COAL TRUST FUND INTEREST

Revenue Description

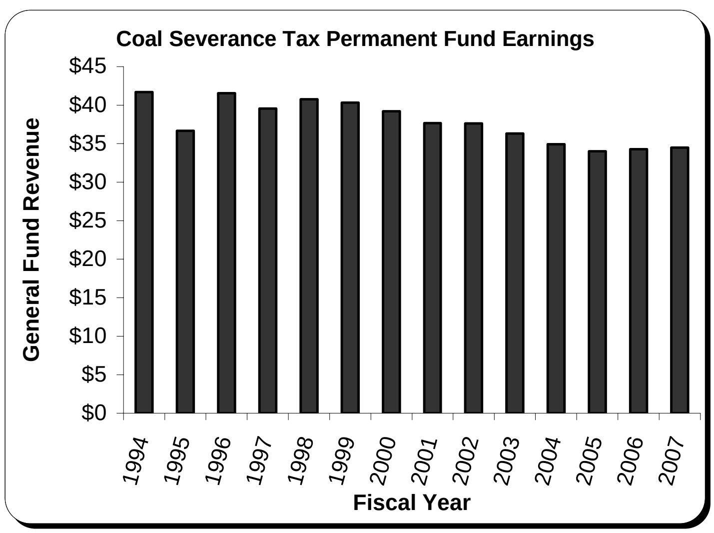
Article IX, section 5 of the Montana Constitution established a permanent trust fund into which at least half of coal severance tax revenue must be deposited. Under current law, half of severance tax revenue is deposited in the trust fund, which is divided into several funds with different purposes. Interest earnings from the coal severance tax permanent fund and the coal severance tax bond fund are paid into the state general fund.

Historical and Projected Revenue

Table 1 shows interest income payments from these coal tax trust funds to the general fund from FY 1994 through FY 2004, and forecasts for FY 2005 through FY 2007.

Table 1
Coal Tax Fund Interest Earnings
($ millions)

	Fiscal Year	General Fund	Percent Change
A	1994	41.725	-16.19%
A	1995	36.675	-12.10%
A	1996	41.532	13.24%
A	1997	39.554	-4.76%
A	1998	40.746	3.01%
A	1999	40.306	-1.08%
A	2000	39.195	-2.76%
A	2001	37.660	-3.92%
A	2002	37.605	-0.14%
A	2003	36.298	-3.48%
A	2004	34.907	-3.83%
F	**2005**	**34.003**	**-2.59%**
F	**2006**	**34.293**	**0.85%**
F	**2007**	**34.484**	**0.56%**



No deposits were made to the permanent fund in the 2003 biennium. Beginning in FY 2004, the trust fund balance will grow as 12.5% of severance tax collections are deposited in the permanent fund. Interest earnings have fallen every year since FY 1998, because long-term interest rates on new bonds have been lower than on bonds already in the trust fund portfolio. In FY 2005 through FY 2007, interest earnings are projected to remain relatively constant at about $34 million each year.

Background on Non-Commercial Loans

Up to 25% of the combined balance of the permanent fund, the treasure state endowment fund, and the treasure state endowment regional water system fund is to be invested in Montana companies, with an emphasis on new and expanding businesses (17-6-305, MCA). These investments take the form of fixed rate loans to private companies. All of these loans are made from the permanent fund, so they can make up more than 25% of the permanent fund portfolio. In FY 2004, many of these fixed rate loans were repaid because the rates on commercial loans were at historic lows.

Pursuant to SB 495 (2001 session), the permanent fund made a loan of $46.337 million to the common school trust. The school trust pays interest on this loan at last year's trust fund bond pool rate, and a portion of mineral royalties from state school lands are pledged to repay the principal of the loan. Projected repayments are explained in the School Trust Interest and Income Forecast.

The legislature has authorized the Board of Investments to make loans from the permanent fund to the Department of Justice to pay the cost of a lawsuit to recover Superfund cleanup costs. HB 160 renewed this authority (2003 session). The loan is to be repaid with interest from funds recovered from this lawsuit, but no interest is paid until then. The Board of Investments lends funds to the Department of Justice as they are expended.

SB 131 authorized the Board of Investments to invest up to $5 million of the permanent fund in local economic development organizations' revolving loan programs. These loans are to have an interest rate of no more than 2%. At the end of April 2004, loans totaling $3.719 million had been made.

Forecast Methodology and Projection Calculation

There are three steps to forecasting general fund revenue from the coal severance tax permanent fund and the coal severance tax bond fund. First, the annual average balance of the funds must be projected. Second, the annual percentage yield of the funds is projected. Finally, payments to the general fund are estimated by multiplying the average annual balance by the annual percentage yield.

Permanent Trust Fund Balance

Half of coal severance tax collections are deposited in the coal trust funds. Beginning in FY 2004, 12.5% of coal severance tax collections will go to the permanent fund. Coal severance tax deposits to the trust fund are projected to be $3.303 million in FY 2005, $3.998 million in FY 2006, and $3.858 million in FY 2007. Severance tax is collected quarterly, and the average balance during a fiscal year equals the beginning balance plus the quarterly deposits, each multiplied by the fraction of the year remaining when the deposit is made. If the deposits are of equal size, the increase in the average balance is 3/8 of the sum of the deposits: $(3/8 = \frac{1}{4} \times \frac{3}{4} + \frac{1}{4} \times \frac{1}{2} + \frac{1}{4} \times \frac{1}{4} + \frac{1}{4} \times 0)$.

Table 2 shows actual beginning and ending balances along with coal severance tax deposits for FY 2004, and projections for FY 2005, FY 2006 and FY 2007.

Table 2
Trust Fund Balances
($ millions)

	FY 2004	FY 2005	FY 2006	FY 2007
Beginning Trust Fund Balance	$542.450	$546.891	$550.194	$554.193
Coal Severance Tax Deposits	$4.441	$3.303	$3.998	$3.858
Ending Trust Fund Balance	$546.891	$550.194	$554.193	$558.051
Average Trust Fund Balance	**$544.200**	**$548.280**	**$552.348**	**$556.233**

The permanent fund balance is invested primarily in three vehicles managed by the Board of Investments (BOI). These vehicles are the Trust Funds Bond Pool (TFBP), the Short Term Investment Pool (STIP), and commercial and non-commercial loans. TFBP and STIP are mutual funds managed by the Board of Investments. TFBP holds a portfolio of long-term corporate and government bonds. It is managed to provide reliable long-term interest earnings. STIP holds a portfolio of short-term bonds and is managed to allow daily transactions while still paying some interest.

The forecast assumes that the portion of the permanent fund balance invested in loans, STIP, and TFBP are fixed. The loan and STIP portions are set at the median proportions for FY 2003 and FY 2004. The TFBP portion is the remaining balance. For each month, the balance is projected from the previous month's balance plus estimated coal severance tax payments.

Table 3 shows the portion of the permanent fund average balance by type of investment.

Table 3
Coal Trust Permanent Fund Average Balance by Investment Type
($ millions)

Fiscal Year	Loan Balance	% Total	STIP Balance	% Total	TFBP Balance	% Total	Average Balance
A 2001	$129.505	23.78%	$13.851	2.54%	$401.252	73.68%	$544.608
A 2002	$191.338	35.41%	$28.797	5.33%	$320.238	59.26%	$540.374
A 2003	$230.041	42.36%	$18.399	3.39%	$294.584	54.25%	$543.024
A 2004	$207.459	38.12%	$32.432	5.96%	$304.309	55.92%	$544.200
F 2005	**$213.203**	**38.89%**	**$24.738**	**4.51%**	**$310.339**	**56.60%**	**$548.280**
F 2006	**$216.402**	**39.18%**	**$25.802**	**4.67%**	**$310.144**	**56.15%**	**$552.348**
F 2007	**$217.924**	**39.18%**	**$25.983**	**4.67%**	**$312.325**	**56.15%**	**$556.233**

Annual Permanent Trust Fund Yield

Table 4 shows investment incomes and rates of return on the permanent fund average balances. Loan yields are fixed at the average loan yield for the previous 12 months. STIP and TFBP yields are the projected rates for STIP and TFBP discussed in the Introduction to Interest chapter. Multiplying the average balance by the yield derives investment income.

Table 4
Coal Trust Permanent Fund Income and Yield
($ millions)

Fiscal Year	Loan Income	% Return	STIP Income	% Return	TFBP Income	% Return	Total Income	Total Yield
A 2001	$7.198	5.56%	$0.884	6.38%	$29.456	7.34%	$37.538	6.89%
A 2002	$11.691	6.11%	$0.861	2.99%	$23.273	7.27%	$35.825	6.63%
A 2003	$13.913	6.05%	$0.264	1.43%	$21.004	7.13%	$35.181	6.48%
A 2004	$12.470	6.01%	$0.362	1.12%	$22.319	7.33%	$35.151	6.46%
F 2005	**$12.664**	**5.94%**	**$0.500**	**2.02%**	**$20.697**	**6.67%**	**$33.861**	**6.18%**
F 2006	**$13.039**	**6.03%**	**$0.846**	**3.28%**	**$20.187**	**6.51%**	**$34.073**	**6.17%**
F 2007	**$13.131**	**6.03%**	**$0.956**	**3.68%**	**$20.150**	**6.45%**	**$34.237**	**6.16%**

Bond Trust Fund Balance and Yield

A balance is maintained in the coal severance tax bond fund equal to principal and interest payments due in the next year on coal severance tax bonds. This provides a reserve fund that guarantees that bond payments will be made even if unforeseen events occur. Having a reserve fund allows the state to obtain a lower interest rate when it sells bonds. All invested funds in the bond fund are invested in STIP. The average STIP balance for the first three months of FY 2005 was $6.706 million. The forecast assumes this balance will be maintained throughout the forecast period.

Table 5 shows the actual and projected annual average bond fund STIP balance, the STIP rate of return and the interest income on this balance for FY 2001 through FY 2007. Interest income is the product of the average balance times the rate of return.

Table 5
Coal Tax Bond Fund
Interest Income

FY	Average Balance		% Return		Interest Income
A 2001	$5.930	X	9.37%	=	$0.556
A 2002	$5.676	X	4.15%	=	$0.235
A 2003	$6.134	X	2.03%	=	$0.124
A 2004	$6.018	X	1.48%	=	$0.089
F 2005	**$6.706**	X	**2.12%**	=	**$0.142**
F 2006	**$6.706**	X	**3.28%**	=	**$0.220**
F 2007	**$6.706**	X	**3.68%**	=	**$0.247**

General Fund Revenue

Table 6 shows the total earnings for the permanent fund and the bond fund for the general fund revenue estimate. The combined fund balance increases every year from FY 2002 through FY 2007, but the combined income decreases from FY 2001 through FY 2005. This is primarily due to decreasing returns in the commercial loan and bond markets. The income grows slightly for FY 2006 and FY 2007 as the fund balance increases and the yield remains fixed. General fund revenue will be about $34 million each year.

Table 6
Coal Severance Tax General Fund Interest Earnings

Fiscal Year	Combined Fund Balance		Combined Fund Yield		Combined Fund Income
A 2001	$550.537	X	6.92%	=	$38.093
A 2002	$546.049	X	6.60%	=	$36.061
A 2003	$549.158	X	6.43%	=	$35.306
A 2004	$550.218	X	6.40%	=	$35.240
F 2005	**$554.987**	X	**6.13%**	=	**$34.003**
F 2006	**$559.054**	X	**6.13%**	=	**$34.293**
F 2007	**$562.939**	X	**6.13%**	=	**$34.484**