Rainy Day Fund
Recommended Policy Enhancements

Presented to the Seattle City Council Budget Committee
by the City Budget Office – July 18, 2011
Recommended Enhancements to Rainy Day Fund Policies

Purpose of the Briefing

The Mayor intends to propose enhancements to the Rainy Day Fund policies in advance of the 2012 Proposed Budget

- To update policies to reflect new economic reality
- To enhance Seattle’s tradition of proactive finance management

Today’s briefing provides background on the proposed changes

- To start to seek input from the Council

Proposed policy changes will be developed/fine-tuned over the next month with the goal of Council consideration before the budget is submitted

- Policies will inform development of the 2012 Proposed Budget
Rainy Day Fund History

- Rainy Day Fund (aka Revenue Stabilization Account) is a subaccount within the Cumulative Reserve Subfund
  - Established in Seattle Municipal Code (SMC 5.80.020 (B))
    - Created in 1999 (Ordinance # 119761)
    - Updated in 2007 (Ordinance #122557)

- Designed to provide the City’s General Fund with a cushion in the event of unanticipated revenue shortfalls
  - To provide time for City to adjust to revenue shortfalls and ease transition into periods of economic recession

- Separate from the Rainy Day Fund, the City also maintains an Emergency Reserve Subfund
  - Designed for expenditure emergencies
  - Current level - $44.3 million
Current Rainy Day Fund Policies

- Basic policy parameters:
  - Expenditures from the fund require, in most cases, an ordinance passed by 2/3 vote of the City Council

- Funded through two mechanisms:
  - Transfers by ordinances
  - Automatic transfer of actual tax revenues that are in excess of the last official revenue forecast

- Value of the Rainy Day Fund cannot exceed 5% of tax revenues
  - For 2011, 5% would be equivalent to $37.5 million
  - The City has never reached the 5% threshold
Historic Funding Levels

Rainy Day Fund Balances
1999 - 2011 YTD

- 4% of tax revenues
- 1.4% of tax revenues
- 1.5% of tax revenues

City Budget Office - Rainy Day Fund Policy Enhancements
July 18, 2011
Why Have a Healthy Rainy Day Fund & Robust Rainy Day Fund Policies?

- Provides protection for the General Fund in response to unexpected changes in revenues
  - Provides ‘bridge’ funding and time to adjust expenditure priorities to revenue disruptions
  - Similar to a personal savings account

- Reflective of responsible financial management
  - Jurisdictions with healthy rainy day funds and robust rainy day fund policies are viewed more favorably
    - Particularly by bond rating agencies
    - Favorable bond ratings reduce the cost of borrowing
Best Practices

While it is common for local jurisdictions to maintain rainy day funds, literature more commonly focuses on states

- Forty-eight states and the District of Columbia have rainy day funds

- Funding Caps:
  - Typical cap is 5% of expenditures, but can range from 2% - 15%

- Funding Sources Can Include:
  - Revenue windfalls and year-end surpluses
  - Percentage of revenues
  - Special appropriations

- Method for Withdraw
  - Vote of legislative body is common

- Repayment Provisions
  - Many do not contemplate repayment provisions
  - Some require withdrawn funds be replenished within 2 – 6 years

Sources:

- Tax Policy Center: “What are rainy day funds?”
- Stateline: “Rainy day funds explained: How much money should states have in the bank”
The City of Seattle Challenge

- Following the Great Recession and the spend down plans developed in 2009, the City’s Rainy Day Fund balance is now low relative to target
  - For 2011, 1.5% of tax revenues, up slightly from 2010
  - At this level, it no longer provides the sufficient cushion the City would need to respond to another unexpected drop in revenue
- Moreover, the existing funding mechanism is out of sync with new economic realities
  - Current economic climate of unprecedented and prolonged slow growth is not likely to provide sufficient funds to replenish the Rainy Day Fund before the next recession

Average Annual Revenue Growth Rate in Recent Post-Recessionary Periods

- 1995 - 2000: 7.9%
- 2003 - 2007: 6.3%
- 2010 - 2014 (est): 3.4%
The City of Seattle Challenge

- Important to maintain a healthy Rainy Day Fund for our bond rating and to keep the costs of borrowing as low as possible
  - Not only for the General Fund, but also for the utilities

“The city’s strong reserve policies and practices are a key credit strength given the cyclicality of the regional economy; maintaining designated reserves at least at the current level with a view to rebuilding as economic recovery takes hold is key for retaining the highest credit quality.”

Fitch Ratings – February 2011
Principles for Recommended Policy Changes

- Predictable and automatic
- Deliberative; not solely relying on circumstantial mechanisms
- Sufficient to ensure funding levels will increase prior to the next economic downturn
- Evaluation of out-year financial consideration to guide how to draw down the fund
- Flexibility to respond to a variety of economic circumstances
- Achievable
Initial Policy Recommendations

- Replace excess revenue mechanism with one that would automatically shift 50% of unanticipated excess General Subfund year-end balance to the Rainy Day Fund
  - 2010 Example

- Create a new policy that would sweep a percentage of forecasted tax revenues at the outset of the budget process to the Rainy Day Fund
  - Recommend starting at 0.25% for 2012 and ramping up to 0.50% for 2013 and beyond
  - Based on current revenue forecast, would require a $1.9 million contribution for 2012 and nearly $4 million each year thereafter
Initial Policy Recommendations

- Establish a policy to suspend the funding mechanisms when absolute tax revenue growth is negative
  - Allows the City to adapt practices to a variety of economic conditions

- Establish language that requires the evaluation of out-year financial projections when developing plans to spend down the Rainy Day Fund.

- Maintain existing policies that set the maximum funding level at 5% of tax revenue and that allow for contributions by ordinance

Impact of Proposed Policies as Compared to Existing Policies 2005 - 2008

- 0.5% of Tax Revenues
- 50% of Previous Year’s Unanticipated Fund Balance
- Cumulative Value of the Rainy Day Fund w/ New Policies
- Actual Value of Rainy Day Fund
- 5% of Forecasted Tax Revenues

Caveat: Looking ahead to future-year application of these policies, it is highly unlikely that the fund balance contributions would be as significant as in the 2005 – 2008 time period. We are in the midst of a slow revenue growth period and tighter budgets – both of which will likely result in lower fund balances moving forward and a longer timeframe to build up the Rainy Day Fund. For example the 2010 fund balance contribution under this policy would have been $1 million.
Next Steps

- Mayor intends on transmitting a final version of proposed policy changes for Council consideration in advance of the budget submittal.

- In the meantime, he is seeking Council input and suggestions.

- Mayor intends on enacting the provisions of the revised policies in the 2012 proposed budget.

“No one is saying this will be easy. It won’t be. Setting aside these funds will require additional tough choices to a budget that has already seen $107 million dollars in general fund reductions over the past three years. But just hoping the fund will replenish itself isn’t a responsible plan either.”

Mayor McGinn, July 12, 2011
Questions