

2023 Biennium Financial Outlook

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LEGISLATIVE FISCAL DIVISION
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Montana's Financial Future for the 2023 Biennium

The purpose of this report is to provide legislators with a preliminary look at the major financial considerations for the upcoming 2023 biennium budget. The report provides the current outlook for ongoing general fund revenues and expenditures in order to project the available resources for the 2023 biennium. The report includes a summary of findings, with further elaboration on the following:

- Risks to the budget
- General fund revenue projection scenarios
- General fund beginning balance for the 2023 biennium, budget stabilization reserve, and general fund structural balance
- Present law expenditure requirements
- Spending pressures on the budget

BUDGET PRESSURES AND BUDGET RISKS

The report contains a discussion of various risks and pressures that are not part of present law but could impact spending or revenues.

“Pressures” are defined as those factors that are not within the statutory definition of present law and are not included in the present law estimate, but that the legislature is likely to be under pressure to fund. Present law base is defined in statute ([17-7-102\(10\), MCA](#)) as that level of funding needed to maintain operations and services at the level authorized by the previous legislature. Pressures are often as compelling as present law and legislators often face difficult choices deciding which or how many pressures to fund.

“Risks” are defined as shocks to the budget. Examples of expenditure risks are Medicaid and K-12 school funding costs greatly exceeding present law estimates. In addition to expenditure risk, revenue risk to the budget may occur if actual taxpayer behavior is significantly different from the estimated taxpayer behavior. For example, taxpayers could respond to the COVID public health emergency in ways not predicted.

General Fund Focus

This report concentrates on the general fund, as it is the primary unrestricted source used by the legislature to make funding decisions for government services, such as education, health and human services, and public safety. General fund was 34.5% of the state budget for the 2021 biennium. In addition, general fund is important to legislators as general fund ending fund balance and structural balance are used to determine the fiscal soundness of the state. Lawmakers entering the 2021 session will be faced with a significantly lower projected fund balance than when they left town in 2019 due to the economic impacts of the COVID-19 public health emergency.

Risk to Budget

As mentioned previously, the economic uncertainty from the COVID-19 public health emergency is projected to persist moving forward into the 2023 biennium. Outlined in this section of the report are an overview of the economic range of possibilities from the coronavirus impacts; 2023 biennium revenue baseline expectations, including an optimistic and pessimistic forecast, compared with expenditure present law assumptions; and expenditure pressures the legislature may wish to consider during the 2021 legislative session.

ECONOMIC RANGE OF POSSIBILITIES

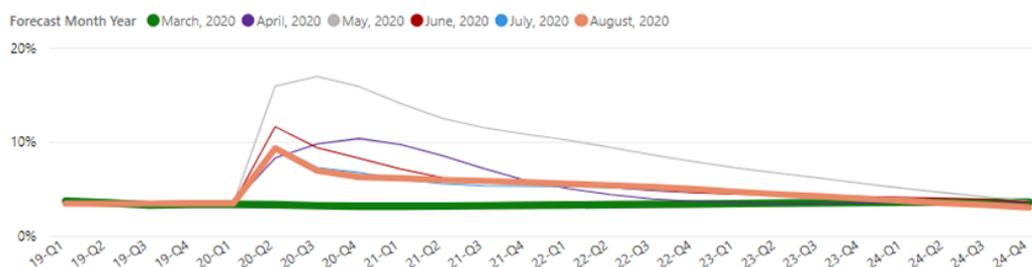
The LFD uses IHS Markit (IHS) as the supplier for both US and Montana specific economic and forecasting data. This includes a wide variety of trends and forecasts that are used to help inform the legislature about the condition of the Montana economy and produce state revenue projections. The ongoing economic reactions to the coronavirus have created increased uncertainty in the forecasts from IHS. This uncertainty is likely to persist for some time but become somewhat better as additional historical data begins to produce a more complete picture of the economic effect from coronavirus and subsequent social distancing measures.

Data and forecasts from IHS are updated monthly. The March data represents a baseline forecast as that was the last update prior to large changes resulting from the coronavirus. Three economic metrics are shown below with the forecast used for the outlook as bold orange and March baseline represented as a bold green line: unemployment rate, gross state product (GSP) (an estimate of goods and services produced in the state), and personal income. All these data are based on the quarterly calendar year.

Key points include:

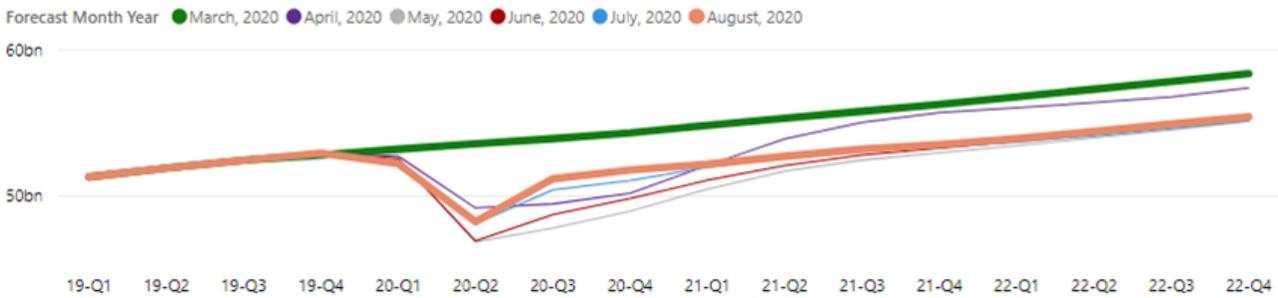
1. The second quarter (Q2) of 2020 remains the low point economically in the forecast. This is the quarter that ended June 30th, 2020;
2. Economic uncertainty remains, however, forecasts especially in out years are becoming more consistent; and
3. The curves of all three metrics are very similar to the national trends, but Montana is projected to perform better than the nation collectively.

Montana Unemployment Rate



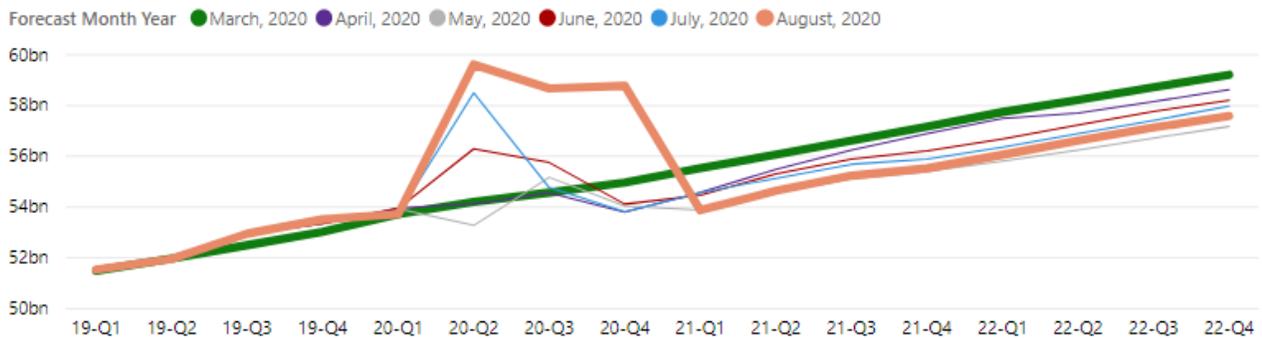
Unemployment in Montana fell to 6.4% in July. This is down from the quarterly high of 9.36% in Q2 of 2020, while nationally, unemployment in Q2 reached 13.02%. Unemployment is forecasted to continue to decline gradually back towards the mid three percent range near the end of the outlook period.

Montana Gross State Product



GSP is forecast to return to pre-coronavirus growth rates, although at a lower absolute value, by Q3-2020, the current quarter at the time of publication of this document. While the growth trend is expected to be similar, the value of GDP is a year and a half lagged from where the growth would be absent the shock. For example, projected GDP half-way through CY-2022 is very similar to the projected GDP at the beginning of CY-2021 pre-shock, about a year-and-a-half lag.

Montana Personal Income



Personal income in Montana follows a similar pattern to national income trends although at a larger bump above base line in CY 2020. Most notably, there is an extended bump from federal relief packages extending from Q2-2020 through the end of the calendar year. This bump is due to the assumption that the federal \$600 per-week unemployment benefit will be extended through December, as well as a second round of stimulus checks. If the current \$400 per-week unemployment benefit and no additional round of stimulus checks occur, it is likely that personal income will fall in Q3 and Q4 2020 relative to the August forecast. This will have effects on the economy, but this metric is not directly included in the outlook revenue forecast as neither unemployment insurance nor the stimulus checks are taxable in Montana.

The limited details and uncertainty continue to make estimating even more challenging. Estimates that we provide in this Outlook are limited by these factors and we will continue to update as new data and information from IHS as well as other sources become available.

REVENUE PROJECTION SCENARIOS

Present Law Revenue Assumptions

HJ 2 estimated revenue growth for FY 2021 at 1.6% compared to FY 2020 actuals. However, due to the economic effects of the recent public health emergency, revenues are now expected to decrease by 9.3% in FY 2021, before rebounding to pre-pandemic levels by the end of the 2023 biennium. This decrease is driven by a forecasted decline in individual income tax of 10.6%. As total collections continue to become more reliant on individual income taxes, projected to account for 59.0% of general fund collections by FY 2025, future revenues will depend upon the health of individual income.

Present Law Revenue Assumptions

The Legislative Fiscal Division developed a revenue forecast for FY 2021 through FY 2025. This forecast uses current year revenue trends, current economic forecasts from IHS Markit, and other data. In mid-November of 2020 these forecasts will be further updated.

Temporary Federal Tax Law Changes and Taxpayer Choices

The fiscal division has estimated the present law impact of the temporary federal tax law changes in response to the COVID based on Congressional Budget Office estimates for the country. However, the tax payment choices of hundreds of thousands of Montanans under these changing tax structures has a wide range of possibilities. The LFD will continue to evaluate the probabilities of the choices of taxpayers. As of now the LFD estimates, with a wide range of possible outcomes, predict these provisions will decrease individual income collections by as much as \$91 million in FY 2021 and \$46 million in FY 2022. For more information please see page 13.

In this report, the Legislative Fiscal Division (LFD) has developed forecasts for three economic scenarios: baseline; pessimistic; and optimistic.

Baseline Forecast

The baseline forecast of the Legislative Fiscal Division (LFD) contains the IHS Markit baseline Montana and national economic assumptions. While there is always uncertainty with revenue forecasts, the current economic climate is especially uncertain. The baseline forecast incorporates federal revenue impacts from the CARES Act adjusted for Montana's personal income and corresponding tax rates. This coupled with taxpayer behavior that seeks to maximize cash reserves, results in a forecast that includes significant reductions to individual income tax in FY 2021. However, it is assumed that some of the strength of FY 2020 was not a result of an inflated

Coronavirus Aid, Relief, and Economic Securities (CARES) Act: Impact of Federal Tax Law Changes on State Revenues

The CARES Act provides businesses with additional methods to carry losses both forward and backwards. Furthermore, it allows business losses to be deducted from non-business income above and beyond what was previously allowed. This is anticipated to reduce Montana individual income tax collections both in the form of increased refunds and lower tax liabilities. The baseline forecast incorporates estimated impacts of the CARES Act from the Congressional Budget Office (CBO).

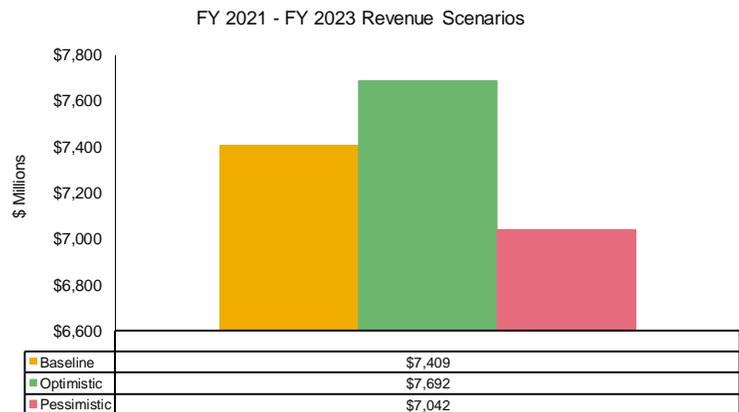
CY 2018 base and will continue into the coming years. Finally, the baseline forecast assumes that the CARES Act loss provisions' impact to individual income tax won't be quite as severe as was expected in August. Corporate income taxes are expected to decline in patterns similar to past recessions, and oil revenues are expected to remain flat.

Alternative Revenue Forecasts

The following forecasts are presented as alternatives to the baseline forecast. While all indicators point to the baseline projection as the future trend, factors impacting revenues may change the forecast significantly. As such, the LFD offers two alternative forecasts below.

Optimistic Forecast

The optimistic revenue scenario incorporates the IHS Markit optimistic forecast for US economic variables. It also assumes that taxpayers did not overpay on estimated payments in FY 2020, and as a result will not drop off as much as the baseline forecast assumes in FY 2021. Furthermore, the individual income tax forecast assumes that the impacts of the CARES Act provisions will be even less severe that what is assumed in the baseline scenario.



Pessimistic Forecast

The pessimistic revenue scenario incorporates the IHS Markit pessimistic forecast for US economic variables. While IHS Markit does not provide a specific pessimistic outlook for MT wages and employment, other indicators such as stock market indices, consumer expenditures, and energy prices are all used in the pessimistic modeling process. It also assumes that the CARES Act loss provisions will be equal to the CBO Montana adjusted estimate.

IMPACTS TO THE BUDGET

In addition to the range of possible revenue projections, there are areas where significant variability in FY 2021 could impact the fund balance going into the 2023 biennium. In general, these scenarios suggest a higher beginning fund balance going into FY 2022 is possible, but the range of possibilities varies significantly, which introduces additional uncertainty into planning for the next biennium. FY 2021 baseline expenditure projections make certain assumptions that could vary in either direction, and additional ranges of “optimistic” and “pessimistic” assumptions are shared with revenues.

K-12 School Potential Impacts

COVID-19 also has potential impacts on schools, which could vary depending on the duration of lockdowns and levels of concern in areas outside of Montana. There is evidence, such as reported in this Bozeman Daily Chronicle [article](#), that people, some of which have school-aged children, are leaving higher population areas for lower population areas such as Montana. This potentially would increase the number of students in some districts, placing additional pressure on districts in the short term and state general fund and local property taxes in the long run.

Department of Public Health and Human Resources – Medicaid Economic Risk

It is possible that the economic contraction associated with COVID-19 could worsen and/or persist for several years. If this comes to pass, the state’s Medicaid program could be an area of fiscal pressure, especially if the enhanced FMAP currently in effect expires. Prolonged economic contraction will make more persons eligible for Medicaid as incomes in the state fall and unemployment rises, and increased Medicaid enrollment will drive expenditures higher. See this [fact sheet](#) from the Kaiser Family Foundation for a discussion of the impact of the 2007-2009 recession on Medicaid expenditures.

Expenditure Projection Scenarios for FY 2021

A typical approach to analyzing the general fund ending balance assumes that all appropriations are valid and will likely be spent, with a small allowance for reversions. However, in this case, due to the state and federal regulation changes and changing economic reality, baseline projections for FY 2021 are assumed to include less general fund spending in DPHHS. Even in the pessimistic projection, there is still a noteworthy underspend as compared to the entire appropriation. These DPHHS scenarios include:

- Baseline
 - Savings of \$47.1 million associated with the FMAP change providing additional federal funding for Medicaid during the COVID emergency declaration, for three quarters of the fiscal year. Additionally, savings of \$29.9 million general fund, similar to FY 2020, are included associated with lower caseloads
- Optimistic
 - If the enhanced FMAP continues through the entire fiscal year, \$62.8 million of general fund authority could be reduced by additional federal funding, and a higher caseload savings of \$38.8 million could be possible as compared to a higher FY 2021 appropriation
- Pessimistic
 - Even in this scenario, six months of enhanced FMAP would provide \$34.1 million of general fund savings as was realized in FY 2020

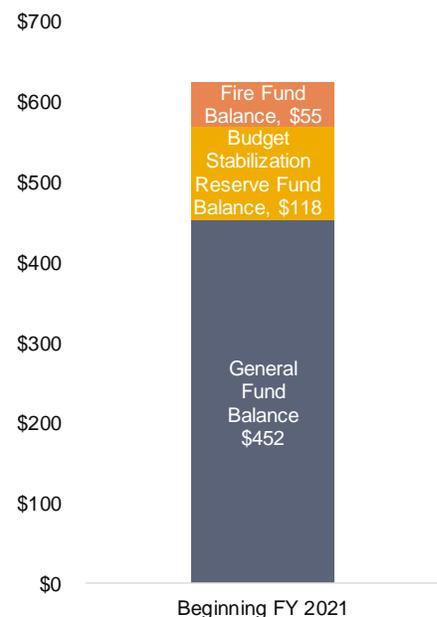
FISCAL YEAR 2021 BIENNIUM BEGINNING GENERAL FUND BALANCE AND OTHER BALANCES

State Financial Reserves

At the beginning of FY 2021, the state financial reserves are full and offer a solid cushion to begin FY 2021. The following chart shows the components of the reserves, which total \$624.0 million, or 24.7% of annual general fund revenues. The FYE 2020 general fund ending fund balance contributed to reserve cushions, as the balance was higher than anticipated at \$451.7 million. In addition, the budget stabilization reserve began FY 2021 with \$117.8 million, and the wildfire suppression beginning fund balance for FY 2021 was \$54.6 million.

If FY 2021 was a normal year, state finances moving into the future would be solid, however, with impacts of COVID-19 on the economy, FY 2021 will be uncertain.

Reserve Balances
Beginning FY 2021
(\$ millions)



General Fund Ending Balance with Operating Reserves and Statutory Minimum

State general fund financial reserve parameters designed to weather financial difficulties recommend maintaining an operating reserve balance of 8.3% of all general fund appropriations in the second year of the biennium, or about \$212 million in the 2021 biennium. The projected baseline LFD fund balance for FY 2021 of \$193 million is \$19 million below the recommended operating reserve.

Maintaining an operating reserve provides the state with a wedge for liquidity management before reaching the minimum ending fund balance required by law. Re-establishing an operating reserve during a downturn, after all other reserves have been spent may require spending reductions, tax increases, or other difficult budget measures.

Current statute requires a minimum state general fund balance of 4% of general fund appropriations in the second year of the biennium prior to October 2020. After October, minimum balance requirements drop incrementally. Please refer to the [May COVID-19 Update Report](#) for a more in-depth look at the minimum statutory balance requirements.

The bar on the left shows the state general fund financial reserves at FYE 2020. The bar on the right shows what reserves might look like at FYE 2021 if baseline assumptions materialize.



Uncertain FY 2021 General Fund Ending Fund Balance

FY 2021 ending fund balances are more uncertain than usual. While the potential variation of expenditures is less than that of revenues, it can still have a substantial effect on the ending fund balance. In FY 2020, the state government spent \$130.3 million less than appropriated in the general fund. If underspending in FY 2021 mirrors FY 2020, the ending fund balance would be higher.

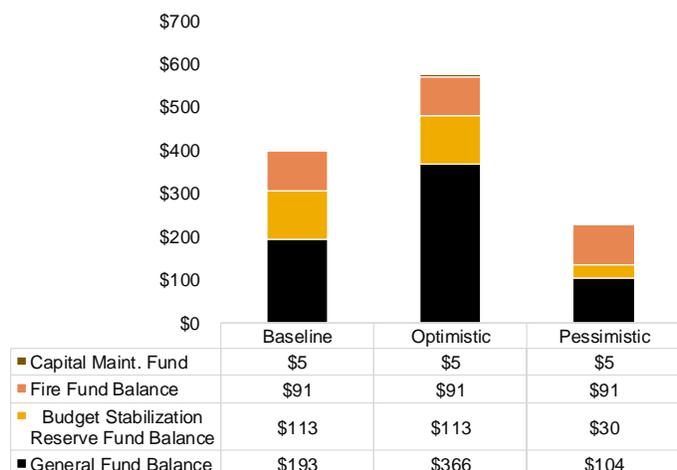
The range of possible fund balances are shown in the graphic, including the baseline forecast more likely to occur.

Baseline General Fund Ending Fund Balance

If the baseline assumptions for revenues and expenditures for FY 2021 materialize, the general fund balance will have been reduced from \$452 million to \$193 million. This is above the statutorily required ending fund balance of about \$104 million, and slightly below the suggested operating reserve of \$212 million.

The LFD baseline forecast leaves state financial reserve fund balances totaling

Uncertain FY 2021 Ending Fund Balances



\$402 million, including the general fund ending balance at \$193 million.

Optimistic and Pessimistic Ending Fund Balance Scenarios

The LFD optimistic forecast has total reserve balances at \$575 million, with the general fund at \$366 million. The forecast includes potential savings mentioned on page 6 under expenditure projection scenarios.

The LFD pessimistic forecast has total reserve balances at \$230 million, including the general fund balance at the statutory minimum of \$104 million. The pessimistic forecast estimates current law revenues to be \$300 million less than LFD estimated expenditures, which will reduce reserves from over \$600 million to \$230 million. In addition, the LFD pessimistic forecast requires \$82.7 million from reserves to reach the statutorily required general fund balance.

Given the wide range of possibilities with the economic impact of COVID-19, both revenues and expenditures in FY 2021 could be different than the assumed baseline levels. The substantial fund balances are an important tool in managing this financial risk.

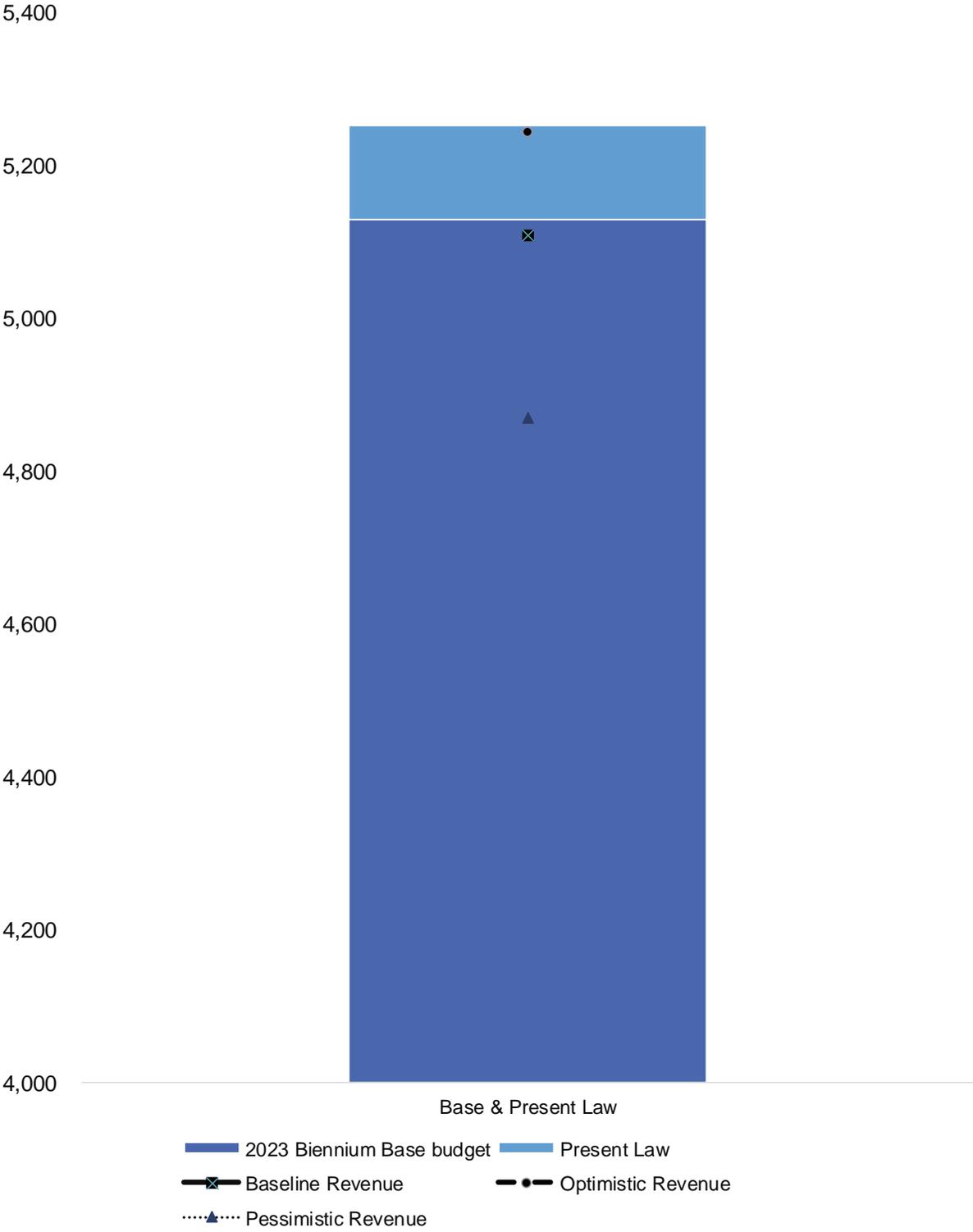
MOVING ON TO THE 2023 BIENNIUM

Structural Balance for the 2023 Biennium

Present law is the level of funding needed to maintain ongoing operations and services authorized by the previous legislature. The graphic below illustrates present law expenditures in relation to anticipated revenues for the 2023 biennium. Baseline revenues are \$5,111 million, or \$142 million lower than the base budget plus present law of \$5,253 million.

The FY 2021 base budget is \$5,131 million and present law adjustments of \$122.4 million, or 2.4% of the biennial base budget, add to the base for a total present law budget of \$5,253 million. This present law adjustment is slightly lower than might have been anticipated due to lower forecasted Medicaid growth than usual.

2023 Biennium General Fund Present Law



EXPENDITURE PRESSURES

Pressures are defined as those factors that are not within the statutory definition of present law and are not included in the present law estimate, but that the legislature is likely to be under pressure to fund. The following table summarizes the expenditure pressures—pressures, potential pressures, and total of all pressures—with specific page numbers referring to the written narrative explaining each pressure in the report.

2023 Biennium General Fund Pressures				
		Potential		
	Pressure	Pressure	Grand Total	Page
All agencies				
Pay increase (1%/3%)	\$11.0	\$21.0	\$31.9	18
Provider Rate increase (1%/3%)	15.8	34.0	49.8	18
20 year layered amortization for pensions	-	24.6	24.6	33
Other items	2.0	-	2.0	30
Subtotal All Agencies	28.8	79.5	108.3	
A - General Government				
Department of Commerce OTO	4.5	-	4.5	19
Subtotal Section A	4.5	-	4.5	
C - Natural Resources				
Designated Surveillance Area Brucellosis	3.0	-	3.0	26
Good Neighbor Authority	1.8	-	1.8	25
Subtotal Section C	4.8	-	4.8	
D - Public Safety				
Additional Judges and staff	-	1.0	1.0	27
Correctional caseload growth	1.7	5.1	6.9	26
Hepatitis C Funding (OTO)	6.1	-	6.1	26
Public Defender caseload 3%	-	3.5	3.5	27
Subtotal Section D	7.8	9.6	17.4	
E - Education				
Fund education for residential treatment	1.6	-	1.6	29
MUS fund switch from 6 mill	1.4	-	1.4	30
K-12 Special Ed inflation	2.8	-	2.8	29
Subtotal Section E	\$5.8	\$0.0	\$5.8	
Grand Total	\$51.6	\$89.1	\$140.7	

Pressures

The expenditure pressures included in this section do not add new services but fund current operations of state government at a level higher than present law. Pressures total \$51.6 million. The items included provide for the following types of adjustments:

- 1% Inflation for provider rates and employee pay
- Corrections caseloads adjustments that are not typically considered in present law
- Items that were funded on a one time basis, but provide a service that is ongoing in nature
- Shift funding to the general fund from state special for the university system as state special funding is expected to be lower

The total general fund anticipated cost, considering base, present law, and pressures is \$5,309 million, and is \$198 million greater than the baseline revenue forecast of \$5,111 million

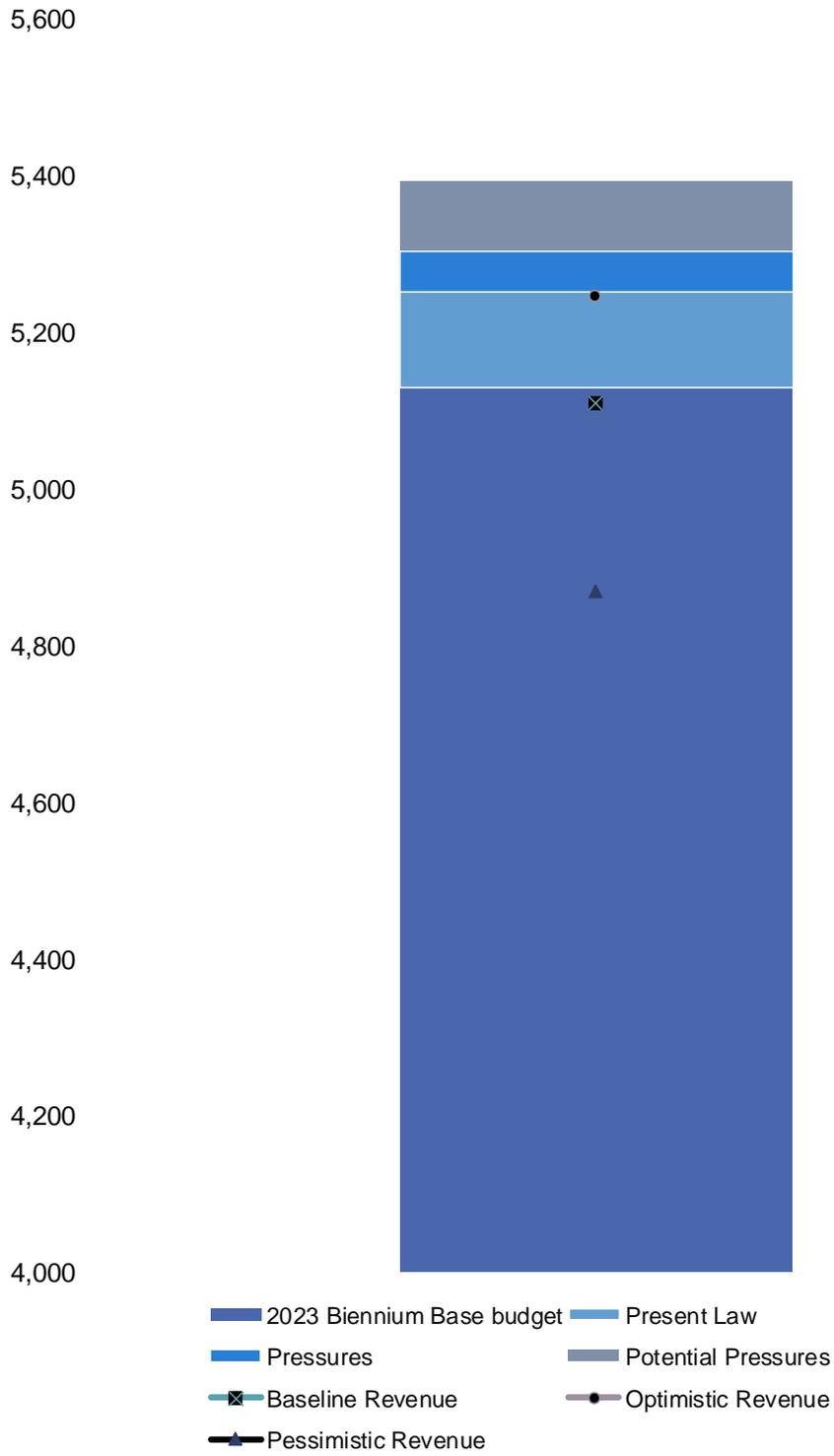
Potential Pressures

The potential pressures total \$89.1 million. The items included provide for the following types of adjustments:

- 3% Inflation provider rates and employee pay
- Higher levels of corrections caseloads
- Higher caseloads for the Office of Public Defender
- Pension costs from pension actuary stress test analysis

The total general fund pressure considering base, present law, pressures, and potential pressures is \$5,399 million, and is \$288 million greater than the baseline revenue forecast of \$5,111 million.

2023 Biennium General Fund Present Law + All Pressures



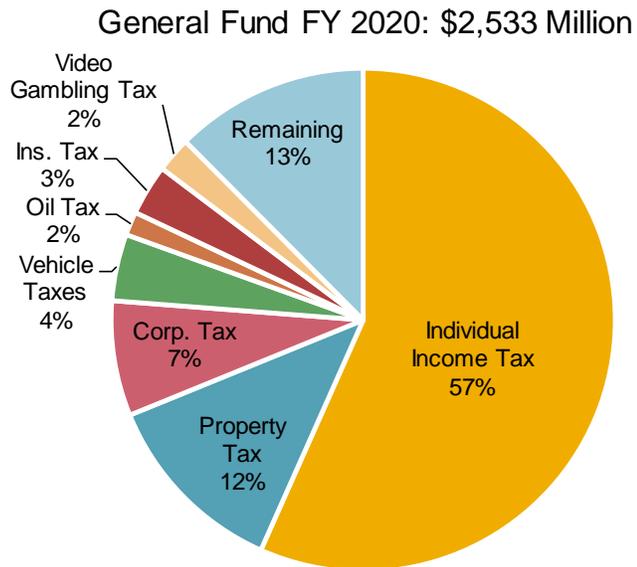
Revenue Details

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. Details of all general fund and most major state special fund revenue sources and allocations are contained in the Legislative Fiscal Division's [2021 Biennium Fiscal Report](#).

GENERAL FUND REVENUE SOURCES

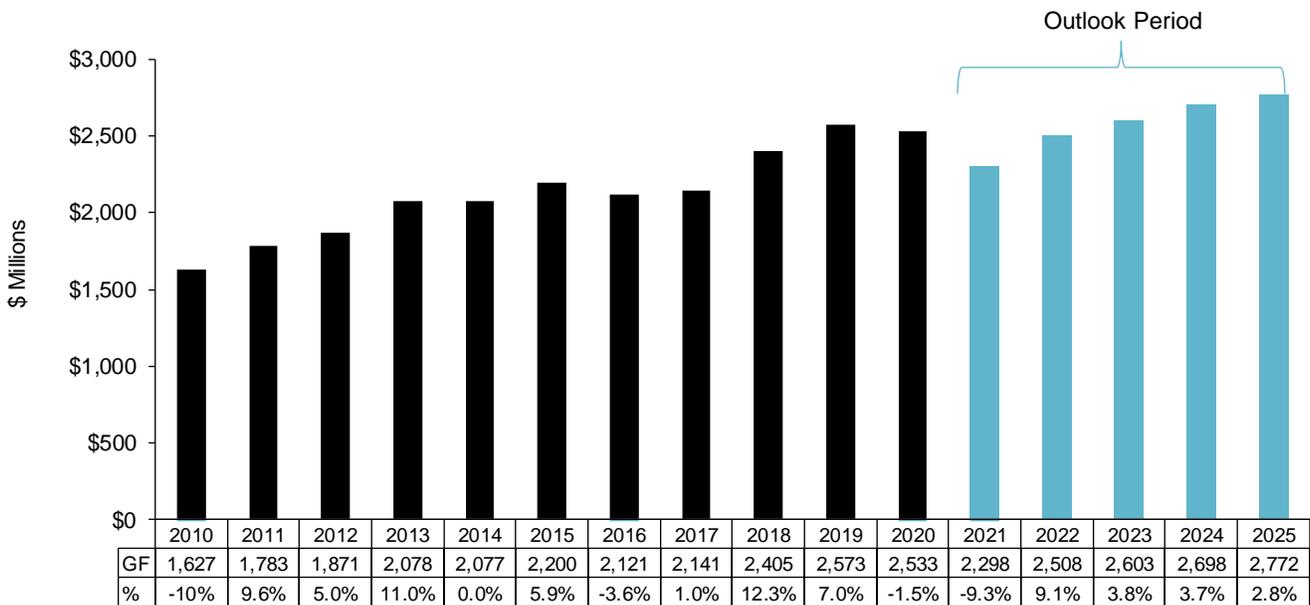
The largest seven sources of general fund revenue are individual income tax, property tax, corporate income tax, oil and natural gas taxes, vehicle taxes, insurance tax, and video gambling tax. In FY 2020, these sources accounted for 88% of general fund revenue. Highlights of the top six tax sources are provided later in this section.

General fund revenue volatility is usually attributable to three sources: individual income tax; corporate income tax; and oil and natural gas production tax. Corporate income tax and oil and natural gas production tax are quite volatile in relative terms, while small percentage swings in individual income tax, which is the largest single contributor to the general fund, can produce significant changes to overall general fund revenue collections.



The chart below shows general fund revenue collections since FY 2010, with actual values shown in black and outlook values shown in light blue.

General Fund Revenue (\$ Millions) by Fiscal Year



General Fund Revenue Outlook and Future Updates

The general fund revenue outlook is produced by estimating the underlying sources of revenue and the economic drivers of those sources. Updated 2023 biennium revenue estimates for the general fund will be produced in November 2020 and presented to the Revenue & Transportation Interim Committee (RTIC). FY 2021 monthly revenue collections will be closely monitored throughout the 2021 Session. It is possible that significant differences in the estimate may occur throughout session, and updates will be provided to the legislature.

The following table summarizes the annual detail for the top seven general fund revenue sources and subtotal of the remaining sources.

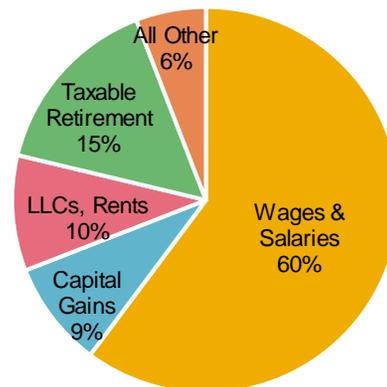
General Fund Revenue Outlook Summary								
(\$ Millions)								
Source of Revenue	Actual FY 2020	Estimated FY 2021	Estimated FY 2022	Estimated FY 2023	Estimated FY 2024	Estimated FY 2025	Estimated 2023 Bien	Estimated 2025 Bien
Individual Income Tax	\$1,435.2	\$1,282.5	\$1,457.3	\$1,522.0	\$1,586.1	\$1,636.2	\$2,979.3	\$3,222.3
Property Tax	308.6	310.3	321.1	325.1	338.8	343.4	646.17	682.19
Corporation Income Tax	187.4	137.4	142.3	150.3	156.8	162.5	292.57	319.28
Vehicle Taxes & Fees	108.5	108.9	109.7	110.6	111.5	112.5	220.38	224.00
Oil & Natural Gas Production Tax	38.4	35.8	39.8	39.5	38.9	37.9	79.29	76.80
Insurance Tax & License Fees	82.5	81.6	78.9	81.3	84.5	87.7	160.18	172.26
Video Gambling Tax	57.4	60.3	63.3	66.5	69.8	73.3	129.84	143.15
Remaining Sources	315.3	281.6	295.6	307.3	311.5	318.9	602.84	630.47
Total General Fund	\$2,533.3	\$2,298.4	\$2,508.0	\$2,602.6	\$2,698.0	\$2,772.5	\$5,110.6	\$5,470.5

Individual Income Tax

The individual income tax is levied against taxable income. The calculation for taxable income begins with the Federal Adjusted Gross Income. Several adjustments are made to produce Montana Adjusted Gross Income, and exemptions and deductions are subtracted to produce taxable income.

Tax rates vary from 1.0% to 6.9%, depending on the level of taxable income. The effective tax rate on capital gains income is less than the tax rate on ordinary income by 2%, due to Montana's 2% capital gains income tax credit.

Individual Income CY 2018: \$26,343 Million

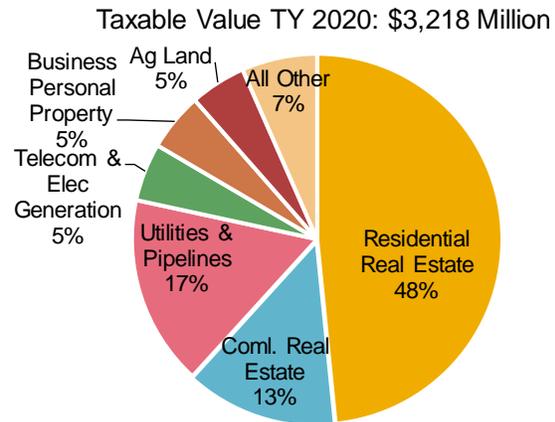


The outlook for individual income is based on the individual income tax model provided by the Department of Revenue and economic indicators from IHS Markit as well as numerous outside-the-model adjustments which attempt to capture taxpayer behavior and federal CARES Act provisions.

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 ([20-25-439, MCA](#)). Taxable value is defined as the market value of statutorily defined property times a statutory tax rate.

The outlook for property tax is based on taxable value data by property class type for TY 2020, and assumes historic growth patterns by class adjusted during reappraisal years.

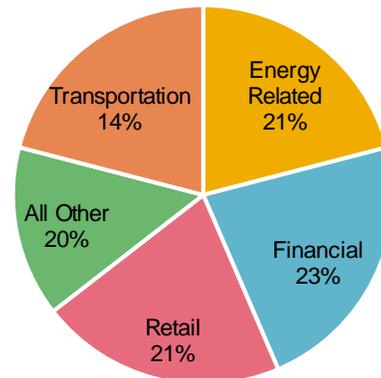


Corporate Income Tax

The corporate 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 ([15-31-322, MCA](#)), who pay a 7.0% tax on their net income.

The financial, energy, and retail related sectors are the largest contributors to corporate income tax liability. Primary economic drivers of this source include oil prices, median house price, and retail sales. The forecast for this source is based on [prior statistical analysis](#) by LFD.

Estimated Corp. Tax Liability CY 2019: \$133 Million

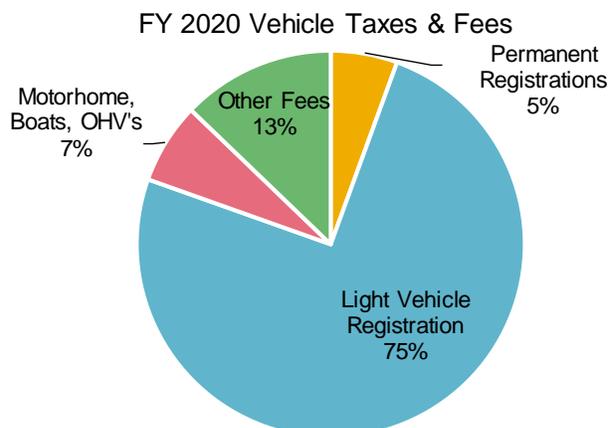


The outlook for corporation income tax assumes a significant decrease in the manufacturing and financial sectors and virtually stagnant growth amongst the remaining sectors.

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.

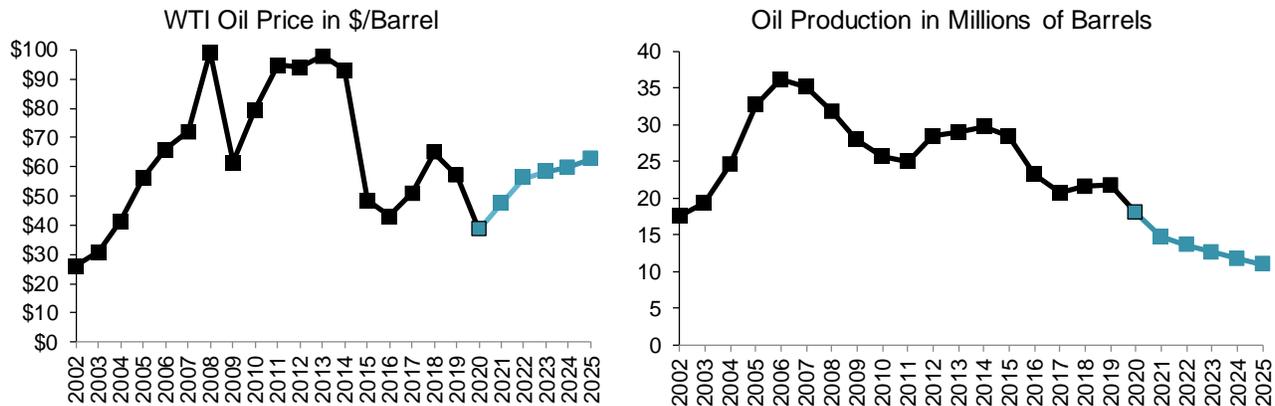
In addition, the state assesses a variety of motor vehicle fees such as fees for motor vehicle liens, fees for new license plates, and title fees.



The outlook for vehicle taxes assumes a slight increase in inventory of total vehicles and a slight decrease in new vehicle sales in FY 2021, with increasing sales in the following years.

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 for newly developed wells. The charts below show the West Texas Intermediate (WTI) oil price and Montana production.



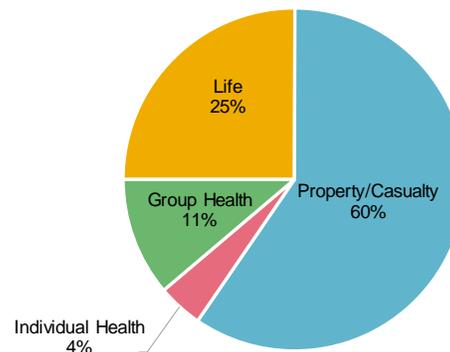
The outlook for oil production tax assumes declining production and a sharp decrease in 2020 prices, followed by a gradual return to current price levels in the 2023 biennium. Oil production taxes could be different than forecast if prices are materially different than assumed in the forecast. Sudden changes to drilling activity would also have a delayed revenue impact in the 2023 biennium due to the oil tax holiday for newly completed wells, although drilling activity over the past couple years has been very minimal.

Insurance Tax

The majority of insurance tax revenue comes from a tax of 2.75% on net premiums sold. There is an additional 2.5% levied on fire insurance premiums sold, and a number of small fees. In the last few years there has been an increase in collections of the additional fire premium due to a tightening of rules by the State Auditor's Office.

There has been concern that the elimination of the individual health insurance mandate that started in 2019 would impact insurance tax revenues. The number of people covered under individual policies peaked in 2015 at nearly 78,000. As of the end of CY 2019 that number had declined to 45,000. However, this has had little impact on total revenue as individual policies are a small portion of total insurance taxes, accounting for only 4%, or \$3.3 million of general fund insurance tax collections.

CY 2019 Insurance Premium Tax by Type



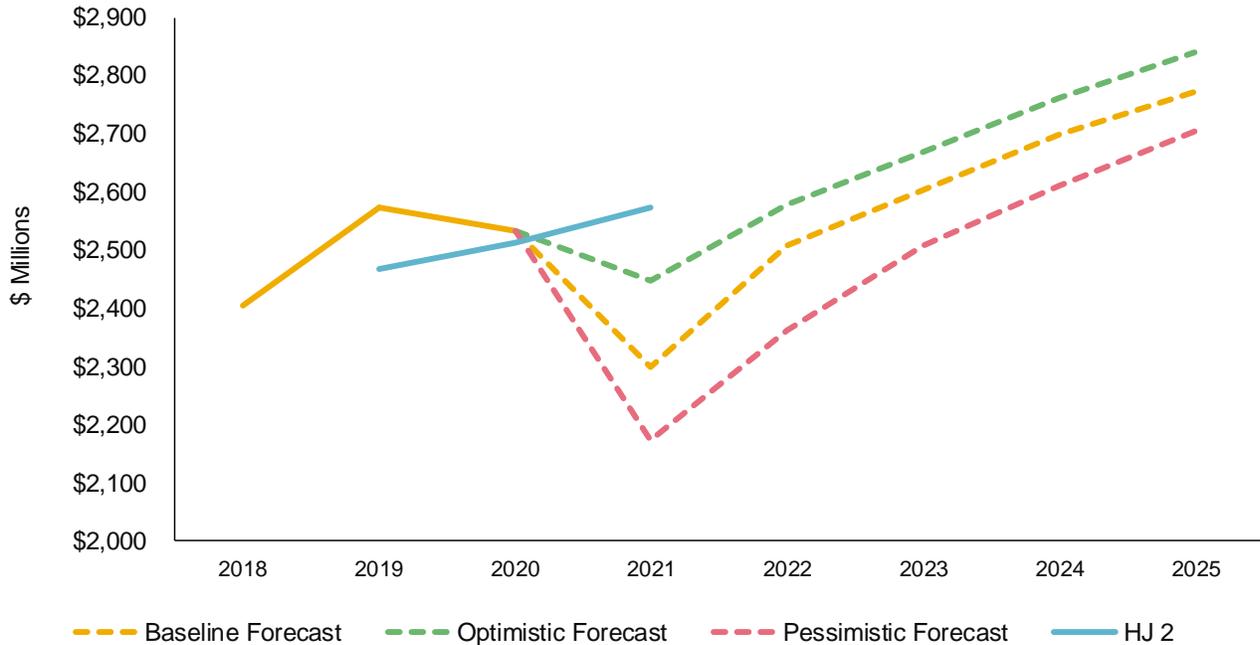
Video Gambling & Remaining Sources

The outlook for video gambling tax predicts a return to pre-pandemic values relatively quickly. This source decreased in FY 2020 when establishments were required to close. The remaining sources are expected to fall below FY 2020 values. This is primarily driven by expected declines in accommodations taxes and short-term interest earnings from treasury cash.

GENERAL FUND FORECAST SCENARIOS SUMMARY

The following chart shows the baseline, optimistic, and pessimistic forecasts through 2025 along with the 2021 biennium HJ 2 estimates. Note that all three scenarios are significantly below the adopted FY 2021 number. The optimistic scenario for FY 2021 is \$127 million below the HJ 2 estimate.

2023 & 2025 Biennia Revenue Forecasts



In the above forecasts there is significant upside and downside risk. In FY's 2021-2023, the range of possibilities is \$650 million. This is driven by extremely high uncertainty in individual income taxes, which accounts for \$560 million of the variation between the optimistic and pessimistic scenarios. Due to near-term uncertainty in taxpayer behavior and impacts of the CARES Act provisions, the range is larger in the next two years, before narrowing by FY 2023.

Since early spring the IHS Markit economic indicators used in the revenue modeling process have varied considerably month-to-month. This may continue in the coming months, causing the revenue forecasts to change prior to the adoption of HJ 2 in November.

Expenditure Details

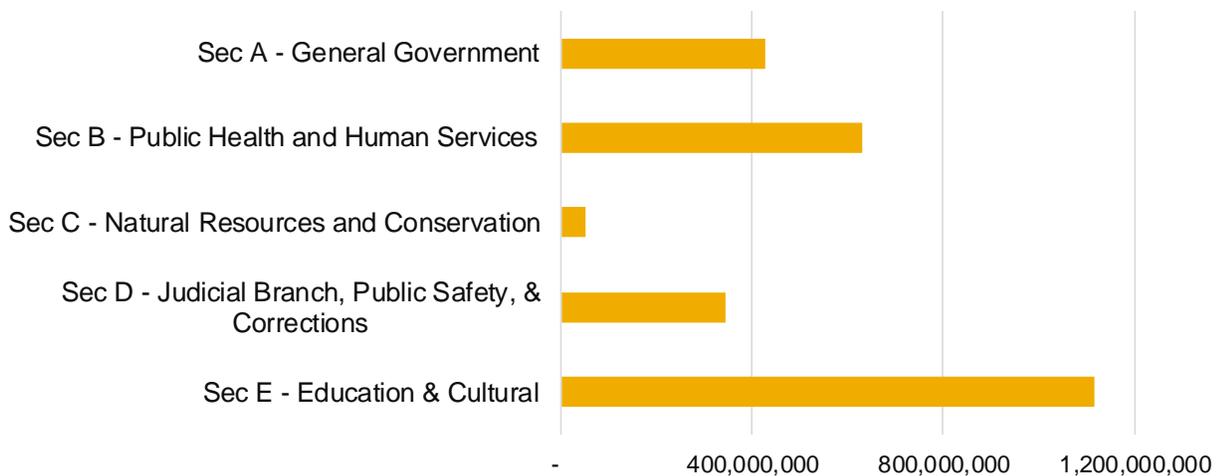
General fund present law expenditures in the 2023 biennium are projected to total \$122.4 million a decrease of \$220.3 million from the FY 2021 ongoing appropriation level. Appropriations are comprised of HB 2, statutory appropriations, non-budgeted transfers, and other bills.

GENERAL FUND APPROPRIATIONS BY SECTION OF GOVERNMENT

Base budget

The base budget is defined as the resources authorized by the legislature for the ongoing operation of state government in FY 2021. The total general fund base budget is \$2,565 million. The chart demonstrates the general fund base budget for each section of government, with section E, education including K-12 school distributions as the largest portion.

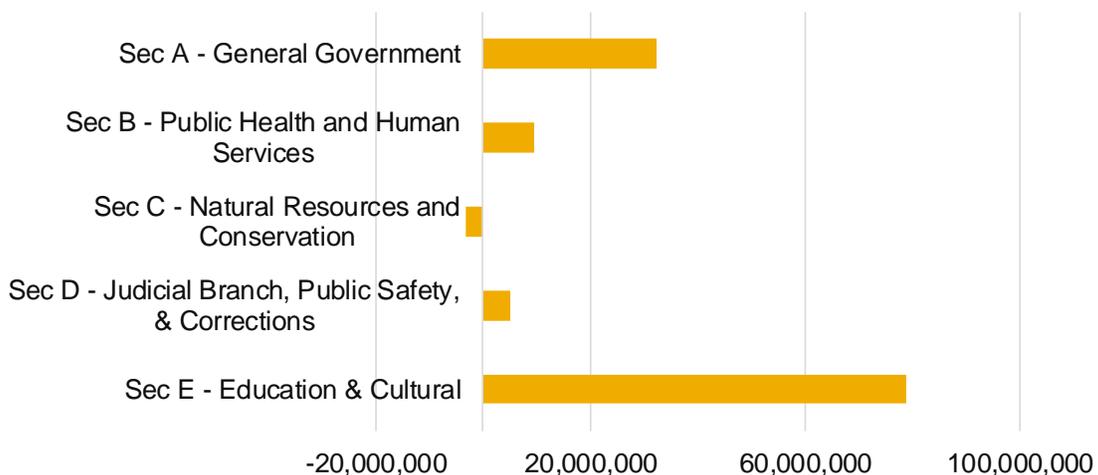
Agency General Fund Base Budgets by Section of Government



Present law adjustments

Present law adjustments increase the base budget to account for anticipated spending under the previously approved ongoing level of services.

General Fund Present Law by Section of Government



The expenditure projections for the 2023 biennium for present law obligations are \$122.4 million, which is below the 2021 biennium by \$226.2 million. The key area of present law decrease was in the Department of Public Health and Human Services (DPHHS), which decreased \$155.4 million from the 2021 biennium due to policy changes between the biennia.

Pressures and Potential Pressures

As described earlier in this report, additional budget pressures will likely be considered by the 2021 legislative session. All pressures total \$140.7 million in the biennium.

The present law adjustments along with the pressures summarized in the table on page 10, are described in the following pages by traditional budget sections A through E. A brief description of the adjustments across all agencies precedes the budget section descriptions.

ALL AGENCIES

Present Law

Present law adjustments calculated statewide for all agencies include adjustments for personal services, fixed costs, and inflation:

- The present law adjustment for personal services totals \$27.3 million over the 2023 biennium. This adjustment includes the annualization of the pay plan provided in HB 2 and other changes. The elected officials salary increases provided for in statute are included in the present law adjustment for personal services and totals \$663,544
- The present law adjustment for statewide fixed costs totals \$9.4 million general fund over the 2023 biennium. This adjustment includes, but is not limited to, estimated increases in insurance, the human resources information system, capitol complex rent, legislative audit fees and information technology costs

Across all funds, statewide fixed costs are estimated to increase \$27.3 million over the 2023 biennium. Information technology costs comprise approximately 50.0% of the increase in the fixed costs in FY 2022 and slightly over 70.0% in FY 2023. This is an expected increase of \$16.4 million over the biennium. One contributing factor is the cybersecurity enhancement project, which was included in HB 2 during the 2019 Legislative Session. This project received funding of \$6.3 million general fund in the 2021 biennium. It was the intent of the legislature that funding for the cybersecurity enhancement project be moved to the proprietary rates if the project was successful. The general fund appropriation for this project has been eliminated in HB 2 and moved to the proprietary rates for the 2023 biennium

Pressures

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 1.0% per year for salary increases and 0.0% to 10.0% per year for insurance contribution increases. Last biennium, as an alternative, the legislature approved pay plans that grant an additional \$0.50 an hour pay increase to state employees. Each 1.0% per year in the employee pay increase would cost \$11.0 million in general fund for the biennium without an increase in health insurance.

Provider Rate Increases

The 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.

In the 2019 Legislative Session, the legislature approved increases in provider rates of 0.91% in FY2020 and 1.83% in FY 2021 for DOC contracted statewide treatment facilities.

A 1% annual rate increase is estimated to cost \$15.8 million general fund over the 2023 biennium with:

- \$13.4 million for DPHHS
- \$2.4 million for DOC

A 3% annual rate increase for all providers is estimated to cost an additional \$31.6 million general fund over the 2023 biennium, for a total of \$47.4 million.

SECTION A: GENERAL GOVERNMENT

Department of Administration

Present Law – Infrastructure

The 2019 Legislature passed [HB 553](#) that included two general fund appropriated transfers in the Department of Administration (DOA) budget. According to the law, these transfers are to be included as present law appropriations. The appropriations are as follows:

- Major repairs: Current law requires that the state invests 0.6% of the current replacement value (CRV) of Long-Range Building Program (LRBP) eligible buildings for purposes of major repairs and maintenance of the buildings. The general fund appropriations are equal to the difference between 0.6% of CRV and the LRBP dedicated revenues of cigarette taxes and coal severance taxes. In early projections, the appropriated transfers for major maintenance would equal \$11.9 million in the 2023 biennium and \$12.7 million in the 2025 biennium
- Capital Development: Current law requires an appropriation transfer for capital developments of an amount equal to 1% of general fund revenues less current and authorized but unissued general fund general obligation bond debt service. In early projections, these appropriation transfers would equal \$19.3 million in the 2023 biennium and \$17.7 million in the 2025 biennium. The legislature would have the ability to authorize the use of these funds for state or local government infrastructure projects through new cash or bonded capital improvement programs, but only if the appropriations for maintaining existing state buildings has been funded at a level equal to or greater than the 0.6% of CRV as described above. The appropriation is also available for use if there are general fund shortfalls experienced in the state budget, or as a “working rainy day fund”.

Other Items

Other item that are pressures to fund in Section A total \$4.0 million for the 2023 biennium. This section primarily includes OTO appropriations in the Department of Commerce for the Indian Country Economic Development program, the Native Language Preservation program, and the Primary Sector Business Training program.

Statutory Appropriations

Statutory appropriations are in law and are not part of the biennial budgeting process but remain in statute until changed or terminated. Most general fund statutory appropriations are within Section A, General Government and are responsible for \$299.8 million of the \$458.3 million in base and present law adjustment in general government. The increases in general government statutory appropriations are driven by the following major components:

- Entitlement share payments to local governments are expected to increase by \$6.8 million from the FY 2021 biennium level. Please see page 33 for additional details.

- Present law payments for employee, local fire, police, and teacher retirement costs are expected to grow by \$10.0 million from the FY 2021 biennium level. Please see page 33 for additional details on pension pressures and risks.
- Debt service payments are expected to grow by \$9.0 million from the FY 2021 biennium level. Please review the debt service portion of the report that begins on page 32 for additional details

Non-Budgeted Transfers

Non-budgeted transfers all occur in Section A, General Government. The majority of non-budgeted transfers are vehicle revenues distributed to various state special revenues funds and the Old Fund (State Fund) liabilities. Non-budgeted transfers are expected to decrease by \$85.1 million from the FY 2021 biennium, with the majority of the decrease the result of one-time-only transfers that occurred in the 2021 biennium to the budget stabilization reserve fund and the wildfire suppression fund.

SECTION B: HEALTH AND HUMAN SERVICES

Section B consists of a single agency, the Department of Public Health and Human Services. Medicaid is typically one of the larger drivers of present law budget growth and is summarized below, along with other significant programs. Overall, there is a projected present law general fund increase of \$9.6 million in the 2023 biennium, as compared to the 2021 base budget.

Present Law - Traditional Medicaid

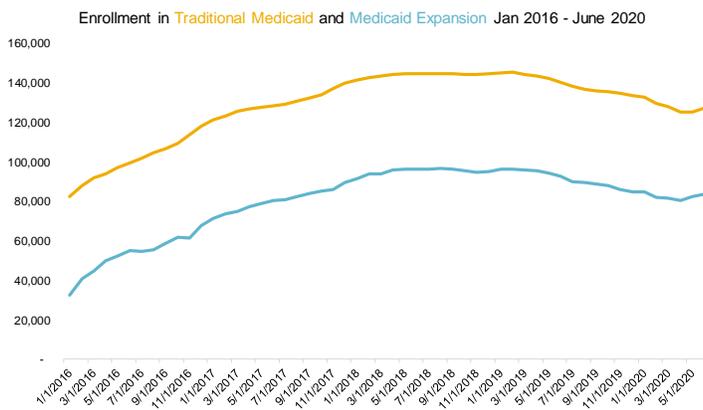
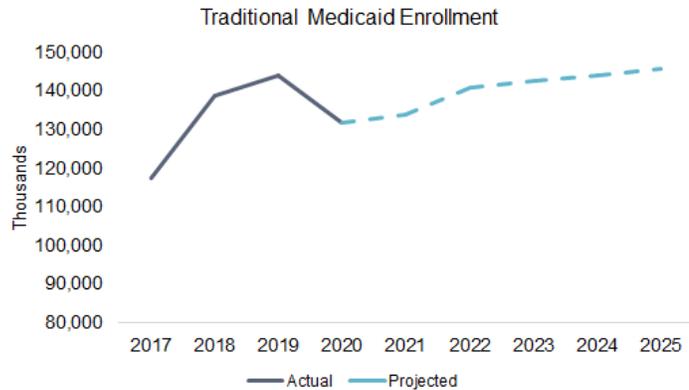
Montana's traditional (non-expansion) Medicaid program expenditures totaled \$1,217 million in FY 2020 (\$257.4 million general fund and \$107.7 million state special funds). The FY 2021 base budget for the traditional Medicaid program is \$1.32 billion, \$342.7 million of which is general fund and \$121.3 million of which is state special funds. State fund expenditures in traditional Medicaid were lower than anticipated in the second half of FY 2020 due to the enhanced Federal Medical Assistance Percentage (FMAP) associated with COVID-19 related federal legislation.

FMAP

In FY 2020, the enhanced FMAP change resulted in lower state share for Medicaid expenditures by approximately \$38.0 million (\$31.4 million general fund), resulting in savings to both the general fund and some state special revenue funds. While the duration of this enhanced rate is unknown, as long as it continues it will result in additional federal Medicaid funding of approximately \$20.0 million per quarter. The enhanced FMAP will persist until the end of the quarter in which the Secretary of Health and Human Services declares an end to the COVID-19 state of emergency. The enhanced FMAP also lowers the state share required for Children's Health Insurance Program (CHIP) by 4.34% for the duration of the COVID-19 state of emergency. For this analysis the LFD assumes the enhanced FMAP will persist for the duration of FY 2021 but will not carry into FY 2022.

Participation

Changes in Medicaid expenditures are driven by several factors: enrollment shifts, changes in the amount of services provided, and changes in the costs of those services. For this analysis the LFD projects a modest increase in traditional Medicaid enrollment through the 2025 biennium. The graph below illustrates this projection. Over the period (FY 2022-2025) the FMAP is expected to remain in the 65.5% range, similar to the last several years.

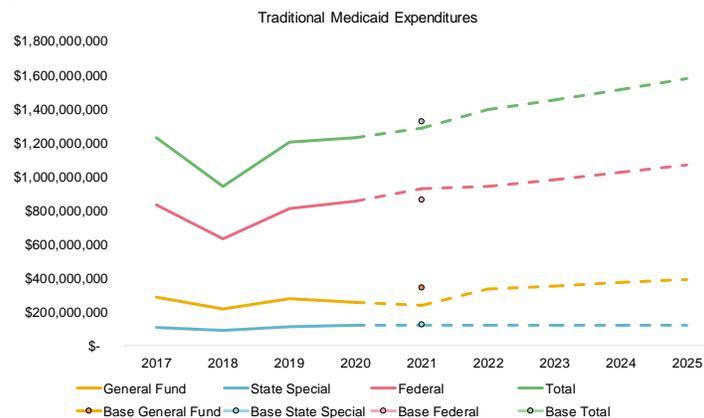


If the traditional Medicaid population were to grow as projected, it would reverse a significant decline in enrollment over the last year or so. The graph at left shows enrollment in both the traditional and expanded Medicaid programs. Both traditional and expanded Medicaid have experienced a decline in enrollment from the spring of 2019 up until the spring of 2020, during which both traditional and expanded Medicaid have experienced an increase, likely associated with the COVID-

related economic contraction and expanded unemployment in the state.

Expenditures

The graph below shows actual, FY 2021 base (represented by circles), and projected expenditures for the traditional Medicaid program. Expenditures are projected to grow modestly through the end of FY 2025 due to a combination of growing enrollment and higher per-user annual expenditures (inflated at 3% per year for the projection period).



Present Law – Medicaid Expansion

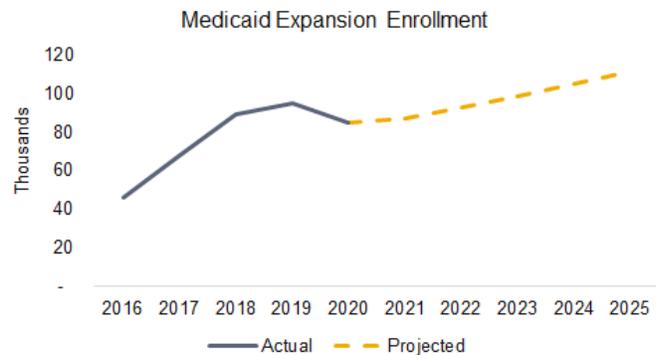
The 2019 Legislature passed HB 658 which authorized the extension of the Medicaid expansion program. In FY 2020 Montana’s Medicaid expansion program expenditures totaled \$823.1 million (\$25.8 million general fund and \$49.9 million state special funds). The FY 2021 base budget for the

Medicaid expansion program is \$905.0 million, \$40.2 million of which is general fund and \$73.1 million of which is state special funds.

The FMAP rate for the Medicaid expansion population was phased-in from CY 2016 through CY 2020. As of FY 2021 the federal FMAP is now 90.0% with the state responsible for the remaining 10.0%. The FMAP is in statute and will remain 90/10 barring federal legislative action. The enhanced FMAP contained in the Families First Coronavirus Response Act (FFCRA) is exempted from the Medicaid expansion population and will not affect expansion expenditures during either the 2021 or 2023 biennia.

Participation

Changes in Medicaid expansion expenditures are driven by the same factors that affect the traditional Medicaid population: enrollment shifts, changes in the amount of services provided, and changes in the costs of those services. For this analysis the LFD has projected a modest increase in Medicaid enrollment through the 2025 biennium. The rate of growth is based on the average monthly increase in the Medicaid expansion population between January of 2018 and July of 2020. The graph below illustrates the projection.

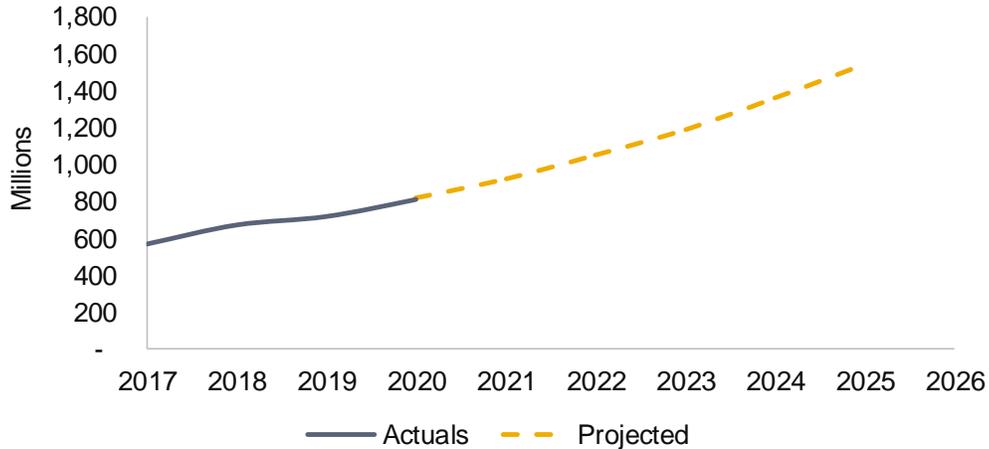


Similar to traditional Medicaid, the expansion population saw a decline in enrollment from the spring of 2019 up until the spring of 2020, during which both traditional and expanded Medicaid experienced an increase, likely associated with the COVID-related economic contraction and expanded unemployment in the state.

Expenditures

Due to the phasing in of the FMAP, the LFD has projected Medicaid expansion expenditures based on all fund types. Expenditures are projected to grow through the end of FY 2025 due to a combination of modest growth in enrollment and higher per-user annual expenditures (inflated at 7.0% per year for the projection period). This inflation rate represents the average annual inflation for per-user expenditures for services between 2017 and 2020.

Medicaid Expansion Expenditures (\$ Millions)



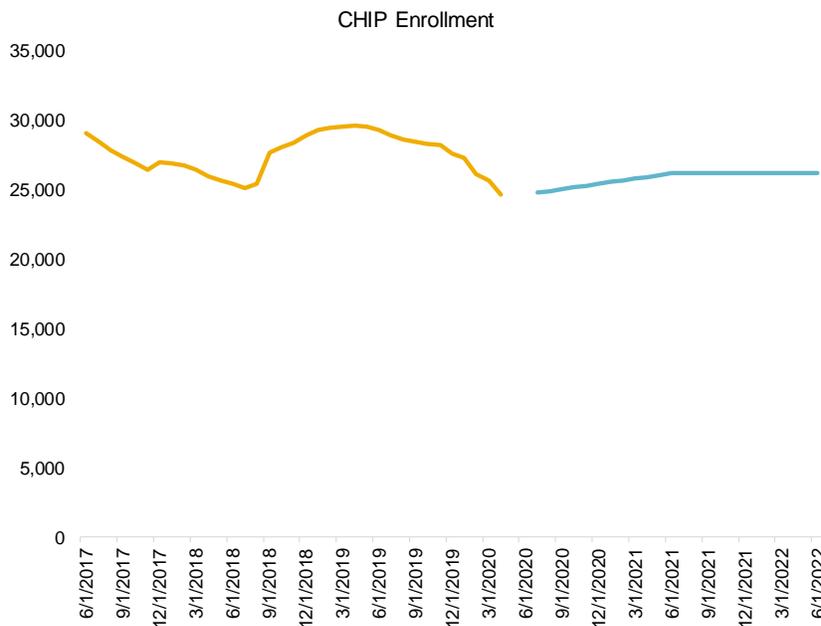
Present Law - Non-Medicaid

In addition to the Medicaid components of present law caseload growth, present law includes an adjustment for the Children’s Health Insurance Program (CHIP) and Child & Family Services.

Children’s Health Insurance Program

Participation

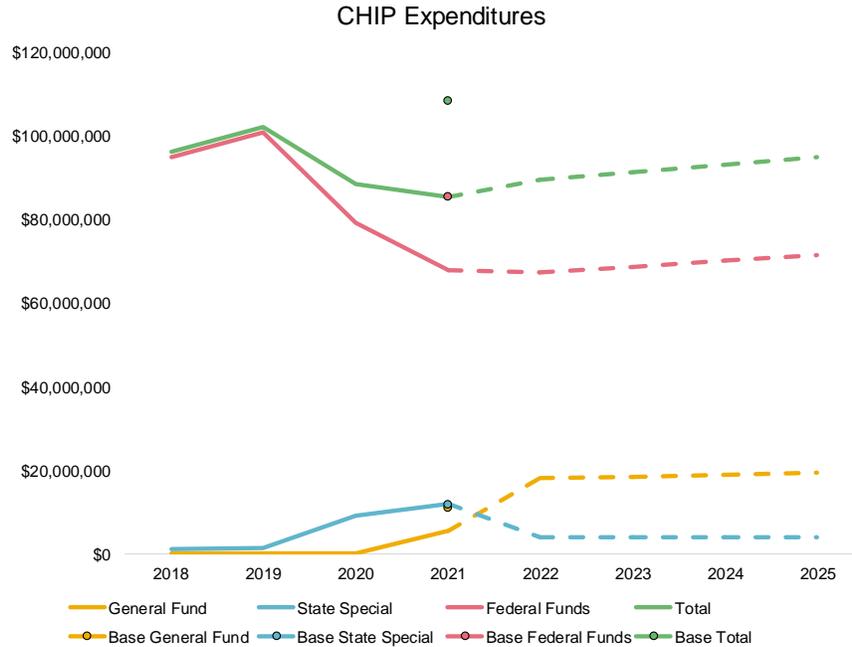
The graph below presents historic and projected enrollment in CHIP. CHIP enrollment declined throughout FY 2019 in a pattern similar to the enrollment decline in the Medicaid program. In this analysis LFD assumes that this decline will arrest, and CHIP enrollment will increase slightly in FY 2021 before stabilizing in FY 2022 and beyond. This reverse in enrollment decline is expected to occur due to COVID-related economic contraction.



Expenditures

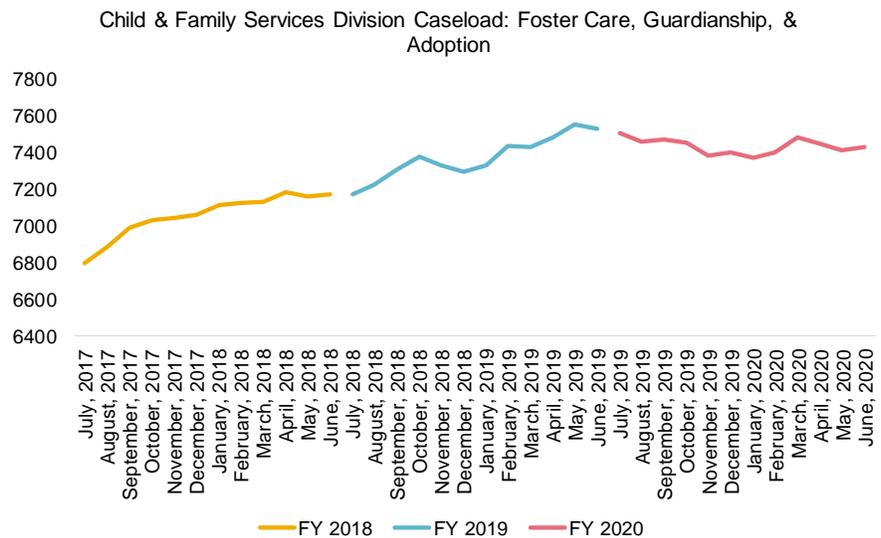
The graph below shows actual, FY 2021 base (represented by circles), and projected expenditures the CHIP. Expenditures are projected to increase modestly from FY 2021-FY 2025. Note that the projected

FY 2021 expenditures are well below the FY 2021 base. This difference is due to the budgeted amount for CHIP, which assumed modest enrollment growth, being different from the actual outcome: significant enrollment decline over the FY 2019-2020 period. The federal share of CHIP declines in the FY 2020-2022 period due to federal action that shifts the federal share of CHIP from 98.9% to 76.0% over the period. Note that state special revenue expenditures for CHIP in the FY 2022-2025 are limited to the projected revenues in the CHIP state special revenue fund (\$4.0 million per year). General fund expenditures for CHIP are expected to rise in the FY 2021-2025 period due to the phased-in increasing state share of CHIP expenditures mentioned above.



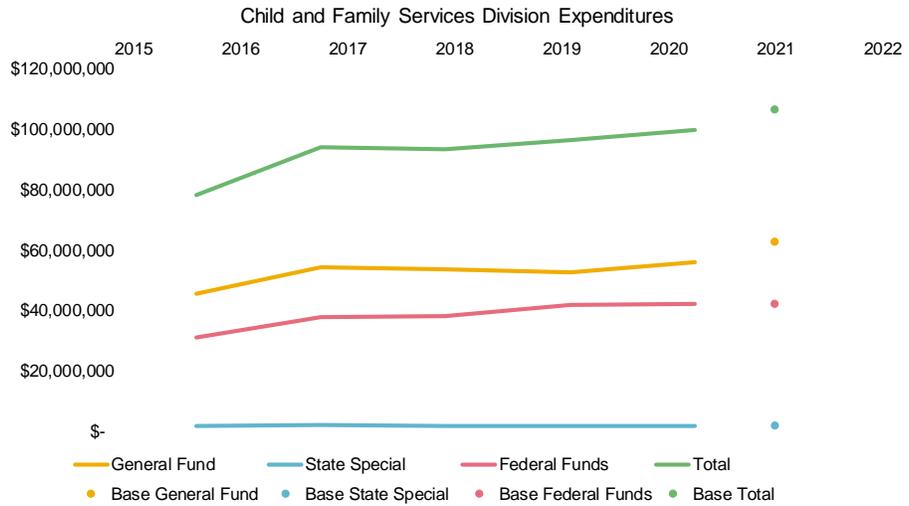
Child and Family Services Division Caseload

The graph below shows the caseload (a sum of children in foster care, guardianship, and adoption arrangements) for CFSD for the last three fiscal years. Increased rates of child abuse and/or neglect impact CFSD in several ways. Higher prevalence rates require higher levels of spending on CFSD administration: more caseworker-hours (and sometimes overtime hours) are needed to investigate and track potential cases of abuse or neglect. Higher rates of abuse and neglect have tended to lead to more children in foster care in Montana. There is some evidence that foster care use is becoming more limited and guardianship arrangements are more prevalent over the last fiscal year.



The graph below shows recent expenditures in CFSD as well as the 2021 base. Given that caseload growth in CFSD seems to have slowed over the last fiscal year LFD analysis projects a modest increase of \$3.0 million over the FY 2021 general fund base for the 2023 biennium.

It is possible that confirmed cases of maltreatment could rise again as schools reopen post the COVID-based closures of the spring of 2020. DPHHS has indicated to the interim Children, Families, Health, and Human Services Committee that they witnessed a sharp drop in child protective services maltreatment referrals in the early stages of the COVID-19 public health emergency, and DPHHS stated that this decrease was likely due, in part, to the closure of K-12 schools as K-12 educators and staff are a significant source of these referrals. A decrease in referrals could be associated with an increase in child maltreatment if there is a stable level of maltreatment but lower probabilities of detection and intervention.

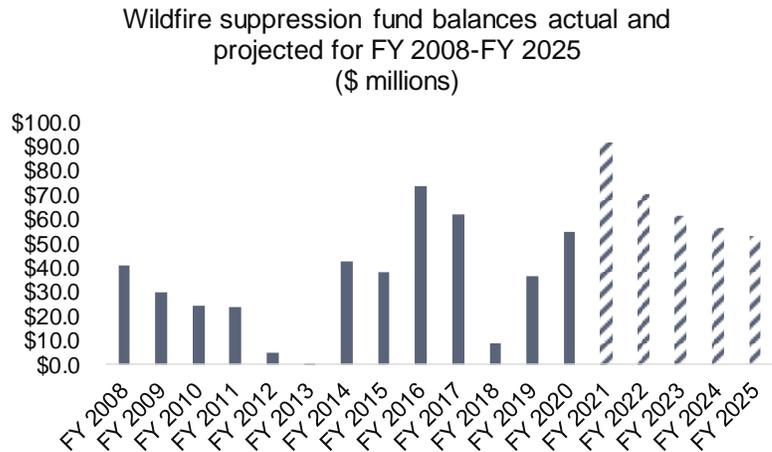


SECTION C: NATURAL RESOURCES

Wildfire Suppression Fund

The chart shows a history of state wildfire suppression fund balances since FY 2008 and projects FY 2021 – FY 2025 fund balances. The projected fire suppression fund balance for FY 2021 represents 3.6% of annual general fund revenues. Higher than average fund balances are expected to continue into the 2025 biennium, provided average fire seasons occur.

The following explains how the fund balances developed historically over time:



- Low fund balances in FY 2013 and FY 2018 were the direct result of severe fire seasons in the summer of 2012 and 2017 when total acres exceeded 1 million acres
- Increases in FY 2019 and FY 2020 are a result of mild fire seasons and temporary revenue sources provided in the 2017 November Special Session
- Increases in FY 2021 resulted from high reversions (unspent authority) of general fund in accordance with [76-13-150, MCA](#)
- Forecast FY 2021 and beyond are based on the average annual fire cost, adjusted for inflation

Department of Natural Resources and Conservation

Present Law

The Montana sage grouse habitat conservation program base funding of \$4.0 million general fund ends in FY 2021 per legislation passed in 2017 regular session, [HB 228](#).

Pressure

The 2019 Legislature approved a one-time-only (OTO) appropriation totaling \$1.7 million from the general fund. The appropriation supports 6.5 FTE and associated operating expenses in support of the Good Neighbor Authority (GNA). It was anticipated in following biennium the revenues generated from the GNA would support these FTE. However, there is a possibility that the timing of certain projects and receipt of revenues may not cover the cost in the 2023 biennium. It is possible that the legislature may be requested to renew a portion of the 6.5 FTE in the next biennium.

The GNA program treated 3,822 acres in FY 2020 an increase from 571 acres treated in FY 2019. The program is anticipated to grow to 5,500 acres by FY 2023.

Department of Livestock

Pressure

The Department of Livestock anticipates increased designated surveillance areas for brucellosis testing. In February 2020, new test kits replaced old style kits. The original test kits returned higher than reasonable false positive results and the department implemented new kits to obtain more accurate data. Pressure is expected to increase appropriation authority by \$1.5 million general fund each fiscal year to administer more accurate tests.

SECTION D: PUBLIC SAFETY

Department of Corrections

Present Law

The Department of Corrections (DOC) is federally mandated to treat patients that have Hepatitis C in its facilities. There is an anticipated need for \$6.1 million in general fund in FY 2022 for Hepatitis C funding.

Pressures and Potential Pressures

During the past five years, the Department of Corrections has seen an average growth in expenditures of 3.88%. The average growth rate in programs that work with offenders in which caseload increases are a driving factor is 2.06%. In order to account for the cost savings that will be measured in the coming years as a result of justice reinvestment, a growth factor of 2.0% is used as a potential pressure for increased expenditures within the department. This would result in an increase of \$1.7 million in expenditures in FY 2020 and an increase in \$3.4 million in FY 2023.

It should be noted that caseload adjustments for some other state agencies are included as present law adjustments but historically DOC has included caseload as a new proposal in its budget submission and thus it is included as a pressure in this report.

The executive has historically requested funding to increase rates for providers. If provider rates are increased by 1.0%, this would result in a \$2.4 million in increased expenditures for the agency.

Office of Public Defender

Present Law

The Office of Public Defender uses a 3.0% annual growth rate for caseloads within the department. In the past five years, the numbers of caseloads for total cases has grown at a rate of 1.9%. This growth rate is a factor of total cases rather than cases by type which can vary in time and expense depending on the type of case. This growth rate has decreased from FY 2013 to 2017, which maintained an average growth rate of 3.8%. If accounting for a 3.0% growth rate, increased expenditures for caseload growth would average \$3.7 million over the biennium. A 2.0% growth rate would result in a \$2.1 million increase in expenditures over the biennium.

Current Service Level

The Office of Public Defender experiences extensive fees when a death penalty case occurs. In order to account for those fees, the agency requests \$500,000 in general fund in each fiscal year. In previous biennia, the legislature has provided restricted and one-time-only funding of \$1.0 million to fund capital defense.

Judicial Branch

Potential Pressure

Potential pressure to fund additional judges and staff in the district court operations program totals \$1.0 million for the 2023 biennium.

Other

Included in the forecasts is \$1.4 million general fund for the pre-trial diversion program in the Judicial Branch as part of the justice re-investment policy adopted by SB 59 (2017 session), but designated at one-time-only funding.

SECTION E: EDUCATION

K-12 Education Office of Public Instruction

The Office of Public Instruction provides technical assistance and distributes funds to the school districts across the state. School funding is primarily driven by statutory formulas that vary by property tax wealth, enrollment, and other factors of school districts. Schools receive a substantial portion of the state general fund budget, comprising approximately 33.4% of total general fund expenditures.

Based on the statutory formulas and enrollment forecasts, general fund to support K-12 education is anticipated to increase by approximately \$76.1 million for the 2023 biennium. In addition to these primarily formula-based increases, there is anticipated to be other cost pressures in K-12 education as described in the following section.

Present Law

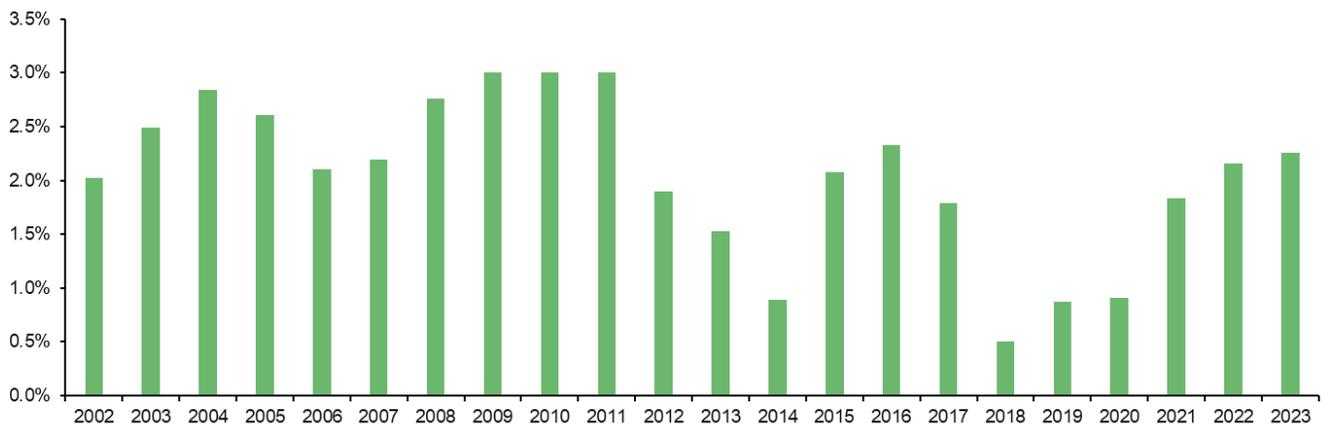
A summary of the components increasing present law is shown in the table below. The increase is almost entirely due to K-12 schools funding; however, there is approximately \$338,000 for the operation of the Office of Public Instruction (OPI) for personal services and operating adjustments.

OPI Present Law Detail (\$ in millions)	
Component	Growth
BASE Aid (Inflation & ANB Growth)	63.7
K-12 Facilities Payment (2017 Session)	2.8
Transformational Learning (2019 Session)	4.3
Advanced Opportunities (2019 Session)	4.2
All Other	1.2
Total (Including BASE Aid)	\$76.1

BASE Aid

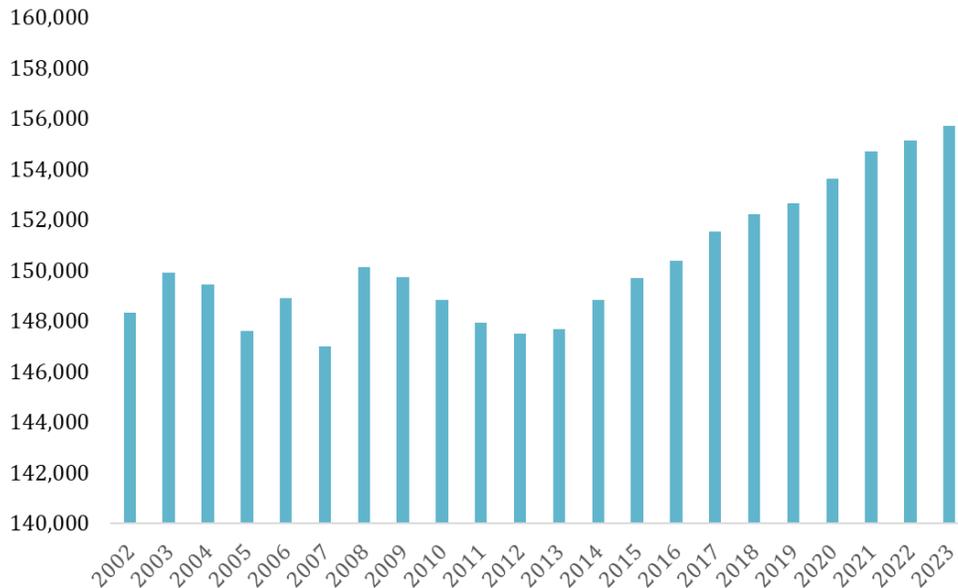
The largest present law increase in school funding occurs for BASE Aid, which accounts for \$63.7 million in increases over the 2023 biennium. Statute requires that certain components of school funding include a present law adjustment for inflation in the superintendent’s budget request (per 20-9-326, MCA). Anticipated inflationary increases in the 2023 biennium are set at 2.16% in FY 2022 and 2.26% in FY 2023 for BASE Aid. BASE Aid includes 5 components— the basic entitlement, the per-ANB entitlement, the quality educator payment, the Indian education for all payment, and the American Indian achievement gap payment. This growth rate is higher than previous biennium growth rates which were statutorily set at 0.91% in FY 2020 and 1.83% in FY 2021, due to changes in the consumer price index.

Statutory Applied Inflation to Basic Entitlements, Per ANB, and State Funded Components by Fiscal Year



Enrollment counts (ANB) are projected to increase by 0.26% in FY 2022 and increase by 0.64% in FY 2023, and the BASE Aid adjustment includes funding for both the growth in enrollment (ANB) and the inflationary increases in the statutory funding rates.

Enrollment (ANB) cycled up and down slightly between FY 2002 and FY 2012, but the recent uptick in enrollment from FY 2013 is projected to continue into the future. (Note that the scale on this chart does not begin at zero.)



Other Present Law Adjustments

- K-12 Facilities Payment— This statutory payment for school major maintenance was established in HB 647 (2017 Session) for the purpose of supporting district facility needs. In the 2023 biennium, there is an anticipated increase of \$2.8 million
- Transformational Learning— This program was established in HB 351 (2019 Session) in order to provide grants for flexible learning systems and amounts to an increase of about \$4.3 million over the biennium
- Advanced Opportunities— This program was established in HB 387 (2019) to expand personalized career and technical education opportunities for middle and high school students, and amounts to an increase of about \$4.2 million over the biennium
- All Other— All other present law growth (including increases in personal services costs, operating expenses, at-risk funds, and in-state tuition) amounts to \$1.2 million over the biennium

Pressures

Pressures for funding in the 2023 biennium for K-12 education are likely to come from several different sources.

- Approximately \$2.8 million for increases in special education funding. Anticipated inflationary increases in the 2023 biennium are set at 2.16% in FY 2022 and 2.26% in 2023, which are the same rates as the increases for BASE Aid
- Approximately \$1.6 million for educational expenses for K-12 students residing in in-state children's psychiatric hospitals and residential treatment facilities and who are covered by Medicaid. Medicaid does not pay for education services

Montana's University System (MUS)

The MUS has an increase of \$9.8 million because of present law adjustments in the 2023 biennium. The present law adjustment includes increases due to the annualization of the pay plan. The present law adjustment also has an increase for fixed costs, which includes but is not limited to insurance, legislative audit, information technology, utilities, and repairs and maintenance.

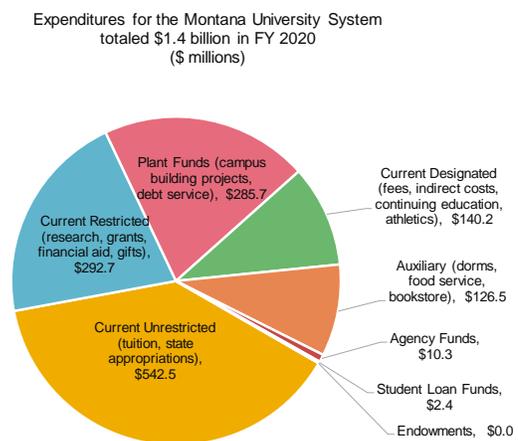
Pressures

MUS pressures for continued funding in the 2023 biennium include the six-mill levy state special revenue fund, which primarily receives revenues from property tax and oil and natural gas tax. The estimated expenditures from the six-mill levy fund are expected to be higher than the forecasted revenue in the 2023 biennium. This may result in a \$1.4 million pressure on the general fund.

Additional pressures for continued funding for the seed lab, wool lab, and the groundwater program at Montana Tech total \$2.0 million.

COVID Impact Risk – Not General Fund Risk

In HB 2, the legislature directly appropriates general fund, the six-mill levy, and certain federal funds. Actual HB 2 expenditures totaled \$272.1 million in FY 2020, of which \$237.5 million was general fund. The majority of the funding that the MUS receives is not appropriated or approved by the legislature. This funding includes but is not limited to tuition, federal research grants, financial aid, campus building projects, debt service, and auxiliary funds. Total funding expended by the MUS was \$1.4 billion in FY 2020. The chart to the right shows the breakout of expenditures by funding category.



The COVID-19 pandemic has caused challenges for colleges and universities across the nation. COVID-19 is anticipated to impact enrollment, revenues from dorms and food service, and revenues from collegiate sporting events and conferences.

Enrollment Challenges

While official enrollment numbers are not available yet for the MUS, it is anticipated that enrollment will be down systemwide. The current unrestricted fund, or the primary general education fund, partly receives revenue from tuition. With decreased enrollment, the tuition revenue may decline. The current unrestricted fund received \$248.7 million in net tuition revenue in FY 2020 and this revenue source will likely be impacted by the pandemic.

Impacts on Dorms and Food Services

Additionally, the COVID-19 pandemic will likely impact the auxiliary fund, which had expenditures totaling \$126.5 million in FY 2020. This fund includes revenues from dorms and food services. Decreased enrollment and students potentially choosing to live off-campus may contribute to decreased revenues.

Collegiate Sporting Event Cancellation Impacts

The current designated fund will also likely be impacted. In FY 2020, this fund expended \$140.2 million. This includes revenues from athletics and many collegiate sporting events have been cancelled for the fall semester.

Bond Risk

There is a potential risk related to outstanding bond debt at the MUS. At the end of FY 2020, Montana State University had \$169.3 million, Montana State University Billings had \$5.3 million and the University of Montana had \$159.5 million in outstanding bond debt. The COVID-19 pandemic causes uncertainty related to university revenues, which may cause pressures related to bonds and notes payable.

COVID-19 and Federal funding

The MUS has received federal funding from the CARES Act. The Montana University System and Community Colleges directly received \$27.8 million from the education stabilization fund and \$6.7 million from the Governor's Emergency Relief Fund. The Montana University System also received \$20.0 million from the Coronavirus Relief Fund to mitigate the impact of COVID-19 on the MUS. The Legislative Fiscal Division (LFD) will continue analyze the impacts of COVID-19 on the MUS and will provide updates as additional information becomes available.

STATE AND LOCAL GOVERNMENT

Section F: State and Local Government Long-Range Planning Programs

The Long-Range Planning (LRP) programs include a series of state and local infrastructure funding programs. The state infrastructure programs fund the construction, repairs, and maintenance of state lands, buildings, and IT infrastructure. Local infrastructure programs are primarily focused on water and wastewater infrastructure. The programs include:

State

Long-Range Building Program
FWP Capital Investment Program
State Building Energy Program
Long-Range Information Technology Program

Local

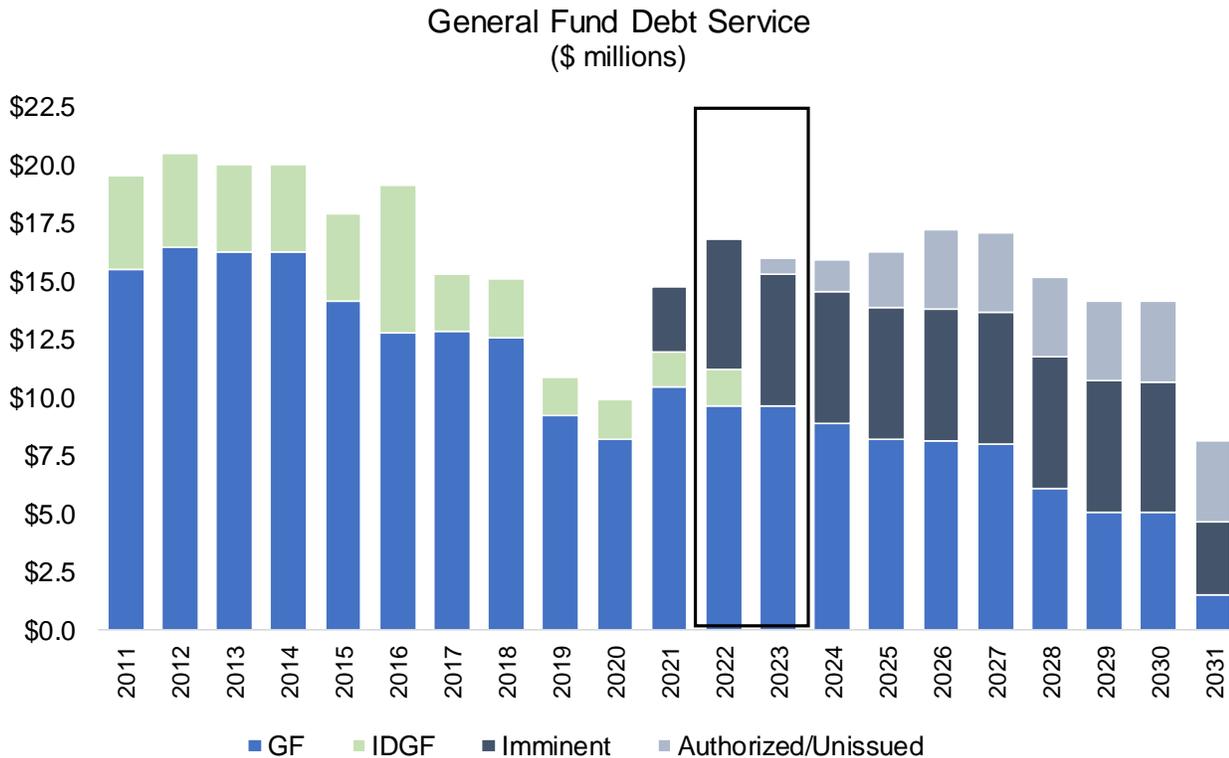
Treasure State Endowment Program
Treasure State Regional Water Program
Renewable Resources Grant and Loan Program
Reclamation and Development Grants Program

Long range planning programs typically are funded with special funds set aside for that purpose and are at times augmented by state general fund or general obligation debt. Several of these special funds have experienced declining revenue streams.

During the 2019 Session the legislature passed HB 553, which provided two general fund appropriated transfers to address declining program revenues and to provide a stream of revenue that could be used to address the demands experienced in all the infrastructure programs. The first, \$11.9 million for the 2023 biennium, is appropriated for the major maintenance and repair of existing general fund-supported state buildings and will ensure a minimum level of funding equal 0.6% of current replacement value. The second, \$ 19.3 million for the 2023 biennium is available, with legislative approval, to provide a steady stream of funding for major state and/or local government infrastructure projects and provides a level of funding equal to 1% of total general fund revenues less the state's general fund general obligation debt service payments. Both transfers have the effect of smoothing historically unpredictable state infrastructure funding.

General Fund Debt Service

Significant investments in state infrastructure have been historically financed with debt in the form of bond issue proceeds. The general fund obligation for debt service including a bond issue planned by the executive for late September 2020 is expected to average \$15 million per year. The following figure illustrates the debt service cost for issued and authorized general obligation (GO) debt, a debt obligation where the full faith and credit of the state is pledged to the repayment.



The figure above includes general fund historic debt service payments (2011-2020) and the debt service projections (2021-2031) for the following:

- General Fund (GF) – General obligation (GO) bonds paid directly by the general fund. The proceeds from these bond issues primarily funded the construction of state government buildings and a purchase of school trust lands¹. The total cost of GF bonds is \$19.3 million in the 2023 biennium
- GF Indirect (IDGF) – This category includes GO bonds and special revenue bonds that are paid indirectly through the general fund. The related bond issues include state building energy conservation bonds and revenue bonds for the state hospital that offset general fund revenue that would otherwise flow into the general fund. The total cost of IDGF bonds is \$1.5 million in FY 2022, when the bonds will be fully retired
- Imminent Issues – In September 2020 the executive has planned a bond issue of approximately \$50.0 million which includes \$40.2 million of bonds from the State and Local

¹ Trust land bonds will be refunded in September 2020, leading to a reduction in debt service costs over the remaining life of the bonds.

Infrastructure Act of the 2019 Session (HB 652)², \$6.7 million for the Montana Heritage Center project, and \$3.0 million for matching funds to make emergency repairs on the St. Mary's diversion system. The total debt service cost of this issue is projected to be \$11.3 million in the 2023 biennium³

- Authorized/Unissued – This category includes the projections for debt services costs on \$43.2 million of authorized but unissued bonds. Included in this category are the remaining authority from the HB 652 bonds, two issues that cover the state's share of the costs of two tribal compacts, and the remainder of the state's share of the St. Mary's diversion structure repairs. The total cost of Authorized/Unissued bonds is projected to be \$0.7 million in the 2023 biennium

Local Government Funding - Entitlement Share

Statutory appropriations

Legislation passed during the 2001 Legislative Session revised laws governing local and state government revenue collection and allocation. The state would assume control of alcohol, vehicle, and gambling taxes as well as district court fees; in return, the state would reimburse local governments for the lost revenue in the form of an entitlement share payment and assume the costs associated with district courts and local welfare offices. For more information on the entitlement share, please read the [LFD entitlement share brochure](#).

The entitlement share to local governments for the 2023 biennium is estimated to increase by 2.3% from the 2021 biennium. This estimate assumes the past three year's revenue collections.

State and Local Government Funding Pressure - Pensions

Statutory appropriation pressures

In addition to the present law adjustments to pensions funding, there may be pressure to fund additional pension costs due to recent analysis of the pension actuaries.

Legislative reforms made during the 2013 Session to Montana's two primary defined benefit (DB) retirement plans, the Teachers' Retirement System (TRS) and the Public Employees' Retirement System (PERS/DB), significantly helped improve the fiscal health of both plans. However, current funding policies leave the systems heavily reliant on investment earnings and unable to adjust contributions to maintain an actuarially sound basis in times of significant financial declines.

HB 715 from the 2019 session required pensions stress testing in this interim. The interim Pension & Local Trends Subcommittee of the Legislative Finance Committee directed the LFD in work in this area. MPERA and TRS actuaries and Pew Public Sector Retirement Systems researchers shared the results of their respective actuarial stress test analyses to the Legislative Finance Committee and the State Administration & Veteran Affairs Interim Committee, the results of which are briefly summarized in the following paragraphs.

² For the purpose of the analysis of currently unissued bonds, it is assumed that the HB 652 bonds will be issued for as 10-year bonds and the remainder would be issued as 20-year bonds. Issuance of these bonds would be the spring of FY 2022..

³ The actual debt service costs for the September issue will be available before the start of the 2021 Legislative Session.

The Pew Public Sector Retirement Systems research team provided a [stress test analysis](#), which included several types of scenarios for Montana’s pension systems. Pew’s stress test analysis examined the current policies of Montana’s pension systems and their sensitivity to changes in the market. Pew’s analysis found that the state’s current funding policy may not be enough to improve funded status if investment returns fall short of expectations. Additionally, in a severe market downturn, there is a risk of insolvency. One potential way identified by Pew to mitigate this risk would be to apply an actuarial funding policy to Montana’s pension plans, which would be sustainable across a range of outcomes. Layered amortization, evaluated in the MPERA/TRS actuarial analysis and described in more detail below, is one type of actuarial funding policy that would adjust employer contributions based on the plans’ annual returns. Regardless of the actuarial funding policy adopted, if any, Pew recommends annual stress testing analysis.

Cavanaugh MacDonald, actuary for TRS and MPERA, also provided a [stress test analysis](#) of the current PERS and TRS systems to provide more insight into potential risks of the current funding system and how to potentially mitigate those risks. The current valuation results of the PERS and TRS systems assume all current actuarial assumptions will be met. However, these actuarial assumptions are sensitive to market volatility as was demonstrated in the analysis with a number of different scenarios. In order to account for market volatility, the analysis demonstrated an alternative approach known as layered amortization to amortize the unfunded accrued liability either within 20 years or 30 years. Using layered amortization, employer contributions are adjusted to account for changes within the market based on annual returns. Currently, employer contributions are set in statute at a fixed rate. A layered amortization approach would allow for fluctuations based on the most recent actuarial experience with adjustments in employer contributions based on those results. Therefore, the layered amortization approach adjusts more quickly to changes in the market.

According to the Cavanaugh MacDonald PERS stress test report, the total amount of employer contributions paid over a 30-year period for a 20-year layered amortization is \$4.7 billion, for a 30-year layered amortization \$6.0 billion, and under the current funding policy \$6.2 billion. Even though the 20-year layered approach costs significantly less in the long-term, it comes at an increased near-term cost. The increased cost in the near term is approximately \$28 million per year. If this were funded with increased employer contributions the corresponding cost shares would be as follows.

Funding Source	(\$ Millions)
City	\$4.37
Consolidated	0.6
County	5.6
Other Local Gov't	1.1
School Districts*	2.9
University System	1.9
General Fund	4.6
State Special Funds	3.7
Federal	2.1
Other State Funds	1.2
Total	\$28.0
* Approximately \$0.8 million of this would be GF	

A similar analysis for TRS showed that the total amount of employer contributions paid over the 30-year period is \$4.6 billion, \$5.8 billion, and \$6.2 billion for the 20-year layered amortization, 30-year layered amortization, and the current funding policy respectively. The increased cost in the near-term would be approximately \$25 million per year. The increased employer contributions are shown below.

Funding Source	(\$ Millions)
State Retirement GTB (General Fund)	\$6.9
Local Retirement Mills	18.1
Total	\$25.0

To put these increased contributions in perspective, in FY 2019 local property taxes statewide totaled approximately \$1.6 billion. To fund the 20-year layered amortization for PERS and TRS, local funds would need to increase by \$33 million, an increase of 2.0%. Expenditures of state funds would increase by \$20.4 million, with \$11.5 million being in the form of general fund.

Regardless of the actuarial funding policy adopted, the LFD and Pew recommend annual stress testing analysis in order to regularly monitor the pension system and the continual evaluation of any potential changes moving forward.

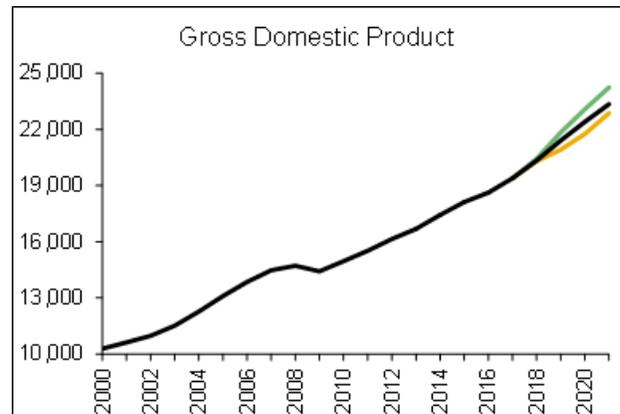
Appendix A

ECONOMIC SCENARIO HIGHLIGHTS

Economic data provided by IHS Markit, 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 Markit is the primary source for forecast data. Three forecast scenarios—baseline, optimistic in green and pessimistic in yellow—of selected variables are provided in this section. Note that IHS Markit only provides alternative scenarios for national statistics, and not for state-specific statistics.

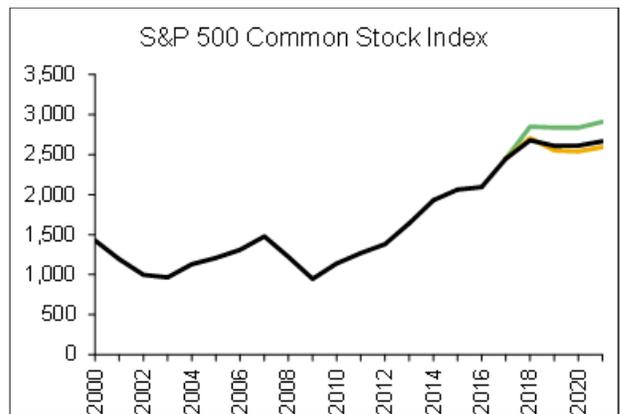
Gross Domestic Product

GDP is one of the most comprehensive national economic statistics. As noted by the Bureau of Economic Analysis (BEA), GDP is used by the White House and Congress to prepare the Federal budget, by the Federal Reserve to formulate monetary policy, by Wall Street as an indicator of economic activity, and by the business community to prepare forecasts of economic performance that provide the basis for production, investment, and employment planning.



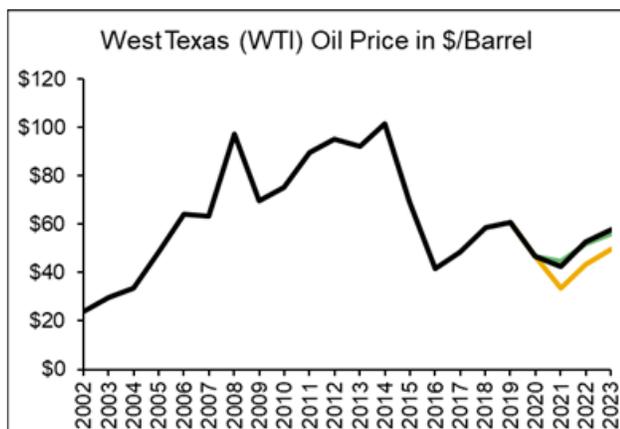
S&P 500 Stock Market Index

The S&P 500 is a stock market index based on the market capitalizations of 500 large companies. Due to the diversity of companies, it is a good indicator for investment income.



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 part of the individual income tax estimate.

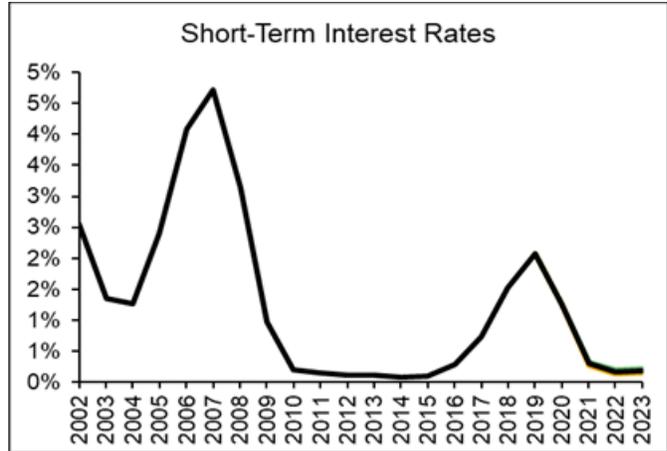


After averaging about \$100/barrel from 2011 through 2014, oil prices began declining in the fall of 2014 and averaged just below \$60/barrel through the last biennium. Prices through the outlook period are expected to be slightly lower, and average around \$52/barrel.

Interest Rates

A large portion of Montana's revenues is derived from investment earnings from trust accounts and daily invested cash. Interest rates also affect the amount of investment income that is reported on individual income tax returns. In addition to the state revenue impact, interest rates impact the climate in which consumers and businesses are likely to make investments and large purchases.

The outlook assumes interest rates to remain near zero through the next biennium and end at 0.2% in 2023



Appendix B – Long Term Structural Balance

Rating agencies and other experts recommend considering budget implications in a long-term horizon to help guide decision making. The chart below illustrates the early stages of development of a longer-term budget view. It shows present law, pressures, and potential pressures compared to revenue scenarios for both the 2023 biennium and the 2025 biennium.

Revenue scenarios are described in the 2023 Biennium Revenue section. While LFD predicts the baseline revenue to continue into the 2025 biennium, optimistic revenues would provide for base and present law, but not all pressures.

Similarly, expenditures were forecast forward an additional biennium. Present law increases steadily, but baseline revenues may not be sufficient in the 2023 biennium, although improvement is seen in the 2025 biennium. Pressures are anticipated to grow steadily over time.

2023 and 2025 Biennia General Fund Projections

