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Local Government Interim Committee

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ENTITLEMENT SHARE GROWTH RATE

OVERVIEW

As HB 124 worked its way through the legislature in 2001, much of the discussion around the proposed entitlement share program focused on adding a growth rate that was equitable for both the state and local governments. Since local governments would be remitting to the state revenue collected on items such as alcohol and gaming taxes, coal severance taxes, and vehicle fees, local governments would not have a method to ensure they were adequately compensated for growth unless a calculation was added. Determining the best method to equitably account for growth while still maintaining a streamlined revenue collection system has proven a challenge since the program's inception.

This document illustrates the changes in the growth factor calculation over time, focusing primarily on policy changes that have impacted the calculation. The growth rate has seen more legislative changes than almost any other part of the entitlement share program, and is an important component when looking at how the state attempts to manage the program over time.

THE ORIGINAL CALCULATION

When HB 124 passed in 2001, the state assumed district court costs and reduced FY2001 entitlement share payments. The state also assumed public welfare costs, and those costs were taken from FY 2002 payments. Since these reductions could unnecessarily impact the growth rate calculation, and because the program was not yet fully implemented, HB 124 provided that the growth rate for FY2002 and FY2003 would be set at 3% for all local government entitites.

Beginning with calendar year 2004, the following calculation was used to determine the growth rate.

1. To determine the growth rate of the **entitlement share pool**[1], the Department of Revenue calculated the average annual growth rate of:
    a. the Montana gross state product; and
    b. Montana personal income.

    The averages for these two factors was derived from data collected during the prior 4 calendar years.

2. The growth rate of the entitlement share pool was then determined for the different types of local government as follows:
    a. Counties = 54% of the average growth rate of the MT gross state product and personal income;
    b. Consolidated local governments = 62% of the average growth rate of the MT gross state product and personal income; and
    c. Incorporated cities and towns = 70% of the average growth rate of the MT gross state product and personal income.

3. Then, to determine **individual growth amounts** for each local government entity, the following calculation was used:
    a. 50% of the growth amount was allocated based on the entity's percentage of the base year entitlement share pool; and
    b. 50% of the growth amount was allocated based on the percentage of population, which is calculated differently for each type of local government entity. The percentage of population is determined:
        i. for counties, the percentage that each county's population bears to the state population not residing within consolidated local governments;
        ii. for consolidated governments, the percentage that each consolidated government's population bears to the state's total population residing with consolidated local governments; and
        iii. for cities and towns, the percentage that each city or town's population bears to the state's total population residing in incorporated cities and towns.

For example, to determine an individual city's growth rate, 50% of the growth would be based on the portion of that city's base year entitlement share pool (the pool whose total growth rate was calculated using the formulas in

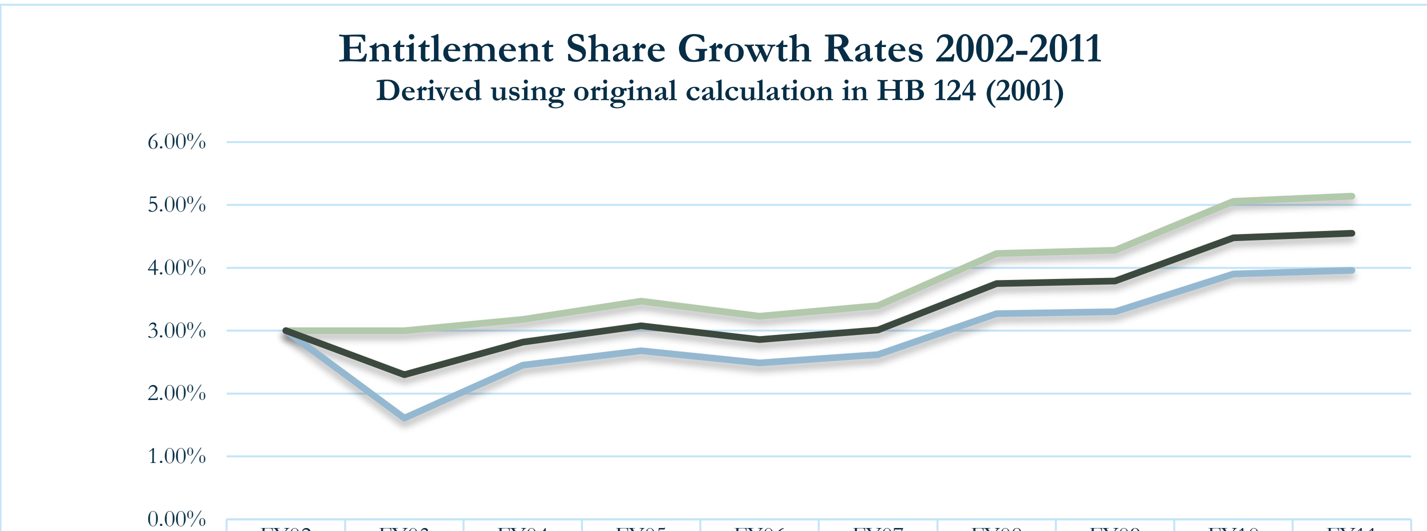
[1] The entitlement share pool is the total amount of money to be allocated to each type of local government. The first calculation using the MT gross state product and personal income growth rates would be applied to the entire pool, thus calculating the total amount that **all** counties, consolidated governments, and cities grew.
The second calculation was needed to determine how each entitlement share payment would be calculated and distributed to each individual local government entity.

points 1 and 2 above). Then, the city's growth would also be determined using the percentage of that city's population as compared to the total state population of other citizens residing in cities.

This procedure was used to ensure that local government entities would only be compared against those of the same kind (i.e. counties would not be compared against cities).

GROWTH RATES 2002-2011

The original calculation was used from 2002-2011, and the calculated growth rates are illustrated here.



	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11
Cities	3.00%	3.00%	3.18%	3.47%	3.23%	3.40%	4.23%	4.28%	5.06%	5.14%
Counties	3.00%	1.61%	2.45%	2.68%	2.49%	2.62%	3.27%	3.30%	3.90%	3.96%
Cons. Govt	3.00%	2.30%	2.82%	3.08%	2.86%	3.01%	3.75%	3.79%	4.48%	4.55%

Cities Counties Cons. Govt

This calculation was used until 2011, when HB 495 enacted a new formula.

HB 495 in 2011 proved very impactful for entitlement share payments since it also eliminated the growth factor for fiscal years 2012 and 2013. When a growth rate was applied again in fiscal year 2014, the growth rate was determined using a new calculation and was also capped at 3.0% for counties, 3.25% for consolidated governments, and 3.5% for cities.

THE NEW CALCULATION (2011-PRESENT)

The new calculation ties the growth rate to vehicle licensing, gaming, and alcohol revenues and personal and corporate income taxes. These two revenue factors are used to generate ratios for the three most recently completed fiscal years. The two factors are then weighted and summed together. The revenue amounts used in each factor are determined using revenue estimates.

Factor 1: Alcohol/Gaming/Vehicle Revenue[2] is collected for the most recently collected first, second, and third fiscal years.

To determine Factor 1, the following are added together for each fiscal year:

- vehicle, boat, and aircraft taxes and fees;
- gaming revenue pursuant to Title 23, chapter 5 part 6, except for the permit fee in 23-5-612(2)(a); and
- all beer, liquor, and wine taxes pursuant to 16-1-404 (license tax on liquor), 16-1-406 (taxes on beer), and 16-1-411 (taxes on wine and hard cider).

Then the ratio is determined as:

$$F1\ ratio = \frac{(sum\ 1st\ most\ recent\ FY) + (sum\ 2nd\ most\ recent\ FY)}{(sum\ 2nd\ most\ recent\ FY) + (sum\ 3rd\ most\ recent\ FY)}$$

Once the Factor 1 ratio is determined, it is weighted at 75% of the total, so the ratio is multiplied by .75 to determine final factor value.

$$F1\ weighted\ value = Factor\ 1\ ratio * .75$$

Factor 2: Individual/Corporate Income Tax is collected for the most recently collected first, second, and third fiscal years.

To determine Factor 2, the following are added together for each fiscal year:

- individual income tax as provided in Title 15, chapter 30; and
- corporate income tax as provided in Title 15, chapter 31.

Then the ratio is determined as:

$$F2\ ratio = \frac{(sum\ 1st\ most\ recent\ FY) + (sum\ 2nd\ most\ recent\ FY)}{(sum\ 2nd\ most\ recent\ FY) + (sum\ 3rd\ most\ recent\ FY)}$$

Once the Factor 2 ratio is determined, it is weighted at 25% of the total, so the ratio is multiplied by .25 to determine final factor value.

$$F2\ weighted\ value = Factor\ 2\ ratio * .25$$

To determine the final growth factor, the weighted values of each factor are added together.

$$\boldsymbol{Final\ growth\ factor = F1\ weighted\ value + F2\ weighted\ value}$$

[2] The statutory references for the specific revenues allowed are found in MCA15-1-121 subsections (2)(b), (2)(c), and (2)(g).

Example of completed growth rate calculation for FY2021:

Table 1[3]		
Fiscal Year	**Factor 1 (Alcohol/Gaming/Vehicles**	**Factor 2 (Individual & Corp. Income Tax)**
FY2017	$233,311,146	$1,294,216,278
FY2018	$243,924,587	$1,464,876,402
FY2019	$249,149,117	$1,615,546,031
Non-weighted ratio	1.0332	1.1165
Weighted ratio	0.7749	0.2791
Growth factor	**1.0540 (5.40%)**	

GROWTH RATE CAP

HB 495 also set upper and lower statutory limits on the growth rate.

Upper cap - the growth rate may not be greater than the following:

1. 1.0300 (3.0%) for counties
2. 1.0325 (3.25%) for consolidated governments
3. 1.0350 (3.5%) for cities and towns

Lower cap – the growth rate may not be less than 1 (0%).

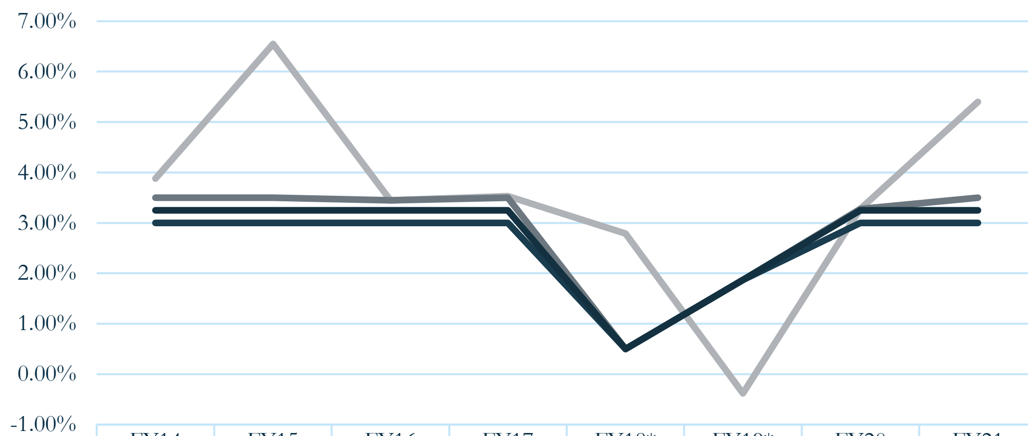
Using the example in Table 1 above for FY2021, counties will be assessed a growth rate of 3.0%, consolidated governments, 3.25%, and cities 3.5% because the calculated growth rate (5.4%) exceeds the statutory limit.

[3] Table taken from a letter, "Entitlement Share Growth Calculation for FY 2021", compiled by the Department of Revenue and sent to MACO and MLCT, dated October 25, 2019.

GROWTH RATES 2014-2021

The following graph compares the calculated growth rate to the statutorily allowed growth rate. The applied growth rate is fairly consistent, with the exception of FY2018 and FY2019. During the 2017 session, [HB565]() set the entitlement share growth rate for all local government entities at .50% for FY2018 and 1.87% for FY2019. FY2020 and fiscal years going forward are calculated using the regular growth rate formula as if the payment had been calculated using growth rates for fiscal years 2018 and 2019.

Calculated Growth Rate Compared to Statutorily Allowed Growth Rate



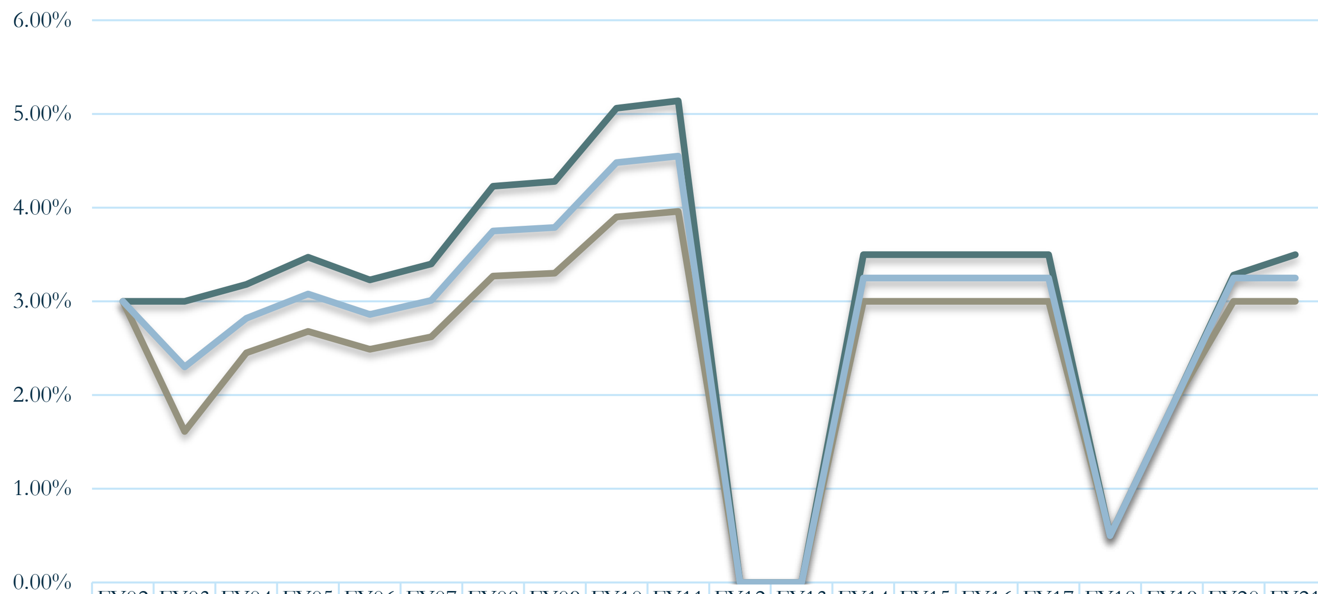
	FY14	FY15	FY16	FY17	FY18*	FY19*	FY20	FY21
Calculated Growth Rate - with no cap	3.88%	6.55%	3.45%	3.53%	2.79%	-0.38%	3.28%	5.40%
Applied Growth Rate- Cities	3.50%	3.50%	3.45%	3.50%	0.50%	1.87%	3.28%	3.50%
Applied Growth Rate - Counties	3.00%	3.00%	3.00%	3.00%	0.50%	1.87%	3.00%	3.00%
Applied Growth Rate - Cons. Govt	3.25%	3.25%	3.25%	3.25%	0.50%	1.87%	3.25%	3.25%

Calculated Growth Rate - with no cap; Applied Growth Rate- Cities; Applied Growth Rate - Counties; Applied Growth Rate - Cons. Govt

*HB565 set growth rates of .50% in FY2018 and 1.87% in FY2019 for all local government entities.

GROWTH RATES 2002-2021

Entitlement Share Growth Rates Over Time



	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21
Cities	3.00%	3.00%	3.18%	3.47%	3.23%	3.40%	4.23%	4.28%	5.06%	5.14%	0.00%	0.00%	3.50%	3.50%	3.50%	3.50%	0.50%	1.87%	3.28%	3.50%
Counties	3.00%	1.61%	2.45%	2.68%	2.49%	2.62%	3.27%	3.30%	3.90%	3.96%	0.00%	0.00%	3.00%	3.00%	3.00%	3.00%	0.50%	1.87%	3.00%	3.00%
Cons. Govt	3.00%	2.30%	2.82%	3.08%	2.86%	3.01%	3.75%	3.79%	4.48%	4.55%	0.00%	0.00%	3.25%	3.25%	3.25%	3.25%	0.50%	1.87%	3.25%	3.25%

Significant changes:

2011 – HB495 amended the growth rate calculation and eliminated the growth factor for FY2012 and FY2013. FY2014 was the first year that the new calculation, with caps, was applied.

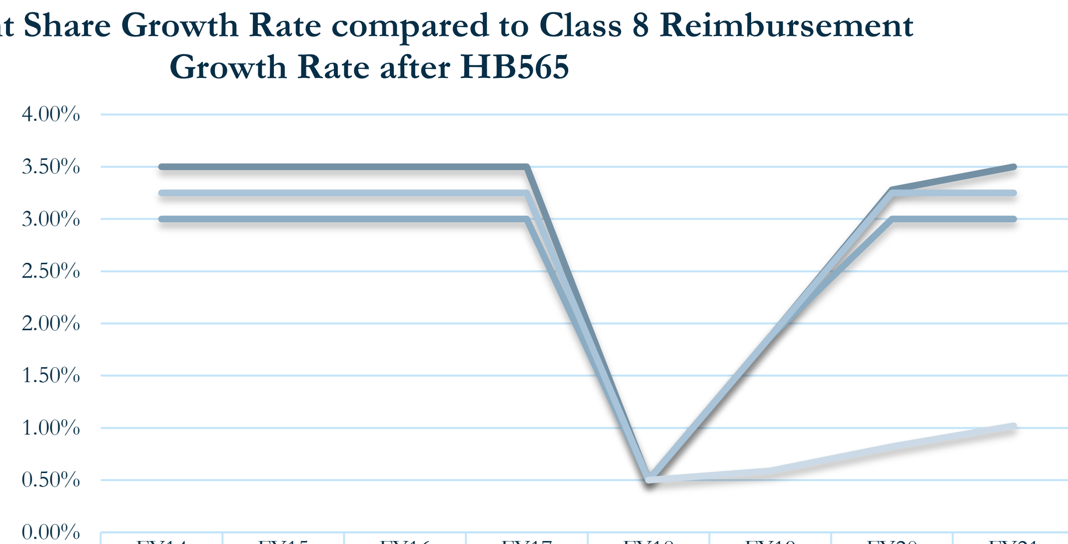
2017 – HB565 set the entitlement share growth rate for all local government entities at .50% for FY2018 and 1.87% for FY2019. Growth rate calculations are restored in FY2020.

OTHER CHANGES

In addition to the general entitlement share growth rate formula, the way Class 8 (business equipment) tax cuts are reimbursed has changed slightly as well. The specific Class 8 reimbursements included in entitlement share payments are listed in 15-1-123(1).

Starting in 2001, Class 8 reimbursements were included into the base calculations for each local entity and allowed to grow at the respective calculated or applied growth rate. In 2017, HB565 segregated Class 8 reimbursements from the rest of the entitlement share pool and applied a different growth rate.

Class 8 reimbursements now grow at one-half of the average rate of inflation for the prior 3 years - the same growth rate allowed to local governments' levy authority under 15-10-420.



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Cons. Govt	3.25%	3.25%	3.25%	3.25%	0.50%	1.87%	3.25%	3.25%
Class 8 Reimbursement Growth after HB565 (2017)					0.50%	0.59%	0.82%	1.02%

It is important to note, when looking at the graph, that prior to 2017 Class 8 reimbursements were added to the entitlement share pool and grew at the same rate as the rest of the revenue. The graph is intended to show the departure of Class 8 reimbursements in 2017 from the other funds in the entitlement share pool and the different growth rate that is applied going forward.

A local government entity's total entitlement share payment for each fiscal year is calculated by growing the base component and Class 8 reimbursements by their correct growth factors and then adding the products together.