Y01A
State Reserve Fund

Executive Summary

The State Reserve Fund provides a means to designate monies for future use. This analysis includes the Revenue Stabilization Account (Rainy Day Fund), Dedicated Purpose Account (DPA), and Catastrophic Event Account. Discussion of the Economic Development Opportunities Account can be found in the analysis of the Department of Commerce.

Operating Budget Data

($ in Thousands)

	FY 18 Actual	FY 19 Working	FY 20 Allowance	FY 19-20 Change	% Change Prior Year
General Fund	$10,000	$9,345	$670,161	$660,816	7071.1%
Adjustments	0	0	0	0	
Adjusted General Fund	**$10,000**	**$9,345**	**$670,161**	**$660,816**	**7071.1%**
Adjusted Grand Total	**$10,000**	**$9,345**	**$670,161**	**$660,816**	**7071.1%**

- Fiscal 2020 includes a required appropriation of $443.8 million to the Rainy Day Fund.
- The Administration proposes a $125 million Washington Metropolitan Area Transit Authority contribution in the DPA.
- As required by law, $50 million is proposed for the pension sweeper in the DPA.
- The transfer tax repayment totals $43.9 million in the DPA.
- The Administration is proposing $7.5 million to increase the Catastrophic Event Account balance to $10 million.

Note: Numbers may not sum to total due to rounding.

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Key Observations

- The Administration proposed to increase the end of fiscal 2020 Rainy Day Fund balance to $1,027 million, which is equal to 6.5% of estimated general fund revenues. The Spending Affordability Committee recommended a minimum balance of 6%.

- The State has not had a transfer from the Catastrophic Event Account in excess of $3 million since fiscal 2000. When there are events that require more than $3 million, such as Hurricane Isabel, the transfers are spread over a number of years. The Department of Legislative Services recommends a $4 million fund balance for the account.

Operating Budget Recommended Actions

		Funds
1.	Reduce the grant to the Maryland Department of Transportation for the Washington Metropolitan Area Transit Authority contribution.	$ 15,000,000
2.	Reduce the appropriation into the Catastrophic Event Account.	6,000,000
3.	Adopt annual narrative requiring the Department Budget and Management and the Department of Housing and Community Development to report on a Catastrophic Event Account and a Small, Minority, and Women-Owned Businesses Account repayment plan.	
	Total Reductions	**$ 21,000,000**

Updates

- Fiscal 2020 is the first year that the revenue volatility cap, enacted in Chapters 4 and 550 of 2017, is applied. The cap reduces fiscal 2020 general fund revenues by $94 million to adjust for unusually high projected nonwithholding income tax revenues.

- There is no repayment plan for $716.8 million in prior transfers out of the Local Income Tax Reserve Account.

- The Department of Housing and Community Development reports that approximately $489,000 of the $2.5 million transferred from the Catastrophic Event Account to the Neighborhood BusinessWorks program has been returned or repaid.

Y01A
State Reserve Fund

Operating Budget Analysis

Program Description

The State Reserve Fund provides a means to designate monies for future use. It comprises four individual accounts:

- Revenue Stabilization Account (Rainy Day Fund);
- Dedicated Purpose Account (DPA);
- Catastrophic Event Account; and
- Economic Development Opportunities Account (Sunny Day Fund).

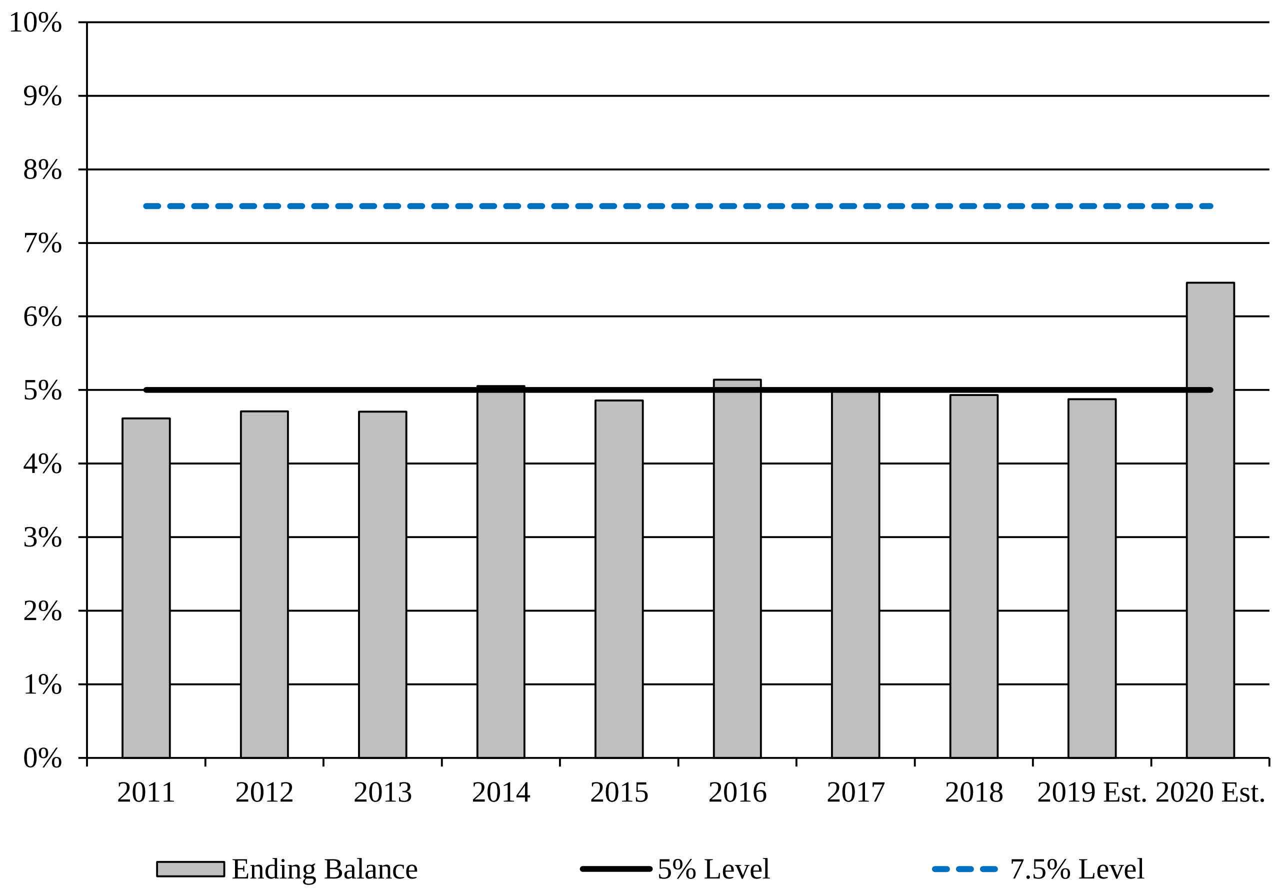
The purpose and status of the first three of these accounts are discussed in more detail in this analysis. Discussion of the Sunny Day Fund can be found in the analysis of the Department of Commerce.

Performance Analysis: Managing for Results

1. Rainy Day Fund Is Expected to Close Fiscal 2020 with a Balance Above 5% for the First Time in 13 Years

Section 7-311 of the State Finance and Procurement Article establishes a target reserve balance of 7.5% of estimated general fund revenues. The State last was materially above 5% in fiscal 2007 when the Rainy Day Fund ended with a balance in excess of 11% of general fund revenue. This was before the Great Recession, which began in December 2007. In fiscal 2008, the State transferred $978 million from the Rainy Day Fund to the General Fund, which reduced the balance to 5%. **Exhibit 1** shows that the State has not made any progress toward increasing the fund balance above 5% until fiscal 2020.

Exhibit 1
Rainy Day Fund End-of-year Balances
Fiscal 2011-2020 Est.



Source: Department of Budget and Management

Fiscal 2020 Allowance

Proposed Budget Change

Exhibit 2 shows that the fiscal 2020 allowance is $670.2 million, which is $660.8 million more than the fiscal 2019 appropriation. The allowance includes three statutorily required appropriations. Two relate to a "sweeper" to support the Rainy Day Fund and State employee pensions, and the third is a required repayment to Program Open Space (POS) for prior year transfer tax revenue diversions into the General Fund.

Exhibit 2
Proposed Budget
State Reserve Fund
($ in Thousands)

How Much It Grows:	**General Fund**	**Total**
Fiscal 2018 Actual	$10,000	$10,000
Fiscal 2019 Working Appropriation	9,345	9,345
Fiscal 2020 Allowance	670,161	670,161
Fiscal 2019-2020 Amount Change	$660,816	$660,816
Fiscal 2019-2020 Percent Change	7071.1%	7071.1%

Where It Goes:	
Rainy Day Fund	
Statutorily required appropriation: Rainy Day Fund sweeper	$443,836
Remove fiscal 2019 appropriation	-3,345
Dedicated Purpose Account	
Grant to MDOT for the Washington Metropolitan Area Transit Authority	125,000
Statutorily required appropriation: Pension sweeper	50,000
Statutorily required appropriation: Transfer into Program Open Space (POS)	43,861
Remove fiscal 2019 transfer into POS	-6,000
Catastrophic Event Account	
Fiscal 2020 appropriation	7,464
Total	**$660,816**

MDOT: Maryland Department of Transportation
Rainy Day Fund: Revenue Stabilization Account

Note: Numbers may not sum to total due to rounding.

Rainy Day Fund and Pension Sweeper

Since fiscal 2000, the State's sweeper requires that the Administration appropriate an amount equal to any unassigned general fund balance at closeout in excess of $10 million into the Rainy Day Fund. This appropriation is made to the budget two years after the unassigned general fund surplus is realized. The Budget Reconciliation and Financing Act (BRFA) of 2015 (Chapter 489) amended the sweeper requirement so that the Rainy Day Fund receives only 50% of any unassigned general fund surplus for fiscal 2017 to 2020. The other 50% is appropriated to reduce the State's unfunded pension liability. The pension appropriation is capped at $50 million.

Fiscal 2018 ended with an unassigned balance totaling $503.8 million. After deducting $10 million, per law, this leaves a $493.8 million unassigned balance. Of this amount, $443.8 million is to be appropriated in fiscal 2020 to the Rainy Day Fund, and $50 million is to be appropriated in fiscal 2020 to the State pension fund.

The Administration's budget plan proposes to transfer $158 million from the Rainy Day Fund appropriation to the General Fund.

Program Open Space Repayment

The allowance also includes $43.9 million for POS repayment. Chapter 10 of 2018 requires that transfer tax revenues redirected to the General Fund be reimbursed to POS. In fiscal 2019, this requires that a $37.9 million repayment to the transfer tax be distributed through the transfer tax formula and $6 million to critical maintenance projects at State parks.

Washington Metropolitan Area Transit Authority Contribution

For fiscal 2020, the budget bill includes a $125 million to provide a portion of the funding needed for the Washington Metropolitan Area Transit Authority (WMATA) capital grant. Chapters 351 and 352 of 2018 added provisions to the Transportation Article that require a new mandated $167 million dedicated capital grant for WMATA in addition to the capital grant already being provided. The Administration is funding $125 million of the WMATA capital grant with general funds instead of Transportation Trust Fund (TTF) revenues. As discussed in the WMATA budget analysis (J00A01.04), total funding (TTF and general funds) for the WMATA capital grant (including the new mandated amount of $167 million) is $15 million more than the identified Maryland capital contribution in the proposed WMATA budget. **The Department of Legislative Services (DLS) recommends that the general fund support for the WMATA capital grant be reduced by $15 million.**

Exhibit 3 provides an overview of State Reserve Fund activity between fiscal 2019 and 2020. Detail for each account may be found in **Appendix 3** (Rainy Day Fund), **Appendix 4** (DPA), and **Appendix 5** (Catastrophic Event Account).

Exhibit 3
State Reserve Fund Activity
Fiscal 2019-2020
($ in Millions)

	Rainy Day Fund	Dedicated Purpose Account	Catastrophic Event Account
Estimated Balances June 30, 2018	**$856.8**	**$0.0**	**$5.0**
Fiscal 2019 Appropriations	$47.8	$6.0	$0.0
DHCD BusinessWorks Loan Repayment[1]	0.0	0.0	0.0
Funds Restricted for Legislative Initiatives	-44.5	0.0	0.0
DHCD BusinessWorks Loan Repayment Supporting Ellicott City Flood Relief	0.0	0.0	-2.5
Transfer to Program Open Space	0.0	-6.0	0.0
Interest Earnings	22.1	0.0	0.0
Estimated Balances June 30, 2019	**$882.3**	**$0.0**	**$2.5**
Fiscal 2020 Appropriations	$443.8	$218.9	$7.5
Transfer to General Fund	-158.0	0.0	0.0
Transfer Funds to State Pensions	0.0	-50.0	0.0
Transfer to Program Open Space	0.0	-43.9	0.0
Grant to MDOT for WMATA	0.0	-125.0	0.0
Interest Earnings	38.6	0.0	0.0
Estimated Balances June 30, 2020	**$1,206.7**	**$0.0**	**$10.0**
Percent of Revenues in Reserve	**6.5%**		

DHCD: Department of Housing and Community Development
MDOT: Maryland Department of Transportation
Rainy Day Fund: Revenue Stabilization Account
WMATA: Washington Metropolitan Area Transit Authority

[1] Additional repayments anticipated.

Source: Department of Budget and Management, January 2019

Issues

1. Catastrophic Event Account

The State has a Catastrophic Event Account. The account was established in 1990 to enable the State to respond quickly to a natural disaster or catastrophe that could not be addressed within existing State appropriations. This issue examines how the State can efficiently use the Catastrophic Event Account.

Statutory Purpose and Guidelines

Section 7-324 of the State Finance and Procurement Article establishes the Catastrophic Event Account. The account was established in 1990 "to enable the State to respond without undue delay to a natural disaster or other catastrophic situation that cannot be taken care of within the resources of existing appropriations."

State law identifies uses for the funds in the account. Subsection (e) notes that:

> (e) *Uses.* – Funds appropriated to the Catastrophic Event Account:
>
> (1) may not be used to offset operating deficiencies in regular programs of State government; but
>
> (2) may be expended to assist a unit of State government in funding costs in connection with a natural disaster or catastrophic situation.

The account is nonlapsing, and any interest earned is deposited into the Rainy Day Fund. There is no minimum or maximum account balance or requirement to replenish the account. The Governor may transfer funds from the account to "an appropriate unit of State government" after a 15-day review and comment period by the Legislative Policy Committee (LPC). The law does not define what uses are appropriate, how the agency can spend the funds, or what a catastrophic situation is. Expenditures must be consistent with State law, but this section does not place any additional restrictions on spending funds from this account.

Recent Activity in the Maryland Catastrophic Event Account

The fund has been used since fiscal 2000 to support various natural disasters and catastrophic situations. **Exhibit 4** shows that $18.5 million has been transferred to State agencies with the most common transfers supporting flood relief, Hurricane Isabel, and snowstorms. Over the period, fiscal 2000 was the only year with multiple large events. The fund's uses have been expanded in recent years to support revolving loan funds and heating, ventilation, and air conditioning (HVAC) systems in local schools.

Exhibit 4
Types of Relief Provided by the Catastrophic Event Account
Fiscal 2000-2019
($ in Thousands)

Types of Transfers for Relief	Number	Amount
Ellicott City Flood Relief	2	$5,000
Hurricane Isabel Relief	3	4,262
Snowstorms	3	3,236
Baltimore City HVAC	1	2,500
Drought Assistance	1	2,000
Southern Maryland Tornado Relief	1	1,500
Total	**11**	**$18,497**

HVAC: heating, ventilation, and air conditioning

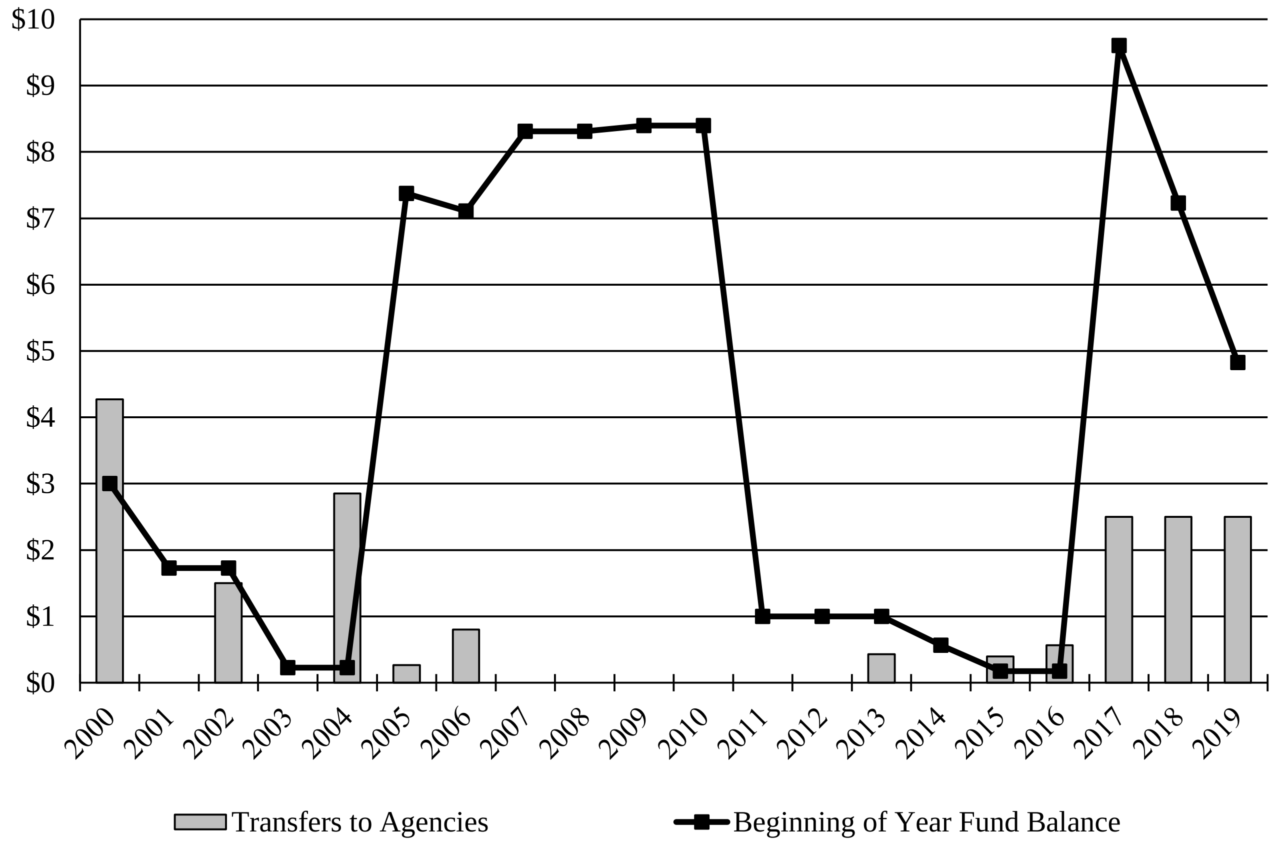
Sources: Department of Budget and Management; Department of Legislative Services

Fund balances have fluctuated since fiscal 2000. **Exhibit 5** shows that there are four years (fiscal 2003, 2004, 2015, and 2016) that began with a balance that was less than $250,000. By contrast, fiscal 2017 began with a balance of more than $9.6 million.

In times of fiscal stress, funds have been transferred from the Catastrophic Event Account to the General Fund. In fact, the largest annual transfer from account was not attributable to a major catastrophic event; rather, the largest annual transfer was $7.4 million to the General Fund.

It has been common to have large unused account balances. From fiscal 2005 to 2010, account balances exceeded $7 million, and the largest catastrophic event transfer was $0.8 million for a share of Hurricane Isabel costs in fiscal 2006. On the other hand, it is also common to have low fund balances. Fiscal 2011 to 2015 all began with fund balances that were less than $1 million. The data suggest that there are periods of underfunding and overfunding, raising questions about how efficiently the fund is being used.

Exhibit 5
Catastrophic Event Account
Beginning of Year Account Balances and Transfers to Agencies
Fiscal 2000-2019
($ in Millions)



Sources: Department of Budget and Management; Department of Legislative Services

Annual transfers to agencies for catastrophic events have ranged from a minimum of no transfers in eight fiscal years to a maximum of $4.3 million in fiscal 2000 when transfers supported both drought assistance and snowstorms. **Exhibit 6** shows that average annual transfers are approximately $847,000. Adjusting for inflation shows that the largest annual transfer for a specific event, in real dollars, was $3.3 million, and the largest annual transfer was $6.4 million.

Exhibit 6
Summary of Transfer to State Agencies
Fiscal 2000-2019
($ in Thousands)

Transfers in Response to Catastrophic Event	Amount	In September 2018 Dollars[1]
Average Annual Transfer	$847	$1,147
Median Transfer	330	388
Smallest Annual Transfer (Eight Different Years)	0	0
Largest Annual Transfers (Two Transfers in Fiscal 2000)	4,273	6,390
Costliest Event (Hurricane Isabel from Fiscal 2004 to 2006)	2,853	3,277

[1] The federal Bureau of Labor Statistics' Consumer Price Index for Urban Consumers without seasonal adjustments is used to calculate September 2018 dollars.

Source: Department of Budget and Management; Department of Legislative Services

Catastrophic Event Account Replenishment Options

DLS surveyed all 50 states and the District of Columbia in 2018 for options used to replenish the accounts and identified the following:

- ***Dedicated Fee:*** Indiana has a dedicated public safety fee that is deposited into its account.
- ***Appropriations Required to Maintain a Target Account Balance:*** Michigan requires an account balance between $2.5 million and $10 million. Appropriations are required to keep the account within these targets.
- ***Discretionary Appropriations:*** This is Maryland's current approach. There are no rules or guidelines about when or how a fund is replenished. Appropriations are determined by factors such as the availability of funds and administration priorities.
- ***Transfer from Another Fund:*** North Dakota requires an unobligated balance of $20 million. The account receives an allocation from the Oil and Gas Gross Production and Extraction Taxes if funds are less than $20 million.
- ***Borrow from Another Fund:*** In California, Colorado, and Illinois, the Governor may transfer funds from other accounts. This may require review or approval from another entity. For example, transfers in Colorado require the concurrence of the Disaster Emergency Council.

Characteristics of Other State Catastrophic Event Accounts

While some states do not have any specific account, some states have accounts dedicated only for natural disasters, and other states have contingency accounts that are not just limited to natural disasters. There are also differences with respect to when the account is used, what is reimbursed, who is reimbursed, and how a recipient is reimbursed. **Exhibit 7** lists different attributes of State Catastrophic Event Accounts.

Exhibit 7
Attributes of Catastrophic Event Accounts

Focus of Fund

1. Disaster relief for events such as hurricanes, tornadoes, wildfires, and other public calamity
2. Contingency Fund that allows Governor to transfer funds to manage unexpected costs

When Can the Fund Be Used

1. Presidentially declared disaster
2. Request by Governor
3. Request by elected official

What is Reimbursed

Immediate Response
1. Cost of first responders
2. Disaster assistance programs

Cleanup and Other Costs
3. Infrastructure repair or replacement
4. Mitigate environmental damage
5. Federal cost share assistance
6. Workers' compensation claims
7. Self-insured employers
8. Other nondisaster-related costs

Who is Reimbursed

1. State agencies
2. Local governments
3. Individuals
4. Other entities

How a Recipient Is Reimbursed

1. Grants
2. Loans

How Is the Account Replenished

1. Dedicated fees
2. Mandatory appropriations
3. Discretionary appropriations
4. Transfers from other funds
5. Borrow from other funds

Source: Department of Legislative Services

While there is quite a bit of variation, the funds can be divided into these basic categories:

- ***No Fund***.

- ***Limited Catastrophic Event Account:*** An account that supports State spending for catastrophic events that are a natural disaster, such as hurricanes, tornadoes, and wildfires. The fund only reimburses State costs for the immediate response, infrastructure repair and replacement, and environmental cleanup. The fund only provides grants to State agencies.

- ***Expansive Catastrophic Event Account:*** The limited account could be expanded to allow reimbursement of local government costs, support loan programs, as well as individuals and nongovernmental agencies.

- ***Governor's Contingency Fund:*** A fund that does not restrict when the fund is used, what can be used reimbursed, who is reimbursed, and how individuals and organizations are reimbursed.

Evaluating an Appropriate Fund Balance

With respect to managing the Catastrophic Event Account, a key question is what the account should be prepared to fund. Specifically:

- should the account's fund balance be sufficient to fund any event, no matter how large or unlikely; or

- should the account's fund balance only fund common events so that other sources should fund large, uncommon events.

Common Events Require Less Than $4 Million

Recent data suggest that there are quite a few events that require a few million dollars. Since fiscal 2000, there have been seven transfers for catastrophic events between $1 million and $3.3 million and five transfers that were less than $1 million. These events may not occur each year, but they do occur regularly. Since these costs are fairly predictable, a limited account that funds common events can be managed efficiently. Such an account can provide funding for common catastrophes without requiring substantial appropriations that are unused for years.

Supporting an account to fund large and uncommonly large events requires a substantial account balance that will rarely be used. This results in a fund with a large account balance that is unused in most years.

Rare Expensive Events Also Occur

Another complication is that there are some events that are rare and costly. A recent example of extraordinary events that required substantial resources were the protests in Baltimore City in spring 2015 that culminated in the Governor declaring a State of emergency. The funding required to respond exceeded peak funding in the Catastrophic Event Account. The state of emergency gave the Governor the authority to suspend certain laws and regulations, which allowed the Governor to transfer $13.1 million from the Rainy Day Fund to State agencies. Approximately $1 million was not needed and returned to the Rainy Day Fund, so the final costs totaled $12.1 million.

This demonstrates how difficult it is to estimate how large a fund balance is sufficient if the goal of the fund is to have a balance sufficient to support all events. By definition, there is little data available from rare events. Fortunately, State law allowed the Governor to manage the event by transferring funds from the Rainy Day Fund. The State has an implicit policy that a state of emergency that overwhelms the Catastrophic Event Fund's resources can be supported by the Rainy Day Fund. The advantage of this approach is that it obviates the need to maintain an excessively large Catastrophic Event Account balance for rare events.

Most Large Events Are Funded Over a Period of Years

The largest single event was Hurricane Isabel. The hurricane required transfers from fiscal 2004 to 2006, and books were finally closed in fiscal 2008, when approximately $88,000 in unused funds were transferred back into the account. Since large events' requirements are over a period of years, the State does not need to have funds sufficient for the whole event in the Catastrophic Event Account. As funds are transferred, the State can appropriate more funds each year. The State also has the ability to make deficiency appropriations during the fiscal year. Since the spending lifecycle of large catastrophic events is years, this provides time for the State to adjust appropriations. When Hurricane Isabel struck Maryland, the account balance was approximately $228,000. That year, the account received a $10 million deficiency appropriation.

DLS Recommends a $4 Million Target Account Balance

Based on recent transfers, it appears that a $4 million account balance is sufficient to manage common catastrophic events. However, the data also show that multiple catastrophic events can occur in the same year. Most recently, this happened in fiscal 2000, when funds were transferred for drought and snowstorm relief. **DLS recommends that the State adopt a policy of maintaining a $4 million fund balance at the beginning of each fiscal year.**

Operating Budget Recommended Actions

		Amount Reduction	
1.	Reduce the grant to the Maryland Department of Transportation for the Washington Metropolitan Area Transit Authority (WMATA) contribution. Capital appropriations for WMATA are more than required, so a reduction is recommended.	$ 15,000,000	GF
2.	Reduce the appropriation into the Catastrophic Event Account. Since fiscal 2001, the State has not appropriated more than $3 million from the account in any fiscal year. This leaves $4 million in the account that should be sufficient.	6,000,000	GF

3. Adopt the following narrative:

Repayment of the Catastrophic Event Account and the Small, Minority, and Women-Owned Businesses Account: In September 2016, $2.5 million was transferred from the Catastrophic Event Account, and $2.3 million was transferred from the Small, Minority, and Women-Owned Businesses Account into the Department of Housing and Community Development (DHCD) Neighborhood BusinessWorks program to provide loans to businesses in Ellicott City. Another $2.5 million was transferred from the Catastrophic Event Account in July 2018. As part of its review of the transfer of funds from the Catastrophic Event Account, the Legislative Policy Committee recommended that DHCD develop a process by which the funds or repaid loans are credited to the Catastrophic Event Account. The department should submit a report that provides data regarding the number and amount of loans provided, the outstanding balance of these loans, and the number and amount of any forgiven loans. This report should be submitted to the budget committees by January 24, 2020.

Information Request	**Authors**	**Due Date**
Report on the Catastrophic Event Account and the Small, Minority, and Women-Owned Businesses Account repayment	DHCD Department of Budget and Management	January 24, 2020

Total General Fund Reductions	**$ 21,000,000**

Updates

1. Revenue Volatility Cap Is Applied in Fiscal 2020

Due to the business cycle, revenue volatility is unavoidable for State governments. States that rely heavily on highly volatile revenue sources like capital gains to fund ongoing spending are especially vulnerable to the vagaries of the economy. Minimizing reliance on unstable revenue sources can help states soften the impact of recessions and avoid building unsustainable ongoing spending into their budgets during economic booms. In recent years, a number of states have adopted or considered changes to their revenue forecasting and budgetary practices to reduce their vulnerability to revenue volatility.

The 2016 *Joint Chairmen's Report* (JCR) required that the Department of Budget and Management, (DBM), the Comptroller of Maryland, and DLS examine the volatility of Maryland's revenue structure and recommend an approach to reducing volatility. The report was submitted in November 2016. It recommended that some statutory changes be made to revenue forecasting and the Rainy Day Fund. Specifically, all three agencies recommended that there be a cap on income tax nonwithholding revenues and that there be a requirement to appropriate funds into the Rainy Day Fund if the balance is below 10% of general fund revenues.

Legislation to Cap Income Tax Nonwithholding Revenues to Dedicate Funds for Reserves and Capital Projects Is Enacted

Chapters 4 and 550 of 2017 codified key recommendations of the report. The legislation provided for a methodology to estimate excess income tax nonwithholding, increase Rainy Day Fund balances, and determine how excess funds are appropriated. The legislation established a cap on income tax nonwithholding revenues based on the 10-year average of income tax nonwithholding revenues, up to 2% of general funds.

Chapter 10 modified the amount of excess funds so that the impact would phase in gradually. Limits were set at 0.5% of general funds in fiscal 2020, 1% for fiscal 2021, and 2% beginning in fiscal 2022.

Use of Income Tax Nonwithholding Income Tax Revenues

Beginning with fiscal 2020, if actual income tax nonwithholding income tax revenues exceed the cap, the amount of income tax nonwithholding revenues that exceed the capped estimate must be applied as follows:

- the first priority is to close the revenue gap for that fiscal year so that funds must be used to close any budget deficit;

- if the available nonwithholding income tax revenues exceed the amount that is needed to close the gap (or there is no budget deficit), the Comptroller must distribute any remaining amount to the Rainy Day Fund;

- if the Rainy Day Fund balance is equal to or exceeds 6% of estimated general fund revenues, the Comptroller must distribute 50% of any remaining amount to the Rainy Day Fund and the other 50% into the Fiscal Responsibility Fund; and

- if the Rainy Day Fund balance exceeds 10% of estimated general fund revenues, any remainder must be distributed to the Fiscal Responsibility Fund.

Establishment of the Fiscal Responsibility Fund

The bill established a special, nonlapsing Fiscal Responsibility Fund to provide supplemental pay-as-you-go (PAYGO) capital funds for public school construction, public school capital improvement projects, capital projects at public community colleges, and capital projects at four-year public institutions of higher education. The Governor must include in the budget bill for the second following fiscal year an appropriation equal to the amount in the fund for PAYGO capital projects.

Fiscal 2020 Is the First Year That the Cap Is Applied

The law requires that the State apply the cap in fiscal 2020, as modified by Chapter 10. **Exhibit 8** shows that total fiscal 2020 general fund revenues are estimated to be $18.7 billion of which income tax nonwithholding revenues total $2.9 billion. Since the income tax nonwithholding revenues have averaged 13.59% of total general fund revenues over the last 10 years, income tax nonwithholding is capped at $2.5 billion. Applying the 10-year average to total revenues results in an income tax nonwithholding cap of $411 million. The law also limits the cap to 0.5% of total general fund revenues in fiscal 2020, 1% of revenues in fiscal 2021, and 2% of revenues beginning in fiscal 2022. In fiscal 2020, this limits the cap to $94 million. Fiscal 2020 general fund revenues have been reduced by this $94 million cap.

Exhibit 8
Effect of Cap on General Fund Revenues
Fiscal 2020
($ in Millions)

	Cap Calculation
December 2018 General Fund Revenue Estimate	
Total Fiscal 2020 General Funds	$18,716
State Income Tax Nonwithholding Revenues	2,899
Share to Total General Funds	15.49%
Income Tax Nonwithholding Limit	
10-year Average: Income Tax Nonwithholding Share of Total General Fund Revenues	13.59%
State Income Tax Nonwithholding Cap	$2,543
Cap Adjustment Calculation	
State Income Tax Nonwithholding Cap	$2,543
State Income Tax Nonwithholding Estimate	2,899
Preliminary Adjustment (Cap – Estimate)[1]	-411
Maximum Test: Percent of General Fund Revenues	0.50%
Maximum Income Tax Nonwithholding Cap	-$94
Final General Fund Revenue Adjustment	**-94**

[1] When calculating the nonwithholding cap, it is adjusted so that the final share of total general funds equals the 10-year average if the cap is triggered. This is done by dividing nonwithholding adjustment by 1 minus the 10-year average nonwithholding share (in other words, the share of total general fund revenues that is everything other than nonwithholding)

Source: Office of the State Comptroller; Department of Legislative Services

2. Local Income Tax Reserve Account Update

The State maintains a Local Income Tax Reserve Account. The State collects income taxes for local jurisdictions and makes payments to the counties and Baltimore City from this account. According to generally accepted accounting principles, the State is supposed to maintain a sufficient fund balance to pay future refunds realized during the fiscal year in case the income tax is no longer collected. If the account is insufficiently capitalized at the end of a fiscal year, the State is required to report the underfunding as an unfunded liability in the *Comprehensive Annual Financial Report* (CAFR). If the State has a plan in place to reimburse the account, the State does not need to show an unfunded liability in CAFR. This is a concern because the State has transferred funds from this account to support general fund spending.

To fund the State budget, the following actions have transferred funds out of this account:

- $366.8 million was transferred in fiscal 2009 to support operating budget spending. The Comptroller's Office advises that this is attributable to the State having deposited more State funds on behalf of local jurisdictions than was necessary. As such, the Comptroller's Office classifies this as a local liability. When the transfer was made, Chapter 487 of 2009 (the BRFA) required that local jurisdictions reimburse the account. Chapter 1 of the first special session of 2012 (the BRFA) repealed the repayment requirement.

- $350 million to the Education Trust Fund. Chapter 484 of 2010 (the BRFA) required that this amount be repaid in $50 million increments from fiscal 2014 through 2020. Chapter 425 of 2013 (the BRFA) repealed the repayment requirement.

- $200 million for Medicaid. Chapter 484 required that this amount be repaid from fiscal 2021 through 2026 at $33.3 million per year.

- $100 million was transferred to the General Fund in fiscal 2015. Chapter 489 required that $10 million be reimbursed each year, beginning in fiscal 2016, with a final payment in fiscal 2025. The reimbursement is not appropriated; instead, the portion of personal income tax net receipts deposited into the reserve account will be increased to provide an additional $10 million annually.

Insofar as there is no repayment plan for the $366.8 million that was transferred in fiscal 2009 and no repayment plan for the $350 million that was transferred in fiscal 2011, the total unfunded liability is $716.8 million. The State reports these unfunded liabilities in CAFR.[1] **Exhibit 9** summarizes actions taken since fiscal 2009.

[1] Page 69 of the fiscal 2018 CAFR notes that there is a plan to reimburse $200 million from fiscal 2021 to 2026 and $100 million reimbursed through fiscal 2025. The note mentions that no dates are specified to reimburse the remaining balance.

Exhibit 9
Local Income Tax Reserve Account Transfers and Repayments To the General Fund and Medicaid
Fiscal 2009-2026
($ in Millions)

Transfers	Amount
Fiscal 2009 General Fund transfer that the State forgave, but it still is a local liability	$366.8
Fiscal 2010 Education Trust Fund transfer	350.0
Fiscal 2011 Medicaid transfer	200.0
Fiscal 2015 General Fund transfer	100.0
Payments Made from fiscal 2016 to 2018 to reimburse fiscal 2015 transfer (these are the first of 10 annual payments)	-30.0
Total Liability at Close of Fiscal 2018	**$986.8**
Anticipated Reimbursements	
Transfers to reimburse Medicaid transfer, $33.3 million annually from fiscal 2021 to 2026	$200.0
Remaining payments made from fiscal 2019 and 2026 to reimburse fiscal 2015 transfer (this is 10 annual payments with 7 to go with continuous payments after the initial $100 million is paid off)[1]	80.0
Total Anticipated Reimbursements	**$280.0**
Unfunded Liability[1]	**$706.8**

[1] Chapter 10 of 2018 (Budget Reconciliation and Financing Act) extended this $10 million repayment indefinitely that will help reduce the unfunded liabilities.

Sources: Comptroller's Office; Department of Legislative Services, 2009, 2010, and 2011 *The 90 Day Report*

The 2018 JCR required that the State Comptroller's Office and DBM to develop a repayment plan. In the response, agencies noted that the fiscal 2009 to 2011 transfers' initial repayment plans would have cumulatively paid back the account in 23 years. With this yardstick, agencies recommended a plan that repays the account in 20 to 25 years, which requires payments between $29 million and $36 million annually.

The response also notes that local jurisdictions owe the Local Income Tax Reserve Account almost $250 million as a result of the *Wynne* case. Chapters 28 and 824 of 2018 delayed this repayment by two years, so that repayment begins in fiscal 2021.

The budget does not include any funds to repay the Local Income Tax Reserve Account.

3. Status of Neighborhood BusinessWorks Program Loan Repayments to the Catastrophic Event Account

In July 2016, the Patapsco River waters rose after heavy rains and flooded Ellicott City. The flood damaged many businesses and homes. In response, the Administration proposed to help Ellicott City recover. This included providing loans for businesses to rebuild.

To support the recovery, $2.5 million was transferred from the Catastrophic Event Account into the Department of Housing and Community Development's (DHCD) Neighborhood BusinessWorks (NBW) program to provide loans to businesses. As required by State law, LPC reviewed and approved the amendment. As part of its review, LPC concurred with DLS' recommendation that DHCD develop a process by which the funds or repaid loans are deposited into the Catastrophic Event Account.

The 2018 JCR required that DHCD and DBM report to the budget committees about the status of the loans. **Exhibit 10** shows the status of the loans.

Exhibit 10
Status of BusinessWorks Loan Repayment
As of January 15, 2019
($ in Thousands)

	Amount
Amount Transferred to Neighborhood BusinessWorks	$2,500
Amount Returned or Repaid	489
Remaining Balance	2,011

Note: No loans have been forgiven.

Source: Department of Housing and Community Development; Department of Budget and Management

Complicating repayment is a second flood in Ellicott City and the surrounding areas in May 2018. In response, another $2.5 million was transferred from the Catastrophic Event Account to DHCD's NBW program. DHCD advises that these funds will support grants instead of loans. DHCD will work with flood victims with loans from the first flood if they are facing hardships as a result of the second flood.

DLS recommends that the budget committees adopt annual narrative requesting that DHCD and DBM report on the status of repayment of these loans.

Appendix 1
Current and Prior Year Budgets
State Reserve Fund
($ in Thousands)

	General Fund	Special Fund	Federal Fund	Reimb. Fund	Total
Fiscal 2018					
Legislative Appropriation	$10,000	$0	$0	$0	$10,000
Deficiency/Withdrawn Appropriation	0	0	0	0	0
Cost Containment	0	0	0	0	0
Budget Amendments	0	0	0	0	0
Reversions and Cancellations	0	0	0	0	0
Actual Expenditures	**$10,000**	**$0**	**$0**	**$0**	**$10,000**
Fiscal 2019					
Legislative Appropriation	$53,826	$0	$0	$0	$53,826
Budget Amendments	-44,481	0	0	0	-44,481
Working Appropriation	**$9,345**	**$0**	**$0**	**$0**	**$9,345**

Note: Numbers may not sum to total due to rounding.

Fiscal 2018

In fiscal 2018, the $10 million legislative appropriation was spent, and there was no other activity.

Fiscal 2019

In fiscal 2019, budget amendments transferred $44.5 million from the Dedicated Purpose Account to State agencies. **Appendix 6** summarizes the transfers.

Appendix 2
Fiscal Summary
State Reserve Fund

Program/Unit	FY 18 Actual	FY 19 Wrk Approp	FY 20 Allowance	Change	FY 19 - FY 20 % Change
01 Revenue Stabilization Account	$ 10,000,000	$ 3,345,241	$ 443,836,013	$ 440,490,772	13167.7%
01 Dedicated Purpose Account	0	6,000,000	218,860,950	212,860,950	3547.7%
01 Catastrophic Event Account	0	0	7,464,250	7,464,250	0%
Total Expenditures	**$ 10,000,000**	**$ 9,345,241**	**$ 670,161,213**	**$ 660,815,972**	**7071.1%**
General Fund	$ 10,000,000	$ 9,345,241	$ 670,161,213	$ 660,815,972	7071.1%
Total Appropriations	**$ 10,000,000**	**$ 9,345,241**	**$ 670,161,213**	**$ 660,815,972**	**7071.1%**

Appendix 3

Revenue Stabilization Account (Rainy Day Fund)

Section 7-311 State Finance and Procurement Article

Account Characteristics

- ***Purpose:*** The account was established in 1986 to retain State revenues to meet future short-term funding needs and to reduce the need for future tax increases by moderating revenue growth.

- ***Appropriations:*** The account consists of direct appropriations in the budget bill and interest earned from all reserve fund accounts.

- ***Required Appropriations If Account Balance Is Less Than 7.5% of General Fund Revenues:*** Current law requires that if the fund balance is between 3% and 7.5% of projected general fund revenues, annual appropriations of at least $50 million must be made until the account balance reaches 7.5% of estimated general fund revenues. If the account balance is below 3%, State law requires an appropriation of at least $100 million.

- ***Sweeper Provision:*** State law requires that the Administration appropriate an amount equal to any unassigned general fund balance at closeout in excess of $10 million into the Revenue Stabilization Account (Rainy Day Fund). This appropriation is made to the budget two years after the unassigned general fund surplus is realized. For example, fiscal 2008 closed with an unassigned surplus totaling $185.7 million; thus, the Administration's fiscal 2010 allowance included a $175.7 million appropriation to the Rainy Day Fund. This appropriation to the Rainy Day Fund is referred to as the "sweeper." Chapter 489 modified the sweeper so that:

    - for fiscal 2017 to 2019, for surpluses above $10 million, an amount equal to up to $100 million is split between the Rainy Day Fund and the Pension System. Amounts above $110 million go to the Rainy Day Fund;

    - for fiscal 2020, for surpluses above $10 million, an amount equal to up to $50 million each year goes to the Rainy Day Fund and the Pension System on a dollar-for-dollar basis, and amounts above $110 million go to the Rainy Day Fund; and

    - per Chapter 557 of 2017, for fiscal 2021 and beyond, for surpluses above $10 million, the first $100 million is divided between the Rainy Day Fund, the Pension System, and the Postretirement Health Benefits Trust Fund so that the Rainy Day Fund receives 50%, the Pension System receives 25%, and the Postretirement Health Benefits Trust Fund receives 25% on a dollar-for-dollar basis. Amounts above $110 million are credited to the Rainy Day Fund.

Mechanisms for Transferring and Spending Funds

The Governor can transfer balance from the Rainy Day Fund above 5% of estimated general fund revenues in the budget bill. To transfer an amount that would reduce the Rainy Day Fund balance below 5% requires the transfer to be authorized in an Act of the General Assembly other than the budget bill.

Rainy Day Fund Activity

The following table illustrates fiscal 2016 through 2020 activity in the Rainy Day Fund. An appropriation totaling $50 million was made in fiscal 2016 and $10 million in fiscal 2018 to keep a minimum 5% fund balance in those years. The fiscal 2017 allowance included the required sweeper appropriation, which totaled $235.3 million. The budget was amended so that $80 million was restricted for other uses. The Governor did not transfer funds for the restricted purposes, so the funds reverted to the General Fund. In fiscal 2018, the fund received $1 million in unspent funds from the state of emergency that was declared to respond to disturbances in Baltimore City in May 2015. At the time, $13.1 million was transferred to State agencies to support operations. These are the unused funds. The fiscal 2020 allowance includes the $443.8 million sweeper appropriation. The Administration proposes to transfer $158 million to the General Fund. The fund is expected to end fiscal 2020 with a fund balance that is equal to 6.5% of general fund revenues.

Revenue Stabilization Account Status
Fiscal 2016-2020 Est.

	2016	2017	2018	2019 Est.	2020 Est.
Beginning Balance	$773.5	$832.4	$832.5	$856.8	$882.3
Appropriation	50.0	235.3	10.0	47.8	443.8
Transfer to General Fund	0.0	-170.0	0.0	0.0	-158.0
Transfer from BPW Contingent Fund	0.0	0.0	1.0	0.0	0.0
Fund Projects and Programs	0.0	0.0	0.0	-44.5	0.0
GF Reversions	0.0	-80.0	0.0	0.0	0.0
Interest Earnings	8.9	14.7	13.4	22.1	38.6
Ending Balance	**$832.4**	**$832.5**	**$856.8**	**$882.3**	**$1,206.7**

BPW: Board of Public Works
GF: General Fund

Note: Numbers may not sum to total due to rounding.

Source: Department of Budget and Management

Governor's Out-year Forecast

The out-year Rainy Day Fund forecast anticipates transfers into the fund, since the fund balance is less than 7.5% of general fund revenues. The Department of Budget and Management's forecast projects minimum $50 million appropriations annually, which combined with interest earnings, increase the fund balance to $1,540 million at the end of fiscal 2024. This is 7.2% of general fund revenues. The forecast does not assume that any funds attributable to the revenue volatility cap enacted by legislation in 2017 are credited to the account.

Appendix 4

Dedicated Purpose Account

Section 7-310 State Finance and Procurement Article

Account Characteristics

- ***Purpose:*** The account was established in 1986 to retain appropriations for major, multi-year expenditures in which the magnitude and timing of cash needs are uncertain and to meet expenditure requirements that may be affected by changes in federal law or fiscal policies or other contingencies.

- ***Appropriations:*** The account consists of direct appropriations in the budget bill committed to a specific purpose. Interest earnings generated by the account are credited to the Revenue Stabilization Account (Rainy Day Fund).

- ***Other:*** The unspent balance of an appropriation reverts to the Rainy Day Fund four years after the end of the fiscal year for which the appropriation was made.

Mechanisms for Transferring and Spending Funds

To transfer funds from the Dedicated Purpose Account (DPA):

- funds may be reflected in the State budget subject to appropriation;

- after submission to the budget committees and 45 day review and comment by the Legislative Policy Committee (LPC), funds may be transferred by budget amendment to the appropriate Executive Branch agency; or

- the Governor may declare appropriations to the DPA surplus and may transfer funds by budget amendment to the Rainy Day Fund following review by the budget committees and LPC.

DPA Activity

The following table illustrates the activity in the DPA from fiscal 2016 through 2020. The account ends the period with no fund balance. In fiscal 2016, $152.5 million was appropriated. This includes $140 million to fund legislative priorities, $10 million to reduce an unfunded liability in the Local Income Tax Reserve Account, and $2.5 million for information technology (IT) upgrades. In fiscal 2016, $118.6 million was spent for legislative priorities, and the remaining $21.4 million reverted to the General Fund. IT upgrades were made in fiscal 2016 and 2017. In fiscal 2019, $6 million was appropriated for Program Open Space (POS) repayments. As submitted, the fiscal 2020 Governor's allowance includes $93.9 million in statutorily required appropriations: $50 million to reduce the pension liability; and $43.9 million in POS repayments. The allowance also includes $125 million for a grant to the Maryland Department of Transportation for the Washington Metropolitan Area Transit Authority.

Dedicated Purpose Account Status
Fiscal 2016-2020
($ in Millions)

	2016	2017	2018	2019	2020
Beginning Balance		**$1.8**	**$0.0**	**$0.0**	**$0.0**
Appropriation	**$152.5**	**$0.0**	**$0.0**	**$6.0**	**$218.9**
Information Technology Upgrades	2.5				
Local Income Tax Reserve Repayment	10.0				
Pension Sweeper					50.0
Section 48 to Restore Funding	140.0				
WMATA Contribution					125.0
POS Repayment for General Fund Transfers				6.0	43.9
Transfers	**-$150.7**	**-$1.8**	**$0.0**	**-$6.0**	**-$218.9**
Local Reserve Account Repayment	-10.0				
POS Repayment for General Fund Transfers				-6.0	-43.9
Information Technology Upgrades	-0.7	-1.8			
Transfer to Pension Fund					-50.0
WMATA Contribution					-125.0
Section 48 Initiatives Funded by Administration	-49.9				
Section 48 Salary Restoration	-68.7				
General Fund Reversion	-21.4				
Ending Balance	**$1.8**	**$0.0**	**$0.0**	**$0.0**	**$0.0**

POS: Program Open Space
WMATA: Washington Metropolitan Area Transit Administration

Source: Department of Budget and Management

Governor's Out-year Forecast

The Department of Legislative Services expects the following appropriations into the DPA from fiscal 2021 to 2024:

- $133.3 million to reimburse the Local Income Tax Reserve Account;
- $112.5 million for POS repayment;

- $23.8 million for the pension sweeper in fiscal 2021; and

- $23.8 million for the other postemployment benefits sweeper in fiscal 2021.

Dedicated Purpose Account Anticipated Out-year Activity
Fiscal 2021-2024
($ in Millions)

	2021	2022	2023	2024
Beginning Balance	**$0.0**	**$0.0**	**$0.0**	**$0.0**
Appropriation	**$124.8**	**$64.5**	**$52.0**	**$52.0**
Local Income Tax Reserve Repayment	$33.3	$33.3	$33.3	$33.3
Pension Sweeper	23.8			
Other Postemployment Benefits Sweeper	23.8			
POS Repayment for General Fund Transfers	43.9	31.2	18.7	18.7
Transfers	**-$124.8**	**-$64.5**	**-$52.0**	**-$52.0**
Local Reserve Account Repayment	-$33.3	-$33.3	-$33.3	-$33.3
POS Repayment for General Fund Transfers	-43.9	-31.2	-18.7	-18.7
Transfer to Pension Fund	-23.8			
Other Postemployment Benefits Sweeper	-23.8			
Ending Balance	**$0.0**	**$0.0**	**$0.0**	**$0.0**

POS: Program Open Space

Source: Department of Budget and Management

Appendix 5

Catastrophic Event Account

Section 7-324 State Finance and Procurement Article

Account Characteristics

- ***Purpose:*** The account was established in 1990 to enable the State to respond quickly to a natural disaster or catastrophe that could not be addressed within existing State appropriations.

- ***Appropriations:*** The account consists of direct appropriations in the budget bill. Interest earnings generated by the account are credited to the Revenue Stabilization Account.

Mechanisms for Transferring and Spending Funds

Prior to transferring funds by budget amendment to the appropriate Executive Branch agency, the Administration must notify the Legislative Policy Committee of the proposed amendment. The committee has 15 days to review and comment.

Catastrophic Event Account Activity

The following table shows that the account's balance was $172,937 at the start of fiscal 2016. In fiscal 2016, the Administration's budget included a $10,000,000 deficiency appropriation. In response to snowstorms, $567,687 was transferred to the Military Department in fiscal 2016. The Department of Housing and Community Development's Neighborhood BusinessWorks (NBW) program received $2,500,000 to support Ellicott City's flood cleanup in fiscal 2017. As of January 2019, $432,507 of the flood cleanup has been repaid from fiscal 2017 to 2019 with additional repayments anticipated. The Administration has processed a budget amendment to provide $2,500,000 for Baltimore City schools' heating, ventilation, and air conditioning repairs in fiscal 2018 and another $2,500,000 for NBW in fiscal 2019 in response to a second flood. The allowance proposes $7,464,250 in fiscal 2020, bringing the fund balance over $10 million.

Catastrophic Event Account
Fiscal 2016-2020 Est.
($ in Thousands)

	2016	2017	2018	2019 Est.	2020 Est.
Beginning Balance	**$173**	**$9,605**	**$7,231**	**$5,034**	**$2,538**
Appropriation	**$10,000**	**$0**	**$0**	**$0**	**$7,464**
Snowstorms	-568	0	0	0	0
Ellicott City Flood Relief through DHCD Neighborhood BusinessWorks	0	-2,500	0	-2,500	0
DHCD Neighborhood BusinessWorks Loan Repayment	0	126	302	4	0
Baltimore City HVAC	0	0	-2,500	0	0
Ending Balance	**$9,605**	**$7,231**	**$5,034**	**$2,538**	**$10,002**

DHCD: Department of Housing and Community Development
HVAC: heating, ventilation, and air conditioning

Source: Department of Budget and Management

Appendix 6
Fiscal 2018 Rainy Day Fund Transfers to State Agencies

Program	Description	Amount
M00Q01.03	Medicaid – Nursing Homes and Community Providers – Raise Rates from 1% to 3%	$17,200,000
D15A05.16	One-time School Safety Grants	9,000,000
D15A05.16	Maryland Violence Intervention and Prevention Program – Local Grants (SB 545)	5,000,000
R15P00.04	Maryland Public Television Tubman and Douglass Documentaries	3,000,000
N00G00.01	Raise provider rates from 1% to 3% at DHS Foster Care Program	2,526,726
R00A02.13	Maryland Early Literacy Initiative	2,500,000
R00A02.13	Career and Technical Education Innovation	2,000,000
R62I00.49	Maryland Higher Education Commission Scholarships	2,000,000
V00G01.01	Raise Provider Rates from 1% to 3% at Department of Juvenile Services	473,274
R00A02.13	Teacher Recruitment and Outreach	250,000
L00A12.10	Maryland Farm and Families Fund	200,000
R00A02.13	Special Education Study	121,000
D40W01.07	Maryland Humanities Council	100,000
S00A24.01	Laurel Advocacy and Referral Services, Inc.	40,000
T00G00.08	901 Arts in Baltimore City	25,000
T00G00.08	Arts for Every Day Life in Baltimore City	25,000
D60A10.01	Archives for Old Senate and House Chamber Histories	20,000
Total		**$44,481,000**

DHS: Department of Human Services