

MEMORANDUM



DATE: December 11, 2013
TO: Interested Parties
FROM: Kyle I. Jen, Deputy Director
RE: Tobacco Settlement Funds

This memorandum provides an update on tobacco settlement revenue received by the State of Michigan and discusses the potential impact of Senate Bill 269 on expenditures from that revenue.

Background Information

The Master Settlement Agreement providing for tobacco manufacturer payments to states was originally reached between 46 states and the four largest U.S. tobacco manufacturers in 1998. (A number of smaller manufacturers have since joined the agreement.) Payments began in 2000 and are due in perpetuity. Annual payment amounts due from the manufacturers to the State of Michigan have declined from over \$300 million in the early years of the agreement to \$256 million in FY 2012-13, due in part to declining cigarette sales.

As part of a dispute regarding state enforcement of provisions of the settlement related to non-participating manufacturers, participating manufacturers withheld payment amounts totaling roughly \$200 million from FY 2005-06 to FY 2011-2012. An arbitration settlement between the manufacturers and a number of states, including Michigan, was reached earlier this year that resulted in the following:

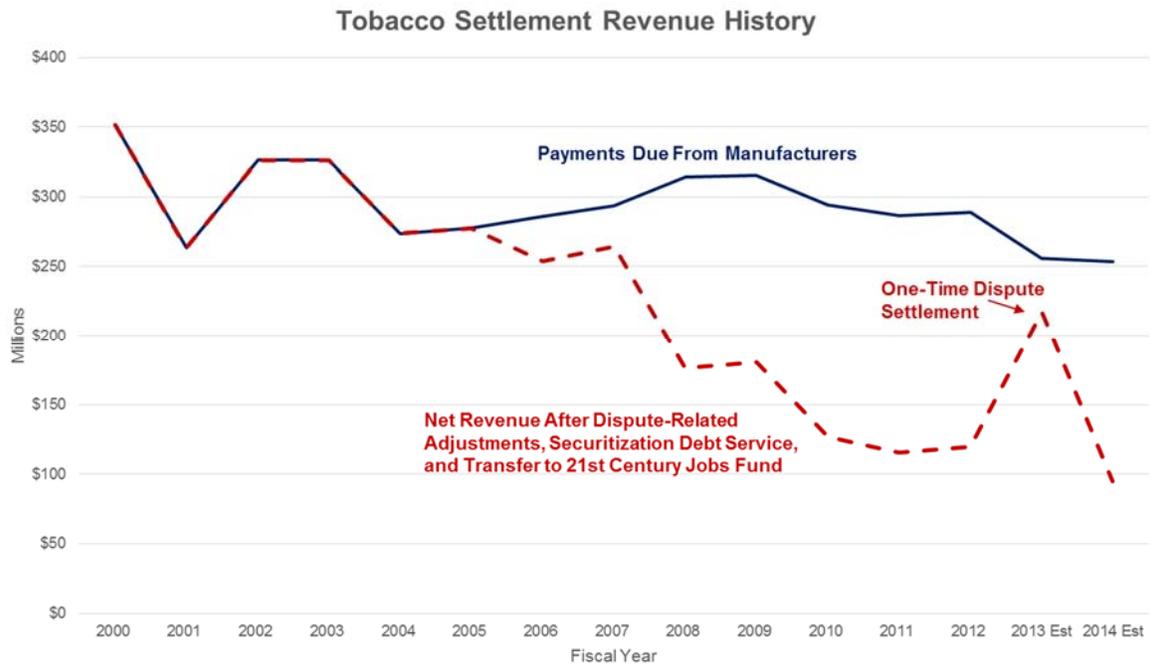
- Net receipts of an additional \$129 million for the state in FY 2012-13 on a one-time basis.
- Ongoing credits to the manufacturers of \$23 million per year in FYs 2013-14, 2014-15, and 2015-16, with an additional negative adjustment for the state of \$7 million per year in FYs 2013-14 and 2014-15.
- Agreement that the manufacturers will not dispute payment amounts through FY 2014-15.

Two types of payments are made each year from tobacco settlement revenue prior to other appropriations by the Legislature.

Securitization payments: Michigan has securitized a portion of its tobacco settlement revenues on two occasions, receiving an up-front payment of revenue in return for annual debt service payments to bond-holders. In 2005, \$400 million was securitized to fund the starting balance of the 21st Century Jobs Fund, an economic development program administered by the Michigan Strategic Fund (MSF) the Michigan Economic Development Corporation (MEDC). In 2007, \$415 million was securitized to help balance the FY 2006-07 state budget. As a result of these transactions, 24.1% of annual tobacco settlement receipts are now paid as debt service.

21st Century Jobs Fund transfers: An additional \$600 million has been statutorily earmarked for the 21st Century Jobs Fund through ongoing annual transfers, to bring the total cumulative amount of tobacco settlement funds dedicated to the fund to \$1.0 billion. This was originally to be accomplished through an earmark of \$75 million per year for six years, from FY 2007-08 through FY 2014-15. Due to temporary reductions in the earmark as part of budget balancing efforts, an additional earmark of \$72 million was created for FY 2015-16.

Payments due from manufacturers and net revenue available to the state after dispute-related adjustments, securitization payments, and transfers to the 21st Century Jobs Fund have been made are shown in the chart below:



The Michigan Trust Fund Act provides that remaining tobacco settlement revenues after securitization payments and the transfer to the 21st Century Jobs Fund are to be deposited in the Merit Award Trust Fund (MATF). Under statute, expenditures can be made for the following purposes:

- The Merit Award scholarship program and associated administrative costs. This program was subsequently replaced with the Promise Grant Program, which was then defunded beginning in FY 2009-10.
- The Tuition Incentive Program, a financial aid program targeted at students from low-income families. This program is now funded with federal TANF funds as part of the state’s TANF maintenance-of-effort (MOE) plan.
- The Michigan Nursing Scholarship Program, which was defunded beginning in FY 2009-10.
- “Other expenditures as determined by law.”

In recent years, available tobacco settlement funds have been used similarly to General Fund/General Purpose (GF/GP) revenue under the final provision cited above. Currently, the two largest uses of the revenue are for the state’s Medicaid program in the Community Health budget and the Family Independent Program in the Human Services budget (in place of the appropriation for the Tuition Incentive Program, under the TANF MOE plan referenced above).

Tobacco Settlement Revenue Projections

An attached table shows current appropriated tobacco settlement revenue amounts, the most recent projections for tobacco settlement revenues over the next four years, and assumed flat funding for Merit Award Trust Fund expenditure items. These projections assume that manufacturers will not withhold further payments after the agreement on that matter expires in 2015.

As a result of payment adjustments under the recent arbitration settlement, fund expenditures now exceed fund revenues on an annual basis, depleting a balance created by the dispute settlement in FY 2012-13. The balance is projected to decline to approximately \$11 million at the close of FY 2015-16. The currently scheduled expiration of the statutory earmark for the 21st Century Jobs fund would then result in additional resources becoming available for MATF expenditures beginning in FY 2016-17.

Senate Bill 269

As part of a larger package of bills related to economic development programs administered by the MSF and the MEDC, Senate Bill 269 would amend the Michigan Trust Fund Act to extend the earmark of tobacco settlement funds for the 21st Century Jobs Fund for an additional three years, through FY 2016-19. (The bill would also effectively increase the current FY 2015-16 earmark amount of \$72 million to \$75 million.) This would increase cumulative tobacco settlement revenues dedicated to the fund from \$1.0 billion to \$1.2 billion or more.

As the bill passed the Senate, the current language specifying an earmark of exactly \$75 million would simply be extended. An (H-2) substitute to the bill reported by the House Commerce Committee on December 3 would revise the earmark language to provide that “not more than” \$100 million could be deposited into the 21st Century Jobs Fund annually. The amount of the deposit would presumably be subject to legislative appropriation each year.

Based on the projections discussed above, an annual deposit amount of \$100 million could be sustained for only one year. If that deposit were made in FY 2014-15, it would reduce the projected ending balance from about \$28 million to \$3 million. The fund would then be in deficit for FY 2015-16, absent reductions to existing spending items.

On an ongoing basis, an annual deposit above roughly \$70 million per year would require that other expenditures from tobacco settlement funds be reduced from current levels—by \$30 million per year if the full \$100 million allowed under Senate Bill 269 (H-2) were appropriated. This would presumably require offsetting increases in GF/GP expenditures for those items. If additional payments were withheld by tobacco manufacturers after FY 2014-15, or other factors reduce tobacco settlement payments from the current level, that threshold would be lower and offsetting GF/GP expenditures would be higher.

For more information on the MSF bill package, see this HFA memorandum:

http://www.house.mi.gov/hfa/pdf/GeneralGovernment/Proposed_MSF_Act_Changes.pdf

Attachment

Merit Award Trust Fund Projections

\$ in Millions

	<u>Appropriated</u>		<u>Projected</u>				
	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Beginning Balance	0.6	76.6	53.2	27.9	10.9	65.9	138.1
Revenues							
Payment Due from Manufacturers*	256.0	253.5	250.9	250.9	250.9	250.9	250.9
Arbitration Settlement-Related Adjustments	129.0	(29.7)	(29.7)	(22.7)	(22.7)	0.0	0.0
Securitization Debt Service	(92.8)	(54.0)	(53.3)	(55.0)	(55.0)	(60.5)	(60.5)
Transfer to 21st Century Jobs Fund	(75.0)	(75.0)	(75.0)	(72.0)	0.0	0.0	0.0
Interest/Other Adjustments	10.0	0.1	0.1	0.1	0.1	0.1	0.1
Net Revenue Available	227.2	94.9	93.0	101.3	173.3	190.5	190.5
Expenditures							
Medicaid - DCH	76.7	81.8	81.8	81.8	81.8	81.8	81.8
Family Independence Program - DHS	30.1	30.1	30.1	30.1	30.1	30.1	30.1
Offset portion of HICA shortfall	37.6	0.0	0.0	0.0	0.0	0.0	0.0
Other Appropriations	6.8	6.4	6.4	6.4	6.4	6.4	6.4
Total Expenditures	151.2	118.3	118.3	118.3	118.3	118.3	118.3
Net Increase/(Decrease) in Balance	76.0	(23.4)	(25.3)	(17.0)	55.0	72.2	72.2
Ending Balance	76.6	53.2	27.9	10.9	65.9	138.1	210.3

*Payments protected from "hold back" only through FY 2015.