



# 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

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## ▶ 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

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- ▶ **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

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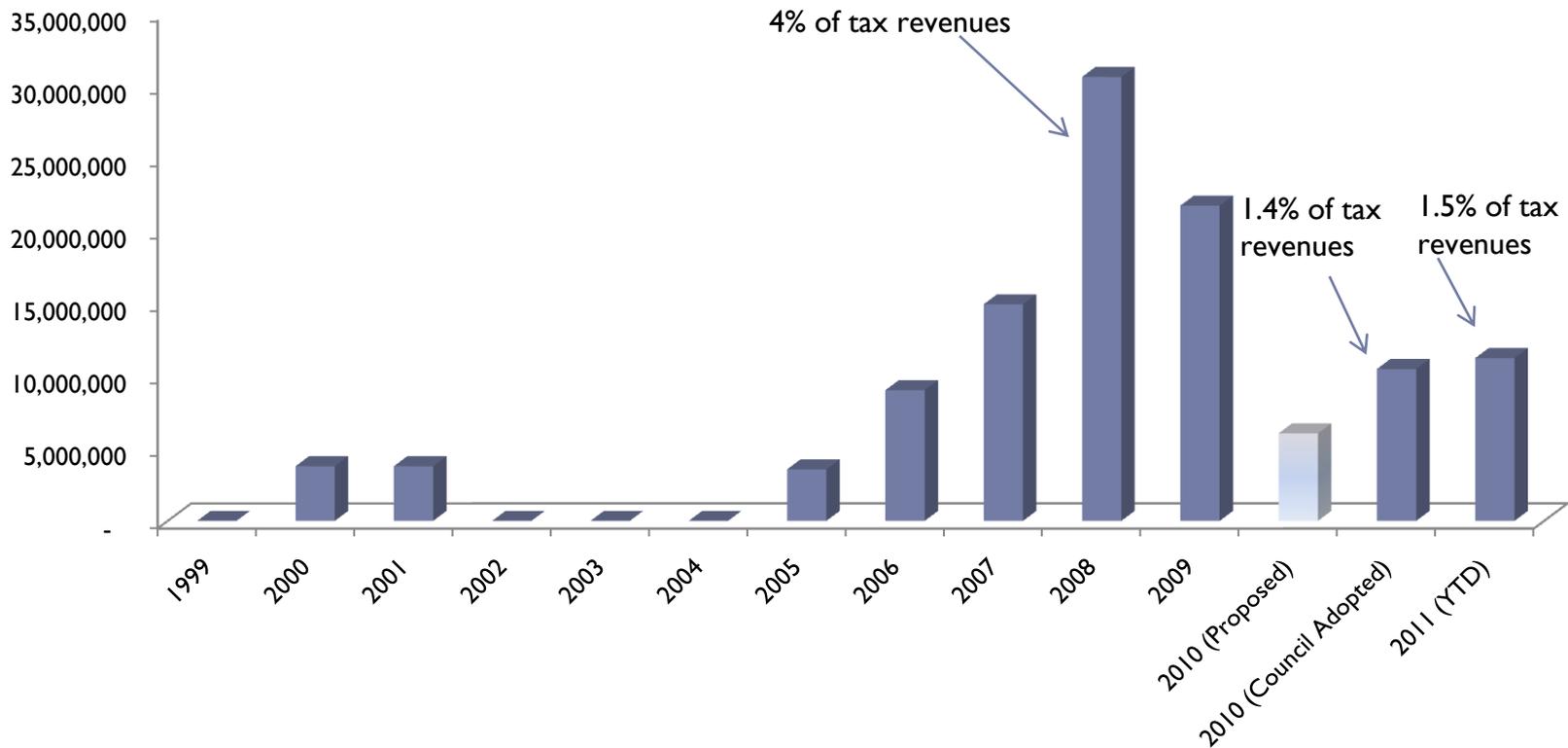
- ▶ **Basic policy parameters:**

- ▶ 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



# Why Have a Healthy Rainy Day Fund & Robust Rainy Day Fund Policies?

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- ▶ 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

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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?”

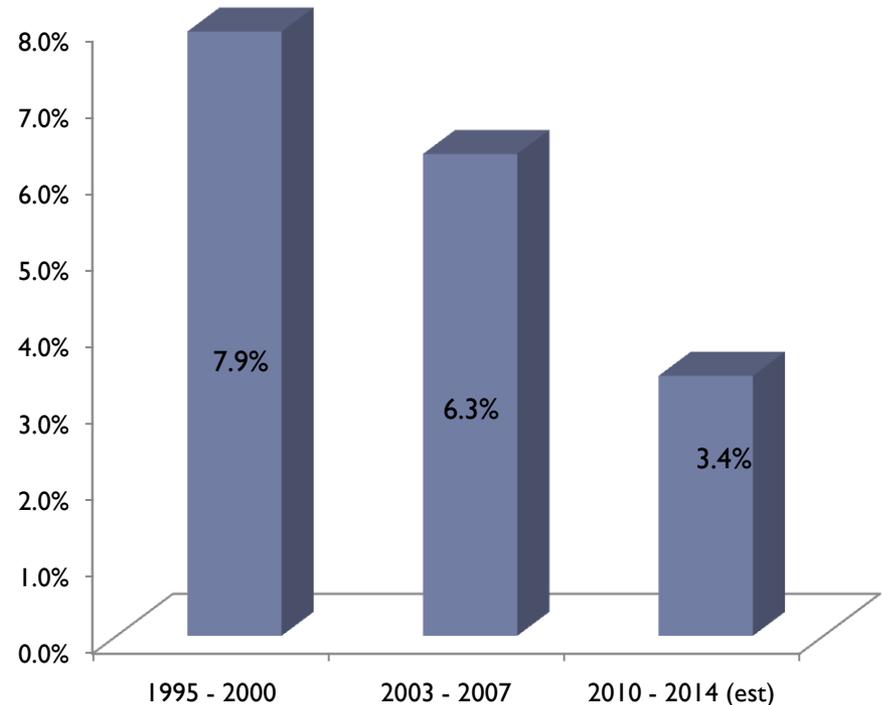
Stateline: “Rainy day funds explained: How much money should states have in the bank”

# 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**



# The City of Seattle Challenge

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- ▶ 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 cyclical nature 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

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- ▶ 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

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- ▶ 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

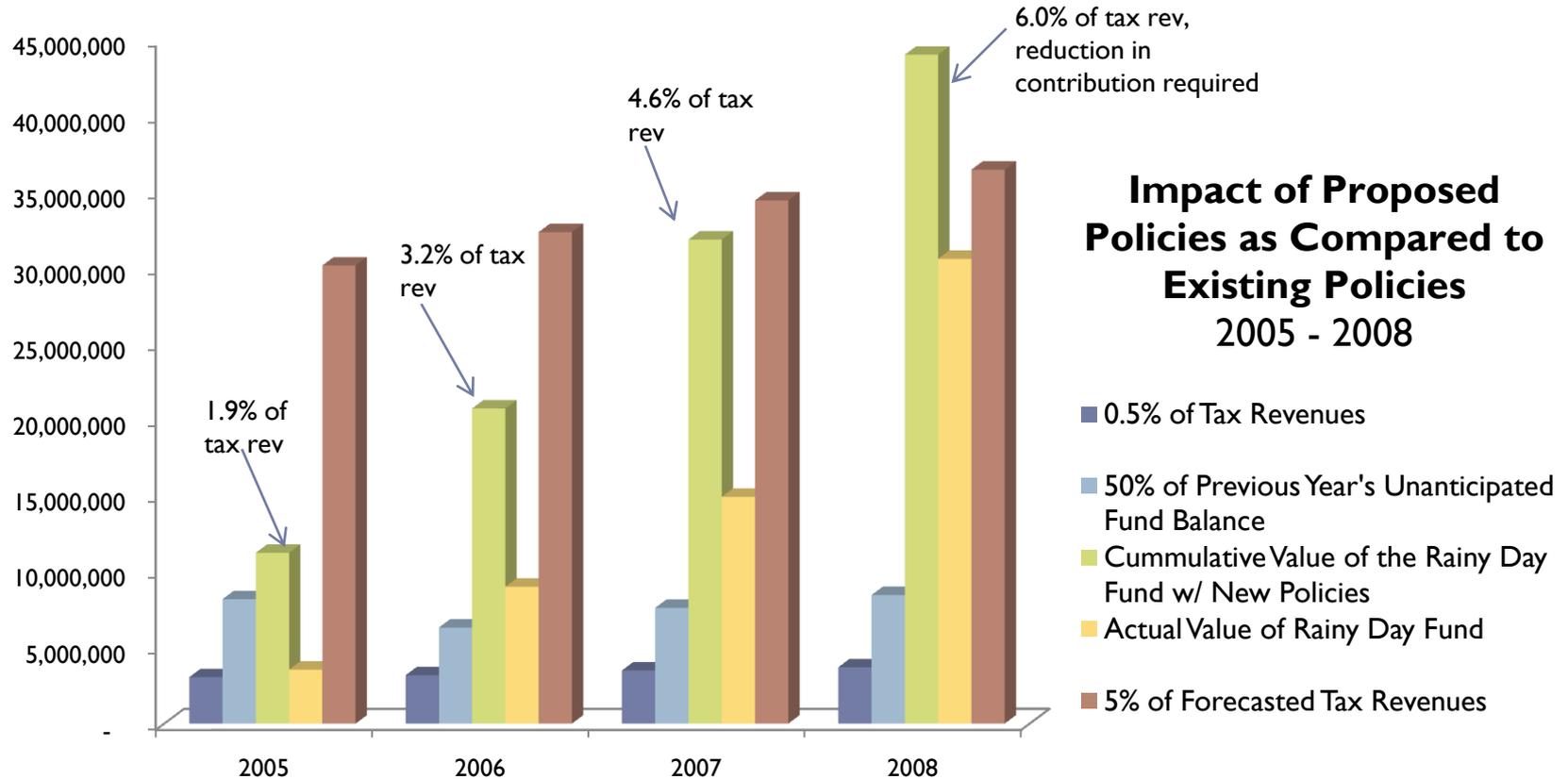
# Initial Policy Recommendations

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- ▶ 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

# A Retrospective Look: How Policies Would Have Worked – 2005 – 2008



**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

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- ▶ 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

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