Acknowledgements
The Legislative Budget Analysis report is the product of many hours of analysis by the staff of the Legislative Fiscal Division (LFD), a nonpartisan office which provides fiscal and policy information and advice to the legislature. The LFD thanks the many entities that assisted in its completion.

For information on this report and others, contact the Legislative Fiscal Division at (406) 444-2986 or visit the division’s website at: [http://leg.mt.gov/css/fiscal/default.asp](http://leg.mt.gov/css/fiscal/default.asp)

The LFD is located at Room 110, State Capitol, Helena, MT 59620.
December 2016

Members of the Sixty-Fifth Legislature:

I submit for your consideration the high level state budget outlook for 2019 biennium as preliminary Volume 1 of the Legislative Budget Analysis. More details in volumes 2 through 8 will be available prior to session at http://leg.mt.gov/content/Publications/fiscal/Budget-Books/2019/fiscal-publications.asp. Additional reference material, standard charts and tables are available online at the same website as appendices to this Volume 1. If you are unable to access the online version please let staff know and we will provide you with printed versions of the documents.

The Legislative Fiscal Division works for you, the Legislators of Montana. We have no partisan alliance and seek to deliver high quality information and analysis of fiscal issues. A significant quantity of additional information is available online at our general website: www.leg.mt.gov/css/fiscal. Some specific resources that you may be interested in are reports on specific fiscal issues presented to the Legislative Finance Committee over the interim. Reports on state employee benefits, local government infrastructure, and our budgeting and analysis methodologies were some of the key areas researched this interim.

In addition to this analysis, the LFD has access to the state accounting system and other resources for researching specific fiscal questions. If a fiscal question arises, please feel free to contact either myself or any member of our staff to help answer your questions.

We look forward to working with you all during the 2017 Session.

Sincerely,

Amy Carlson
Legislative Fiscal Analyst
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VOLUME 1: INTRODUCTION

The purpose of this report is to provide legislators with the information needed to assist them in crafting a balanced state budget and fiscal policy, and in reflecting their priorities in the 2019 biennium general appropriations act and other appropriations bills. It seeks to accomplish this by providing perspectives on the state’s fiscal condition and the budget proposed by the Governor for the 2019 biennium, and identifying some of the major issues now facing the Legislature. As such, this document is intended to complement the Legislative Budget Analysis – 2019 Biennium online, which contains our review of the 2019 Biennium Executive Budget. In addition, this document is a reference document for all legislators, providing budget information for state government.

While the Legislative Budget Analysis – 2019 Biennium reports the results of our detailed examination of revenue estimates and expenditures and proposed budgets of state programs, this Statewide Perspective presents a broader fiscal overview and discusses significant fiscal and policy issues which either cut across program or agency lines, or do not necessarily fall under the jurisdiction of a single fiscal subcommittee of the legislature. Volume 1 provides an updated general fund balance sheet, projects the general fund structural balance, compares biennial appropriations, and includes a summary of anticipated ongoing general fund revenues, ongoing present law expenditure requirements, including budget risks and budget pressures.

This volume is divided into five parts:

- The Overview provides a summary of our analysis of the proposed executive budget
- State Revenues provides a review of the revenue assumptions adopted by the Revenue and Transportation Interim Committee
- State Expenditures provides an overview of the Governor’s state expenditure plan for the 2019 biennium
- Risks highlights key underlying assumptions in revenues and expenditures, and also details some of the pressures that the legislature may face in the upcoming session
- Appendix: Extra documents that provide additional detailed information

REVENUE ESTIMATES

A summary and overview of the state’s major revenue sources is included online. This volume will be provided to the House and Senate Taxation committees for use as a working document, and delineates the economic assumptions used to derive revenue estimates adopted by the Revenue and Taxation Interim Committee (RTIC) on November 17, 2016.

EXPENDITURE BUDGET ANALYSIS

The Budget Analysis offers detailed analyses of individual agency budgets, as proposed through the Governor’s Executive Budget submitted in mid-November, but before the December 15 revisions were received. These volumes feature program-by-program detail, as well as the LFD analysis of each agency budget. Agency presentations are grouped in sections corresponding to the appropriations subcommittee addressing the agency.

- Section A – General Government
- Section B – Health and Human Services
- Section C – Natural Resources and Transportation
- Section D – Judicial Branch, Law Enforcement, and Justice
- Section E – Education
- Section F – Long-Range Planning
**OTHER USEFUL LINKS**

In addition to the Legislative Budget analysis prepared for session, there are a number of other documents online that you may find helpful in your deliberations:

**Understanding State Finances**

Legislative Finance Committee Reports
GENERAL FUND BALANCE 2017 BIENNUM

When the legislature adjourned in April 2015, general fund revenue estimates for the 2017 biennium as contained in HJ 2 were anticipated to grow by $380 million or 9.0% over the 2015 biennium. Actual and current estimated revenue for the 2017 biennium are $303 million less than the anticipated HJ 2 (2015 session). While these lower revenues are somewhat offset by lower expenditures, without legislative action, the 2017 biennium ending fund balance is forecast to be just $79.0 million or 1.7% of biennial expenditures. This is $236 million less than expected at the end of the 2015 session.

The drop from 6.7% budgeted to the currently expected 1.7% is extraordinary, but the lower percentage has been experienced in the past. Prior to the 2009 biennium, small ending fund balances were the norm, so in the long history of general fund budgets, while 1.7% is low, this level or lower was observed in the 1995, 1997, and 2003 biennia. Since the 2009 biennium, budgeting large ending fund balances has been used as a way of managing state financial volatility. While this is one way to manage state financial volatility and is included in the Governor’s budget proposal, other options are available to the legislature. Other budgeting tools described in the Legislative Fiscal Division’s Montana’s Financial Volatility and discussed later in this report could be used by the legislature to manage state finances.

As stated above the primary cause of the general fund ending fund balance decline is general fund revenue not meeting projection in the 2017 biennium.
GENERAL FUND REVENUES THROUGH THE 2019 BIENNUM

As shown in the chart below, FY 2016 revenues were 3.6% lower than the previous year or 6.3% lower than HJ 2. Most of the difference was attributed to lower-than-expected growth in individual income tax, and decline in corporation income tax and oil & natural gas taxes. Currently, 2017 HJ 2 adopted revenues are anticipated to grow from FY 2016 by 3.4% in FY 2017, 4.9% in FY 2018, and 6.6% in FY 2019. While the FY 2016 revenue reduction caused fund balance declines and structural spending imbalance, the anticipated revenue improvements return present law expenditures and regain structural balance as seen on page 5.

Present Law Budget

Statute provides a definition of the present law budget, or the level of funding necessary to maintain current government services. Present law gives the legislature a baseline budget presentation and illustrates a beginning point of the legislative budget decisions that require legislation.1

The general fund budget is measured in two ways: ending fund balance; and structural balance. Structural balance is the measure of ongoing revenue to ongoing spending and is important since it sets the stage for the following biennium budget. For example, if the budget is at a structural deficit or spending more than current year revenue, the budget for the following biennium will likely be out of balance and require reductions in order to balance the budget.

Present Law Structural Balance Positive in FY 2019

While the structural balance of the present law general fund is at a deficit for FY 2016 through FY 2018, the budget returns to structural balance in FY 2019 when estimated revenues increase. In FY 2019, revenues exceed ongoing present law expenditures by $20.4 million.

---

1 Assumptions used for present law include LFD estimates for HB 1, statutory appropriations, and non-budgeted transfers estimates. Prior year revenue adjustments for FY 2017 were included in LFD present law. LFD assumes a lower general fund standard reversion percentage than the Governor’s Office of Budget and Program Planning. Present law assumes excess authority remaining in the Governor’s emergency and disaster statutory appropriation be transferred to the fire suppression fund after the end of the 2017 biennium.
This small positive structural balance in the last year of the 2019 biennium means that the current financial situation is a short term rather than a long term budget problem.

Present Law Ending Balance
The ending fund balance is important since Montana has only ending fund balance and the fire suppression fund (fire fund) to cushion against unexpected revenue declines and expenditure increases. Under the present law calculation the ending fund balance is negative beginning in FY 2018 and increases, but is still negative in FY 2019.

Montana lawmakers established 17-7-140 to direct the reduction of spending when general fund ending balance drops below certain measuring points. When the legislature convenes in January, this statute directs that the 2019 biennium ending fund balance be $121 million or greater. The legislature can accomplish this through changes in funding, statute, and other budget tools. Lawmakers can improve the ending fund balance by at least $124 million and therefore meet the obligation to get to the $121 million minimum ending fund balance.

In addition to the ending fund balance, the fire suppression fund (fire fund) balance also acts as a cushion against future financial shocks. The FY 2017 balance is estimated at $65 million and the FY 2019 present law balance is estimated at $29 million. For more information about the fire fund please see page 15.
## Present Law Budget

The following spreadsheet summarizes the present law budget.

### Present Law General Fund Balance Sheet

**Includes Present Law ONLY and HJ 2 Revenue Estimates**

LFD Estimates for Statutory, Transfers, HB 1, and other technical

($ Millions)

<table>
<thead>
<tr>
<th></th>
<th>Actual FY 2016</th>
<th>Current FY 2017</th>
<th>Present Law FY 2018</th>
<th>Present Law FY 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning Fund Balance</td>
<td>$455.436</td>
<td>$255.110</td>
<td>$78.597</td>
<td>($23.907)</td>
</tr>
<tr>
<td>Revenue as adopted in HJ 2</td>
<td>2,121.288</td>
<td>2,194.337</td>
<td>2,301.383</td>
<td>2,452.611</td>
</tr>
<tr>
<td>Prior Year Adjustments</td>
<td>(3.667)</td>
<td>5.236</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Revenue Funds Available</strong></td>
<td><strong>2,573.057</strong></td>
<td><strong>2,454.683</strong></td>
<td><strong>2,379.980</strong></td>
<td><strong>2,428.704</strong></td>
</tr>
</tbody>
</table>

### Disbursements

**Ongoing**

- HB 2: $1,908.415, $1,985.305, $2,061.514, $2,083.898
- Statutory, including HELP Act: $265.168, $297.842, $314.275, $325.217
- Actual & Assumed Appropriations - HB 1 Legislative Session: $5.025, $9.635, $2.227, $10.270
- Other Appropriation Bills: $6.011
- Assumed Standard Reversions: $(6,959), $(7.194), $(7.319)
- Assumed Add'l Reversions ($16 mil. HB 2 & $13 mil. Emergency Stat.): $(29,000)

**OTO**

- HB 2: $64.519, $48.925, $0.008, $0.072
- Fire Fund Transfers: $50.310, $11.422, $13,000
- Sage Grouse Transfer: $10,000
- Governor's proposed HB 3 Agency Supplemental Appropriation request: $20,006
- Other (includes: carry forward): $1.147, $1.907

**Total Disbursements**: $2,323,836, $2,376,086, $2,403,488, $2,432,289

### Adjustments - incl. tying to Comprehensive Annual Financial Report

- $5,889

**Ending Fund Balance (Unassigned)**: $255,110, $78,597, $(23,907), $(3,585)

**Structural Balance (ongoing revenues minus ongoing expenditures)**: $(86,573), $(89,489), $(89,497), $20,394

Assumptions: This balance sheet only shows present law obligations and HJ 2 revenues. It also includes LFD estimated statutory appropriations and general fund transfers. The only Governor's proposals included on this balance sheet are the supplemental appropriations requested in HB 3 and assumed other reversions. We assume that since the fund balance drops to a level that would trigger 17-7-140, MCA, the 0.5% fire fund transfer would not occur. The Governor's pay plan proposal for FY 2018 - FY 2019 is not included.
**GOVERNOR BULLOCK’S GENERAL FUND BUDGET PROPOSALS**

The Governor has made proposals to increase general fund ending fund balance to $300 million and a positive structural balance of $113.6 million per year.

The graphic illustrates groups of components of the Governor’s new proposal general fund budget recommendations and each group’s impact on the general fund balance. Increases in revenue and decreases in spending both increase ending fund balance and are shown above the line and total $370 million. Increases in expenditures and decreases in revenue decrease ending fund balance and are shown below the line and total $88 million. Cumulatively, the Governor’s proposals increase ending fund balance by $282 million ($370 million increase and $88 million decrease).

Notes: 1) HB 2 is the general appropriations act. It contains the appropriations or authority to spend general fund for most state agencies and most services supported by the general fund. 2) To tie to the present law ending fund balance on page 6 to the Governor’s recommended ending fund balance on page 18, the differences in budget details also need to be included from page 16.
KEY GOVERNOR RECOMMENDED NEW PROPOSALS

A) Revenue Increases: $123 million general fund and $33 million state special funds

The Governor recommends increasing tax revenue in a variety of ways. The largest revenue generating increases are in income tax, generating $78 million in higher revenue, followed by consumption taxes with a combined general fund and state special fund increase of $65 million. Corporation tax collections would increase $8 million due to proposed changes in how corporation income is apportioned.

**Income tax increases**

The Governor’s recommended increases for individual income tax to increase general fund revenue include:

- Creating a new tax bracket for individuals with a Montana taxable income in excess of $500,000, anticipated to generate $37 million additional revenue in the biennium
- Eliminating the capital gains credit for taxpayers with a Montana adjusted gross income over $1 million, anticipated to generate $26 million of additional revenue in the biennium
- Equalizing deductions for individuals, estates, and trusts, estimated to generate $3 million of additional revenue in the biennium; and
- Eliminating the energy tax credit, anticipated to generate $12 million in the biennium, but replacing it with a grant program as seen in item H) Non-HB 2 new expenditures.

**Volatility of Income Tax**

As discussed in the interim and in the Montana’s Financial Volatility report in September of 2016, the general fund has become more reliant on income tax as a revenue source, and income tax as a source
of revenue has become more volatile over time. Individuals with high incomes and high capital gains tend to have even more volatile income streams than the average income tax payer. These factors will be evaluated in the January Budget Analysis of the Legislative Fiscal Division, but are unavailable at this time.

**Consumption Tax Increases**

The Governor proposes increasing the following consumption taxes:

- Adding a tax to medical marijuana of 6% with anticipated revenues being $2.6 million general fund over the biennium
- Increasing the cigarette tax by $0.50 per pack with anticipated general fund revenue being $23.6 million and various state special funds by $30.4 million over the three year period FY 2017 through FY 2019
- Increasing the wine tax by $0.27 per liter with anticipated general fund revenue being $5.0 million and state special funds being $2.3 million over the biennium
- Tightening the lodging facility tax to increase general fund revenue from online companies by $0.75 million

**B) Transfers into the General Fund from other funds: $83 million one-time increase to ending fund balance**

Transfers into the general fund do not increase revenue to the state, but reduce money in one fund and move it to another. The Governor recommends $95.6 million of transfers into the general fund from several sources to increase the general fund balance. The Governor recommends replacing some of the transferred funds with state bonding.

- $10 million of Local 911 funds and $16 million various other state special fund balances that are not replaced by other means
- Transferring funds from infrastructure programs and replacing them with bonds as seen on page 20
  - $41 million from local infrastructure programs such as Treasure State Endowment and Quality Schools scholarship program
  - $15 million in state infrastructure funds
C) New Proposals to Reduce HB 2: $74 million increase to ending fund balance

The Governor recommends reductions to the HB 2 general appropriations act present law budgets of general funded agencies. The $74 million of reductions include:

- $48.1 million of the reductions are generally from the 5% plans submitted by nearly all agencies. A comparison of these changes can be found in the appendix section of this document. The details of these base reductions are described in Volumes 3 –7 of the Budget Analysis.

- In addition to these base reductions, the Governor’s recommendations include reductions requiring changes in law, specifically:
  - In the Department of Health and Human Services there is a statutory physician inflationary adjustment. The Governor proposes to change statute to reduce the rate of inflation in the 2019 biennium and thereafter.
  - K-12 funding has various statutory components. The recommended reductions include:
    - $6.2 million for the elimination of the data for achievement payment which decreases K-12 spending,
    - $3.2 million of district excess oil and gas revenues being redirected to the guarantee fund and the guarantee fund revenue reducing the general fund needed to fund schools, the LFD is concerned that with the current low oil and gas prices that there will be no district excess revenue to transfer to the guarantee fund, and
    - $10.6 million that eliminates the natural resource development payments. Note that the $10.6 million net reduction in natural resource payments will result in an increase in property taxes in local districts by the same amount.

D) Proposed HB 2 Fund Switches: $55 million increase to ending fund balance by changing funding for expenditures from general fund to special funds

Switching or changing funding sources simply shifts expenditures between one source and another, therefore there is no net increase or decrease in expenditures. The Governor recommends switching the funding source for several HB 2 general fund present law items. Specifically, the most significant items are:

- Proposed switching $6 million of funding for Substance Abuse Treatment Refinance from general fund to federal special revenue by providing federal facility reimbursement to qualified facilities serving Medicaid eligible populations.
- Switching Medicaid caseload funding to tobacco tax state special revenue. This would lower general fund by $21 million. In order for this to work, the Governor proposes increasing the

<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
<th>Funding Source</th>
<th>Amount</th>
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<tbody>
<tr>
<td>A</td>
<td>General Government</td>
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<td>$5.1</td>
</tr>
<tr>
<td>B</td>
<td>Health and Human Services</td>
<td></td>
<td>$18.9</td>
</tr>
<tr>
<td>C</td>
<td>Natural Resources</td>
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<td>$5.9</td>
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<tr>
<td>D</td>
<td>Public Safety</td>
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<td>$8.2</td>
</tr>
<tr>
<td>E</td>
<td>Education MUS &amp; other Ed</td>
<td></td>
<td>$14.6</td>
</tr>
<tr>
<td>E</td>
<td>Education - K-12</td>
<td></td>
<td>$21.3</td>
</tr>
</tbody>
</table>
A proposed increase in the wine tax as shown in the revenue increase section, would provide new revenue that would increase state special funds available for mental health services. This proposal switches $2 million of current general fund expenditures to this state special revenue source.

The Governor proposes to switch the Department of Natural Resources Forestry division funding from the general fund to the fire suppression fund commonly referred to as the fire fund. This proposal saves the general fund $25 million, but decreases the fire fund balance by an equal amount.
E) Non-HB 2 reductions: $35 million increase to ending fund balance

The Governor proposed the following reductions to areas of the budget not included in HB 2:

- Restructure the transfers to the Sage Grouse state special fund from $10 million in FY 2017 to $2 million per year for 5 years beginning in FY 2017. By stretching the transfer out to five years and reducing each year transfer, this increases the 2019 biennium general fund ending fund balance by $4 million in the 2019 biennium.
- Statute provides a local government revenue sharing provision known as the entitlement share. The Governor proposed to lower the growth rate for the entitlement share payments to local governments, increasing general fund balance by $8.1 million.
- Lower payments to the pension system by $1.7 million and lower general fund transfer to water adjudication state special fund by $1.9 million.
- $13 million from the fire fund: statute requires that the unspent Governor’s emergency authority be transferred to the fire fund after the end of the biennium. The Governor proposes to change statute to not make this transfer after the end of the 2017 biennium.

While all of the above changes increase ending fund balances, the Governor also recommends several increases in expenditures or decreases in revenue that reduce ending fund balance.
F) Reduce General Fund Revenue: $7 million reduction in general fund balance

- The Governor proposes a refundable earned income tax credit beginning in tax year 2018 that reduces individual income tax by $4.7 million per year beginning in FY 2019
- Also beginning in tax year 2018 and affecting fiscal years 2019 and thereafter an apprenticeship tax credit increase costing $1 million per year
- As a part of the Build Montana Trust proposal, a restructure of the coal severance tax trust fund, the coal trust interest revenue is diverted away from the general fund by $1.7 million
G) HB 2 New Expenditures: $37 million decrease to ending fund balance

The Governor recommends the following increases in the HB 2 general appropriations act general fund budget:

- Child care and early education in the Department of Health and Human Services $14.4 million
- Increased funding for the Department of Corrections County Jail Holds by $6 million for the biennium
- Reinstate $3.6 million of the one-time only appropriations in the Department of Commerce for Native languages, primary sector business training and economic development.
- Reinstate the $2.4 million of funding for Aquatic Invasive Species prevention and control efforts
- Increase funding for additional judges and reinstate one-time only appropriations for child abuse court diversion and information technology staffing for a total of $1.9 million
- Provide $1.9 million in general fund to replace declining revenue in the Natural Resource operations fund
- Provide an inflationary increase of $1.9 million for special education costs in K-12 school districts
- Various other smaller increases including: $1.5 million in area aging services funding, $1.2 million for youth crisis diversion, and other items
**H) New Non-HB 2 New Expenditures: $43 million decrease to ending fund balance**

The Governor recommends the following additional spending:

- $18.1 million in new bonding associated with the infrastructure investment in HB 14 known as Jobs in Montana
- $11.0 million for a 1% per year increase in state employee pay
- Restructure the transfers to the Sage Grouse state special fund from $10 million in FY 2017 to $2 million per year for 5 years beginning in FY 2017, increasing the 2019 biennium general fund ending fund balance by $4 million in the 2019 biennium (see page 12)
- Creating a new program for energy grants called PACE in LC 900, offsetting about half of the savings from removal of the energy tax credit.
- Other smaller items include $1 million for youth suicide prevention funding and IT costs at the Department of Revenue for system enhancements to implement proposed new tax legislation

**FIRE FUND SUMMARY**

With all of the present law assumptions, the present law fire fund balance would be expected to be $29 million at the end of the 2019 biennium.

In contrast to the present law assumptions, the Governor recommends not to transfer either unspent general fund appropriations or the remaining unused emergency statutory appropriation. The Governor also proposes to spend $25.3 million of fire fund reserves in the Department of Natural Resources Forestry Division. The Governor’s proposals reduce the ending fund balance in the fire suppression fund by $38.3 million causing estimated ending fund balance to decline to zero. The proposal anticipates $10 million of typical fire costs being paid from the general fund.
Governor’s Budget Wrap Up

Budget Assumption Differences
The Governor’s budget makes several assumptions on present law fund balance that are different than the Legislative Fiscal Division. The following summarizes these differences.

Present Law Fire Suppression Fund Balance Assumptions
The fire suppression fund is available for expenditure surprises associated with wildland fire costs. Under current law, the executive makes two deposits into the fund on a regular basis:

1) Reversion Transfer: General fund appropriations that are underspent (or reverted) by more than 0.5% of all appropriations. This transfer need not be made by the executive if there is a risk that the ending fund balance is lower than the minimum directed by the MCA 17-7-140, or $121 million. It is estimated that under present law no transfer will be made in August of 2017.

2) Unspent Governor’s Emergency Authority: Remaining authority from the Governor’s emergency statutory appropriation is transferred to the fire suppression fund after the end of the biennium. Unlike the reversion transfer there is no statutory provision to not make this transfer if the general fund balance is low. It is estimated that under present law $13 million will transfer after the end of the 2017 biennium.

Present law expenditures are forecast to be as follows: Anticipated fire costs $16 million in FY 2017. Fire costs vary dramatically from year to year. In the past several years they have varied from $4.7 to $61.5 million. While the variance is wide, the seven year trended fire costs are $21.5 million in FY 2018 and $22.5 million in FY 2019. Fuel mitigation statutory appropriations are $5 million each biennium.

<table>
<thead>
<tr>
<th>Balance Sheet Differences FY 2017 - FY 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>LFD includes FY 2017 prior year revenue</td>
</tr>
<tr>
<td>Statutory Appropriation estimate - mostly HELP Act</td>
</tr>
<tr>
<td>Transfer estimate - mostly Old Fund</td>
</tr>
<tr>
<td>Net reversion estimates</td>
</tr>
<tr>
<td>HB 1 estimate difference</td>
</tr>
<tr>
<td>Other</td>
</tr>
<tr>
<td>Total difference</td>
</tr>
</tbody>
</table>

The largest single difference is the difference in statutory appropriations estimated for the estimate of Medicaid Expansion costs within the HELP Act from the 2015 session. This very new program has little data to rely on for the estimate. The Fiscal Division will recommend that the subcommittee consider both estimates in its deliberations to determine which should be used on the general fund status sheet during session.

Budget Change Differences
At the time of print deadlines in early December, the Legislative Fiscal Division has either not received all the bills associated with the new proposals, or has not had the time necessary to analyze many of the new proposals contained in the Governor’s Budget. These proposals should be available and the LFD should be able to analyze them in time for the January 2 presentation to the Legislature.

At present the LFD is aware of the following technical concerns with budget items in the Governor’s Budget:

1) In K-12 funding there are two concerns
   a. Concern that the revenue proposed to be moved to the guarantee fund from excess Oil and Gas revenues in school districts is lower, or zero instead of the $3.6 million of savings anticipated in the Governor’s Budget
   b. The present law calculations for K-12 Base Aid are low relative to current cost estimates

2) Statute does not give the Governor the authority to modify the Legislature’s budget. In his proposed budget the Governor reduces the Legislative budget

3) The LFD calculations for anticipated bond payments are less than the Governor’s budgeted level
The LFD will continue to analyze these and other issues and in the Final Volume 1 of the Budget Analysis.

**Governor’s Recommended Structural Balance**
The Governor’s budget leaves substantial structural balance available to the 2019 session. Legislators and the Governor would have a structurally positive budget that would give the next Legislature and the Governor the ability to increase spending or decrease taxes in the 2021 biennium.

Inconsistency between anticipated revenue and expenditure leads to variation in service levels and tax rates from one biennium to the next.

**Governor’s Recommended Ending Fund Balance**
By proposing HB 2 reductions to present law expenditures and new revenue legislation, the Governor recommends an ending fund balance of $300 million by the end of FY 2019. This higher ending fund balance is the method of managing volatility chosen in recent biennia. Note that the Governor recommended general fund ending fund balance of $300 million is accompanied by a zero balance anticipated in the fire fund, see page 15.
Governor's Recommended Budget

With the Governor’s assumptions and estimates for present law and new proposals the following spreadsheet summarizes his budget recommendation.

<table>
<thead>
<tr>
<th>Governor's Budget</th>
<th>Governor's Assumptions for all Items</th>
<th>Projected HJ2 Revenues</th>
<th>Proposed FY 2018</th>
<th>Proposed FY 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning Fund Balance</td>
<td>Actual FY 2016</td>
<td>$455.436</td>
<td>$255.110</td>
<td>$121.834</td>
</tr>
<tr>
<td>Revenue as adopted in HJ 2</td>
<td>FY 2017</td>
<td>$2,121.288</td>
<td>2,194.337</td>
<td>2,301.383</td>
</tr>
<tr>
<td>A) Revenue Increases - all ongoing</td>
<td></td>
<td>3.381</td>
<td>61.945</td>
<td>57.566</td>
</tr>
<tr>
<td>B) Transfers In - ongoing portion only</td>
<td></td>
<td></td>
<td>1.425</td>
<td>1.419</td>
</tr>
<tr>
<td>F) Revenue Reductions - all ongoing</td>
<td></td>
<td>-</td>
<td>(0.500)</td>
<td>(6.963)</td>
</tr>
<tr>
<td>B) Transfers In - one-time only</td>
<td></td>
<td>27.344</td>
<td>26.484</td>
<td>25.982</td>
</tr>
<tr>
<td>Prior Year Adjustments</td>
<td>(3.667)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Revenue Funds Available</td>
<td></td>
<td>2,573.057</td>
<td>2,480.172</td>
<td>2,512.571</td>
</tr>
</tbody>
</table>

Disbursements

| Ongoing | HB 2 | 1,908.415 | 1,985.305 | 2,061.514 | 2,083.898 |
| C) HB 2 ongoing reductions | | (36.252) | (37.675) |
| D) HB 2 fund switch | | (27.430) | (27.966) |
| G) HB 2 New Spending | | 14.142 | 14.765 |
| Gov. estimate - Statutory, inlcuding HELP Act | | 265.168 | 290.646 | 309.893 | 318.518 |
| Gov. estimate - Transfers | | 29.254 | 18.321 | 18.330 | 17.600 |
| Governor's legislation requests | | | | |
| H) Non-HB 2 New Spending | | 2.575 | 15.624 | 25.001 |
| E) Non-HB 2 Reductions | | - | (3.924) | (7.771) |
| Gov. est. Actual & Assumed Appropriations - HB 1 funding the Le | | 5.025 | 11.327 | 1.975 | 11.667 |
| Assumed Standard Reversions - Governor's estimate | | (9.234) | (8.939) | (8.383) |
| Assumed Add'l Reversions ($16 mil. HB 2 & $13 mil. Emergency Stat.) | | (29.000) | | |
| Ongoing Disbursements | 2,207.861 | 2,269.940 | 2,345.203 | 2,389.655 |
| OTO | HB 2 | 64.519 | 48.925 | 0.008 | 0.072 |
| G) HB 2 New Spending | | 4.351 | 3.852 |
| Fire Fund Transfers | | 50.310 | 11.422 | 13.000 |
| Sage Grouse Transfer | | 10.000 | | |
| E) Non-HB 2 Reductions (one-time only) | | (10.000) | (13.000) |
| Governor's proposed HB 3 Agency Supplemental Appropriation request | | 20.133 | | |
| Other (includes: carry forward) | | 1.147 | 7.918 | |
| Total Disbursements | 2,323.836 | 2,358.338 | 2,349.562 | 2,393.578 |
| Adjustments - incl. tying to Comprehensive Annual Financial Report | 5.889 | | | |
| Ending Fund Balance (Unassigned) | $255.110 | $121.834 | $163.009 | $300.046 |
| Structural Balance (ongoing revenues minus ongoing expenditures) | ($86.573) | ($72.222) | $17.624 | $113.559 |
CHOICES FOR MANAGING VOLATILITY

While the Governor has chosen the above recommendations to manage the financial volatility of the general fund, other states and fiscal experts offer alternative methods of managing volatility. Please refer to the previously mentioned LFD published report entitled Montana’s Financial Volatility in September of 2016. This document discussed the maximum balances that could be justified based on revenue volatility and also outlined alternative means of managing volatility. Key options for managing volatility include:

Rainy Day Fund

The differences between a rainy day fund and general fund ending fund balance are: 1) rainy day funds limit the Governor’s immediate access to reserved funds so that a combination of spending reductions and rainy day fund transfers can occur at the same time and 2) rainy day funds have statutory provisions that determine when deposits are made into the fund. For example: deposits to rainy day funds could be made when revenues exceed the long term trend. The graphic illustrates that at times revenues are both above and below trend. As discussed in the LFD Montana’s Financial Volatility report, rainy day funds are typically capped based on calculated revenue volatility. The cap suggested by the research of Erik Elder, an economist at the University of Arkansas at Little Rock, was in the range of $480 to $720 million. Please see the LFD report for more information.

Multi-year financial plan

The Legislature could develop a multi-year financial plan to work through short term budget shortfalls. In the current time frame for example, a plan could be developed over a four year window through the 2021 biennium, instead of a two year window through the 2019 biennium, to re-establish reserves back to “comfortable” levels.

Prioritized Spending Plan

Develop a prioritized spending plan to identify reductions ahead of time. The Legislature could identify specific items that if revenues do not meet expectation, reductions can be made as directed by the legislature.

Debt Management Policy

Develop a full debt management policy that sets limits and policies for debt repayment when funds are available and sets maximum debt levels to manage when cash is short. A policy would also include regular state reporting on the current debt. The Governor has recommendations for bonding in this biennium, but does not recommend a long-term debt policy.

Pay as You Go Infrastructure

The Legislature could develop a long-term plan for “pay as you go infrastructure funding” when budget and revenue levels permit, and bonding when revenues cannot support it. One step in this direction is
the legislation proposed by the Legislative Finance Committee regarding developing a funding stream for building maintenance.

**Summary**

The Governor has presented several significant proposals that impact the state’s management of volatility. The legislature may wish to consider these policy choices along with the Governor’s recommended policies and other alternative methods to soundly manage the state’s financial volatility.

**OTHER MAJOR GOVERNOR’S BUDGET PROPOSALS**

In addition to the major general fund proposals listed above, the Governor is also recommending several major budget proposals that are not explained in detail above. Two of these recommendations of the Governor are substantial and important to mention in this summary:

**Infrastructure**

The Governor recommends an infrastructure program that issues $205 million in bonds. Of this amount $48 million is from Coal Severance tax bonds that are guaranteed by the Coal severance tax trust fund, but are paid by local governments. The remaining $157 million of bond authority is recommended as state debt.

In addition to the programs mentioned above, the Governor also recommends creation of a Build Montana Trust within the Coal Severance Tax Trust fund to benefit future infrastructure funding. Please see the Long-Range Building Budget Analysis for more information.

**Proposed New Infrastructure Trust: The Build Montana Trust Fund**

As proposed by the executive LC 905 would establish The Build Montana Trust Fund, a sub-trust within the Permanent Coal Severance Tax Trust. 75% of coal severance taxes flowing into the permanent trust, less any required costs of the coal tax bond fund, would flow into the new Build Montana Trust. These are funds that are currently flowing into the Coal Severance Tax Permanent Fund. Those coal severance taxes, along with interest earnings within the Build Montana Trust, will continue to flow into the account and must be retained within the Build Montana Trust until the balance is $50.0 million.
This proposed legislation does not itself create a program for administration or distribution of future interest earnings once the program meets this $50.0 million threshold. The Build Montana Trust is projected to reach a balance of $50.0 million around FY2020. Should this legislation be passed and approved, a program will need to be developed for administration and distribution of these infrastructure funds.

**The Governor’s recommendation on managing the Highway State Special Fund**

In addition to the balance shortfalls found in the general fund, the Highway State Special Fund also has budget challenges. The account supports the transportation activities of several agencies, which include:

- Department of Transportation
  - State roads and highways
  - County roads
- Department of Justice
- Fish, Wildlife, and Parks

The Governor recommends reductions in all three of these agencies, but does not reduce the gas tax funds to county, city, and towns to address the balance shortfall. Given the balance shortfall, the Legislature will need to review the fund and either reduce demands upon the fund or increase revenues.

**Other Budget Issues to Watch**

There are several budget issues that may develop in the coming months. These issues are generally covered in the Issues and Pressures section of this Volume 1 of the Budget Analysis and include items like the funding for the CSKT Water Compact, lawsuits that the state has pending, and pension funding. An item that is becoming a financial concern in early December is the declaration of emergency regarding invasive mussels in Montana’s waters. As the financial implications of these items become available, they will be reported to the Legislature.