



CAPPING THE COAL SEVERANCE TAX TRUST FUND---IMPACT AND
ALTERNATIVE

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Introduction

The coal severance tax trust fund (CSTT) includes a bond fund and four separate sub-trusts. Under current statute, 50.0% of the coal severance tax flows through the bond fund before the remaining proceeds are allocated to the sub-trusts. Bonds are issued to fund the renewable resource development loan program. The four sub-trusts and their respective allocation percentages are shown below:

- Permanent Trust (75.0%)
- Big Sky Economic Development Trust (25.0%)
- Treasure State Endowment Trust (0.0%)
- Treasure State Endowment Regional Water Trust (0.0%)

Background

Section 17-5-7, MCA authorizes the sale of coal severance tax bonds to finance renewable resource projects (85-1-6, MCA) and local government infrastructure projects (80-6-7, MCA). The bonds are to:

1. “Finance renewable resource projects in the state designed to provide, during and after extensive coal mining, a healthy economy, the alleviation of social and economic impacts created by coal development, and a clean and healthful environment for present and future generations; and
2. Finance loans to local governments for infrastructure projects.”

The coal severance tax bond fund is pledged as collateral for bonds issued. The maximum amount of bonds that can be issued is \$250.0 million with a maximum of \$30.0 million outstanding at any given time. Revenues in the bond fund are to pay any debt service on the bonds if interest and principal payments by the loan recipients are insufficient (state subsidy). In some instances, the interest rates charged for the bonds is higher than the interest rate charged to the loan recipients. In addition, an amount equal to the principal and interest payment due the following year is also maintained in the fund. All bonds are authorized by the legislature and projects are reviewed and approved by the legislature during the appropriation process. The Department of Natural Resources and Conservation administers the program.

The principal amount in each sub-trust is invested by the Board of Investments. Each sub-trust has an investment income fund that receives the investment earnings. The legislature appropriates these funds every two years during the legislative appropriation process. The investment earnings from these trusts are used to fund the following programs:

- Treasure State Endowment program – local government infrastructure projects
- Treasure State Endowment Regional Water program – large region water projects
- Big Sky Economic Development program - local government economic development programs
- Permanent fund – general fund programs

Implications of Capping Coal Severance Tax Trust

As discussed previously, the CSTT consists of a bond fund and four sub-trusts. If the fund were capped, the bond fund and the four sub-trusts would not receive any further coal severance tax deposits. Since the bond fund is pledged as collateral for existing bond issues, the state would be in violation of bonding requirements. In addition, investment earnings from the Big Sky Economic Development sub-trust would have minimal growth potential since the corpus of the trust would be capped. Legislation to cap the CSTT fund would require a $\frac{3}{4}$ vote of each house of the legislature.

Instead of capping the CSTT, the allocations to the trust could continue but the distribution to the permanent trust could be capped. This approach would ensure that the existing renewable resource

development bonds would not be jeopardized and any flow to the other three sub-trusts would continue. The proceeds received from capping the permanent fund could be re-routed to an infrastructure bonding account. Bonds could be issued and the revenues in the new account could be used to pay annual principal and interest costs.

Figure 1 shows the amount of bonds that could be issued based on an interest rate of 2.5% with a term of 20 years. Using these assumptions, approximately \$300.0 million in bonds could be issued with annual principal and interest costs of about \$19.1 million. The re-routed revenue flow from capping the permanent trust would be about \$21.0 million a year, more than enough to cover the costs. However, if coal production were to decline by 9.0% compared to SFY 2016, tax proceeds would be insufficient to cover the annual payment.

Figure 1

Interest Rate ==>	2.50%
Years ==>	20
Principal ==>	\$300,000,000

Summary

The CSTT includes the bond fund and the four sub-trusts. Capping this trust would jeopardize the existing renewable resource development bonds as well as capping the Big Sky Economic Development sub-trust. An alternative would be to cap the permanent fund sub-trust thereby bypassing the impact to the bond fund and other three trusts. Capping the permanent fund could provide sufficient revenue in to finance about \$300.0 million in bonds that could be used for local government infrastructure projects. It should be noted, however, that the coal sector in Montana is experiencing a significant softening in domestic and international markets. If an infrastructure bond account was created, it would be appropriate to carefully analyze the coal severance tax potential into the future.