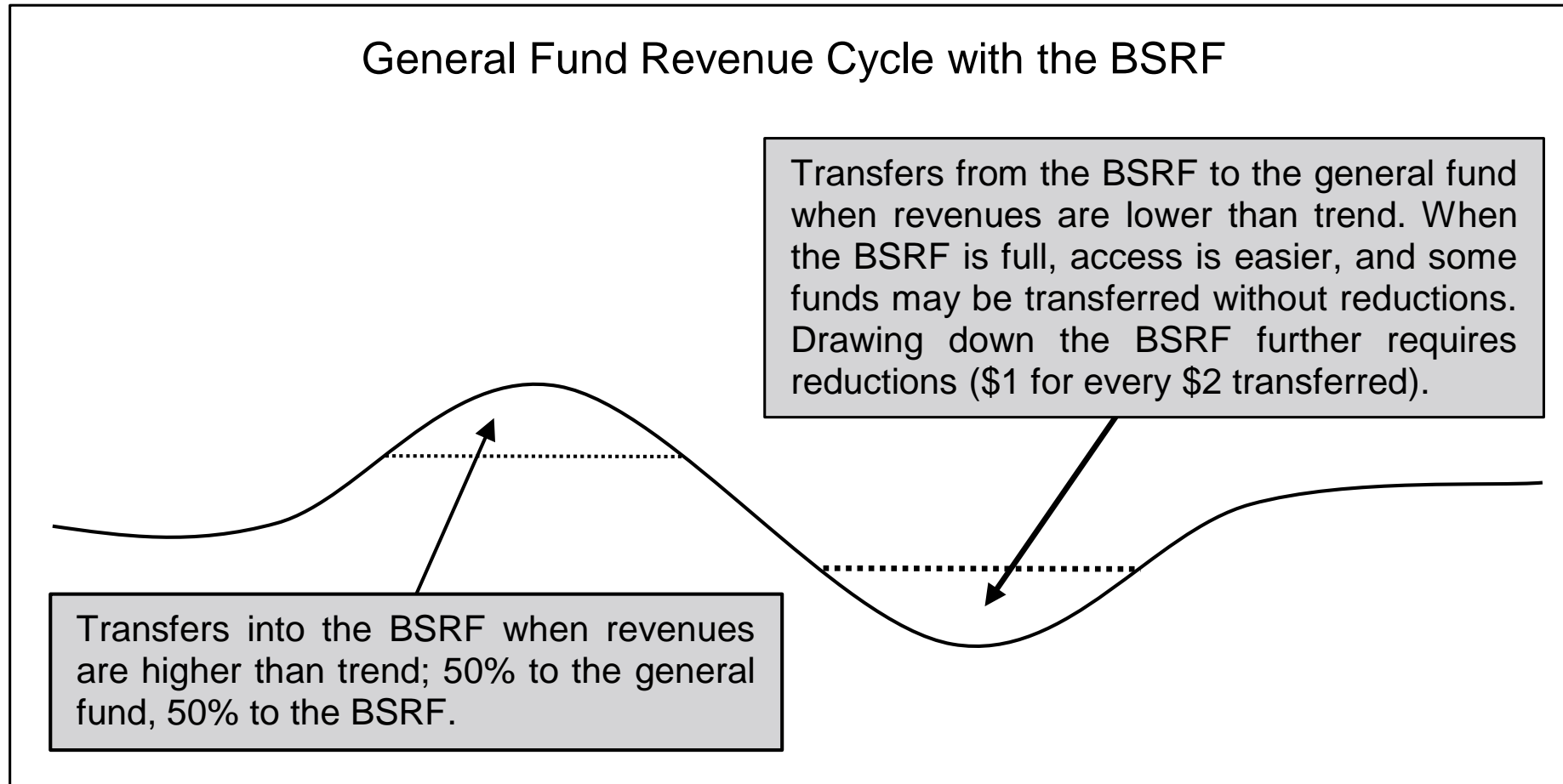


Montana's Budget Stabilization Reserve



Interim SB 261 Study Documents

- October 2017 – LFD Academic studies of Rainy Day funds
- March 2018
 - [LFD Statistical analysis](#)
 - [LFD Comparison to other states](#)
 - [Pew Charitable Trusts Analysis](#)
- May and June 2018
 - [LFD recommendations](#)
 - [OBPP recommendations](#)
- September 2018 – [LFD summary](#)

October 2017

Academic Research Review

- Rule bounded Rainy Day Fund
- Determining optimal fund size
- Outcomes of having Rainy Day Fund
 - Smooth expenditures over the revenue cycle
 - Counter cyclical benefits
 - Can improve bond ratings

Other State's Summary Statistics

- Deposit rules
- Withdrawal rules
- Comparison of state balances over time

March 2018 Pew Report

Concluding Comments

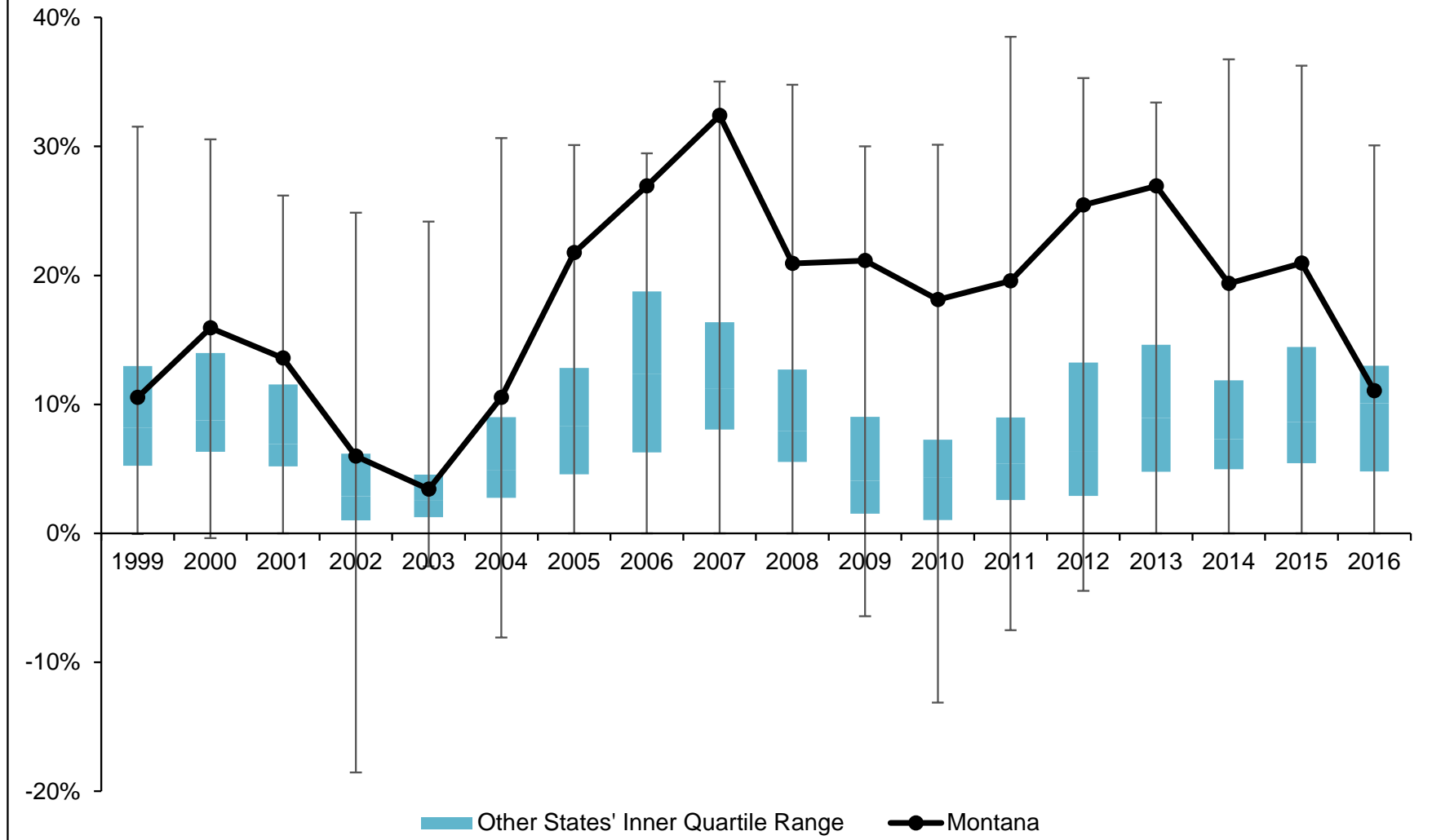


- Budget stabilization reserve fund rules established in SB 261 will help the state mitigate revenue volatility in the future.
- Assess changes in the state's volatility and re-evaluate target levels, withdrawal triggers, and excess growth definition on a regular basis.
- Consider techniques other states have used to mitigate especially volatile tax sources.
- Examine the benefits of increasing the length of budget projections.

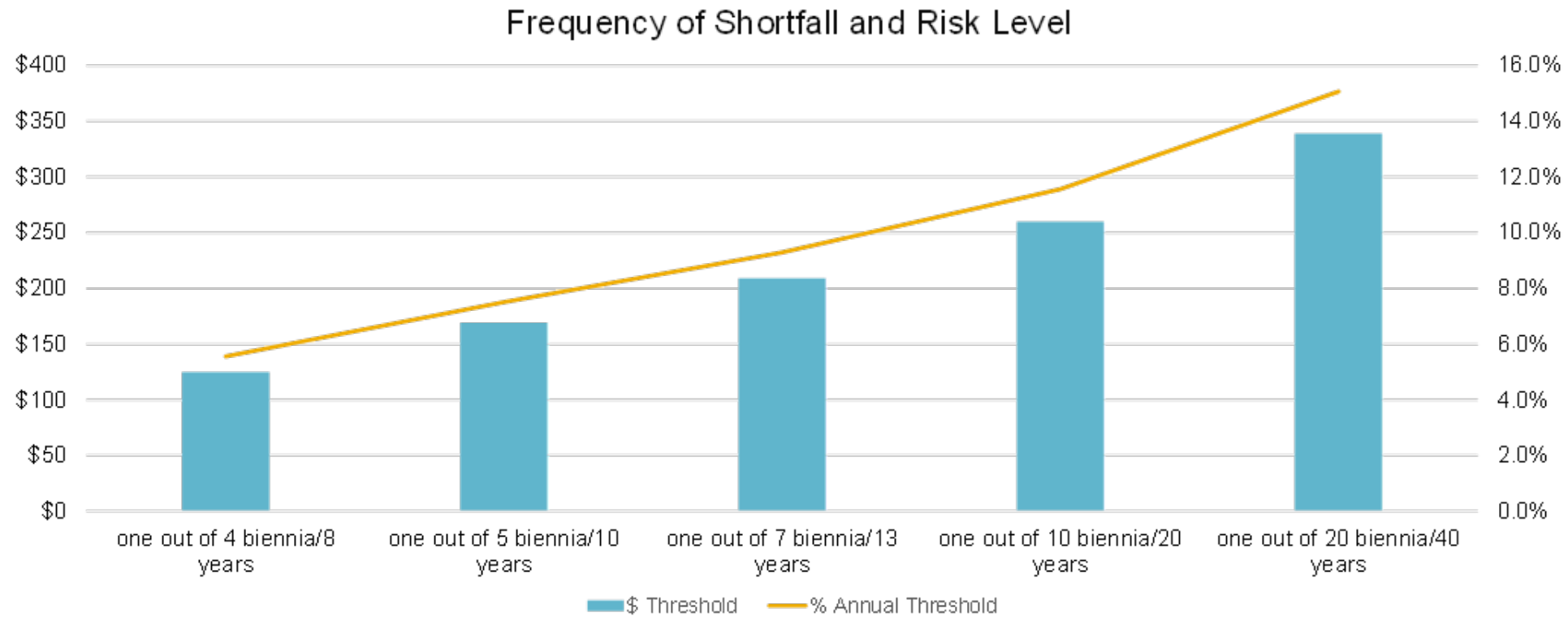
March comparison to other states

Tool	Most States	Montana	Other states with tool	Comment
1. Structural balance	+	+		Most states consider structural balance
2.				
3. Reporting	+	+		Most states have reporting structures
4. Operating Reserve 8.3% total	FY 2017 All state: median 2.6% average 2.7%	+ 8.3%	California, Minnesota, Oklahoma	Few states have specifically defined operating reserves. However, most states have cash reserves at some level, median 2.6% and average 2.7%. (Table 31-32 National Association of State Budget Officers (NASBO) Fall 2017 Fiscal Survey of States)
5. Governor's Emergency \$16 million or 0.7% of annual expenditures	+	+	39 states have a small amount of funds available for declared emergencies	Not including California & North Dakota, these funds average 0.2% of annual expenditures in FY 2014 in comparison 0.7% for Montana. (National Association of State Budget Officers (NASBO) Budget Processes in the States Spring 2015)
6. Fire Suppression Account/fund	-	+	North Dakota had \$89 million or 2.7% of annual expenditures in FY 2014	California's op reserve can also be used for emergencies. See Appendix W
7. Supplemental Appropriation	+	+		All states can authorize supplemental appropriations
8. Spend Operating Reserve 3.3% to minimum level of 5%	-	+	California (0.5 - 3.1%), Minnesota (1.6%), Oklahoma	Few states have specifically defined operating reserves, but five states limit appropriations, which would have a similar effect. See appendix Y
9. Governor Spend BSRF & Cuts	Legislative action required for most	+	13 states allow the Governor to access RDF; 16 states allow the Governor to make cuts	Montana's Governor can access the BSRF or fire suppression fund & cuts when the 17-7-140 trigger is met. See appendix X
10. Legislature transfers from other funds	+	+		All state legislatures have funds they can transfer from in if needed
11. Legislature increase revenues	+	+		All state legislatures can raise revenue
12. Legislature reduce appropriations	+	+		All state legislatures can lower appropriations
13. Legislature reduce minimum ending fund balance 5%	-	+	Colorado 6.5% Kansas 7.5%	Most states do not have a minimum ending fund balance so it cannot be reduced in tight fiscal times.

Combined GF Ending Balance & RDF: Montana vs. Other States
Does Not Include Alaska, North Dakota or Texas



Revenue Shortfalls – Frequency & Risk



Legislature & Executive - revenue risk and reserve level

March 2018 – LFD analyzed revenue risk and reserve level results

RDF Size Required for Forward Looking Time-Squared Trend				
Risk Levels	5%	10%	20%	25%
Reserve Amount (\$ Millions)	339	260	169	135
Percent of \$2.3 Billion Annual Budget	15.1%	11.6%	7.5%	6.0%
Percent of \$4.5 Billion Biennial Budget	7.5%	5.8%	3.8%	3.0%

Table 4

Montana's system of Managing Volatility

And possible improvements

Measurement

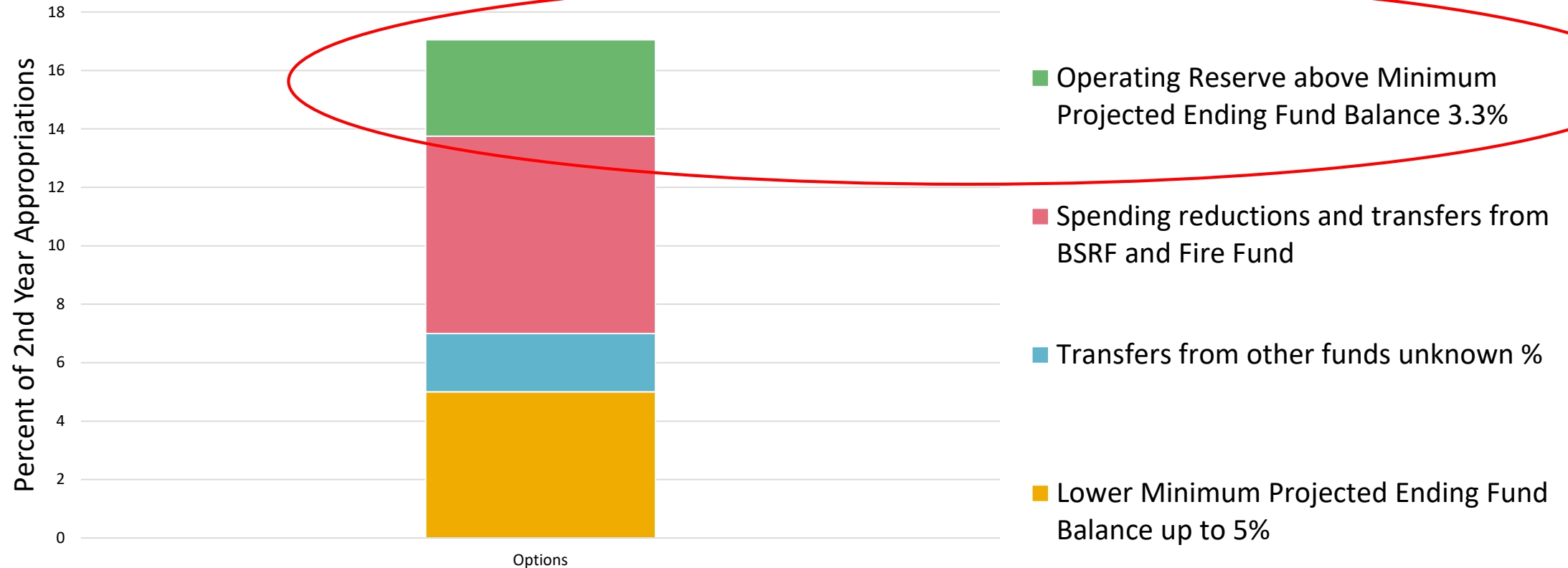
Measurement tools for managing volatility in Montana are from the appropriation level in the second year of the biennium.

Percentages are applied to this measurement point. This creates a consistent relative budget measurement over time as budgets change.

Example of General Fund Balance Sheet	1 st Year of Biennium	2 nd Year of Biennium	Notes
Beginning Fund Balance	200	100	
Revenue	2,405	2,435	
Total Resources	2,650	2,650	
Expenditures			
<i>Appropriations*</i>	2,385	2,415	<i>Measure from this point</i>
Other	20	20	
Total Expenditures	2,405	2,435	
Ending Fund Balance	200	200	

1st Reserve: Operating Reserve 3.3% above the Minimum Ending Fund Balance

Tools for Managing Volatility



1st Reserve: Operating Reserve Cash Buffer

How it works

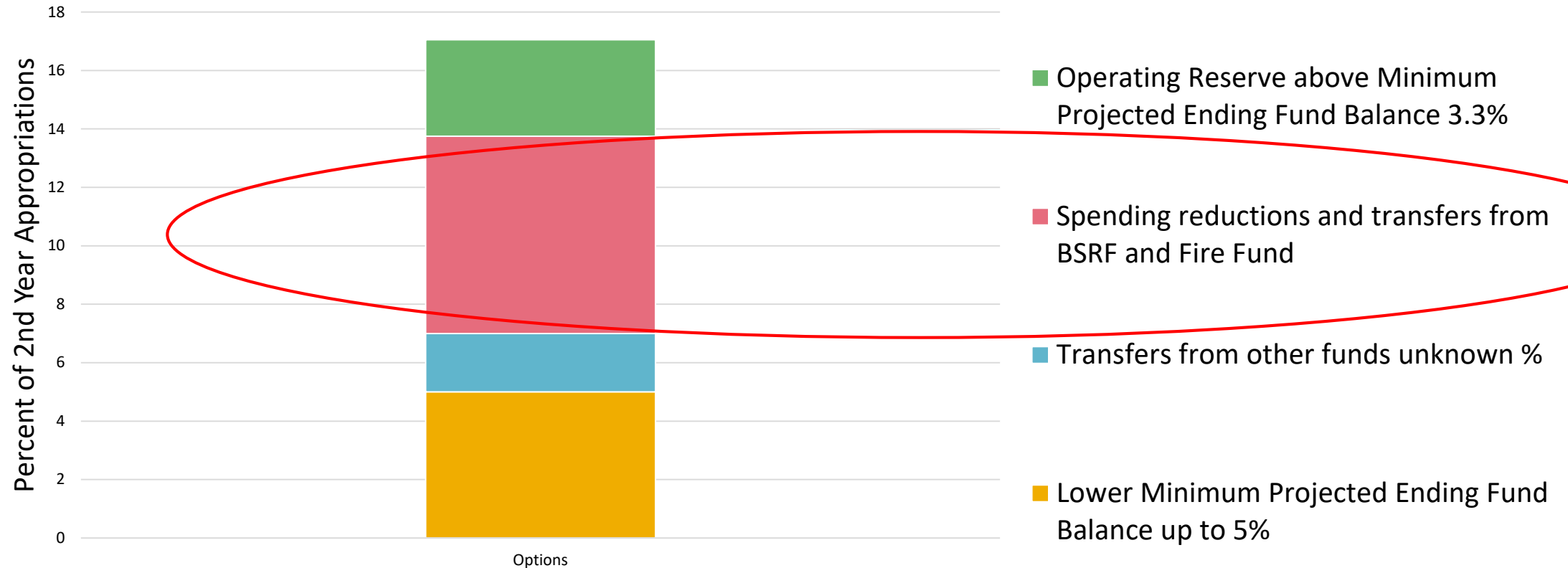
- Operating Reserve Cash Buffer is that is the level of operating reserve above the minimum required ending fund balance
- The Governor has immediate access to the funds in the cash buffer
- Currently this buffer is 3.3% of the second year appropriations or approximately \$78 million

Possible improvements

- The total Operating Reserve appears to be higher than necessary for cash management
- The legislature may wish to reduce the level of Operating Reserve while maintaining the cash buffer at near 3%*

2nd Reserve: Budget Stabilization Reserve and Reductions

Tools for Managing Volatility



2nd Reserve Budget Stabilization Reserve Fund

How it works

- Currently set at 4.5% of second year appropriations
- Access funds limited to \$2 from reserve fund for every \$1 in spending reductions

Possible improvements

- Seems lower than ideal to manage volatility** (4.5% + 2.25% cuts)
- If the legislature wishes to maintain current 12.8% of second year appropriation level as the total reserve level, then increases in this area could be used to reduce other areas of the reserve structure*

Details: Budget Stabilization Reserve Fund

Fund/Account can be used for:

- (a) to mitigate budget reductions when there is a revenue shortfall; and
- (b) when there are funds in excess of the operating reserve level, to:
 - (i) pay down the debt service on bonds for capital projects previously authorized by the legislature if allowed without penalty by the terms of the bond issuance;
 - (ii) delay, forego, or reduce the amount of an issuance of bonds authorized by the legislature; and
 - (iii) allow the funds to remain in the account.

The reserve level is set at 4.5% of annual appropriations.

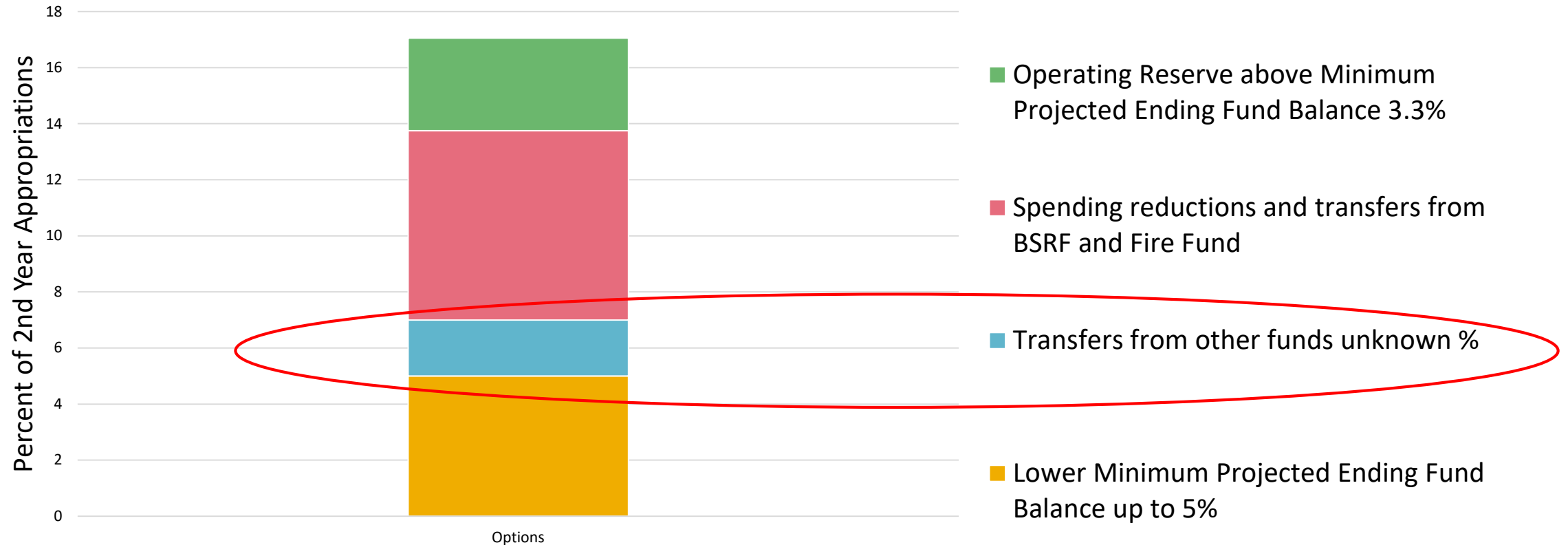
50% of higher than trend revenues are deposited into the fund beginning in FY 2022

Details: Reductions and Mitigations

- The Governor can reduce general fund expenditures for most executive branch agencies, except K-12, up to 10%. This law has been in effect for decades.
- New last session: reductions in expenditures are mitigated with transfers from either:
 - First from the Budget Stabilization Reserve Fund in a ratio of \$2 of transfers to \$1 of reductions
 - After the BSRF is exhausted, Fire Fund in a ratio of \$1 of transfers to \$1 of reductions

3rd Reserve: Other Funds

Tools for Managing Volatility

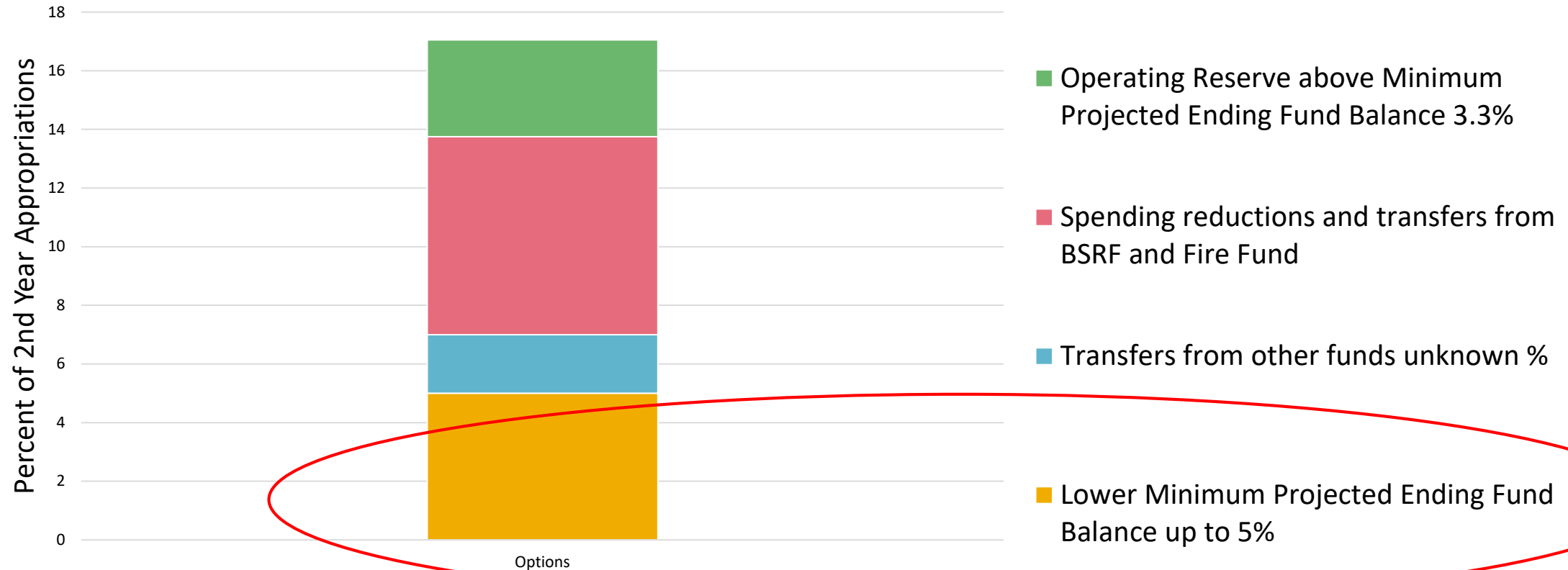


3rd Reserve: Transfers from Other Funds

- In every downturn, the Legislature has chosen to transfer fund balances from certain funds in to the general fund
- The evaluation of which funds and how much is available is specific to the time of the shortfall

4th Reserve: Lower Minimum Projected Ending Fund Balance

Tools for Managing Volatility



4th Reserve Lower Minimum Projected Ending Fund Balance

How it works

- Montana has a unique practice of maintaining a statutorily required minimum projected ending fund balance in the general fund of 5 – 6%
- This law can be temporarily or permanently suspended in times of a shortfall

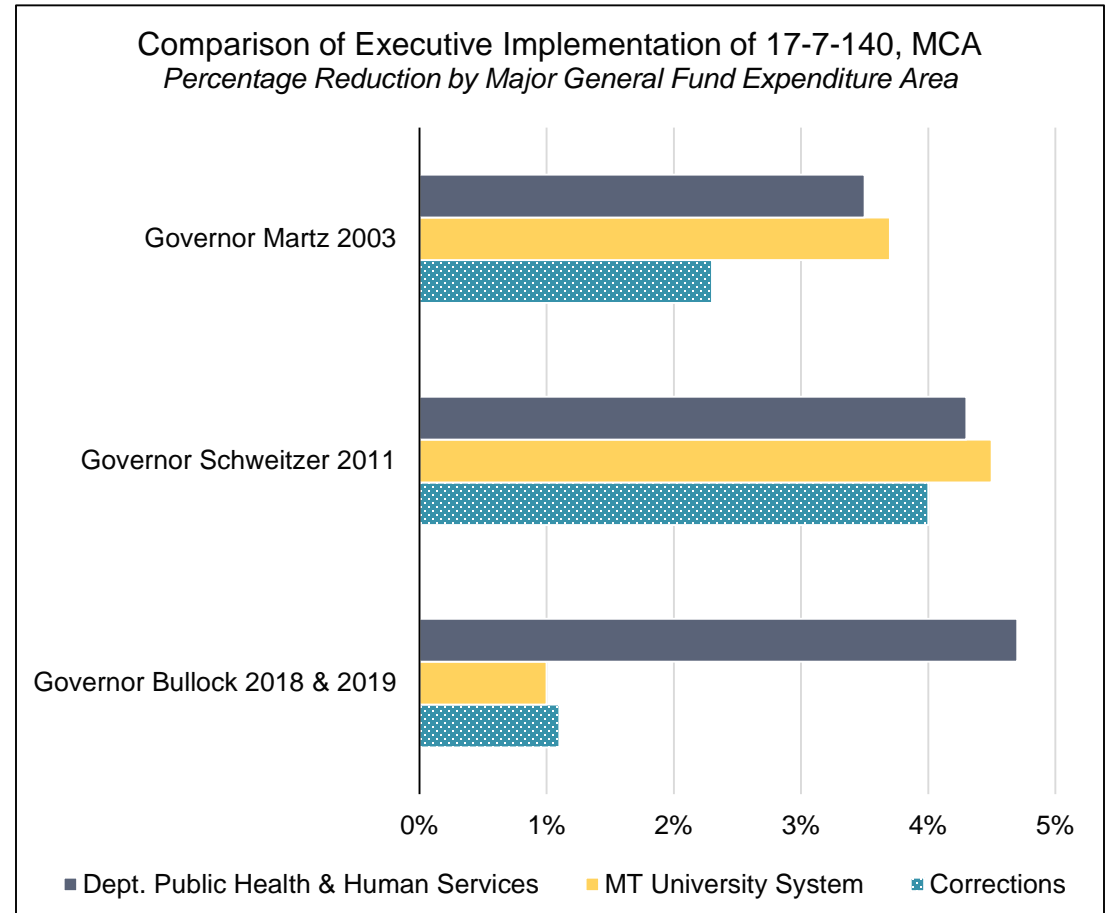
Possible improvements

- This portion of the reserves may better serve the state if it were moved from this reserve level which is difficult to access for both the Legislature and Governor to the Budget Stabilization Reserve*

Other Questions to Consider

How much should the Governor reduce expenditures?

- Only 16 other states have statute that directs the Governor to reduce spending without Legislative action
- Different Governor's make different choices
- The legislature may wish to further limit the spending reductions available to the Governor*



Consensus Revenue Forecasting**

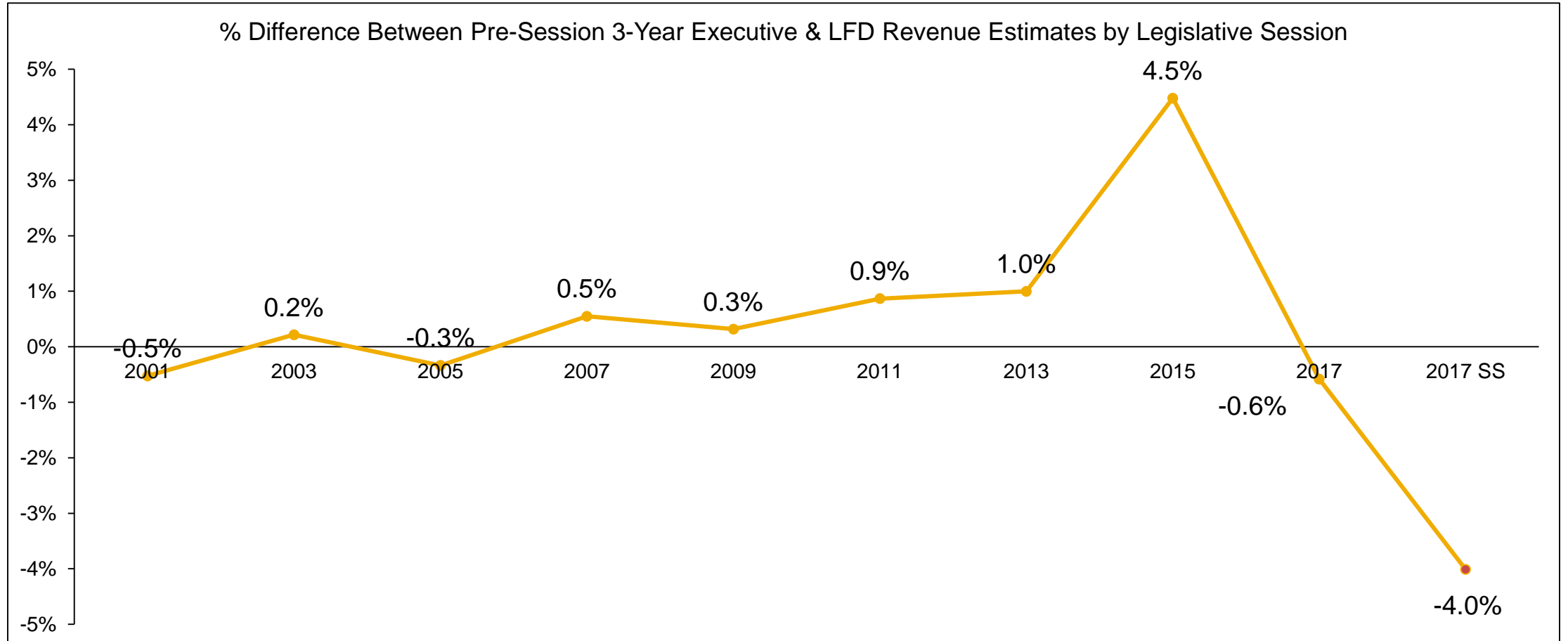
How it works in other states

- Varies state to state depending on custom and culture of the state
- Academic studies show that consensus forecasting is not necessarily more accurate than current system
- Can lead to better policy decisions

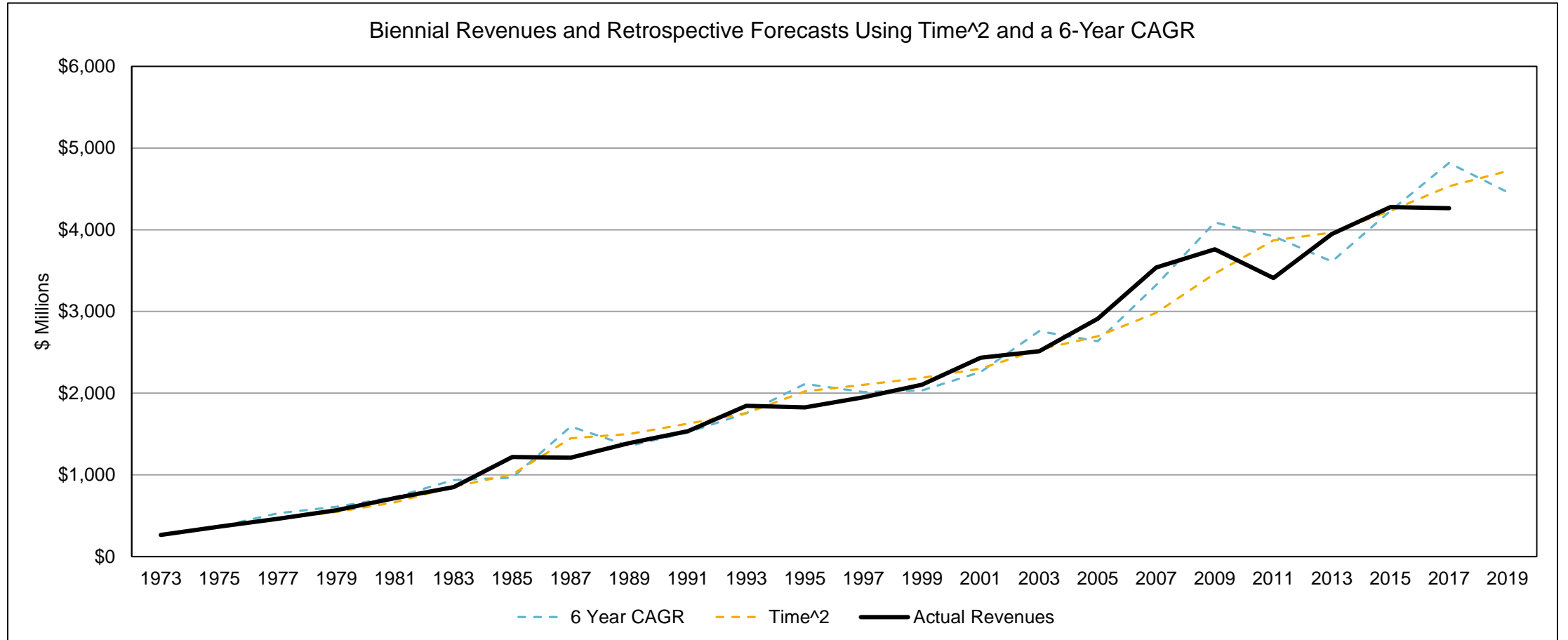
Montana Culture and Process change

- Executive using more diverse economic assumptions than IHS Markit
- LFD has improved modeling techniques to improve forecast

Montana's Cultural Shift



Deposit Rules**



Operating Reserve Level

- Updated analysis demonstrates that the cash flow need would be satisfied with a fund balance of 5.5%
 - In times of high need, additional cash can be flowed from the BSRF, the fire fund, other state balances, or borrowing through Tax Anticipation Notes
- Currently law is defined as 8.3% of second year appropriations
- The lower level of cash need could shift reserves from the operating reserve to the BSRF*

OBPP Recommendations

- No change to 5% minimum ending fund balance
- Allow Executive access to Budget Stabilization Reserve Fund when there are certain expenditure pressures
- Consensus Revenue Forecasting**
- Higher level of reserve level for the BSRF**
- Change deposit rules to put more funds into the BSRF**
- The operating reserve should be increased from 8.3% to 14.6%. Note this allows the Governor access to the difference between 14.6% and 5% or a 9.6% revenue cushion before reductions or access to BSRF.

LFD Other Suggestions

- Pension liability
- Multi-year financial plan
- Debt Management policy
- Pay go financing of capital
- Economic development strategy