Y01A
State Reserve Fund

Operating Budget Data

($ in Thousands)

	FY 16 Actual	FY 17 Working	FY 18 Allowance	FY 17-18 Change	% Change Prior Year
General Fund	$72,500	$235,336	$50,000	-$185,336	-78.8%
Adjustments	0	-79,959	-40,000	39,959	
Adjusted General Fund	**$72,500**	**$155,377**	**$10,000**	**-$145,377**	**-93.6%**
Adjusted Grand Total	**$72,500**	**$155,377**	**$10,000**	**-$145,377**	**-93.6%**

Note: Includes targeted reversions, deficiencies, and contingent reductions.

- The Governor's proposed appropriation into the State Reserve Fund totals $10 million.

- The Budget Reconciliation and Financing Act (BRFA) of 2017 reduces the statutory $50 million by $40 million.

- In fiscal 2017, the legislature restricted $80 million in appropriations for other purposes. The Administration did not fund any of the programs for which funds were restricted.

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

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Analysis in Brief

Major Trends

Rainy Day Fund Balance Remains at 5.0% of Revenues for the Eleventh Consecutive Year: If the fund balance is below 7.5%, the Governor is required to appropriate at least $50 million into the fund. The BRFA of 2017 transfers $170 million out of the fund in fiscal 2017 and includes a $40 million contingent reduction in fiscal 2018. Both years end with a fund balance that is 5.0% of general fund revenues.

Issues

Report Examining Revenue Volatility Recommends Changes to the Revenue Forecasting Process and the Rainy Day Fund: The 2016 *Joint Chairmen's Report* required that the Department of Budget and Management (DBM), the Comptroller of Maryland, and the Department of Legislative Services (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 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. SB 371 and HB 503, which propose to codify the recommendations of the report, have been introduced. **DLS recommends that the General Assembly adopt appropriate implementing legislation.**

Neighborhood BusinessWorks Program Loan Repayments Should Be Deposited into 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 and resulted in the transfer of $2.5 million from the Catastrophic Event Account to the Department of Housing and Community Development (DHCD). **DLS recommends that the budget committees adopt language requiring DBM, in consultation with DHCD, to submit a report providing the aggregate status of all outstanding loans and the status of current and proposed repayments to the Catastrophic Event Account by January 1, 2018.**

Recommended Actions

1. Add a section requiring the Department of Budget and Management and the Department of Housing and Community Development to report on a Catastrophic Event Account repayment plan.

Updates

Comparison of AAA-rated States' Rainy Day Funds: There are nine states with AAA bond ratings from the three major rating agencies. They are Delaware, Georgia, Maryland, Missouri, North Carolina, Tennessee, Texas, Utah, and Virginia. The update examines the reserve fund policies and recent actions in these states.

Statutory Changes to Program Open Space Repayment: In fiscal 2006, $90 million in transfer tax revenues that would otherwise have supported Program Open Space (POS) was transferred to the General Fund. Chapter 10 of 2016 mandates repayment to POS for this and other transfers between fiscal 2018 and 2029. Any future transfers after fiscal 2018 would have to be repaid over three subsequent years.

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 three of these accounts is discussed in more detail in this analysis. Discussion of the Sunny Day Fund can be found in the analysis of the Department of Commerce.

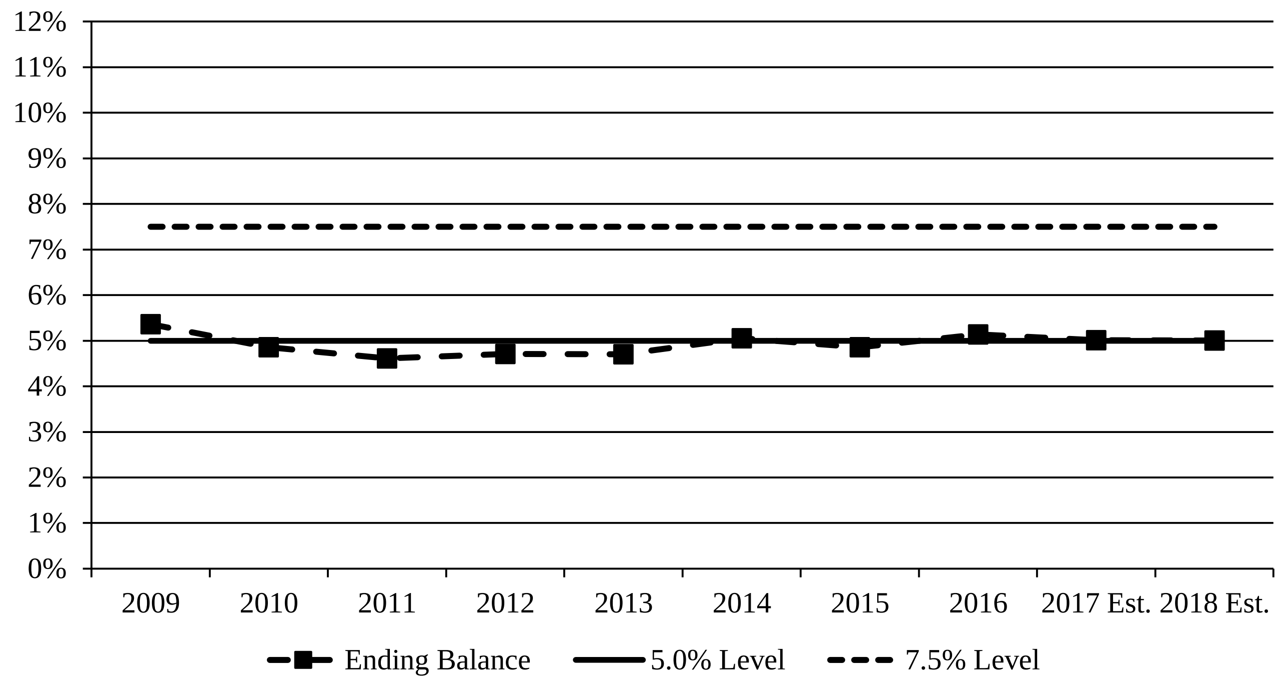
Performance Analysis: Managing for Results

1. Rainy Day Fund Balance Remains at 5.0% of Revenues for the Eleventh Consecutive Year

Section 7-311 of the State Finance and Procurement Article establishes a target reserve balance of 7.5% of estimated general fund revenues. Except for fiscal 2017 and 2018, the Governor is authorized to expend balances down to 5.0% in the annual budget bill. In fiscal 2017 and 2018, legislation is required to transfer any fund balance below 7.5% of 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 balance remained at 5% throughout the recession. Since the recession ended, the State has not increased its balance.

Exhibit 1
Rainy Day Fund End-of-year Balances
Fiscal 2009-2018 Est.



Source: Department of Budget and Management, January 2017

Proposed Budget

Exhibit 2 shows that the fiscal 2017 allowance is $10 million. Since the Rainy Day Fund balance is less than 7.5% of general funds, the Administration is required to appropriate at least $50 million annually. HB 152, the Budget Reconciliation and Financing Act (BRFA) of 2017, includes a $40 million contingent reduction, effectively reducing the appropriation to $10 million. This is the minimum amount required to maintain a fund balance that is at least 5% of general funds.

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

How Much It Grows:	General Fund	Total
Fiscal 2016 Actual	$72,500	$72,500
Fiscal 2017 Working Appropriation	155,377	155,377
Fiscal 2018 Allowance	10,000	10,000
Fiscal 2017-2018 Amount Change	-$145,377	-$145,377
Fiscal 2017-2018 Percent Change	-93.6%	-93.6%

Where It Goes:	
Rainy Day Fund Changes	
Remove fiscal 2017 Rainy Day Fund appropriation	-$155,377
Statutorily required appropriation	50,000
Governor's contingent reduction	-40,000
Total	**-$145,377**

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

The State also has a "sweeper." 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 Rainy Day Fund. This appropriation is made to the budget two years after the unassigned general fund surplus is realized. The 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 limited to $50 million.

Chapter 10 of 2016 further amended the sweeper so that:

- for fiscal 2017 to 2019, for surpluses above $10 million, an amount equal to up to $50 million goes to the State Retirement and Pension System (SRPS);

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

- for fiscal 2021 and beyond, for surpluses above $10 million, an amount equal to unappropriated surpluses above $10 million will be appropriated into the Rainy Day Fund.

HB 152, the BRFA of 2017, includes a contingent reduction to the pension sweeper for fiscal 2018. This reduces general funds by $50.0 million[1], special funds by $3.6 million, federal funds by $2.1 million, and current unrestricted funds by $2.4 million.

The fiscal 2017 appropriation totaled $235.3 million. The General Assembly amended the bill to restrict $80 million for other purposes. The restriction required the Administration to either fund all of the priorities or the funds would revert to the General Fund. The Governor did not fund any of these programs, so the entire $80 million will revert to the General Fund at the end of fiscal 2017. **Appendix 3** shows what programs were funded.

Exhibit 3 provides an overview of State Reserve Fund activity between fiscal 2017 and 2018. Detail for each account may be found in **Appendix 4** (Rainy Day Fund), **Appendix 5** (DPA), and **Appendix 6** (Catastrophic Event Account).

[1] $1.2 million of this total represents the share of the reduction to the Judiciary and the Legislative Branch, which the Governor cannot reduce. The Administration reflects the amount as expected reversions.

Exhibit 3
State Reserve Fund Activity
Fiscal 2017-2018
($ in Millions)

	Rainy Day Fund	Dedicated Purpose Acct.	Catastrophic Event Acct.
Balances June 30, 2016	**$832.4**	**$1.8**	**$9.6**
Fiscal 2017 Appropriations	235.3	0.0	0.0
Transfer to General Fund	-170.0	0.0	0.0
Information Technology Upgrades	0.0	-1.8	0.0
Excess Revenue/Transfers	-80.0[1]	0.0	0.0
Ellicott City Flood Relief Assistance	0.0	0.0	-2.5
Interest and Other Net Revenues	14.8	0.0	0.0
Estimated Balances June 30, 2017	**$832.6**	**$0.0**	**$7.1**
Fiscal 2018 Appropriations	50.0	0.0[2]	0.0
Contingent Reduction	-40.0	0.0	0.0
Interest and Other Net Revenues	17.7	0.0	0.0
Estimated Balances 6/30/18	**$860.3**	**$0.0**	**$7.1**
Percent of Revenues in Reserve	**5.0%**		

[1] The fiscal 2017 budget bill restricted approximately $80 million from within the Rainy Day Fund appropriation to fund other projects and programs. With the Administration's decision to not release those funds for the identified purposes, the restricted funds will revert to the General Fund at the close of fiscal 2017.

[2] State law requires that an additional $50 million be appropriated to reduce the unfunded pension liability. The Administration has chosen to increase the pension contribution rates, instead of appropriating this in the Dedicated Purpose Account. The Administration's Budget Reconciliation and Financing Act has also proposed to delete this requirement in fiscal 2018.

Source: Department of Budget and Management, January 2017

Issues

1. Report Examining Revenue Volatility Recommends Changes to the Revenue Forecasting Process and the Rainy Day Fund

The 2016 *Joint Chairmen's Report* required that the Department of Budget and Management, (DBM), the Comptroller of Maryland, and the Department of Legislative Services (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 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.

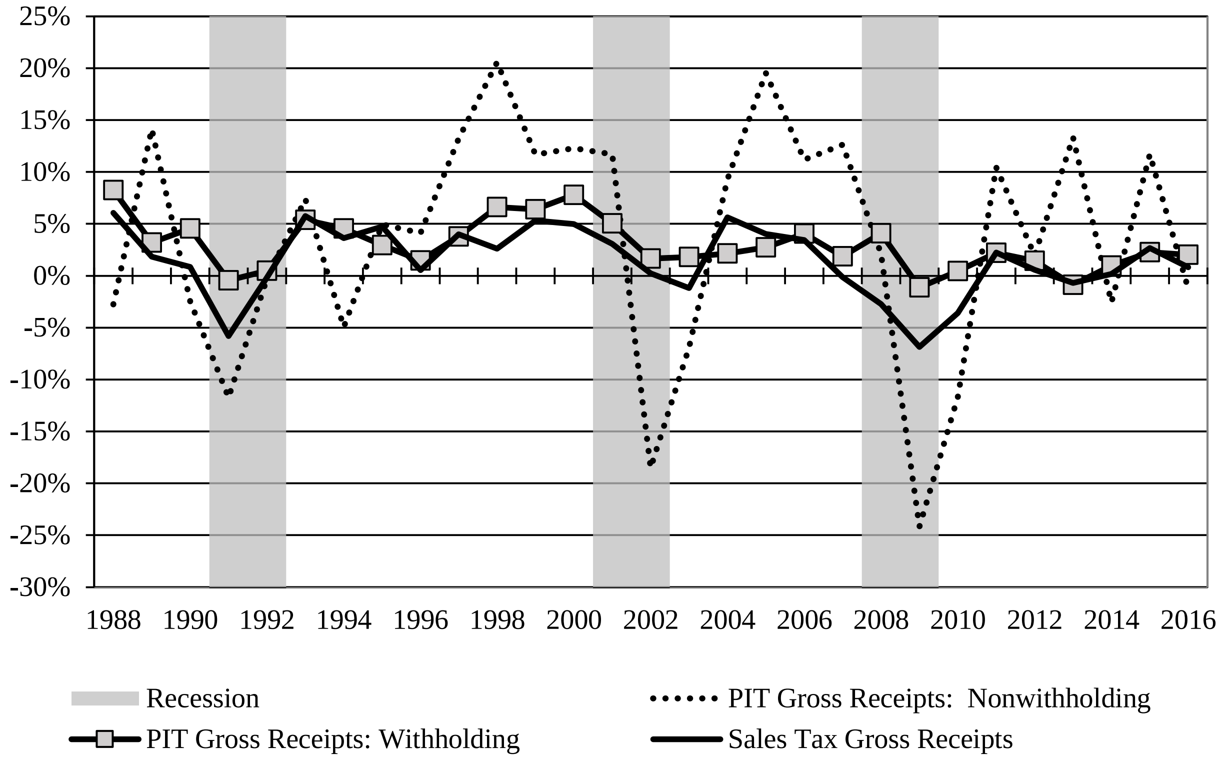
Due to the ups and downs of the business cycle, revenue volatility is unavoidable for State governments. States that rely heavily on highly volatile revenue sources like capital gains to fund ongoing spending are especially vulnerable to the vagaries of the economy. Minimizing reliance on unstable revenue 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 objective is to develop a methodology that identifies revenues that are less likely to materialize so that the State is less likely to approve unsustainable operating budgets.

Income Tax Volatility

General fund revenue growth varies considerably for a number of reasons. The two main revenue sources, personal income and sales tax, are largely driven by the economy; thus, growth moves up and down across the business cycle. Income and sales taxes account for 80% of general fund revenue. Gross receipts for income taxes can be broken down into two categories – payroll withholding and nonwithholding. Nonwithholding consists of quarterly estimated payments and final payments with returns from both individuals and fiduciaries. Withholding accounts for 78% of income tax gross receipts on average.

Exhibit 4 shows the year-over-year percent change for the three revenue sources: (1) sales tax gross receipts; (2) income tax gross receipts from withholding; and (3) income tax gross receipts from nonwithholding. The series have been adjusted for major law changes and inflation. The period – fiscal 1988 to 2016 – covers three recessions, which began in fiscal 1990, fiscal 2001, and the Great Recession that started in fiscal 2008.

Exhibit 4
Inflation-adjusted Year-over-year Percent Change
Fiscal 1988-2016



PIT: personal income tax

Note: Revenues have been adjusted for major law changes and inflation.

Source: Comptroller of Maryland

While all three revenue sources vary with the business cycle, nonwithholding is substantially more volatile than either withholding or sales tax receipts. Withholding and sales taxes, not surprisingly, tend to move together as they are both dependent on employment and wage growth. Sales tax receipts, however, tend to weaken more than withholding during recessions. Income tax nonwithholding swings significantly with years of double-digit gains and double-digit declines. In addition, the volatility of nonwithholding has increased as the gyrations during the 2001 and 2008 recessions were considerably more pronounced than during the 1990 recession.

The underlying variability in taxpayers' incomes is what drives the volatility of the income tax. Nonwithholding payments are generally related to income other than wages, and this income is often quite volatile, especially capital gains. In 2014, capital gains income totaled $9.5 billion for Maryland residents and generally accounts for 5% to 6% of net State income tax revenues.

Capital gains income is notable for being highly concentrated among high-income taxpayers. As a result, the behavior of a relatively small group of taxpayers can significantly impact the level of capital gains income in any given year. **Exhibit 5** shows the portion of capital gains income accounted for by each income class using data provided by the Comptroller of Maryland. The top 1.0% of Maryland tax returns generally account for around 70.0% to 75.0% of all capital gains income. The top 0.1% (around 2,600 returns) normally contributes close to 50.0% of capital gains. Tax year 2013 was an unusual year in that capital gains for the highest income taxpayers fell substantially while increasing for everyone else.

Exhibit 5
Maryland Taxable Capital Gains Income

	Tax Year 2010		Tax Year 2011		Tax Year 2012		Tax Year 2013	
Income Class	**Returns**	**Share of Capital Gains Income**	**Returns**	**Share of Capital Gains Income**	**Returns**	**Share of Capital Gains Income**	**Returns**	**Share of Capital Gains Income**
Top 0.1%	2,538	49.7%	2,577	54.0%	2,611	48.8%	2,690	35.7%
>0.1% and <=1%	22,851	23.3%	23,198	20.5%	23,501	23.5%	24,213	20.4%
>1% and <=5%	101,556	11.5%	103,102	10.5%	104,452	11.8%	107,615	16.1%
>5% and <=10%	126,945	4.0%	128,878	3.6%	130,564	3.9%	134,518	6.9%
>10% and <=25%	380,835	4.1%	386,632	4.0%	391,693	4.1%	403,554	8.0%
>25% and <=50%	634,725	2.1%	644,388	2.4%	652,821	2.5%	672,590	4.8%
>50% and <=75%	634,725	0.8%	644,387	1.1%	652,821	1.6%	672,590	2.9%
>75% and <=100%	634,726	4.5%	644,388	3.8%	652,821	3.9%	672,591	5.1%
	2,538,901	**100.0%**	**2,577,550**	**100.0%**	**2,611,284**	**100.0%**	**2,690,361**	**100.0%**
Top 1%		73.0%		74.5%		72.3%		56.1%

Note: Date includes full-year Maryland residents only. The income class is defined by net Maryland Income.

Source: Comptroller of Maryland

The shortcoming associated with estimating excess capital gains is that the State does not get reliable capital gains data in time to make an informed decision. Reliable data is not available until after the final income tax filing in the fall. By the time the data becomes available, it is almost one year after the close of the tax year.

Report Recommends Capping Nonwithholding Income Tax Revenues

Many states, including Maryland, limit how much spending can grow, often tied to growth in population, inflation, personal income, or some combination of these. A few states (including Colorado, Florida, Michigan, and Missouri) apply a limit to the revenue estimate itself. Recently, some states have focused specifically on the most volatile aspects of the personal income tax. While not altering the revenue forecast itself, California and Massachusetts have sweeper provisions tied to tax revenue from capital gains income.

Virginia has taken a different approach, focusing on nonwithholding income tax revenue rather than capital gains specifically. Rather than a sweeper provision, Virginia puts a cap on nonwithholding income tax revenues, referred to as a collar, beginning with the fiscal 2015 budget. The cap involves limiting the estimated nonwithholding income tax revenue to a certain share of estimated total general fund revenues.

After a thorough review of the strategies adopted by other states, DBM, the Comptroller's Bureau of Revenue Estimates, and DLS recommend that the State consider limiting estimated revenues from nonwithholding income tax revenues. This should be done by placing a cap on the amount of nonwithholding revenues. To estimate the cap, the State should determine the average share on nonwithholding revenues to total general fund revenues. If nonwithholding revenues exceed this collar, amounts in excess will not be appropriated in the upcoming budget. The collar should be estimated each time that the Board of Revenue Estimates (BRE) prepares a revenue estimate. Since this amount can become rather substantial, the State may consider placing a limit on how large the collar can become. For instance, the collar may be limited to 1% of revenues. This approach has the following advantages:

- ***Encourages Savings at Height of Business Cycle:*** In years that revenues are increasing at unsustainable levels, the collar reduces the available revenues and spending while creating additional reserves. In years that revenues are growing at sustainable levels, revenues and spending are unaffected.

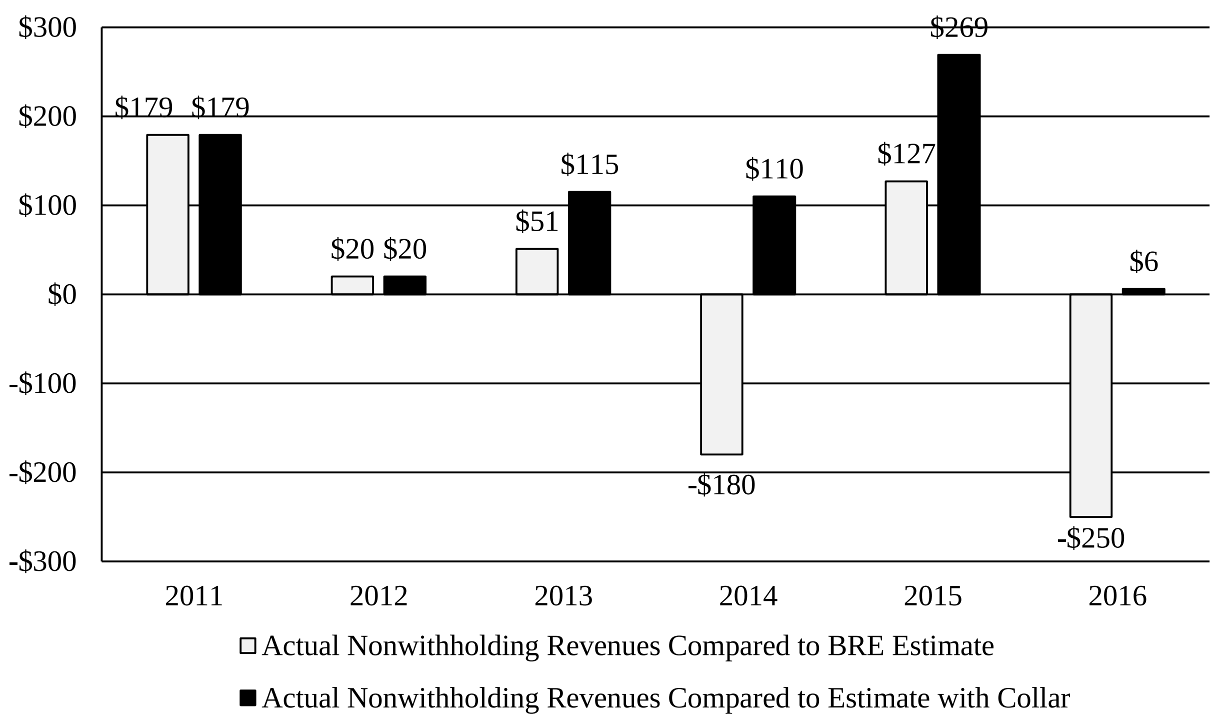
- ***Promotes Structural Balance:*** By constraining the amount of unsustainable capital gains revenues built into the State's revenue forecast, the collar will encourage the funding of ongoing spending with more stable sources of revenue. A sluggish or recessionary economy will still produce structural deficits, but the collar should mitigate the magnitude of such deficits.

- ***Relies on Real-time Data to Calculate Collar:*** The State collects nonwithholding data during the fiscal year. As such, calculations made during the year are based on current revenue collections. This contrasts with capital gains specific data that does not become available until well after the close of the fiscal year. The availability of data during the year makes it easier to prepare reliable estimates. It should be noted, however, that since the State collects both the State and local income taxes, payments from taxpayers are always a mix of the two. Therefore, general fund nonwithholding receipts will have to be estimated using an estimate of the State share of total State and local collections.

- ***Collar Is Self-adjusting:*** If the State adopts an approach that uses a 10-year rolling average to compute the collar, the collar estimate will be adjusted each year to reflect the most recent actual data. As the economy changes, the collar changes with it.

In four of the last six fiscal years, the collar would have reduced the revenue forecast leaving less money available for appropriation. Consistent with the intent of the collar, no revenues would have been withheld during the recession (fiscal 2011 and 2012), and only minimal revenues would have been captured by the collar as the economic recovery began in fiscal 2013. While the collar would have captured substantial sums in each of the last three years, the estimates of nonwithholding revenues fell far short of the actuals in two of those years. **Exhibit 6** shows that, had the collar been in place in fiscal 2016, the State would have closed the year with nonwithholding revenues $6 million in excess of expectations rather than $250 million below the estimate.

Exhibit 6
Impact of Cap on Closeout
Fiscal 2011-2016
($ in Millions)



BRE: Board of Revenue Estimates

Source: Department of Legislative Services

The Spending Affordability Committee recommended that the appropriate committees consider legislation to mitigate the impact of revenue volatility on the State budget.

SB 371 and HB 503, which propose to codify the recommendations of the report, have been introduced. The Administration has also introduced HB 430/SB 306 with a similar purpose. The bills provide for a methodology to estimate excess nonwithholding, increase Rainy Day Fund balances, and determine how excess funds are appropriated. The legislation proposes a cap on nonwithholding revenues based on the 10-year average of nonwithholding revenues. This process begins with fiscal 2020, to give BRE and the agencies participating in the board time to make any necessary changes. The bills also establish the Extraordinary Nonwithholding Income Tax Revenues Fund (ENITRF), into which the excess revenues are deposited. The legislation also includes rules that prioritize how these excess funds are to be appropriated. The rules are that:

- in years that end with a budget gap, the first use of the funds is to close the budget gap in the current year;
- if there is no budget gap, an amount equivalent to the remaining funds in the ENITRF is appropriated into the Rainy Day Fund if the fund balance is less than 10%. This appropriation is limited to $50 million;
- if the revenues exceed $50 million, an amount equivalent to the lesser of $100 million or the remaining funds in the ENITRF is appropriated to pay-as-you-go (PAYGO) capital projects. This appropriation is limited to $100 million;
- if the revenues exceed $150 million, an amount equivalent to the remaining funds in the ENITRF is appropriated is appropriated so that:
    - one-half of the remaining balance supports PAYGO capital projects, and
    - one-half is appropriated into the Rainy Day Fund. The appropriation is the lessor of the remaining balance in the fund or whatever amount is required for the Rainy Day Fund balance to exceed 10% of general fund revenues; and
- once the Rainy Day Fund's balance exceeds 10% of general fund revenues, the remaining funds are deposited into the Postretirement Health Benefits Trust Fund.

DLS recommends that the General Assembly adopt appropriate implementing legislation.

2. Neighborhood BusinessWorks Program Loan Repayments Should Be Deposited into 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.

Budget amendment 011-17 transferred $2.5 million from the Catastrophic Event Account into the Department of Housing and Community Development’s (DHCD) Neighborhood BusinessWorks program to provide loans to businesses. As required by State law, the Legislative Policy Committee (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. DLS also recommended that DHCD issue a report each January 1 that details the number and amount of loans provided, the outstanding balance of these loans, and the number and amount of any forgiven loans. **DLS recommends that the budget committees adopt language requiring DBM, in consultation with DHCD, to submit a report providing the aggregate status of all outstanding loans and the status of current and proposed repayments to the Catastrophic Event Account by January 1, 2018.**

Recommended Actions

1. Add the following section:

<u>SECTION __. AND BE IT FURTHER ENACTED, That $100,000 of the general fund appropriation for the Department of Budget and Management (DBM) Executive Direction program F10A01.01 and $100,000 for the special fund appropriation for the Department of Housing and Community Development (DHCD) Office of the Secretary program S00A20.01 made for the purpose of operations may not be expended until DBM, in consultation with DHCD, submits a report to the budget committees on the balance of outstanding loans and current and proposed repayment for loans made by the DHCD's Neighborhood BusinessWorks program. It is the intent of the budget committees that DHCD repay the Catastrophic Event Account for $2,500,000 transferred from the account to DHCD. The report shall be submitted by January 1, 2018, and the budget committees shall have 45 days to review and comment. Funds restricted pending the receipt of a report may not be transferred by budget amendment or otherwise to any other purpose and shall revert to the General Fund or be cancelled if the report is not submitted to the budget committees.</u>

Explanation: In September 2016, $2.5 million was transferred from the Catastrophic Event Account into the DHCD Neighborhood BusinessWorks program to provide loans to businesses in Ellicott City. As part of its review, the Legislative Policy Committee recommended that DHCD develop a process by which the funds or repaid loans are deposited into 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 1, 2018.

Information Request	**Authors**	**Due Date**
Report on Catastrophic Event Account repayment	DBM DHCD	January 1, 2018

Updates

1. Comparison of AAA-rated States' Rainy Day Funds

Nine states have AAA ratings from all three bond rating agencies: Delaware, Georgia, Maryland, Missouri, North Carolina, Tennessee, Texas, Utah, and Virginia. All AAA-rated states have a Rainy Day Fund. Tennessee, which was upgraded to AAA from Standard and Poor's in May 2016, is the newest member of this group. **Exhibit 7** compares reserve fund policies. Most states' Rainy Day Fund balances were substantially reduced from fiscal 2007 to 2010. This was due to revenue reductions attributable to the Great Recession. Texas, which receives substantial energy revenues, did not substantially reduce Rainy Day Fund balances. Delaware had never used its Rainy Day Fund.

Recent State Rainy Day Fund Actions

AAA-rated states had built up their Rainy Day Fund balances before the 2008 recession began. In response to the downturn, a number of states have withdrawn funds from their reserves. Examples of states' actions include:

- ***Delaware:*** Delaware has not used the balance of its reserve account since its inception. Its account ended fiscal 2016 with a $215.0 million balance, which is 5.0% of general fund revenues.

- ***Georgia:*** The Revenue Shortfall Reserve's balance totaled $1,545.0 million in fiscal 2007. Funds were transferred out of the account to help balance the budget after the recession, with the balance declining to $104.0 million at the end of fiscal 2009 (equal to 1.0% of revenues). The fund has been replenished, with a balance of $2,033.0 million at the end of fiscal 2016. This represents about 9.1% of prior year revenue.

- ***Missouri:*** The Budget Reserve Fund balance has been used to help balance budgets in recent years. The balance was $585.6 million at the end of fiscal 2016. This is about 6.7% of net general fund revenue collections.

- ***North Carolina:*** The projected balance for the end of fiscal 2008 was $786.6 million, which was approximately 4.0% of the prior year's general fund appropriation. The state used some of these funds in fiscal 2009; the account balance declined to $150.0 million. Appropriations to the reserve account increased the fund balance to $1,101.6 million by the end of fiscal 2016, bringing the balance to 5.2% of the prior year's appropriation.

Exhibit 7
AAA States' Rainy Day Funds

State	Fund Name	Determination of Fund Size	Procedure for Expenditures
Maryland	Revenue Stabilization Account	Statutory 7.5% of general fund revenues.	Authorization in legislation or budget bill for balances above 5.0%. Separate legislation to spend balance below 5.0%[1].
Delaware	Budget Reserve Account	Excess unencumbered funds, no greater than 5.0% of gross general fund revenues set by joint resolution for the next fiscal year.	Three-fifths vote of the legislature for unanticipated deficit or revenue reduction resulting from legislative action.
Georgia	Revenue Shortfall Reserve	Capped at 15.0% of the prior year's net revenue.	The Governor can spend balances over 4.0%, but not below 4.0% unless there is a revenue shortfall at the end of a fiscal year. A mid-year allocation is made for education if revenues exceed estimates by 1.0% or more at closeout.
Missouri	Budget Reserve Fund	Capped at 10.0% of net general revenue. If the balance is less than 10.0.%, general revenues appropriated into fund.	Up to one-half of the fund balance may be transferred upon a request from the Governor after he has either declared an emergency or reduced expenditures below their appropriations due to a cash shortfall, and a two-thirds super majority vote by the legislature.
North Carolina	Savings Reserve Account	July 2007 established a goal that the balance equal at least 8.0% of the prior years' general fund operating budget.	Appropriations by the General Assembly.

State	Fund Name	Determination of Fund Size	Procedure for Expenditures
Tennessee	Tennessee Reserve for Revenue Fluctuations	State law requires that the Governor recommend appropriations if the fund balance is below 8.0% of general fund revenues. The law requires that these appropriations are at least 10.0% of the growth in revenues for general and education funds.	The law allows the Commissioner of Finance and Administration to transfer funds if expenses exceed appropriated funds. The law requires that the General Assembly be notified and have a committee hearing, but no vote of the General Assembly is required.
Texas	Economic Stabilization Fund	The fund receives an amount equal to 75.0% of oil and natural gas production revenues in any fiscal year that exceeds fiscal 1987 collections and one-half of any unencumbered General Revenue Fund (GRF) balance at surplus at the end of each biennium. The fund balance cannot exceed 10.0% of certain GRF revenues.	Funds may be appropriated to close a deficit caused by a revenue decline if approved by 3/5 of the legislature. For other purposes, 2/3 of the legislature must approve an appropriation.
Utah	General Fund Budget Reserve Account and Education Fund Budget Reserve Account	25.0% of end-of-year general fund surplus is deposited into the Budget Reserve Fund, and 25.0% of any education fund revenue surplus is deposited in the Education Reserve Fund. An additional 25.0% of any surplus is deposited when funds have been used until balances are replenished to prior levels. Automatic year-end deposits are capped at 8.0% of general fund appropriations and 9.0% of education fund appropriations for that year. The legislature can appropriate above those levels.	Expenditures are limited to retroactive tax refunds, legal settlements, and operating deficits, upon legislative approval.

State	Fund Name	Determination of Fund Size	Procedure for Expenditures
Virginia	Revenue Stabilization Fund	Capped at 15.0% of average annual tax revenues on income and retail sales tax receipts for the three years immediately preceding that fiscal year.	Legislative appropriation of the lesser of the deficit or one-half of the fund's balance if income and sales tax revenue falls more than 2.0% below projections in the enacted budget.

[1]Except for fiscal 2017 and 2018, which require separate legislation to transfer any amount below 7.5%.

Source: State Legislative Fiscal Offices, January 2017

- ***Tennessee:*** Received AAA ratings from all major rating agencies in May 2016. The State's Rainy Day Fund ended fiscal 2016 with a $568.0 million balance. This is 5.0% of general and education fund revenues.

- ***Texas:*** Unlike most states, Texas' Economic Stabilization Fund increased its ending balances from fiscal 2007 ($1.3 billion) to 2010 ($7.7 billion). Funds increased because of high levels of oil and natural gas production transfers and limited use of the fund. In fiscal 2011, $3.2 billion was transferred to reduce the projected budget shortfall. Another $1.9 billion was transferred in a supplemental appropriation to support wildfire and water development board projects. At the end of fiscal 2016, the fund balance was $10.4 billion, which is 6.4% of general fund revenues.

- ***Utah:*** The general fund Budget Reserve Account and Education Fund Budget Reserve Account balances peaked at $429.0 million at the end of fiscal 2008. Funds were withdrawn, and the balances are actually at $210.0 million at the end of fiscal 2010. At the end of fiscal 2013, the fund balances increased to $491.0 million. Fund balances are just under 8.2% of general and education fund appropriations.[2] The Administration does not propose to withdraw additional funds. In addition to any required fund balances, the Governor's proposed fiscal 2015 budget includes an additional $1.0 million to the balances.

- ***Virginia:*** The Revenue Stabilization Fund's balance peaked at the end of fiscal 2007 at $1.19 million. Funds were withdrawn to help balance post-recession budgets, leaving the fund with a balance of $295.2 million at the end of fiscal 2010. At the end of fiscal 2014, the fund balance was $687.5 million. The fund was used again in fiscal 2015 and 2016, leaving a $281.7 million balance the end of fiscal 2016.

Exhibit 8 summarizes how states that were rated AAA from the three major rating agencies reacted to the Great Recession. They can be divided into three groups:

- Delaware and Missouri took little or no actions;

- Utah moderately used the fund; and

- Georgia, North Carolina, and Virginia aggressively used their rainy funds to the point that they were almost depleted.

[2] In Utah, substantial revenues, such as individual and corporate income taxes, are deposited into the education fund instead of the General Fund. Since these revenues are general fund revenues for other states, the Rainy Day Fund balance comparison to general funds includes education funds.

Exhibit 8
AAA-rated States' Rainy Day Fund Responses to Great Recession

State	Pre-recession Balance	Response to Recession	Assessment
Limited Use			
Delaware	5.0% of revenues in fiscal 2007 and 2008	Maintained 5.0% of revenues in fiscal 2009 and 2010	No Rainy Day Fund actions taken
Missouri	7.5% of general fund revenue	Small withdrawals but maintained balance near statutory limit	No substantial Rainy Day Fund actions taken
Moderate Use			
Utah	8.0% of revenues in fiscal 2008	Withdrew funds and reduced balance to 5.0% of revenues in fiscal 2009 and 2010	Moderate use of fund to manage recession cash flows
Aggressive Use			
Georgia	9.0% of revenues in fiscal 2007	Withdrew funds and reduced balance to 1.0% of revenues by fiscal 2009	Aggressively used funds to manage recession cash flows
North Carolina	4.0% of revenues in fiscal 2008	Withdrew funds and reduced balance to 1.0% of revenues by fiscal 2009	Aggressively used fund to manage recession cash flows
Virginia	8.0% of revenues in fiscal 2007	Withdrew funds and reduced balance to 2.0% of revenues by fiscal 2010	Aggressively used funds to manage recession cash flows

Source: State Budget Offices; State Legislative Fiscal Offices

2. Statutory Changes to Program Open Space Repayment

In 2006, legislation amended Section 13-209 of the Tax – Property Article that any transfer tax revenues transferred to the General Fund from the transfer tax special fund after fiscal 2005 had to be repaid by the General Fund beginning in fiscal 2012. The law requires that an amount equivalent to unassigned general fund revenues exceeding $10 million be appropriated into the transfer tax special fund. The maximum annual transfer is limited to $50 million. This process is referred to as a "sweeper."

In fiscal 2006, $90 million in transfer tax revenues that would otherwise have supported Program Open Space (POS) was transferred to the General Fund.

Fiscal 2012 was the first year for repayment, but no funds were included in the budget due to mandate relief provided in budget reconciliation legislation.

The fiscal 2013 budget included a mandated appropriation of $50 million but was deleted by the Governor in budget reconciliation legislation as part of the plan to balance the budget.

The appropriation is included in the fiscal 2014 allowance with a similar proposal to again forego repayment, tied to the BRFA of 2013, which also defers repayment until fiscal 2016.

The BRFA of 2015 delayed the earliest repayment until fiscal 2019.

Chapter 10 of 2016 finally settles this issue. Provisions are established that mandate general fund appropriations over multiple years that represent reimbursement for the $90 million transferred in fiscal 2006:

- $5 million to be appropriated in fiscal 2018 to the Maryland Agricultural and Resource-Based Industry Development Corporation to provide grants for the use of the Next Generation Farmland Acquisition Program;

- $45 million to be appropriated in fiscal 2019, 2020, and 2021 ($15 million in each fiscal year) to the transfer tax special fund, to be allocated according to an existing allocation among POS, the Agricultural Land Preservation Fund, the Rural Legacy Program, and the Heritage Conservation Fund; and

- $40 million to be appropriated in annual amounts of $6 million in fiscal 2019 through 2024 and $4 million in fiscal 2025 for park development and critical maintenance of State projects located on lands managed by the Department of Natural Resources for public purposes.

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

	General Fund	Special Fund	Federal Fund	Reimb. Fund	Total
Fiscal 2016					
Legislative Appropriation	$200,000	$0	$0	$0	$200,000
Deficiency Appropriation	12,500	0	0	0	12,500
Budget Amendments	-118,565	0	0	0	-118,565
Reversions and Cancellations	-21,435	0	0	0	-21,435
Actual Expenditures	**$72,500**	**$0**	**$0**	**$0**	**$72,500**
Fiscal 2017					
Legislative Appropriation	$235,336	$0	$0	$0	$235,336
Cost Containment	0	0	0	0	0
Budget Amendments	0	0	0	0	0
Working Appropriation	**$235,336**	**$0**	**$0**	**$0**	**$235,336**

Note: Does not include targeted reversions, deficiencies, and contingent reductions Numbers may not sum to total due to rounding.

Fiscal 2016

The fiscal 2016 Rainy Day Fund's legislative appropriation totaled $200.0 million. Actual expenditures totaled $72.5 million. This difference is attributable to:

- a $10.0 million deficiency appropriation into the Catastrophic Event Account;

- a $2.5 million deficiency appropriation into the Dedicated Purpose Account to upgrade obsolete information technology hardware and software across State agencies. The concern was that current hardware and software posed a security risk; and

- transferring $140.0 million out of the Rainy Day Fund. These funds were restricted by the General Assembly for other purposes, including:

  - $68.7 million to restore a 2% general salary increase that State employees received on January 1, 2016;

  - $40.8 million to support Medicaid and other entitlement programs;

  - $7.4 million to support State agencies;

  - $1.7 million for the Maryland State Department of Education nonpublic placement State aid; and

  - $21.4 million was reverted to the General Fund.

Fiscal 2017

The fiscal 2017 legislative appropriation is $235.3 million. To date, there have not been any transfers out of the Reserve Fund.

Appendix 2
Fiscal Summary
State Reserve Fund

Program/Unit	FY 16 Actual	FY 17 Wrk Approp	FY 18 Allowance	Change	FY 17 - FY 18 % Change
01 Revenue Stabilization Account	$ 50,000,000	$ 235,335,792	$ 50,000,000	-$ 185,335,792	-78.8%
02 Dedicated Purpose Account	12,500,000	0	0	0	0%
04 Catastrophic Event Account	10,000,000	0	0	0	0%
Total Expenditures	**$ 72,500,000**	**$ 235,335,792**	**$ 50,000,000**	**-$ 185,335,792**	**-78.8%**
General Fund	$ 72,500,000	$ 235,335,792	$ 50,000,000	-$ 185,335,792	-78.8%
Total Appropriations	**$ 72,500,000**	**$ 235,335,792**	**$ 50,000,000**	**-$ 185,335,792**	**-78.8%**

Note: Does not include targeted reversions, deficiencies, and contingent reductions.

Appendix 3
Rainy Day Fund Appropriations Restricted for Other Purposes
Fiscal 2017

Program	Amount
Program R00A02.03 Aid for Local Employee Fringe Benefits: To provide additional one-time funding to local education agencies to support a portion of their share of the actual normal cost of pensions for their teachers	$18,999
Program M00Q01.03 Medical Care Provider Reimbursements: To increase primary and specialty physician evaluation and management rates to 96% of Medicare	13,200
Program M00Q01.10 Medicaid Behavioral Health Provider Reimbursements: To increase psychiatrist evaluation and management rates to 96% of Medicare	880
Program M00Q01.03 Medical Care Provider Reimbursements: To increase funding over that provided in the fiscal 2017 budget to the Baltimore City Health Department for the Administrative Care Coordination Unit	500
Program M00Q01.03 Medical Care Provider Reimbursements: For lead remediation activities in the homes of Medicaid children with a confirmed elevated blood lead level of over 10 micrograms/deciliter	500
Facilities Renewal Fund: To provide funds for the repair and rehabilitation of State- owned capital facilities (Statewide)	15,000
Aging Schools Program: To provide additional grants for capital improvements, repairs, and deferred maintenance work at existing public school buildings	6,109
Public Safety Communication System: To provide funds to continue to design, construct, and equip a statewide unified public safety communication	9,190
Demolition of Buildings at the Baltimore City Correctional Complex: To provide funds to begin design and demolition of the buildings at the Baltimore City Correctional Complex	6,581
Maryland Agricultural Cost- Share Program: To provide funds for financial assistance for the implementation of best management practices that reduce soil and nutrient runoff from Maryland farms	6,000
Program N00G00.08 Assistance Payments: To provide funds to support a State supplement to the Food Supplement Program	1,000
National Great Blacks in Wax Museum	200
Maryland Business Roundtable on Education	300
Maryland Humanities Council	175

Y01A – State Reserve Fund

Program	Amount
Arts Everyday	38
901 Arts	38
Maryland Center for Construction Education and Innovation	250
Baltimore City Health Department: To fund the operation of Baltimore City Safe Streets Program	1,000
Total	**$79,959**

Source: Fiscal 2017 Budget Bill

Appendix 4

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 3.0% and 7.5% of projected general fund revenues, annual appropriations of at least $50.0 million must be made until the account balance reaches 7.5% of estimated general fund revenues. If the account balance is below 3.0%, State law requires an appropriation of at least $100.0 million.

- ***Sweeper Provision:*** State law requires that the Administration appropriate an amount equal to any unassigned general fund balance at closeout in excess of $10.0 million into the 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 10 of 2016 modified the sweeper so that:

  - for fiscal 2017 to 2019, for surpluses above $10.0 million, an amount equal to up to $50.0 million goes to the Pension System;

  - for fiscal 2020, for surpluses above $10 million, an amount equal to up to $50.0 million each year goes to the Rainy Day Fund and the Pension System on a dollar-for-dollar basis and amounts above $110.0 million go to the Rainy Day Fund; and

  - for fiscal 2021 and beyond, for surpluses above $10.0 million an amount equal to unappropriated surpluses above $10.0 million will be appropriated into the Rainy Day Fund.

Mechanisms for Transferring and Spending Funds

Except for fiscal 2017 and 2018, to transfer funds from the Rainy Day Fund requires specific authorization by an Act of the General Assembly or specific authorization in the budget bill if the transfer results in a Rainy Day Fund balance that is at least 5.0% of projected general fund revenue. To transfer an amount that would reduce the Rainy Day Fund balance below 5.0% requires the transfer to be authorized in an Act of the General Assembly other than the budget bill. The use of any balance below 7.5% requires separate legislation for fiscal 2017 and 2018.

Rainy Day Fund Activity

The following table illustrates fiscal 2014 through 2017 activity in the Rainy Day Fund. An appropriation totaling $55.3 million was made in fiscal 2014 to keep a minimum 5.0% fund balance. In fiscal 2015, the Board of Public Works withdrew $4.9 million of the appropriation to the fund. This amount was withdrawn because the Administration anticipated that this was the amount above the 5.0% fund balance target. The fiscal 2017 allowance included the required sweeper appropriation, which totaled $235.3 million. The budget was amended so that $80.0 million was restricted for other uses (see Appendix 3 for details.) The Governor's plan for fiscal 2017 includes a proposed transfer of $170.0 million to the General Fund. The fiscal 2018 allowance includes the required $50.0 million appropriation to the Rainy Day Fund, along with a $40.0 million contingent reduction in the Budget Reconciliation and Financing Act of 2017. The fund is expected to end fiscal 2018 with a fund balance that is equal to 5.0% of general fund revenues. In response to unrest in Baltimore City in April 2015, the Governor declared a State of Emergency and suspended Section 7-311 of the State Finance and Procurement Article. This allowed the Governor to transfer $13.1 million to support the State's response to the unrest.

Revenue Stabilization Account Status
Fiscal 2014-2018 Est.
($ in Millions)

	2014	2015	2016	2017 Est.	2018 Est.
Beginning Balance	**$700.4**	**$763.6**	**$773.5**	**$832.4**	**$832.6**
Appropriation	55.3	19.7	50.0	235.3	50.0
Transfer to General Fund	0.0	0.0	0.0	-170.0	0.0
Contingent Reduction	0.0	0.0	0.0	0.0	-40.0
BPW Reduction	0.0	-4.9	0.0	0.0	0.0
Transfer to BPW Contingent Fund	0.0	-13.1	0.0	0.0	0.0
Reverted to the General Fund	0.0	0.0	0.0	-80.0	0.0
Interest Earnings	7.9	8.1	8.9	14.8	17.7
Ending Balance	**$763.6**	**$773.5**	**$832.4**	**$832.6**	**$860.3**

BPW: Board of Public Works

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

Source: Department of Budget and Management, January 2017

Governor's Out-year Forecast

In the out-years, the Administration's Rainy Day Fund forecast projects that the fund balance increase to 5.7% through fiscal 2022. Since the fund balance is projected to be less than 7.5% of general fund revenues, a minimum \$50 million appropriation is assumed from fiscal 2019 to 2022. The Adminstration's plan is to keep these appropriations in the fund. Fiscal 2022 ends with an estimated balance of \$1,134 million.

Appendix 5

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 where 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 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 review and approval 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.

Dedicated Purpose Account Activity

The following table illustrates the activity in the DPA from fiscal 2014 through 2018. The account ends the period with no fund balance. In fiscal 2013, $10.0 million was appropriated to offset lost revenues attributable to federal sequestration. Funds were transferred in fiscal 2014 to the following agencies: $4.1 million to Maryland State Department of Education (MSDE) Head Start programs; $1.6 million to Department of Health and Mental Hygiene substance abuse programs; $1.4 million for Department of Aging nutrition and employment support; $1.2 million to support Department of Human Resources social service block grants; $0.8 million to support MSDE vocational rehabilitation services; $0.5 million to support Department of Labor, Licensing, and Regulations (DLLR) training and job placement programs; and $0.4 million to support DLLR adult education programs.

In fiscal 2016, $152.5 million was appropriated. This includes $140.0 million to fund legislative priorities, $10.0 million to reduce an unfunded liability in the Local Income Tax Reserve Account, and $2.5 million for information technology upgrades. In fiscal 2016, $118.6 million was restored and the remaining $21.4 million reverted to the General Fund. Information technology upgrades were made in fiscal 2016 and 2017.

Dedicated Purpose Account Status
Fiscal 2014-2018
($ in Millions)

	2014	2015	2016	2017	2018
Beginning Balance	**$10.0**	**$0.0**	**$0.0**	**$1.8**	**$0.0**
Appropriation:	**$0.0**	**$0.0**	**$152.5**	**$0.0**	**$0.0**
Information Technology Upgrades			2.5		
Local Income Tax Reserve Repayment			10.0		
Section 48 to Restore Funding			140.0		
POS Repayment for General Fund Transfers			0.0		
Transfers:	**-$10.0**	**$0.0**	**-$150.7**	**-$1.8**	**$0.0**
Local Reserve Account Repayment			-10.0		
Federal sequestration	-10.0				
Information Technology Upgrades			-0.7	-1.8	
Section 48 Initiatives Funded by Administration			-49.9		
Section 48 Salary Restoration			-68.7		
General Fund Reversion			-21.4		
Ending Balance	**$0.0**	**$0.0**	**$1.8**	**$0.0**	**$0.0**

POS: Program Open Space

Source: Department of Budget and Management, January 2017

Governor's Out-year Forecast

The Administration does not have any plans to appropriate any funds into the DPA through fiscal 2022.

Appendix 6
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 Rainy Day Fund.

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 and allow the committee 45 days to review and approve the proposed amendment.

Catastrophic Event Purpose Account Activity

The following table shows that the account's balance was $568,687 at the start of fiscal 2014. In fiscal 2014, $394,750 was provided to support the Military Department's deployment during severe snowstorms. In fiscal 2016, the Administration's budget includes a $10,000,000 deficiency appropriation. In response to snowstorms, $567,687 was transferred to the Military Department in fiscal 2016. DHCD's Neighborhood Business Development program received $2,500,000 to support Ellicott City's flood cleanup in fiscal 2017. The account is expected to close fiscal 2018 with a $7,103,243 balance.

Catastrophic Event Account
Fiscal 2014-2018
($ in Thousands)

	2014	2015	2016	2017	2018
Beginning Balance	**$568**	**$173**	**$173**	**$9,605**	**$7,105**
Appropriation	0	0	10,000	0	0
Snowstorms	-395	0	-568	0	0
Ellicott City Flood Relief	0	0	0	-2,500	0
Hurricane Sandy and Derecho Storm Relief	0	0	0	0	0
Ending Balance	**$173**	**$173**	**$9,605**	**$7,105**	**$7,105**

Source: Department of Budget and Management, January 2017