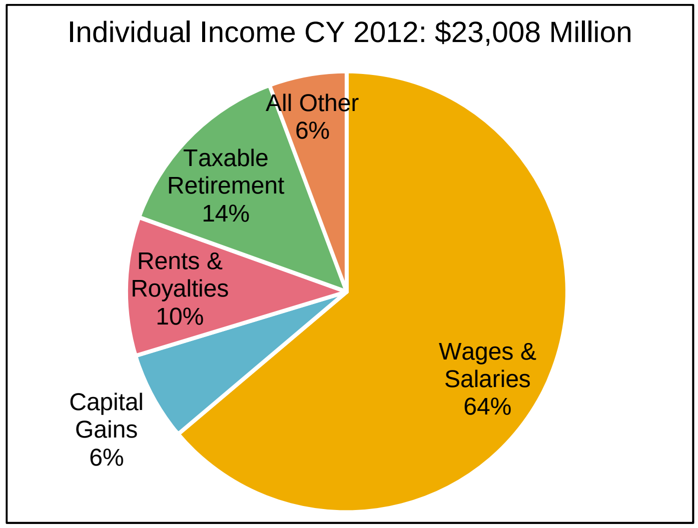


The general fund revenue outlook is produced by estimating the underlying sources of revenue and the economic drivers of those sources. The methodology of estimating each source of revenue is reviewed each biennium to determine if another method could be more accurate. Each biennium, improvements are made to the analysis. In November of this year, these revenue estimates will be updated with final FY 2014 revenues and other data available in the fall. In addition, the current year-to-date FY 2015 revenues are to be examined throughout the session. If significant difference occurs between the estimate and the actual revenues received, updates will be provided to the legislature.

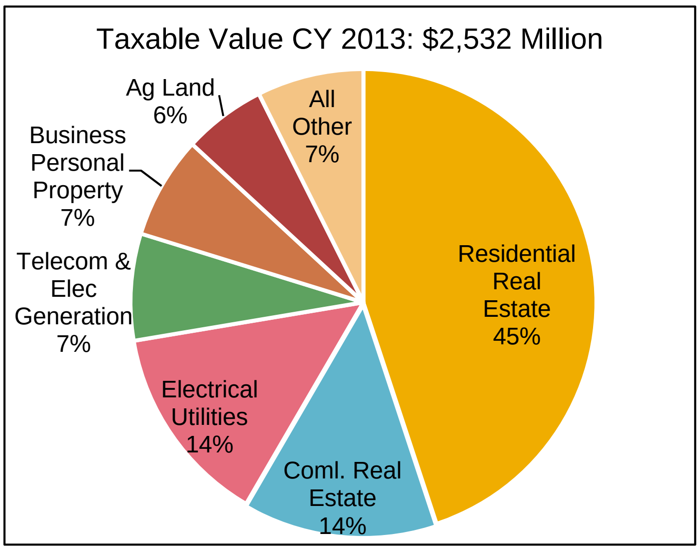
A summary of the top six tax sources, the significant economic drivers and their influence on the general fund is outlined in the next section, as well as any areas of potential risk. More details on all sources of revenue can be found in the Legislative Fiscal Division's June 2013 Revenue Report.

INDIVIDUAL INCOME TAX

The individual income tax is levied against taxable income, which is defined as total Montana income adjusted for exemptions and deductions. In 2012 full year resident income totaled over $23 billion. Once tax liability is determined, the amount of tax due is computed by subtracting allowable credits. Tax rates vary from 1.0% to 6.9%, depending on the level of taxable income. Tax brackets, personal exemption amounts, and the standard deduction are adjusted by the rate of inflation in each year. The tax rate on capital gains income is less than the tax rate on ordinary income by 2%. Wage income accounts for nearly two-thirds of total individual income, while withholding tax on wages accounts for about one-third of total general fund revenue.



PROPERTY TAX



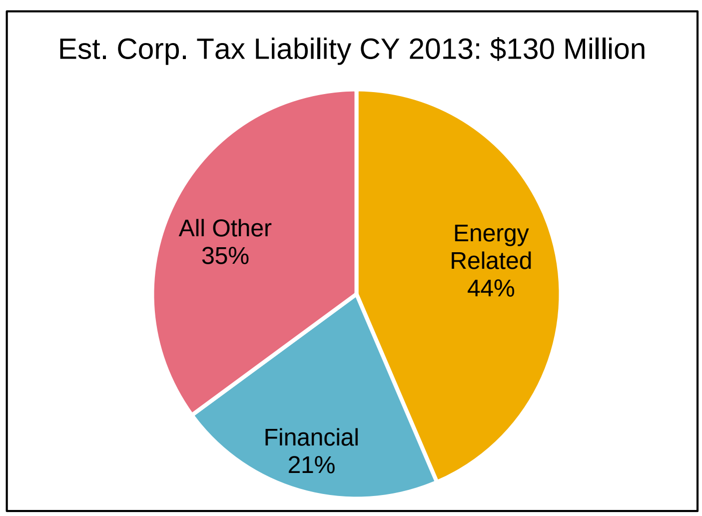
Montana law requires counties to levy a county equalization levy of 55 mills, a state equalization levy of 40 mills, and 6 mills for the university system against all taxable value in each county. A mill levy of 1.5 mills is also applied against all property in the five counties with a vocational technology (vo-tech) college. Taxable value is defined as the market value of statutorily defined property times a statutory tax rate.

Agricultural land, timber land, and residential and commercial land values are reappraised every six years; all other property classes are reappraised annually. The reappraisals are currently in process and will be the basis for FY 2016 property tax. Details of how the reappraisal may cause a budget pressure are highlighted in the Budget Pressures section on page 21 and the revenue risk of an initiative impacting cable company taxable values can be found on page 25.

CORPORATE INCOME TAX

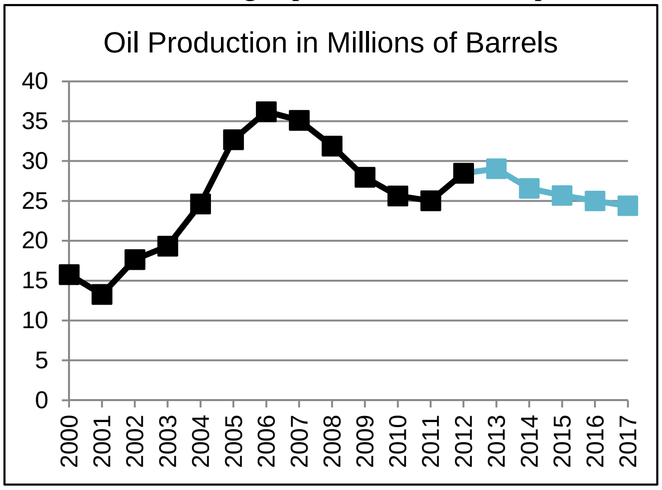
The corporation income tax is levied against a corporation's net income earned in or attributable to Montana, adjusted for allowable credits. The tax rate is 6.75%, except for corporations making a "water's edge" election (see 15-31-322, MCA), who pay a 7.0% tax on their net income.

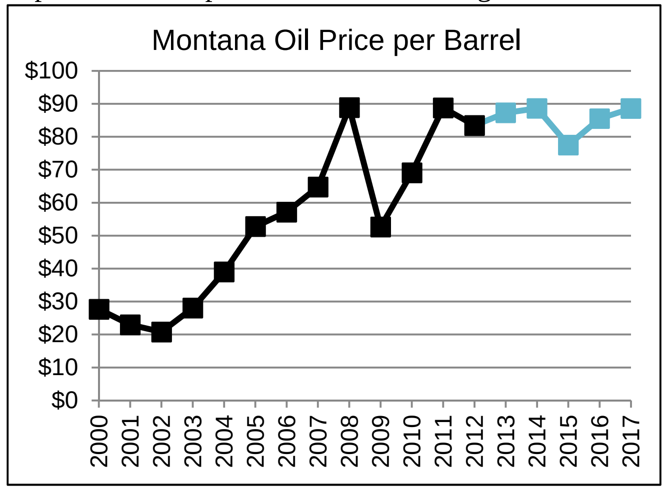
Financial and energy related sectors are the largest contributors to corporation income tax liability. Primary economic drivers of this source include oil prices, median house price, and retail sales.



OIL & NATURAL GAS PRODUCTION TAXES

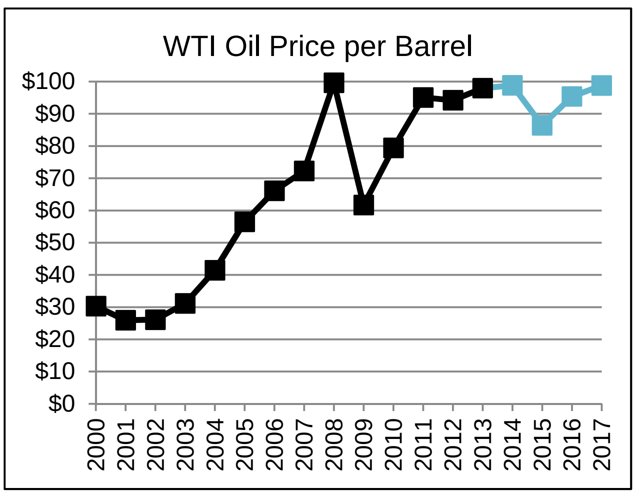
The oil and natural gas production tax is imposed on the production of petroleum and natural gas in the state.





The gross taxable value of oil and natural gas production is based on the type of well and type of production, and whether the production occurs within the tax holiday.

Oil production peaked in Montana in 2006 and fell 34% by 2011. Exploratory drilling in 2012 and 2013 resulted in an increase in production; the outlook expects a gradual decline as the surge in exploratory drilling has tapered off. The price of oil produced in Montana is less than the most quoted prices due to transportation costs to major markets.



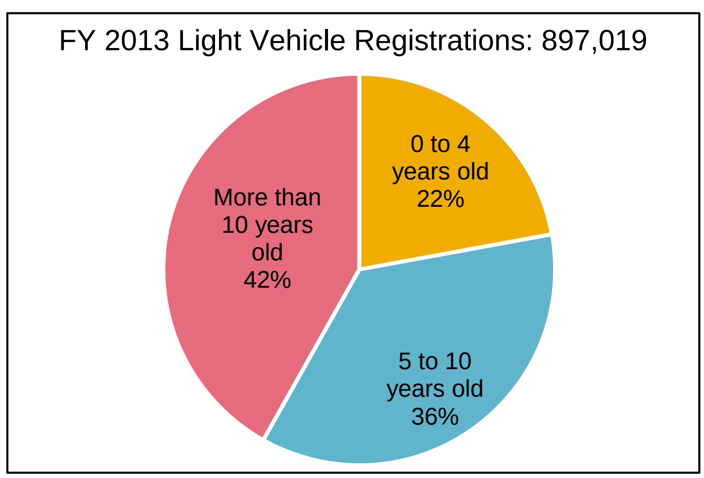
Energy and Commodity Prices: Energy prices in particular and commodity price in general impact several general fund revenue sources. Oil prices have the largest impact, with strong ties to oil production tax, corporate income tax and individual income tax.

Higher oil prices may result in increased drilling activity—thereby increasing oil production and potentially increasing employment in oil-related industries. Higher oil prices are also correlated with increased refining activity, which impacts corporation income in Montana. Conversely, lower prices may result in less drilling and decreased related economic activity.

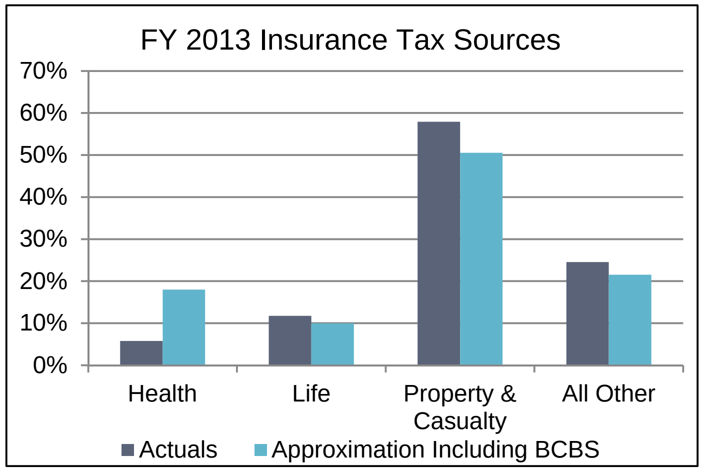
VEHICLE TAXES

Revenue for this source is primarily generated by taxing light vehicles and a variety of other vehicles under a fee schedule that varies by age and weight. Light vehicles aged 0 to 4 years are taxed at $217; vehicles aged 5 to 10 years cost $87; and vehicles 11 years of age and older cost $28, although there is the option to permanently register them for $87.50.

In addition, the state assesses a variety of motor vehicle fees such as fees for motor vehicle liens, fees for new license plates, and title fees.



INSURANCE TAX



The majority of insurance tax collections come from 2.75% of net premiums sold. There is an additional 2.5% levied on fire insurance premiums sold, and a number of small fees. The general fund portion is made up of 100% of fire insurance taxes, 95% of captive insurance taxes, and 67% of all other premium taxes as well as a fraction of the fees.

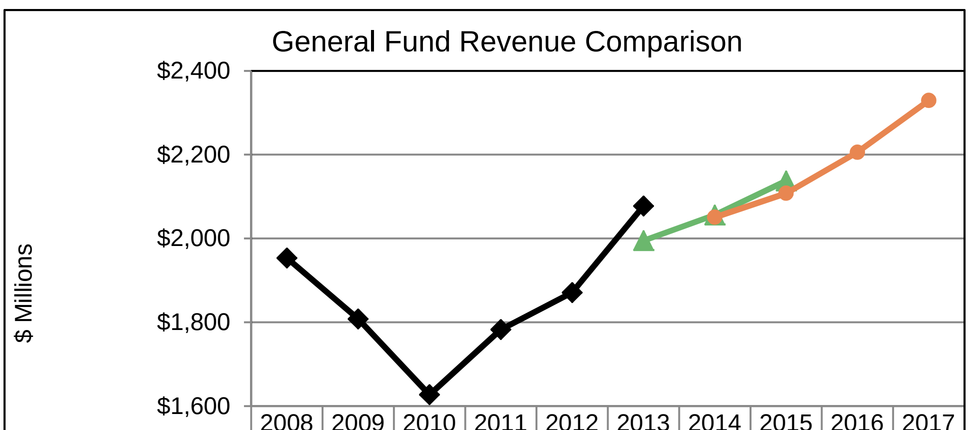
Two recent changes will impact this revenue source: Blue Cross and Blue Shield (BCBS) was bought out by Health Care Services Corporation (HCSC) at the beginning of FY 2014 under terms that made all of its policies taxable where they had previously been exempt; and the implementation of the Affordable Care Act.

Risk: Departures from historic trends and the Affordable Care Act (ACA) may have implications for insurance tax revenue. Premiums sold through BCBS from calendar year 2013 increased above what historic trends suggested. Additionally, about 51,000 new policies were sold by BCBS during the health insurance exchange window (this includes policies both on and off the exchange). BCBS is the only provider subject to insurance premium tax that offers policies on the exchange. At this time, there is no data that can specify whether the increase in new policies is due to: (1) growth in the overall number of policies sold; or (2) policy holders switching to BCBS from another insurance provider. If policy holders switched, the number of net policies will stay about even; however, if these were new policies then the net will increase. The impact of the potential increase in net policies will be moderated by lower premium costs since insurance premium tax is a percentage of the paid premium rather than a fee per policy. The State Auditor's Office is currently conducting an analysis to try to determine whether or not the number of insurance policies sold increased.

SUMMARY

Updated 2017 biennium revenue estimates for the general fund will be produced in November 2014. These estimates will be updated throughout the legislative session using a monthly review of year-to-date revenue collections and updating models with new economic data from IHS and other sources.

The chart to the right shows the difference between the current outlook and SJ 2.



	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Actual	1,954	1,808	1,627	1,783	1,871	2,078				
2013 SJ2						1,995	2,056	2,137		
2017 Outlook							2,051	2,108	2,206	2,329

The table on the next page shows the annual detail for the top seven general fund revenue sources along with Treasury Cash Account (TCA) interest and subtotal of remaining sources. As mentioned in the Revenue Risk section below, the projected strong increase in TCA interest growth is an area of risk. The forecast shows a biennial increase of nearly $40 million. While not large compared to total general fund revenue, it is the most significant relative increase compared to any revenue source.

General Fund Revenue Outlook Summary ($ Millions)								
Source of Revenue	Actual FY 2013	Estimated FY 2014	Estimated FY 2015	Estimated FY 2016	Estimated FY 2017	Actual 2013 Bien	Estimated 2015 Bien	Estimated 2017 Bien
Individual Income Tax	$1,047.8	$1,028.9	$1,074.7	$1,148.0	$1,224.2	$1,946.6	$2,103.6	$2,372.2
Property Tax	244.6	248.1	251.2	262.6	274.7	481.3	499.2	537.3
Corporation Income Tax	177.5	153.1	151.5	149.3	152.9	305.3	304.6	302.2
Vehicle Taxes & Fees	99.4	100.4	101.1	102.0	102.8	199.3	201.5	204.8
Oil & Natural Gas Production Tax	98.7	104.9	99.2	95.6	98.1	196.2	204.0	193.7
Insurance Tax & License Fees	61.7	53.9	58.9	59.1	59.2	120.6	112.8	118.3
Video Gambling Tax	57.3	61.1	63.6	68.2	73.5	111.1	124.6	141.7
Treasury Cash Account Interest	2.5	2.2	3.8	14.2	31.3	5.1	6.0	45.5
Largest Seven Subtotal	$1,786.9	$1,750.3	$1,800.2	$1,884.8	$1,985.4	$3,360.4	$3,550.5	$3,870.3
Treasury Cash Account Interest	2.5	2.2	3.8	14.2	31.3	5.1	6.0	45.5
Remaining Sources Subtotal	288.3	298.1	303.8	306.8	312.7	583.0	601.9	619.5
Total General Fund	$2,077.6	$2,050.6	$2,107.8	$2,205.9	$2,329.4	$3,948.6	$4,158.4	$4,535.3

Volatility: General Fund Revenues

Several sources of general fund revenue are responsible for a large share of historical year-over-year revenue fluctuations. Corporation income tax is in particular noted for its volatility; income tax, while more stable overall, represents such a significant portion of general fund revenue that even small changes in growth can produce large revenue differences. Oil and natural gas production tax is another potentially volatile source, as is interest income.

A rigorous standard error analysis is underway to better understand the source of estimate volatility—underlying econometric data forecasting error, modeling error, or intrinsic revenue unpredictability—and to direct data and model changes that would minimize the estimating error. Preliminary results from this analysis are available for corporation income tax and treasury cash account (TCA) interest income. The corporation income tax analysis has enabled a more informed choice for underlying economic indicators that simultaneously fit historical collection patterns more closely and minimize the error bounds in forecast years.

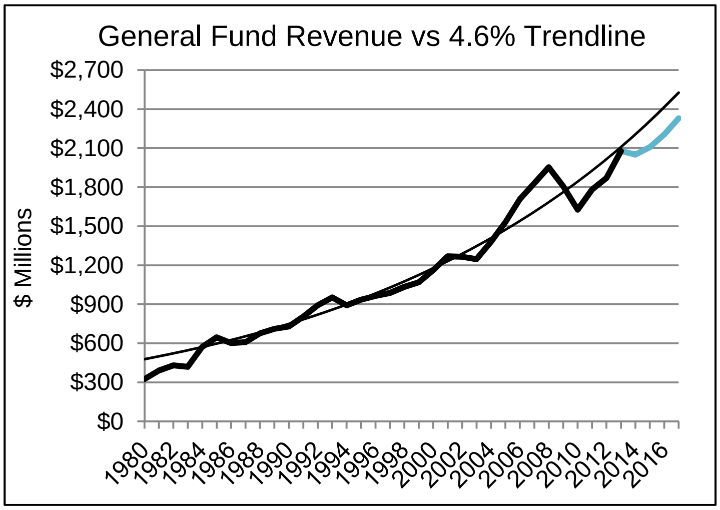
This analysis also examines past forecasts of certain economic variables provided by IHS, and compares the data forecasts of 1, 2 and 3 years in the future with what actually occurred. This analysis finds that while the historical IHS forecasts of the variables for the corporation income tax estimate are, on average, lower than actual, with the implication that collections may be underestimated by 8% to 9%. Conversely, the historical IHS forecasts of various interest rates have been consistently above actual, with the implication that TCA earnings could be overestimated by as much as 65%.

Further analysis will expand to include capital gains income and oil price volatility. Ultimately, a rigorous measure of the standard error of at least the top seven general fund revenue sources (which account for about 80% of total general fund revenue) could be used as a tool for managing general fund revenue volatility.

Outlook Compared to Historical Trend

The revenue outlook is based on an economic forecast from IHS that shows a relatively slow average economic growth of 4.8% as measured by gross domestic product (GDP). Although the economy is continuing to improve following the recession, the outlook for growth is below the average annual GDP growth of 6.3% from 1980 through 2007.

The impact of slower overall economic growth on the outlook for general fund revenue collection is shown in the adjacent chart. Although the outlook for revenue is on average increasing, it is below the long term revenue trend of 4.6% annual growth.



Extended Outlook

The purpose of the revenue outlook is to give legislators a sense of overall trends and associated risks regarding revenues in the 2017 biennium. As mentioned at the beginning of this section, the outlook for the 2017 biennium general fund is a decline of 1.3% in FY 2014, followed by increases of 2.8% in FY 2015, 4.7% in FY 2016 and 5.6% in FY 2017. This forecast appears moderate in comparison to historical trends, as discussed above. Based on current data and modeling techniques, the extended outlook for the 2019 biennium continues a moderated growth pattern with an average annual growth of 4.5%.

EXPENDITURES

General fund present law expenditures in the 2017 biennium are projected to total $4.4 billion. Expenditures are comprised of HB 2, statutory appropriations, non-budgeted transfers and other appropriations. The following figure summarizes the adjustments made to each funding source, each of which is explained further.

- Annualization of FY 2015 costs (the difference between FY 2015 and FY 2014) into the next biennium
- General present law adjustments
- Adjustments specific to certain agencies

Summary of Present Law Adjustments
(in Millions)

Funding Source	Annualize to FY 2015	General Present Law Adjustments	Specific Present Law Adjustments	Total from Base
HB 2	$ 76.6	$ 12.6	$ 124.7	$ 213.9
Statutory	15.1	16.7		31.8
Non-budgeted	(1.3)	(5.0)		(6.3)
Other (ongoing bills not incorporated in 2013 HB 2)	(2.2)	(28.0)		(30.2)
Total adjustments from the Base 2015 Bienniun	**$ 88.1**	**$ (3.7)**	**$ 124.7**	**$ 209.2**

STATUTORY APPROPRIATIONS

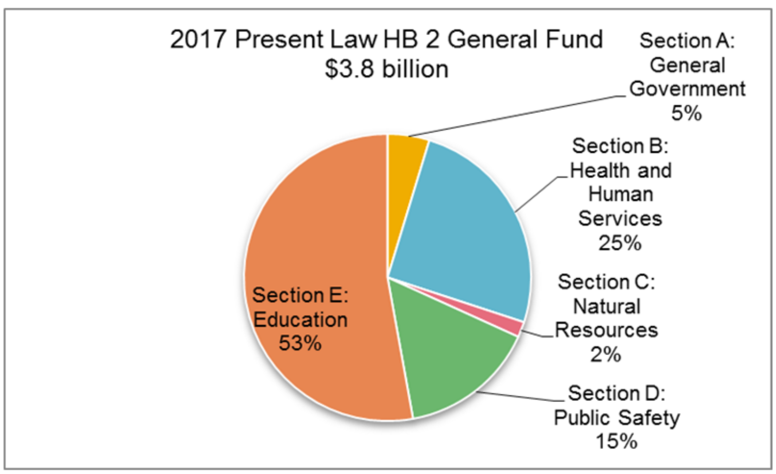
Statutory appropriations, which are controlled by statute and not routinely examined by the legislature, are almost 13% of all general fund expenditures or $565 million in the biennium. Statutory appropriations and transfers are dominated by three types of expenditures:

- Entitlement share payments to local governments - 47% of statutory appropriations or $266 million in the biennium
- Payments for local fire, police, and teacher retirement costs - 42% of statutory appropriations or $236 million in the biennium
- Debt service payments - 5% of statutory appropriations or $27 million in the biennium

Statutory appropriations are projected to increase $31.8 million predominantly due to projected increases in local government entitlement share payments and pension contributions.

NON-BUDGETED TRANSFERS AND OTHER

Non-budgeted transfers are dominated by Old Fund (State Fund) transfers and transfers of vehicle revenues to various state special revenue funds. The projected decrease of $6.3 million is primarily due to an anticipated reduction in the Old Fund transfer. Other appropriations are projected to decrease by $30.2 million, as these ongoing expenditures are incorporated in the HB 2 projection, primarily in K-12.



HB 2

The figure shows HB 2 expenditure projections for the 2017 biennium for present law levels by function totaling $3.8 billion. Note that this chart excludes statutory, non-budgeted, carryover, the feed bill, and other potential appropriations discussed in this report.

2017 Biennium General Fund Present Law Budget

HB 2 (the general appropriations act) is the primary source of appropriations of state general fund. In present law, HB 2 is anticipated to be $3.8 billion or 86% of the total $4.4 billion present law budget. As shown in the figure above 88% of all HB 2 projected general fund expenditures are made in three areas:

- Education, consisting of both the Office of Public Instruction (K-12 education) and the Commissioner of Higher Education – 53%
- Department of Health and Human Services (DPHHS) – 25%
- Corrections 10% (remaining Section D Department of Justice, the Judiciary, and Public Defender 5%)

The following discussion details the assumptions used in the above calculations.

Assumptions for HB 2 Expenditures

A number of assumptions were used to derive the present law level for expenditures. Present law includes those expenditures used to fund functions and funding of state government designated as ongoing by the legislature.

General Adjustments

General adjustments to the budgets of all general fund agencies include:

- Annualization of the pay plan provided in HB 13, which equated to 3.0% each year beginning July 1, and a stepped-in adjustment for insurance. No adjustment was made for the Governor's additional 2% increase in FY 2015 (see "Other Budget Pressures" on page 20 of this report)
- Elimination of the legislature's one-time 2% additional vacancy savings, by reinstating the funding removed by the 2% additional vacancy savings
- Maintenance of funding consistent with the HB 2 language that removed the FTE associated with the 4% vacancy savings
- Various increases and decreases for certain fixed costs, which were calculated by looking at historical usage trends, current fund balance, and possible future costs
- Inflation on various operating costs that were forecast using the IHS projections
- Inclusion of estimated legislative audit cost

The total general fund adjustment for all of these factors is $12.6 million in the 2017 biennium.

Specific Adjustments to Agency Budgets

Costs were adjusted for projected caseload and other changes in a number of areas.

Human Services

The 2017 biennium outlook includes present law adjustments that net to a $32.0 million general fund increase for Department of Health and Human Services (DPHHS). Changes that increase general fund costs by $90.2 million over the biennium include:

- $70.7 million for service utilization and enrollment growth in Medicaid services
- $13.3 million for changes in the federal Medicaid, foster care, and subsidized adoption match rate
- $3.6 million for state facility operating cost increases, including medical supplies and tests
- $2.7 million for foster care and subsidized adoption caseload increases

General fund cost growth is offset by $58.2 million due to two factors:

1) The increase the federal match rate for the Children's Health Insurance Program (CHIP) will make $51.9 million in Healthy Montana Kids (HMK) state special funds available. The Patient Protection and Affordable Care Act (ACA) will raise the federal match rate for CHIP by 23% effective October 1, 2015. This change lowers the state match rate for CHIP to less than 1% for the last three quarters of FY 2016 and all of FY 2017.

2) The additional $6.3 million in premium tax revenue from Health Care Services Corporation (HCSC) purchase of Blue Cross Blue Shield (BCBS). After this purchase, the premium tax applied to policies sold by HCSC.

The outlook report assumes that this Healthy Montana Kids (HMK) state special revenue could be shifted to cover general fund costs for services and administration for the HMK population funded with Medicaid. For more information on this assumption see Appendix D, page 33. LFD staff will continue to research statutes governing funds allocated to HMK to ensure that there are no barriers to using the funds to offset general fund costs.

Risk: Although ACA increases the federal CHIP match rate, federal funding for the CHIP program is not authorized beyond September 30, 2015, the day before the match rate increases. If the federal funding is not authorized prior to the change in the federal match rate it is unknown how the additional match will be affected.

Utilization and Enrollment Growth/Caseload

Most Medicaid benefit costs are assumed to grow at 6.6% per year based on Centers for Medicare and Medicaid (CMS) projections for national Medicaid cost growth not including enrollment growth due to Medicaid expansion. At this time, the LFD modeling results in a similar estimate. Further refinement of the LFD model and the executive forecast will be presented to the 2015 legislative session.

For both foster care and subsidized adoption, a steady 4% annual growth rate is assumed. This rate is informed by the past five years and moderates the high growth seen, especially in FY 2014. Additionally, this assumes that general fund and Title IV-E eligible caseloads will increase at the same rate.

Risk: A 1% annual change in overall Medicaid services results in an $11 to $12 million biennial change in state funding. A 1% change over the 4% assumption in utilization of foster care and subsidized adoption over the biennium would result in a change of $0.6 million general fund.

FMAP Adjustments

FMAP adjustments were made using the forecasts supplied by Federal Funds Information for States (FFIS). The FMAP used for the 2015 appropriation was 66.27%. For federal FY 2016 FFIS estimates 65.54%, meaning that the state is responsible for 0.73% more funding in the coming biennium than was assumed in the 2015 biennium appropriation.

Risk: The federal match rate for Medicaid, child care services, and Title IV-E for foster care services changes annually and is usually published between October 1 and November 1 for the following federal fiscal year, although the FY 2015 FMAP was not published until January 2014. A 1% change in the FMAP can cause an $18 to $20 million biennial change in state funding necessary to support current benefits.

Department of Corrections

The primary adjustments for the Department of Corrections are for changes in populations of offenders under the department's supervision and inflationary increases in medical costs. Offender population projections for the 2017 biennium are based on the most recent projections published by the department for each placement facility type (secure facilities, treatment, pre-release, probation and parole, etc.) and are based on the corresponding FY 2015 budget amount for the associated facility type. The FY 2015 budget includes the funding for all provider rate increases for the biennium as funded by the legislature. Outside medical costs are based on inflationary increases forecast by data from IHS for consumer pharmaceutical and other medical products.

Risk: There are two areas in corrections that pose the greatest risk:

- o The population of individuals sentenced to supervision by the department
- o Outside medical costs

A 1% fluctuation in population, using an average cost across the types of supervision (i.e. secure care or probation and parole) equates to $1.5 million in general fund over the biennium.

As described above, estimates for the growth in outside medical costs are based on the IHS forecast for medical inflation. For each 1% difference in this growth rate, an additional financial risk over the biennium of $394,000 is incurred. There is also the risk that high cost patient services, such as cancer or heart surgery, could be higher than previous experience.

Office of the Public Defender

Since caseloads have been flat, no increase was assumed for OPD due to caseload increases.

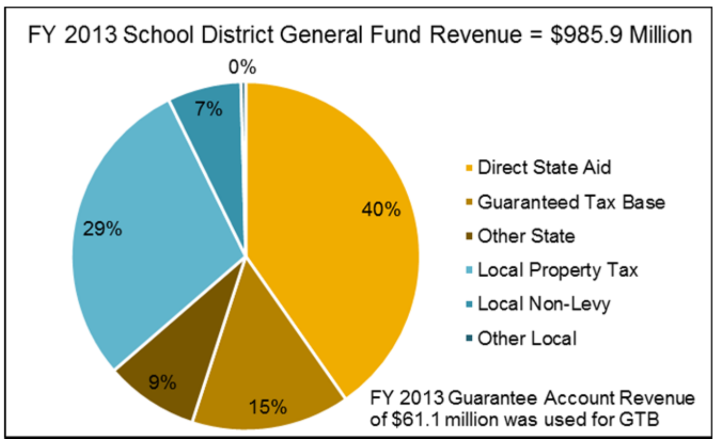
Risk: Increases in caseloads could result in the need for additional staff and/or contracts to address the workload. It is estimated that for every 1% deviation from the estimated caseload an additional $526,000 in financial risk for the biennium is incurred.

In addition, the office has had numerous death penalty cases. Almost all of the $500,000 OTO appropriation made for death penalty cases in the 2015 biennium has been expended. While the death penalty appropriation will also likely be a pressure point for the 2015 Legislature, there is also a risk that these costs could be higher.

K-12 Education

General fund to support K-12 education is forecast to increase by $86 million due to four primary factors:

1. Increases due to inflation - $36 million;
2. Projected increases in enrollment - $9 million;
3. Annualized ongoing spending - $22 million; and
4. Added components of SB 175 - $19 million.

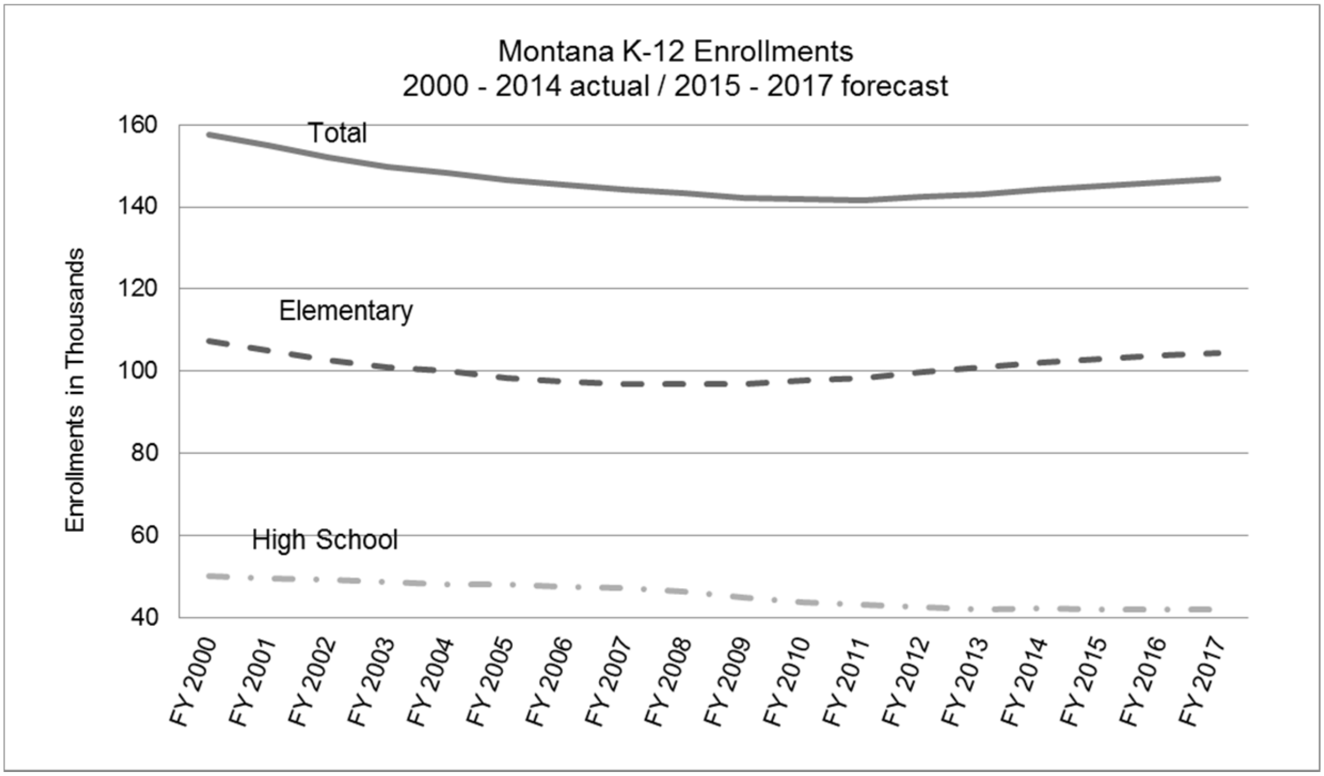


K-12 education is funded by state and local sources[1]. School district general fund budgets are the primary fund to which state appropriations contribute.

Funding from the state includes the guarantee account and general fund, local sources include local tax revenue, non-levy revenues, and any balances remaining from the previous year.

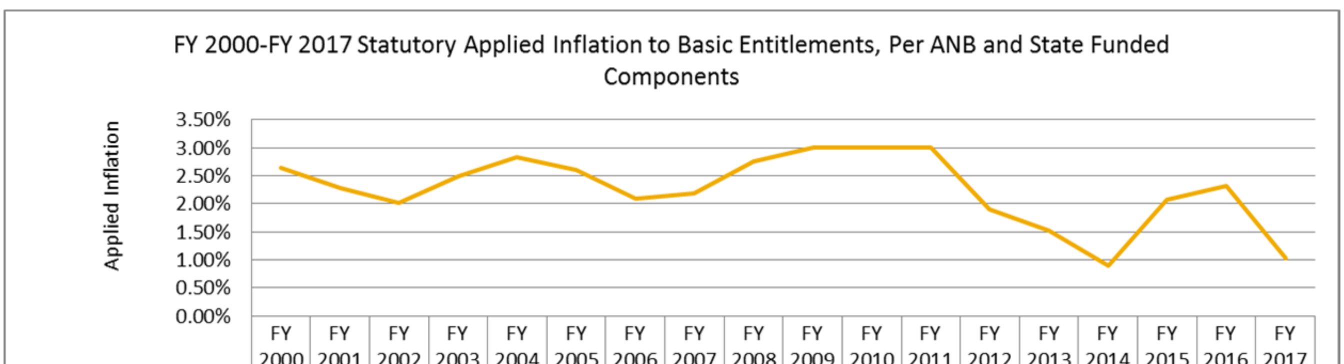
Revenues into the guarantee account are comprised of interest and income from common schools trust land. This includes the interest made from the common schools portion of the trust fund bond pool. The primary sources of the income portion of the funding are leases for agriculture and other natural resources such as oil and coal.

[1] School districts also receive federal funds which are not discussed in this report



A school funding formula is used to determine the level of funding. Adjustments in the overall level of funding are dependent primarily on changes in student enrollment. Projections for enrollment are based on the most recent Office of Public Instruction forecast of an increase of 0.6% for FY 2016 and 0.7% in FY 2017. Enrollments declined for several years, but are now rising at a rate that is slightly less than the overall IHS growth rate anticipated for population in Montana.

For most components of school funding, statute requires a present law adjustment for inflation be included in the Governor's budget. Anticipated inflationary increases in the 2017 biennium are 2.33% in FY 2016 and 1.03% in FY 2017. These present law growth rates reflect relatively low inflation in recent years.



	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
Applied Inflation	2.65%	2.29%	2.02%	2.49%	2.84%	2.61%	2.10%	2.19%	2.76%	3.00%	3.00%	3.00%	1.90%	1.53%	0.89%	2.08%	2.33%	1.03%

The forecast included in this report contains increases for enrollments, inflation, and forecasted revenues into the guarantee account. Guarantee account revenues are anticipated to be $52.2 million in FY 2016 and rise to $59.0 million for FY 2017 as compared to guarantee account appropriation of $58.7 million in FY 2015. FY 2017 values are dependent on concentric circles expiring. More information is available in the "pressures" section of this report.

Risk: Two consistent risks in K-12 education funding are fluctuations in student enrollment and volatility in additional funding sources for education, particularly the guarantee account, non-levy revenue, and school district ending fund balances.

Enrollment Volatility

About 80% of the state funding is driven directly by student enrollments. In the last three years, OPI has had a forecasting error, on average, approximately 0.2%. An error of 0.2% in the forecast for enrollments would correspond to an error in the funding forecast of about $2.3 million for the biennium.

Other Funding Source Volatility

- Guarantee Account: required payments, known as BASE aid to the school districts are funded first from the guarantee account with the remainder paid out of the state general fund. Guarantee account revenues may be greater or less than the level estimated, resulting in a different general fund requirement

- Non-Levy Revenue: school districts estimate non-levy revenue which is used to offset local levies and state funding required to fund the districts BASE budget. If districts budget more or less revenue than anticipated the cost to the state general fund will vary.

- District Ending Fund Balance: school district general fund remaining at the end of the year in excess of the limit provided in statute also offset local levies and state funding required funding the districts BASE budget. This component of the budget is volatile. In the past five budgets, general fund balance remaining has ranged from as low as $4.3 million to as high as $22.5 million. The assumption used is $6.2 million for each year of the biennium.

Higher Education

The primary funding source of the Montana University System (MUS) is known as the current unrestricted fund. This fund is supported with state general fund, the statewide six mill levy, and tuition and fees. The Board of Regents controls the level of tuition and fees, while the legislature appropriates the six mill levy and general fund. During some sessions, agreements on the level of funding and tuition increases between the legislature, the Governor, and the Regents can be established. Resident-student tuition was capped during the 2015 biennium as part of such an agreement between the Governor, the Board of Regents, and the 2013 Legislature.

The following items were considered in developing the MUS present law level of funding:

- A significant factor for the MUS campuses' budgets is enrollment. For the 2017, biennium, the Office of the Commissioner for Higher Education (OCHE) has stated that while changes in the mixture between in-state and out of state enrollment may occur at various campuses, the enrollment across the system is anticipated to remain relatively steady
- Recent budget issues primarily impacting Montana State University – Bozeman and University of Montana – Missoula are anticipated to be resolved prior to session and will not impact the MUS budget request
- The only adjustment included in the MUS present law in this outlook is the general fund inflationary increase based upon 2014 funding ratios totaling $1.2 million

Wildland Fire

This report assumes all wildland fire costs could be funded with the fire suppression fund and the Governor's emergency fund. Appendix C provides further information.

OTHER BUDGET PRESSURES

In establishing the estimate of present law contained in the 2017 Biennium Outlook, LFD staff adhered to present law as defined by the last legislature. However, there are some areas where, although they are not present law, the legislature will likely be under pressure to fund for various reasons. The following list is provided to alert the legislature to where they will likely experience pressure to either maintain current one-time-only (OTO) spending, or provide other funding.

CURRENT SERVICE LEVEL

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

Current Service Level Adjustments for the 2017 Biennium (in Millions)	
Adjustment Area	2017 Biennium
Natural Resources (FWP, Livestock, DNRC)	$3.51
Education	2.81
Department of Administration (Facilities Management)	2.35
Department of Commerce (Economic Development)	2.80
Medicaid and Health Services Branch	2.00
Judiciary, Public Defender, and Other	1.64
Grand Total	15.11

As shown in the chart to the right, the current service level items total $15.1 million for the 2017 biennium. Key items in the list include:

- $3.5 million in natural resource projects such as aquatic invasive species and brucellosis control
- $2.3 million from the Department of Administration's maintenance of common areas in state buildings
- $1.8 million for the Montana Digital Academy in the Office of Public Instruction
- $2.8 million of economic development funding in the Department of Commerce
- $2.0 million in the Department of Public Health and Human Services for overtime currently funded with OTO funds

GOVERNOR'S 2% ADDITIONAL PAY PLAN

HB 13 included funding for a 3% increase each year (beginning on July 1) and an increase for insurance of 10% each calendar year. As stated, continuation and annualization of this increase and the insurance adjustment was assumed in this report.

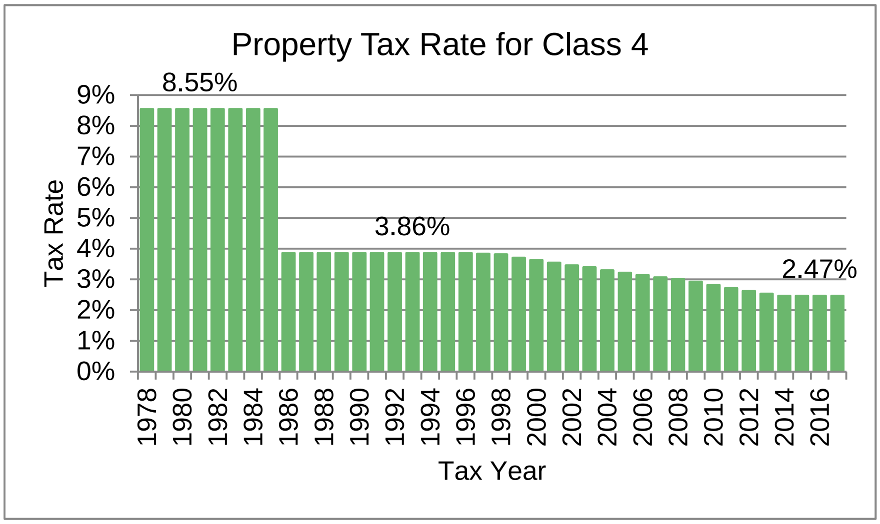
After the legislative session, the Governor negotiated a pay plan that included a 5% increase in FY 2015, with a delayed implementation date of November 15, 2014. While the cost of the negotiated pay plan is within the HB 13 appropriation for FY 2015 due to the delayed implementation date, it increases the annualized cost of the pay plan in the 2017 biennium. While individual state employees are entitled to the increase negotiated by the Governor, the funding associated with the increase is not automatic. The legislature may either provide the additional funding, or reduce spending by vacancy savings or other measures to stay within the lower budget amount.

The following figure shows the projected cost of the additional 2% in the 2017 biennium.

Estimated cost of Additional 2% pay plan negotiated by the Governor			
	2016	**2017**	**2017 Biennium**
General Fund	$5.4	$5.4	$10.8
All other funds	10.2	10.2	20.5
	$15.6	$15.6	$31.3

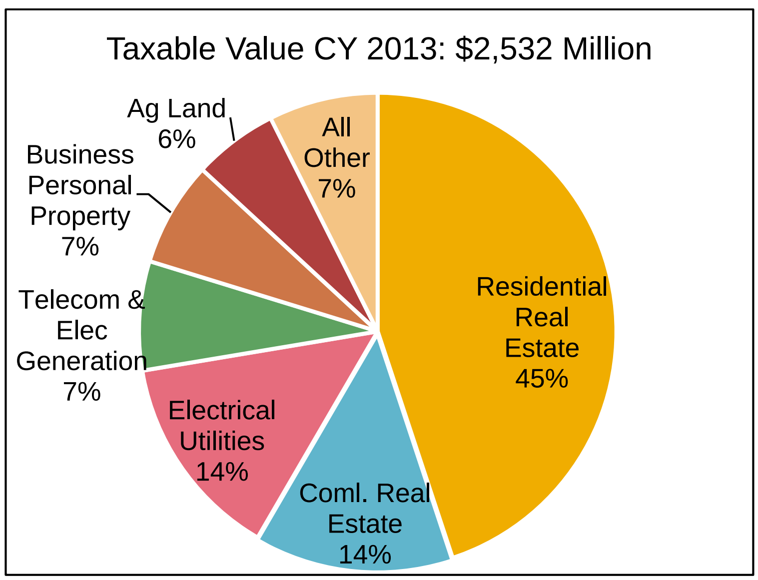
PROPERTY REAPPRAISAL MITIGATION

Agricultural land (Class 3), timber land (Class 10), and residential and commercial land (Class 4) values are reappraised every six years; all other property classes are reappraised annually. Large increases in property valuation that may occur over a six year reappraisal cycle can put pressure on the legislature to mitigate the tax effects of the valuation increases. Historically this has been done by decreasing the tax rate, shown for Class 4 in the adjacent chart. Exemptions such as the homestead exemption for residential properties and comstead exemption for commercial properties have also been used to mitigate increasing property values.



Every reappraisal cycle can present unique pressures to the legislature. The 2008 reappraisal was based on the height of the housing bubble, which resulted in high taxable values on subsequently declining property values. This cycle, statewide residential property will have much more modest increases than many past reappraisal cycles. However, there will likely be stronger valuation growth in areas of the state affected by energy development, which will drive up property taxes in those areas. This is counter to recent historic trends where strong value growth was concentrated in the western half of the state.

Another possible pressure point is the strong increase in valuation of Class 3 property, due to increasing agricultural prices. Agricultural lands represents a much smaller portion of the total taxable value—market value multiplied by tax rate—than residential and commercial property value, shown in the adjacent figure. As Class 3 and Class 4 tax rates are tied by MCA 15-6-133, and the current law tax rate is constant at 2.47%, a large increase in agricultural valuation would cause a disproportionate share of the total tax increase to fall in agricultural landowners.



Statewide mitigation of property values is often used to keep the total property tax class revenue neutral while property values increase. Mitigation that addresses both the strong Class 3 growth and the more moderate Class 4 growth, using preliminary numbers, will likely cause a $6.2 million reduction in income to the general fund. Alternatively, due to the modest increases in Class 4 property, if only Class 3 was mitigated a reduction in $4.5 million to the general fund would likely occur. These reductions in income as compared to present law are shown as expenditures on the structural balance chart.

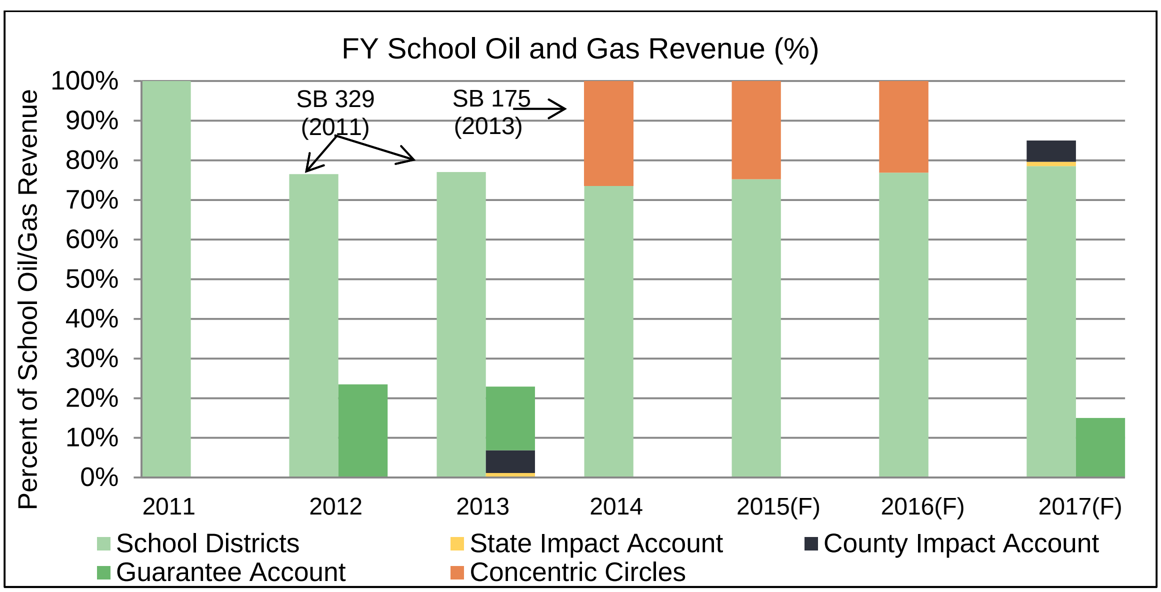
OIL & GAS REVENUE TO K-12 DISTRICTS ALSO KNOWN AS CONCENTRIC CIRCLES FROM SB 175

"Concentric circles" is part of the current method of distributing oil and natural gas production tax (ONG tax) to school districts. It essentially diverts money from school districts that have met maximum funding thresholds to nearby school districts that may be feeling impacts from oil and natural gas production. This is a pressure point for the legislative session as concentric circles has an approaching sunset date, which will change the distribution of some of the funds. Under current law this distribution will cause an estimated $5.8 million to flow from eligible concentric-circles-school-districts to the guarantee account in FY 2017.

There are two recent bills, SB 329 (2011) and SB 175 (2103), that affected this distribution, which had in 2011 and prior been going 100% to school districts where the oil and gas production was occurring.

- SB 329 was the first bill to cap the amount of ONG tax money districts could retain, and distribute some of the additional money to nearby affected districts. It placed a limit on the amount of ONG tax school districts could retain to 130% of the school district's maximum budget. It also established: (1) a state school oil and natural gas impact account; and (2) a county school oil and natural gas impact fund, for the purpose of providing money to schools that were not receiving oil and natural gas production taxes but were being affected by oil and natural gas production. These accounts went into effect in FY 2013, with additional tax revenue being directed to the guarantee account
- SB 175 changed the allocation a second time in order divert a greater portion of the ONG tax funds, above given school district thresholds, to nearby school districts that have not yet met the thresholds. This was done to provide additional ONG tax funds to school districts that were not meeting funding thresholds but were facing impacts from nearby oil and natural gas production

Post FY 2016 allocations will revert to a level similar to FY 2013, assuming the impact accounts will be fully appropriated, which they were not in FY 2013 (the reason the state and county impacts accounts are stacked with the guarantee account in FY 2013). The chart below displays how that money is allocated on a *percentage basis* in order to see the effects of the distribution. As can be seen, SB 329 and SB 175 had significant effects on the allocation of school ONG tax money compared to FY 2011, and with the sunset of some provisions of SB 175 at the end of FY 2016, distributions will change once again, diverting money to the state guarantee account.

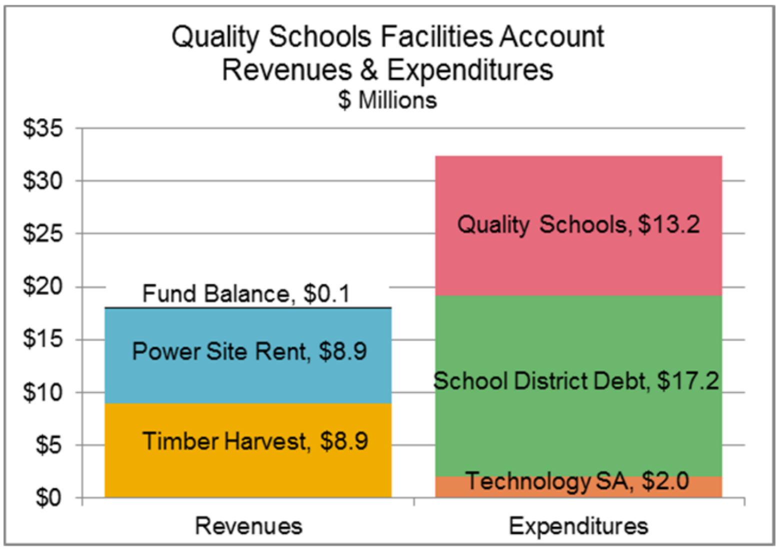


QUALITY SCHOOLS FACILITIES PROGRAM PRESSURE

The current appropriations for the programs funded in the 2015 biennium with the school facility and technology account exceed the anticipated account revenues in the 2017 biennium. The school facility and technology account was originally established to fund the Quality Schools Facilities Program (quality schools), in response to the 2004 Columbia Falls v. State of Montana (school funding) lawsuit. The account is currently used to fund programs that are appropriated approximately $32 million for the 2015 biennium, which includes the following:

1) Payment of statutory appropriations for school technology ($2 million/biennium), MCA 20-9-534;
2) State reimbursement for school district bonded debt (estimated at $17 million/biennium) MCA 20-9-371; and
3) Quality schools program (with total appropriations of $13 million in the 2015 biennium) MCA 90-6-809.

The account/fund receives transfers of certain revenues from the school guarantee account which are estimated to be approximately $18 million in the 2017 biennium.



The implied funding imbalance of approximately $14 million will require legislative consideration. Options for the legislature include:

1) Reducing appropriations from the 2015 biennium level for one or more of the programs,
2) Move some expenditures from this fund/account to alternative funding, and/or
3) Add revenue to the account

Changing the funding source or adding funds to the account may impact the general fund, thus a pressure on general fund balance.

STATE EMPLOYEE PAY PLAN

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

MONTANA UNIVERSITY SYSTEM TUITION IMPACT FROM PAY PLAN

Funding for pay plan increases is generally funded based on the ratio of state funding to total current unrestricted funding, which in FY 2014 was 38% general fund. If the legislature wished to limit or eliminate resident student tuition increases, it is likely that the Board of Regents would request additional state support. In order to eliminate a tuition increase, the Board of Regents may request the full resident and WUE student share of funding or approximately 81% general fund. The additional cost of the pay plan plus the 38% current funding ratio would be $5.0 million for a 1% pay plan and $15 million for a 3% pay plan.

PROVIDER RATE INCREASES

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

Provider rate increases in the past have ranged from 0% to 5% for selected providers. A 1% annual rate increase is estimated to cost $12.5 million general fund over the 2017 biennium with:

- $11.3 million for DPHHS
- $1.2 million DOC

A 3% annual rate increase for all providers is estimated to cost $37.5 million general fund over the 2017 biennium.

PENSIONS

When the legislature passed pension funding legislation in the 2013 session, statute included a reduction in the Guaranteed Annual Benefit Adjustment (GABA). Since that time, lawsuits have been filed and preliminary injunctions have been granted to at least temporarily eliminate the reductions in the GABA. The funding levels of both the Teachers' Retirement System (TRS) and Public Employees' Retirement System (PERS) depend on the outcomes of the pending lawsuits regarding the GABA decreases. The PERS funding level is also dependent on coal severance tax collections and coal trust interest earnings. The TRS system funding level, while impacted by the preliminary injunction, does not exceed the actuarial recommended funding period of 30 years even if the GABA reduction does not occur.

The PERS funding level with the preliminary injunction in effect keeps the GABA at 3.0% for retirees. If the GABA remains at 3.0%, it will result in a shortfall of 1.41% of payroll in order to keep the system's amortization period at 30 years. This shortfall amounts to approximately $10.1 million in general fund over the next biennium. In addition, coal revenues that are less than were anticipated during the most recent actuarial valuation would require additional funds to keep the system's amortization period at 30 years. Currently, coal contributions over the 2017 biennium are forecast to be $0.90 million lower than was forecast in the last valuation. This, coupled with the preliminary injunction, results in a combined general fund potential pressure of approximately $11.0 million. The year-to-year amounts are displayed below in millions.

Public Employee Retirement System Pressures (in Millions)				
Fiscal Year	Coal GF Pressure	GABA Pressure	GABA GF Pressure	Total GF Share
2016	$0.8	$18.2	$4.9	$5.7
2017	0.1	18.9	5.1	5.3
Total	$0.9	$37.0	$10.1	$11.0

INITIATIVES RISK

Three primary ballot measures that have the greatest financial ramification are:

1) Prohibition of expenditure of state funds for enforcement of the Affordable Care Act;
2) Expansion of Medicaid; and
3) Reclassification of cable companies for property taxation purposes.

PROHIBITION OF EXPENDITURE TO ENFORCE AFFORDABLE CARE ACT

This ballot measure would prohibit the state from expending state resources to administer or enforce the federal Affordable Care Act, or to expand Medicaid or plan, create, or participate in an insurance exchange. The executive assumes in its fiscal note that the state would not be in compliance with Medicaid law, meaning that the state would lose federal Medicaid funding, Children's Health Insurance Program, and other federal program funding, and that these services would not be replaced. The reduction in funding over the next five years is estimated at $60.6 million in state funds and $4.8 billion in federal funds. This outcome is uncertain as it is not possible to know the federal and state response to this initiative, were it to pass, and how the initiative interacts with current state law regarding these programs.

EXPANSION OF MEDICAID

This ballot measure would expand Medicaid coverage to the level allowable under the Affordable Care Act. The impacts of the Medicaid expansion for state funds are expected to be approximately as follows:

FY 2016	$5 million savings
FY 2017	$13 million cost
FY 2018	$40 million cost
FY 2019	$52 million cost
FY 2020	$87 million cost
FY 2021	$91 million cost

The LFD has not created an alternate detailed fiscal analysis using LFD growth assumptions. The estimates above use the growth estimates of the executive in the fiscal note prepared by the Office of Budget and Program Planning (OBPP), but remove the impact of the assumption of savings as a result of additional CHIP match, since the CHIP match rate increase has been included in the present law analysis. The additional years above demonstrate the phase in to the full 10% state funding.

RECLASSIFICATION OF CABLE COMPANIES FOR PROPERTY TAXATION PURPOSES

I-172 would change the property rates for the video portion of cable television property for companies that provide physically bundled services of cable television, phone, and high speed internet. In 2009, the Department of Revenue determined that a company that upgraded its cable television services to include bundled telecommunication services should be assessed a higher rate, and sought retroactive property tax payments going back to 2006. This determination increased the property taxes owed by the company. I-172 would reverse this increase by moving "cable television systems" from a higher property tax classification (Class 13, 6% tax rate) into a lower property tax classification (Class 8, $100,000 exemption then 1.5% on first $6 million and 3% on the remaining).

I-172 applies retroactively to tax year 2006. According to the fiscal note, I-172 would result in a $12.9 million reduction to the general fund over the biennium, in large part due to this retroactivity. This includes both the property tax reduction of approximately $1.3 million per year and the $150,000 per year increase in state funding to schools as a result of lower local taxes.

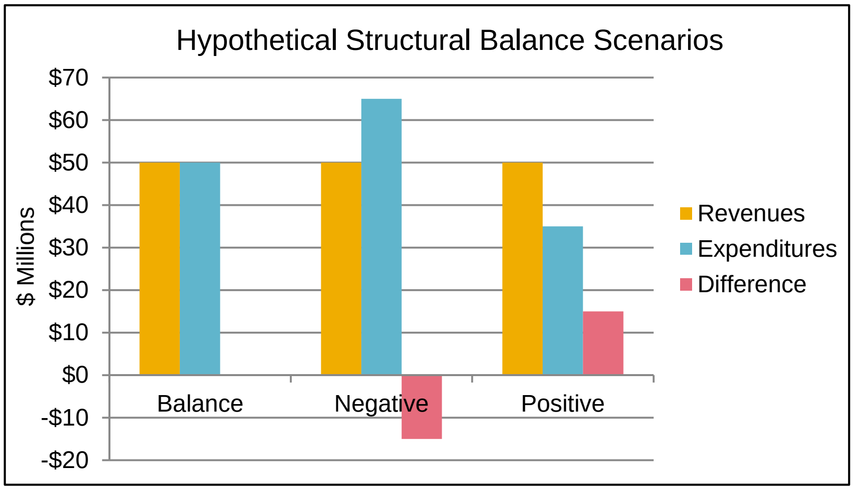
APPENDIX A

MANAGING BUDGET VOLATILITY

In all biennia, volatile revenue streams are always a possibility. As shown in the revenue section, annual general fund revenue growth has varied from -10.0% to +12.8% since 1985. While some of these changes are predictable, many are not. Consequently, the ability to anticipate changes in revenue has been and will continue to be a challenge. In order to mitigate this risk, two tools are regularly used by the Montana legislature: 1) structural balance; and 2) ending fund balance.

Structural Balance

Structural balance is defined as the difference between ongoing revenues and ongoing expenditures during a fiscal year. Per the chart below, consider structural balance in three different scenarios.



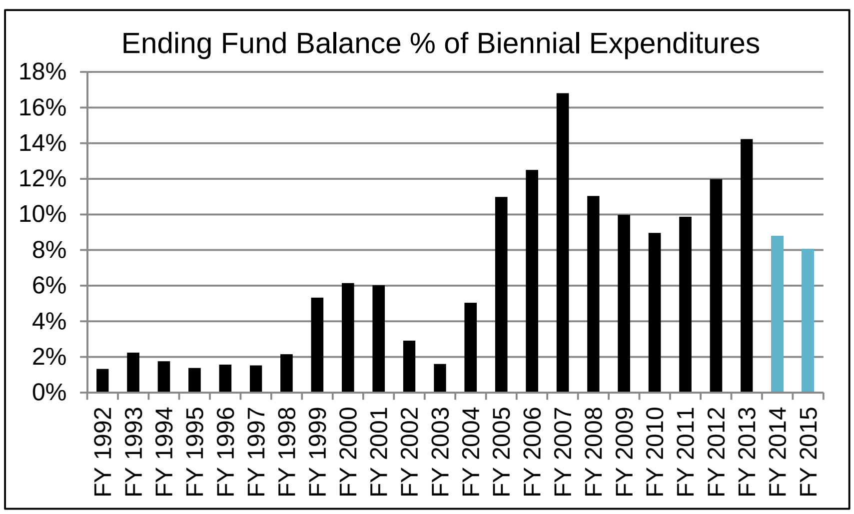
1) Balance – Structural balance exists when revenues and ongoing expenditures are equal.

2) Negative – A negative structural balance exists when revenues (yellow bar) fall short of ongoing appropriations (blue bar). When this occurs, the ending fund balance could be utilized to supplement revenues to meet the expenditure demands. The short fall can come from revenue volatility, costs of natural disasters, or other unanticipated costs.

3) Positive – A positive structural balance exists when ongoing revenues (yellow bar) exceed ongoing expenditures (blue bar). When this occurs, the ending fund balance is increased by the difference. The increase can come from revenue volatility and/or reduced expenditures.

Ending Fund Balance (EFB)

The general fund ending fund balance is effectively the "checking account balance" of the state. Most other states use a "Rainy Day Fund" to manage volatility. In recent years, Montana has used the general fund ending fund balance for managing volatility like other states use a "Rainy Day Fund". In addition, in the 2013 session the legislature passed HB 354, which added a funding stream to the Wildland Fire Suppression Fund. This fund is similar to a "Rainy Day Fund" in that it is used for emergencies.



Montana statute MCA 17-7-140 defines a minimum ending fund balance at 1% of the biennial appropriations or approximately $43 million. Historically the ending fund balances have been between 1.3% and 16.8% of biennial expenditures. The Legislative Finance Committee considered this topic in the 2013 interim and further information on managing volatility can be found in the Legislative Fiscal Division's Managing Financial Volatility Report.

APPENDIX B

ECONOMIC HIGHLIGHTS

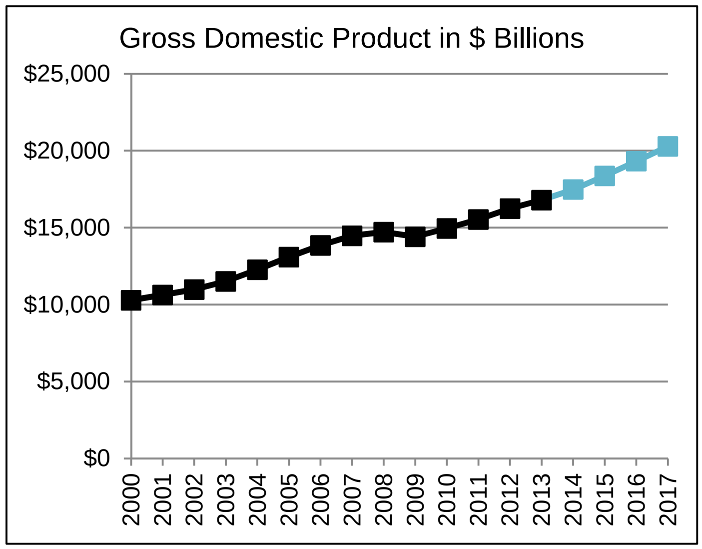
Economic data provided by IHS, the econometric data service contracted by the state, forms the basis of most revenue forecasts. Many other data sources are used for historical information, but IHS is the primary source for forecast data. Current IHS forecasts of important U. S. and Montana variables used in the revenue estimating process are highlighted in this section. The national forecast from IHS assumes increasing economic growth, accelerating consumer spending, and moderate inflation through most of the outlook period. Short-term interest rates are expected to remain low until mid-2015. More details on significant variables in the estimate are provided here.

U.S. ECONOMIC VARIABLES

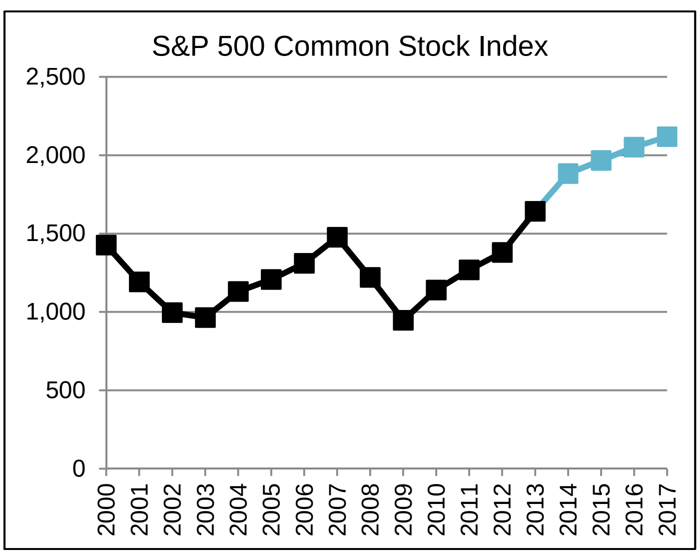
Gross Domestic Product (GDP)

GDP is a closely watched measure of the economy that is defined as the value of the goods and services produced by the U.S. economy in a given time period. The U.S. economy as measured by GDP contracted in 2009, and experienced relatively slow growth overall from 2008 through 2011 at 1.8%. Annual average growth of 4.0% from 2012 through 2014 is expected to be better, although still moderate by historical standards. Growth through the outlook period is expected to increase to 5.1% on average.

GDP is used in the individual income tax and corporation tax estimates.



S&P 500 Common Stock Index



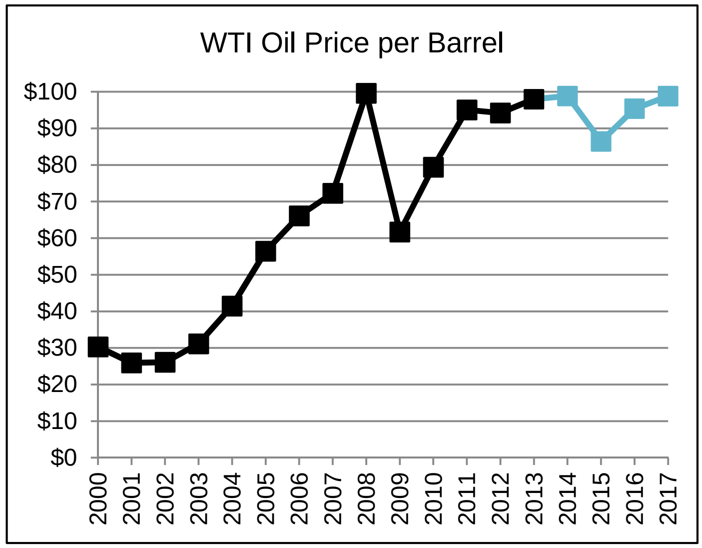
The S&P 500 index is a broad gauge of the U.S. stock market. As the adjacent graph indicates, it has been quite volatile since 2000, as it reflects both the end of the technology bubble in the early 2000's and the end of the housing bubble in 2007. The current IHS forecast suggests more moderate future growth than the strong growth since the lowest point of the recession in 2009.

This variable is strongly correlated with capital gains income, which is the most volatile portion of individual income. Capital gains income accounts for around 7% of total individual income on average, but the fluctuations of contributed disproportionately to the year-over-year changes in total income. S&P 500 is also used for corporation income tax and a few smaller sources.

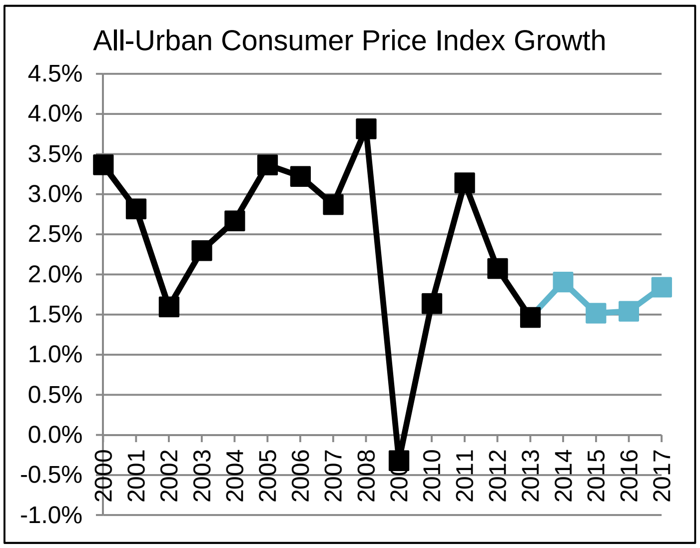
West Texas Intermediate Oil Price

West Texas Intermediate (WTI) spot oil prices are a good indicator of Montana oil prices, and are used for the oil and natural gas production tax estimate. In addition, WTI price is used for several sectors of the corporation income tax estimate and the part of the individual income tax estimate.

After a sharp decline in 2009, the WTI price has stabilized at just below $100/barrel. The current IHS forecast assumes a decrease to about $86/barrel in 2015, then increasing back to just under $100/barrel in the outlook period.



Consumer Price Index (CPI)



The inflation rate is measured by the price change of a "shopping basket" of goods and services. Inflation may have good and bad effects. As prices rise, businesses increase prices and tend to become more profitable. However, if wages do not keep pace with inflation, consumers realize a reduction in disposable income and may spend less.

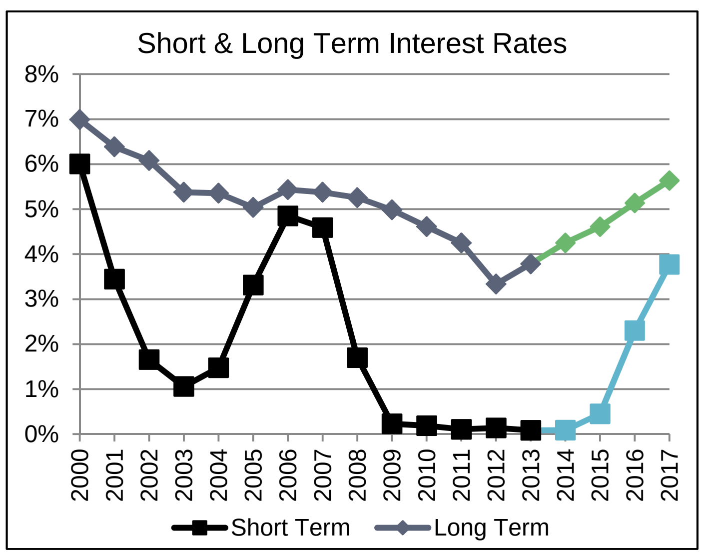
Since Montana's individual income tax structure is fully indexed to changes in CPI, this assumption is critical for the individual income tax forecasts. CPI is also used to estimate several smaller sources.

The IHS forecast suggests inflation will average 1.7% through the outlook period.

Long & Short Term Interest Rates

A significant share of total revenue comes from investment earnings on trust accounts and daily invested cash. Interest rates also affect the amount of investment income that is reported on individual income tax returns. Two types of interest rates, long and short-term, are produced from an average of several IHS interest and bond rate forecasts.

Short-term interest rates have been at or near zero since 2009. Current IHS forecasts suggest this rate will increase to nearly 4% by the end of the outlook period. If this increase is realized, it will have a strong impact on treasury cash account earnings in FY 2017. Long-term rates are expected to recover more gradually; changes to this rate have a less immediate impact on revenue.

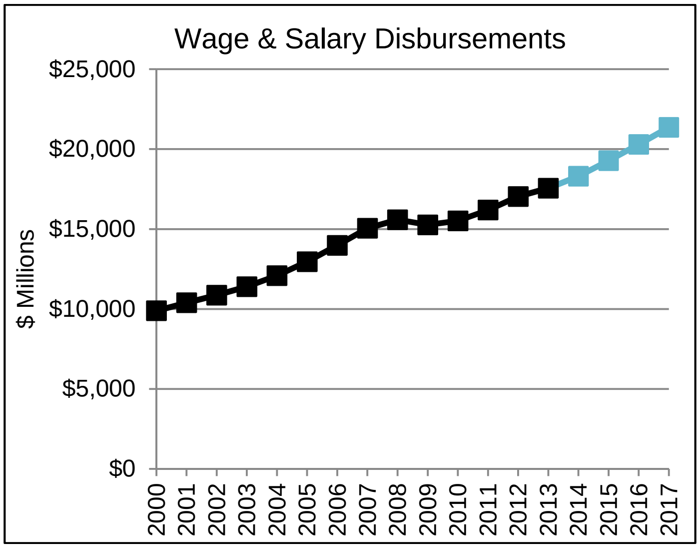


MONTANA VARIABLES

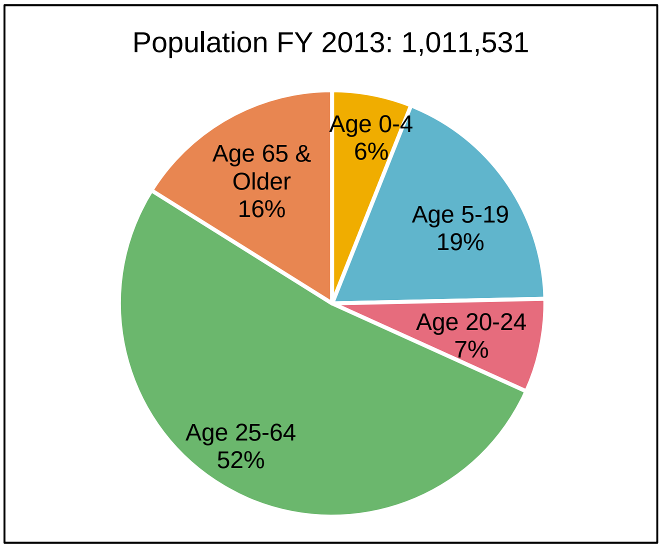
Wages

Wage and salary income accounts for nearly 65% of total individual income, and individual income tax accounted for 50% in FY 2013. The estimate of wages and salaries may be the largest single factor in the total general fund revenue estimate.

Wage disbursements grew strongly from 2000 to 2007 at 6.2% on average. The average between 2008 and 2013 was 2.6%. The IHS assumption for the outlook period is an average growth of 5.0%. Wage growth is correlated with inflation growth, so the low inflation described above is consistent with the moderate growth.



Population



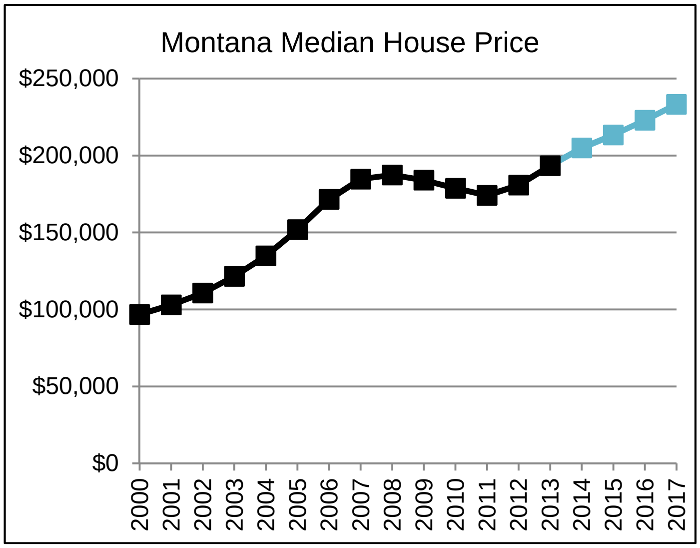
Population statistics are used to develop estimates for many of the revenue sources including beer, wine, liquor, and cigarette taxes. In addition to those sources where population has a direct effect, the size of the population indirectly affects the profitability of all businesses and the employment levels statewide. Accurate population estimates are especially important when determining the changes expected in overall and per capita income for the state.

Since 2000, population growth has varied between 0.4% in 2001 to 1.3% in 2007. Growth during the recession slowed to an annual average of 0.8% from 2009 to 2013. Growth through the outlook period is expected to increase slightly to an annual average of 0.9%.

Median House Price

Median house price is used in the capital gains income portion of overall individual income tax, as well as corporation income tax estimate.

After three consecutive years of decline during the last recession, median house price appears to have recovered to the 2008 peak; IHS assumes an average of 5% annual growth for the forecast period.



APPENDIX C

WILDLAND FIRE RISK

The fire suppression account has a significant fund balance and a means of maintaining this ending fund balance, which provides a buffer to the general fund from cost shocks due to emergency wildland fire costs.

Average Fire Cost Summary 2004 - 2013 *in millions*					
Fiscal Year	Acres Burned	Total Cost	Reimburse-ments	Net Cost	Biennial Net Cost
2004	176,795	$ 79.6	$ (44.6)	$ 35.0	
2005	6,678	4.0	(1.0)	3.0	38.0
2006	16,062	8.3	(3.2)	5.1	
2007	466,992	61.0	(21.3)	39.7	44.8
2008	175,058	108.2	(56.8)	51.4	
2009	124,323	10.1	(3.2)	6.9	58.3
2010	6,760	6.7	(1.0)	5.6	
2011	39,616	3.3	(0.8)	2.5	8.1
2012	181,479	20.4	(3.6)	16.8	
2013	406,149	70.8	(14.0)	56.8	73.6
Total Net Cost 2004 - 2013				**$ 222.7**	**$ 222.7**
		10-Year Average Cost		$ 22.3	
		5 Biennial Average Cost			$ 44.5

Background and History

The risk of wildland fire is dependent upon a number of environmental factors. The financial severity of fire season is dependent upon location and duration of the fire, as well as reimbursement policies adopted by the federal government. In the past five biennia, the state share of fire suppression has ranged from a high in 2013 of $73.6 million and a low of $8.1 million.

For FY 2014, there are expected to be $13.2 million of state fire costs, including $500,000 for spring fires. The estimated fiscal year end fund balance of the fire suppression account fund is $38.5 million. The table to the right provides more information.

HB 354 and the Fire Suppression Account

As a result of HB 354 in the 2013 session the revenues flowing to the fire suppression account were revised. For FY 2014 revenue streams to the fund included the following:

- One time transfer of funding from HB 3 - $11.9 million
- Unspent Governor’s emergency appropriation for 2013 biennium – $0.9 million
- General fund reversions greater than 0.5% - $13.3 million; and
- Excess corporate income tax revenues - $25.5 million

Future of the Fire Suppression Account

Over the long term, comparing anticipated revenues to average fire costs, it is anticipated that the account will be replenished at approximately the same or better rate than it is expended. Transfers into the fund include:

- Unspent Governor’s emergency statutory appropriations: HB 354 requires transfer of unspent authority of the Governor’s emergency statutory appropriation of $16 million at the end of each biennium. For the last three completed biennium, this amount would have been $3.3 million (2009 biennium), $15.4 million (2011 biennium) and $0.9 million (2013 biennium). The average reversion per biennia would be approximately $6.5 million
- HB 354 requires reversions greater than 0.5% of annual spending be transferred to the fire suppression account. Historically, with extraordinary circumstances removed, reversions have varied from 0.8% to 4.0%. Extraordinary circumstances removed include items such as the impact of the bonus payment for the Otter Creek coal lease. An average level of reversions that removes these large anomalies is approximately 1.9%. This implies a transfer from the general fund to the fire suppression account

equivalent to 1.4% of annual spending or approximately $26.6 million per year, or $53.2 million for the biennium

- Additional transfers of excess corporation income tax revenues are not expected. The revenue estimates in FY 2014 and 2015 do not exceed the thresholds in HB 354 and the provision for these revenues to transfer to the fire suppression account expires after FY 2015

Biennial Average Revenues and Expenditures Wildland Fire Supression Fund (in Millions)		
		Biennial
Biennial Average costs	$	(44.5)
Biennial transfers from reversions exceeding 0.5%		53.2
Biennial transfers from Governor's Emergency Statutory Appropriation		6.5
Potential average biennial growth in fund balance	$	15.2

Due to the volatility of fire costs and the transfer schedule, the stability of the fund could be considered on a biennial basis. With average costs running approximately $44.5 million per biennia and average transfers into the fund over $59.7 million per biennia, the fire suppression account appears to have a stable future. The current anticipated ending fund balance of $38.5 million adds to the overall stability of state government finance and the fund is available to take some of the expenditure shocks from wildland fires.

In future biennia, the legislature may wish to consider the ending fund balance of the fire suppression account when considering the level of ending fund balance needed to manage volatility as discussed in Appendix A: Managing Budget Volatility on page 26.

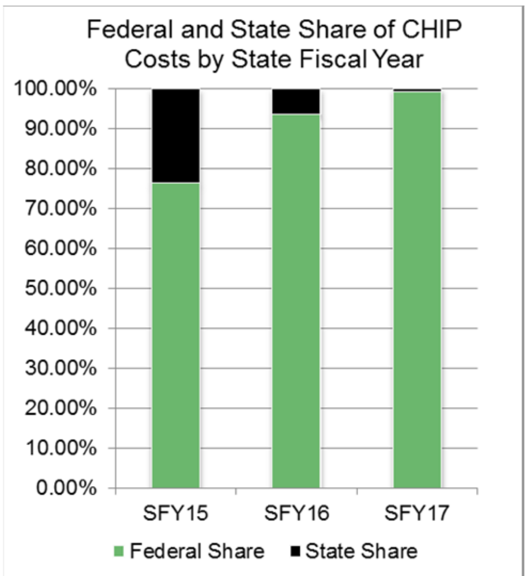
APPENDIX D

HEALTHY MONTANA KIDS STATE SPECIAL REVENUE EVALUATION

The Patient Protection and Affordable Care Act (ACA) raises the federal match rate for the Children's Health Insurance Program (CHIP), which is one of the funding sources of the Healthy Montana Kids (HMK) program. Specifically, the federal match will increase by 23% effective October 1, 2015. This change will free up an estimated $51.9 million in HMK state special revenue over the 2017 biennium. In addition, insurance premium tax revenue into the HMK fund is $6.3 million higher than budgeted last session. This presentation reviews the analysis that concludes that the $58.2 million of state special revenue may be used to replace general fund that is currently supporting other HMK services and administrative costs.

Background

The HMK program combines medical services funded by Medicaid and CHIP into a single program for children in households with incomes up to 250% of the federal poverty level. Only the CHIP match rate is increased by the ACA, the Medicaid program match rate as a result of ACA. The Medicaid match rate is expected to be about 66% federal funds and 34% state funds in the 2017 biennium.



Annual CHIP Match Rate

The adjacent figure shows the state and federal share of CHIP costs for FY 2015 compared to the projected rate for each year of the 2017 biennium. ACA reauthorized the CHIP program through September 30, 2019. Congress has not authorized funding for CHIP beyond September 30, 2015, the day before the increase in the federal match rate will take effect. This report assumes that the federal CHIP program as authorized in ACA will be implemented.

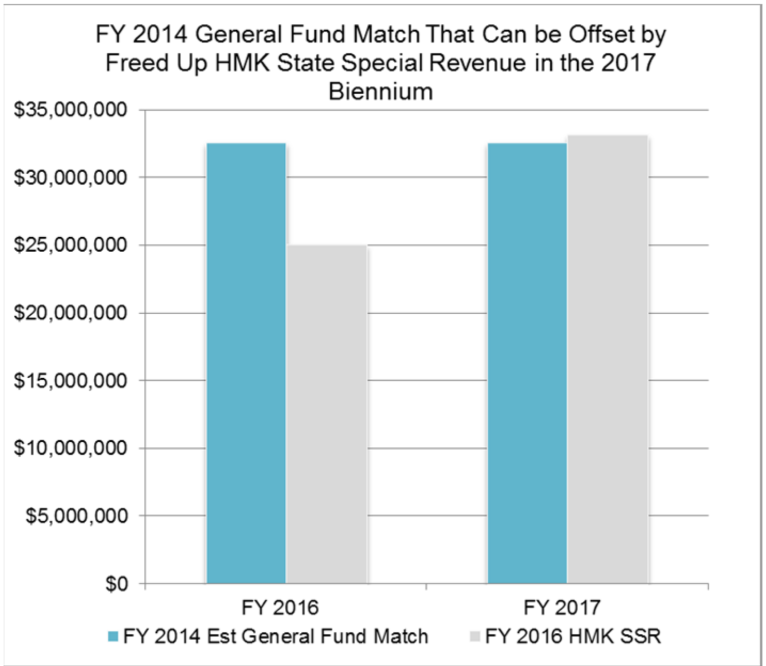
The increased federal funding will offset approximately $51.9 million of services currently funded with HMK state special revenue.

Insurance Premium Tax Proceeds

About one third of insurance premium taxes collected are deposited into the HMK state special revenue fund, or about $52.2 million estimated over the 2017 biennium. When Health Care Services Corporation (HCSC) bought out Blue Cross Blue Shield (BCBS), the premium tax became applicable to policies sold by HCSC. This increase is accounted for by incorporating historical premiums sold through BCBS in the estimate. The total biennial impact is estimated to be $6.3 million. In addition, there may be further effects of this buyout on the amount of revenue as described as a positive general fund risk on page 11. This upside risk described for the general fund also applies to this HMK state special revenue source.

General Fund Cost Offset

The HMK portion of the insurance tax may be used only to fund HMK services for the children above the number of children enrolled in November of 2008, or above about 64,000 children. Most enrollment increases in HMK have been in children whose services are funded through Medicaid. Compared to November 2008 enrollment levels, as of February 2014, there are about 28,000 additional enrollees whose services are funded through Medicaid and about 15,000 whose services are funded through CHIP.



The adjacent figure shows the estimated general fund match to pay only the HMK Medicaid funded services in FY 2014 - about $32.6 million compared to the additional HMK state special revenue that will available each year of the 2017 biennium. Recent enrollment growth and provider rate increases will be implemented in FY 2015 and will increase this FY 2014 annual cost. The 2017 biennium costs are anticipated to exceed $70 million.

Summary of the Net Impact

The state share of the 2017 biennium HMK Medicaid costs is anticipated to be in excess of the combination of the $51.9 million of reduced matching funds needed for CHIP and the $6.3 million of additional revenue available in the HMK state special revenue fund. In other words, the $58.2 million in additional state special revenue could be used to offset a like amount of general fund HMK Medicaid costs.