



MONTANA LEGISLATIVE BRANCH

Legislative Fiscal Division

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Director
AMY CARLSON

DATE: April 17, 2019

TO: Sen. Scott Sales, Senate President
Rep. Greg Hertz, House Speaker
Sen. Roger Webb, Chair, Senate Tax Committee
Rep. Alan Redfield, Chair, House Tax Committee
Sen. Fred Thomas, Senate Majority Leader
Rep. Brad Tschida, House Majority Leader
Sen. Jon Sesso, Senate Minority Leader
Rep. Casey Schreiner, House Minority Leader

FROM: LFD Revenue Team

RE: General Fund Revenue Forecast Update #4

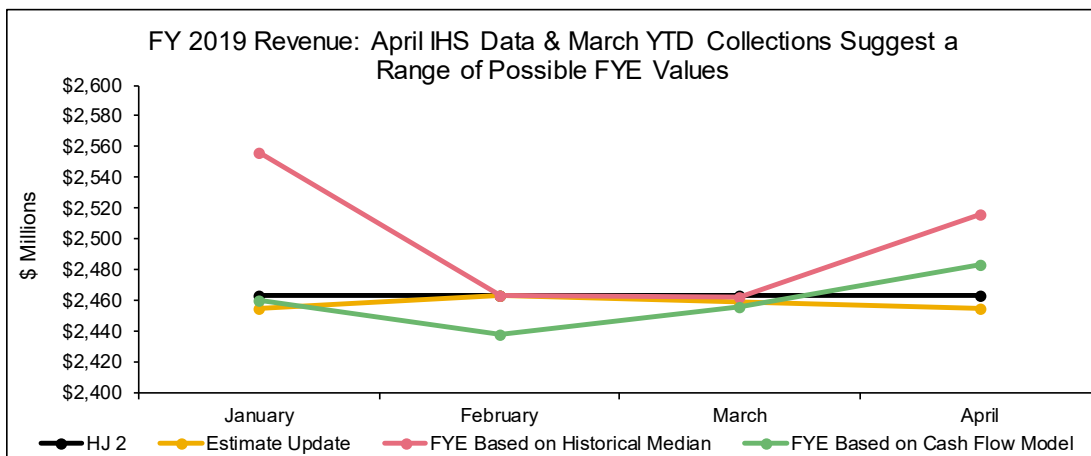
GENERAL FUND REVENUE SUMMARY

Mixed Messages: Economic Outlook Below HJ 2 but Year-to-Date Collections Above HJ 2

This is the fourth of the monthly revenue forecast updates throughout the 2019 Session. This update includes both a three-year forecast update based updated economic forecast from IHS Markit and a year-to-date analysis for FY 2019. While the two types of calculations give statistically similar results, they give mixed messages relative to HJ 2 for FY 2019.

FY 2019 Mixed Message Illustrated

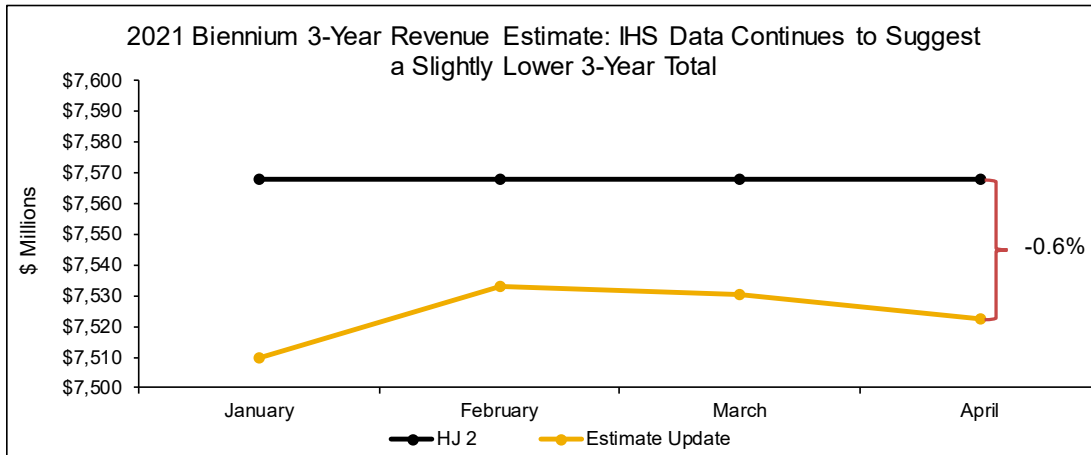
The following chart illustrates the mixed messages of the data. The black line depicts HJ 2, which has not changed since the beginning of session. The yellow line shows the LFD forecast update each month of session based on economic data from IHS Markit. The pink and green lines represent two methodologies of extrapolating year-to-date revenue collections to estimate total collections at the end of the fiscal year.



In the chart on the previous page, the fiscal year end (FYE) revenue extrapolation based on the middle-of-the-road or median historical pattern (pink line) tends to be more sensitive to unusual timing or accounting anomalies, and should be viewed with caution. FYE based on the cash flow model (green line) and the FY 2019 estimate update are quite close to the official estimate, and well within the estimate margin of error.

Economic Outlook for the 3-Year Period

Only the LFD forecast based economic forecast from IHS Markit is available for comparison, since year-to-date revenue collections are only available for FY 2019. The economic forecast has changed slightly each month during session, but the resulting updates have been in a narrow range of 0.5% to 0.8% below HJ 2. While these differences over the three-year period have varied between \$35 - \$58 million, they are statistically very small differences relative to HJ 2. The table below illustrates the variance.



Forecast Update Based on New Data & Other Updates: \$45.4 Million Below HJ 2

The April economic forecasts from IHS combined with LFD updated revenue models generates a general fund revenue forecast that is \$45.4 million lower than the official estimate in HJ 2 over the three-year forecast period. The table below shows the HJ 2 estimate and the LFD April update based on revised assumptions.

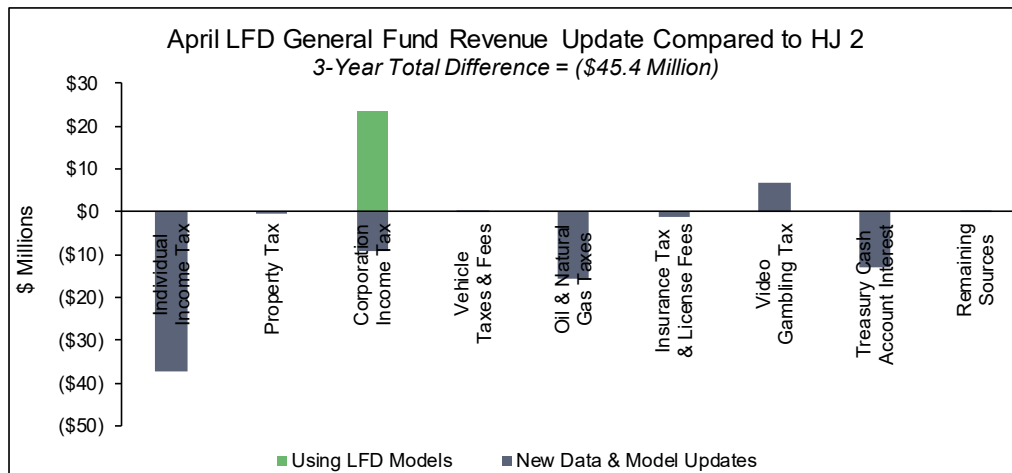
FY	HJ 2	April Update	\$ Difference	HJ 2 Growth	April Update Growth
2018	\$2,405.4	\$2,405.4			
2019	2,463.5	2,455.1	(\$8.4)	2.4%	2.1%
2020	2,513.6	2,498.5	(15.1)	2.0%	1.8%
2021	2,590.7	2,568.7	(21.9)	3.1%	2.8%
3-Yr	\$7,567.7	\$7,522.3	(\$45.4)		

The revised forecast from IHS incorporates the following key assumptions:

- Lower nominal GDP growth in the early years—from 4.9% in FY 2019 to 4.2% in FY 2020 and 4.5% in FY 2021—due to slowing global growth, a strong dollar, fading fiscal stimulus, tightening monetary policy, weaker stock prices, and the effects of recent tariffs; HJ 2 assumed 5.4%, 4.8%, and 4.3% respectively
- Lower oil prices: West Texas Intermediate (WTI) prices of \$62/bbl in FY 2019, \$65/bbl in FY 2020 and \$60/bbl in FY 2021, compared to the HJ 2 assumptions of \$71, \$71, and \$67 respectively
- Dampened outlook for Montana wage growth: 3.8% in FY 2019, 3.8% in FY 2020 and 4.0% in FY 2021, compared to the HJ 2 assumptions of 4.6%, 4.3%, and 4.5% respectively

In addition, the update includes a \$4.1 million Core Civic scheduled transfer to the general fund in FY 2020.

The LFD April update changes compared to HJ 2 are shown in the graph below, with fiscal year detail provided in the table. The April IHS data results in lower revenue expectations for most sources; however, the reductions are somewhat offset by excluding the RTIC negative adjustment for corporate income tax, and model updates for individual income.



Revenue Source	FY 2019	FY 2020	FY 2021	3-Yr Total
Individual Income Tax	(\$2.1)	(\$15.0)	(\$20.3)	(\$37.3)
Property Tax	-	(0.0)	(0.0)	(0.0)
Corporation Income Tax	3.1	4.7	6.7	14.5
Vehicle Taxes & Fees	0.0	0.1	0.1	0.2
Oil & Natural Gas Production Tax	(7.6)	(4.6)	(3.3)	(15.5)
Insurance Tax & License Fees	(0.1)	(0.7)	(0.4)	(1.2)
Video Gambling Tax	2.0	2.2	2.6	6.8
Treasury Cash Account Interest	(1.8)	(4.9)	(6.5)	(13.1)
Remaining Sources	(1.9)	3.1	(0.9)	0.3
General Fund Total	(8.4)	(15.1)	(21.9)	(45.4)
Guarantee Fund	4.8	0.1	(0.2)	4.8
General Fund Total	(\$3.6)	(\$14.9)	(\$22.1)	(\$40.6)

Colstrip: No Specifics, but a Downside Revenue Risk

Ultimately, the long-term fate of the Colstrip plants and the mine are unknown. If at some point the Colstrip plants stop running due to contract disputes or closure of the mine, the timing, order, and magnitude of potential revenue impacts would be as follows:

The first impact would likely be seen in coal severance tax collections. If the Rosebud mine does not find a new customer or the Colstrip plant does not agree to a higher price, production would stop, and severance tax collections would decrease. Production from the Rosebud mine represents approximately one-third of Montana’s total coal production. Similarly, coal gross proceeds tax collections, a property tax paid on coal proceeds, would decline soon after production ended. US mineral royalties would also begin declining as soon as production ceased at the Rosebud mine. The state also imposes a resource indemnity and groundwater assessment (RIGWA) tax on the gross value of coal that would be immediately impacted.

Electrical production and transmission tax impacts would take longer to materialize. Even if no alternative coal supplier is found, there is likely a backlog of coal that has already been purchased that would be used to run the plant. The length of time before impacts are seen by the state would depend on the amount of coal that is on site at the plant. Impacts to property tax collections would take time to materialize as well. Depending on when the plant ceases operation, changes to its property tax valuation would not be seen until after a reappraisal for the next tax year. If the reappraisal shows a decrease in value, as expected, it would result in a tax shift at the local levels, local spending reductions, and a decrease to the state property tax collections. Finally, changes in income tax collections could take years to materialize as reclamation and cleanup jobs may partially replace those at the mine, power plant, or other related industrial activities.

The table below shows the anticipated order of impacts to the state as well as the potential total fiscal impact if the plant is fully decommissioned. These estimates were produced using a previous [analysis](#) done by the LFD, which calculated the direct fiscal impacts of Colstrip units 1 and 2 closing. It did not account for any indirect effects or the timing in which the impacts would be felt, it simply compared a baseline scenario when they were both in operation to another scenario where they were not in operation. Colstrip units 1 and 2 make up approximately one-third of the total plant; therefore, the estimates below were produced by multiplying the initial analysis findings by three.

Potential Direct Fiscal Impact if Colstrip Power Plant is Fully Decommissioned <i>Shown by Likely Order of Revenue Reduction</i> (\$ Millions)			
Revenue Source	GF	Other	Total
Coal Severance Tax	\$3.1	\$8.6	\$11.7
Coal Gross Proceeds	3.4	3.5	6.9
Resource Indemnity & Groundwater Assessment		0.4	0.4
US Mineral Royalties	2.5	0.9	3.4
Electrical Production and Transmission	4.0		4.0
Property Tax			22.5
GF	6.3		
Local Governments and School Districts		16.2	
Individual Income Tax	2.3		2.3
Grand Total	\$21.7	\$29.4	\$51.1

The IHS Markit economic forecast for Montana does not include specific impacts related to a sudden change in coal production or associated power production.

YEAR-TO-DATE GENERAL FUND REVENUE

General Fund Revenue Monitoring Report							
(\$ Millions)							
Revenue Source	Actual FY 2018	HJ 2 FY 2019	HJ 2 Est. % Change	Mar FY 2018	Mar FY 2019	YTD Difference	YTD % Change
Largest Seven Sources							
Individual Income Tax	\$1,297.777	\$1,359.066	4.7%	\$995.526	\$1,036.614	\$41.088	4.1%
Property Tax	276.414	283.225	2.5%	160.385	169.265	8.880	5.5%
Corporation Tax	167.100	160.824	-3.8%	105.118	110.236	5.118	4.9%
Vehicle Taxes & Fees	109.540	111.525	1.8%	72.294	72.790	0.495	0.7%
Oil & Natural Gas Taxes	54.508	60.049	10.2%	12.075	15.805	3.729	30.9%
Insurance Tax	75.273	77.475	2.9%	41.782	43.314	1.533	3.7%
Video Gaming Tax	60.324	60.158	-0.3%	31.642	31.442	(0.200)	-0.6%
Other Business Taxes							
Drivers License Fee	4.581	4.342	-5.2%	3.292	2.890	(0.402)	-12.2%
Investment Licenses	7.683	7.963	3.6%	7.184	7.486	0.302	4.2%
Lodging Facilities Sales Tax	24.091	25.218	4.7%	13.704	14.805	1.101	8.0%
Public Contractor's Tax	4.267	3.503	-17.9%	3.990	4.176	0.186	4.7%
Railroad Car Tax	3.649	3.492	-4.3%	3.356	3.083	(0.273)	-8.1%
Rental Car Sales Tax	3.719	3.730	0.3%	2.156	2.588	0.432	20.1%
Retail Telecom Excise Tax	13.726	12.889	-6.1%	7.041	6.789	(0.252)	-3.6%
Other Natural Resource Taxes							
Coal Severance Tax	14.107	13.555	-3.9%	7.518	7.836	0.317	4.2%
Electrical Energy Tax	4.302	4.547	5.7%	2.155	2.106	(0.049)	-2.3%
Metal Mines Tax	6.291	6.749	7.3%	2.094	0.155	(1.939)	-92.6%
U.S. Mineral Leasing	20.139	20.934	3.9%	9.473	12.302	2.830	29.9%
Wholesale Energy Trans Tax	3.628	3.516	-3.1%	1.817	1.740	(0.076)	-4.2%
Other Interest Earnings							
Coal Trust Interest Earnings	17.938	17.088	-4.7%	11.417	11.395	(0.021)	-0.2%
TCA Interest Earnings	10.888	21.514	97.6%	5.902	13.235	7.333	124.3%
Other Consumption Taxes							
Beer Tax	3.002	3.074	2.4%	1.947	1.994	0.047	2.4%
Cigarette Tax	27.755	27.313	-1.6%	19.725	19.497	(0.228)	-1.2%
Liquor Excise Tax	21.007	22.884	8.9%	13.976	14.559	0.582	4.2%
Liquor Profits	12.200	12.900	5.7%	-	-	-	-
Lottery Profits	10.699	11.510	7.6%	6.639	7.292	0.653	9.8%
Tobacco Tax	6.058	6.273	3.6%	4.047	3.989	(0.058)	-1.4%
Wine Tax	2.446	2.461	0.6%	1.637	1.671	0.034	2.1%
Other Sources							
All Other Revenue	117.645	90.686	-22.9%	91.369	59.899	(31.471)	-34.4%
Highway Patrol Fines	3.754	3.907	4.1%	2.412	2.525	0.114	4.7%
Nursing Facilities Fee	4.405	4.275	-3.0%	2.239	2.223	(0.016)	-0.7%
Public Institution Reimbursement	13.754	13.887	1.0%	8.872	8.076	(0.796)	-9.0%
Tobacco Settlement	<u>2.778</u>	<u>2.996</u>	7.9%	<u>0.006</u>	<u>0.337</u>	<u>0.331</u>	5464.5%
Ongoing Revenue Subtotal	2,333.618	2,412.503	3.4%	1,582.620	1,654.649	72.029	4.6%
OTO Revenue & Transfers Subtotal	71.829	51.024		70.173	37.466	(32.707)	
Grand Total	\$2,405.447	\$2,463.527	2.4%	\$1,652.793	\$1,692.115	\$39.322	2.4%

Note that total year-to-date growth of 2.4% is influenced by the timing of one-time-only transfers in FY 2018. When one-time-only transfers and revenue is excluded, the ongoing revenue is above last year by 4.6% and above the anticipated growth of 3.4%.

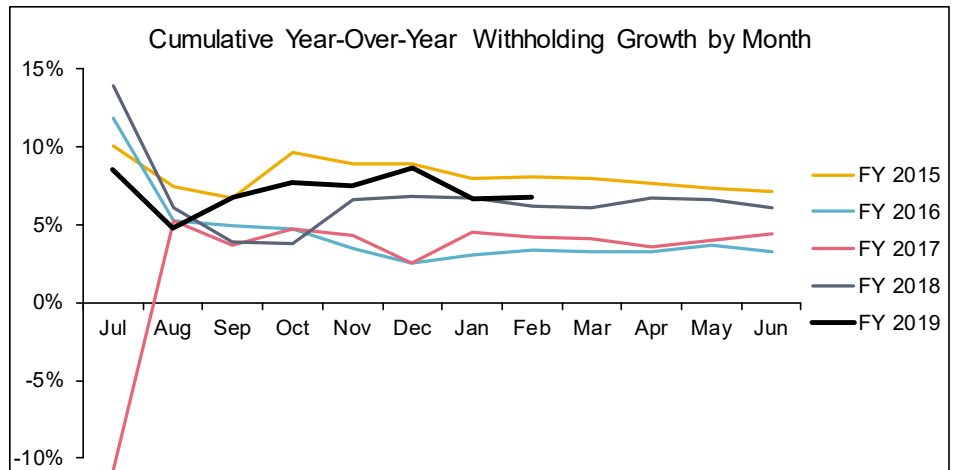
LFD MARCH REVENUE UPDATE DETAIL BY MAJOR SOURCE

Individual Income Tax: Approaching HJ 2

Individual income tax collections through the end of March are \$41.1 million or 4.1% above the year-to-date collections in FY 2018, but somewhat below the 4.7% growth anticipated in HJ 2. The year-over-year increase is driven by continued withholding growth; growth in most other accounts offset the decline in estimated payments.

Individual Income Tax (\$ Millions)				
	YTD 2019	YTD 2018	\$ Difference	% Difference
Withholding	\$770.8	\$723.0	\$47.9	6.6%
Estimated Payments	184.9	217.1	(32.2)	-14.8%
Current Year Payments	43.0	39.2	3.8	9.7%
Audit, P&I, Amended	31.0	29.1	1.9	6.6%
Refunds	(195.1)	(198.1)	3.0	-1.5%
Refund Accrual Reversal	161.9	153.2	8.7	5.7%
Partnership Income Tax	34.5	26.8	7.7	28.9%
Mineral Royalties	5.6	5.4	0.2	4.3%
Total	\$1,036.6	\$995.5	\$41.1	4.1%

Withholding, which accounts for over two-thirds of individual income tax and about one-third of total general fund revenue, is continuing to hold at above 6% year-over-year growth. As shown in the following chart, withholding growth tends to be relatively variable in the first half of the year, but stabilizes by February, allowing for potential assessments of overall fiscal year withholding growth.



The LFD April update for individual income tax is below the three-year HJ 2 estimate by \$37.3 million. The difference is primarily due to the April IHS lower outlook for wage disbursements and interest rates; these declines are somewhat offset by increased stock market growth, as well as model updates and the inclusion of the charitable endowment credit sunset.

Property Tax: YTD Increase Due to Protested and Non-Levy Revenue

Property tax collections are above last year by \$8.9 million or 5.5%, and above the increase of 2.5% anticipated in HJ 2. There have been only one of two large property tax payments made, but protested taxes and non-levy revenue appear to be bolstering collections compared to HJ 2. There may be some upside risk, but property tax is still expected to come in close to estimate. The property tax estimate has remained virtually unchanged since the adoption of HJ 2, as it has decreased by \$0.0 million over the three-year period.

Corporate Income Tax: On Track with Estimate

Corporation income tax collections through the end of March are 4.9% or \$5.1 million above this time in FY 2018. As the table below shows, corporation tax payments and estimated payments have shown strong growth in FY 2019. A large one-time audit from FY 2018 has offset most of the growth in payments, but that audit will have less and less weight as time progresses. Estimated payments typically make up 80% of total corporation income tax collections. Therefore, if the current estimated payments growth rate continues

throughout FY 2019, final collections will likely come in above HJ 2 and perhaps slightly above last year's collections.

Corporation Income Tax				
(\$ Millions)				
Account	YTD 2019	YTD 2018	\$ Difference	% Difference
Corporation Tax	\$21.6	\$13.7	\$8.0	58.4%
Estimated Payments	82.3	77.9	4.5	5.8%
Refunds	(9.1)	(14.1)	5.0	-35.4%
Refund Accrual Reversal	4.9	3.3	1.6	46.7%
Audit, P&I, Amended	10.5	24.4	(13.9)	-57.0%
Total	\$110.2	\$105.1	\$5.1	4.9%

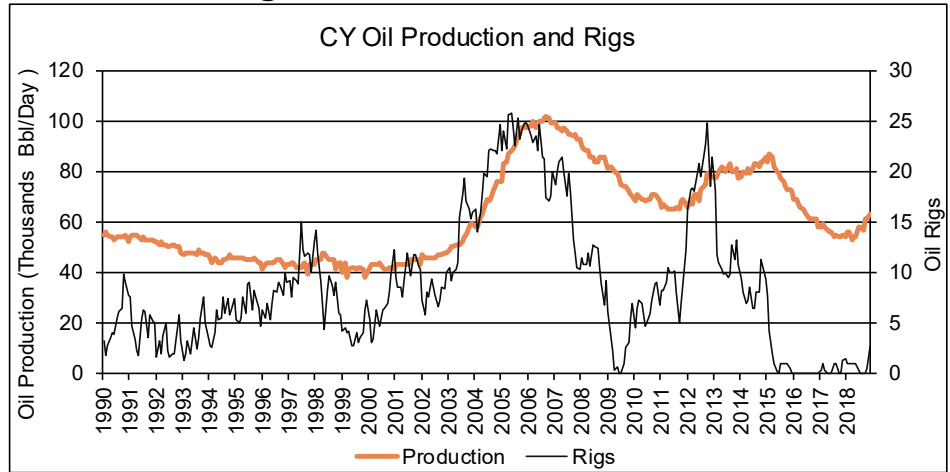
The LFD April update for corporation income tax is above the three-year HJ 2 estimate by \$14.5 million. The LFD revenue models do not include the \$23.5 million negative adjustment related to federal tax reform that was included in HJ 2; however, the increase was offset by the lower April IHS outlook, which reduced the three-year LFD estimate by \$9.0 million.

Vehicle Fees & Taxes: Slightly Below Estimate

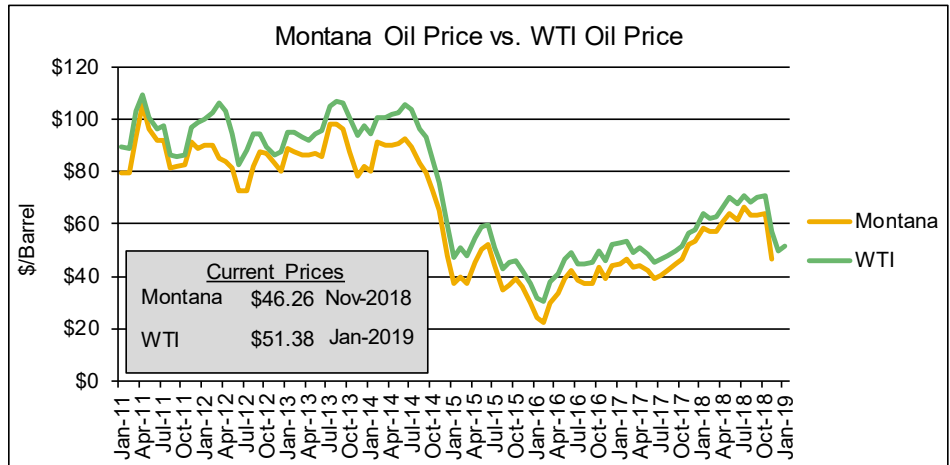
Nine months into FY 2019, vehicle taxes and fees are 0.7% or \$0.5 million above collections last year. In HJ 2, this source was expected to grow by 1.8%. As of now, this source appears that it will end up close to HJ 2. The April IHS forecast increased the vehicle fees & taxes estimate by \$0.2 million over the three years. The difference was driven by an increase in the estimate of new car sales in Montana for FY 2019.

Oil & Natural Gas Production Tax: Strong First Quarter Growth

In January, the first oil and natural gas payment was booked to the accounting system. High prices in the first quarter of FY 2019 caused this source to grow by 30.9% compared to the first quarter of FY 2018. In HJ 2 this source was expected to grow by 10.2%. Prices have since fallen compared to their first quarter levels, suggesting that the robust growth of 30.9% will not continue but should instead gradually approach the HJ 2 estimate.



As the top right chart shows, oil production had been declining since the beginning of 2015, as there was at most two rigs operating in the state since early 2015. However, production has increased since the summer of 2018 as up to four rigs moved into the area for the second half of 2018. The increased activity was likely spurred by increased prices, shown in the adjacent chart.



The LFD April update for oil & natural gas taxes is below the three-year HJ 2 amount by \$15.5 million. The decrease is due to revised oil prices by IHS. Specifically, the IHS outlook for West Texas Intermediate oil price has been revised downward by \$9/bbl in FY 2019, \$6/bbl in FY 2020, and \$8/bbl in FY 2021.

Insurance Tax: In Line with Estimate

Current insurance tax collections are 3.7% or \$1.5 million above FY 2018 through March, and in line with the 2.9% growth anticipated in HJ 2. The LFD April update for insurance tax is below the three-year HJ 2 amount by \$1.2 million, primarily due to the reduced IHS outlook for consumer expenditures in the finance and insurance sector.

Video Gambling Tax: On Track with Estimate

Revenue from video gambling is currently \$0.2 million or 0.6% below collections from last year. Last month had some unusual timing issues, and prior to last month this source had seen modest growth. As a result, the updated forecast has increased the three-year estimate by \$6.8 million.

TCA Interest Earnings

Treasury cash account interest earnings are \$7.3 million or 124.3% above collections last year at this time, and above the HJ 2 anticipated growth of 97.6%. The increase has been driven by the rise in short-term interest rates. The April IHS update decreased the estimate by \$13.1 million over the three-year period, due to lower expectations for short-term interest rates.

All Other Revenue

To date, all other revenue collections are 34.4% or \$31.5 million below last year's collections. The decrease is due to legislatively authorized transfers from [SB 261 \(2017 Session\)](#) and [HB 6 \(2017 Special Session\)](#) that were made in the first half of FY 2018. These have been partially offset by transfers from the same legislation that have now occurred in FY 2019. The April update increased the estimate by \$2.4 million over the three-year period. The increase was due to including a \$4.1 million Core Civic scheduled transfer to the general fund in FY 2020.

Remaining Sources

Revenue from the remaining sources, excluding legislatively authorized transfers and one-time-only revenue, was 2.6% above FY 2018. The April IHS forecast resulted in very small changes to most of the remaining sources. In aggregate, the new data and revised modeling resulted in a decrease of \$3.8 million over the three-year period.

Guarantee Fund

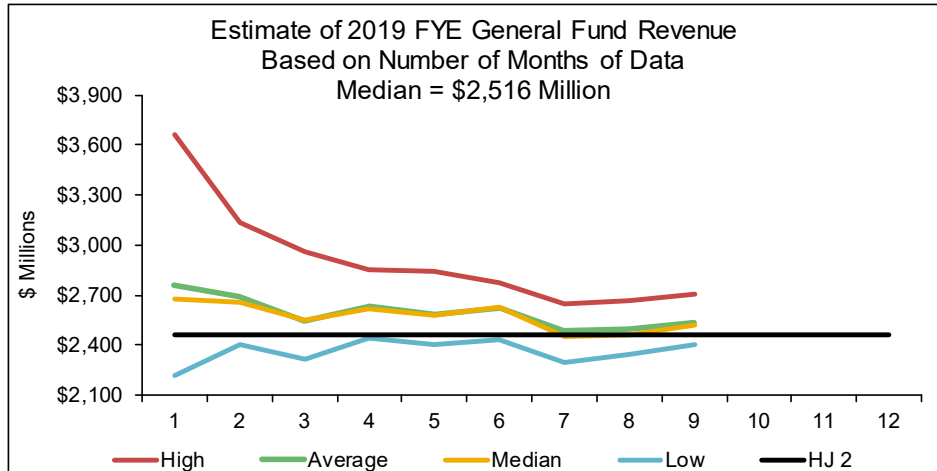
The LFD April update for the guarantee fund is above the three-year HJ 2 amount by \$4.8 million. The increase is due to the inclusion of \$4.8 million in 2017 Special Session transfers to the guarantee fund in FY 2019 that were not included in HJ 2.

APPENDIX

Based on data through March, two analyses of possible fiscal-year-end revenue collections based year-to-date revenue suggest final revenue collections in the range of \$20 million to \$52 million above HJ 2.

Year-to-Date Relative to Historical Collection Patterns

As the fiscal year progresses, the accruing data allows for a closer estimate of final collections based on historical collection patterns. Potential total general fund collections for FY 2019 are calculated using various year-to-date percentages—minimum, maximum, median and average—since FY 2002. The results are shown in the graph below. Based on collections through the end of March, the difference between the high and low amounts is about \$301 million, and median value is \$52 million above the HJ 2 estimate.

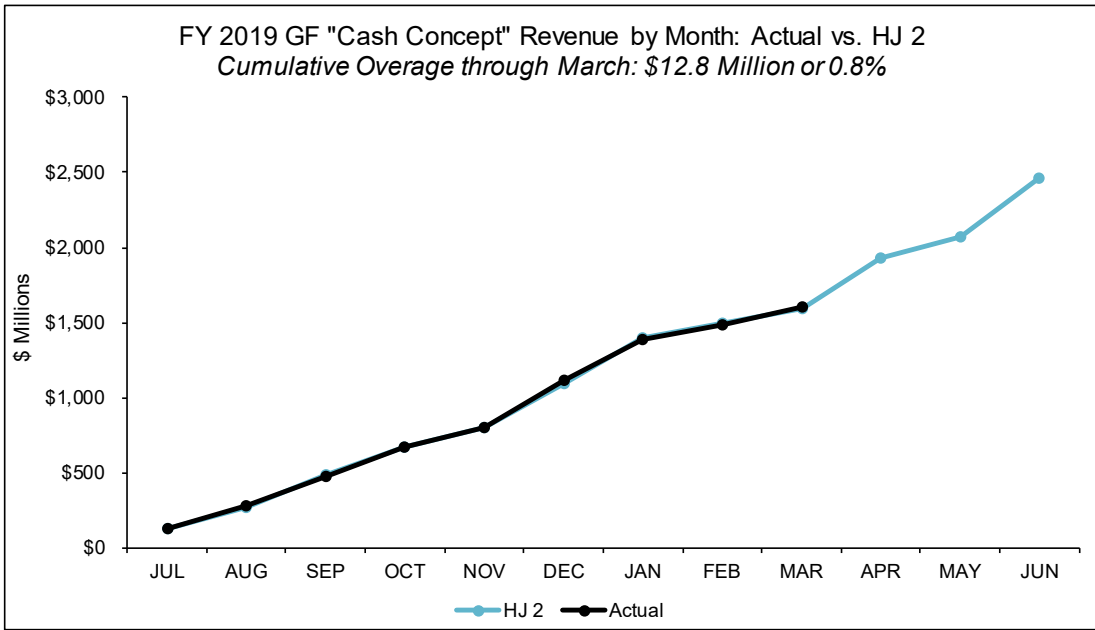


Potential total general fund collections range from a low of \$2,403 million to a high of \$2,704 million, with a median amount of \$2,516 million and average of \$2,531 million. The FY 2019 forecast for total general fund in HJ 2 is \$2,464 million.

Cash Flow Model

The monthly cash flow model is based on state accounting (SABHRS) revenue data by month from FY 2002 to FY 2018, with accruals and subsequent accrual reversals removed. The top seven revenue sources and general fund transfers are modeled separately, with the remaining sources estimated as a group.

The following chart shows modeled cumulative HJ 2 by month with the blue line, and actual collections with the black line. Through March, the cash concept model suggests general fund revenue is above what would be expected based on the official revenue estimate by \$12.8 million or 0.8%. If revenue continues to be above HJ 2 by 0.8% through FY 2019, final collections could be \$19.8 million more than expected.



Corporate income tax has the largest difference with respect to the estimate in HJ 2; based on the cash flow model, corporate income tax through March is \$13.3 million above the HJ 2 estimate.

