

TREASURE STATE ENDOWMENT 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. The trust fund is divided into several funds with different purposes. Income from the Treasure State Endowment Fund is used for local government infrastructure investments.

Projected Revenue

Table 1 shows actual interest earnings for the treasure state endowment fund from FY 1996 through FY 2004 and projections for FY 2005 through FY 2007.

Table 1		
Treasure State Endowment Trust Fund Interest Earnings		
(\$ millions)		
Fiscal Year	Interest Earnings	Percent Change
A 1996	\$3.194	NA
A 1997	\$3.824	19.73%
A 1998	\$4.374	14.38%
A 1999	\$5.031	15.01%
A 2000	\$5.106	1.49%
A 2001	\$5.803	13.64%
A 2002	\$6.814	17.42%
A 2003	\$7.201	5.68%
A 2004	\$8.371	16.26%
F 2005	\$8.765	4.70%
F 2006	\$8.322	-5.05%
F 2007	\$8.812	5.88%

Treasure State Endowment Trust Fund

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Earnings grew from FY 1997 through FY 2004, generally through increasing balances due to contributions from the coal tax. Income in FY 2005 is projected to be higher due to expected capital gains distributions. Decreasing yields due to the replacement of older, high coupon bonds with newer low coupon bonds is expected to dampen interest earnings growth from FY 2005 through FY 2007.

Forecast Methodology and Projection Calculation

There are five steps to forecasting revenue from the trust fund. First, the average monthly balance of the fund must be projected. Second, this balance is allocated to the three basic types of investment made by the fund. Third, monthly yields are projected for each type of investment. Fourth, the three balances are multiplied by their respective yields to find monthly interest income. Finally, the twelve months of income are summed to estimate annual interest income. This write-up shows annual totals for each of the steps.

Treasure State Endowment Trust Fund Balance

Half of coal severance tax receipts are deposited in the coal tax trust funds. Beginning in FY 2004, 12.5% of collections are to be deposited in the permanent fund, 25% in the treasure state endowment trust fund, and 12.5% in the treasure state endowment regional water system trust fund (17-5-703, MCA).

Table 2 shows actual coal severance tax receipts and deposits to the components of the coal tax trust fund for FY 2003 and FY 2004 and projections for FY 2005 through FY 2007. In FY 2003 transfers normally distributed to the permanent fund were distributed to the treasure state endowment instead.

Table 2				
Coal Severance Tax Revenue and Trust Fund Deposits				
(\$ millions)				
Fiscal Year	Severance Tax	Permanent Fund	Treasure State Endowment	Regional Water System Fund
A 2003	\$31.789	\$0.000	\$10.702	\$3.567
A 2004	\$31.371	\$3.336	\$6.672	\$3.336
F 2005	\$35.920	\$4.490	\$8.980	\$4.490
F 2006	\$31.986	\$3.998	\$7.996	\$3.998
F 2007	\$30.865	\$3.858	\$7.716	\$3.858

Each biennium, the legislature approves a list of projects for funding from the income of the treasure state endowment fund. If trust fund earnings exceed the amount appropriated for infrastructure projects, the difference is added to the trust fund balance.

Coal severance tax is collected quarterly, and the average balance of one of the trusts 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 ($3/8 = 1/4 \times 3/4 + 1/4 \times 1/2 + 1/4 \times 1/4 + 1/4 \times 0$).

Table 3 shows actual treasure state endowment fund average annual balances for FY 1998 through FY 2004 and projections for FY 2005 through FY 2007.

Table 3	
Average Balances	
(\$ millions)	
----Treasure State Endowment----	
<u>Fiscal Year</u>	<u>Average Balance</u>
A 1998	\$52.083
A 1999	\$60.685
A 2000	\$68.591
A 2001	\$82.005
A 2002	\$93.772
A 2003	\$105.082
A 2004	\$115.427
F 2005	\$123.056
F 2006	\$131.555
F 2007	\$139.325

Annual Trust Fund Yields

The Montana Board of Investments manages the treasure state endowment trust fund. The Board of Investments invests trust fund balances in two mutual funds that it manages, the Trust Funds Bond Pool (TFBP) and the Short Term Investment Pool (STIP). The forecasts of the annual yields of these mutual funds are explained in the Interest Earnings Introduction. The Board of Investments also makes loans, primarily to local governments for infrastructure projects, from the treasure state endowment fund. The average yield on these loans from October 2003 through September 2004 was 7.12%. The forecast assumes that this will be unchanged through FY 2007.

On average from October 2003 through September 2004, the treasure state endowment fund has been invested 85.71% in TFBP, 12.42% in fixed rate loans, and 1.87% in STIP. The forecast assumes that these percentages will continue to hold through FY 2007.

UTreasure State Endowment Trust Fund Interest Earnings

Table 4 shows the annual average balance, interest earnings, and derived annual yield for FY 2004 through FY 2007. Forecast yield is higher in FY 2005 largely because of substantial expected capital gains in the Trust Fund Bond Pool. Yield is expected to decline in FY 2006 and FY 2007 due to a decreasing average coupon rate in the same pool. Thus earnings are expected to decrease in FY 2006 despite the increasing average balance; however, with the increase in the average balance, interest earnings grow in FY 2007.

Table 4			
Treasure State Endowment Fund			
Projected Interest Earnings			
----Treasure State Endowment Fund----			
<u>Fiscal Year</u>	<u>Average Balance</u>	<u>Interest Earnings</u>	<u>Derived Annual % Yield</u>
	<u>(\$ millions)</u>	<u>(\$ millions)</u>	
A 2004	\$115.427	\$8.091	7.01%
F 2005	\$123.056	\$8.765	7.12%
F 2006	\$131.555	\$8.322	6.33%
F 2007	\$139.325	\$8.812	6.32%