COST PRESSURES

Cost pressures include increases applied to current services in costs to maintain ongoing services such as personal services, fixed costs, and inflation, implementing increases approved by the previous legislature, and new changes in workload and/or utilization, some of which would require legislation to reduce. Cost pressures are also due to new proposals for inflation-like items for providers of services in state government and funding shifts to fund certain present law items with state funds, such as Medicaid share and to ease tuition pressure in the Montana University System (MUS).

MANAGING RISK: REVENUE VOLATILITY

Montana's revenue volatility is primarily due to an increasing reliance on individual income tax including capital gains, an economy with relatively high reliance on the natural resources sector, and budgets based on biennial forecasts. The LFD's September 2016 report on Montana's Financial Volatility highlights the on-going challenge of managing financial volatility, and summarizes the major factors contributing to Montana's relatively high and increasing revenue volatility. It summarizes the best policies and practices of state government finances according to Standard and Poor's and comments on Montana's current approach to each issue. The report wraps up with options for next steps if the legislature wishes to consider a more in depth study of managing state general fund volatility, including

- Stress test the budget to find the amount of general fund gap that would result in a mild or moderate recession
- Consider further legislative investigation—potentially through a session or interim committee, or by passing a joint resolution to evaluate which financial management strategies, if any, would be appropriate for Montana

MANAGING RISK: EXPENDITURE ESTIMATE ERROR OR SUPPLEMENTAL

Along with the risk that revenue estimates can cause financial stress, so can errors in expenditure estimates. Estimates are used to develop several large appropriations; when required expenditures are greater than the appropriations, a shortfall occurs and the agency must request a supplemental appropriation. Examples of expenditure estimates include caseloads for public defender, Medicaid benefits, county jail holds, prison populations, and student enrollment in school districts. The following agencies requested $20.0 million in FY 2017 supplemental appropriations: Office of Public Instruction, Department of Corrections, and Office of the Commissioner of Higher Education.

STATUTORY COST INCREASES

Some cost increases to personal services have been previously approved by the legislature, including: health insurance costs that were funded for the second half of FY 2017; longevity increment adjustments; and phased-in employer cost increases for pensions.

ANNUALIZING THE FY 2017 PAY PLAN

HB 2 included an appropriation for the employee pay plan for an increase of $.50 cents on January 1, 2017. While the cost of the negotiated pay plan is within the HB 2 appropriation for FY 2017, it increases the annualized cost of the pay plan in the 2019 biennium.

2019 BIENNIUM STATE EMPLOYEE PAY PLAN

The executive has proposed a 1% pay plan increase beginning on November 15, 2017 and a 1% increase on November 15, 2018.

OTHER INFLATION INCREASES

Other items are inflated or deflated in the budget from FY 2017. These include statewide adjustments for fixed costs such as insurance and car rental rates, and inflation such as natural gas and electricity.

4% Vacancy Savings

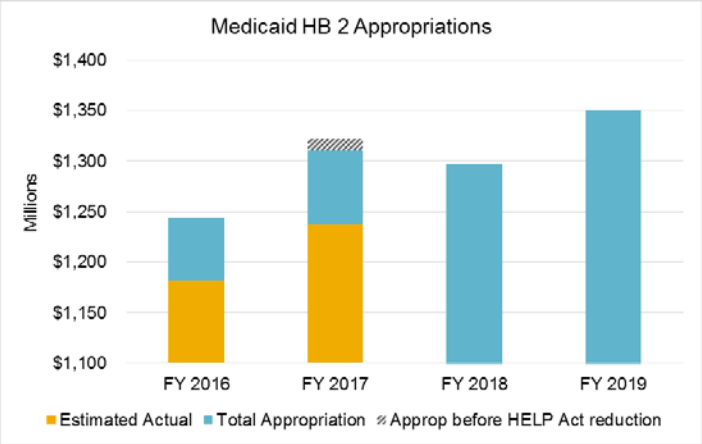
This item is not inflation or inflation like, but is part of the Governor's recommended personal services budget, and thus included in this section. The executive proposes a 4% vacancy savings reduction for most executive branch agencies. For general information on vacancy savings, please refer to the following guide:
http://leg.mt.gov/content/Publications/fiscal/leg_reference/Brochures/Vacancy-Savings.pdf

Medicaid Forecast

For an overview of Montana Medicaid, see the Medicaid 101 primer developed by the LFD.

Medicaid is a major cost driver for state governments nationally. For federal fiscal years (FFY) 2010-2014, the national average annual growth in Medicaid expenditures was 5.2%, while the Montana annual growth was only 3.8%. However, for FFYs 2007-2010 the national average growth in spending was 6.8% while Montana experienced a growth of 8.5% annually.[2]

During the 2015 Legislature, Medicaid appropriations were made for FY 2016 in the amount of $1,243.9 million and for FY 2017 in the amount of $1,311.0 million. The Medicaid appropriation for FY 2017, which serves as the base for the 2019 biennium budget, included a reduction of $10.8 million in anticipation of savings due to Medicaid expansion, as authorized in the HELP Act.



As can be seen in the Medicaid appropriations chart, the FY 2017 executive request is greater than the projected FY 2018 Medicaid expenditure, but lower than the FY 2019 projection. The executive proposes a negative adjustment in FY 2018, with an overall increase for the 2019 biennium.

Medicaid HB 2 Caseload

A 1% annual change in traditional Medicaid from the budgeted FY 2017 level (exclusive of the HELP Act population) results in approximately a $12 million total budget change. Approximately 30.1% of this is the responsibility of state funds, including both general fund and other state special funds, resulting in a state liability of $4.0 million for each 1% increase.

Medicaid HB 2 FMAP State Share

The FMAP is set each year by CMS, and at the time of budgeting, LFD uses a projection of that FMAP, currently forecasted to be approximately 65.4% in FFY 2018 and FFY 2019. A 1% change in the FMAP will have a state share impact of over $8.2 million each year. If the FMAP is off by 1% in FY 2018 and an additional 1% in FY 2019, the cumulative impact could be over $25.0 million.

HELP Act

For an overview of the Medicaid expansion, see the HELP Act primer developed by the LFD.

The expenditures associated with the Medicaid expansion will not be included in HB 2, but will impact the general fund. For the 2019 biennium, the authority for the Medicaid expansion is statutory.

[2] kff.org

Because this program is so new, there is little data to rely upon. The totals reported in the table here for FY 2016 are subject to revision, as providers have up to a year to submit billable claims. Additionally, these totals are for six months, during which enrollment growth was high. There is base information to build upon, although there is significant risk associated with the assumptions utilized in projecting these costs.

Fiscal Year 2016 Montana HELP Act Expenditures Including Accruals			
	General Fund	Federal Funds	Total
Benefits & Claims			
Health Resources Division	$1,300,127	$129,368,682	$130,668,809
Senior & Long-Term Care	0	2,374,546	2,374,546
Addictive & Mental Disorders	0	13,793,154	13,793,154
	1,300,127	145,536,382	146,836,508
Administration			
Personal Services	226,800	385,936	612,736
Operating Expenses	2,381,522	6,619,069	9,000,591
	2,608,322	7,005,005	9,613,327
Third Party Administrator	1,059,831	1,059,933	2,119,764
TOTAL	$4,968,280	$153,601,319	$158,569,600

The primary risk factors associated with the cost of the Medicaid expansion are associated with the continued enrollment growth and the per member benefit. An increase of 1% enrollment in each of the three years FY 2017 – FY 2019, has a cumulative 2019 biennium general fund cost of approximately $1.0 million. Additionally, if the average annual per member benefit changes by 1% each of those three years, the general fund impact would be a $1.5 million change. Using the assumptions outlined below, the total estimated biennial general fund cost is $70.1 million.

HELP Act Medicaid Expansion				
	FY 16 Actuals	FY 17	FY 18	FY 19
Assumptions				
Growth Rate		15%	7%	3%
Actual Newly Enrolled	47,399			
Reported Refinanced Population	8,458			
Total Annual Average Enrollment		59,412	64,875	67,657
Per Member Per Month (PMPM) cost of TPA	$26.39	$25.39	$26.15	$26.94
Medical Benefit inflation		4.6%	4.1%	3.0%
Average Annualized Per Member Benefit	$6,055	$6,334	$6,594	$6,791
Annualized FMAP (Federal Match Rate)	100.0%	97.5%	94.5%	93.5%
Statutory Expenditures				
TOTAL Benefits & Claims	$146,836,508	$376,314,553	$427,762,996	$459,494,419
General Fund Benefits & Claims	**1,300,127**	**12,785,362**	**27,372,340**	**34,003,138**
Third Party Administrator Admin Fee (PMPM)	2,119,764	5,148,404	7,072,103	7,476,314
General Fund TPA Admin Fee	**1,059,831**	**1,801,942**	**2,475,236**	**2,616,710**
TPA IT Expenses		3,000,000		750,000
General Fund TPA IT Expense		**300,000**		**75,000**
DPHHS Aministration Expenses	9,613,327	7,320,525	7,244,042	7,438,722
General Fund DPHHS Administration	**2,608,322**	**1,986,231**	**1,965,479**	**2,018,300**
Net General Fund Premium Revenues	**0**	**90,000**	**198,000**	**234,000**
TOTAL Statutory General Fund Expense	**$4,968,280**	**$16,783,534**	**$31,615,056**	**$38,479,149**

CHANGES IN FEDERAL MEDICAID PARTICIPATION

The federal medical assistance percentage (FMAP) is based on national economic factors and determines how much of Medicaid (and other medical costs) is funded by the federal government and how much by the state.

2019 BIENNIUM PROVIDER RATE INCREASES

The vast 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.

MONTANA DEVELOPMENTAL CENTER CLOSURE

The SB 411 Council recommends retention of the Assessment and Stabilization Unit, utilization of the existing comprehensive waver and the creation of a new waiver called "waiver 2" to transition clientele into community based homes. Additionally, legislation sponsored by the governor's office could retain $2.8 million and $2.5 million in FY18 and FY19 from the roughly $7.2 million loss in each year in facility revenue from MDC. The legislature would have to pass the bill to ensure two cottages and the ICF-IDD licensure stay intact and continue partial operations at the facility. This would be in contrast to SB-411 that mandates the closure of MDC by July 1, 2017. It had been reported prior that approximately $2.4 million in general fund may be required for the biennium. This number did not include several recent assumptions and may be higher providing proposed legislation does not pass. New legislation regarding the Governor's proposal was unavailable at the time of publication.

AQUATIC INVASIVE SPECIES

On November 23, 2016, Montana's rapid response team submitted a mussel detection strategy recommendation to Governor Bullock. The team proposed a phase one funding request of $5.0 million for rapid response to prevent new zebra or quagga mussels introductions to Montana waters. The Governor's emergency and disaster statutory appropriation authorizes up to $16.5 million general fund for the biennium to be spent on emergencies or disasters. The potential costs for this declared emergency are not included on the balance sheet in this report.

CONFEDERATED SALISH AND KOOTENAI TRIBES (CSKT) WATER COMPACT

The 2015 Legislature passed legislation in SB 262 ratifying a water rights compact with the State of Montana, the United States federal government, and the CSKT. Currently, no appropriation authority remains in HB 2 for state costs associated with the water compact. The Governor has not submitted any budget proposals related to the CSKT compact.

OTHER FUND BALANCES IMPACTED BY DECLINES IN NATURAL RESOURCE REVENUE

Funds outside the general fund may cause pressure on the general fund or other taxes or fees. In addition to direct impacts to the general fund due to continued low oil and natural gas tax collections, numerous state special funds will be impacted by low commodity prices.

Guarantee Fund

The guarantee fund, which is the first source of funding for schools generates revenue from common school trust land. These revenues are in the form of grazing, agriculture, oil, and other mineral leases as well as coal and oil bonus payments. The remaining revenue is generated from this fund's permanent trust in the form of interest payments. Over the past four years, common school trust land revenues have averaged $50.7 million. In the next biennium, annual revenues are expected to be approximately $9.0 million less than this four-year average. This will result in an indirect hit to the general fund as the general fund will make up the difference to fully fund BASE aid. The decline will likely be driven by lower oil bonus payments and a drop in cattle prices, which directly affects the grazing lease rates.

Coal Shared Fund

Funds that receive distributions from the coal severance tax may also be impacted. The coal shared fund receives 5.46% of total coal severance tax collections and these funds are distributed to the State

Library Commission, Conservation Districts, and MT Growth through Agriculture Programs. In addition to these programs, 12.0% of coal severance tax collections are distributed to the Long-range Building Program. The legislature appropriates this money in HB 5 to finance building projects throughout the state. Ultimately, although lower earnings in these accounts do not automatically increase general fund spending, if oil and coal severance tax collections decrease, the services provided by these funds will need to be either scaled back or backfilled by the general fund or alternate funding source.

Other Natural Resource Funds

Other natural resource funds will also continue to be impacted by the drop in oil prices. The orphan share, natural resource operations, and natural resource projects funds will likely receive oil tax funding similar to those numbers in FY 2016, far lower than preceding years. These funds are used to provide services within the Department of Environmental Quality and the Department of Natural Resources.

BALANCING THE HIGHWAY STATE SPECIAL REVENUE ACCOUNT

Fuel taxes and other highway user fees are deposited into the restricted highway state special revenue account (HSRA). The Article VIII, Section 6, of the Constitution restricts the use of the revenues for specific uses that include:

- Payment of obligations incurred for construction, reconstruction, repair, operation, and maintenance of public highways, streets, roads, and bridges
- Payment of county, city, and town obligations on streets, roads, and bridges
- Enforcement of highway safety, driver education, tourist promotion, and administrative collection costs

The revenue may be used for other purposes with a three-fifths vote of the members of each house of the legislature. The fuel tax rates, which are the primary source of revenues deposited in the fund, were last changed in 1994. The account is administered by the Montana Department of Transportation (MDT).

The account supports the activities of several agencies, which include:

- Montana Department of Transportation – the primary account user
- Department of Justice (DOJ)
- Fish, Wildlife, and Parks (FWP)

Following the receipt of funding from the American Recovery and Reinvestment Act of 2009, MDT was able to amass a sizable fund balance. An adequate working capital balance allows MDT to pay for costly federal-aid highway construction projects ahead of the receipt of federal project reimbursements. For the past five fiscal years, FY 2012 through FY 2016, expenditures from the account have exceeded the available revenues, requiring the use of fund balance to make up the difference. Over that time, the HSRA working capital balance has declined from $99.6 at the end of FY 2011 to $35.6 million at the end of FY 2016. If this imbalance were to continue, the account would reach the point where MDT could no longer pre-fund federal-aid projects, and in response the executive has recommended a series of budget reductions entitled “NP-560: Balancing the Highway State Special Revenue Account”. The executive proposals are projected to result in a working capital balance of $47.7 million by the end of the 2019 biennium, assuming revenues come in as anticipated and all appropriation authority is fully expended.

According to the executive, the reductions for the HSRA users were made on a pro-rata basis, reducing the budget to provide an adequate fund balance to support the pre-payment of federal-aid construction projects. The budget reductions would apply to appropriations in MDT and DOJ, and FWP. The implied impacts of the reductions would include:

- MDT ($42.8 million HSRA, $193.0 million FSR)
    - Construction Program – The total biennial reduction of authority in the Construction program would be $221.9 million below the agency present law request. This would be a reduction of $28.8 million in HSRA funds, and a reduction of $193.0 million of

federal fund authority. Over the biennium, the proposal is equivalent to a reduction of $172.1 million, or 34.4%, below actual FY 2016 expenditures. With this budget reduction the Construction Program may not have sufficient state special authority to match all the federal funding available for highway construction in the 2019 biennium

    - Maintenance Program – HSRA expenditures from the program budget would be reduced by a biennial $14.0 million. This would reduce personal services authority by $1.0 million per year, and operating expenses by $6.0 million per year. While the reductions would provide a Maintenance Program budget that in total exceeds the actual expenditures of FY 2016, the proposal would reduce the appropriations for construction of state roads by 50% of its normal appropriation, or 25.2% of the actual 2016 expenditures
- DOJ ($6.95 million and 32.24 FTE in FY 2108 and 22.75 FTE in FY 2019)
    - Montana Highway Patrol – The total biennial reduction in the Montana Highway Patrol would be $5.5 million, including reductions of 27.00 FTE in FY 2018 and 19.00 FTE in FY 2019. All FTE reductions are grade 5 patrol officer positions
    - Justice Information Technology Services Division – The total biennial reduction in the Justice Information Technology Services Division would be $11,854 in unspecified operating expenses
    - Motor Vehicle Division - The total biennial reduction in the Motor Vehicle Division would be $1.3 million, including 4.49 FTE in FY 2018 and 3.00 FTE in FY 2019 in unspecified positions
    - Central Services Division - The total biennial reduction in the Central Services Division would be $52,283, including 0.75 FTE each year in unspecified positions
- FWP ($2.0 million HSRA in the 2019 biennium)
    - The proposal would eliminate the normal $2.0 million appropriation for repairs and maintenance of state parks roads made in the long-range building program bill. Although the Parks program continues to request authority for parks roads, LFD analysts believe that the remaining Parks program funds will not support all the proposed agency projects. As a result this reduction is likely to mean that re-construction of park roads, including the proposed Makoshika Park road, may be postponed

In addressing the imbalance in the HSRA account there are two sides to the equation. The Legislature could either address the account revenues or the account expenditures, or a combination of the two. The executive has recommended adjusting only one side of the equation, the expenditure side. The spending reductions proposed would balance the account, but would lead to reductions in current service levels and loss of federal funds for highway construction.

PENSIONS

Update on Current Valuations

At the time of the FY 2016 actuarially calculated valuations, the unfunded liability across Montana's nine retirement systems totaled $3.6 billion. The two largest systems, the Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS) had actuarially calculated unfunded liabilities of $1.7 billion and $1.5 billion respectively. The calculated funding levels and amortization periods of the nine systems are shown below.

Compared to FY 2015, all of the retirement systems either improved or remained the same in terms of both funding ratios and amortization periods. Improvements were due to actuarial asset returns of 8.60%, as opposed to the assumed rate of 7.75%. The actuarial value of assets smooths investment gains and losses on a market value basis over a four year period. As a result, the market asset returns, which averaged only 2.05% compared to the assumed 7.75%, were only partly recognized. The lower-than-assumed investment returns will be recognized over the next three years. As those lower return

years are included in the actuarial calculations, the funded ratios are expected to decrease and amortization periods increase.

Funding Challenges Revisited

Due to the funding challenges of most public pensions in recent years, the calculations used to determine if a public pension system is sound has been researched extensively. Questions as to the best method of calculating amortization schedules, funding ratios, discount ratios and asset appreciation have been considered. Research is generally showing that current actuarial calculations, may overstate the fiscal soundness of the pension systems. This new analysis and proposed methodologies will influence how actuarial valuations of public pensions will be calculated in the future and will give public policy makers across the country better information upon which to make public policy decisions.

The follow sections describe key research in this area and how this research may influence future calculations.

Level of Rate of Return Assumptions

In contemporary pension literature a topic of much discussion is the assumed rate-of-return for pension plans moving forward. According to "An Overview of the Pension/OPEB Landscape" from the Center for Retirement Research at Boston College, the long-term return assumption used by state and local pension plans in 2014 averaged 7.6 percent. The paper notes that the average rolling 10- and 30- year nominal returns for hypothetical portfolios over the past 50 years exceeded the long-term assumption of 7.6% by at least 1%. However, many investment experts currently forecast returns to be far lower than this amount over the next decade. For instance, Goldman Sachs forecasts an average annual return of 4.7%-5.5% over the next five years while Charles Schwab forecasts an average rate of 6.3% over the next ten years. The realized rate of return plays the largest role in the overall calculated health of a system.

Consistency of Rate of Return Assumptions

Montana Pension Systems Valuation June 30, 2016		
	Funded Ratio	Years to Amortize
Teachers' Retirement System (TRS)	69%	24
Public Employees' Retirement System (PERS)	77%	26
Judges' Retirement System	166%	0
Highway Patrol Officers' Retirement System	66%	28
Sheriffs' Retirement	83%	Does not amortize
Game Wardens' Retirement System	84%	Does not amortize
Municiple Police Officers	69%	18
Firefighters' Unified Retiremenet System	78%	9
Volunteer Firefighters	80%	7

Results from actuarial valuations assume that there will be an average rate of return moving forward. Typically, this number ranges from 7.0% to 8.0% across most public pension plans. Actuarial results typically assume that not only will future investments average a certain return rate, but that this rate of return will occur each year. Receiving the same rate-of-return year after year is unlikely. Instead, the year-to-year returns are often quite volatile. A recent report by The Rockefeller Institute "Public Pension Funding Practices" studies the effects of varying rates of return even when the assumed average rate-of-return is met. The health of a system can vary dramatically even when the assumed rate-of-return is met. The discrepancy arises from the timing of higher returns. Higher returns early on reflect healthier systems than if the higher returns occur later. In the Rockefeller study multiple simulations were performed all using an average rate of return of 7.5%, but allowing the rate to vary year-over-year. The study states "…simulations can produce very different results, including funded status above 100 percent for extended periods, and funded status well below 40 percent…". This demonstrates that even if the average assumed rate-of-return is met over the long-run, at any given time the funded ratios can differ drastically, causing employers to increase their contributions to keep the systems sound.

Discount Rate Assumption

In addition to return rates, the assumed discount rate also plays a large role in illustrating the health of a pension system. The purpose of using a discount rate is to ascertain the current value of a future liability, and in this case to determine how much the retirement benefits owed to future pensioners is valued today. Future liabilities are discounted to a present value using the discount rate. As a result, the larger the discount rate the smaller the liabilities, and vice versa.

Current actuarial practice evaluates the health of a pension system with the discount rate equal to the assumed rate of return. Recently, this traditional practice has come under some debate. Opponents of this practice argue that future liabilities are guaranteed, thus a certain and a lower discount rate that includes this level of certainty should be used. Discount rates that have risk included, or uncertainty if the liability will be owed or not, can be higher since it is assumed that some of the liability would not be paid.

Proponents of this practice argue that if a system expects to earn a particular rate on its investments, then discounting liabilities at this rate provides an appropriate means for comparing present values of assets and liabilities. Ultimately, choosing a discount rate that is too high understates the liability associated with future pension benefits and overstates the funding position of the system.

Future of Calculating Pension Health

Moving forward, the public pension landscape will likely be more unpredictable than in past years.

A portion of pension health will be determined by actual rates of return in markets of uncertainty. In order to achieve desired rates of return most funds are invested in stocks. In the past, investing in bonds yielded steady and much higher returns with far less risk.

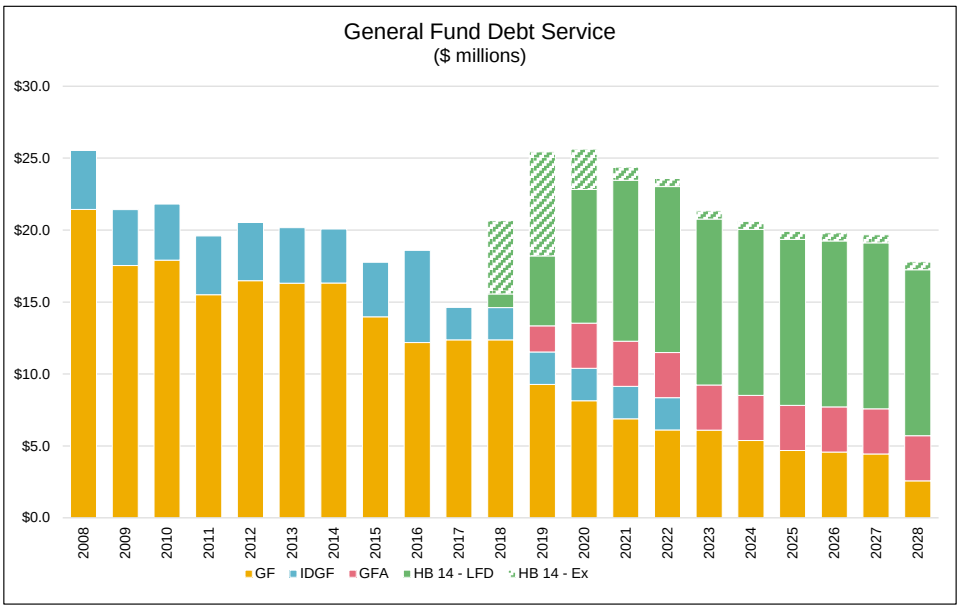
Secondly, as the new research gets assimilated in to the current actuarial calculations of valuations, the fiscal health may be more accurate, but may also be more challenging to fund appropriately.

DEBT SERVICE

Montana's debt liability is relatively low and unless additional bonds are approved, the payment streams will decrease over time. Montana ranks well when compared to the country as a whole according to the 2015 State Debt Medians Report by Moody's Investor Services. In comparison with the 44 states that issue tax supported debt, with lower debt states having a higher rank, Montana ranks as follows:

- 43rd in gross tax supported debt
- 42nd in tax supported debt per-capita; $247
- 41st in net tax supported debt as a percent of personal income; 0.6%

The following table illustrates current debt service and includes projections for authorized but unissued debt service, as well as projections related to the executive proposal to authorize more bonds related to improvements to statewide infrastructure (HB 14).



- Yellow GF – General obligation (GO) bonds paid by the general fund. The bond issues related to this debt service primarily funded the construction of state government buildings ($21.6 million in the 2019 biennium)
- Blue 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 two of the state's hospitals that offset general fund revenue through institutional reimbursements that would otherwise flow into the general fund ($4.5 million in the 2019 biennium)
- Pink GO/GFA – This category includes the projections for debt services costs on authorized but unissued bonds. This category includes bonds authorized for the costs of two tribal compacts, the St. Mary's diversion structure repairs, and the remaining authority for the Montana Heritage Center ($1.8 million in the 2019 biennium)
- Green HB 14-LFD – This category illustrates the debt service costs of the Creating Jobs and Infrastructure executive proposal for the 2019 biennium (HB 14) using the assumptions of the LFD. This estimate includes an assumption that the $157.4 million of GO bonds will issued at over 3½ years with debt service costs beginning in the second-half of FY 2018 ($5.8 million in the 2019 biennium)
- Green Hatched HB 14-Ex – This category illustrates the debt service costs of the HB 14 as shown on the executive balance sheet. The green hatched line demonstrates the difference between the LFD and executive (Ex) assumptions. Included in the executive assumptions is the issuance of $157.4 million of GO bonds, half in July, 2017 and half in July, 2019. The executive assumptions also include somewhat higher issuance costs and higher interest rates (total $18.1 million in the 2019 biennium)

In the 2019 biennium, the debt service paid directly and indirectly through the general fund for existing bond issues is expected to average $13.1 million per year. The debt service for executive proposal for HB 14 as calculated by the LFD is projected to have a general fund debt service cost of $946,208 million in FY 2018 and $4.9 million in FY 2019. The executive calculation provides a more aggressive bond issuance schedule, leading to a cost estimate that is $12.3 million higher than LFD estimates in the 2019 biennium. Once all bonds are issued, the projected annual cost HB 14 debt service as calculated by the LFD would be $11.5 million per year.

TASK FORCE ON STATE PUBLIC DEFENDER OPERATIONS

During the 2017 interim, a task force was formed to study various aspects of state public defender operations. The task force was created under HB 627 and directed to study the operations of the Office of State Public Defender and develop a long-term organizational plan that would allow it to provide effective assistance of counsel to those who qualify.

Among other things, the task force was required to take into consideration:

- The constitutional and statutory duties of the office
- The ethics and professional responsibilities of attorneys employed at the office
- How other states provide assistance of counsel to those who qualify for assistance
- The effects of compensation and workloads on the recruitment and retention of attorneys and administrative and support staff
- Measures and resources that could be implemented or assigned to improve staff and attorney recruitment and retention issue
- The possibility, costs, and benefits of restructuring the office

After an interim of study, the task force provided recommendations through the following legislation requests:

- Provide an overall agency director appointed by the governor, convert the public defender commission to an advisory body, provide that the commission shall nominate three candidates for director, provide that the governor shall select a director from the list of nominees, and provide that the director would be a hired position, not a politically appointed position, so that the director could only be removed with cause
- Eliminate the statutory requirement for the chief appellate defender to confer with the chief public defender on the Office of the Appellate Defender's budget
- Transfer determination of eligibility for public defender services to the Department of Public Health and Human Services
- Provide that the Montana Department of Revenue is responsible for collecting any fees for public defender services imposed by a judge pursuant to 46-8-113, MCA
- Establish a holistic defense pilot program in up to four public defender office locations across the state
- Require the Office of the State Public Defender to contract for a workload assessment study
- Revise the appointment of a public defender to a putative father in a dependent neglect case
- Revise the appointment of a public defender to an absent parent in a dependent neglect case

For additional information, please refer to the following web page:
http://leg.mt.gov/css/Committees/interim/2015-2016/Public-Defender/default.asp

COMMISSION ON SENTENCING ACTIONS

A Commission on Sentencing was undertaken during the 2017 interim. The commission was the result of passage of SB 224 by the 2015 Legislature and was aided in large part by staff resources provided by the Bureau of Justice Assistance, the Pew Center on the States, and Council of State Governments (CSG). The commission studied and made recommendations for legislation to the 2017 Legislature on the following areas that, if enacted, could impact various aspects of Montana's criminal justice system and could impact related costs in future years:

- Criminal justice laws
- Sentencing laws
- Laws on community corrections
- Behavioral health treatment services
- Laws related to the Board of Pardons and Parole
- Crime Victim's Compensation
- Laws related to supervision of probationers and defendants serving a deferred or suspended sentence

As the legislature has to act on any of these initiatives, there is no estimate of what increased or avoided costs will result. However, the staff from CGS provided the following preliminary estimates of the impact if all recommendations CGS offered were undertaken:

- Avert at least $80 million between FY 2018 and FY 2023
- Reduce the prison population from the baseline projection by 518 people between FY 2018 and FY 2023, bringing the prison population below the current level
- Reduce the supervision population of the Montana Department of Corrections from the baseline projection by 2,639 people
- Double the number of people who can be served in prerelease centers with the existing number of beds
- Provide numerous tools that can enable counties to manage the growth in or reduce their jail populations
- Averting growth in the prison population and generating savings in this six-year time frame would position Montana to instead reinvest $28 million in strategies to save beds, reduce recidivism, and increase public safety at a lesser cost to taxpayers.

The full Montana Justice Reinvestment Impacts and Reinvestments document and a list of bills associated with the council work can be found on the Commission on Sentencing web page at: http://leg.mt.gov/css/Committees/interim/2015-2016/Sentencing/default.asp

K-12 Decennial Funding Commission Study Results

The School Funding Interim Commission was created by Senate Bill 128 (2015) and fulfilled an existing statutory requirement that every 10 years the Legislature authorize a "study to reassess the educational needs and costs related to the basic system of free quality public elementary and secondary schools." This reassessment is sometimes referred to as "the decennial study."

Through a public survey and hearing from education stakeholders at its initial meeting in September 2015, the commission focused its attention on four main topics over the interim:

- Recruitment and retention
- School facilities
- Special needs (including special education and gifted and talented)
- District size, structure, and equity

Although the commission was able to dive deeply into these and other topics, members acknowledged the complexity of school funding and suggested in the final report that K-12 funding be examined on a regular basis more often than every 10 years, perhaps through an existing or restructured interim standing committee or subcommittee.

Bill drafts adopted by the commission for the 2017 session that may have a fiscal impact are outlined in the final commission report located on the web at: http://leg.mt.gov/css/Committees/interim/2015-2016/School-Funding/default.asp

Lawsuits

Montana –v- Volkswagon

Montana joined other states and the federal government in suing Volkswagon (VW) over the practice of installing illegal software in thousands of its diesel vehicles and cheating on emissions tests. Montana has settled with VW. Under the settlement, affected VW owners will receive restitution payments of at least $5,100 each. VW will buy back, or modify, certain VW and Audi 2.0-liter diesel vehicles from consumers. VW agreed not to engage in future unfair or deceptive acts and practices in connection with its dealing with consumers and regulators. VW will pay $2.7 billion into a trust to support environmental programs throughout the country to reduce emissions of NOx. Montana will be eligible to request financial support to fund environmental mitigation projects. Additionally the Montana Attorney General will receive $2.5 million for violations of state consumer protection laws. The Montana Attorney

General's office expects to receive the $2.5 million in November or December 2016, which will go into the state special revenue settlement fund already established. At the end of FY 2017, it is projected that the Office of Consumer Protection will need approximately $2.3 million to replenish its 4-year reserve.

United States and State of Montana v. Exxon Mobil Pipeline Co. (EMPCO), No. CV-26-143-BLG-SPW-CSO (D. Mont.)

A complaint and proposed consent decree to settle all natural resource damage claims of the United States and the State of Montana under the Oil Pollution Act and State Comprehensive Environmental Cleanup and Responsibility Act (CECRA) for a total of $12 million was filed September 21, 2016. The split of the settlement proceeds is $2.5 million for the U.S., and $9.5 million for the State. The consent decree and a related restoration plan are subject to public comment. The comment period closes Oct. 31, 2016, and after that the parties will ask the Court to enter judgment. EMPCO's payment under the consent decree is due 30 days after the time for appeal from entry of judgment (90 days) has run. Assuming that judgment is entered in November, the earliest anticipated date is end of February, 2017. Under OPA settlement proceeds the $9.5 million must be held separately from general funds, and only used to "restore, replace or acquire the equivalent of" the injured natural resources.

Duane C. Kohoutek, Inc., Bucher Sales, LLC, Nobles, Inc., and Spirits Plus, LLC v. State of Montana

A group of liquor store owners is challenging state statute that provides for a formula used to calculate the compensation for mandatory discounts provided to liquor licensees. The court ordered mediation between store owners and representatives from the legislative and executive branches. The court noted that while rulings are subject to appellate review, the State currently faces substantial damages and mediation is an attempt to resolve litigation carrying significant taxpayer implications. The Montana Department of Revenue identified potential exposure of $37.0 million in general fund.

All parties met on November 16, 2016 and no agreement was reached. If appealed, any impacts on general fund may not be determined for some time.

Department of Revenue and Northwest Energy

The Department of Revenue settled a tax protest by Northwest Energy that lowered the company's taxable value, the result of which lowered FY 2017 taxable values in 19 counties by a total of $21.3 million dollars. The lower taxable value will require districts to raise mill values to generate the same revenue or use other non-levy revenue if available. The 15 counties include 62% of the states total enrollment of K-12 students. The counties impacted are shown in the table. Lowering the available tax base for school districts increases the amount of Guaranteed Tax Base payments from the general fund. Using the school funding model and the lower tax base resulting from this settlement, LFD estimates the impact to be $0.3 million.

19 Counties Impacted by Settlement

County	Decrease in Taxable Value	Increase in General Fund Mills
Broadwater	($177,423)	1.4
Carbon	(513,578)	5
Cascade	(4,612,902)	9.27
Chouteau	(263,685)	3.47
Deer Lodge	(346,362)	1.33
Gallatin	(1,752,183)	9.99
Glacier	(34,165)	1.28
Jefferson	(716,185)	4.8
Judith Basin	(264,915)	3.03
Lewis & Clark	(2,939,555)	7.74
Meagher	(125,955)	1.67
Missoula	(2,848,803)	4.26
Park	(772,893)	3.42
Powell	(22,182)	0.12
Ravalli	(651,721)	2.59
Sanders	(1,364,722)	6.39
Stillwater	(38,481)	1.83
Sweet Grass	(283,559)	2.18
Yellowstone	(3,550,671)	4.75
Grand Total (Mills total Average	($21,279,940)	3.92

Libby Asbestos

The state has reached a tentative $32.0 million settlement agreement with a second group of claimants regarding asbestos in Libby. Two different groups of claimants were consolidated into one case for the purposes of the settlement. Once the district court agrees to the settlement the state must pay a total of $14.2 million within 30 days and the remaining $10.0 million within the year. The remaining $7.8 million would be paid if the state reaches agreement with the insurance company that indemnified a portion of the state's general liability risk. The state self- insures for general liability and currently anticipates paying this settlement from the proprietary funds generated through state agency premiums. As proposed, premiums for self-insurance increase in the 2019 biennium, in part because of the increased costs associated with general liability claims.