

MINUTES OF THE MEETING  
TAXATION COMMITTEE  
MONTANA STATE SENATE

March 12, 1981

The 44th meeting of the committee was called to order at 8:00 a.m. in Room 415 of the State Capitol Building, Chairman Pat Goodover, presiding.

ROLL CALL: All members present except Senator Steve Brown and Senator Healy.

CONSIDERATION OF HOUSE BILL 415:

"AN ACT TO PROVIDE THAT GAIN OR LOSS UPON A CORPORATE LIQUIDATION IS RECOGNIZED FOR STATE TAX PURPOSES BY THE LIQUIDATING CORPORATION IF ANY STOCKHOLDER OF THE CORPORATION IS NOT SUBJECT TO MONTANA INCOME TAX OR CORPORATE LICENSE TAX UNDER TITLE 15, CHAPTER 30 OR 31, AS APPROPRIATE: AMENDING SECTIONS 15-30-111, 15-30-121, 15-31-113, AND 15-31-114, MCA: AND PROVIDING AN APPLICABILITY DATE."

Representative Sivertsen said the bill introduced at the request of the Department of Revenue, deals with problems caused by a fluke in the law which has allowed certain corporations to liquidate property and not pay taxes by transferring money from the sale from Corporation A to Corporation B; all members are non-residents of Montana.

PROPOSERS: Jerry Foster, Administrator Corporate Tax Division, DOR, said large interstate corporations are more sophisticated all the time in selling under section 337 and 331 liquidations; the tax passes on to the parent corporation. The bill's purpose would be to correct the jurisdictional question DOR is faced with so that gain on the sale reverts back to the corporation. Montana has probably lost 2 million dollars in the past few years. There were no more proponents, no opponents, and no questions from the committee. The hearing was closed on HB 415.

CONSIDERATION OF HOUSE BILL 433:

"AN ACT TO INCREASE THE INTEREST RATE ON DELINQUENT PERSONAL INCOME TAX FROM 9 PERCENT TO ~~15~~ 12 PERCENT TO ~~10~~ 15 PERCENT WHEN A PURPOSEFUL OR KNOWING VIOLATION IS INVOLVED: INCREASING THE INTEREST RATE ON IMPROPERLY PAID MEDICAL ASSISTANCE: AMENDING SECTIONS 15-30-142, 15-30-321, AND 15-30-323, MCA; AND PROVIDING AN APPLICABILITY DATE AND AN IMMEDIATE EFFECTIVE DATE."

Representative Dozier said the title explains the bill. With an interest rate of 9% no one can even borrow at that, so they just don't pay the state.

PROPOSERS: Ellen Feaver: The reason the bill was needed was that our accounts receivable have risen from 1.8 to 3.7 million in 1980. A sample of 49 individual returns, which add to the

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assessed interest at 9%, show 406, or 69%, was attributable to taxpayers with an adjusted gross of over \$50,000. Twelve percent is a rate we think will be effective in the individual area, although 15% would be more effective.

There were no more proponents, no opponents, and questions were called from the committee.

ELLIOTT: What is "improperly paid medical assistance" language in the title? Ellen Feaver said this covers money given by public assistance--when amounts are inappropriately paid, the individual has to pay 3% more than the person who doesn't pay his tax on time.

ECK: It seems even at 12% there would be advantages for not paying.

FEAVER: There is a penalty unless you have applied for an extension. In this case only the tax runs. It still is advantageous for the taxpayer to wait. That's why we asked for 15% originally.

The hearing was closed on HB 433.

#### CONSIDERATION OF HOUSE BILL 435:

"AN ACT TO AMEND SECTION 15-31-502, MCA, TO INCREASE THE INTEREST ON DELINQUENT CORPORATE LICENSE TAX FROM 9 PERCENT A YEAR TO 15 12 PERCENT A YEAR; PROVIDING AN APPLICABILITY DATE AND AN IMMEDIATE EFFECTIVE DATE."

Representative Dozier said HB 435 is basically the same as HB 433--this time corporate taxes are dealt with. This article deals with property taxes, but we are having the same problem with income taxes, Attachment #1.

#### PROPOSERS:

Jerry Foster, DOR, said this bill is at DOR's request and addresses a unique situation. We have 100 multi-state corporations that pay the bulk of our license tax. They automatically get a 6-month extension to pay their taxes. In the past they have made tentative payments in May and the final payment in November. We have found they don't make any tentative payments now, and we have had a 7-million-dollar loss during the last biennium. Even if they have the money, they can put it in short-term notes and still make money. In addition, we also have a very aggressive out-of-state audit program and we now have 5 million on the books. With our low interest rates there is very little incentive for these corporations to pay us. We would suggest this committee amend this to 15%. There were no further proponents, no opponents, so questions were called from the committee.

MANLEY: The corporations are within the law that now exists in using the 6-month extension.

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CRIPPEN: There is nothing wrong with using the law but what we will try to do is change the law so they think twice before they use it.

ECK: If they exceed the statutory extension, would there be another penalty?

FOSTER: If they exceed the extension date they are subject to a 10% penalty.

ECK: What would be the amount if 10% were added on to the penalty?

FOSTER: They are careful to file within extended due date.

GOODOVER: This law doesn't change the 6-month extension, the corporation gets it regardless.

FOSSTER: That is correct.

The hearing was closed on HB 435.

CONSIDERATION OF HOUSE BILL 753:

"AN ACT TO INVEST ONE-FOURTH OF THE DEPOSITS TO THE COAL SEVERANCE TRUST FUND IN HOME MORTGAGES WHEN THE PRIME RATE EXCEEDS 12 PERCENT."

Representative Kemmis, District 94, said HB's 753 and 762 cover much the same ground and he wanted to present background together. Theory of the coal tax and the trust fund: coal tax was instituted for historical and economic reasons. It was passed because the State of Montana had come to the conclusion that Montana felt its non-renewable resources should not be taken without anything to show for it and, in particular, that the depreciation of a non-renewable resource had certain costs that aren't reflected in the price of the product. Beyond that it was recognized when you take a non-renewable you take from future generations something about which they have no say. For that reason we said we would set aside 50% for future generations. The way the trust fund is invested according to what's called the "prudent man rule" requires investments for safety, as well as return. Result of that burden is almost all the coal tax trust fund is outside the State of Montana. These bills address that fact.

His belief is that the people of Montana feel strongly that they should get more money invested within the state. There will be arguments against these bills: 1) You should let the market decide, as they will dictate highest return, and 2) In the capital market the same thing is true--it attracts money by excluding certain costs. If you look at the areas where we have invested, we have invested where they can exclude costs.

The purpose of these bills is to recognize that there are some inefficiencies in the market and that the purpose of the fund is to benefit future generations. If we take that seriously, we have to wonder how future generations would like to see it in-

vested, but we spend the return. What they get is a pile of constantly depreciating American dollars. Would they prefer that or to invest inside Montana for the purpose of strengthening Montana economy? I think they would prefer strengthening of the economy rather than the stack of depreciated dollars.

He wasn't criticizing the Board of Investments, but thought we have told them the wrong thing to do. He said we are cheating future generations and are cheating ourselves. We have a tool to strengthen Montana's economy and are wasting it.

CONSIDERATION OF HOUSE BILL 762:

"AN ACT TO MAKE SHORT-TERM INVESTMENTS OF COAL TAX TRUST FUNDS IN MONTANA BANKS AND LENDING INSTITUTIONS WHICH HAVE A RECORD OF ADVANCING THE STABILITY AND DIVERSITY OF THE MONTANA ECONOMY."

House Bill 762 is a bill to invest a significant portion of the receipts to the Coal Tax Trust Fund in Montana banks. It would say that each quarter when the tax is collected that 1/4 of what is set aside in the trust fund could be set aside in Montana banks. The bill would allow banks to bid in this manner--a percentage they would pay on certificate of deposits no more than 2% below going rate for treasury bills. If necessary, the bill should be clarified to clarify what we mean by treasury bills. Banks, at the same time, supply information about what their lending portfolio looks like in terms of how much their total assets are and how much they have loaned to Montana businesses. They submit that information to the Department of Commerce. The Department looks at that information and, according to rules they will have adopted, it transfers lending institutions into a point system. Most points will be added to the bid of the lending institutions and that will determine who gets the money. The money will be put into certificates of deposit. Any money not bid for goes back to the Board of Investments. One amendment clarifies our reference to the prime interest rate. Prime is a private matter and we referred to the rate from City Bank of New York. One amendment to this bill is to guarantee information supplied by the banks will be held confidential by the Department of Commerce.

HOUSE BILL 753:

HB 753 is a bill to re-direct investment of the trust fund, this time with an effort to stabilize Montana economy in one portion unstable at the present time--housing and wood products. The purpose is to require that during periods of high interest rates (above 12%) 1/4 of the money going to the coal tax trust fund will be made available to Montana home mortgages at a rate of 10%. Mortgages would be let at 13 3/8%. The theory behind this is that when rates go up, housing drops drastically, construction drops, etc. This is an attempt to level out fluctuations.

The Board of Investments has authority to lend on home mortgages

and they do this. This bill talks about this time when interest rates fluctuate. The way the bill would work is that during periods of high interest rates the Board of Housing (under Department of Commerce) would effect availability of this mortgage money during those periods. If the criteria and applied by the Board of Housing is met, a borrower could apply for a loan at 10 3/8%. Those that meet the criteria would go to a drawing. Those who were drawn would be told they have 90 days existing home or 6-months new construction. If they succeed in getting the loan the Board of Housing would be instructed to purchase that mortgage and invest it at 10%.

There are amendments to this bill. We went over them carefully for language with the Board of Housing.

PROPOSERS: Don Judge, Montana AFL-CIO for HB 753.

Tom Harrison, Montana Home Builders Association, HB 753. Mr. Harrison thought a necessary amendment to make on the bill to do the things he wants to have done would be as follows: The fiscal note indicates there would be 3 million dollars involved available for this program, and at \$50,000 a loan you are talking about less than 70 homes. The way the bill is drafted, it could result in a turnover of money. If the bill is amended to reflect that construction be a new owner or first-ownership new construction, then you would get all the things Representative Kemmis mentioned. Without that, you are subject to the rollover and loss of revenue. Mr. Harrison said he would be happy to prepare the amendment.

Cliff Christian was a proponent; Mark Meloy, Board of Directors, Montana Small Business Association; Harold Pitts, Supporting HB 762; John Cadby, HB 762; Larry Huss, representing Montana Savings and Loan League. Mr. Huss felt there was a problem in the context of the bill which gives a considerable advantage to banks as opposed to other lending institutions. He had many amendments he would like to propose to the bill.

OPPOSERS: Dean Albert, Chairman Board of Investments, State of Montana. He said he opposed HB 753 in its present form, Attachment 2; he also opposed HB 762, Attachment 3.

Representative Kemmis closed by saying if a subcommittee were appointed he would be happy to work with them and the Board of Investments on technicalities mentioned. He said he concurred with Mr. Huss's suggested amendments and would leave it to the committee to solve the dispute between realtors and the construction industry. He thought the deeper issue with the Board of Investments is who determines how coal tax trust is going to be invested. The fact of the matter is, it's the legislature's responsibility how these funds will be invested for high return immediately, or in Montana for what will eventually be a higher return and to decide whether we want monies reinvested to a greater degree in Montana.

CRIPPEN: Re the "prudent man rule". I think we overlook the

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basic concept referring to the safety of the corpus. It's pretty cut and dried when looking at 1% inflation. Now with higher rate of inflation, are we violating the rule when we don't invest in several investments?

Mr. Albert agreed saying the problem is you have to work with what's available for investments and choose among best of the opportunities. The best investment would be just to leave the coal in the ground.

Senator Eck said it appears to her it's the responsibility of the new Department of Commerce. How is the responsibility split? Does Board of Investments have responsibility for what the Department of Commerce does?

ALBERT: BOI only has to invest according to what the bill addresses. They would not be required to do any more administering than they do now.

ECK: Beldon Daniels was not so much concerned about keeping BOI as it is now as the fact that you needed to go to different bodies for various kinds of investments. Is that the gist of his argument?

KEMMIS: We have problem of unified investment program so it would not be easy to give someone authority for investment.

GOODOVER: What's your response to Dean Albert's comment that the monies should be appropriated out of the funds?

ALBERT: Absolutely opposed. When you appropriate out of the trust fund, you are saying it is not a trust. The question is how it should be invested. Highest rate now and pass on much smaller corpus to future generations? The current approach is robbing future generations.

GOODOVER to HUSS: I would like to echo what Senator Crippen said. Originally imposed on a private trust. Since that time, with the rule transferred to public or private investors, it has become perverted where original investors ignore the theory and go to high-risk investments.

CRIPPEN: Senator Towe had a bill that would provide investment capital to speculative ventures in Montana with a success rate of 1 out of 4. Would you envision that this would fall within the confines of the prudent man rule as you understand it with coal tax trust?

KEMMIS: If there was some mechanism to guarantee losses would be covered out of income, it would be all right.

TOWE: What you are getting at--you are proposing the bidder who comes out with a higher point system would have a privilege. One of the things they would look at are loans outstanding to Montana businesses, so those banks would be in a preferred condition. You have reference to the Housing Authority Act of 1975.

I am not sure on that but believe one of the qualifiers is a federal guarantee.

KEMMIS: We are going for the guarantee.

NORMAN TO KEMMIS: If SB 409 and this bill pass, in 409 we cut out a fund or sub-fund and under that is where the money goes first. If money is not needed for servicing the bonds, it flows to the permanent fund.

GOODOVER: How do you use 1/4 of the trust income without taking it out of the trust account?

KEMMIS: Money in the fund is invested now. We would just be investing in CD's.

ELLIOTT: I feel some favor for the bill but wonder how you get the 10% or 10 3/8% figure. Had you considered a variable rate? Why wasn't this directed that the Board of Investments would handle rather than going into the Department of Commerce.

KEMMIS: The effect will be the same. The Board of Housing sets up the rules. I would have no objection to doing that. As to the choosing of the 10% we tried to pick a rate that seemed to be excessive to those Montanans who qualify under housing criteria.

CRIPPEN: On 762 it really applies to your comments on your essay on page 6. You are trying to get capital enterprise in Montana. It seems you are assuming that good Montana banks will invest in Montana businesses. What it doesn't address is that they can't succeed and have poor management. I wonder if this bill wouldn't end up by just giving them more capital to roll over.

KEMMIS: I agree with your valuation of what this bill does. I see this as a first step. Maybe we can come forward to something to get more money directly to Montana business. My feeling is if there are capital gaps in Montana it results from the fact that there is not as much available for lending as there is demand for it.

CRIPPEN: How will you handle this great infusion of capital? Will it affect Montana businesses more than now?

PITTS: Before banks can bid they have to prove they are supporting. You will be bidding against one another in 3 categories. If you are successful, it will be just like any money.

CRIPPEN: Once you get this money you will make every effort whether business has presentable success or not?

PITTS: Unless you put it to use for a benefit you don't be doing a job.

ALBERT: In establishing different criteria for coal tax fund, does that establish two "prudents"?

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TOWE: The point is that the prudent man rule was devised to determine what criteria should be used by private trust. In that trust document there may be certain restrictions that the trustor wanted carried out.

TOWE TO HOWEX: The law says you may bid 2% lower than treasury bill rate. What's the average treasury rate if you would buy a CD?

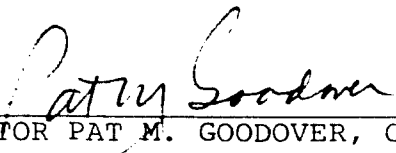
HOWEX: Treasury bills are reported on a discount basis and there is a difference between discount and corporate yield.

TOWE: You are willing to go down 4 points below effective rate. Do you want to put a limit in?

KEMMIS: Yes.

The Chairman announced there would be a sub-committee meeting on fees at 1:00 p.m. today.

The meeting adjourned at 10:00 a.m.

  
SENATOR PAT M. GOODOVER, Chairman



ROLL CALL

TAXATION COMMITTEE

47th LEGISLATIVE SESSION - - 1981

Date Mar. 12, 1981

NAME	PRESENT	ABSENT	EXCUSED
Goodover, Pat M., Chairman	✓		
McCallum, George, Vice	✓		
Brown, Bob	✓		
Brown, Steve		✓	
Crippen, Bruce D.	✓		
Eck, Dorothy	✓		
Elliott, Roger H.	✓		
Hager, Tom	✓		
Healy, John E. "Jack"		✓	
Manley, John E.	✓		
Norman, Bill	✓		
Ochsner, J. Donald	✓		
Severson, Elmer D.	✓		
Towe, Thomas E.	✓		

Each day attach to minutes.

DATE Mar. 12, 1981

COMMITTEE ON Information

# VISITORS' REGISTER

NAME	REPRESENTING	House BILLS#	Check One	
			Support	Oppose
	Bills 415, 433, 435, 753, 762			
Paul Young	Board of Transit	753		✓
"	"	762		✓
Tom Spivack	"	762		✓
"	"	753		✓
"	"	762		✓
"	"	753		✓
Don Dubois	NY State Assembly	753	X	
Mr. S. J. [unclear]	SP 100	433-435	X	
Mr. Fidler	Dept of Rev	435, 415, 433	X	
Timothy Korman	District 24	753, 762		
"	"	753, 762		✓
"	"	753, 762		✓

(Please leave prepared statement with Secretary)

# Tax delinquents blame hard times, cheap rates

By KIM LARSEN  
Of The Gazette Staff

"Interest is cheaper at the courthouse than at the bank," Fred Pierce replied when asked why Pierce Packing Co. has not paid its property taxes since 1977.

The firm owes more than \$100,000 for each year back to 1977.

Money that could be used for taxes is put back into the company for operating expenses instead of seeking commercial loans, Pierce said.

As long as he pays penalty and interest on back taxes, Pierce said, he is doing nothing illegal. And he's right.

The firm pays each year's taxes about four years late, just before the deadline when the county can seize and sell property for back taxes. This, in effect, gives the firm a four-year loan with a better interest rate than banks offer.

Pierce said the practice started originally as a protest against high taxes. The firm's protest has resulted in about a 40 percent reduction in taxes originally levied, he said. The amounts now due represent that adjustment, he added.

Pierce's comments were among those obtained by The Gazette from tax delinquents in Yellowstone County.

Hard times and oversight, along with using the county for cheap interest, were the most common excuses.

Said Charles E. Gamble: "Have you been aware of the state of the economy? That's why they (taxes) have not been paid."

Gamble's Executive Homes are located in Oaks Subdivision. He said he is one of four stockholders and that he's working to clean the tax slate soon. "I'm reluctant to pay more than my share of taxes," he said, referring to his partners.

As for the taxes that he, his wife and his ICR Realty firm owe, Gamble said he has set April 15 as his "target date" for paying them.

Maurice R. Colberg Jr. and Gerald Grose, School District No. 2 trustees who help set school taxes, cited economic problems in their failure to pay.

Colberg was irked that The Gazette was preparing a story on tax delinquents, calling it "a crappy idea."

He owes \$1,047.44 for 1979 on a lot in the Yellowstone Country Club area. He said he has a buy-sell agreement on the lot, and plans to pay the taxes as soon as the transaction is completed.

"I have a lot of other places to put my money (other than in tax payments) with kids in college," Colberg said. He noted that most of the tax due is for special improvements (streets, water line) and only about \$50 is for property tax. Of that \$50, about \$20 is school tax, he said.

Although Colberg did not like the idea of his name being listed with delinquents, he admitted he should have paid the tax and that he understood why a trustee, who helps establish school taxes, would be questioned about his delinquency.

Colberg said he paid off a delinquency last year for the year before, and that the delay in paying 1979 taxes until this year gives him an income-tax writeoff he needs for 1981.

quent because he cannot sell lots in Centennial Subdivision he bought as an investment. He had planned to build houses on the lots but "the housing market went kaput." He will pay after he sells the lots, something he said he hopes to do this spring when he expects interest rates to drop.

Most of the taxes due on these lots are for special improvements, not property levies, according to Grose. He said he could borrow money at 17 percent interest to pay the taxes, but noted it is cheaper to pay the county's penalty and interest fees.

David Oberly, a School District No. 2 administrator, confirmed he owes \$1,249.45 for 1979 and said he has not paid because "I'm short of money."

When he bought a house he had to put a lot of money into repairs, leaving nothing for taxes, Oberly said. He plans to pay the taxes when he receives this year's income-tax refund.

Jan Richau, principal of Alkali Creek School, said the tax she and her husband, Lavio, owe is on the only one of about nine of their properties that is not paid automatically by their bank. She said the county never sent them a tax-due notice but that they will pay the \$400.21 due immediately.

"I ain't got the money," said Laurel Mayor Larry D. Herman, who promised to pay \$1,424.22 when he gets the cash.

Herman recently issued a directive cutting Laurel city spending by 25 percent and instituting a hiring freeze until the city's cash flow improves. The cash flow is down because property taxes are being received at a slower rate than normal, Herman told city department heads when he issued the order.

Betty J. Novasio, who works in the treasurer's office collecting taxes, said she simply did not have the money to pay her 1979 taxes on time. She finally cleared the record this year. "I had to borrow the money to pay them," she said.

Doug Wilson of Wilson Enterprises, which the county says owes \$6,824.57 for 1978, hung up in the middle of a question when he was called for comment.

Paul A. Mogen blames his \$28,409.33 delinquency on the negative economic times "and a few other things." He did not elaborate.

"I'm trying to do something about it," Mogen said, adding that he does not know if he can pay because real estate is moving "pretty slow." His taxes are due on a subdivision he is developing.

Bob Bowman of Hardin, who owns La Bonnie Realty Co., pleaded hard times: "Well, it seems like I don't have any money." He cannot sell La Bonnie's lots because mortgage rates are too high, Bowman said. He plans to pay the taxes as each of numerous lots are sold. Taxes are high on these lots because of special improvements.

James Wold Martin's delinquency includes about \$17,000 charged by the city of Laurel for razing the Butte Hotel, which had been condemned.

Taxes on the property were doubled after the condemnation, Martin complained. There is no reason to pay these taxes on land that would sell for only \$3,000 to \$10,000, he said: "It's ridiculous."

.....\$305.29  
.....\$4,665.65  
.....\$72,768.61

.....\$20,251.51  
.....\$10,731.32

.....\$1,919.89  
.....\$32,902.72

.....\$29,803.00  
.....\$28,961.77  
.....\$9,755.42

.....\$2,338.54  
.....\$6,042.44  
.....\$10,225.61

.....\$349.33  
.....\$28,711.34  
.....\$28,409.33

.....\$26,553.29  
.....\$25,204.31

.....\$1,494.72  
.....\$1,512.08

.....\$17.18 since Jan. 1  
.....\$1.50, including pen-

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Remarks

by

Dean H. Albert, Chairman

of the

MONTANA BOARD OF INVESTMENTS

Before

Senate Committee on Taxation  
Hearing House Bill Number 753

March 12, 1981

Mr. Chairman, Members of the Committee:

Thank you for allowing me to testify regarding this Bill today. My name is Dean H. Albert, and I am Chairman of the Board of Investments of the State of Montana. I have the unanimous consent of the four Board members who attended the Investment Board's regular meeting on February 20, 1981, and considered this Bill to enter testimony in opposition to it in its present form.

While the Board does not have any opposition to the social or economic aspects of the Bill, it does see problems in administering it in its present form. For instance, at line 21 of page 1, which is paragraph 2 of section 2, the definition of "lending institution" does not allow the Board the opportunity to prequalify those institutions who sell mortgages to the Board of Investments. Once a mortgage is sold to the Board of Investments, the Board relies entirely upon the "lending institution" to service that mortgage over its lifetime, many of which run for 25 or 30 years. The Board has exercised great discretion and requires certain minimal qualifications in qualifying loan servicers, so that the Board is assured that that institution is in a position to continue in business and, on a long-term basis, continue to service the mortgage so the Board does not end up in the retail business of having to make its own collections and do service work on loans it has purchased. We think any agency purchasing mortgages ought to have that latitude.

On line 3 of page 2, which is paragraph 4 of section 2, the Bill ties its implementation to the prime rate determined by Citibank of New York. When considering real estate mortgages, it would seem more appropriate to tie any implementation of the Bill to a rate relating to real estate mortgages rather than commercial loans. There is not a good parallel between the "prime rate" and the secondary mortgage market, where, at the present time, with prime at 18%, the secondary mortgage market is more in the area of 15%, while, in June of 1980, for a brief period, prime hit 11.5% when the secondary mortgage market was still in excess of 13%. Certainly, if this legislation is to pass, it would be better to tie to a secondary market rate such as the Federal National Mortgage Association Auction or similar market.

There is a slight defect on page 4 at line 4, where the word "bank" is used, when it undoubtedly refers to "lending institutions".

The Board's greatest concern is with the Bill's attempt to legislatively amend the "prudent man rule" by mandating that the investment is prudent and that "men of prudence, discretion, and intelligence would exercise in the management of their own affairs" the investment of funds well below the present market, in this instance, at 10%, while the prime rate is at 18%. We think this raises some constitutional questions that this committee should deeply consider.

The Board of Investments is presently administering \$76 million in Montana mortgages with a very limited staff and would not have the present capability nor the expertise to administer a program so large as this.

Our recommendation, if this type of legislation is to be implemented, would be as follows:

- 1) That the Legislature appropriate these funds from the Coal Severance Tax Trust Fund by the required vote to take principal out of that Trust Fund.

- 2) That the triggering mechanism be not the "prime rate" but a secondary mortgage market rate.
- 3) That the administration of this type of social program be delegated to the Board of Housing, who already has the staff and the expertise to run a subsidized housing program.

In summary then, the Board of Investments, with one member absent from its last Board meeting, unanimously opposes this Bill Number 753 as it is presently written.

I would be glad to answer any questions the Chairman or the Committee members may have.

Respectfully submitted, Dean H. Albert, Chairman, Board of Investments.

Remarks

by

Dean H. Albert, Chairman

MONTANA BOARD OF INVESTMENTS

Before

Senate Committee on Taxation  
Hearing House Bill Number 762

March 12, 1981

Mr. Chairman, Members of the Committee:

Thank you for allowing me to testify regarding this Bill today. My name is Dean H. Albert, and I am Chairman of the Board of Investments of the State of Montana. I have the unanimous consent of the four Board members who attended the Investment Board's regular meeting on February 20, 1981, and considered this Bill to enter testimony in opposition to it in its present form.

The Board of Investments has never objected to the implementation of social or economic programs so long as it does not become involved in administering those programs in the name of "prudent investments". Beginning four years ago, when the Coal Tax Oversight Committee was studying alternatives of the use of Coal Tax funds, we adopted and have continued to maintain that posture, and some eighteen months to two years ago, received an endorsement of that posture by a noted economist and investment counselor who appeared before a legislative committee at the request of Senator Towe and who demonstrated in some detail, in a day long presentation, that our stand was appropriate and that social and subsidized programs should be separately administered and never developed in connection with investments.

Here are the Board's comments, in chronological order, relating to the Bill. On line 18 of page 1 of the Bill, it refers to "lending institutions" without specifying who those might be. Certainly, it identifies banks, but does the Bill expect to

include, perhaps in addition to savings and loan associations, insurance companies who are active in the real estate market, credit unions, PCA's, finance companies, the Federal Lank Bank, and perhaps brokers, all of whom lend funds to their customers. To my knowledge, only banks and savings and loans may issue certificates of deposit, though, apparently, credit unions have some similar document, but I'm not aware how other cited lenders would be able to participate in the program. On line 1 of page 2, it refers to the purchase of one-year certificates, and the questions arise, "What happens when those one-year certificates mature?", "Are they somehow to be renewed?", "Are those participating expected to make loans of a term nature when the source of funding may expire sooner than the term of the loan?". On line 3, the Bill states that the interest rate shall be up to two points below the interest rate recieved on one-year United States Treasury Bills. Treasury bills are sold at a discount rate which brings a higher "coupon equivalent" or actual return. For instance, a one-year Treasury Bill selling at a discount rate of 12.8% will yield to the purchaser an additional 1.5%, or 14.3%. Under the Bill, would C.D.'s be purchased at 10.8% or at 12.3%? On line 8 of page 2, again is a reference to Montana lending institutions without identifying who they are and what their eligibility for time certificates might be. On line 12 of page 2, the Bill provides a limitation of the amount that one institution may have in certificates. It is not clear whether this limitation of 10% relates to the individual institution's quarterly bidding or to the total time certificates that institution may have. In order to fairly allocate State funds under the present administration of the Board of Investments and to properly protect the State against possible loss, the Board of Investments has set up certain criteria for allocating time certificates under its present program. Presently, the Board will not allow any one institution to have more than two times its capital surplus and undivided profits or, in the case of savings and loans, their reserves, in State deposits or <sup>more than</sup> 15% of their total deposits as reported to the Board on a quarterly basis. The Board also requires that, where an institution has a greater amount in time



certificates than their total capital, that that institution shall pledge 100% of the excess of time certificates they have issued. If this limitation of 10% of an institution's total assets is on a quarterly basis, it is conceivable that an institution already participating in the Board's present time certificate program were to fully participate for four quarters in this program, that at the end of one year, 50% of its liabilities (equal to assets) would be in Montana time certificates. Does the Bill anticipate this type of concentration of State funds in certain financial institutions?

There is a slight defect in the Bill on line 16 of page 3, where it refers to banks rather than lending institutions and a similar defect on line 25 of page 4, where it refers to an institution's loan portfolio, but seems to have excluded that institution's investment in a variety of qualifying investments under paragraph 2 of section 3.

On page 5 at line 6, there is a reference to subsection 1 regarding criteria for evaluation of participating institutions, and I do not find that subsection. At line 8 on page 5, it also speaks to the institution's "lending portfolio" when it undoubtedly refers to total Montana investments. There is further confusion on line 9 of page 5, where it speaks to a premium that may be added to an interest rate, when it would appear the intent of the Bill is to offer a discount.

The Board also has problems in reconciling legislative mandate suggesting the prudent man rule can be amended by direction as to specific investments. The Board questions whether the people of the State of Montana who are the ultimate beneficiaries of the Coal Tax Trust Funds would find the subsidizing of certain financial institutions in Montana for their benefit or for the benefit of their individual customers a proper form of investment.

From a practical standpoint, it would appear that this legislation might be tremendously bureaucratic to administer and ultimately be unsatisfactory to the

institutions it is intended to serve. A similar program was instituted in the State of Colorado some years ago, not by legislative enactment, but by administrative procedure, and was later abandoned. I have not been able to determine to what degree the interest rate was subsidized but do have information from the Division of Banking in Colorado that indicated when the program first began, only five or six banks in the state were not participating in the state's time certificate investment program, and, after the new policy was in effect, more than 50% of the banks dropped out of the program because of the horrendous paperwork involved in filling out forms and making their bids. To properly administer the program, the Department of Commerce would be required to evaluate the financial statements and supplemental data of some 170 banks, 20-some savings and loans, and innumerable credit unions and others who might qualify which would appear to require a tremendous staff for that purpose, to say nothing of the data the banks and savings and loans and others would have to submit to qualify for the program.

The Board has a continuing program of buying time certificates from Montana banks and savings and loans with present outstandings approximating \$54 million and has the capability to expand that for banks willing to pay a market rate for those certificates.

The Board feels that, if the sponsors of this legislation are successful in implementing such a program, that the Bill should be amended so that the Legislature will accept the responsibility of appropriating these funds to the Department of Commerce and let them administer it as a subsidized program, not something one would call an investment.

I would be pleased to answer any questions the Committee may have regarding this Bill or regarding the operation of the Board of Investments.

Respectfully submitted, Dean H. Albert, Chairman, Board of Investments.