

SCHOOL INTEREST AND INCOME

Revenue Description

When Montana became a state, the United States government granted public lands to the state to provide income to support public schools. This land grant has been supplemented over time through gifts to the state and reversions of unclaimed property. Proceeds from sales of property from the school lands are deposited into a constitutionally-mandated trust fund. Ninety-five percent of the trust fund interest and net income from school lands goes to the guarantee account to be distributed to school districts; the remainder is deposited in the trust fund. Costs of administering state lands are deducted from allocations of the income produced from property sales and leases, and interest income.

Historical and Projected Revenue

Table 1 shows actual revenue from the common school trust for FY 1990 through FY 2004 and forecasts for FY 2005 through FY 2007.

Table 1 School Interest and Income General Fund and Guarantee Account (\$ millions)		
Fiscal Year	General Fund/ Guarantee Account	Percent Change
A 1994	\$40.944	-1.75%
A 1995	\$37.904	-7.42%
A 1996	\$42.032	10.89%
A 1997	\$39.539	-5.93%
A 1998	\$41.130	4.02%
A 1999	\$41.433	0.74%
A 2000	\$44.296	6.91%
A 2001	\$46.846	5.76%
A 2002	\$50.875	8.60%
A 2003	\$48.977	-3.73%
A 2004	\$55.663	13.65%
F 2005	\$58.919	5.85%
F 2006	\$55.368	-6.03%
F 2007	\$54.851	-0.93%

Fiscal Year	Revenue (\$ millions)
1994	40.944
1995	37.904
1996	42.032
1997	39.539
1998	41.130
1999	41.433
2000	44.296
2001	46.846
2002	50.875
2003	48.977
2004	55.663
2005	58.919
2006	55.368
2007	54.851

Through FY 2001, school interest and income was deposited in the general fund. SB 495 (2001 session) and HB 7 (2002 special session) created a new special revenue account, the guarantee account. Beginning in FY 2002, school trust

interest and income is deposited in the guarantee account rather than the general fund.

On average, this revenue source grows relatively slowly from year to year. Revenue increased significantly in FY 2002 because SB 495 resulted in a loan of \$46 million from the coal trust to the school trust fund. The higher trust fund balance increased interest earnings.

Revenue from the first 18 million board feet (MMBF) of timber sold during a fiscal year goes for general school funding, and any additional timber sales revenue is earmarked for school technology expenditures. The revenue earmarked for school technology expenditures formerly went in to a separate special revenue account. HB 7 directs that it is to be deposited in the guarantee account and statutorily appropriated for school technology expenditures.

Forecast Methodology and Projection Calculation

There are three parts to forecasting school trust interest and income going to the guarantee account. They are: 1) estimating school trust fund interest earnings; 2) estimating income from state lands; and 3) determining the distribution of the interest and income among the guarantee account, the trust fund, and the costs of administering state lands.

Trust Fund Interest Earnings

There are two steps to estimating the trust fund earnings for any year: estimating the annual yield on the trust fund; and estimating its average balance each year.

The school trust fund is invested in two funds managed by the Board of Investments. On average during FY 2003 and FY 2004, 98.9% was in the Trust Funds Bond Pool and 1.1% was in the Short Term Investment Pool. Other state agencies and trusts also invest in these two funds.

The Trust Fund Bond Pool yield is projected to be 7.16% in FY 2005, 6.23% in FY 2006, and 6.21% in FY 2007. The return on the Short Term Investment Pool is projected to be 2.12% in FY 2005, 3.28% in FY 2005, and 3.68% in FY 2005. These yield forecasts are explained in the introduction to interest earnings.

The annual yield of the common school trust fund is forecast as a weighted average of the yields on the two Board of Investments funds. It equals 98.8% of the yield on the Trust Funds Bond Pool, plus 1.1% of the yield on the Short Term Investment Pool.

The average trust fund balance for each year is calculated in two steps. First, the beginning balance is estimated. For FY 2005, it is known. For FY 2006 and FY

2007, it is calculated by adding the previous year's trust fund deposits to the previous year's beginning balance. Second, deposits during the year are multiplied by the fraction of the year that each is in the trust fund and added to the beginning balance. Tables 4 through 6, located near the end of this revenue estimate, provide the calculations showing how much is deposited annually into the trust fund.

Table 2 shows the forecast of yields, balances, and income earnings. The balance grows each year as part of the interest and income is reinvested in the trust fund. The large increase in FY 2002 is from the loan of \$46.4 million from the coal trust required by SB 495. The school trust is to pay interest on this loan monthly and to repay the principal from mineral royalty receipts beginning in FY 2004. In FY 2004 and FY 2005, 20% of mineral royalties are pledged to repay principal. Beginning in FY 2006, 25% of mineral royalties go to repay the loan.

Fiscal Year	Annual Yield	Average Balance	Earnings
A 1999	7.648%	\$318.032	\$24.322
A 2000	8.019%	\$323.173	\$25.916
A 2001	8.011%	\$329.649	\$26.407
A 2002	7.760%	\$387.671	\$30.082
A 2003	7.019%	\$387.559	\$27.202
A 2004	7.346%	\$381.041	\$27.991
F 2005	7.082%	\$382.612	\$27.098
F 2006	6.182%	\$385.708	\$23.845
F 2007	6.162%	\$388.736	\$23.955

Income From School Lands

For the purposes of this forecast, the income generating activities on state lands are divided into six categories: agricultural rents; grazing rents; other rents and leases; timber sales; mineral royalties; and miscellaneous receipts. Table 3 shows the actual and forecast income in each of these categories for FY 1998 through FY 2007.

Fiscal Year	Ag Rents	Grazing Rents	Other Rents	Net Timber Sales	18 MMBF	Over 18 MMBF	Mineral Royalties	Miscellaneous	Total
A 1998	\$8.965	\$3.733	\$2.712	\$2.801	\$2.801		\$5.752	\$1.380	\$25.343
A 1999	\$8.381	\$4.174	\$2.394	\$3.370	\$3.370		\$4.629	\$1.527	\$24.475
A 2000	\$9.053	\$4.066	\$3.294	\$5.380	\$5.380		\$8.541	\$1.797	\$32.130
A 2001	\$8.377	\$4.851	\$9.381	\$1.649	\$1.636	\$0.013	\$11.269	\$1.467	\$36.994
A 2002	\$6.999	\$5.467	\$2.797	\$5.447	\$3.625	\$1.822	\$6.898	\$1.267	\$28.874
A 2003	\$7.975	\$5.243	\$2.930	\$2.803	\$1.703	\$1.100	\$9.703	\$0.885	\$29.540
A 2004	\$8.051	\$4.971	\$3.790	\$4.946	\$3.846	\$1.100	\$12.416	\$1.582	\$35.756
F 2005	\$7.709	\$5.300	\$3.898	\$3.550	\$1.950	\$1.600	\$16.220	\$2.327	\$39.004
F 2006	\$7.438	\$5.308	\$4.170	\$3.647	\$1.947	\$1.700	\$15.392	\$2.538	\$38.492
F 2007	\$7.303	\$5.264	\$4.220	\$3.631	\$1.931	\$1.700	\$14.390	\$2.611	\$37.418

Agricultural rents are received from crops grown on school lands. The state receives a share of the value of the crop, so income from this source varies with crop prices. Agricultural rents are due by December of each year, so the receipts in a fiscal year are for the previous calendar year. The U.S. Department of Agriculture projects that wheat and barley prices will be lower in the next several years, and this is reflected in slightly lower agricultural rents in FY 2005 through FY 2007.

Grazing leases are based on a fixed fee per animal unit month (AUM). Grazing fees are paid in advance and are due by April each year. The fee is recalculated every year, and depends on cattle prices. The fee per AUM in FY 2005 is significantly higher than in FY 2004, and this is reflected in higher forecast grazing revenue. The U.S. Department of Agriculture forecasts cattle prices to be fairly steady for the next several years. Grazing rentals, therefore, are projected to be at about the FY2005 level through FY 2007.

Other rents and leases consist of rental payments on mineral leases and bonuses, and several small sources of income. Mineral rents are payments that leaseholders pay each year to retain the rights to a lease regardless of the level of production. Bonuses are up-front payments for new leases. Total mineral rents and bonuses change from year to year as new mineral leases are signed and old ones expire, but they show no trend.

The Department of Natural Resources and Conservation (DNRC) has an annual timber sales goal based on the estimated maximum sustained yield on state forestlands. The successful bidders on state timber sales have several years to harvest the timber. Timber harvests vary from year to year because timber companies harvest as quickly as they can when prices are high, and wait to harvest when prices are low in the hope that they will go up. In FY 2004, there were large harvests of trees killed or damaged by fire. This resulted in relatively high timber sales revenue with over three-fourths of the revenue going to the school technology fund. DNRC has adopted a new, higher sustainable yield, and this is reflected in projected revenue of about \$3.6 million per year. The school technology portion of timber sales revenue is projected to be \$1.6 million in FY 2005 and \$1.7 million in FY 2006 and FY 2007.

Changes in mineral royalties are primarily due to changes in coal production on school lands and changes in oil and natural gas prices. Most of the state's coal mines have checkerboard mineral rights ownership, where the state owns one or a few sections in a tract where most mineral rights are owned by the federal government or private parties. This causes coal production from state lands to vary from year to year. Estimates of future production on state lands were obtained from the coal companies. Coal royalties are projected to increase in FY 2005 and then decrease in FY 2006 and FY 2007. Oil and gas prices are expected to peak in FY 2005 and then decline. Oil and gas production is projected to increase through FY 2007. Oil and gas royalties are projected to be 45% higher in FY 2005 than in FY

2004 and then to decrease slightly in FY 2006 and FY 2007. Royalties from other minerals are forecast to equal the average of royalties in the last four fiscal years.

Miscellaneous income includes cabin site and commercial leases, special use permits, easements, interest payments on past land sales, and interest earned on school lands income between the time DNRC receives it and the time it is distributed. Miscellaneous income is projected to increase every year through FY 2007. Rising short-term interest rates will increase interest earnings. Income from cabin leases is projected to grow through FY 2007 because of the phase-in of new values following reappraisal. New commercial leases are expected in FY 2005 and FY 2006.

Allocation of Revenue to the Guarantee Account

Part of the revenue from state school land is used to pay the costs of administering state lands. The rest is divided between the guarantee account and the common schools trust fund. There are three allocation formulas applied to different categories of revenues.

Each fiscal year, the legislature makes an appropriation for timber sales costs. This amount is deducted from timber sales revenues. Net revenue from sale of the first 18 MMBF of timber from school land and trust fund interest are allocated 95% to the guarantee account, 4.75% to the trust fund, and 0.25% is earmarked for trust land administration costs. All income from the sale of more than 18 MMBF of timber from school land goes to the guarantee account and is statutorily appropriated for school district technology expenditures.

Rents and miscellaneous revenues that are not specifically earmarked are allocated 3% to the resource development account for expenditures that will increase future income from trust lands, 92.15% to the guarantee account, 4.6075% to the trust fund, and 0.2425% is earmarked for trust land administration costs.

All mineral royalties, income from easements, and timber sales on non-school lands are earmarked first for trust land administration costs. If the total amount earmarked for trust land administration is greater than the amount that the legislature appropriated for this purpose, the excess from school trust lands is deposited in the guarantee account and the excess from other trust lands is deposited in the corresponding trust funds.

All revenues from land sales are deposited in the trust fund.

Table 4 shows the allocation of school trust interest and income for FY 2005.

Table 4									
FY 2005 Allocation of School Trust Interest and Income - (\$ millions)									
Income Type	Total	Resource Development		Trust Lands Administration		Guarantee Account		Trust Fund	
		%	\$	%	\$	%	\$	%	\$
Net Timber Sales, 18 MMBF	1.950	0.0%	0.000	0.250%	0.005	95.0%	1.853	4.750%	0.093
Timber over 18 MMBF	1.600	0.0%	0.000	0.0%	0.000	100.0%	1.600	0.000%	0.000
Rents & Misc. Income	18.154	3.0%	0.545	0.2425%	0.044	92.15%	16.729	4.6075%	0.836
Trust Fund Interest	27.098	0.0%	0.000	0.250%	0.068	95.0%	25.743	4.750%	1.287
Mineral Royalties	16.220	0.0%	0.000	100.0%	16.220	0.0%	0.000	0.0%	0.000
Easements	1.077	0.0%	0.000	100.0%	1.077	0.0%	0.000	0.0%	0.000
Land Sales	0.003	0.0%	0.000	0.0%	0.000	0.0%	0.000	100.0%	0.003
Total	<u>66.102</u>		<u>0.545</u>		<u>17.414</u>		<u>45.924</u>		<u>2.219</u>
Initial Trust Lands Administration Allocation					17.414				
+ Non-School Revenue Earmarked for Trust Lands Administration					+ 3.008				
= Total Earmarked for Trust Lands Administration					= 20.422				
- Trust Lands Administration Appropriation					- 4.061				
= Excess Earmarked Funds					= 16.361				
x School Share of Trust Lands Administration Excess					x 85.3%				
= Excess Earmarked from School Trust					= 13.951	13.951	13.951		
% from Royalties, Other						x 93.1%	x 6.9%		
					17.414	12.995	0.956		
					- 13.951	+ 45.924	+ 2.219		
Final Allocation			<u>0.545</u>		<u>3.463</u>	<u>58.919</u>	<u>3.175</u>		
Interest Payments to Coal Trust						- 3.325			
Principal Payments to Coal Trust						- 2.599			
School Technology Fund Payment						- 1.600			
Funding for School Equalization Aid						= 51.395			

Revenue to the guarantee account is projected to be \$58.919 million in FY 2005. This includes an initial allocation of \$45.924 million and \$12.995 million in mineral royalties not needed to fund trust lands administration. This calculation is shown at the bottom of Table 4. Total school trust revenue earmarked for trust lands administration is \$17.414 million. Revenue of \$3.008 million from other trusts is also earmarked for trust lands administration. Eighty-five percent of the earmarked funds are from school trust revenue. The appropriation for trust lands administration is \$4.061 million. This leaves an excess of \$16.361 million. The 85.3% of this from school trust income is \$13.951 million. This is divided between the guarantee account and the trust fund in the proportions of the earmarked revenue from mineral royalties and other sources. The guarantee account receives 93.1%, or \$12.995 million, which is added to the initial allocation of \$45.924 million to give the total guarantee account revenue of \$58.919 million.

Of the funds deposited in the guarantee account, \$1.600 million is statutorily appropriated for school technology purchases, \$3.325 million is pledged to repay interest on the loan from the coal trust, and \$2.599 million will go to repay principal.

Table 4 also shows the forecast of \$3.175 million to be deposited in the trust fund. This increases the balance in the trust fund at the beginning of FY 2005.

Table 5 shows the allocation of school trust interest and income for FY 2006.

Table 5									
FY 2006 Allocation of School Trust Interest and Income - (\$ millions)									
Income Type	Total	Resource Development		Trust Lands Administration		Guarantee Account		Trust Fund	
		%	\$	%	\$	%	\$	%	\$
Net Timber Sales, 18 MMBF	1.947	0.0%	0.000	0.250%	0.005	95.0%	1.850	4.750%	0.092
Timber over 18 MMBF	1.700	0.0%	0.000	0.0%	0.000	100.0%	1.700	0.000%	0.000
Rents & Misc. Income	18.374	3.0%	0.551	0.2425%	0.045	92.15%	16.932	4.6075%	0.847
Trust Fund Interest	23.845	0.0%	0.000	0.250%	0.060	95.0%	22.652	4.750%	1.133
Mineral Royalties	15.392	0.0%	0.000	100.0%	15.392	0.0%	0.000	0.0%	0.000
Easements	1.077	0.0%	0.000	100.0%	1.077	0.0%	0.000	0.0%	0.000
Land Sales	0.003	0.0%	0.000	0.0%	0.000	0.0%	0.000	100.0%	0.003
Total	62.337		0.551		16.578		43.133		2.075
Initial Trust Lands Administration Allocation					16.578				
+ Non-School Revenue Earmarked for Trust Lands Administration					+ 3.023				
= Total Earmarked for Trust Lands Administration					= 19.601				
- Trust Lands Administration Appropriation					- 4.021				
= Excess Earmarked Funds					= 15.580				
x School Share of Trust Lands Administration Excess					x 84.6%				
= Excess Earmarked from School Trust					= 13.177				
						13.177	13.177		
						x 92.8%	x 7.2%		
					16.578	12.235		0.943	
					- 13.177	+ 43.133		+ 2.075	
Final Allocation			0.551		3.400		55.368		3.017
Interest Payments to Coal Trust						- 2.733			
Principal Payments to Coal Trust						- 3.059			
School Technology Fund Payment						- 1.700			
Funding for School Equalization Aid						= 47.877			

Revenue to the guarantee account is projected to be \$55.368 million in FY 2006. Of the \$55.368 million deposited in the guarantee account, \$1.700 million is statutorily appropriated for school technology purchases, \$2.733 million is pledged to repay interest on the loan from the coal trust, and \$3.059 million will go to repay principal.

Deposits to the school trust fund are projected to be \$3.017 million.

Table 6 shows the allocation of school trust interest and income for FY 2007. Revenue to the guarantee account is projected to be \$54.851 million. Of this, \$1.700 million is for school technology projects, \$2.532 million will go to the coal trust as interest on the loan and \$2.920 million will go to the coal trust to repay principal. The amount deposited in the trust fund is projected to be \$3.039 million.

Table 6										
FY 2007 Allocation of School Trust Interest and Income - (\$ millions)										
Income Type	Total	Resource Development		Trust Lands Administration		Guarantee Account		Trust Fund		
		%	\$	%	\$	%	\$	%	\$	
Net Timber Sales, 18 MMBF	1.931	0.0%	0.000	0.250%	0.005	95.0%	1.834	4.750%	0.092	
Timber over 18 MMBF	1.700	0.0%	0.000	0.0%	0.000	100.0%	1.700	0.000%	0.000	
Rents & Misc. Income	18.318	3.0%	0.550	0.2425%	0.044	92.15%	16.880	4.6075%	0.844	
Trust Fund Interest	23.955	0.0%	0.000	0.250%	0.060	95.0%	22.757	4.750%	1.138	
Mineral Royalties	14.390	0.0%	0.000	100.0%	14.390	0.0%	0.000	0.0%	0.000	
Easements	1.077	0.0%	0.000	100.0%	1.077	0.0%	0.000	0.0%	0.000	
Land Sales	0.003	0.0%	0.000	0.0%	0.000	0.0%	0.000	100.0%	0.003	
Total	61.373		0.550		15.576		43.171		2.076	
Initial Trust Lands Administration Allocation					15.576					
+ Non-School Revenue Earmarked for Trust Lands Administration					+ 5.825					
= Total Earmarked for Trust Lands Administration					= 21.401					
- Trust Lands Administration Appropriation					- 4.030					
= Excess Earmarked Funds					= 17.371					
x School Share of Trust Lands Administration Excess					x 72.8%					
= Excess Earmarked from School Trust					= 12.643	12.643	12.643			
% from Royalties, Other						x 92.4%	x 7.6%			
					15.576	11.680	0.963			
					- 12.643	+ 43.171	+ 2.076			
Final Allocation			0.550		2.933	54.851	3.039			
Interest Payments to Coal Trust						- 2.532				
Principal Payments to Coal Trust						- 2.920				
School Technology Fund Payment						- 1.700				
Funding for School Equalization Aid						= 47.699				

Table 7 summarizes the allocation of school trust revenue for FY 2005 to FY 2007.

Table 7							
Allocation of School Trust Interest and Income							
(\$ millions)							
Fiscal Year	Resource Development Account	Trust Lands Administration Account	Coal Trust Loan Principal and Interest	School Technology	School Equalization	Deposited in Trust Fund	Total
F 2005	0.545	3.463	5.924	1.600	51.395	3.175	66.102
F 2006	0.551	3.400	5.792	1.700	47.877	3.017	62.337
F 2007	0.550	2.933	5.452	1.700	47.699	3.039	61.373

STATE LAND TRUSTS INTEREST AND INCOME Revenue Estimates for FY 2005 through FY 2007

DNRC manages all state trust land. Revenue for the smaller land trusts is estimated as part of the process of estimating revenue from the school trust. Table 8 shows forecast revenue from all state land trusts for FY 2005 through FY 2007 and its allocation.

Table 8 State Trust Funds Interest and Income Revenue and Its Allocation (\$ millions)							
Trust Fund		Trust Lands Administration	Resource Development Account	Guarantee Account	Special Revenue Fund	Deposited to Trust Fund	Total
FY 2005							
Capitol Building	09007	\$0.321	\$0.009		\$1.577	\$0.000	\$1.907
MSU	09009	\$0.058	\$0.002		\$0.635	\$0.232	\$0.926
Morrill	09010	\$0.097	\$0.005		\$0.395	\$0.389	\$0.885
Deaf & Blind	09011	\$0.021	\$0.002		\$0.282	\$0.084	\$0.389
Pine Hills	09012	\$0.063	\$0.004		\$0.349	\$0.255	\$0.672
Normal School	09013	\$0.028	\$0.004		\$0.562	\$0.111	\$0.705
Montana Tech	09014	\$0.010	\$0.005		\$0.472	\$0.041	\$0.528
Veterans Home	09015	\$0.000	\$0.000		\$0.008	\$0.000	\$0.008
UM	09016	\$0.001	\$0.003		\$0.201	\$0.005	\$0.210
Common Schools	09020	\$3.463	\$0.545	\$58.919		\$3.175	\$66.102
Total FY 2005		\$4.061	\$0.578	\$58.919	\$6.081	\$4.293	\$72.331
FY 2006							
Capitol Building	09007	\$0.338	\$0.009		\$1.591	\$0.000	\$1.938
MSU	09009	\$0.057	\$0.002		\$0.575	\$0.222	\$0.855
Morrill	09010	\$0.090	\$0.005		\$0.389	\$0.349	\$0.833
Deaf & Blind	09011	\$0.019	\$0.002		\$0.261	\$0.072	\$0.354
Pine Hills	09012	\$0.066	\$0.004		\$0.337	\$0.257	\$0.664
Normal School	09013	\$0.032	\$0.004		\$0.513	\$0.126	\$0.676
Montana Tech	09014	\$0.016	\$0.005		\$0.432	\$0.064	\$0.517
Veterans Home	09015	\$0.000	\$0.000		\$0.007	\$0.000	\$0.008
UM	09016	\$0.001	\$0.003		\$0.186	\$0.005	\$0.196
Common Schools	09020	\$3.400	\$0.551	\$55.368		\$3.017	\$62.337
Total FY 2006		\$4.021	\$0.585	\$55.368	\$5.993	\$4.112	\$68.377
FY 2007							
Capitol Building	09007	\$0.851	\$0.009		\$3.947	\$0.000	\$4.807
MSU	09009	\$0.045	\$0.002		\$0.587	\$0.193	\$0.826
Morrill	09010	\$0.078	\$0.005		\$0.409	\$0.338	\$0.830
Deaf & Blind	09011	\$0.014	\$0.002		\$0.264	\$0.059	\$0.339
Pine Hills	09012	\$0.061	\$0.004		\$0.352	\$0.262	\$0.679
Normal School	09013	\$0.033	\$0.004		\$0.519	\$0.140	\$0.696
Montana Tech	09014	\$0.014	\$0.005		\$0.434	\$0.062	\$0.515
Veterans Home	09015	\$0.000	\$0.000		\$0.007	\$0.000	\$0.008
UM	09016	\$0.002	\$0.003		\$0.185	\$0.007	\$0.197
Common Schools	09020	\$2.933	\$0.550	\$54.851		\$3.039	\$61.373
Total FY 2007		\$4.030	\$0.583	\$54.851	\$8.406	\$4.101	\$70.270

Data Sources

Information on trust lands income through FY 2004 is derived from the state accounting system and the Department of Natural Resources and Conservation's annual reports. Information on current and expected future revenues came from staff of the Trust Lands Management Division of DNRC. Trust fund balances and yields through FY 2004 are from the Board of Investments' annual reports and the state accounting system. Actual and forecast interest rates and coal, oil and natural gas prices are from Global Insight's September 2004 forecast.