


OFFICE OF THE GOVERNOR
BUDGET AND PROGRAM PLANNING
STATE OF MONTANA



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TO: Amy Carlson, Legislative Fiscal Analyst
Legislative Fiscal Division

FROM: David Ewer, Budget Director 
Office of Budget and Program Planning

DATE: December 15, 2010

SUBJECT: Amendments to the Governor's 2013 Biennium Executive Budget

In accordance with 17-7-112, MCA, I am submitting the following formal written amendments to the November 15 preliminary 2013 biennium Executive Budget. All changes are reflected in the R02 version in MBARS.

Revenue Adjustments:

As a result of more recent data and a change to forecasting methodology, OBPP is updating its revenue estimates originally submitted as part of the November 15, 2010 budget submission. The net effect of these changes adds \$118.70 million to the three year forecast period. Please see Addendum 1 for further detail regarding changes to methodology and year-by-year change to the revenue estimates.

Expenditure Adjustments:

- In the Department of Natural Resources and Conservation, NP 2324 removes \$27,979 of funding from the Treasure State Endowment state special revenue fund and replaces it with a like amount of funding from the Natural Resources Operations state special revenue fund in accordance with 90-6-701(2), MCA.
- The transfer of funding from the Treasure State Endowment Program state special revenue fund to the state general fund has been revised to be \$17,614,270 for the 2013 biennium. This amount is reflected in the introduced version of HB 11.
- The transfer of funding from the Long-Range Building fund to the state general fund, included in HB 5, has been increased by \$1 million to accommodate corrected revenue estimates for the fund.

- In the Department of Public Health and Human Services, DP 55141 in the Addictive and Mental Disorders Division has been removed. This reduction was already made in the base year and therefore is not needed for FY 2012 and FY 2013.
- In the Department of Public Health and Human Services, funding for the Healthy Montana Kids program has been adjusted to increase funding from the I-155 state special revenue fund by approximately \$3.1 million and decrease funding from the general fund by a like amount for the biennium. The change is reflected in DP 11001 – Medicaid Benefits, Physical Health.
- In the Health Resources Division of the Department of Public Health and Human Services, DP 11017 – HMK-Chip Caseload was revised and therefore funding is reduced by approximately \$1.5 million state special revenue and \$4.7 million federal special revenue.
- In the Department of Public Health and Human Services, DP 11022 for the Health Resources Division has been revised to eliminate a duplication of some funding for the CPI-MMIS components that was also requested by the Technology Services Division.
- In the Department of Public Health and Human Services, a decision package for the Recovery Audit Contract program has been added in the Quality Assurance Division. The request increases funding by \$69,788 general fund, \$68,238 state special revenue and \$138,024 federal funds for the biennium to operate the program. In addition, a language appropriation of up to \$103,061 state special revenue and up to \$204,308 federal funds is requested to pay the contractor fee for the recovery actions.
- In the Department of Public Health and Human Services, \$180,000 state special revenue funding for tobacco prevention was added for distribution to the Little Shell Tribe because the funding was not spent in the base year so it was not captured in the base budget.
- In the Department of Justice, funding for the Highway Patrol Officers budget is corrected which results in an approximate \$368,000 savings for the general fund over the biennium.
- In compliance with the salary survey required in 2-18-303(5), MCA, the Department of Justice – Montana Highway Patrol requests a decision package for a pay increase for Highway Patrol officers. Funding, of \$950,000 per year for the increase comes from the state special revenue fund statutorily dedicated for this purpose.
- Funding for DP 1301 – Troopers on the Road in the Department of Justice – Montana Highway Patrol budget has been corrected among state special revenue funds with a net change of \$0.
- Funding for the Gambling Control Division budget has been corrected among state special revenue and enterprise funds with a net change of \$0.

- Decision package 920 has been added in the Commissioner of Higher Education budget to reduce funding for retirement by \$2,363,207 general fund in order to correct an error in the calculation formula. This correction to the retirement amount reduces the agency's 4% personal services reduction target within decision packages 55400, 55401 and 55402 by \$94,373 for the 2013 biennium. NP 918 – University System Funding has been increase by \$2,363,207 general fund to bring the request up to \$6,344,690 for FY 2012 and \$8,678,518 for FY 2013 to enhance student access and success, promote economic development, and more readily respond to workforce development needs.

MBARS has been updated to include these changes in the R02 version. The following documents are attached for further clarification:

- Updated Balance Sheet
- Addendum 1 – Updates to 2013 biennium revenue estimates

Proposed FY 2011 and 2013 Biennium General Fund Balance Sheet

	Projected FY 2011	Projected FY 2012	Projected FY 2013
Beginning Fund Balance	316.57	271.32	233.99
Adjustments	(5.93)		
Adjusted Fund Balance	310.64	271.32	233.99
OBPP Revenue Estimate	1732.04	1796.47	1887.55
Prior Year Revenue	0.00	0.00	0.00
Proposed Revenue Bills and Other OTO Transfers-In			
Eliminate Foreign Country Tax Shelter		2.65	2.65
Revise Business Equipment Tax		(8.54)	(13.50)
Tax Cut for Homeowners		(12.00)	(24.00)
Revise Corporate Tax Audit Advantage		2.90	2.90
Eliminate Corporate Net Operating Carryback		2.15	2.15
Nonresident High Value Real Estate Property		1.50	1.50
Eliminate Nevada Tax Dodge		2.80	2.80
Technical Fix to SB 407 (2003 Session)		2.00	2.00
DOR Tax Compliance Package		2.00	3.00
HB 5	11.69		
HB 10	10.74		
HB 11 TSEP and Regional Water Transfer		10.44	12.05
Big Sky Eco Devo Transfer		1.33	1.56
Fire Suppression Fund Transfer		20.00	0.00
PPL/Avista - School Facility Account Transfer		10.00	10.00
Health Care & Benefits Division Transfer	0.10		
Natural Resource Damage Program Transfer	1.30		
Coal Bed Methane Account Transfer		6.00	0.00
Total Funds Available	2066.50	2111.02	2124.64
Disbursements - Ongoing General			
General Appropriations Act - Base	1549.54	1511.49	1509.93
General Appropriations Act Decision Packages		145.79	170.46
Statutory Appropriations	181.24	189.99	199.55
Non-Budgeted Transfers	11.09	16.42	12.86
Feed Bill	7.63	1.92	7.48
Reversions	(90.35)	(5.65)	(5.68)
Other Appropriations	0.08	0.00	0.00
Subtotal Ongoing	1659.23	1859.96	1894.60
Disbursements - One-Time-Only			
General Appropriations Act Decision Packages	20.83	4.45	(13.62)
Non-Budgeted Transfers	38.21	0.00	0.00
HB 645	59.38	0.00	0.00
House Bill 13 - Personal Services Contingency	3.68	4.08	0.00
Carryforward	7.98	0.00	0.00
Other House or Senate Bill	3.03	0.00	0.00
Subtotal OTO	133.10	8.52	(13.62)
Total Disbursements Before Other Bills	1792.34	1868.48	1880.98
Proposed (Non HB 2) Bills - OTO			
HB 3 - Supplementals	2.85	0.00	0.00
DOR Gentax Upgrade		0.30	
Otter Creek - Water Protection		5.00	
Otter Creek - School Windmills and Energy		5.00	
Subtotal	2.85	10.30	0.00
Proposed (Non HB 2) Bills - Ongoing			
HB 13 - Pay Plan		2.50	12.50
Cap HB 124 Growth Rate		(3.73)	(6.83)
1% ORP Revision		(0.53)	(0.54)
Subtotal	0.00	(1.76)	5.13
Total Disbursements	1795.19	1877.03	1886.12
Ending Fund Balance After Adjustments	271.32	233.99	238.53

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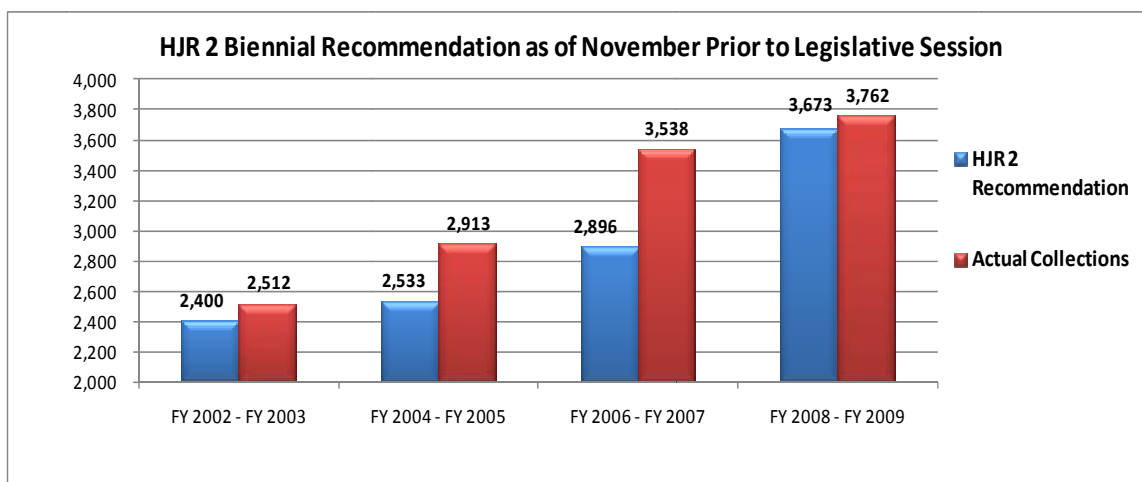


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**Addendum 1 – Updates to FY 2011
and 2013 Biennium Revenue Estimates**

Econometric Models

Over the past decade, revenue models used by OBPP and the LFD have consistently missed the mark during times of rapid accelerating (or decelerating) economic trends. This is due in large part to frequency of the measurement to which projections are anchored – namely prior fiscal year-end collections. As is shown in the following table, HJR 2 which sets out the official revenue estimate used by the Legislature and made in each respective November directly preceding a legislative session have missed actual revenue collections for the upcoming biennium by an average of 11%.



The most likely explanation for the revenue understatement is that there has been too much reliance on old data and an over-reliance on information that only indirectly, not directly, estimates state revenues, for example, proxies such as predictions of economic growth, oil prices, and the like.

While the economic outlook continues to brighten and while the econometric inputs are improving, their updates do not come timely enough. As an example, the Montana GSP estimate for the first quarter of CY 2010 and U.S. GDP estimate for the third quarter of CY 2010 were recently revised and moved up relative to the projections available in October. This means the base data for our complete revenue forecasts in November were understated.

There is, however, a key data point that is not lagging, and that is not a proxy for revenue collections and that is the actual amount of collections to date. Through November, 2010 total general fund revenue was \$459.245 million. This is \$50.541

million (12.37%) more than collections posted in SABHRS through November of FY 2010. This means that collections through November 2010 are currently running \$5.554 million above the anticipated FY 2011 HJR 2 gain over FY 2010 collections (\$44.987 million) for all of FY 2011. While there may be accounting and collections anomalies, the pattern and level of such timing adjustments (late posting of motor vehicle revenue in FY 2010, late reversal of video gaming accruals in FY 2011, etc.) effectively cancel each other out. Please see the following chart which shows year-to-date general fund revenue through November, 2010.

General Fund Revenue Monitoring Report								
Fiscal Year 2011 - Revenue Through November								
(\$ millions)								
Revenue Source	Actual FY 2010	Projected FY 2011	\$ Change	% Change	FY 2010 YTD	FY 2011 YTD	\$ Change	% Change
MAJOR TAXES								
Individual Income Tax	\$717.034	\$730.761	\$20.927	2.92%	\$247.759	\$276.090	\$29.139	11.76%
Property Tax	\$222.510	\$229.084	\$6.574	2.95%	\$11.784	\$9.662	(\$2.122)	(18.01%)
Vehicle Taxes and Fees	\$103.858	\$107.025	\$3.167	3.05%	\$6.745	\$36.414	\$29.669	439.84%
Corporation License Tax	\$87.901	\$103.320	\$15.419	17.54%	\$25.513	\$30.425	\$4.912	19.25%
Insurance Premiums Tax	\$54.892	\$54.587	(\$0.305)	(0.56%)	\$12.283	\$12.257	(\$0.026)	(0.21%)
Video Gambling Tax	\$52.396	\$55.340	\$2.944	5.62%	\$30.371	\$12.414	(\$17.957)	(59.13%)
Total Major Taxes	\$1,239.392	\$1,288.117	\$48.725	3.93%	\$334.455	\$378.069	\$43.614	13.04%
NATURAL RESOURCE TAXES								
Oil and Gas Production Taxes	\$95.491	\$101.421	\$5.930	6.21%	\$0.000	\$0.000	\$0.000	
U.S. Mineral Royalties	\$30.288	\$29.674	(\$0.614)	(2.03%)	\$6.920	\$7.520	\$0.600	8.67%
Coal Severance Tax	\$10.322	\$14.848	\$4.526	43.85%	\$3.138	\$3.540	\$0.403	12.83%
Metalliferous Mines Tax	\$6.541	\$6.481	(\$0.060)	(0.92%)	\$0.000	\$0.001	\$0.001	890.00%
Electrical Energy Tax	\$4.713	\$4.452	(\$0.261)	(5.55%)	\$0.956	\$1.279	\$0.323	33.76%
Wholesale Energy Transactions Tax	\$3.556	\$3.657	\$0.101	2.84%	\$0.822	\$1.028	\$0.206	25.12%
Total Natural Resource Taxes	\$150.911	\$160.533	\$9.622	6.38%	\$11.835	\$13.308	\$1.533	12.95%
INTEREST EARNINGS								
Coal Trust Interest Earnings	\$26.914	\$26.512	(\$0.402)	(1.49%)	\$6.757	\$6.548	(\$0.209)	(3.10%)
Treasury Cash Account Interest	\$2.692	\$1.666	(\$1.026)	(38.12%)	\$1.165	\$0.988	(\$0.178)	(15.25%)
Total Interest Earnings	\$29.606	\$28.178	(\$1.428)	(4.82%)	\$7.922	\$7.535	(\$0.387)	(4.88%)
LIQUOR TAXES								
Liquor Excise and License Taxes	\$15.626	\$16.104	\$0.478	3.06%	\$2.532	\$5.566	\$3.034	119.83%
Liquor Profits	\$9.000	\$9.511	\$0.511	5.68%	\$0.000	\$0.000	\$0.000	
Beer Tax	\$3.032	\$3.142	\$0.110	3.63%	\$1.145	\$1.117	(\$0.028)	(2.45%)
Wine Tax	\$1.933	\$2.098	\$0.165	8.55%	\$0.674	\$0.664	(\$0.010)	(1.42%)
Total Liquor Taxes	\$29.591	\$30.855	\$1.264	4.27%	\$4.351	\$7.347	\$2.996	68.86%
TOBACCO TAXES								
Cigarette Tax	\$32.218	\$31.029	(\$1.189)	(3.69%)	\$13.580	\$12.624	(\$0.957)	(7.04%)
Tobacco Products Tax	\$5.334	\$5.680	\$0.346	6.48%	\$1.914	\$1.950	\$0.036	1.87%
Tobacco Settlement	\$3.469	\$3.565	\$0.096	2.78%	\$0.000	\$0.000	\$0.000	
Total Tobacco Taxes	\$41.021	\$40.274	(\$0.747)	(1.82%)	\$15.494	\$14.573	(\$0.921)	(5.94%)
SALES TAXES								
Telecommunications Excise Tax	\$23.523	\$21.772	(\$1.751)	(7.45%)	\$3.021	\$5.501	\$2.480	82.10%
Institutional Reimbursements	\$22.000	\$17.555	(\$4.445)	(20.21%)	\$4.653	\$0.000	(\$4.653)	(100.00%)
Accommodations Tax	\$12.331	\$12.852	\$0.521	4.23%	\$5.122	\$5.849	\$0.727	14.19%
Health Care Facility Utilization Fees	\$5.300	\$5.039	(\$0.261)	(4.93%)	\$1.321	\$1.296	(\$0.027)	(2.08%)
Rental Car Sales Tax	\$2.807	\$2.999	\$0.192	6.82%	\$1.193	\$1.300	\$0.107	8.95%
Total Sales Taxes	\$65.962	\$60.217	(\$5.745)	(8.71%)	\$15.312	\$13.946	(\$1.366)	(8.92%)
OTHER TAXES AND REVENUES								
Lottery Profits	\$10.631	\$12.327	\$1.696	15.95%	\$0.000	\$0.000	\$0.000	
Highway Patrol Fines	\$4.646	\$4.666	\$0.020	0.42%	\$1.421	\$1.155	(\$0.266)	(18.74%)
Investment Licenses and Permits	\$6.225	\$6.008	(\$0.217)	(3.48%)	\$0.900	\$1.022	\$0.110	12.80%
Contractors' Gross Receipts Tax	\$6.969	\$6.477	(\$0.492)	(7.07%)	\$3.740	\$4.325	\$0.585	15.63%
Driver's License Fee	\$4.156	\$3.561	(\$0.595)	(14.32%)	\$1.461	\$1.777	\$0.316	21.62%
Rail Car Tax	\$2.579	\$2.031	(\$0.548)	(21.25%)	\$1.499	\$1.647	\$0.217	15.20%
Other Revenue	\$35.454	\$28.888	(\$6.566)	(18.52%)	\$10.375	\$14.479	\$4.104	39.56%
Total Other Revenue Sources	\$70.661	\$63.958	(\$6.703)	(9.49%)	\$19.333	\$24.405	\$5.072	26.23%
Total General Fund	\$1,627.145	\$1,672.132	\$44.987	2.76%	\$408.704	\$459.245	\$50.541	12.37%

Updates to Estimates

With five months of FY 2011 general fund revenue actually known, the forecast results using the current models strongly indicate that they are not high enough, and unless there is a substantial economic softening, the use of the current models will, once again, significantly understate revenues, and continue a decade-long pattern of missing actual collections, but never by overstating them. It is analogous to having a compass that always points to magnetic north and has never been recalibrated to point to true north. OBPP is now shifting to a more realistic and defensible estimating methodology that will reduce the likelihood of underestimating revenue.

OBPP's current FY 2011 total general fund revenue estimate is \$1,694 million. Today OPBB is updating its FY 2011 estimate to \$1,732 million, and has applied this base number to its revenue growth rates for 2012 and 2013 to arrive at a new total of \$118.7 million increase over the next three years.

Methodology Change

The following table details the past eleven years history of the percentage of cumulative revenue received through November of each respective year. A higher number reflects a year in which revenue was proportionately collected earlier in the year whereas a lower number reflects a year in which revenue was collected proportionately later. Extrapolating general fund revenue is done by dividing the revenue received year-date by the 11-year average (26.51%) of cumulative revenue received through November (i.e. \$459.245 million/26.51%).

Cumulative Revenue Received through November	
<u>Fiscal Year</u>	<u>% Received</u>
FY 2000	25.06%
FY 2001	24.74%
FY 2002	28.21%
FY 2003	27.33%
FY 2004	26.17%
FY 2005	26.35%
FY 2006	26.39%
FY 2007	25.69%
FY 2008	26.91%
FY 2009	29.69%
FY 2010	25.12%
11-Year Average	26.51%

As seen in the following table, the result of applying this methodology to general fund revenue estimates for FY 2011 increases OBPP's November estimate by \$37.93 million to \$1,732.04 million. This figure assumes a 6.43% increase in revenue between FY 2010 and FY 2011. For FY 2012 and FY 2013, original growth rates as estimated on November 15 were used. The net effect of applying this methodology to OBPP's general fund revenue estimates adds \$118.70 million to OBPP's three year general fund revenue estimate. This increase reflects a 2.24% increase over the November 15 estimate.

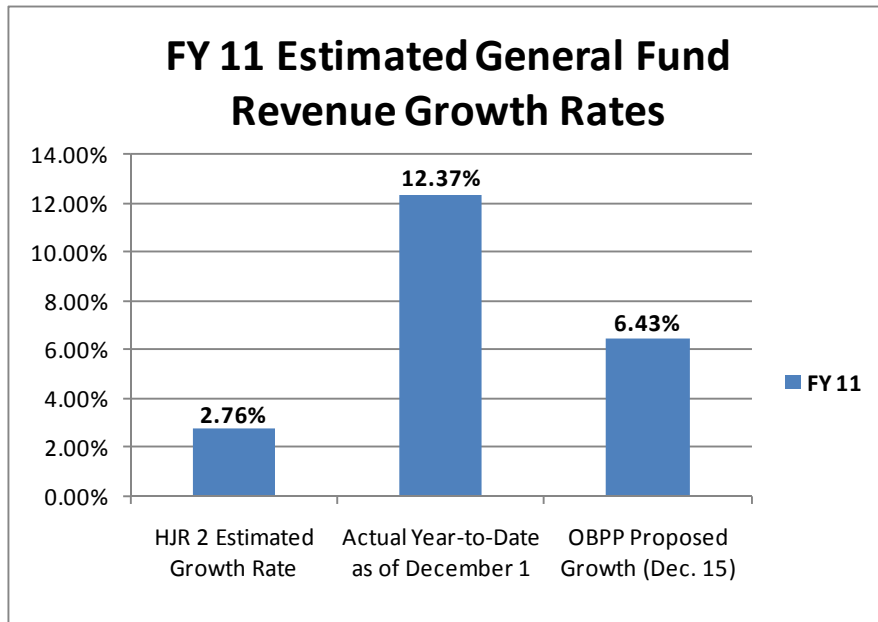
OBPP General Fund Revenue Estimates Change - As of December 15, 2010							
	General Fund Revenue				Estimated Growth Rates		
	FY 2011	FY 2012	FY 2013	Three Year Total	FY 2011	FY 2012	FY 2013
OBPP Nov. 15	1,694.11	1,757.10	1,846.14	5,297.35	4.09%	3.72%	5.07%
OBPP Dec. 15	1,732.04	1,796.47	1,887.55	5,416.05	6.43%	3.72%	5.07%
Change	37.93	39.37	41.41	118.70	2.34%	0.00%	0.00%

Reasonability of New Methodology

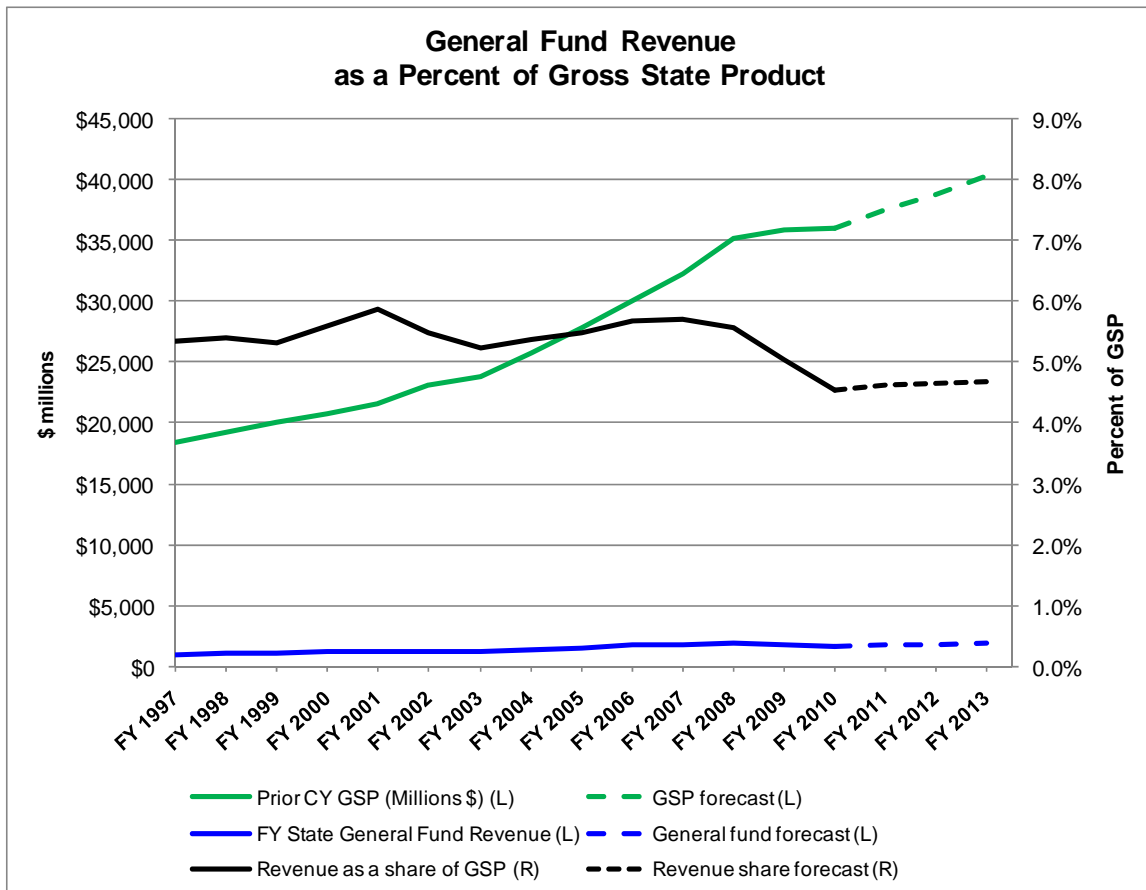
Many data points suggest that these proposed changes are reasonable. First, analysis was undertaken to determine a reasonable amount of growth in revenue in fiscal years which follow a recession. The following table shows that in FY 1995, for every dollar lost to revenue decline in FY 1994, approximately \$0.76 was recouped. Likewise, in FY 2003, for every dollar lost to revenue decline in FY 2002, approximately \$0.61 was recouped. Using OBPP's revised growth rate of 6.43% for FY 2011, it is estimated that only \$0.37 will be recouped in FY 2011 for every dollar lost in the back-to-back recession years of FY 2009 and FY 2010 – far less than the amount recovered in previous recessions.

General Fund "Bounce Back" After Recession			
Fiscal Year	GF Revenue In Millions	% Change from Previous Year	GF Revenue Loss/Reclaim Factor
1994	892	-6.42%	
1995	935	4.88%	0.76
2002	1,214	-4.35%	
2003	1,246	2.65%	0.61
2009	1,808	-7.50%	
2010	1,627	-10.00%	
2011	1,732	6.43%	0.37

Additionally, the following chart compares OBPP's revised growth rate for FY 2011 with the official growth rate adopted by the Revenue and Transportation Interim Committee on November 19, 2010 and the actual year-to-date collections growth rate (12.37%). When compared, OBPP's growth rate errs on the conservative side as it is significantly less than the actual year-to-date rate and implicitly assumes that collections will not continue at the rate currently realized through the end of November, 2010.



Furthermore, it is important to consider state general fund revenues in the context of other global variables which inevitably have impact on general fund revenue. State general fund revenue tracks the broadest measure of state economic activity - gross state product (GSP) - well. The following chart presents the relationship between calendar year GSP and the subsequent fiscal year's general fund revenue collections.



These data show the FY 1997 – FY 2010 actual general fund collections and OBPP projection of general fund revenue for FY 2011 and the 2013 biennium relative to the Bureau of Economic Affairs estimates of GSP (CY 1996 - CY 2009) and the Global Insight projection of GSP for CY 2010 through CY 2012. The results show that estimated revenue share in the forecast period experiences minimal gain with respect to total state economic activity in CY 2010, CY 2011 and CY 2012. The share for this forecast period averages approximately 4.65% of GSP while the FY 1997 – FY 2010 average share is 5.40% of GSP. This implies a conservative range of proposed revenue estimates relative to recent and projected recovery in economic activity in the state of Montana.

This new methodology when employed to last year produces estimates that may be very telling going forward. July-Nov. 2009 actual collections were \$400.703 million; the ten year total collection rate was 26.65% resulting in a total FY 2010 predicted revenue estimate of \$1,533 million. Applying the methodology for July through December 2009 (FY 2010); actual collections data amounted to \$600.813 million; 10 year cumulative average collected 36.97%. The predicted 2010 total revenue was \$1.625 million. FY 2010 resulted in an actual total revenue collection of \$1,627 million.

There are at least three points that can be made:

- 1) The model can cause significant revenue adjustments by just one month's data. This can be viewed as a new volatile component or an appropriate way to capture inflection points. The change in revenue estimates from the November to December projections rose by 6%.
- 2) The December prediction turned out to be amazingly accurate. This model may have caught the inflection point of the economy recovering out of recession.
- 3) December numbers, not yet known, may suggest that \$1,732 is still significantly under-estimated.

Finally, OBPP will be assessing its revenue outlook during the 2011 legislative session, especially in an economic environment that may well suggest even higher revenue estimates.