2021 BIENNIUM OUTLOOK
GENERAL FUND BUDGET

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LEGISLATIVE FISCAL DIVISION
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MONTANA LEGISLATIVE FISCAL DIVISION

Montana's Financial Future for the 2021 Biennium

The purpose of this report is to provide legislators with a preliminary look at the major financial considerations for the upcoming 2021 biennium budget. The report provides the current outlook for ongoing general fund revenues and expenditures in order to project the available resources for the 2021 biennium. The report includes a summary of findings, with further elaboration on the following:

- General fund beginning balance for the 2021 biennium, budget stabilization reserve, and general fund structural balance
- General fund revenue projection scenarios
- Present law expenditure requirements
- Spending pressures on the budget
- Risks to the budget

Budget Pressures and Budget Risks

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

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

"Risks" are defined as shocks to the budget. Examples of expenditure risks are Medicaid and K-12 school funding costs greatly exceeding present law estimates. In addition to expenditure risk, a good example of a revenue risk to the budget is actual taxpayer behavior that is significantly different from the estimated taxpayer behavior. For example, taxpayers could respond to the lower federal tax rates by realizing additional capital gains and other non-wage income.

General Fund Focus

This report concentrates on the general fund, as it is the primary source used by the legislature to make funding decisions for government services, such as education, health and human services, and public safety. General fund was 36% of the state budget for the 2019 biennium. In addition, general fund is important to legislators as general fund ending fund balance and structural balance are used to determine the fiscal soundness of the state. Lawmakers entering the 2017 session were faced with a significantly lower fund balance than when they left town in 2015, therefore legislators focused on improvements to the ending fund balance and stabilizing state finances.

2021 Biennium Beginning General Fund Balance

Legislators completed their work in the 2017 sessions and the anticipated ending fund balance for the 2019 biennium is estimated to be at the operating reserve level of 8.3% of annual appropriations (operating reserve[1] is defined in statute). After considering all anticipated changes in revenue and expenditure, including supplemental pressures, the general fund balance at the beginning of the 2021

[1] Legislative Fiscal Division Budget Stabilization Fund Report III, May 1, 2018.

biennium continues to be at or above the operating reserve level of 8.3% of annual appropriations or $200 million.

In addition to the general fund balance, the budget stabilization reserve fund is anticipated to have a fund balance of $45.7 million. SB 9 (2017 Special Session) stipulated that if FY 2018 revenues were close to the HJ 2 revenue levels, up to $45.7 million may be transferred into the budget stabilization reserve fund in August 2018.

While both the general fund balance and the budget stabilization reserve fund balances are positive, there is no wildland fire suppression fund balance anticipated. As a result, assumptions are included to cover additional fire suppression expenses.

Beginning the 2021 biennium budget process with a funded budget stabilization reserve and a solid fund balance provides consistency for lawmakers.

Moving Forward into the 2021 Biennium

The work undertaken by the previous legislature provides Montana with a lower expenditure base and the continued growth in revenues forms a steady financial picture to begin the 2021 biennium budget process. Outlined in this section of the report are 2021 biennium revenue expectations, including an optimistic and pessimistic forecast, compared with expenditure present law assumptions, and expenditure pressures the legislature may wish to consider during the 2019 legislative session.

A series of graphics visually depict revenue projections in relation to estimated spending levels for the base budget, present law, and various levels of pressure considerations.

Revenue Projection Scenarios

Present Law Revenue Assumptions

The legislative revenue estimate (HJ 2 adjusted for legislation) expected revenue growth from the 2017 biennium is 15.7%. Current revenue trends indicate that growth from this level will be 4.4% in the 2021 biennium. The primary reason for lower revenue growth in the 2021 biennium is that the 2019 biennium includes several revenue impacts such as fund transfers, the Hospital Community Benefit Assessment, and a partial diversion of the Department of Commerce share of lodging tax revenue, that do not continue to the 2021 biennium.

Baseline Forecast

The baseline forecast contains the IHS Markit baseline for Montana and national economic assumptions, and assumes current HJ 2 for the remainder of the 2019 biennium as the uncertainty in taxpayer response due to the federal changes in Tax Cuts and Jobs Act of 2017 continues.

Tax Cuts & Jobs Act of 2017 (TCJA): Impact of Federal Tax Law Changes on State Revenue

The baseline and alternative revenue forecasts incorporate economic and direct impacts of the individual and corporate income tax changes due to TCJA. FY 2019 tax collections could be higher than the ongoing level if taxpayers respond to lower federal tax rates by realizing additional capital gains, business profits, and other non-wage income in CY 2018. It is unlikely that these additional revenues would continue beyond FY 2019.

Given the uncertainty of taxpayer response to the federal changes, the revenue outlook assumes current HJ 2 for the 2019 biennium.

Alternative Revenue Forecasts

While the baseline forecast is the primary comparison for the Outlook budget, comparing alternative forecasts with expenditure pressures can help articulate potential budget challenges.

Long-term Trend Forecast

The long-term trend forecast does not consider current economic trends. It is a purely mathematical calculation based on historical revenue collections and a comparison point for legislative consideration.

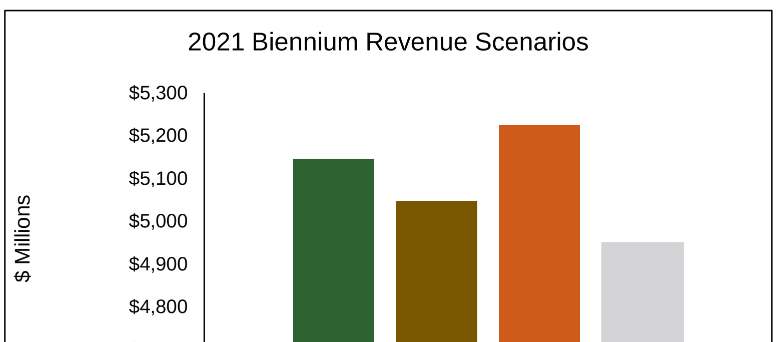
Pessimistic Forecast

The pessimistic revenue scenario incorporates the IHS Markit pessimistic forecast for national economic variables. In addition, the individual income tax forecast includes an adjustment that allows for the observed change in taxpayer timing of payments in weak stock market years, and the corporate income tax forecast assumes a higher level of refunds and lower audits.

Optimistic Forecast

The optimistic revenue scenario incorporates the IHS Markit optimistic forecast for national economic variables. Furthermore, the corporate income tax forecast assumes additional revenue due to repatriated income and the elimination of certain deductions, both provisions of the Tax Cuts and Jobs Act of 2017.

The adjacent chart illustrates the range of potential 2021 biennium revenue collections under the various scenarios.



Baseline	$5,147
Long Term Trend	$5,048
Optimistic	$5,225
Pessimistic	$4,950

BASE BUDGET

The base budget is defined as the resources authorized by the legislature for the ongoing operation of state government in FY 2019. The 2021 biennium outlook base has several key components:

1) Eliminates funding for the HELP Act, including Medicaid expansion, as that act sunsets at the end of the 2019 biennium
2) Appropriations approved for FY 2019 by the 2017 regular and special sessions:
    a. Final appropriations in HB 2 for FY 2019 appropriation authority from the November 2017 special session
    b. Adjusted by SB 9 (2017 Special Session), which stipulated that if FY 2018 revenues were higher than the executive expected, up to $45.7 million could be added back to agency appropriation authority in FY 2019. The Outlook assumes that the full $45.7 million is returned to the FY 2019 base

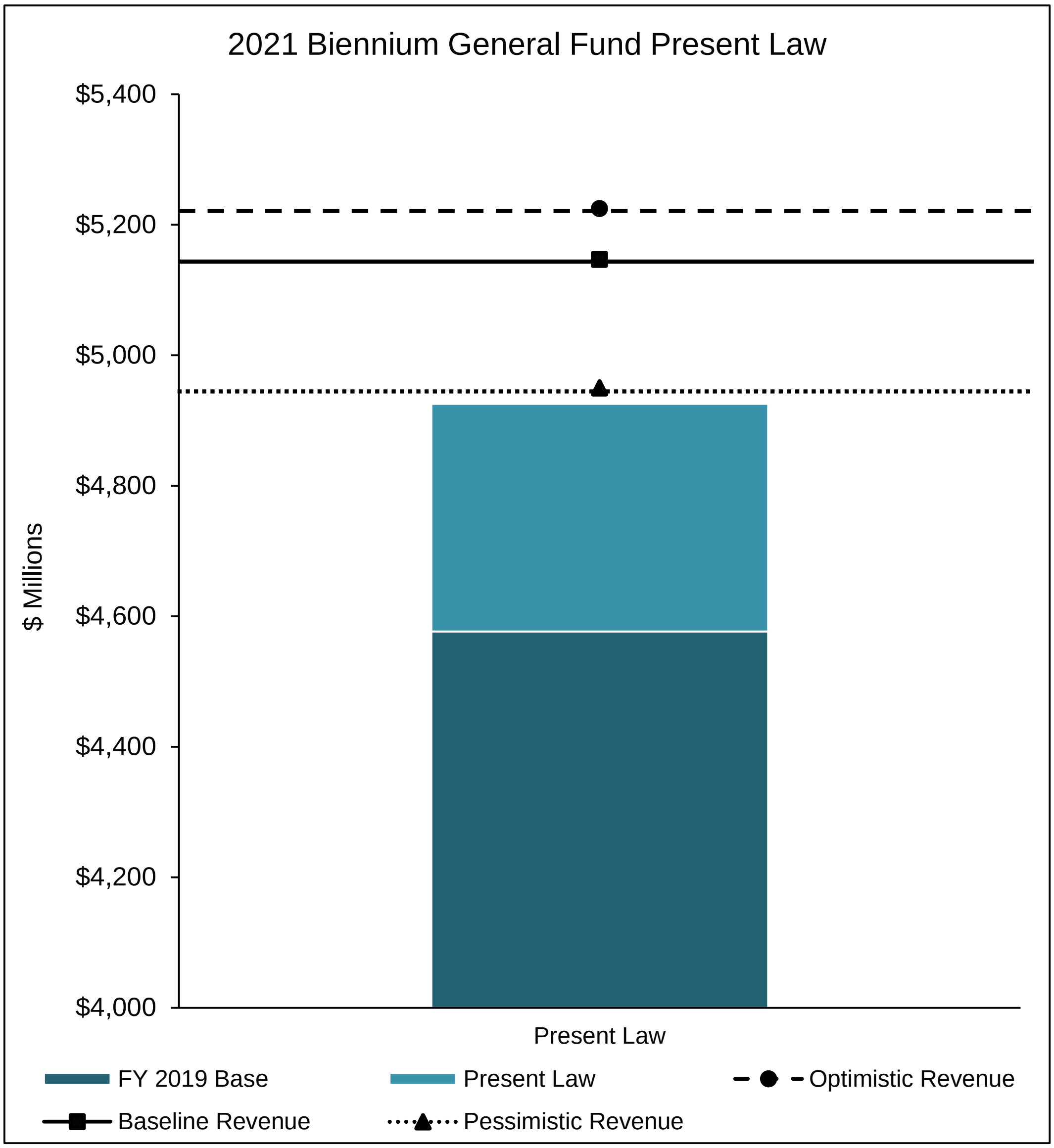
Including the SB 9 appropriation restorations in the base budget for the 2021 biennium, the base budget totals $4,577 million.

PRESENT LAW FOR THE 2021 BIENNIUM

Present law is the additional level of funding needed to maintain operations and services authorized by the previous legislature as ongoing. The graphic below illustrates present law expenditures in relation to anticipated revenues. As the graphic depicts, the 2021 biennium baseline, optimistic, and pessimistic revenue projections are above present law expenditure assumptions. Baseline revenues are $5,147 million compared to a total base budget plus present law of $4,925 million.

Present law adjustments from the base total $348.6 million. While present law includes the level of funding authorized by the previous legislature, in the session and interim many reductions were taken that were unclear as to the intent to the underlying program. When unclear, the Outlook present law level assumes the level the executive could request in present law, including the level of the Medicaid entitlement program.

In comparison to previous biennial Outlook present law adjustments, this amount for present law is unusually high. Most of the non-standard items occur in the budget of the Department of Health and Human Services (DPHHS), but some are associated with K-12 funding.

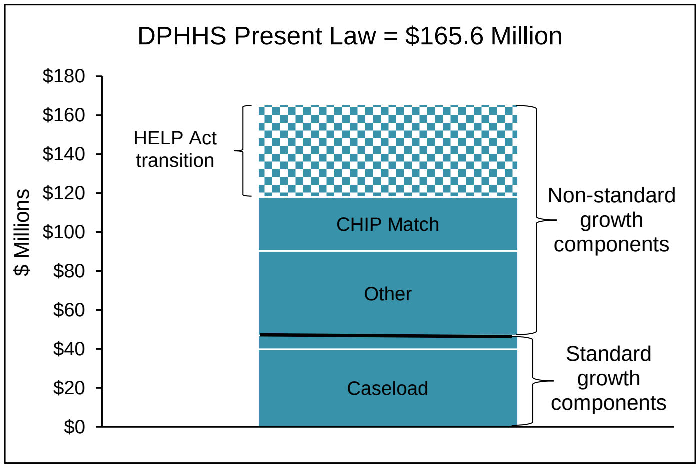


Present Law Detail

Present law of $348.6 million is primarily composed of growth in the Department of Public Health and Human Services (DPHHS) and K-12 education. This section provides further detail on changes in those two areas.

Department of Public Health and Human Services (DPHHS)

DPHHS represents $165.6 million in increased present law, which is 48% of the total present law amount.



Approximately $47 million of this would be considered standard growth components in present law, consisting of:

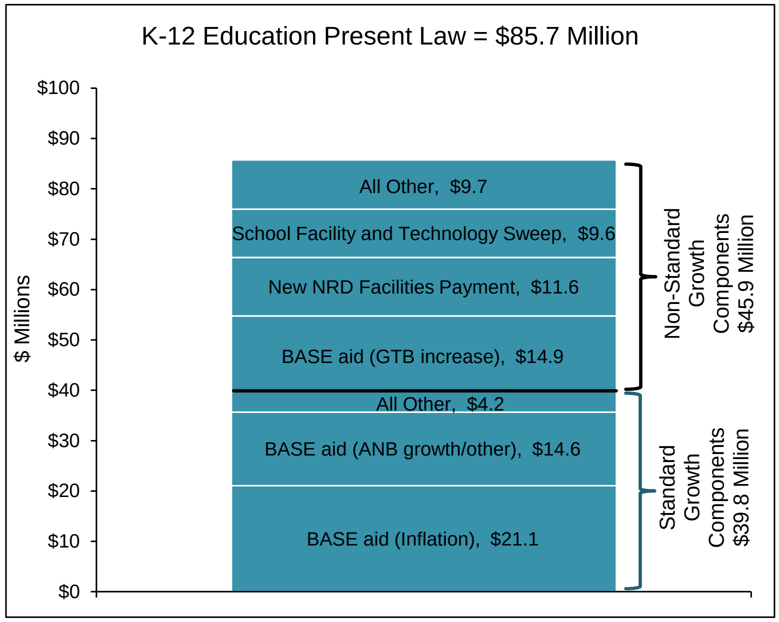
- $31.9 million for traditional Medicaid caseload, which assumes provider rates return to pre-2017 session levels and includes a portion for targeted case management
- $8.0 million for caseload growth in Child & Family Services
- $7.0 million for standard items such as annualizing the costs of previously approved changes and anticipated fixed cost increases

There are also a number of items included that are not typical of a standard present law adjustment and result in an additional $118.7 million of present law adjustments. These include:

- $47.6 million for HELP Act sunset transition – The HELP Act sunsets and is not included in the base budget. Present law allows certain participants in the HELP Act to transition to traditional Medicaid and requires additional budget authority
- $27.7 million increase for the Children's Health Insurance Program due to changing federal matching rates
- Other non-standard growth components:
  - $13.7 million backfill for SB 261 (2017 Session) Medicaid reductions, driving a higher overall Medicaid caseload increase
  - 2017 session legislation: $5.3 million for waiver slots and assisted living reimbursement rates due to HB 17 (2017 Session) and $13.1 million for direct care worker wages for HB 638 (2017 Session) not funded in the base budget, but approved by the 2017 Legislature
  - Additionally, there were a couple of areas where the 2019 biennium budget exceeded appropriations for a variety of reasons, and have ongoing effects on the budget into the near future. Included in this increase for cost overruns are:
    - Montana State Hospital: $7.0 million
    - Vocational Rehabilitation: $4.4 million

K-12 Education

The Office of Public Instruction funding represents $85.7 million in increased present law for the 2021 biennium. The changes include $39.8 million in standard growth components and $45.9 million in non-standard growth components due to restoring reductions made by the 2017 legislature.



The pieces making up the standard growth components include:

- $21.1 and $14.6 million for BASE Aid components: $21.1 million is for inflation, and $14.6 million is for additional enrollment and other adjustments. These other adjustments include $1.9 million in reduced funding needed due to forecasted growth in the guarantee fund
- $4.2 million all other: $2.4 million statutory growth established in HB 647 (2017 Session) for the purpose of supporting district facility needs, $0.4 million growth in the Data-for-Achievement payment, $0.4 million growth in transportation payments, and $0.9 million growth in all other categories

The pieces making up the non-standard growth components are comprised of reductions that occurred in FY 2019 and will statutorily return in FY 2020 and FY 2021:

- $14.9 million BASE Aid component: $14.9 million is for increases to the guaranteed tax base (GTB) ratio as adopted in HB 647 (2017 Session). This is a restoration of state support that will have the effect of reducing local property levies
- $11.6 million in the NRD facilities payment: This is a restoration of the payment that was established in HB 647 (2017 Session) for the purpose of supporting district facility needs
- $9.6 million in School Facility and Technology: This is a restoration of $4.8 million that was transferred to the guarantee fund in FY 2019. Absent this transfer, in FY 2020 and FY 2021, additional general fund will be needed for BASE Aid annually, which will amount to $9.6 million over the biennium
- $9.7 million all other: $6.4 million to restore the SB 261 (2017 Session) suspension of Data-for-Achievement payments and $3.4 million in transportation

EXPENDITURE PRESSURES

Pressures are defined as those factors that are not within the statutory definition of present law and are not included in the present law estimate, but that the legislature is likely to be under pressure to fund. Current service level pressures are identified as one-time-only (OTO) or sunset appropriations that were for functions that could be considered ongoing, but are excluded from the base. The following table summarizes the expenditure pressures—current service level, pressures, potential pressures, and total of all pressures—with specific page numbers referring to the written narrative explaining each pressure in the report.

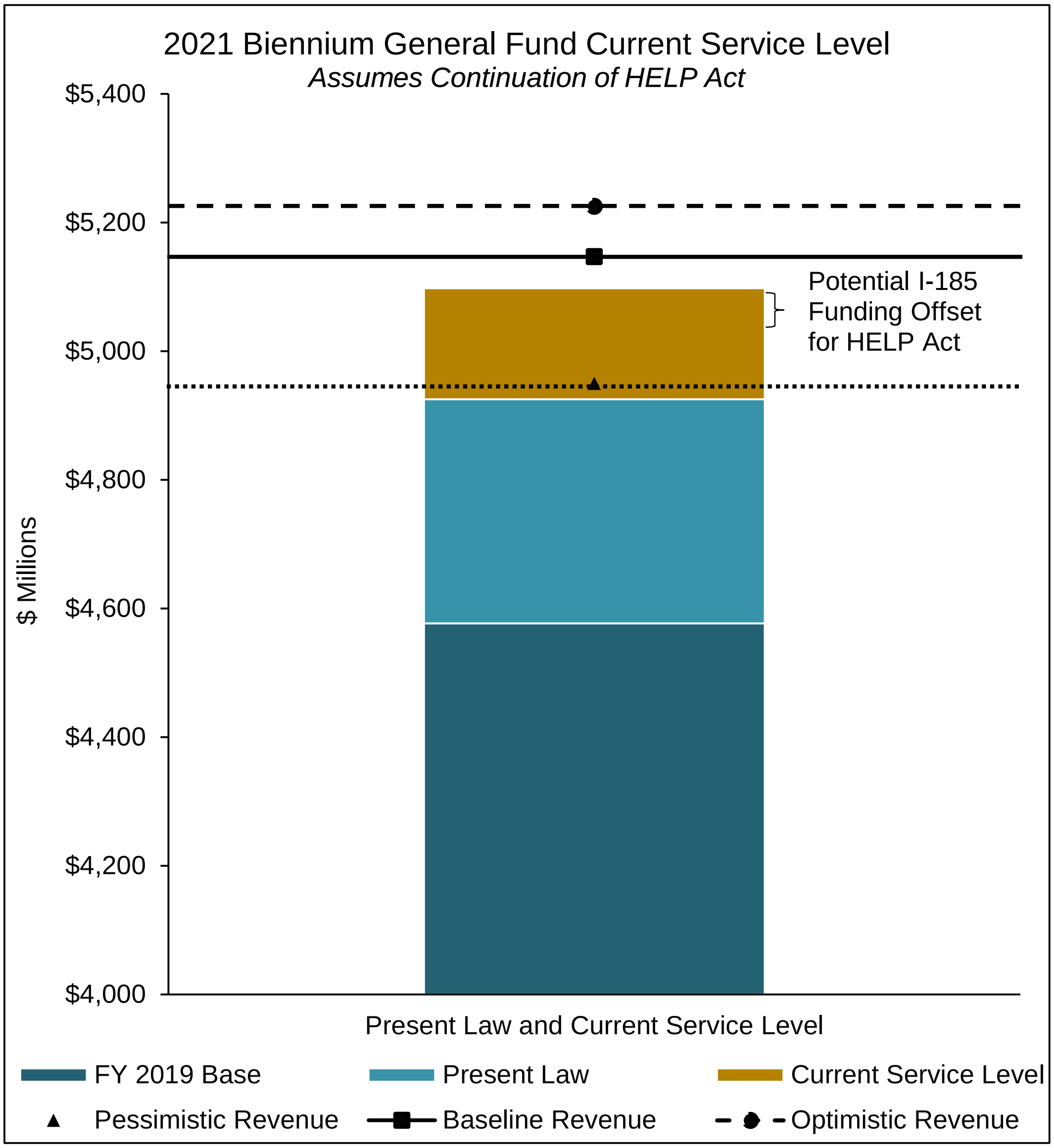
General Fund Expenditure Pressures
($ Millions)

	Current Service Level	Pressure	Potential Pressure	Total	Page
All agencies					
Pay Plan (- / 1% / 3%)	-	$13.7	$27.6	$41.3	18
SB 261 reduction restoration	-	12.3	-	12.3	18
Other reductions restoration	-	-	36.9	36.9	19
Other items	$4.0	1.4	-	5.4	18
Section A - General Government					
Return funding level to Coal Board grants	-	3.3	-	3.3	19
Legislative infrastructure needs	-	3.0	-	3.0	19
Section B - Health & Human Services					
HELP Act continues (current/ - / -)	150.3	-	-	150.3	20
Child & Family OTO replacement	10.2	-	-	10.2	26
Pre-Kindergarten (OTO / - / 2015 request)	6.0	-	25.0	31.0	26
DPHHS 1% provider rates	-	-	10.0	10.0	27
Section C - Natural Resources					
Fire average cost above anticipated available funds	-	27.1	-	27.1	27
Section D - Public Safety					
Corrections Caseload (- /with 2017 legislation/without)	-	3.0	9.0	11.9	29
Corrections provider rates (- / 1% / 3%)	-	2.2	4.4	6.6	29
Public Defender cost pressure	-	10.0	-	10.0	29
Section E - Education					
Return professional education general fund	-	2.7	-	2.7	33
Other items	2.1	3.2		5.3	32
Section F - Long Range Building					
Return transferred long range funds (OTO)	-	14.6	-	14.6	33
Long-term funding for long range	-	-	45.6	45.6	33
Total	$172.6	$96.5	$158.4	$427.4	

Current Service Level

The current service level pressures total $172.6 million. The Health and Economic Livelihood Partnership (HELP) Act passed in the 2015 session expanded Medicaid benefits to adults up to 138% of the federal poverty level until June 30, 2019. Since this legislation is set to terminate, it was not included in the base budget, but is considered a current service level pressure for the 2021 biennium. The HELP Act is the most significant expenditure in this category and is projected at $150 million in addition to the $47 million included in present law for the 2021 biennium. If an extension of the HELP Act is placed on the November ballot as a citizen initiative and passes, then an additional $52 million from tobacco tax revenue in the biennium will reduce the level of general fund expenditures. For a complete write-up of the HELP Act please see page 20.

The total general fund pressure considering base, present law, and current service level is $5,098 million, and is $49 million less than the baseline revenue forecast of $5,147 million.



Pressures

The expenditure pressures included in this section do not add new services, but fund current operations of state government at a level higher than present law. Pressures total $96.5 million and the most significant areas are the following:

- $27.1 million for wildland fire fund authority if an average fire biennia occurs (page 27)
- $14.6 million for restoration of other state infrastructure funds transferred to the general fund during the 2017 Special Session (related to infrastructure page 33)
- $13.7 million for a 1% employee pay increase (page 18)
- $12.3 million to restore SB 261 (2017 Session) reductions that occurred when the FY 2017 revenues were less than anticipated in HJ 2 (page 18)
- $10.0 million for the Office of the Public Defender (page 29)

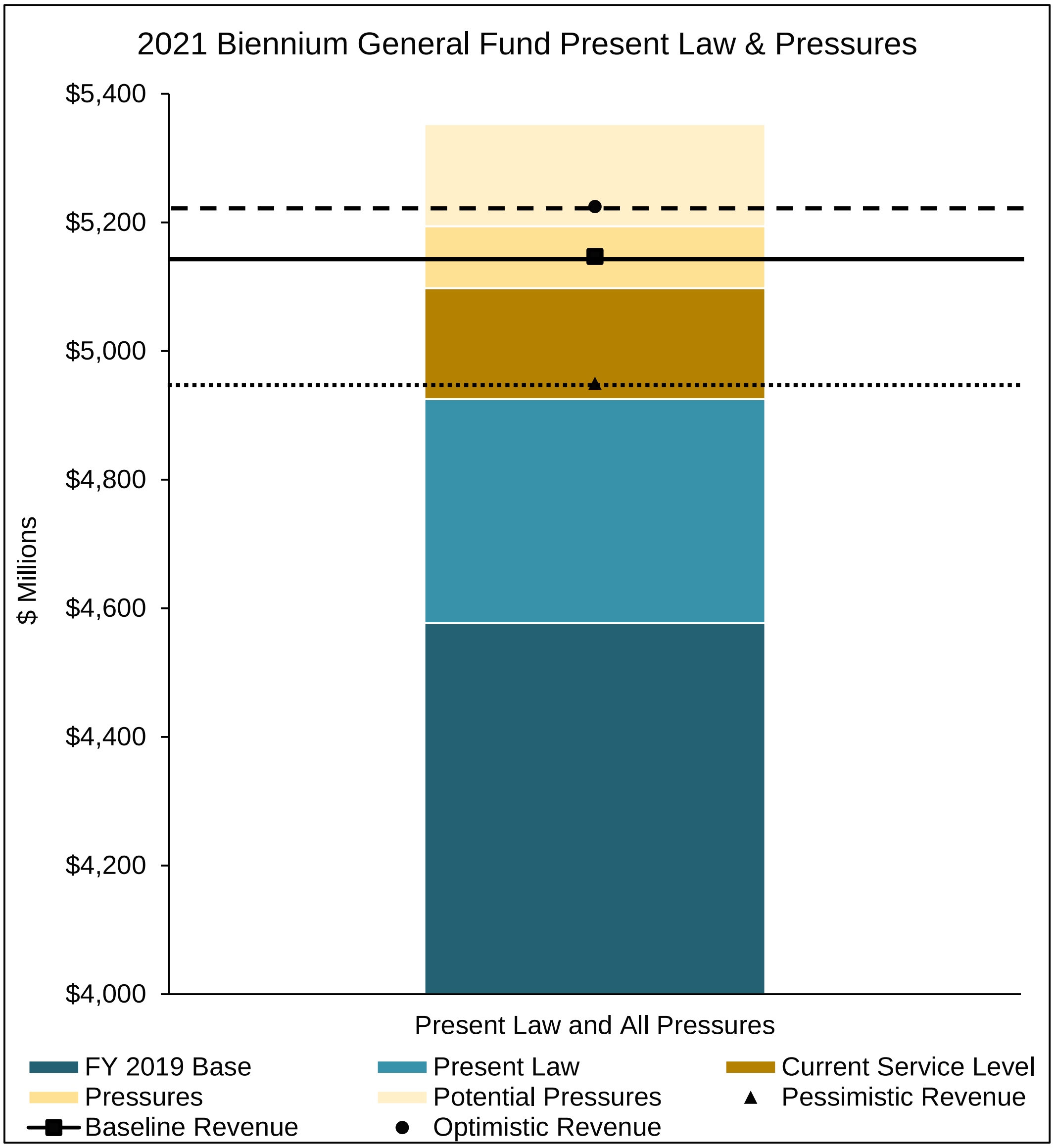
The total general fund pressure considering base, present law, current service level, and pressures is $5,195 million, and is $48 million greater than the baseline revenue forecast of $5,147 million.

Potential Pressures

The potential pressures total $158.4 million. They include a higher range of pressures in identical categories as in the pressures, such as an additional $25 million to bring the total for early child development for four-year-olds (pre-K) to that previously requested by the Governor and additional items such as long-term funding for infrastructure. Additional items shown as potential pressures include:

- $45.6 million for a long-term funding structure for state infrastructure needs (page 33)
- $36.9 million to restore reductions, not restored in other items, that occurred during the 2017 regular session (page 19)
- $10 million for 1% provider rate increases to DPHHS. Normally the Outlook would include higher levels of provider rate increases in the pressures section; however, since the Outlook already includes present law rates returning to the pre-2017 session levels, it seemed unlikely that large provider rate increases would occur (page 18)

The total general fund pressure considering base, present law, current service level, and all pressures is $5,353 million, and is $206 greater than the baseline revenue forecast of $5,147 million.


2021 Biennium General Fund Present Law & Pressures
$5,400
$5,200
$5,000
$4,800
$4,600
$4,400
$4,200
$4,000
$ Millions
Present Law and All Pressures
FY 2019 Base
Present Law
Current Service Level
Pressures
Potential Pressures
Pessimistic Revenue
Baseline Revenue
Optimistic Revenue

SUMMARY OF GENERAL FUND OUTLOOK

The general fund outlook is solid as recent legislative changes like implementation of a budget stabilization reserve fund have steadied state finances. In addition, general fund revenue has continued to be strong and is anticipated to end FY 2018 close to official HJ 2 revenue estimates adjusted for transfers. Structural balance, considering general fund revenue and current service level expenditure in the next biennium, will be positive.

The Outlook presented here has many moving and changing parts. Revenue estimates will continue to evolve as will expenditure estimates. A specific unknown expenditure impact is that the executive has initiated a different type of executive planning process (EPP) as stated in the following excerpt from a budget memo:

> *"The EPP for the 2021 Biennium must take into account the current budget realities. Executive Agencies must focus on living within their means and finding efficiencies in existing services. To help in that process, OBPP will be collecting a program inventory. There will be no traditional EPP this cycle. The purpose of the inventory is to develop a database of distinct stand-alone products, services, functions, and facilities offered by agencies. …"*

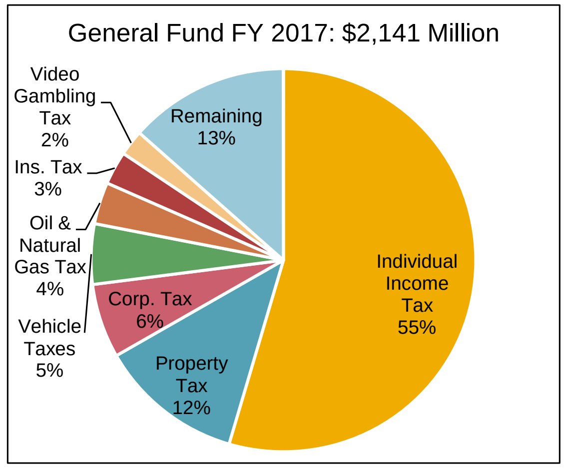
As described above, the executive is considering efficiencies in general fund expenditures. If the executive finds opportunities for efficiencies, it may reduce expenditures in some areas and allow for additional expenditures in other areas.

Revenue Details

Most general taxes are deposited in the state general fund. The general fund is used for most broad purposes of state government; education, health, and corrections are the predominant uses of this fund. Details of all general fund and most major state special fund revenue sources and allocations are contained in the Legislative Fiscal Division's [2019 Biennium Fiscal Report.]

General Fund Revenue Sources

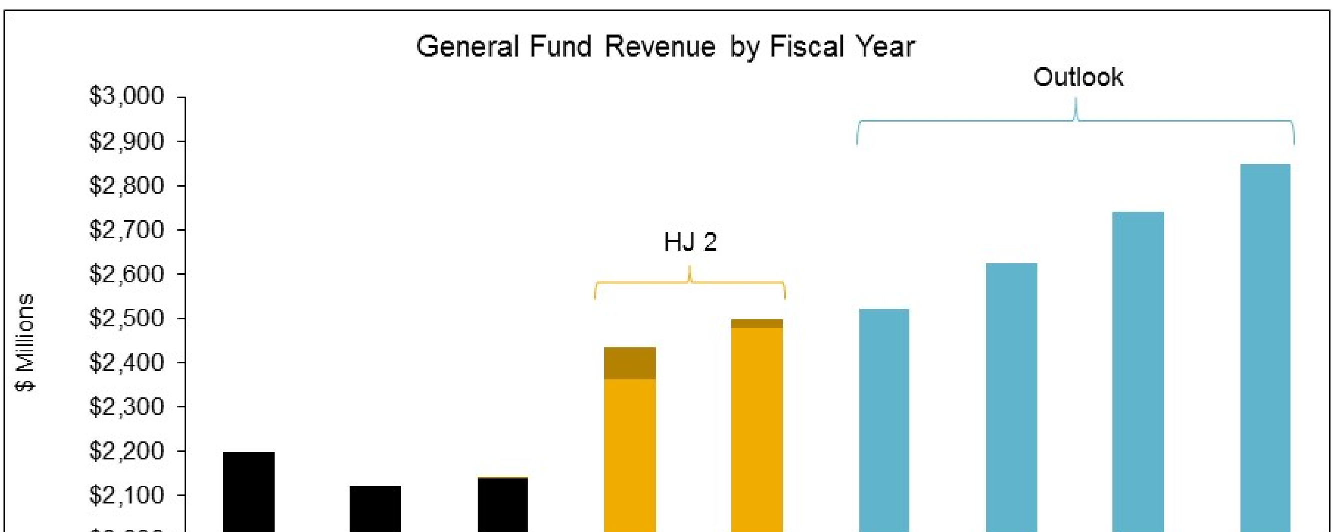
The largest seven sources of general fund revenue are individual income tax, property tax, corporate income tax, oil and natural gas taxes, vehicle taxes, insurance tax, and video gambling tax. In FY 2017, these sources accounted for 87% of general fund revenue. Highlights of the top six tax sources are provided later in this section.



General fund revenue volatility is usually attributable to three sources: corporate income tax, and oil and natural gas production tax are quite volatile in relative terms, while small percentage swings in individual income tax can produce significant changes to overall general fund revenue collections. More details on revenue risk is provided in the risk sections of this report.

General Fund Revenue Outlook and Future Updates

The chart below shows general fund revenue collections since FY 2007, with actual values shown in black, HJ 2 values in yellow, and outlook values shown in light blue. One-time-only (OTO) revenue and transfers for the 2019 biennium are indicated explicitly in the graphic and table. The outlook for total annual growth in general fund revenue for FY 2020 is 1.1% and for FY 2021 is 4.0%. Based on current data and econometric forecasts, the extended forecast for the 2023 biennium suggests general fund revenue growth of 4.4% in FY 2022 and 3.9% in FY 2023.

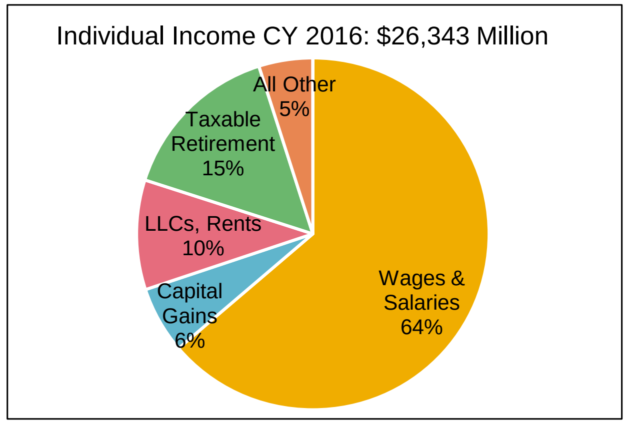


	2015	2016	2017	2018	2019	2020	2021	2022	2023
2019B OTO			4	74	20				
Ongoing	2,200	2,121	2,137	2,360	2,476	2,523	2,624	2,740	2,847
Ongoing Gr.	5.9%	-3.6%	0.7%	10.4%	4.9%	1.9%	4.0%	4.4%	3.9%
Total Growth	5.9%	-3.6%	1.0%	13.7%	2.5%	1.1%	4.0%	4.4%	3.9%

The general fund revenue outlook is produced by estimating the underlying sources of revenue and the economic drivers of those sources. Updated 2021 biennium revenue estimates for the general fund will be produced in November 2018 and presented to the Revenue & Transportation Interim Committee (RTIC). FY 2019 monthly revenue collections will be closely monitored throughout the 2019 session. If significant differences occur between the FY 2019 estimate and the actual revenues received, updates will be provided to the legislature.

Individual Income Tax

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

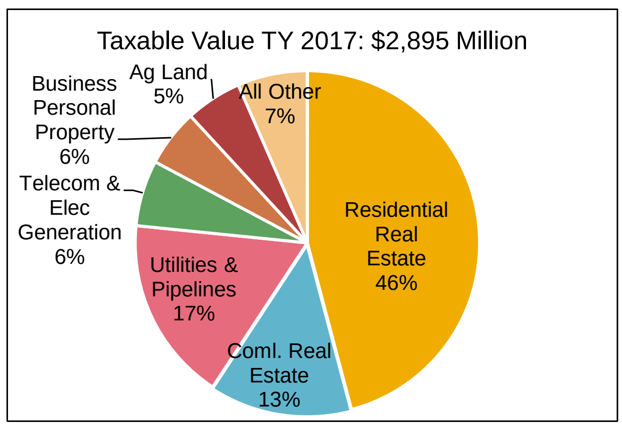


Tax rates vary from 1.0% to 6.9%, depending on the level of taxable income. The effective tax rate on capital gains income is less than the tax rate on ordinary income by 2%, after accounting for the 2% capital gains income tax credit.

The outlook for individual income is based on the updated individual income tax model provided by the Department of Revenue, which incorporates the revised federal tax law and the Montana earned income tax credit.

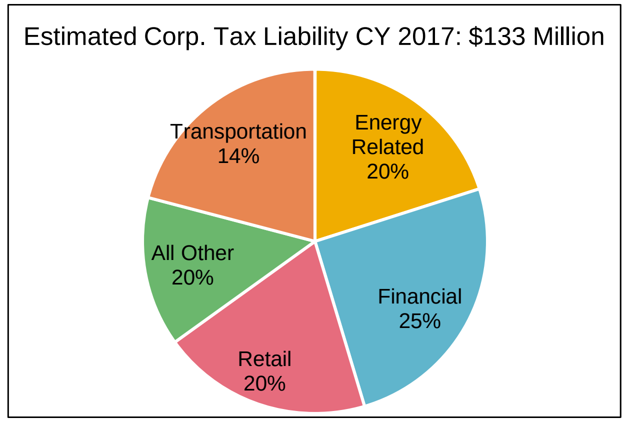
Property Tax

Montana law requires counties to levy a county equalization levy of 55 mills, a state equalization levy of 40 mills, and 6 mills for the university system against all taxable value in each county. A levy of 1.5 mills is also applied against all property in the five counties with a vocational technology (vo-tech) college (20-25-439, MCA). Taxable value is defined as the market value of statutorily defined property multiplied by a statutory tax rate.



The outlook for property tax is based on taxable value data by property class type for TY 2017, and assumes historic growth patterns by class adjusted during reappraisal years.

Corporate Income Tax

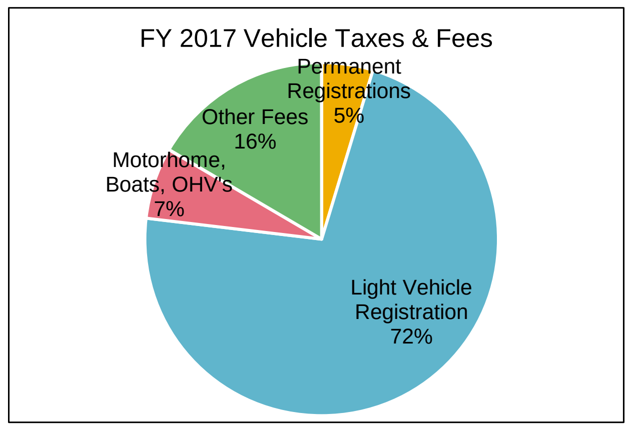


The corporate income tax is levied against a corporation's net income earned in or attributable to Montana, adjusted for allowable credits. The tax rate is 6.75%, except for corporations making a "water's edge" election (15-31-322, MCA), who pay a 7.0% tax on their net income.

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

The outlook for corporate income tax assumes slow growth across all sectors and estimates that refunds and audits will reflect historical patterns.

Vehicle Taxes

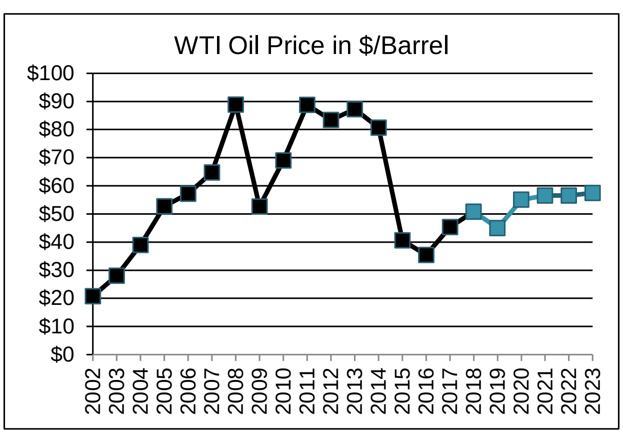


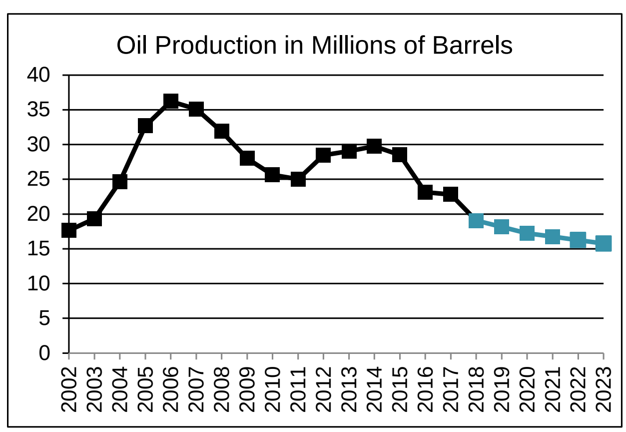
Revenue for this source is primarily generated by taxing light vehicles and a variety of other vehicles under a fee schedule that varies by age and weight. Light vehicles aged 0 to 4 years are taxed at $217; vehicles aged 5 to 10 years cost $87; and vehicles 11 years of age and older cost $28, although there is the option to permanently register them for $87.50.

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

Oil & Natural Gas Production Taxes

The oil and natural gas production tax is imposed on the production of petroleum and natural gas in the state. The gross taxable value of oil and natural gas production is based on the type of well and type of production, and whether the production occurs within the tax holiday. The charts below show the West Texas Intermediate (WTI) oil price and Montana production.



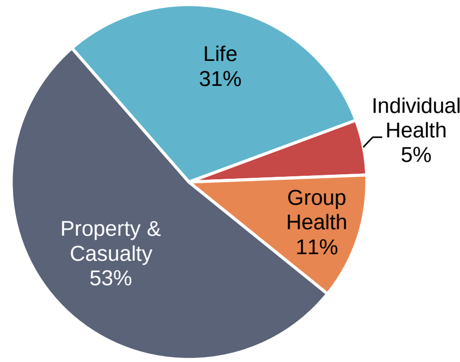


The outlook for oil production tax assumes declining production and slight increases in prices. Oil production taxes could be different than forecast if prices are materially different than assumed in the forecast. Sudden changes to drilling activity would have a delayed revenue impact in the 2021 biennium due to the oil tax holiday for newly completed wells.

Insurance Tax

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

FY 2017 Insurance Premium Tax by Type



There has been concern that the elimination of the individual health insurance mandate starting in 2019 will impact insurance tax revenues; however, individual policy insurance tax collections account for only 5%, or $4.1 million, of general fund insurance tax collections. The number of people covered under individual policies peaked in 2015 at nearly 78,000. As of the end of CY 2017, that number had declined to 57,000. Total premiums collected increased for individual policies during the same time as rates increased. In 2015, $190 million in taxed individual premiums was written, which grew to $228 million in 2017.

Remaining Sources

The outlook for video gambling tax and all remaining sources is relatively stable after accounting for the one-time legislatively authorized transfers in FY 2018, temporary revenue from the Hospital Community Benefit Assessment, and partial diversion of the Department of Commerce share of lodging tax revenue which are ending in FY 2019.

Expenditure Details

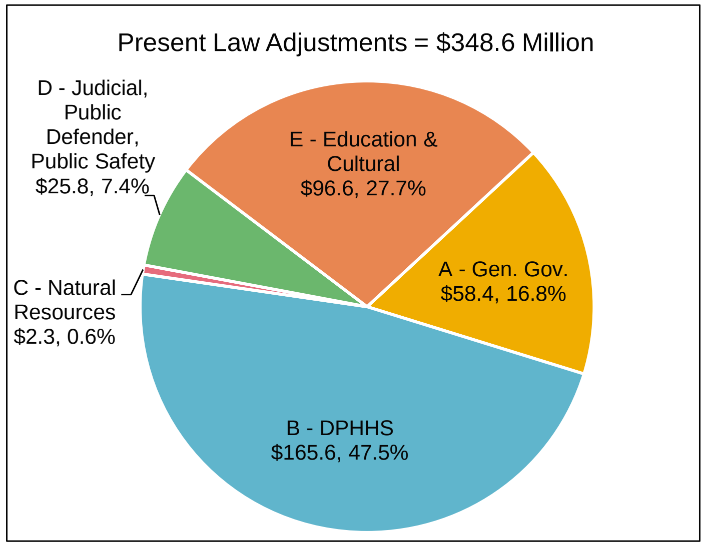
General fund present law expenditures in the 2021 biennium are projected to total $4,925 million, an increase of $348.6 million from the FY 2019 ongoing appropriation level, including amounts restored per SB 9 (2017 Special Session). Appropriations are comprised of HB 2, statutory appropriations, non-budgeted transfers, and other bills.

General Fund Appropriations by Section of Government

Present law

The expenditure projections for the 2021 biennium for present law obligations are $348.6 million, which is roughly double the comparable amount calculated two years ago in the 2019 Biennium Outlook. The non-standard increase is due the return of several items temporarily removed from the 2019 budget and returned in present law. The key areas of increase include:

- $165.6 million in Section B: Health and Human Services
- $96.6 million in Section E: primarily additional BASE Aid and other K-12 school district funding
- $58.4 million in Section A: primarily increases in statutory payments to local governments and pensions



Pressures: Current Service Level, Pressures, Potential Pressures

As described earlier in this report, additional budget pressures will likely be considered by the 2019 legislative session. These pressures total $427.4 million in the biennium.

The present law adjustments along with the pressures summarized in the table on page 8, are described in the following pages by traditional budget sections A through F. A brief description of the adjustments across all agencies precedes the budget section descriptions.

All Agencies

Present Law

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

- The present law adjustment for personal services totals $20.5 million over the 2021 biennium. This adjustment includes the annualization of the pay plan provided in HB 2, statutory increases in the employer contribution for the Montana Public Employees Retirement System, and a reduction in workers' compensation rates
- The present law adjustment for fixed costs and inflation totals $21.3 million over the 2021 biennium. This adjustment includes estimated increases in information technology costs and other operating expenses, as well as estimated legislative audit costs

Current Service Level

Other Items

The current service level for other items totals $4.0 million for the 2021 biennium. Current service level pressures are identified as one-time-only (OTO) or sunset appropriations that were for functions that could be considered ongoing, but are excluded from the base. This section primarily includes OTO appropriations in the Department of Commerce for the Indian Country Economic Development program, the Native Language Preservation program, and the Primary Sector Business Training program.

Pressures

State Employee Pay Plan

State employee pay plans are generally, but not always, approved by the legislature. In the past ten years, pay plans have ranged from 0% to 3.6% per year for salary increases and 0% to 10% per year for insurance contribution increases. Each 1% per year in the employee pay increase would cost $13.7 million in general fund for the biennium without an increase in health insurance. A 3% per year increase in pay would cost an additional $27.6 million in general fund, for a total of $41.3 million in the biennium.

Provider Rate Increases

The majority of medical and community services administered by the Departments of Public Health and Human Services (DPHHS) and Corrections (DOC) are provided through contracts with private businesses. In some instances, the state agency is the primary or only customer for these services. As business entities or private non-profits, contractors are subject to the same economic conditions as other employers. These businesses traditionally request that the legislature consider rate increases to cover cost growth and to maintain operations.

Provider rate increases in the past have ranged from 0% to 5% for selected providers. A 1% annual rate increase is estimated to cost $12.2 million general fund over the 2021 biennium with:

- $10.0 million for DPHHS
- $2.2 million for DOC

A 3% annual rate increase for all providers is estimated to cost $36.6 million general fund over the 2021 biennium.

SB 261 Restoration

SB 261 (2017 Session) triggered appropriation reductions across all state agencies because FY 2017 revenues were lower than anticipated in HJ 2 with adjustments for other anticipated revenue bills during the session. The pressure to restore SB 261 reductions totals $12.3 million.

Other Reductions Restoration

During the 2017 regular session, the legislature approved reductions to state agency appropriations based on either the 5% reduction plans submitted under 17-7-111, MCA or FY 2016 reversions. The potential pressure to restore the regular session reductions totals $34.6 million.

During the 2017 special session, the legislature approved reductions to the State Information Technology Services Division rates that agencies pay for computer related services. The potential pressure to restore the special session rate reduction impacting general fund totals $2.2 million.

SECTION A: GENERAL GOVERNMENT

Coal Board

The Coal Natural Resource Account receives a portion of the coal severance tax revenue. Money in this account is appropriated to the Coal Board in HB 2 for local impact grants and administrative costs. The coal tax allocation was doubled to 5.8% beginning FY 2010. After September 2013, the allocation decreased to 2.9%. The allocation was increased to 5.8% for the 2017 biennium and again for the 2019 biennium.

Present law decreases the allocation to 2.9% after the 2019 biennium. It is anticipated that there will be pressure to continue the allocation at 5.8%. This results in the general fund not receiving $3.3 million because after allocations are made to the coal trust and state special funds, the remaining coal severance tax collections are distributed to the general fund.

Legislative Infrastructure

The Legislative Branch has several anticipated pressures related to infrastructure in the 2021 biennium. These pressures include:

- Implementation of the last phase of the session system replacement, which is anticipated to be $2.0 million
- Installation of vote display boards on the Senate Floor and House Floor, which is anticipated to be $1.0 million

Statutory Appropriations

Statutory appropriations are in law and are not part of the biennial budgeting process. The majority of general fund statutory appropriations are within general government, and are responsible for $38.8 million of the $58.4 million in present law adjustments in general government. The increases in general government statutory appropriations are driven by the following major components:

- Entitlement share payments to local governments are expected to grow by $23.0 million from the FY 2019 level
- Payments for employee, local fire, police, and teacher retirement costs are expected to grow by $6.4 million from the FY 2019 level
- The emergency and disaster statutory appropriation is forecast to grow by $12.0 million from the FY 2019 level, which is low due to use of emergency fund in FY 2018
- Debt service payments are expected to decrease by $3.5 million from the FY 2019 level and will offset some of the increases from the other components

Non-Budgeted Transfers

The non-budgeted transfers all occur in general government. The majority of non-budgeted transfers are vehicle revenues distributed to various state special revenues funds and the Old Fund (State Fund) liabilities. Non-budgeted transfers are expected to grow by $1.3 million from the FY 2019 level, with the majority of the increase driven by higher vehicle revenue forecasts.

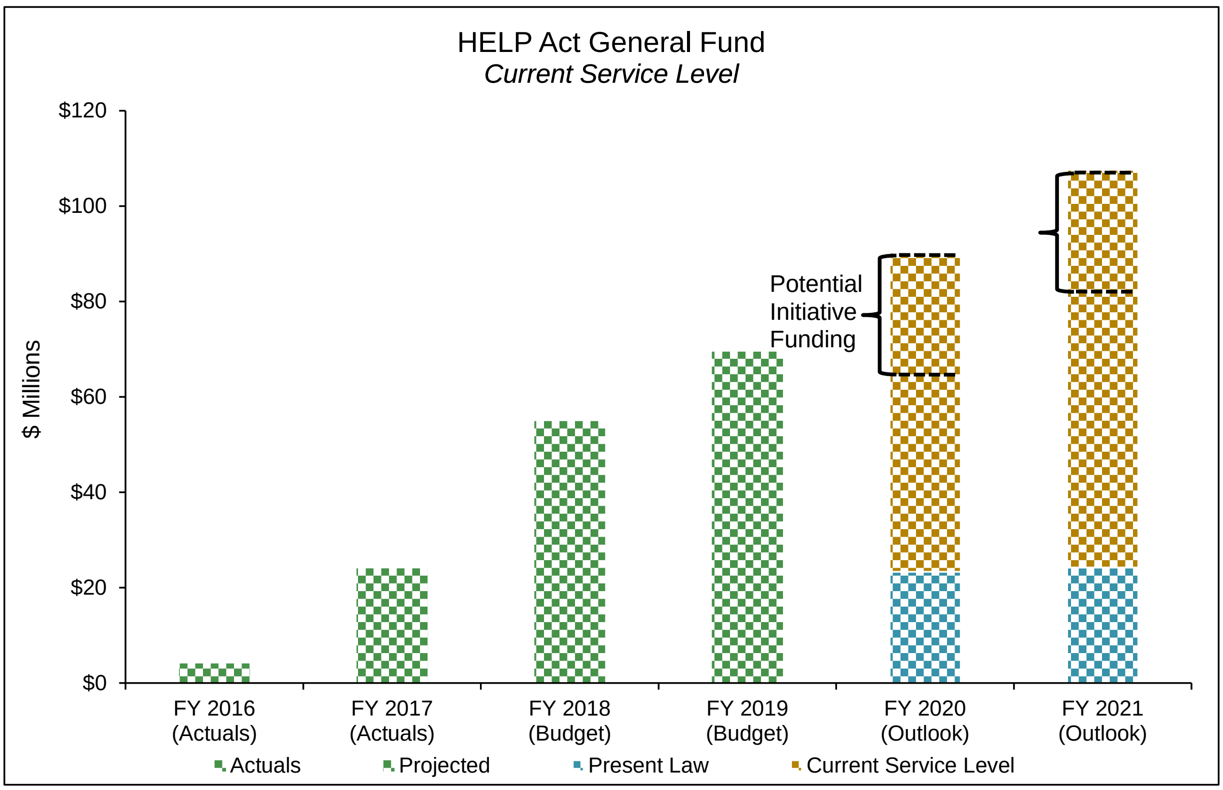
SECTION B: HEALTH AND HUMAN SERVICES

The Department of Public Health and Human Services (DPHHS) expenditure projections fit into three main categories: present law (including statewide present law adjustments), pressures, and current service level that represent a total potential increase of $297 million for the 2021 biennium, as compared to the 2019 biennium. This section provides further detail on the expenditure projections of the two largest subsets of the DPHHS budget, as well as the total budget. The section is organized as follows:

- HELP Act (Medicaid expansion)
- Total Medicaid Benefits & Claims
- Total DPHHS Budget

Montana Health and Economic Livelihood Partnership (HELP) Act

The HELP Act SB 405 (2015 Session) authorized an expansion of Medicaid under the Affordable Care Act. HELP provides coverage to childless adults under 138% of the federal poverty level, but includes a sunset provision that terminates the act at the end of FY 2019. As a result, without legislation or the passing of I-185, which extends the HELP Act, the HELP Act does not exist in the 2021 biennium. Consistent with the treatment of other sunset expenditures for services that could be considered ongoing, the cost of the continuation of Medicaid expansion is included as a current service level in the Outlook analysis.



The three components shown above for the 2021 biennium include:

1) A present law component that will be required if the HELP Act expires;
2) The additional current service level amount to meet the projected expenditures under Medicaid expansion if it is extended; and
3) The possibility of a reduced general fund impact, as a result of I-185, which would provide up to $26 million per year of new state special revenue to cover a portion of the costs of the HELP Act. This is shown as a positive risk, but not included in the total costs.

Present Law

Approximately 8,500 people moved from traditional Medicaid into the expansion population, allowing the state to save money by leveraging a higher federal matching rate for HELP participants. It is assumed that HELP participants eligible for traditional Medicaid would switch back if the HELP Act expires, creating a present law cost to pay a higher state portion for benefits and claims, with an estimated general fund impact of $47.6 million during the 2021 biennium.

Current Service Level

Spending levels are impacted by two main variables: participation rates and the Federal Medicaid Assistance Percentage (FMAP).

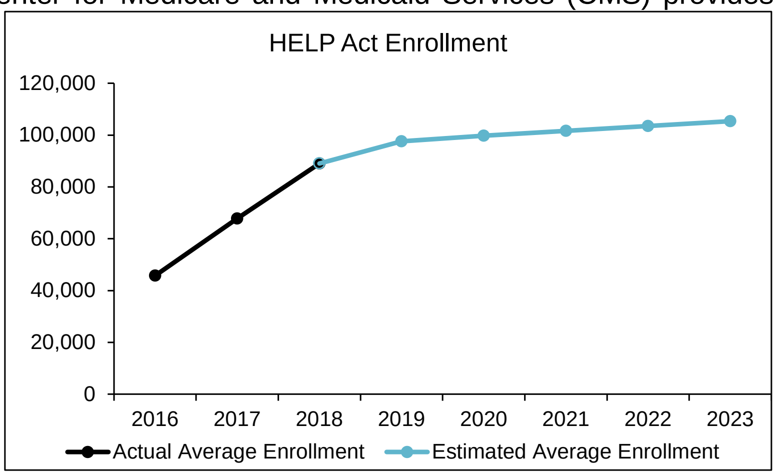
FMAP

The FMAP for HELP benefits started at 100% in 2016, however, each year a phased-in reduction requires an increased share from the state. The requirement will level off, under the current waiver, in calendar year 2020 when the federal share will be 90% and Montana's share will be 10%. During the 2019 biennium, Montana's share of HELP services averaged 6%. The state share will be 7% for the first six months of the 2021 biennium, at which point it will max out under present law.

Federal Match Rate		
Calendar Year	Federal Share	State Share
2016	100.0%	0.0%
2017	95.0%	5.0%
2018	94.0%	6.0%
2019	93.0%	7.0%
2020+	90.0%	10.0%

Participation

On March 1, 2018, enrollment reached 93,950. According to the most recent census data, approximately 109,000 Montanans meet the eligibility requirements for HELP enrollment, so the growth in enrollees should begin to slow. The Center for Medicare and Medicaid Services (CMS) provides federal oversite of Medicaid; their actuaries predict the take-up rate for Medicaid expansion could reach 95% in 2020. This means Montana would have around 104,000 enrollees by 2020.



Finally, as previously noted, the state portion of Medicaid expansion has been phased-in and will max out starting in CY 2020. Once the state obligation of Medicaid expansion hits 10%, if enrollment stabilizes around 100,000, assuming annual participation growth of 1%, the state portion to cover expansion costs will increase around $5 million/fiscal year.

The total projected cost to the state for Medicaid expansion in the 2021 biennium is $197.9 million.

Pressures if HELP does not continue

Since January 1, 2016, some inmates in Montana prisons have qualified for HELP benefits. If the offender qualifies for HELP and receives outside medical care lasting more than 24 hours, the benefits are eligible for Medicaid reimbursement. DOC applied for HELP reimbursement 258 times between January 1, 2016 and March 12, 2018. If HELP expires, hospitalizations for inmates that do not qualify for traditional Medicaid would have to be paid for by the department. The same is true for DPHHS institutions with residents receiving HELP eligible outside medical services.

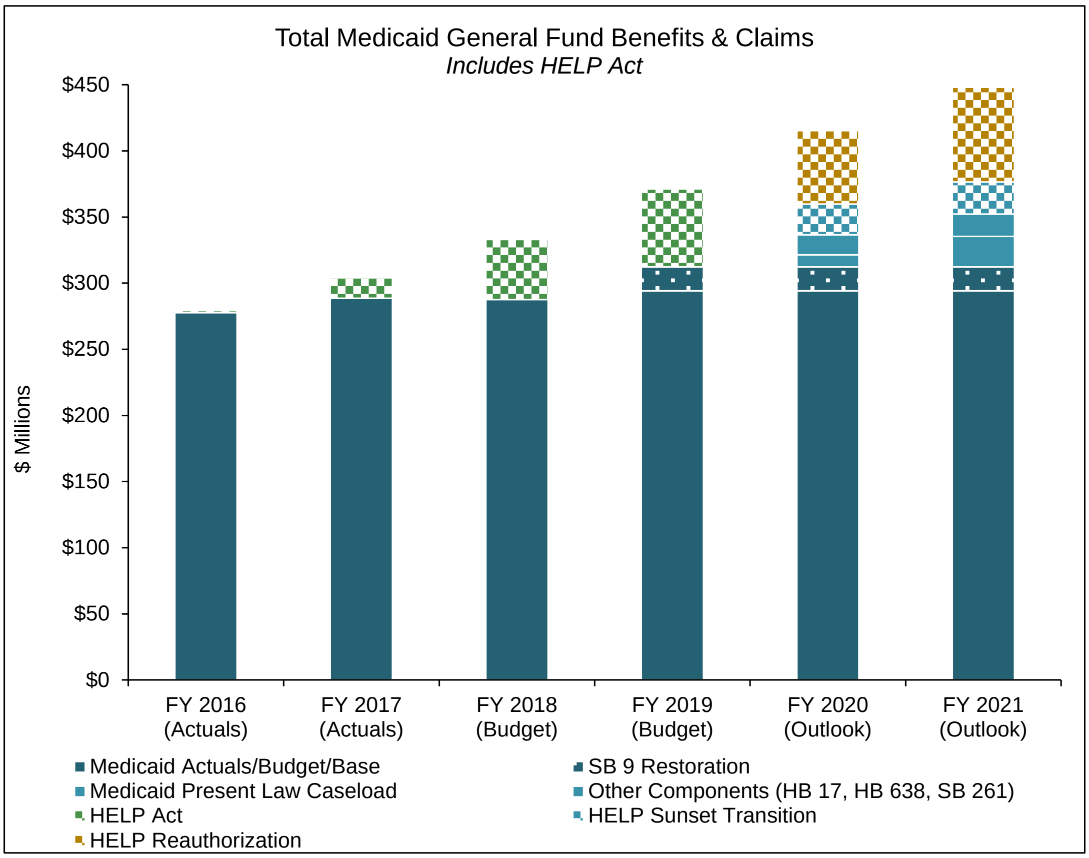
Section 9 of the HELP Act requires DOC and DPHHS to reimburse outside medical at Medicaid rates. This has resulted in reduced costs for both agencies. If the HELP Act does not continue, there will be pressure for the department to pay higher rates for medical services. This cost pressure has not been included in the Outlook totals, since the HELP Act services are assumed to continue.

Ballot Initiative Upside Risk

In February 2018, a ballot initiative was filed with Montana's Secretary of State that would remove the section containing the sunset clause from the HELP Act and increase tobacco taxes. Revenue is generated from increasing the state tax on cigarettes by $2 per pack and increasing the wholesale price of all other tobacco products, including electronic cigarettes, by 33%. If passed, I-185 would result in up to $26 million per year of state special revenue to partially offset the cost to the general fund for Medicaid expansion.

Total Medicaid Benefits & Claims

In the 2019 biennium, $2.5 billion was appropriated for Medicaid benefits & claims, of which $619.8 million was general fund. The graph below illustrates general fund DPHHS Medicaid benefits from FY 2016 to FY 2021, with Medicaid expansion shown with checkered bars.



SB 9 (2017 Special Session) provides for a restoration of the budget reductions made to the FY 2019 department budgets if certain FY 2018 revenue targets are met. Within DPHHS, this would restore almost $30.6 million of general fund authority to the FY 2019 budget, with $18.0 million applied to Medicaid benefits, mirroring the reductions. These amounts are carried through into the 2021 biennium as present law, and specifically identified in the chart above.

Present Law

In addition to the present law included for the Help Act as described in the previous section, there are other Medicaid benefit present law adjustments.

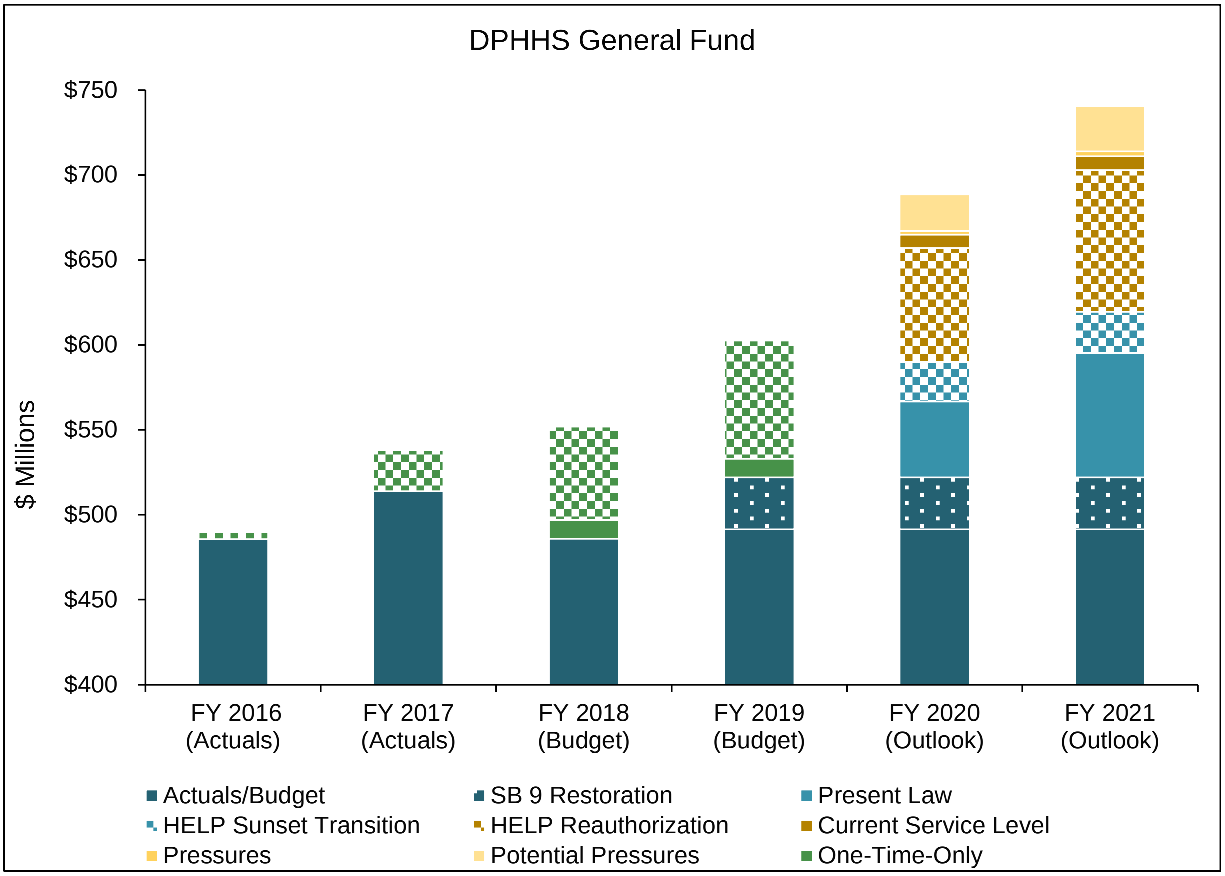
Caseload
Higher present law spending in Medicaid is driven by several factors: higher enrollment in Medicaid, more services provided, and increased costs of those services. The Legislative Fiscal Division Medicaid model uses historical claims data to project future trends in Medicaid expenditures. Caseload growth in traditional Medicaid is expected to cost $31.9 million in state funds for the 2021 biennium. Each state dollar spent on traditional Medicaid is matched with just under two federal dollars.

Other Components
Both HB 17 (2017 Session) and HB 638 (2017 Session) were subsequently modified by SB 261 (2017 Session) due to FY 2017 actual revenues. While the funding was stripped from HB 17, the policy was left in place, and as such was treated as present law in the Outlook. The final status of HB 638 is yet to be determined, as FY 2017 revenues delayed implementation without voiding the bill. There is a second opportunity for this bill to be funded for FY 2019, based on actual FY 2018 revenues, and this bill has also been included as present law in the previous chart. The combined general fund impact of these bills for the 2021 biennium is $18.3 million.

SB 261 also removed Medicaid and non-Medicaid funding in the DPHHS budget. The Medicaid present law caseload adjustment builds on the base, toward a projected total cost, with the SB 261 Medicaid reductions of $13.7 million added back separately.

Current Service Level
The only component included in the total Medicaid benefit current service level category is the continuation of the HELP Act. For more information, see the previous section on Medicaid expansion. Of note however, is that in the previous HELP Act chart on page 20, the total costs of Medicaid expansion, including administration, were included. In the chart on page 22, only benefits and claims are included, to be consistent with the way traditional Medicaid is normally portrayed.

Total DPHHS Budget
While the majority of the large adjustments to the DPHHS budget do happen in Medicaid, there are a variety of other interactions as well. The following chart includes both the previous HELP Act and Medicaid charts into a total DPHHS chart. Many of the pieces are explained in the previous sections, but the overall scale reflects the scope of the entire department budget.



Present Law - Non-Medicaid

In addition to the Medicaid components of present law caseload growth, present law includes an adjustment for the Children's Health Insurance Program (CHIP), Child & Family Services, and two areas where expenditures have overrun previous appropriations: Montana State Hospital and Vocational Rehabilitation.

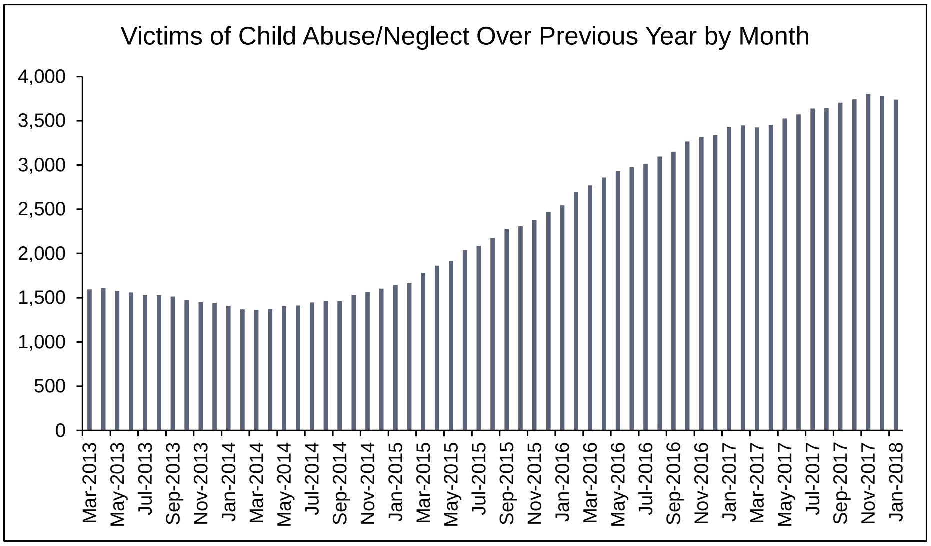
Changes in Children's Health Insurance Program

CHIP has federal matching rates that are higher than those under traditional Medicaid. The "enhanced federal medical assistance percentage" (E-FMAP) for CHIP was increased by 23 percentage points for the 2016-2019 period (from about 76.0% to about 99.0%). This E-FMAP increase declines in future years before going away, which will leave Montana at the standard E-FMAP rate in 2021 and beyond (see table). The additional state funds obligation associated with this federal change is $27.7 million in the 2021 biennium. Note that the table below assumes zero caseload growth, so the total obligation could be higher if significant CHIP caseload growth occurs.

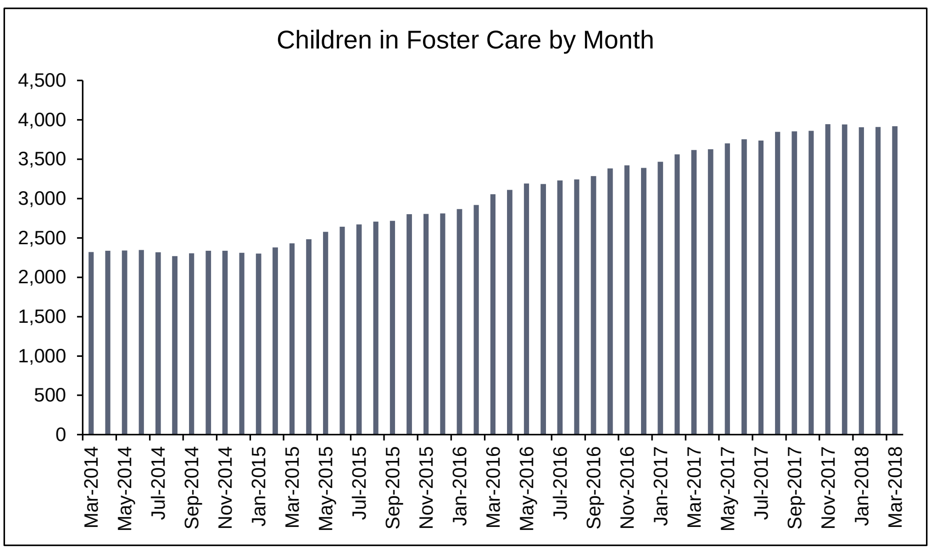
State and Federal Shares of CHIP Benefits Funding ($ Millions)				
State FY	Federal Costs	Federal Share	State Costs	State Share
2014	$72.9	77.2%	$21.5	22.8%
2015	65.1	77.1%	19.4	22.9%
2016	87.9	95.4%	4.3	4.6%
2017	95.7	98.9%	1.1	1.1%
2018	95.7	98.9%	1.1	1.1%
2019	95.7	98.9%	1.1	1.1%
2020	87.4	90.3%	9.4	9.7%
2021	76.3	78.9%	20.4	21.1%
2022	73.5	76.0%	23.2	24.0%
2023	73.5	76.0%	23.2	24.0%

Child and Family Services Division Caseload

The Child and Family Services Division (CFSD) has been experiencing high rates of caseload growth over the past several biennia, resulting in the inclusion of $8 million for caseload growth in the 2021 biennium. The last few months of data suggest growth is slowing or potentially declining.



Increased rates of child abuse and/or neglect impact CFSD in several ways. Higher prevalence rates require higher levels of spending on CFSD administration: more caseworker-hours (and sometimes overtime hours) are needed to investigate and track potential cases of abuse or neglect.



Higher rates of abuse and neglect have tended to lead to more children in foster care in Montana. Montana removes children from the home during such incidents at a higher rate compared to other states, leading to more children in the foster care system. A recent report from the U.S. Administration for Children and Families indicates Montana is not in substantial conformity in any of seven child welfare outcomes or any of seven child welfare systemic factors. The graph above illustrates the growth of children in foster care over the last several years. The last few months of data suggest growth is slowing or potentially declining. Foster care costs were $29.7 million (all fund types) in FY 2017.

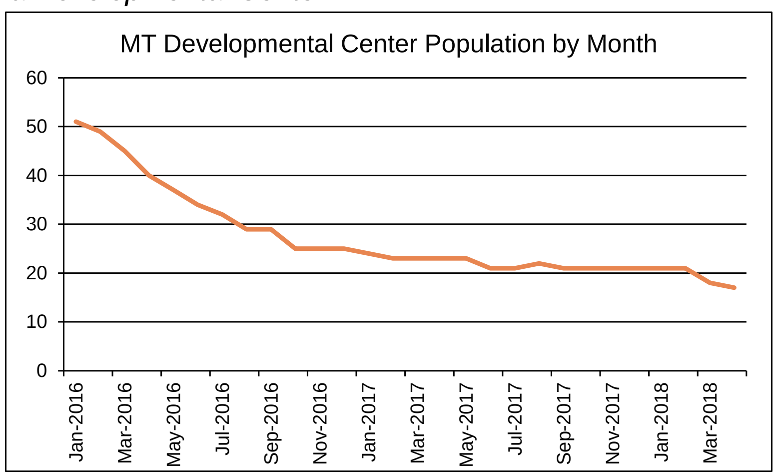
Unanticipated Present Law Expenditures

There are two other present law areas in which DPHHS is projected to spend at higher levels than previously anticipated. These areas (Montana State Hospital and the Vocational Rehabilitation Program) are discussed in the March Section B Budget Status Report.

The Montana State Hospital (MSH) was found in January of 2017 by the Centers for Medicare and Medicaid Services (CMS) to have severe staffing shortages. According to CMS, MSH corrected the staffing deficiencies that related to a shortage of nurses and direct-care staff. Since January 2017, expenditures for professional and consulting services at MSH have increased from a monthly average of $0.4 million in FY 2016 to a monthly average of $0.8 million in FY 2018. The costs associated with contract staff are driving the projected present law cost increases for MSH, which total $7.0 million general fund over 2021 biennium.

Spending on benefits in the Vocational Rehabilitation Program has increased sharply over the past two fiscal years from $4.4 million general fund in FY 2016 to $9.5 million general fund in FY 2017. This higher level of spending is expected to continue. This program operates as an entitlement once an individual enters the program, with the only point of control being category closures. All three service categories are now closed and not accepting new participants, and will remain closed until caseload is reduced through case closure and spending comes back in line with the federal grant award. Projected present law cost increases for Vocational Rehabilitation are $4.4 million general fund above the base for the 2021 biennium.

Disability Services Division and the Montana Developmental Center



SB 411 (2015 Session) required DPHHS to develop a plan and close the Montana Developmental Center by June 30, 2017. The department was instructed to transition most residents into community placement by December 31, 2016. HB 387 (2017 Session) extended the closure date to June 30, 2019, and provided for a secure facility on an ongoing basis. In addition, HB 639 (2017 Session) authorized the department to transfer appropriation authority from MDC to cover the expenses of persons that otherwise would have been served at the facility. Most clients at MDC are transitioned to community placement on Disability Services Division (DSD) developmentally disabled (DD) waiver. In FY 2018, DPHHS transferred $2.5 million from MDC to the DD waiver to cover the associated costs. It is assumed in present law that this $2.5 million in general fund authority will remain outside MDC during future biennia, and be utilized for the DD waiver.

Current Service Level

Two items are included in current service level because they were approved by the 2017 Legislature on a one-time-only (OTO) basis:

- $10.2 million to cover a caseload adjustment in Child and Family Services Division (CFSD) for foster care and adoption
- $6 million to fund a limited program for the education of 4-year-olds (pre-K) in the Human and Community Services Division

Pressures

The only item included in the pressures category specific to DPHHS that was not previously included in the Medicaid section is $2.5 million of non-Medicaid reductions as a result of SB 261.

Potential Pressures

The largest item specific to DPHHS included in the potential pressures category is that of an expanded pre-K (4-year-old) education system, included at a level requested by the executive during the 2015 Legislature. The result is a $25 million potential pressure, on top of the $6 million included in the current service level.

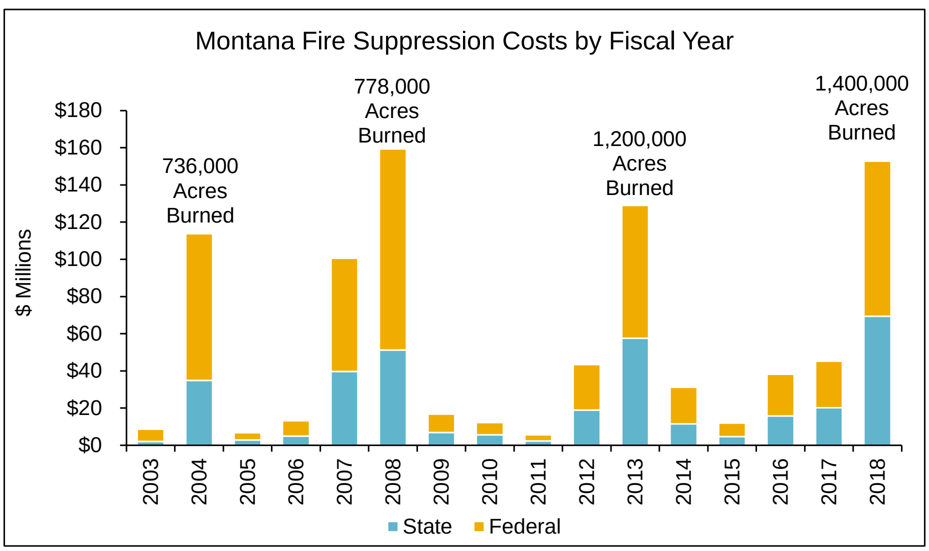
Provider rates were reduced in the interim, but have been included at the previous level in the Medicaid caseload adjustment. However, a potential pressure exists for further increases, and a 1% increase could cost almost $10 million over the 2021 biennium.

SECTION C: NATURAL RESOURCES

Wildland Fire Fund

The summer of 2017 was the most expensive fire season in Montana's history. As of April, FY 2018 total fire costs are anticipated to be $69.3 million expended from the fire suppression fund and an additional $11.1 expended from the Governor's general fund appropriation for emergencies. By the end of September, when changes in weather patterns aided in the control of most fires, total acres burned were estimated at about 1.4 million.

The chart shows a history of state fire suppression expenditures since FY 2003, yellow represents federal reimbursements to the state.



To put this in perspective, the fire suppression cost for FY 2018 represents 3.4% of anticipated general fund revenues for the fiscal year. By comparison, in the last fifteen years only FY 2013 came close to this level at 2.8%. Three other fiscal years—2004, 2007, and 2008—consumed 2.5%, 2.2%, and 2.6% of the general fund revenue respectively. Ten of the last fifteen years could be considered mild by comparison with less than 1.0% of the general fund revenue consumed in fire suppression.

Sources of funding for fire suppression include the fire suppression fund, the Governor's appropriation for emergency and disasters, and federal reimbursements. Should these sources not be sufficient, pressure is placed on the general fund in the form of a legislative supplemental appropriation.

Volatility in Fire Seasons

Total acreage burned in Montana varies widely by year. Since FY 2003, average fire costs, adjusted for inflation, have been $23.7 million per year. In this period, the state had extreme fire suppression costs in FY 2008, FY 2013, and FY 2018, which all exceed the average by more than one standard deviation; FY 2018 exceeded the average by two standard deviations. In each of these years, the legislature provided supplemental funding for fire suppression and FY 2007 and FY 2004 fire suppression costs also required supplemental funding. In the same period, eleven of the sixteen fiscal years had fire seasons below average.

General Fund Pressure from Fire Suppression Cost in the 2021 Biennium

Sources of funding for fire suppression at the beginning of the 2019 biennium included $32.3 million in the fire suppression fund and $16.0 million in the Governor's general fund appropriation for emergencies. The legislature provided $40.0 million in additional revenue streams during the 2017 special session. The table below assumes an average fire year in FY 2019 and anticipates the need for $21.2 million in additional general fund. Under this assumption, the fire suppression fund would have a zero balance going into the 2021 biennium.

Estimated Fire Suppression Planning
2019 and 2021 Bienna
($ Millions)

Estimated Fire Costs	2019 Biennium	2021 Biennium
FY 2018	$80.9	
FY 2019	23.7	
2021 Biennium		49.3
Biennial Cost	104.6	49.3
Less Governor's Emergency Statutory Appropriation	11.1	12.0
Net Cost	$93.5	$37.3
Fire Suppression Fund Beginning Balance	32.3	0.0
Special Session revenues	40.0	
Estimated revenues		10.2
Total Fire Fund Available	$72.3	$10.2
Potential Shortfall	$21.2	$27.1

Current Sources of Revenue for the Fire Suppression Fund

The 2017 Special Session provided one-time-only funding capped at $40.0 million for the 2019 biennium. The balance of the fire suppression fund is limited to 4% of the total general fund appropriation in the second year of any biennium (76-13-150, MCA). Ongoing sources of revenue include the unexpended appropriation in excess of 0.5% of the total general fund appropriation for each fiscal year and the unexpended portion of the Governor's emergency appropriation (76-13-150, MCA and 10-3-312, MCA).

Anticipated General Fund Pressure from Fire Suppression Costs

In the 2021 biennium, revenue to the fire suppression fund from ongoing sources is estimated at $10.2 million. If an additional $12.0 million is available from the Governor's emergency appropriation, funding sources would fall short by $27.1 million if the biennium experiences average fire costs of $49.3 million.

Extreme Fire Risk

The FY 2018 fire season costs were the worst in recent years. If two fire seasons of the same magnitude as FY 2018 follow, the risk to the state is an additional $89.2 million for the 2021 biennium.

Section D: Public Safety

Department of Corrections

Pressures and Potential Pressures

The Department of Corrections (DOC) utilizes both state owned and private contracted facilities to house and transition offenders back into society. In FY 2017, DOC expended $198.0 million for the custody and care of an average population of 14,475 offenders. Almost half or $92.1 million was paid to private providers.

During the last four years, the department has seen an average growth in expenditures of 3.6%. It should be noted that growth occurring during FY 2017 showed a marked reduction compared to the last four years, measuring only 0.7%. This is the result of a combination of:

- Cost control measures implemented by the department
- The 2015 Legislature capping rates for housing state offenders in county jails at $69/day

In addition, the 2017 Legislature passed a packet of bills[2] aimed at reducing the criminal justice system costs while improving outcomes. Based on these facts, a 0.5% growth factor was used to calculate a caseload adjustment of $3.0 million for the 2021 biennium. Alternatively, a 1.5% growth of $9.0 million was also calculated as a potential pressure. It should be noted that caseload adjustments for some other state agencies are included as present law adjustments but historically DOC has included caseload as a new proposal in its budget submission and thus it is included as a pressure in this report.

The executive has historically requested funding to increase rates for providers. Included as a budget pressure, each 1% increase in the costs paid to contracted providers of DOC is about $2.2 million over the biennium.

Office of Public Defender

Present Law

Expenditures in the Office of the Public Defender (OPD) are partially based on cases requiring defense in court in a given year. The five year average for caseload increases year to year (FY 2013 through FY 2017) is 3.8%. In FY 2017, there were 37,126 cases in OPD. Using average caseload growth an additional 3,078 cases are projected for the 2021 biennium and $4.6 million in additional funding is included in present law.

Pressures and Potential Pressures

Although the caseload five year average has been 3.8%, the average growth in expenditures for OPD is 10.6% during the same five year period. Due to this high expenditure growth, the agency has requested and received supplemental appropriations. For example, in FY 2017 OPD received an additional $1.7 million in supplemental appropriation authority in HB 2. The appropriations for FY 2018 and FY 2019 are $32.8 million and $32.2 million, respectively. OPD requested a $3.0 million fiscal year transfer in FY 2018 and has indicated they will be requesting a supplemental appropriation of $8.0 million at the start the next legislative session. Based on expenditure growth, there may be a pressure to provide an additional $10.0 million in the 2021 biennium.

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[2] The Commission on Sentencing (Commission) conducted a broad study of Montana's criminal-justice system practices during the 2015-2016 interim. The Commission forwarded 12 bills to the 2017 Legislature for its consideration; of those 12, nine were enacted. Several of the bills created new programs or responsibilities for existing agencies with the intent of better outcomes and reduced costs. Collectively the new bills are referred to as the criminal justice reinvestment package and are projected by those working for the Criminal Justice Council to have a cost avoidance of approximately $69 million over the next seven years.

A portion of the pressure for additional expenditure growth is due to capital (death penalty) cases. No funding currently exists for defense in capital cases. In previous biennia, the legislature has provided restricted and one time only funding of $1.0 million to fund capital defense. With the possibility that a prosecutor may seek the death penalty, the legislature may encounter pressures to fund capital defense.

SECTION E: EDUCATION

Office of Public Instruction

General fund to support K-12 education is forecast to increase primarily through present law adjustments totaling $85.7 million for the 2021 biennium, in addition to $5.1 million in current service level and pressures.

Present Law

The amount of present law growth is unusually high this biennium. This is due to the fact that while $39.8 million is attributable to standard growth components, $45.9 million is higher due to legislation requiring certain components of funding to be removed from K-12 funding in FY 2019 and then return as present law funding in the 2021 biennium. A summary of the components increasing present law is shown in the table below. The increase is almost entirely due to K-12 funding; however, there is $0.7 million for the operation of OPI included in the all other category for personal services and operating adjustments.

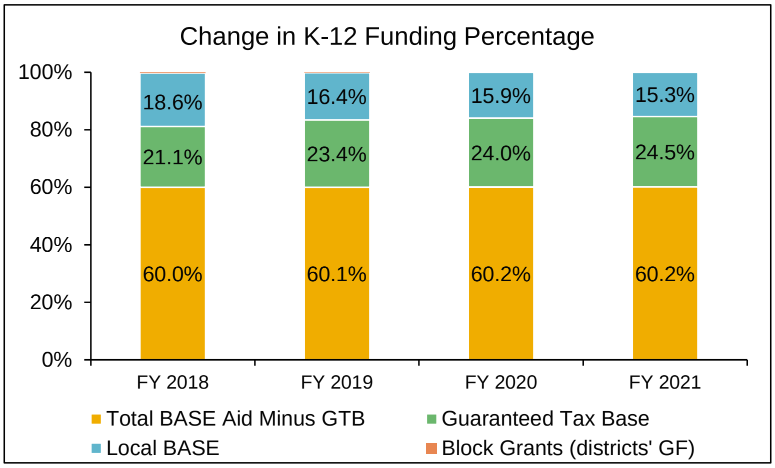
Office of Public Instruction Present Law Detail
($ Millions)

Component		Funding Return	Standard Growth	Total
BASE Aid	(GTB increase)	$14.9		$14.9
	(Inflation)		$21.1	21.1
	(ANB growth/other)		14.6	14.6
	Total BASE Aid	14.9	35.6	50.6
New NRD Facilities Payment (2017 Session)		11.6	2.4	14.0
School Facility and Technology Sweep (20-9-516 MCA)		9.6		9.6
SB 261 Suspension of Data for Achievement		6.4	0.5	6.8
Transportation (block grant switch & growth)		3.4	0.4	3.8
All Other			0.9	0.9
Total (Including BASE Aid)		$45.9	$39.8	$85.7

The largest present law increase in school funding occures in BASE Aid. This is split into three large catagories, the GTB increase, inflation, as well as Average Number Belonging (ANB) which has other smaller adjustments included. These BASE Aid catagories are discussed in further detail below.

BASE Aid (Change in GTB Percentage)

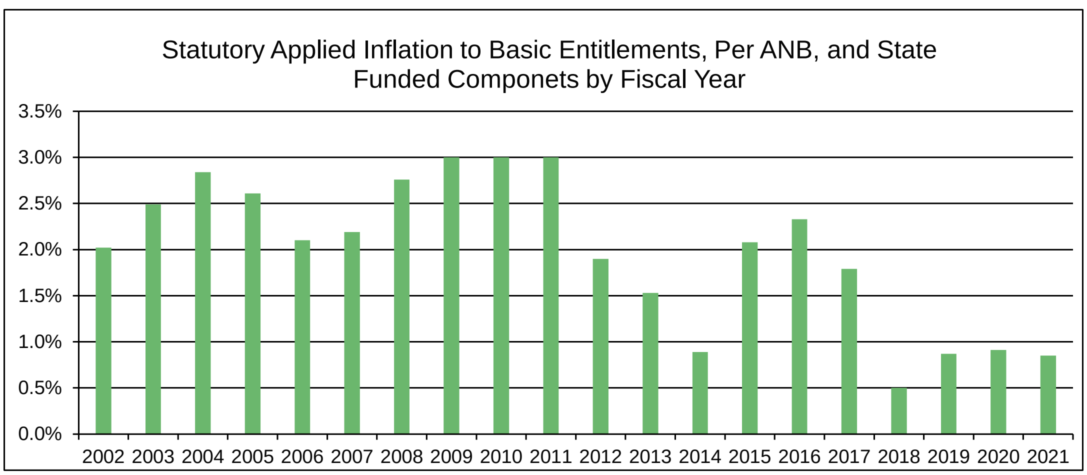
The largest return funding factor, $14.9 million over the biennium, increasing present law funding is the statutory change in the guaranteed tax base (GTB). HB 647 (2017 Session) eliminated block grant payments to school districts beginning in FY 2018, resulting in higher local property taxes for schools and reducing state general fund pressure. These increases to local property taxes under present law are phase out and offset by increased state GTB funding. This results in increased state payments to schools, and reductions in local property tax payments to schools. In the following chart, the reduced portion of local taxes can be seen in blue, falling from 18.6% of BASE Aid funding in FY 2018 to 15.3% in FY 2021.



By FY 2021, the block grant elimination will be completely offset by GTB and state funding returns to a higher percentage. Statewide, the funding split between locals and the state will be very close to the same as before the block grant elimination, but due to the formulaic nature of the GTB which directs more state funding to districts with lower taxable values, the local-to-state funding percentages will be different for each school district compared to their FY 2017 baseline.

BASE Aid (Inflation)

Statute requires that certain components of school funding include a present law adjustment for inflation in the superintendent's budget request (20-9-326, MCA). Anticipated inflationary increases in the 2019 biennium are 0.91% in FY 2020 and 0.85% in FY 2021. This growth rate is higher than previous biennium growth rates which were statutorily set at 0.5% in FY 2018 and 0.87% in FY 2019. Inflation is expected to increase funding levels by $21.1 million.



BASE Aid (ANB growth/other) - Including Guarantee Fund Adjustments

ANB growth in the 2021 biennium along with all other factors outside of GTB changes and inflation is set to increase $14.6 million over the biennium. This includes an offset of increases in the guarantee fund where revenues are anticipated to be $41.8 million in FY 2020 and $43.4 million in FY 2021. Compared to the base year, this is an increase of $0.1 million in the first year of the biennium, and $1.8 in the second year ($1.9 million for the biennium) primarily due to increases in the trust account and higher interest rates. Since the guarantee fund is the first funding for BASE Aid, this increase in anticipated revenue will decrease the need for general fund.

Other Present Law Adjustments

- The New NRD Facilities Payment: There is a statutory payment for school major maintenance of $14 million in the 2021 biennium that was not present in FY 2019 post budget reductions. This payment was established in HB 647 (2017 Session) for the purpose of supporting district facility needs. Of this, $11.6 million could be considered return funding, as a statutory payment of $5.8 million per year existed in FY 2019 prior to being removed in SB 261 (2017 Session)
- School Facility and Technology Sweep: A state special revenue transfer from the school facility and technology account, provided for in 20-9-516, MCA of $4.8 million to the guarantee fund, provided for in 20-9-622, MCA, occurred in FY 2019. Absent this transfer in FY 2020 and FY 2021, additional general fund will be needed for BASE Aid, which will amount to $9.6 million over the biennium and could be considered a funding return
- Suspension of Data for Achievement: The Data-For-Achievement payment is defined in 20-9-325, MCA. This payment of $3.2 million to schools was removed for FY 2018 and FY 2019 in SB 261 (2017 Session) as part of the budget reductions. Under current law this will return in FY 2020 which will amount to $6.4 million over the biennium and could be considered a funding return. Additionally, there is a statutory growth in this payment which amounts to $0.5 million in the 2021 biennium
- Transportation (block grant switch & growth): The budget for pupil transportation was reduced by $1.7 million in FY 2018 and FY 2019 in SB 2 (2017 Special Session). Under present law, this funding will return in FY 2020 and FY 2021, resulting in $3.4 million in additional funding over the biennium. There is also an anticipated $0.2 growth in service needs each year resulting in $0.4 million in present law growth
- All Other: All other present law growth such as increases in operating and personal services costs as well as increases in at-risk funds amounts to $0.9 million over the biennium

Current Service Level

Three items are included in current service level because they were approved by the 2017 Legislature on a one-time-only (OTO) basis:

- $1.7 million for the digital academy
- $0.1 million for audiological services
- $60,000 for national board certified teachers

Pressures

Pressures included in the "Other" for Section E are primarily an additional $1.2 million for inflationary growth in special needs funding and $0.2 million to more fully fund audiological services.

Office of the Commissioner of Higher Education

The primary funding source of the Montana University System (MUS) is known as the current unrestricted fund. The current unrestricted fund is supported primarily with state general fund, the statewide 6-mill levy, and tuition and fees. The Board of Regents controls the level of tuition and fees, while the legislature appropriates general fund and the 6-mill levy.

Present Law

The following items were considered in developing the MUS present law level of funding:

- A significant factor for the MUS budgets is enrollment. For the 2021 biennium, while changes in the mixture between in-state and out-of-state enrollment may occur at various campuses, the Office of the Commissioner for Higher Education anticipates enrollment across the system to remain flat. The MUS present law adjustment does not include changes due to enrollment

- Recent budget challenges at the University of Montana – Missoula are being managed by the system and are not included in the Outlook
- The standard inflationary items included in the MUS present law in the Outlook are for personal service annualization and inflation based upon 2019 biennium general fund ratio of approximately 40%

Pressures and Potential Pressures

As with other agencies, the pressures and potential pressures include additional funding for the appropriation rebase adopted during regular session, and SB 261 (2017 Session) reductions. The increases beyond current service level included within all agency adjustments mentioned previously total approximately $19.8 million for the 2021 biennium.

Professional Education

A portion of the professional education programs were funded with state special revenue for the 2019 biennium. This state special funding is not anticipated to be available in the 2021 biennium. Restoring this funding to general fund results in a pressure of $2.7 million.

Other Section E

Community colleges funding is shared between state, local, and tuition funding. Restoring the state percent share of community college funding to the 2017 biennium level is included in the 'Other' pressure category for Section E, and would increase general fund obligations by $1.8 million.

6 Mill Levy Risk

Every ten years, Montana citizens determine whether or not to continue support for the Montana University System through the 6-mill levy on property. If passed, this revenue tax source provides state special revenue for higher education expenditures. Over the past four votes, the percentage of Montanans in support of the levy dropped from 67.2% to 56.8%. In the event the levy does not pass, there would be a shortfall of $40.9 million to the biennial budget of the MUS and there would be pressure for the state general fund to cover the shortfall.

SECTION F: LONG-RANGE PLANNING PROGRAMS

The Long-Range Planning (LRP) programs include many of the state's infrastructure funding programs. LRP programs are funded with dedicated revenue streams which, barring additional cash infusions or the authorization of bonds, have more demands for funding than available revenues. The projections for the program revenue sources are on track for the 2019 biennium and are generally expected to increase at a modest rate for the 2021 biennium.

Long-Range Planning Programs
2021 Biennium General Fund Pressures
($ Millions)

Program	Transfer Pressure	Increase Pressure	Total Pressure
Long-Range Building	$5.0	$34.7	$39.7
DNRC Grants (2 programs)[1]	2.1	2.1	4.1
Treasure State Endowment	7.5	5.8	13.3
Treasure State Regional Water	-	3.1	3.1
Total	$14.6	$45.6	$60.2

[1]Renewable Resource Grants & Loan and Reclamation and Development Grants

During the 2017 Special Session the legislature transferred $15.0 million of funds from five LRP programs to the general fund, but did not eliminate any projects or reduce appropriations as a part of that action. The special session legislature was shown that since LRP projects take a long time to complete and based on historic spending patterns, all the programs where transfers resulted in projected negative fund balances by the end of the 2019 biennium would be able to cash flow projects through the biennium. However, most of the programs have indicated that their management principles preclude entering into contracts for projects without having the funding on hand (or based on future revenues), or in effect disallowing the ability to cash flow projects. As a result, the 2019 legislature will be working with $14.6 million fewer funds for new projects in the 2021 biennium, causing pressures to transfer the funds back to the programs.

Additionally, in previous biennia the legislature frequently increased LRP project funding to address a backlog of projects or fund larger capital improvements, most often through transfers from the general fund to the LRP programs. In the past six biennia, program increases have averaged a total of $45.6 million. This pressure, in addition to reimbursing the programs for the special session transfers, increases the general fund pressures related to LRP programs to $60.2 million.

State Infrastructure

Long-Range Building Program (LRBP)

The LRBP is responsible for the major construction and maintenance of state buildings and related campus infrastructure. During the 2017 Special Session, the legislature transferred $5.0 million of program funds to the general fund but did not correspondingly reduce appropriations, causing a projected negative ending fund balance for the biennium and a pressure to backfill this transfer during the 2019 session. If no action is taken the 2019 legislature will have $5.0 million less LRBP funds for new projects, since a portion of the future revenue will be needed for the costs of the existing projects.

Additionally, over the past six biennia, the legislature has provided the LRBP budget with transfers averaging $34.7 million from the general fund to increase funding for projects. This pressure, when added to the pressure to replace the transfer funds, increases the overall general fund pressure related to the LRBP in the 2021 biennium to approximately $39.7 million.

Local Infrastructure and Natural Resource Grants

Department of Natural Resources and Conservation (DNRC) Grant Programs

The two DNRC grant programs, Renewable Resource Grant Program (RRGL) and the Reclamation and Development Grant Program (RDGP), are both funded through the revenues of the natural resource projects account. In the 2017 Special Session, the legislature transferred $2.1 million of program funds to the general fund but did not correspondingly reduce appropriations, causing a projected negative fund balance for the biennium and a pressure to backfill this transfer during the 2019 session. The RRGL and RDGP are floating funding programs, so some of the grants that were expected to receive funding in the 2019 biennium will go unfunded as a result of the transfer of program funds to the general fund. If the legislature does not transfer funds into the program, the grant awardees who had their projects provisionally eliminated in the 2019 biennium will have to compete for funding with the new grant requests in the 2021 biennium.

Additionally, over the past six biennia the legislature has increased funding for these programs through general fund transfers that averaged $2.1 million per biennium to fund additional natural resource projects. This pressure, when added to the pressure to replace the transferred funds, increases the overall general fund pressure related to these programs to approximately $4.2 million in the 2021 biennium.

Treasure State Endowment Programs

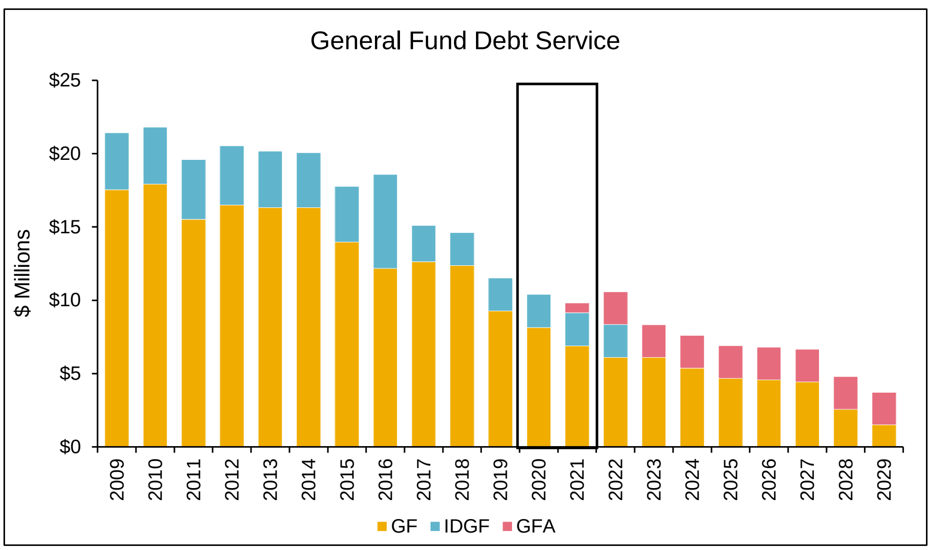
The Treasure-State Endowment Program (TSEP) provides local government funding assistance for water/wastewater infrastructure and bridge projects. In the 2017 Special Session, the legislature transferred $7.5 million from the TSEP program funds to the general fund but did not correspondingly reduce appropriations, causing a projected negative fund balance for the biennium and a pressure to backfill this transfer during the 2019 session. TSEP informed some of the lower ranked grant awardees that their grants would not be funded in the 2019 biennium, but instead would recommend the projects to the 2019 Legislature with the submission of a request letter. If no action is taken the 2019 legislature will have $7.5 million less funds for new TSEP grants, since the grant awardees who had their projects provisionally eliminated in the 2019 biennium will be competing for funding with new grant requests in the 2021 biennium budget.

Additionally, over the past six biennia the legislature has increased the funding for the program through general fund transfers that averaged $5.8 million per biennium to fund additional TSEP projects. This pressure, when added to the pressure to replace the transfer funds, increases the overall general fund pressure related to the TSEP program to approximately $13.3 million in the 2021 biennium.

The Treasure State Regional Water Program (TSEPRW) provides the state funding match for large regional water projects. No TSEPRW funds were transferred from the program during the special session, but over the past six biennia the legislature has increased funding for the program through general fund transfers that averaged $3.1 million per biennium to fund additional projects. Consequently, the general fund pressure related to TSEPRW is approximately $3.1 million in the 2021 biennium.

General Fund Debt Service

Significant investments in state infrastructure have been historically financed with debt in the form of bond issue proceeds. The level of Montana's tax supported debt is low when compared to other states[3], and the (direct) general fund obligation to debt service is projected to average $7.5 million per year in the 2021 biennium, barring new issues. The following figure illustrates the debt service cost for issued and authorized general obligation (GO) debt, that debt where the full faith and credit of the state is pledged to the debt.



The figure above demonstrates the decline in general fund debt service costs, which as projected in the 2021 biennium (GF) would be 30.5% less than the debt service in the 2019 biennium. The figure includes general fund historic debt service payments (2009-2017) and the debt service projections (2018-2029) for the following:

[3] "State Government-US Medians-Total State Debt Remains Essentially Flat in 2017. "Moody's Investor Services. In 2017, Montana tax supported debt per capita: $207, placing Montana at the 47th lowest of the 50 states (2 states do not issue GO debt). Montana tax supported debt as a percent of personal income: 0.5%, again placing Montana at the 47th lowest of the 50 states.

- General Fund (GF) – General obligation (GO) bonds paid directly by the general fund. The proceeds from these bond issues primarily funded the construction of state government buildings. The total cost of GF bonds is $15.0 million in the 2021 biennium
- GF Indirect (IDGF) – This category includes GO bonds and special revenue bonds that are paid indirectly through the general fund. The related bond issues include state building energy conservation bonds and revenue bonds for the state hospital that offset general fund revenue that would otherwise flow into the general fund. The total cost of IDGF bonds is $4.5 million in the 2021 biennium
- GF Authorized (GFA) – This category includes the projections for debt services costs on $27.8 million of authorized but unissued bonds. Included in this category are two issues that cover the state's share of the costs of two tribal compacts, the state's share of the St. Mary's diversion structure repairs, and the remaining authority available for the Montana Heritage Center. The total cost of IDGF bonds is $0.7 million in the 2021 biennium

For the purpose of the analysis of GFA, it is assumed that 20 year bonds would be issued for each of the items in the spring of FY 2020. Given the need for federal action for both the compacts and the St. Mary's project and the need for additional funding for the Heritage Center, this schedule may be optimistic and bond sales are more likely to happen in later years. If these bonds were issued, the general fund cost in the 2021 biennium is projected to be $0.7 million and in the future $2.2 million per year.

2021 Biennium Risk

While the estimated revenues and costs are included in the primary Outlook forecast, there are upside and downside risks throughout the budget. These risks are mentioned in the specific area that the risk is present and also summarized in this section.

Downside Revenue Risk

While the baseline forecast is the primary comparison for the Outlook budget, the pessimistic revenue scenario incorporates the IHS Markit pessimistic forecast for national economic variables (shown in Appendix A). In addition, the individual income tax forecast includes an adjustment that allows for the observed change in taxpayer timing of payments in weak stock market years, and the corporate income tax forecast assumes a higher level of refunds and lower audits. The pessimistic revenue scenario suggests revenue could be lower than the baseline assumption by $197 million in the 2021 biennium.

Upside Revenue Risk

The optimistic revenue scenario incorporates the IHS Markit optimistic forecast for national economic variables (shown in Appendix A), and suggests revenue could be above the baseline assumption by $78 million in the 2021 biennium.

Upside Revenue Risk: Corporate Tax Risk

The Tax Cuts and Jobs Act (TCJA) contained many changes to the federal corporate tax code. These included, but are not limited to, capping interest expense deductions at 30% of taxable income, repatriation of foreign profits, limits on net operating losses, and additional bonus depreciation. The starting point for a Montana corporation's tax liability is the given corporation's federal return. As a result, Montana's corporate tax rate is applied to the Montana attributable taxable income after applying the new federal changes listed above. While some changes, like increased depreciation schedules will lower taxable income, the majority of the changes will create larger tax bases. At the federal level the increased tax bases were more than offset by the reduction in the federal corporate tax rate from 35%

to 21%. However, at the state level the tax rate remained unchanged. As a result, it is anticipated that the TCJA will increase collections. Specifically, a recent study by the State Tax Research Institute estimated that Montana's corporate tax base would increase by 9% from 2018 to 2027.

Up and Downside Risk: Guarantee Fund

The Guarantee Fund is a state special revenue fund dedicated to school funding. Revenues generated from common school state land are deposited into the fund. These revenues include leases for agriculture and extraction industries, bonus payments, timber revenues, and interest from the common school trust fund. In addition, mineral royalties on common school land are deposited into the common school trust. Compared to the current biennium, guarantee fund revenues are expected to increase by $5.9 million in the 2021 biennium and $13.4 million by the 2023 biennium. The increases are almost entirely due to increases in interest earned from the common school trust fund. The current forecast assumes an increasing trust fund balance and higher interest rates which results in the higher interest revenues.

Downside Risk: 6-Mill

Every 10 years, Montana citizens determine whether or not to continue support for the Montana University System through the 6-mill levy on property. If passed, this revenue tax source provides state special revenue for higher education expenditures. Over the past four votes, the percentage of Montanans in support of the levy dropped from 67.2% to 56.8%. In the event the levy does not pass, there would be a shortfall of $40.9 million to the biennial budget of the MUS and there would be pressure for the state general fund to cover the shortfall.

Upside Risk: Health and Economic Livelihood Partnership Act Initiative

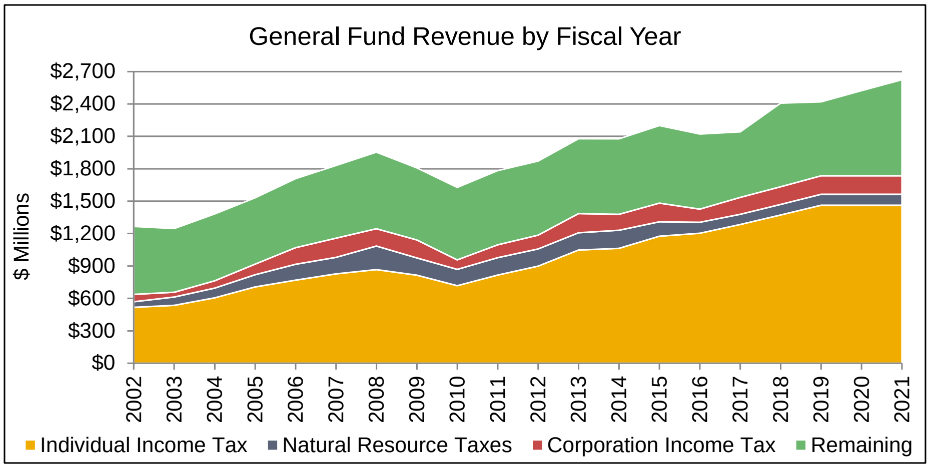
The citizen proposed initiative includes a provision for a portion of the distribution from the already established health and Medicaid initiatives state special revenue fund to be used for HELP Act. The proposed increased distribution would be funded by an increased tax on cigarettes and other tobacco products. Of that increase, 52% would be distributed to the HELP state special revenue fund each fiscal year, up to a total of $26 million, for a biennial impact of $52 million, and would partially offset the $197.9 million state share of the costs associated with re-authorizing the HELP Act.

Downside Risk: Extreme Fire Risk

The FY 2018 fire season costs were the worst in recent years. If two fire seasons of the same magnitude as FY 2018 follow, the risk to the state is an additional $89.2 million for the 2021 biennium.

Long-Term Risk

Increasing Individual Income Tax Reliance



Individual income tax has been a growing share of total general fund revenue since FY 2002, as illustrated in the adjacent chart. In FY 2002, it accounted for 40.9% of general fund revenue; based on the outlook forecast, it may account for 56.5% by FY 2021.

In fact, while all other sources combined grew an average of 1.8% annually from FY 2002 to FY 2017—below the average annual inflation growth of 2.1% over the same period—individual income tax grew at an average annual rate of 5.6%. Although individual income tax is less volatile than corporation income tax or natural resource taxes, the increasing reliance on a single source of revenue may result in more exposure to forecasting error, as well as business cycle fluctuations.

Pensions

At the end of FY 2017, both the Teachers' Retirement System (TRS) and Public Employees' Retirement System (PERS) amortized in 30 years or less. For the most recent actuarial valuation, PERS lowered its investment return assumption from 7.75% to 7.65%. This change lowered the funded ratio from 77% to 73% and increased the amortization period from 26 to 30 years. The funded ratios and amortization periods for all of the state's retirement systems as of July 1, 2017 are shown below.

Retirement System	Percent Funded	Years to Amortize
Public Employees' Retirement System	73%	30
Teachers' Retirement System	70%	22
Game Wardens and Peace Officers	81%	Does not amortize
Highway Patrol Officers	64%	Does not amortize
Judges	167%	0
Sheriffs	81%	25
Municipal Police Officers	69%	16
Firefighters' Unified	76%	10
Volunteer Firefighters	81%	6

The major sources of funding for the retirement systems are investment earnings, employee and employer contributions, and general fund statutory appropriations. While general fund statutory appropriations and the employer/employee contributions are set in statute, investment earnings are much more volatile.

Investment earnings, which constitute the majority of funds flowing into PERS, have averaged a 6.0% market rate of return over the last 10 years. A recent study conducted by the Montana Board of Investments (MBOI) estimated that the future long term expected return would equal 6.57%, compared to the assumed 7.65%. If a return rate of 6.57% is indeed realized over the long-term, additional funds would need to be contributed to the pension system to maintain current levels of funding.

Confederated Salish and Kootenai Tribal Compact

There is one bonding potential that the 2019 Legislature may consider. The 2015 Legislature adopted the Confederated Salish and Kootenai (CSKT) tribal compact, which included costs of $55.0 million for the state's share of mitigation projects. The state currently has two tribal compacts, the Ft. Belknap and the Blackfeet compacts, where significant portions of the state share funding has been provided through the authorization of bond issues. The bonds will not be issued until the compacts are approved by the federal government, as would be the case for the CSKT compact. The 2019 Legislature may consider providing similar authorization for the project costs of the CSKT compact. This action is unlikely to have a general fund cost in the 2021 biennium.

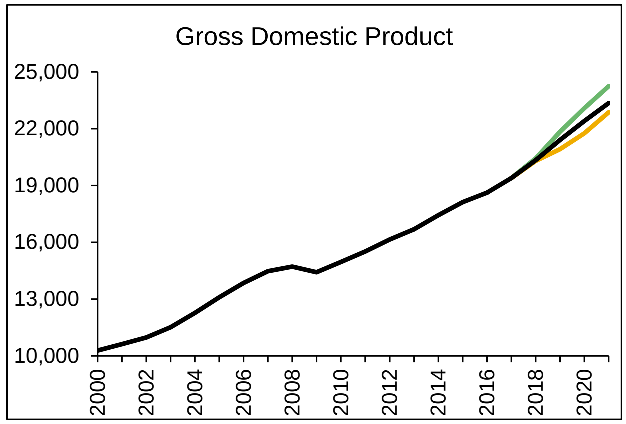
Appendix A

Economic Scenario Highlights

Economic data provided by IHS Markit, the econometric data service contracted by the state, forms the basis of most revenue forecasts. Many other data sources are used for historical information, but IHS Markit is the primary source for forecast data. Three forecast scenarios—baseline, optimistic in green and pessimistic in yellow—of selected variables are provided in this section. Note that IHS Markit only provides alternative scenarios for national statistics, and not for state-specific statistics.

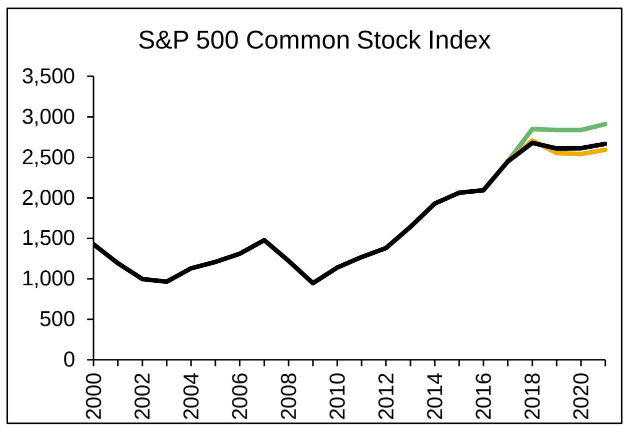
Gross Domestic Product

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



S&P 500 Stock Market Index

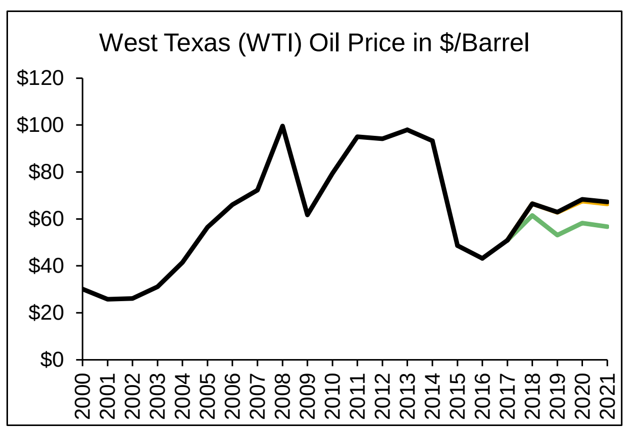
The S&P 500 is a stock market index based on the market capitalizations of 500 large companies. Due to the diversity of companies, it is a broad representation of the U.S. stock market and is a good indicator for investment income.



West Texas Intermediate Oil Price

West Texas Intermediate (WTI) spot oil prices are a good indicator of Montana oil prices, and are used for the oil and natural gas production tax estimate. In addition, WTI price is used for several sectors of the corporation income tax estimate and the part of the individual income tax estimate.

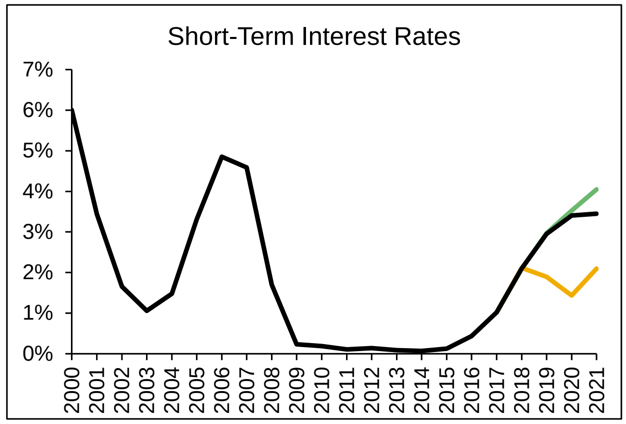
After averaging about $100/barrel from 2011 through 2014, oil prices began declining in the fall of 2014. Prices are expected to average near $70/barrel in the outlook period.



Interest Rates

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

The outlook assumes steadily increasing rates up to 3.4% by 2021.



Appendix B

Rating agencies and other experts recommend considering budget implications in a long-term horizon to help guide decision making. The chart below illustrates the early stages of development of a longer-term budget view. It shows present law, current service level, pressures, and potential pressures compared to revenue scenarios for both the 2021 biennium and the 2023 biennium.

Revenue scenarios are described in the 2021 Biennium Risk section. Note that in the pessimistic forecast, known refund impacts of recessions are factored into the 2021 biennium scenario, but would not expected to continue into the 2023 biennium pessimistic forecast as the impact is temporary. As seen in the chart, this assumption causes the pessimistic scenario to grow faster compared to the other forecasts. Important to note: optimistic and pessimistic forecasts should not be taken as a confidence interval as the variability of the forecast is substantial.

Similarly, expenditures were forecast forward an additional biennium. Present law and current service level costs raise steadily, but without the disproportionate growth seen in the 2021 biennium. Pressures are anticipated to grow steadily over time. With known factors included, if the budget is balanced to the baseline revenue forecast, it appears that present law will be balanced in the 2023 biennium.