FitchRatings

Fitch Affirms Montana's 'AA+' IDR; Outlook Stable

Fitch Ratings-New York-20 December 2016: Fitch Ratings has affirmed the State of Montana's 'AA+' Issuer Default Rating (IDR) and the 'AA+' rating on approximately $117.8 million in outstanding general obligation (GO) bonds.

The Rating Outlook is Stable.

SECURITY

The bonds are general obligations of the state to which the full faith, credit and taxing power of the state are pledged to the payment of principal and interest.

KEY RATING DRIVERS

Montana's 'AA+' IDR is based on its increasingly diverse economic base, strong growth prospects, low liabilities and conservative financial practices. Although a decade of strong revenue gains tied to resource activity ended with the energy sector downturn in 2014, the state's consistently conservative approach to fiscal management and the revenue gains of that period have enabled it to both maintain steady operating performance and simultaneously address longstanding needs, including education and pensions.

Economic Resource Base
Although natural resources remain preeminent, Montana's economy is continuing to diversify and grow, particularly into services. The state's large mining sector is inherently volatile, but its strength over most of the last decade cushioned the state during the last recession and augmented state balances through most of the current economic recovery. The pace of economic growth has slowed in step with the energy sector slowdown, but strong gains in education and tourism continue to support broader growth and the state's unemployment rate remains well below national levels.

Revenue Framework: 'aa' factor assessment
Montana's revenues are diverse but economically sensitive given the dominance of income taxes and natural resource levies. Over time Fitch expects revenue trends to match historical experience, with faster than average growth matching the state's overall economic growth posture and continued diversification beyond natural resources. The state retains full control over tax rates.

Expenditure Framework: 'aaa' factor assessment
As with most states, education and social services are Montana's primary expenditure growth drivers. Expenditure flexibility is based on the solid ability to cut spending common to most U.S. states, as well as Montana's low carrying costs for long-term liabilities. Although not a current concern, litigation, fire suppression and other one-time needs have affected the state's expenditure framework in the past.

Long-Term Liability Burden: 'aaa' factor assessment
Montana's burden of long-term liabilities is low, driven by a reluctance to rely on borrowing for capital needs. Although pension obligations are a higher share of long-term liabilities and posed a challenge in the past, the state has reformed benefits, increase contributions, and devoted excess resources to improve sustainability.

Operating Performance: 'aaa' factor assessment
Financial resilience is solid, with strong gap-closing capacity even in the absence of a formal budgetary reserve mechanism. Multiple trust funds add to budgetary stability by supporting various spending needs. The state consistently budgets to achieve a sizable ending balance cushion and has shown a willingness to make spending cuts in the face of budgetary uncertainty. The state used excess revenues prior to the energy sector downturn to address budgetary demands related to education, pension and fire suppression.

RATING SENSITIVITIES

CONTINUED CONSERVATIVE MANAGEMENT: The rating is sensitive to the state's continued conservative approach to fiscal and liability management.

CREDIT PROFILE

Although Montana's large natural resource sector is inherently volatile, the sector's relative strength prior to the energy sector downturn that began in 2014 helped to cushion the state through the last recession and has augmented state balances over time. Montana's overall economy has been gradually diversifying, supporting continued growth even as mining, construction and other resource-related sectors experience retrenchment. Jobs in tourism, education and healthcare and other services continue to expand. Unemployment has historically trended below national rates and remains well under the U.S. level. Personal income gains have slowed in recent years after an extended period of above-average gains. As of 2015, personal income per capita measured 87% of the U.S. level, ranking Montana 37th among the states.

Revenue Framework

Montana's general fund tax revenues are diverse, although personal and corporate income taxes predominate. Various consumption taxes are levied, but there is no broad-based sales tax. Other important revenue sources include property, insurance and vehicle taxes. Although the general fund receives volatile oil and gas taxes, these are a small share of overall receipts. Half of coal severance taxes are deposited to a separate permanent fund, and another share designated for the general fund is diverted instead to improve pension funded status.

Growth prospects for Montana's revenues are strong, and revenue growth over time has exceeded comparable national GDP and inflation benchmarks. Personal and corporate income taxes are economically sensitive, and resource-related levies, such as coal severance taxes are also exposed to higher volatility, although the allocation of these receipts for specific needs outside the general fund helps to shield the general fund budget from the volatility inherent in these revenues.

The state has an unlimited legal ability to raise revenues.

Expenditure Framework

As with most states, Montana's major expenditure commitments are for education and health care, including Medicaid. In response to past school funding concerns, the state has taken an expansive role in funding local schools, supported in part by a statewide property tax. Certain other state spending needs are supported in part by revenues outside the general fund or by earnings of various permanent funds, helping to support budget stability.

The pace of spending growth in Montana is expected to be marginally higher than revenue growth in the absence of policy actions, consistent with most states. Federal action to revise Medicaid's programmatic and financial structure appears likely, although the magnitude and timing of changes for state budgets remains unknown. Both the incoming Presidential administration and Congressional leadership support significant Medicaid policy shifts. As one of the largest parts of state budgets and by far the biggest source of federal funding to the states, federal decisions could have significant implications for states' ability to manage this key budget item.

Montana retains ample expenditure flexibility, and the state has shown a willingness to make significant cuts to spending in response to revenue underperformance. Carrying costs for liabilities are low.

Long-Term Liability Burden

Montana's overall liability burden is low, measuring 5.6% of personal income as of Fitch's 2016 state pension update. Net tax-supported debt, at about 0.6% of personal income, is exceptionally low, in part due to the state's historical reluctance to rely on borrowing for capital needs. Outstanding debt consists of GO-secured bonds, transportation debt secured by federal grants and state enhanced bonds of the Montana Board of Investments and the Montana Facilities Finance Authority, which support borrowing needs of local governments and health facilities, respectively. Both of the latter enhancement programs have never drawn on state resources available as backup security.

Pensions constitute a larger share of the state's liability and the two largest plans, covering public employees and teachers, were a challenge in the past given inadequate employer contributions. These challenges now appear contained under existing funding parameters, which target maintaining amortization below 30 years and assume a relatively high 7.75% investment return assumption. Several rounds of reform, including reduced benefits, higher employer contributions, and diversions of resource-related revenues to augment funding, have brought both plans to well under the 30-year amortization target as of their 2016 valuations.

Operating Performance

The state's financial resilience is solid, driven by a conservative approach to budgeting, despite the absence of a formal reserve mechanism. The state consistently budgets a sizable ending reserve balance, monitors revenue performance carefully, and has shown a willingness to cut spending in response to revenue underperformance. Economic and revenue momentum from natural resources initially helped to cushion the state during the last recession, although ultimately sizable projected gaps emerged and were addressed through reductions in pay-go capital and broad cuts to program spending.

Montana maintains several sizable trust funds, which Fitch believes enhance the state's financial resilience, despite not being intended as budgetary reserves. The trusts support spending that would otherwise fall to the general fund; the largest fund, the coal severance tax trust, receives half of coal extraction taxes and held over $1 billion at fiscal year-end 2016. The corpus can only be used with approval by three-quarters of the state's legislature.

Montana's solid operating performance is supported by ongoing conservative budgeting practices. The budget separates ongoing and one-time revenue and expenditures. Under a 2015 reform, a decline in forecast balance below 5% of general fund resources triggers automatic spending cuts, replacing an earlier 2% target. In addition to maintaining a sizable ending balance, the state established a fire suppression fund in 2013, which although not a formal trust fund, is viewed by Fitch as reducing a longstanding financial risk to the state. The fund's balance is forecast at $65 million in fiscal 2017; it has a statutory cap of $100 million.

Recent operating performance has been steady despite a slowdown in revenues tied to the energy sector slump. The fiscal 2014-2015 biennium ended with a fund balance of $455 million (20.7% of general fund revenues), although revenue momentum has slowed since then. Actual fiscal 2016 general fund revenues declined 3.6%, to $2.1 billion, and fiscal 2017 revenues are forecast to rise a modest 3.4%, to $2.2 billion. As of December 2016, the governor's budget office is projecting that the biennium will end on June 30, 2017 with a fund balance of $123 million (5.6% of general fund revenues). The executive budget proposal for fiscal 2018 - 2019 forecasts disbursements rising more slowly than revenues, with an ending fund balance on June 30, 2019 of $300 million (12.2% of general fund revenues).

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In addition to the sources of information identified in the applicable criteria specified below, this action was informed by information from Lumesis and InvestorTools.

Applicable Criteria
U.S. Tax-Supported Rating Criteria (pub. 18 Apr 2016) (https://www.fitchratings.com/site/re/879478)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form (https://www.fitchratings.com/creditdesk/press_releases/content/ridf_frame.cfm?pr_id=1016812&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJzZXNzaW9uS2V5IjoiRVZUUzY4M01SSVFST1BJMzNDOVE1VjdZSlNOVF
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S&P Global Ratings

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Montana
Montana Facility Finance Authority; General Obligation; Moral Obligation

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Credit Profile		
Montana GO		
Long Term Rating	AA/Stable	Affirmed

Rationale

S&P Global Ratings affirmed its 'AA' rating on the State of Montana's general obligation (GO) bonds. The outlook is stable.

At the same time, S&P Global Ratings affirmed its 'A' rating on Montana Facility Finance Authority's revenue debt supported by the state's moral obligation through an irrevocable agreement between the authority and Montana Board of Investments, in which the board will lend money to the authority up to an amount equal to maximum annual debt service of each series of bonds to replenish the debt service reserve.

The 'AA' GO rating reflects our view of the state's:

- Low tax-supported debt burden and rapid debt amortization;
- Government framework that requires Montana to adopt a balanced budget and provides some flexibility to the governor to reduce spending across agencies within the biennium to maintain structurally stable fiscal results; and
- Relatively low historical unemployment rate compared with the national rate.

Somewhat offsetting these strengths is our view of:

- Softness in revenue collections and recent weakening of reserves, which has pressured structural budgetary balance;
- The state's continued economic dependence on natural resources, agriculture, and tourism, with the oil and natural gas sectors particularly sensitive to commodity prices; and
- A relatively low pension-funded ratio.

The state's full-faith-and-credit secures the GO bonds.

Recent low commodity prices have contributed to slower-than-projected economic recovery and a $300 million cumulative shortfall in current biennium general fund revenue, or about 7% lower than the original budget. Although the current 2015-2017 biennium budget included a projected $300 million ending fund balance for fiscal year-end 2017, the ending fund balance is now estimated at $79 million, or only 4% of annualized expenditures. Gov. Bullock's executive budget proposes changes to increase the fiscal 2017 reserve to $123 million, or 5% of spending, and to ultimately rebuild balances over the next biennium to $300 million (12.5%) by the end of fiscal 2019, assuming revenue growth, state agency reductions, shifting certain special revenue for general fund purposes, and raising certain cigarette and liquor taxes. We believe the state's formerly good reserve levels have helped the state manage through the unexpected revenue downturn in the current biennium; however, failure to restore reserves or make proactive budgetary adjustments could expose the state to further economic softness that fails to meet projections in the next two years.

Although the 2015 biennium budget projected almost 5% annual general fund revenue growth in fiscal 2017, the state has since revised projected general fund revenue to $2.19 billion in fiscal 2017, or 3.4% growth over the previous year. The revenue shortfall was primarily driven by optimistic projections in a slow economic recovery as well as low commodity prices in energy, metals, and agriculture. Year-to-date fiscal 2017 general fund revenue through the end of February 2017 was tracking 2.6% above the same period in the previous year. Officials attribute slower year-to-date revenue growth to timing or accounting changes; however, slower-than-expected individual income collections could also likely reflect lower calendar 2015 capital gains income relative to the previous year. Although the 2015- 2017 biennium budget included a $300 million ending fund balance in fiscal 2017, which would have equaled almost 15% of the modified fiscal 2017 budget, state officials now project an $80 million ending general fund balance equal to 4% of fiscal 2017 expenditures assuming no additional changes to projected revenue or expenditures in fiscal 2017.

The official joint resolution revenue estimate in November 2016 projected ongoing general fund revenue of $2.3 billion in fiscal 2018, a 5% increase compared with fiscal 2017 estimates, and almost $2.5 billion in fiscal 2019 (6.6% increase). The estimates assume 5% annual growth in wage and salary income over the biennium due, in part, to a tightening labor market, which is in line with IHS Markit's projected growth in 2018 and 2019. The assumed employment growth of about 1% per year is also in line with IHS Markit's projections. In March 2017, a revenue estimate by the legislative fiscal staff for fiscal 2017 and the 2019 biennium was raised slightly by a cumulative $100 million based on higher projected income tax receipts due to estimated recovery in West Texas Intermediate oil prices of $55 per barrel in 2017 and 2018, which align with our expectations, although by fiscal 2019, the revenue estimates assume $64 per barrel, which we believe could be more optimistic. According to the legislative fiscal division's March 2017 forecast, updated revenue estimates also incorporate recent changes at the federal administration with anticipated lowering of federal taxes and $250 billion of expected federally driven infrastructure spending in the next 10 years.

The governor's proposed budget for the biennium totals $2.35 billion in fiscal 2017 and $2.39 billion in fiscal 2019, which is only 1% higher than the previous biennium. The executive budget proposes infrastructure spending on bridges, facilities, and water and sewer projects to be funded with grants, loans, and bonds. The budget also funds a slight increase in kindergarten to grade 12 education spending and proposes pay raises for state employees. The governor also recommended several revenue enhancements that could raise about $50 million per year over the next biennium, including increasing cigarette and liquor taxes and creating a higher income tax rate for an income tax bracket above $500,000, while eliminating the capital gains credit for gains above $1 million per year. The governor's budget proposes to slightly improve fiscal 2017 year-end expenditures and reserves to a total $122 million, or 5% of expenditures and to build balances over the next biennium to $163 million (6.9%) and ultimately $300 million (12.5%) by the end of fiscal 2019.

By contrast, the legislative proposed budget also slightly increases general fund spending compared with the previous year, but makes deeper cuts to health and education programs and leaves $140 million for the ending biennium reserve balance, or almost 6% of annualized expenditures, which is less than the governor has proposed. The legislative budget does not propose revenue increases. The legislature is in session until late April and continues to deliberate on the next biennium budget.

The state general fund relies primarily on individual income taxes (57%) and only derives 3% of its general fund revenue from direct oil and gas-related receipts, excluding other resources-based income from metal and coal mining. However, high paying jobs in the oil and gas industry still produce meaningful economic impact directly and indirectly as well as state corporate and individual income taxes that flow to the general and special funds, as seen with energy price declines in the previous couple years and slow economic trends. A portion of oil and gas revenue also flows to special funds as a component of state support to counties and school districts. As it has historically, the state's 3.8% unemployment rate remained below the national rate of 4.7% in February 2017, based on preliminary estimates. IHS Markit projects overall state employment will increase almost 1.4% in 2017, below the national projected 1.5% growth rate. Montana's aging workforce could create long-term pressure on employment growth prospects. Gross state product (GSP) is forecast to rise 1.8% in 2017 and 2.2% in 2018, although is still projected below forecasted national rates of 2.1% and 2.5% in 2017 and 2018, respectively. Economic dependence on natural resources exposes forecasts to fluctuations in volatile energy and commodity prices.

Montana's tax-supported debt burden is low, in our opinion, at $215 per capita and 0.5% of personal income. The debt service carrying charge is also low, at about 1.5% of state expenditures in fiscal 2016. Debt amortization remains a credit strength, in our view, with about 85% of tax-supported principal, excluding grant anticipation revenue vehicles, amortizing in 10 years. Although the state's debt burden and other postemployment benefit (OPEB) liabilities remain low, estimated long-term unfunded pension liabilities have risen and are funded at a relatively low 74%.

Based on the analytic factors we evaluate for states, we have assigned Montana a composite score of '1.9' on a four-point scale where '1' is the strongest.

Outlook

The stable outlook reflects our expectation that the state will restore structural balance to the biennium budget and manage cyclical revenue trends with timely adjustments in the biennium if unforeseen developments significantly impair structural balance of its budget. Revenue trends that continue to weaken and fail to meet expectations coupled with continued structural budgetary imbalance and reliance on nonrecurring sources to address shortfalls could pressure the rating. Although not expected in the next two years, significant diversification of the economic base and material progress in restoring and sustaining strong reserve levels and addressing unfunded pension liabilities could result in a higher rating. We believe the state's budgeted reserve levels have helped Montana manage through the unexpected revenue downturn; however, potential lags in proactive budgetary adjustments and diminished general fund reserve levels could expose the state to further economic softness that fails to meet projections in the next two years.

Government Framework

The state budgets on a two-year biennial basis that, in our view, can present challenges when revenue fluctuates unexpectedly due to the state's somewhat cyclical economy influenced by oil and gas and other natural resource commodity prices. The governor must submit a balanced biennium budget, and the state constitution requires the legislature to adopt a balanced biennial budget. The governor has the power to make line item vetoes after legislative adoption. Although the budget is not required to stay in balance during the biennium, and at times historically has fallen out of balance, the governor has the statutory power to unilaterally cut as much as 10% of certain agency appropriations within a biennium to maintain budget balance if the Office of Budget and Program Planning (OBPP) projects a second-year midbiennium general fund balance of less than 2% of appropriations (cuts must be made to ensure an ending biennium general fund balance of no less than 1% of appropriations). The governor cannot unilaterally make cuts for certain appropriations, including those for debt service, elected official salaries, public school base funding, or legislative and judicial branches of government; combined, these appropriations represent 35% of total general fund appropriations. In our view, despite these limitations, the state has good flexibility to cut disbursements in most areas, if needed, and has historically made cuts it considered necessary to balance a biennial budget, although Montana has depended on reserve balances in the current biennium. The governor also has the power to call the (part-time) legislature into special session to make midbiennium budget changes. The state has not called a special session since 2007 when two sessions were called to finalize the budget before the end of the fiscal year and to appropriate for costs related to wildfires. The legislature can raise, lower, or impose most taxes by simple majority vote, but the Montana Constitution limits imposition of state sales and use tax to a rate of no more than 4%. The state does not levy a general statewide sales tax at present.

Montana allows voter initiatives, but we believe that the electorate has not approved measures in recent years that significantly affect state finances; although in 1981, voters approved a state expenditure limit tied to state personal income growth. A 2016 voter initiative that would have required the state to bond $200 million for stem cell research did not pass.

The state has flexibility to issue different types of debt, including GO bonds, lease appropriation bonds, revenue bonds, and grant and revenue anticipation notes. GO debt requires a two-thirds vote of the legislature, and the state constitution prohibits issuance of debt for operating deficits. According to the state constitution, interest on public debt is paid out of treasury without an appropriation. There is also a statutory appropriation for payment of debt service on state debt as well as for certain other budgetary areas, although there is no first claim on revenue for debt service. All principal and interest due during a fiscal year must be included in the state budget for that fiscal year, and sufficient revenue must be appropriated from the general fund. If the general fund is not sufficient, bonds are payable from any other legally available funds of Montana.

We believe Montana has wide latitude to reduce or restructure expenditures to local governments, although the state has not regularly made such reductions. The last significant restructuring of such payments occurred in 2001 when Montana consolidated state revenue sharing of specific taxes into block local "entitlement share" payments to localities; this base entitlement pool increases annually based on statutory formula. School aid is also funded by a statutory funding formula. Major expenditures of the combined general fund and state special revenue funds in fiscal 2016 on a generally accepted accounting principles (GAAP) basis include educational expenditures at 32% of total spending, health and human services at 19%, and general government at 17%.

On a four-point scale where '1.0' is the strongest, and '4.0' is the weakest, we have assigned a score of '1.6' to Montana's governmental framework.

Financial Management

Financial management assessment

We consider Montana's management practices "good" under our financial management assessment (FMA) methodology. An FMA of good indicates that practices exist in most areas, although not all might be formalized or regularly monitored by governance officials. Structural balance is an objective articulated in the state constitution, which specifies that the state may not deficit-spend. The governor proposes a two-year financial plan as part of the budget covering the next biennium. The financial plan includes state officials' revenue expectations and details spending requirements. State officials determine revenue and expenditure forecasts through in-house economists and by consulting other, non-state resources such as the U.S. Department of Energy. Each quarter, the state prepares revenue updates, which show cash flows at any point during a fiscal year. This mechanism gives the state an early warning if any revenue categories are unexpectedly low or if expenditures are unexpectedly high.

Montana's long-term capital improvement program is a compilation of capital construction programs from state agencies. The agencies' plans cover six years, with specific funding identified for the first two. The state's Uniform Investment Strategy guides investment management. The strategy details rules for eligible investments. Investment management is overseen by a separate board--the board of investments (BOI)--and investment management policies are reviewed and adopted annually. The state does not have any formal debt management plan, but the Montana Constitution requires a two-thirds vote of the members of each house of the legislature to authorize debt, and there is a long-standing practice of not entering into swaps and other derivative products, not issuing variable-rate debt, and limiting the bond term to 20 years or less, even though there is no official policy. There are also statutory limits on the term of bonds issued for information technology projects and on the issuance amounts of refunding bonds. As per Montana code, if the projected general fund balance falls below 5% in the first year of the biennium and 1.875% in the second year of the biennium, the governor is required to submit proposed spending reductions whereby the state must enact budget cuts of up to 10% for each department so that the ending biennium general fund balance would not fall below 3.5% in the first year of the biennium and about 1.0% in the second year of the biennium. There is also a separate fire suppression fund, capped at $100 million, to mitigate potential volatility in spending from unpredictable wildfire costs. Deposits are to be made from annual unexpended general fund reversions that exceed 0.5% of total appropriations in years where there is no revenue shortfall and unexpended balances from $16 million the governor designated in the biennium budget for emergencies. State officials estimate a $74 million balance in this fund in fiscal 2016 and project a $60 million balance or about 2.5% of annualized budgeted expenditures at the end of fiscal 2017. A proposed senate bill in the current legislative session, if passed, would establish a budget stabilization fund (BSF), up to 4.5% of general fund appropriations, the governor could use to address budget deficits during the biennium. The proposed legislation would require the BSF to be built with deposits from a portion of future general fund revenue receipts that exceed budgeted forecasts and would also require an equal amount of budget cuts as transfers and withdrawals from the BSF. The legislation also proposes a budgeted minimum 8% in the operating general fund balance. We would generally view the establishment of a reserve to address budget contingencies favorably.

Budget management framework

The state's budget management framework includes a consensus revenue forecast by OBPP and a state legislative committee once every two years when the biennium budget is prepared. Montana reports that the OBPP monitors revenues daily and also makes its own internal, informal forecasts throughout the year. About every quarter, the legislative finance and interim revenue and transportation committees meet to review state revenue collections and expenditures, and OBPP provides updates and recommendations pertaining to revenue and expenditure. In the past, the governor has used OBPP midbiennium forecasts of shortfalls to trigger midbiennium budget-cutting actions, although budget reserves will be used to address most of the shortfall in the current biennium. As described above, under statutory law, the governor has the authority to cut as much as 10% of agency appropriations in certain areas to ensure a minimal ending biennium general fund balance of about 1%. We believe this power has been helpful to the state in maintaining budget balance, in light of the two-year span of the budget and potentially difficult-to-predict revenues due to a somewhat cyclical state economy.

On a four-point scale where '1' is the strongest, we have assigned a score of '2' to Montana's financial management.

Economy

Montana is the fourth-largest state in area in the U.S. encompassing 147,000 square miles, although the state's estimated population of 1.04 million in 2016 makes it one of the least populated. The population has been growing at an average annual compounded growth rate just above that of the U.S. in the past five and 10 years, despite falling below the national growth rate between 2009 and 2012. Much of the population growth includes retirees moving to the state, which contributes to a higher age dependency ratio than that of the nation. A higher proportion of elderly residents compared with that of the nation has led to a growing state's services sector, with a rising health care services component. Montana's economy has been historically dominated by agriculture, mining, wood products, and tourism. Leading agricultural products include wheat and livestock.

Employment growth has lagged the national rate since 2014, including a very weak 0.6% gain in 2016 compared to the nation's 1.7% growth. IHS Markit projects a pick-up in employment growth to 1.40% and 1.30% in 2017 and 2018, respectively, although still below the projected 1.50% and 1.35% respective national rates. Despite the slower employment growth, Montana's unemployment rate has consistently remained below that of the U.S., averaging 4.1% in 2015 compared with the nation's rate of 5.3%. The trade, transportation, and utilities sector represents the largest nonfarm employment sector in the state although the he employment base continues to reflect a relatively large share of jobs in the leisure and hospitality sector as well as in government and mining and logging when compared to that of the nation. Government employment makes up 19.6% of the base, compared to 15.8% nationwide. The state's leisure and hospitality employment represents 13.5% of total jobs, compared to 10.6% for the nation, and reflects Montana's wealth of outdoor recreation and national and state parks, which spur tourism in the state. Leisure and hospitality employment was up 5.2% as of November 2016 compared with a year earlier and, according to the University of

Montana's Institute for Tourism and Recreation Research, preliminary estimates reflect 12.3 million nonresidents visited the state in 2016, or 4.9% more than in 2015. Montana's main tourist attractions include Yellowstone National Park, Glacier National Park, Flathead Lake, and the site of the Battle of Little Bighorn.

While the mining and logging sector represents only 1.8% of state employment, this exceeds the national average of 0.6%. In addition, ancillary economic activity associated with supporting oil production multiplies the impact the high-paying energy-related jobs have for the state's economy and revenue. The low metal and energy prices of the previous couple of years and slowing of the mining sector have contributed to weakened economic production and income. The state's major employers include Malmstrom Air Force Base, the State of Montana (including the state universities), Wal-Mart Stores Inc., and Billings Clinic Health System. Incomes remain below average but are adequate, in our view, with personal income per capita that is 87% of the national average.

After demonstrating relatively strong growth through most of the 2000s, Montana's annual GSP growth has fallen below that of the nation since 2012 and IHS Markit projects annual GSP growth rates will continue to lag national GDP growth through 2020. In 2015, GSP per capita was $43,794, which fell to 79% of the national rate compared to 82% in the previous year given Montana's relatively good population growth, but lagging GSP growth,

Montana has vast recoverable coal reserves representing approximately 25% of the nation's total and its mines produced about 4.5% of total annual U.S. coal production in 2015, although overall coal production has been declining. Production in the state declined 6% year-over-year in 2015 and federal clean air initiatives as well as relatively low prices for natural gas could continue to dampen mineral and ore demand. The state's coal production comes largely from surface mines that produce the preferred low sulfur content coal, but is subject to relatively higher costs of mining and transport. Although recent changes in the federal administration could lessen some regulatory challenges, state-specific clean energy initiatives, such as a bill passed in Oregon last year that requires utilities to phase out coal-fired power over the next 13 years, could still pose long-term pressures on demand. In addition to Arch Coal Inc. restructuring under bankruptcy in 2016, a coal-fired power plant in Colstrip, Mt. that serves the Pacific Northwest has announced a planned partial closure in the next several years. In addition to the coal mines, the state taxes oil and natural gas extraction in east Montana as well as metal mining, which has also been challenged by low metal prices. Although the coal industry is vital to certain communities in the state and coal severance taxes directly fund Montana's coal tax trust fund and support several specific government programs, the state general fund receives a relatively minimal share of direct coal tax revenue.

On a four-point scale where '1.0' is strongest and '4.0' is the weakest, we have assigned a score of '2.5' to Montana's economy.

Budgetary performance

Statutes currently include provisions requiring the governor to cut spending 10% to ensure a minimum reserve of about 1%. Montana had regardless historically maintained a strong reserve position and had budgeted for a $300 million ending biennium general fund balance, or about 12% of expenditures. However, slow revenue growth in fiscal 2017 has led to draws of the state's ending general fund balance below budgeted targets to only about $90 million, or 4% of annualized expenditures, at the end of fiscal 2017. When combined with the estimated fire suppression fund balance, we estimate total reserves will approximate about 7% annualized expenditures, which we consider good although well below the fiscal 2015 biennium balance. Montana has a history of making timely revenue adjustments and both the OBPP and legislative fiscal division regularly monitor and forecast revenues. State officials also determine revenue and expenditure items through in-house economists and by consulting other non-state resources.

Principal revenue sources on a GAAP basis are the individual income tax at 57% of general fund revenue in fiscal 2016, property taxes at almost 13%, natural resources taxes at about 3%, and the corporate income tax at about 6%. Given the large dependence on individual income, changes in employment, equity markets, wages, and interest rates as well as federal tax policy could generate significant changes in the state's general fund revenue or timing of receipts. In addition, the state's general fund has historically received various other taxes and transfers, including telephone license taxes, insurance premium taxes, and video gambling machine taxes, as well as cigarette and liquor taxes. Montana also levies a statewide property tax for public school and university funding. The state does not levy a general sales tax but imposes a lodging facility use tax and distributes most of the revenue to various departments and local nonprofit tourism corporations. The state deposits most of the revenue from taxes levied on accommodations and campgrounds as well as rental vehicles base charges to its general fund.

Fifty percent of coal severance taxes are constitutionally dedicated to the coal tax severance tax trust fund (permanent fund), and the legislature is authorized to allocate the remaining 50% of the revenue for various purposes. Before Oct. 1 2013, about 27% of the annual coal severance tax revenue flowed to the general fund; beginning in October 2013, legislation statutorily appropriates a total 24% general fund share of the coal severance tax to the Public Employees Retirement System (PERS) defined-benefit plan to help fund the unfunded actuarial accrued liability of the system. The majority of the remaining share of coal severance tax revenue is distributed to the long-range building cash account for pay-as-you-go capital funding.

Montana has discretion in most of its spending, but there are some areas where the state could be limited from a legal or practical standpoint. Medicaid, being an entitlement, is less discretionary, but the state could adopt changes to contain costs. Community college and K-12 education are funded according to a statutory formula, but the legislature maintains discretion to modify the formula. Funding for the university system is almost entirely discretionary.

Liquidity

As of the fiscal year ended June 30, 2016, the state's general fund cash balance was a healthy $322 million, or 55 days' cash on hand. According to OBPP, cash is monitored regularly and the state BOI manages all state cash to maintain minimum weekly and daily levels of liquidity to cover liquidity with one day's notification for all short-term investment pool participants, which include state agencies, local governmental entities, and the treasurer. OBPP also prepares a general fund cash flow projection every August that estimates inflows and outflows for each month to determine whether the fund will go negative during any month of the next fiscal year. This cash flow projection is updated monthly. Current cash flow projections reflect general fund cash balances, though falling below $50 million in March, April, and June, will remain positive through the end of the fiscal year. Expenditures and revenues generally follow a predictable pattern from year to year, and the state adjusts them as needed to reflect pay increases and other known effects. Since income tax revenue comprises the majority of state revenue, revenue collections are somewhat uneven with most of the state revenue received in April. Wage withholdings represent about 70% of income tax revenue in the state. Under Montana code, the general fund can borrow from other funds, except pension trust funds, and legislative approval is not required. External cash flow borrowing is used occasionally, but the state has not issued tax revenue anticipation notes since 2004.

In addition to the general and state special revenue funds, Montana has major permanent funds, including the coal severance tax trust fund, land grants trust funds, the resource indemnity trust fund, and the tobacco settlement fund. Aggregate permanent fund balances in fiscal 2016 totaled about $1.9 billion. The state's largest permanent fund, the coal severance tax fund, had a total available fund balance of $1.1 billion as of fiscal year-end 2016, or 47% of general fund expenditures; interest generated from this fund is distributed to the general fund. Currently, Montana can tap the principal on a three-fourths vote by both legislative houses. Although this fund provides significant liquidity and financial flexibility, we consider the three-fourths requirement restrictive, and the state reports that the fund is generally difficult to tap. No replenishment is required should the state draw from the fund. A proposed bill in the 2017 legislature would allow Montana to direct a portion of future coal severance taxes to establish a subtrust for infrastructure funding over time, if approved. Based on the fiscal note, the redirection of trust revenue would slightly reduce amounts to the general fund and allocations to PERS for pension contributions. Additional permanent funds with year-end balances include the state's tobacco settlement, land grants fund, and the resource indemnity fund. The resource indemnity trust has a principal balance of about $114 million and the state transfers interest earnings from the fund to pay for natural resource programs.

Fiscal 2016 results on a GAAP basis

The state's fiscal 2016 ending unassigned and assigned general fund balance was $267 million, or what we still consider strong at 12% of general fund annual expenditures, although it is down from $467 million, or 22% of expenditures in fiscal 2015. General fund expenditures exceeded general fund revenue by about $186 million (8%) and the general fund posted a $199 million operating deficit after net transfers.

On a four-point scale where '1.0' is strongest and '4.0' is the weakest, we have assigned a score of '1.8' to Montana's budgetary performance.

Debt And Liability Profile

Montana's total tax-supported debt across all measures remains low in our opinion. Total tax-supported debt at the end of fiscal 2016, which primarily includes GO bonds as well as tax-supported special revenue obligations and notes payable, represented only about $215 per capita, 0.5% of personal income, and a 0.5% of GSP. Debt service also represents a low 1.5% of state spending, and amortization of principal, excluding GARVEE notes, is above average, with 85% to be retired over the next 10 years. The state's Department of Transportation GARVEES are supported solely by federal revenue and are not included in the state's tax-supported debt burden. Although the 2015 legislature failed to pass an infrastructure spending package, the current legislature is reviewing proposed bills in both the house and senate that, if approved, could authorize $33 million-$98 million in additional bonding for infrastructure. Another bill proposes an 8-cent increase to the gas tax, which could fund road and bridge projects, if approved. In addition, a separate senate bill this legislative session proposes to divert a portion of earnings from the coal severance tax trust fund to fund infrastructure.

The state contributes to several defined benefit retirement plans (DBRPs), the largest of which are the PERS defined benefit plan (PERS-DBRP) and the Teachers Retirement System (TRS) plan. We consider the state's three-year average pension-funded ratio across all plans relatively low at 74%, which includes recently declining funded levels in the previous two years to 71% in fiscal 2016 due in part to weak investment returns. PERS-DBRP members are entitled to a guaranteed benefit adjustment of 1.5%-3.0% annually depending on date of hire; TRS members are entitled to 1.5% guaranteed benefit adjustments per year. In 2013, Montana enacted legislation that increased employer and employee contribution rates and allocated the general fund's share of coal severance tax revenue and interest income to help fund the higher pension contributions to PERS. The reform targeted amortization periods for the related liability for each of these key benefit plans that are less than 30 years, where in the past there was no such amortization period. Also included in the pension-related legislation were limits to current automatic guaranteed annual adjustments to the PERS and TRS plan benefits, which would have reduced amortization periods further and improved funded ratios. The benefit adjustments were challenged in court and found unconstitutional.

The state funds retirement contributions at statutorily determined levels based on a percent of employee salary. While the constitution requires the plan unfunded liability to be funded within 30 years on an actuarial basis, increases in actual contributions are subject to legislative and executive approval. The state's actual contributions to all plans before fiscal 2015 did not regularly meet annual required contributions on an actuarial basis. Due to previously enacted pension reform, TRS and PERS-DBRP expect incremental annual increases in supplemental pension contributions to target a minimum amortization of the unfunded liability. However, we calculate that total annual plan contributions for the previous three years did not cover an amount equal to annual service cost and interest cost plus some amortization of the unfunded liability across plans.

We believe, on the whole, management factors and actuarial inputs for Montana's largest pension plans do not significantly encumber or improve our view of the state's overall pension funding discipline. Both PERS-DBRP and TRS assume an open amortization period greater than 20 years as well as use of the "level percentage of pay" method, which assumes rising future payroll and results in escalating pension contributions over time. The five-year average rates of return of 7.68% and 7.69% for PERS-DBRP and TRS, respectively, fall just under the 7.75% long-term assumed rate. Neither system projects an asset depletion date under Governmental Accounting Standards Board 67, which we believe is reasonable, given estimated supplemental pension contributions. However, we believe payroll growth assumptions are somewhat optimistic and future experience studies that update return and mortality assumptions could affect fiduciary net position projections based on current statutory contributions. The PERS-DBRP and TRS plan ratio of active members to beneficiaries equals 1.33 and 1.26, respectively, which is moderately below the median national ratio of 1.5, in our opinion. Although PERS released an economic experience study more recently in 2013, the system produces full experience studies every four to seven years and has not released a full experience study since 2010, which we believe is somewhat dated. TRS produces an experience study every five years,

The state's proportionate share of net pension liability across plans translates to what we view as a moderate $1,939 per capita and 4.6% of personal income.

Montana's combined unfunded OPEB liability for both the state and the Montana University System plans was $458 million as of July 1, 2015. Both plans allow retirees to participate, as a group, at a blended rate with active employees in which retirees do not cover all of their own related costs. This results in the reporting of an "implied rate" subsidy in the related financial statements. We consider the state's unfunded OPEB liability per capita of $440 low compared with that of other states. Montana plans to continue funding the employee health insurance plan implicit subsidy on a pay-as-you-go basis.

On a four-point scale where '1.0' is the strongest and '4.0 is the weakest, we have assigned a score of '1.8 ' to Montana's debt and liability profile.

Ratings Detail (As Of March 30, 2017)		
Montana GO		
Long Term Rating	AA/Stable	Affirmed
Montana GO		
Long Term Rating	AA/Stable	Affirmed
Montana GO		
Long Term Rating	AA/Stable	Affirmed
Montana GO		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Montana Fac Fin Auth, Montana		
Montana		
Montana Fac Fin Auth (Montana) MORALOBLIG		
Long Term Rating	A/Stable	Affirmed
Montana Fac Fin Auth (Montana) MORALOBLIG		
Long Term Rating	A/Stable	Affirmed
Montana Fac Fin Auth (Montana) (Boyd Andrew Comnty Svcs Proj)		
Long Term Rating	A/Stable	Affirmed
Montana Fac Fin Auth (Montana) prerelease ctr rev bnds (Missoula Correctional Svc Proj) ser 1998A dtd 10/15/1998 due 10/01/2000-2008 2013 2018		
Unenhanced Rating	A(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns Aa1 to $25M Montana GO Bonds; outlook stable

Global Credit Research - 18 May 2015

Approximately $135M GO bonds outstanding

MONTANA (STATE OF)
State Governments (including Puerto Rico and US Territories)
MT

Moody's Rating

ISSUE		RATING
General Obligation Bonds (Water Pollution Control State Revolving Fund Program) Series 2015C		Aa1
Sale Amount	$25,000,000	
Expected Sale Date	05/27/15	
Rating Description	General Obligation	

Moody's Outlook STA

NEW YORK, May 18, 2015 --Moody's Investors Service has assigned a Aa1 rating to the State of Montana's General Obligation Bonds (Water Pollution Control State Revolving Fund Program), Series 2015C, to be issued in the estimated amount of $25 million. Following the issuance of these bonds, the state will have approximately $135 million of general obligations bonds outstanding, all rated Aa1.

SUMMARY RATINGS RATIONALE

The Aa1 rating reflects the state's trend of conservative fiscal management, low debt levels, and an economy that is growing and diversifying beyond its traditional concentrations in the natural resource and government sectors.

OUTLOOK

The outlook for Montana's general obligation bond rating is stable reflecting Moody's expectation that the stable financial trends will be maintained, supported by long-standing conservative fiscal management.

WHAT COULD MAKE THE RATING GO UP

- Sustained job growth with continued long-term economic diversification.

- Maintenance of strong financial position.

- Adoption of institutionalized financial best practices.

WHAT COULD MAKE THE RATING GO DOWN

- Deterioration in the state's financial and economic performance leading to strained finances.

- A significant increase in debt levels.

STRENGTHS

- Record of good financial controls underscored by a history of implementing expenditure reductions when needed to address budget shortfalls, the maintenance of healthy fund balances, and adequate liquidity.

- Low state debt levels, moderate unfunded retiree health liabilities, and manageable pension liabilities.

CHALLENGES

- Despite diversification, an above-average dependence on the natural resource and government sectors.

- Personal income levels that remain low compared to national figures.

- Voter initiative activity introducing some fiscal uncertainty.

RECENT DEVELOPMENTS

Recent developments are incorporated in the Detailed Rating Rationale.

DETAILED RATING RATIONALE

ECONOMY

State non-farm payroll employment has seen an ongoing decline in its dependence on the government and natural resources sectors, although these areas still make up a larger percentage of total employment than the national average. The state's economy has benefited in recent years for increased oil production in the Bakken oil field. The decline in oil prices will slow drilling and create a drag on the state's economy. But the oil sector is smaller in Montana than in many other energy states, moderating the impact of both the oil boom and the slowdown on the state's overall economy.

While unemployment rates have historically been higher than the nation, Montana's unemployment rates in recent years have been lower than the national rates, in line with recent job gains. The annual rate for 2014 was 4.7%.

Montana's per capita income levels remain low relative to the nation, although personal income growth has been very good in recent years, exceeding national rates. The state's per capita income figure, which was 77% of the national figure in 2000, is estimated at 88% of the national figure in 2014.

FINANCES AND LIQUIDITY

Largely as a result of its conservative fiscal practices, the state maintained adequate fund balances throughout the recent economic downturn. In fiscal 2010, the lowest year, total general fund balance equaled $310.6 million or 19.1% of revenues. Strong revenue growth in the ensuing years, particularly for personal income taxes, enabled the state to build up its reserves. General fund revenues, which exclude federal revenues, increased by 9.4%, 8.4% and 8.3% in fiscal years 2011, 2012 and 2013, respectively. At the end of fiscal 2013, total general fund balance had grown to $537.3 million, or 25.9% of revenues. The audited financial statements for fiscal 2014 have not yet been released, but officials report that the total ending balance for fiscal 2014 was $426.6 million, with the decline attributable to one-time spending.

The budget for the current fiscal 2014-2015 biennium was based on relatively conservative revenue growth estimates of just 6% for the two year period. The budget continues to fund growth in health and human services, education and corrections. Additional highlights of the 2014-2015 budget include significant one time investments in capital infrastructure in the state and the establishment of a wildfire suppression reserve fund. The wildfire suppression reserve fund comes alongside a new funding mechanism that will provide funds on an ongoing basis, reducing future budgetary pressure for the state in this area. The state currently projects an ending balance for fiscal 2015 of close to $400 million. Actual ending balance is likely to be higher due to agencies spending less than the full appropriated amount.

The legislature recently approved the budget for the 2015-2017 biennium. The adopted budget assumes revenue growth of 4.6% in fiscal 2016 and 4.7% in fiscal 2017 and provides for increased K-12 education funding, employee salary increases, and a tuition freeze for higher education. The legislature also approved Medicaid expansion under the Affordable Care Act, the costs of which will be paid by the federal government. The budget maintains continued structural balance and provides for an estimated ending balance for 2017 of over $300 million.

Liquidity

Liquidity levels are strong. The balance in the treasurer's fund, the state's primary operating cash account, exceeded $1 billion at the end of each of the last 3 fiscal years. The state also maintains sizable balances in a number of trust funds, including the permanent coal trust. The state has not issued TRANs since 2003.

DEBT AND PENSIONS

Debt Structure

Moody's 2014 State Debt Medians Report showed Montana's debt ratios remain well below state medians. Net tax-supported debt, which includes the state's general obligation bonds, coal severance tax bonds and transportation grant anticipation notes, is 0.7% of personal income and net tax-supported debt per capita is $276, versus medians for all states of 2.6% and $1,054, respectively, for these ratios. This ranks Montana 46th among the 50 states for both debt as a percentage of personal income and debt per capita. Officials are currently considering the issuance of new general obligation bonds in 2014 to fund infrastructure projects. The state's conservative approach to debt management is expected to maintain low levels of debt in the future.

Debt-Related Derivatives

The state has no debt-related derivatives.

Pensions and OPEB

The state's retirement systems are administered by the Montana Public Employee Retirement Administration and the Teachers' Retirement Division. The state's pension liabilities are above the averages for US states. Moody's adjusted net pension liability (ANPL) for the state for fiscal 2013 was $3.9 billion or 75.5% of governmental revenues, compared to a medians for all states of 60.3%. Its 3-year average ANPL was $4.1 billion or 78.7% of governmental revenues, compared to a median of 52.8%.

During the 2013 legislative session the state enacted significant reforms to reduce the unfunded pension liabilities in the state's multi-employer Public Employees' Retirement System and Teachers' Retirement System defined benefit plans. The key components of the reforms included increasing employer and employee contributions, increasing state contributions, reducing future benefits for new hires, and incorporating funding triggers to help manage contributions. Elements of the reforms are being litigated, which may delay the state's progress in eliminating the unfunded liabilities.

Montana's post-employment health benefits liability is minimal. The state offers health coverage to retirees at the same rate as current state employees. There is no direct state contribution on the retirees' behalf. The most recent estimate of the liability for the implied subsidy is $219 million.

GOVERNANCE

Montana's financial operations have historically been maintained in a conservative manner. While the state lacks certain institutionalized financial best practices such as the use of binding consensus revenue forecasting and formal multi-year financial planning of revenues and expenditures, it has established mid-course spending adjustments and contingency plans that enable management to take prompt corrective action to address budget shortfalls as it did during the recent recession.

Recent legislative changes have strengthened the mid-biennium correction process. The governor must cut agency spending in the event of a general fund budget deficit (defined as a projected ending balance that is less than 5%, formerly 2%, of the general fund appropriations for the second fiscal year of the biennium prior to October of the year preceding a legislative session) so that the projected ending general fund balance for the biennium will be at least 3.5%, formerly 1%, of biennial general fund appropriations. Protected from reductions are debt service, legislative and judicial branches, elected officials salaries and public schools.

The state does not currently maintain a formal budget stabilization fund, relying instead on prudent budgeting to ensure year-end balances. The legislature and executive branch have demonstrated a willingness to act promptly to correct mid-year imbalances. For Montana, this is particularly important as the economy, and consequently government revenue streams, remain dependent on potentially volatile natural resource prices. The creation and funding of the wildfire suppression reserve fund also protects the general fund from costs associated with a bad fire season.

KEY SCORECARD STATISTICS

Per capita income relative to U.S. average: 88%

Industrial diversity (1=most diverse): 0.69

Employment volatility (U.S.=100): 104

Available balances as % of operating revenue (5-yr. avg.): 21.8%

NTSD/total governmental revenue: 5.4%

3-year avg. adjusted net pension liability/total governmental revenue: 78.7%

OBLIGOR PROFILE

Montana is the 44th-largest state by population, at 1.02 million. Its state gross domestic product, $44.04 billion, is 49th-largest . The state's wealth levels are below average, with per capita personal income equal to 88.0% of the US level.

LEGAL SECURITY

Montana's general obligation bonds are secured by the full faith and credit and taxing powers of the state. Principal and interest must be included in the state's budget for each fiscal year and sufficient revenues must be appropriated for payment of principal and interest from the general fund or any funds legally available for the payment of principal and interest.

USE OF PROCEEDS

Proceeds of the bonds along with matching federal funds will be used to increase the capitalization of the state's Water Pollution Control State Revolving Fund Program. The fund is used to make loans to local governments for water pollution control projects.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was US States Rating Methodology published in April 2013. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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