Department of Legislative Services
Maryland General Assembly
2006 Session

FISCAL AND POLICY NOTE

Senate Bill 542 (Senator Currie, *et al.*)
Budget and Taxation Appropriations

Operating Budget - Revenue Stabilization Account - Use and Minimum Appropriation

This bill increases the minimum account balance of the Revenue Stabilization Account (Rainy Day Fund) from 5% to 7.5% of the estimated general fund revenues. The bill also modifies the circumstances by which the Governor can transfer funds from the Rainy Day Fund to the State's general fund. If any transfer results in an account balance below 5% of the estimated general fund revenues, the transfer must be authorized by an Act of the General Assembly other than the State budget bill.

The bill takes effect July 1, 2006.

Fiscal Summary

State Effect: To reach the 7.5% target, the Rainy Day Fund account balance would have to increase by approximately $319.3 million in FY 2007. State revenues and expenditures would not be directly affected in FY 2007, however, absent action on the FY 2007 budget to retain a balance of at least 7.5% in the Rainy Day Fund, State expenditures in FY 2008 could be affected.

Local Effect: None.

Small Business Effect: None.

Analysis

Current Law: An annual appropriation must be made to the Rainy Day Fund whenever the account balance is less than 5% of the estimated general fund revenues for that fiscal year. If the account balance is between 3% and 5%, the annual appropriation must total at least $50 million or the amount necessary to reach the 5% target. If the account balance is below 3%, the annual appropriation must total at least $100 million.

The Governor may transfer funds from the Rainy Day Fund to the State's general fund if authorized by an act of the General Assembly or if specific authorization is provided in the budget bill. The General Assembly, through the amendment to the budget bill, can reduce the amount of funds that are transferred from the Rainy Day Fund.

In the budget for the second subsequent fiscal year, the Governor must appropriate into the Rainy Day Fund an amount equal to the unappropriated general fund balance at closeout in excess of $10 million. For example, fiscal 2005 closed with an unappropriated surplus totaling $603.3 million, thus the Governor's fiscal 2007 allowance includes a $593.3 million appropriation to the Rainy Day Fund. However, beginning in fiscal 2012, an amount equal to any unappropriated surplus between $11 million and $60 million must be appropriated to the transfer tax special fund until such time as a specified amount has been repaid to the transfer tax special fund.

Background: The Rainy Day Fund was established in 1986 to retain State revenues to meet future needs and to reduce the need for future tax increases by moderating revenue growth. The account consists of direct appropriations in the budget bill and interest earned from all reserve fund accounts except for the Joseph Fund Account. **Exhibit 1** shows the status of the Rainy Day Fund for fiscal 2003 through 2007.

Appropriations into the Rainy Day Fund were made each year except fiscal 2004. The appropriations are attributable to unappropriated general funds being swept into the Rainy Day Fund, as required by law. Funds were transferred out of the Rainy Day Fund and into the general fund in fiscal 2003 and 2005. In fiscal 2006, funds were transferred out to support specific capital projects. In fiscal 2007, the Governor proposes transferring $770 million from the Rainy Day Fund into the Dedicated Purpose Account. This provides $670 million for fiscal 2008 expenditures and $100 million for the State's unfunded retiree health care liability.

From fiscal 2003 to 2005, the Rainy Day Fund balance remained at around 5% of general fund revenues. Each year, the General Assembly appropriated sufficient funds to provide a 5% end-of-year fund balance. The balance did not end the year at 5% in fiscal 2004 and 2005 because actual revenues exceeded estimated revenues. Beginning in fiscal 2006, the law was changed so that only the Board of Revenue Estimates' December (immediately prior to the legislative session) general fund estimate is used. The ratio will no longer drop below 5% when revenues exceed expectations. In fiscal 2006, the Rainy Day Fund balance is $190 million over the 5% targeted minimum fund balance. The Governor proposes to reduce the fund balance back down to 5% at the end of fiscal 2007.

Exhibit 1
Rainy Day Fund Status in Fiscal 2003 - 2007
($ in Millions)

	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
Beginning Balance	$547.9	$490.2	$496.6	$521.4	$755.9
Appropriation	181.0	0.0	103.7	249.7	593.3
Transfer to General Fund	-249.0	0.0	-91.0	0.0	-770.0
Fund PAYGO Capital Projects	0.0	0.0	0.0	-45.2	0.0
Interest	10.3	6.4	12.1	30.1	64.7
Ending Balance	**$490.2**	**$496.6**	**$521.4**	**$755.9**	**$643.9**
GF Operating Revenues	9,317.0	10,240.7	11,394.7	11,306.3	12,843.2
5% of GF Revenues	465.9	512.0	569.7	565.3	642.2
Excess over 5%[1]	24.3	-15.5	-48.4	190.6	1.8

[1] Chapter 430 of 2004, modified how the 5% is calculated. The new law sets the limit at 5% of the Board of Revenue Estimates' (BRE) December (immediately prior to the legislative session) general fund estimate. Beginning in fiscal 2006, the general fund amount represents the BRE estimate, not the actual revenues collected.

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

Source: Department of Budget and Management, January 2006

Spending Affordability Committee (SAC) Recommendation

In its December 2005 report, the Spending Affordability Committee (SAC) expressed the concern that the importance which the bond rating agencies place on maintaining a Rainy Day Fund balance of at least 5% of the estimated general fund revenues has changed the practical use of the Rainy Day Fund. During the recent fiscal distress, maintaining a balance equivalent to 5% of general fund revenues was treated as a necessity. Thus, the reserves were not used to meet the statutory goals for the fund. For the Rainy Day Fund to again serve as a short-term revenue source in times of distress, SAC believed a balance in excess of 5% is required.

Therefore, the committee recommended that Section 7-311 of the State Finance and Procurement Article be amended to require a fund balance of at least 7.5%. This requirement provides the State with a mechanism for ensuring that the Rainy Day Fund balance is well above the amount recommended by the rating agencies, thus providing the State with a more flexible Rainy Day Fund.

Other states have adopted policies similar to the SAC recommendation. At last count, seven states (Indiana, Massachusetts, Mississippi, Oklahoma, Texas, Utah, and Virginia) had targets or caps ranging from 7% to 10%. This includes three states (Missouri, Utah, and Virginia) that have an AAA bond rating from the three major rating agencies (Fitch, Moody's, and Standard and Poor's). In the case of Missouri, the state is required to appropriate funds into its rainy day fund if the balance is below 7.5%.

State Fiscal Effect: For fiscal 2007, increasing the minimum fund balance of the Rainy Day Fund to 7.5% of the general fund revenue estimate would require an account balance of $963 million, which is approximately $321 million above the current 5% target ($642 million). Under the fiscal 2007 budget submitted by the Governor, the fiscal 2007 end-of-year balance is projected to exceed the current 5% target by less than $2 million; however, the budget transfers $770 million from the Rainy Day Fund into the Dedicated Purpose Account. This provides $670 million for fiscal 2008 expenditures and $100 million for the State's unfunded retiree health care liability. The legislature could reduce the amounts transferred from the Rainy Day Fund and appropriated to the Dedicated Purpose Account by an amount sufficient to retain a balance of at least 7.5% in the Rainy Day Fund. However, beginning with fiscal 2008, if the Rainy Day Fund balance exceeds 3% but is less than 7.5% of revenues, this legislation would require an annual appropriation of at least $50 million until reaching the 7.5% target.

Additional Information

Prior Introductions: None.

Cross File: HB 1331 (Delegate Conway, *et al.*) – Appropriations.

Information Source(s): Department of Budget and Management, Department of Legislative Services

Fiscal Note History: First Reader - February 14, 2006
ncs/ljm

Analysis by: Hiram L. Burch Jr.

Direct Inquiries to:
(410) 946-5510
(301) 970-5510