HIGHWAYS STATE SPECIAL REVENUE ACCOUNT: WORKING CAPITAL UPDATE

Prepared for the

Legislative Finance Committee

by

Greg DeWitt

September 20, 2001

Legislative Fiscal Division

www.leg.state.us/fiscal/

INTRODUCTION

The highways state special revenue account (HSSRA) provides the state funding match for more than $300 million annually of federal transportation funding. The resultant more than $500 million of transportation spending provides a significant boost for the state economy as they are spent to maintain and expand the state transportation infrastructure. The HSSRA has historically experienced imbalances between revenues and expenditures. It is because of the significant impact on the state economy and the historical instability of the account that the Legislative Finance Committee (LFC) pays particular interest to the fiscal condition of this account. This report is prepared for the LFC to provide awareness of the fiscal condition of the account. This report presents the latest working capital analysis for the account and includes: 1) assumptions used to develop the analysis; 2) summaries of fiscal impacts on the account; and 3) results of the analysis. The report is structured around Table 1, which illustrates the working capital analysis for the HSSRA.

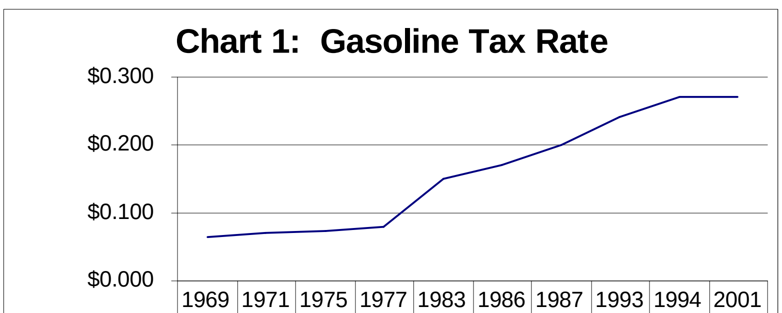
THE HIGHWAY STATE SPECIAL REVENUE ACCOUNT

APPLICABLE FUNDS

The state special revenue account commonly referred to as the highways state special revenue account is used to fund the major activities of the Montana Department of Transportation (MDT). Two funds are combined to form this account, the constitutionally restricted fund (fund 02422) and the non-restricted fund (fund 02349).

BRIEF HISTORICAL PERSPECTIVE

The HSSRA has historically experienced periods of fiscal instability. The instability goes back earlier than the 1993 legislature when account balances last dropped to levels that prompted gasoline and diesel tax increases. Because of the fiscal condition of the account, the 1993 legislature increased gasoline and diesel taxes from 20 cents per gallon to their current levels of 27 cents per gallon and 27 ¾ cents per gallon, respectively. Chart 1 shows the growth of gasoline license tax from its 6.5 cent per gallon rate in 1969 to its current level. Although not shown, diesel taxes have grown as gasoline taxes have grown.



	1969	1971	1975	1977	1983	1986	1987	1993	1994	2001
gasoline tax rate	$0.06	0.070	0.075	0.080	0.150	0.170	0.200	0.240	0.270	0.270

Working capital analyses of the account presented to the LFC and the legislature following the 1999 legislature have shown continued instability, where expenditures have outstripped revenues and the working capital balance has been reduced from one fiscal year to the next. The most recent analyses prior to this report have shown significantly lower ending balances than are shown in this report. Consequently, the analysis shows that the account balance is decreasing, but the balance is not projected to decrease to an alarming level in the foreseeable future.

WORKING CAPITAL ANALYSIS

Table 1 illustrates the most recent working capital analysis for the HSSRA from fiscal 2001 through fiscal 2007. This report explains: 1) the purpose for focusing on the account's working capital balance; 2) the difference between this analysis and the Legislative Fiscal Report 2003 Biennium; 3) the assumptions used in the analysis; and 4) the analysis results.

WORKING CAPITAL

The starting point for the analysis is the combined working capital for all funds of the account. Working capital is the difference between current assets and current liabilities and provides some indication of the ability of the account to meet its current obligations.[1] Current assets are cash and other resources that are reasonably expected to be realized in cash within one year. Likewise, current liabilities are obligations that are reasonably expected to be paid from existing current assets or through the creation of other current liabilities within one year. Fund balance is the difference between total assets and total liabilities.

Working capital is used instead of fund balance because working capital provides a closer approximation of the account's ability to support the operating cash flow needs. The adequacy of the working capital balance to sustain the operating costs of the department provides an indicator of the need for potential adjustments of revenues or service levels so the department can satisfy its mission in the long-term.

Factors for the Improved Fiscal 2001 Ending Working Capital Balance

The ending working capital balances for fiscal 2001 is the known starting point in this analysis for the estimates of succeeding fiscal years. The ending balance for fiscal 2001 is roughly $35 million higher that reported in the Legislative Fiscal Report 2003 Biennium, primarily because of two factors: 1) a fiscal 2000 revenue accrual adjustment; and 2) fiscal 2001 reversions and revenue shortfalls.

Fiscal 2000 Revenue Accrual Adjustment

In previous analyses following the close of fiscal 2000, an adjustment was made in both the Department of Transportation's and the Legislative Fiscal Division's fiscal 2000 ending working capital balance calculation to account for a double entry for the same revenue accrual reversal. This adjustment lowered the fiscal 2000 ending balance by $17.5 million. When the fiscal 2001 ending working capital balance was calculated, a reconciliation between the calculated fiscal 2001 beginning balance and the fiscal 2000 ending balance identified an irregularity that subsequently showed that the adjustment was not appropriate during the prior analysis because of the way the duplicate accrual reversal was corrected. The fiscal 2000 ending balance should be the same as the fiscal 2001 beginning balance. As such, the fiscal 2001 beginning balance was previously understate and is $17.5 million higher in this report.

[1] The ending working capital balance is derived from the fiscal yearend general ledger as recorded on the Statewide Accounting, Budgeting, and Human Resources System (SABHRS).

Fiscal 2001 Reversions and Revenue Shortfalls

In addition to the inappropriate adjustment to the fiscal 2000 ending working capital balance, fiscal 2001 expenditure reversions and revenue shortfalls combine to account for the remaining roughly $17.5 million difference.

ANALYSIS RESULTS

Table 1 illustrates the working capital analysis for the HSSRA from fiscal 2001 through fiscal 2007. Projections of the HSSRA working capital indicate that the account should maintain a positive working capital balance through the current and following two biennia. The ending working capital balance is projected to grow following retirement of the remaining long-term debt, when the last principle and interest payment is made in fiscal 2003. Following this brief increase, the account balance is projected to decline through fiscal 2007. The decline is brought on by two primary factors over and above the current level operations. The two factors that are included in the “Other Considerations” section of Table 1 are: 1) salary growth; and 2) tax incentive legislation.

The current level section, which excludes fiscal impacts of initiatives that, for all practical purposes are likely to occur, indicates that the account is stable. However, if the impacts of salary growth, capital improvements, and conditional tax incentive legislation are factored into the analysis, the account begins to show a trend toward instability. The unstable trend begins in fiscal 2005 when the second year effects of a 3 percent pay plan and broadband pay plan combine to add nearly $6 million to the department’s annual expenditures. This impact is compounded in the 2007 biennium when this impact is added to the base on which the 2007 pay plan is applied. As such, the 2007 annual impact for salary growth is nearly $11 million. Gasoline tax revenue reductions associated with alcohol production and ethanol use tax incentives would further widen the imbalance by nearly $3.6 million per year if an alcohol production facility moves into full production (as an application currently being reviewed by the department anticipates).

As a result of current level operations and other potential impacts in future years, the account could be in a fiscal position by the end of fiscal 2007 in which expenditures from the account exceed revenues into the account by nearly $11 million per year. Since the projections for future biennia include the impacts of initiatives that require approval by future legislatures as well as approval and construction of an alcohol projection facility by interests outside state government, the results should be viewed with caution, knowing full well that the situation could change.

For a description of the assumptions used in this analysis please refer to the following sections.

EXPENDITURE ASSUMPTIONS AND BASIS

The following assumptions were used to develop the expenditure estimates used in this analysis of the HSSRA.

Fiscal 2001

Expenditures for fiscal 2001 are actual expenditures recorded on SABHRS as of the end of fiscal 2001.

Table 1
Working Capital Analysis - Highways State Special Revenue Account
Fiscal Years 2001 - 2007

	Fiscal 2001 Actual	Fiscal 2002 Appropriated	Fiscal 2003 Appropriated	Fiscal 2004 Estimate	Fiscal 2005 Estimate	Fiscal 2006 Estimate	Fiscal 2007 Estimate
Current Level							
Beginning Working Capital Balance	$40,851,906	$40,865,722	$31,269,724	$32,035,799	$35,092,543	$36,486,176	$36,686,712
Revenues							
Gasoline tax	122,017,676	122,739,000	123,382,000	124,028,361	124,678,109	125,331,260	125,987,833
Diesel tax	51,861,214	56,452,000	58,145,000	59,888,769	61,684,833	63,534,761	65,440,168
G.V.W.	31,134,707	26,616,000	26,401,000	26,401,000	26,401,000	26,401,000	26,401,000
Other revenue	6,610,496	6,610,496	6,610,496	6,610,496	6,610,496	6,610,496	6,610,496
General fund transfer (HB 124 & SB 448 2001 legislature)	-	3,142,743	3,189,884	3,237,732	3,286,298	3,335,593	3,385,627
Interest	-	1,634,353	1,058,869	1,296,753	1,464,837	1,487,320	1,471,479
Total Revenues	$211,624,093	$217,194,592	$218,787,249	$221,463,112	$224,125,572	$226,700,429	$229,296,603
Expenditures							
Department of Transportation (MDT) Expenditures							
General Operations Program	14,043,574	17,210,279	17,203,772	17,705,877	18,223,046	18,755,729	19,304,393
Tribal refunds - SA	24,984	24,720	24,798	25,542	26,308	27,097	27,910
Construction Program	62,789,691	71,954,829	75,300,968	75,300,968	75,300,968	75,300,968	75,300,968
Maintenance Program	71,662,037	76,888,784	78,510,319	80,797,246	83,152,780	85,578,981	88,077,967
Motor Carrier Services Program	4,707,933	5,089,780	5,297,604	5,447,454	5,601,799	5,760,774	5,924,519
Transportation Planning Program	1,497,539	2,307,235	2,233,237	2,298,256	2,365,226	2,434,205	2,505,253
Contributed capital to Equipment Program	7,149,682	-	-	-	-	-	-
Debt service/ bond principle and interest	13,641,535	13,936,852	3,798,551	-	-	-	-
Total MDT Expenditures	$175,516,975	$187,412,479	$182,369,249	$181,575,343	$184,670,127	$187,857,754	$191,141,011
County gasoline tax distribution - SA	10,389,000	10,360,000	10,360,000	10,360,000	10,360,000	10,360,000	10,360,000
City gasoline tax distribution - SA	6,323,000	6,306,000	6,306,000	6,306,000	6,306,000	6,306,000	6,306,000
Local technical assistance - SA	54,000	100,000	100,000	100,000	100,000	100,000	100,000
Transfer to noxious weed trust fund	1,125,000	-	-	-	-	-	-
Total Local Distribution	$17,891,000	$16,766,000	$16,766,000	$16,766,000	$16,766,000	$16,766,000	$16,766,000
Department of Justice (DOJ)	16,971,509	18,295,066	19,112,006	19,659,019	20,222,443	20,802,770	21,400,506
HB 5 Long-Range Building Program (construction, maintenance, and repair of MDT buildings)	1,308,009	2,325,185	-	-	-	-	-
HB 5 Long-Range Building Program (Dept. of Fish, Wildlife & Parks) prior continuing authority - unencumbered	598,634	2,157,870	-	-	-	-	-
HB 5 Long-Range Building Program (Dept. of Fish, Wildlife & Parks) authorized by the 2001 legislature	-	400,000	-	-	-	-	-
Total Expenditures	$212,286,127	$227,356,600	$218,247,255	$218,000,362	$221,658,570	$225,426,524	$229,307,517
Impacts of other legislation passed by the 2001 legislature	-	$566,010	$226,081	($406,005)	($1,073,369)	($1,073,369)	($973,369)
Adjustments and prior year activity	675,850	-	-	-	-	-	-
Ending Working Capital Balance (Current Level)	$40,865,722	$31,269,724	$32,035,799	$35,092,543	$36,486,176	$36,686,712	$35,702,428
Current Level Structural Balance (Imbalance)	$13,816	(9,595,998)	766,075	3,056,744	1,393,633	200,536	(984,283)
Other Considerations							
Statewide Issues							
Impacts of potential pay plan adjustments at 3 percent per year	-	-	-	(1,875,311)	(4,873,943)	(6,794,215)	(9,871,529)
Impacts of potential Long-Range Building Program Funding (at amount approved by 2001 legislature for MDT & FWP)	-	-	-	(2,700,000)	-	(2,700,000)	-
Department Inititatives							
Broadband Pay Plan	-	(855,826)	(890,059)	(916,761)	(944,264)	(972,592)	(1,001,769)
Indirect Cost Allocation Plan	-	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000
Alcohol Tax Incentive and Administration Act of 1983 (15-70-501, MCA)	-	-	-	(2,250,000)	(3,000,000)	(3,000,000)	(3,000,000)
Ethanol use incentive (HB 644, 2001 legislature)	-	-	-	-	(593,074)	(593,074)	(593,074)
Interest effect of other considerations	-	553	248,684	427,307	201,248	(5,059)	(464,754)
Adjusted Ending Working Capital Balance	$ 40,865,722	$ 35,414,450	$ 40,539,150	$ 41,281,129	$ 38,464,729	$ 29,600,326	$ 18,684,916
Adjusted Structural Balance (Imbalance)	13,816	(5,451,272)	5,124,700	741,979	(2,816,399)	(8,864,403)	(10,915,410)

2003 Biennium

For the 2003 biennium estimates of HSSRA expenditures are appropriations authorized by the 2001 legislature in the General Appropriations Act (HB 2), the pay plan bill (HB 13), and the Long-Range Building Program cash bill (HB 15).

2005 and 2007 Biennia

Current Level Estimates

The 2005 and 2007 biennia HSSRA expenditure estimates for MDT and the Department of Justice (DOJ) are the fiscal 2003 amounts inflated by 3 percent per year. Three exceptions from this inflation based estimate are: 1) pay plan amounts approved by the 2001 legislature are included in the agency estimates at the fiscal 2003 levels without inflation, 2) Long-Range Planning Program amounts are assumed one time expenditures in the 2003 biennium, and 3) Construction Program estimates are at the fiscal 2003 appropriation level for subsequent fiscal years.

Construction Program expenditures are driven more by the department's construction plans and federal apportionment limits than by cost inflation factors. Since the construction plans are in continuous states of flux and the federal-aid authorizing legislation is up for renewal at the end of federal fiscal 2003 (September 30, 2003), any estimate would be purely speculative. Any significant increase in federal-aid construction funds would result in a similar growth of state construction expenditures to provide the matching funds. Three assumptions were made when estimating Construction Program expenditures for fiscal years 2004 and later: 1) future federal transportation funding will remain at least at the current average level as it is in the current federal-aid authorization legislation, the Transportation Equity Act for the 21st Century (TEA-21); 2) the fiscal 2003 appropriations reasonably approximate the state spending necessary to match federal aid at the current average apportionment level; and 3) construction plans for fiscal years 2004 and later will be similar to the construction plan used to develop the fiscal 2003 budget.

Other Considerations

The "Other Considerations" section making up the bottom third of Table 1 includes initiatives that provide fiscal impacts outside the realm of the budget approved by the 2001 legislature, as well as department initiatives that have come to light since the 2001 legislature. Statewide initiatives such as pay plans and Long-Range Building Program requests that may be considered by future legislatures are included in this section to illustrate the impact on the HSSRA if the legislature approves requests at levels approved by earlier legislatures. Impacts of alcohol production and ethanol use tax incentives are included in this section because their impacts are dependent upon certain triggers that are not certain at this time.

<u>Pay Plan</u>

Estimates for pay plans in the 2005 and 2007 biennia are provided separately to provide the LFC with potential impacts if pay plans are approved by future legislatures. Pay plan estimates assume annual 3 percent base salary adjustments, with similar 3 percent vacancy savings amounts applied. It is further assumed that the salary adjustment will have an average effective date of November 1. Insurance increases were assumed to be $25 per month with January 1 being the effective date during the first year of each biennium.

Long-Range Building Program

Estimates for the Long-Range Building Program expenditures assume future legislatures will approve funding at the level authorized by the 2001 legislature. Since these appropriations are typically biennial amounts, these estimates are included only in the first year of each future biennium.

Broadband Pay Plan

The department is in the process of implementing a broadband pay plan for all department personnel except those positions covered by the pay plan covering blue-collar maintenance workers. Budget authority for this initiative is not included in the appropriations authorized by the 2001 legislature, but the department anticipates using a carry-forward of reverted authority to fund this initiative. Montana law, 17-7-304, MCA, provides authority for agencies to request up to 30 percent of their reverted authority for purposes that are consistent with the agency's goals and objectives. It is this section of substantive law that the department would use to fund the broadband pay plan. Growth factors of 4 percent from fiscal 2002 to fiscal 2003 and 3 percent per year for each succeeding fiscal year were applied to the department's fiscal 2002 estimated impact. These growth factors were chosen to match the pay plan assumptions used throughout the analysis.

Indirect Cost Allocation Plan

The department has negotiated an agreement with the Federal Highways Administration to receive federal reimbursements for department overhead costs associated with federally funded activities. Overhead costs of federally funded programs have previously been funded with state funds. The department estimates that leveraging state funds with federal funds for indirect costs on federally funded programs will reduce expenditures from the HSSRA by $5 million per year.

Alcohol Tax Incentive and Administration Act of 1983

The Alcohol Tax Incentive and Administration Act of 1983 (15-17-501, MCA) provides a refund of gasoline taxes for the production of alcohol blended with gasoline. The department has received an application for a plant with a September 1, 2003, projected production start date. Because the facility is not expected to be at full production until November 2003, and the maximum refund a single producer can receive is $3 million in a consecutive 12-month period, the maximum refund was prorated to 9 months to estimate the impacts in fiscal 2004. The full amount allowed by law was assumed for fiscal years 2005 through 2009. The incentive terminates March 1, 2010.

Ethanol Use Incentive

The 2001 legislature passed HB 644, which provided a demand side incentive for use of ethanol fuels. The bill reduced the tax on gasoline to 85 percent of its full level once certain conditions are met. The conditions under which the incentive applies and a further discussion of HB 644 follows in the section titled "Brief Summary of Legislation Impacting the HSSRA." The analysis includes the estimated impacts of the incentive, which are assumed to begin in fiscal

2005. The impacts included in the fiscal note for HB 644 were used as the estimate of the impact on the HSSRA.

Interest Effect of Other Considerations

Montana law specifies that interest earned on the account balance must be deposited in the HSSRA instead of the general fund. Because the impacts of the initiatives included in the "Other Conditions" section of the analysis impact the working capital balance, an estimate is included for account interest. As stated below, interest is estimated at a simple rate of 4 percent per year.

REVENUE ASSUMPTIONS AND BASIS

The following assumptions were used to develop the revenue estimates used in this analysis of the HSSRA.

Fiscal 2001

Revenues for fiscal 2001 are actual revenues recorded on the Statewide Accounting, Budgeting, and Human Resources System as of the end of fiscal 2001.

2003 Biennium

For the 2003 biennium, revenues for gasoline tax, diesel tax, and gross vehicle weight (G.V.W.) are revenue estimates approved by the 2001 legislature in HJR 2. The "other revenues" category are additional revenues going into the account that are not grouped into either of the categories deemed significant enough for the legislature to provide official revenue estimates. The fiscal 2001 revenues actually received in this category are used to project future estimates, since no specific rational is available to predict future performance.

The 2001 legislature passed SB 448 and HB 124, which provide general fund transfers to the HSSRA beginning in fiscal 2002. General fund transfers for these two bills are included separately as revenue to the HSSRA, and are included at the fiscal note amount for SB 448 and the amount that appears in statute for HB 124.

SB 448 provides funding for transportation services for senior citizens and persons with disabilities. The bill established a fee of $0.25 per year for each vehicle registration. The fee is deposited in the general fund and transferred to the state special revenue account to provide the transportation services.

HB 124, referred to as the "Big Bill," revised laws governing local government and state revenue collections. The bill deearmarked, to the general fund, revenues that previously were deposited in the HSSRA, but provided a general fund transfer to the HSSRA to account for the revised revenue allocation.

As stated, interest revenue earned on balances in the HSSRA is credited to the account. For purposes of this analysis, interest revenue estimates were determined assuming simple interest at an annual rate of 4 percent and applied to the beginning working capital balance, adjusted for the prior year imbalance between revenues and expenses.

2005 and 2007 Biennia

The estimates for the 2005 and 2007 biennia are the previous fiscal year amounts with the following annual inflation assumptions (based on the fiscal 2002 to fiscal 2003 growth factors contained in HJR 2, where applicable):

?? gas tax, 0.52387 percent;
?? diesel tax, 2.999 percent;
?? G.V.W, no inflation (at the fiscal 2003 HJR 2 amount);
?? other revenues, no inflation; and
?? general fund transfer, 1.5 percent.

LEGISLATION IMPACTING HSSRA

Impacts of legislation passed by the 2001 legislature are identified in a separate line of the analysis following the expenditures section. Except for the impacts of HB 578 and HB 644, the amounts shown under the heading "impacts of other legislation passed by the 2001 legislature" are net impacts for revenue and expenditure legislation, and are included at the estimated amounts shown on the most recent fiscal notes that accompany the legislation.

Brief Summary of Legislation Impacting the HSSRA

SB 115 repealed the terminating language associated with Chapter 461, Laws of 1999, and made permanent the revised definitions of agricultural use for gasoline and special fuel tax refund purposes.

SB 150 imposes a penalty on retail fuel outlets for failing to properly mark pumps that dispense untaxed diesel fuel (dyed diesel).

SB 153 increased the penalty for late payment of gasoline and special fuel taxes from $25 to $100, but added a provision that allowed the penalty to be prorated.

SB 326 revised laws governing weed management. In doing so, SB 326 directs that $100,000 is transferred each year from the non-restricted highways state special revenue account to the noxious weed state special revenue account. SB 326 terminates on March 1, 2006.

SB 380 revised the length restrictions and fees for triple trailers.

HB 131 provides authority for department motor carrier enforcement personnel to stop and inspect diesel-powered motor vehicles for the presence of non-taxed dyed diesel fuel in their supply tanks.

HB 148 revised laws on electronic filing for gasoline and special fuels taxes.

HB 578 extended the tax incentive for the production of alcohol used to blend with gasoline for sale as gasohol or the production of ethyl butyl for use in reformulated gasoline. The bill extended the tax incentive termination date from 2005 to 2010. The maximum tax incentive any one producer can receive is $3 million per year, and the maximum annual impact on the HSSRA is capped at $6 million revenue reduction, until the incentive program terminates on July 1, 2010.

HB 644 reduces the state fuel tax on ethanol and biodiesel fuels to 85 percent of the tax rate on unblended fuels. In order for the impacts of HB 644 to be triggered, two conditions must be met: 1) an ethanol plant must be in operation and producing fuel in Montana; and 2) the net working capital in the restricted highway state special revenue account, excluding any proceeds obtained through debt financing, must be at least $20 million on June 30 after the ethanol plant begins producing fuels. When these conditions are satisfied, HB 644 is estimated to result in annual revenue reductions of $593,074 to the highways state special revenue account, at the current level of gasohol consumption.

CONCLUSION

Current projections of the highways state special revenue account indicate that the account has a working capital balance adequate to support the present law operations of the department through the current and next two biennia. A concern is raised that future expenditure patterns could result in a movement toward a structural imbalance between revenues and expenditures. However, the imbalance isn't expected to occur until future biennia, and is dependent upon actions that are uncertain at this time.

I:\Legislative_Fiscal_Division\LFD_Finance_Committee\LFC_Reports\2001\05_Oct\hsra_update_10_01.doc