



Minutes of the Advisory Panel to DEFAC  
Haslett Armory Dover, DE – November 28, 2017

<b>Attendance:</b>	Chairperson, Mr. Michael Houghton		P
K. Lewis	A	H. McDowell	P
E. Ratledge	P	Q. Johnson	P
K. Simpler	P	M. Ramone	P
J. Bullock	P	A. DelCollo	P
R. Geisenberger	P	R. Johnson	P
M. Jackson	P	S. Malfitano	P
M. Morton	A	D. Smits	A

**Support and Staff Present:**

A. Aka, R. Goldsmith, J. Johnstone, N. Roby, D. Roose, S. Bailey, A. Jenkins, B. Scoglietti, S. Scola, D. Burris, A. Loiaconi, B. Fahey, A. Dillione

**Members of the Public:**

M. Bitte, V. Zuk

**1. Call to Order**

Chairman Houghton called the meeting to order.

**2. Presentation of Minutes**

Mr. Houghton declined to raise the October 20<sup>th</sup>, 2017 meeting minutes for approval, citing lack of clarity on certain discussion points.

[UNKNOWN—4:50] proposed a motion to approve the minutes of the September 14, 2017 meeting. The minutes were approved.

**3. Presentation from Pew** Mr. Bailey and Ms. Loiaconi from Pew Charitable Trusts presented to the panel. The presentation was intended to serve as a primer on rainy day funds, specifically the way in which the Rainy Day Fund size and utilization habits are evaluated by ratings agencies.

Senator McDowell noted that Delaware’s Rainy Day Fund is not conceptualized as a budget stabilization fund. Mr. Bailey clarified that the report examines both types of funds as fitting the same broad definition.

Senator McDowell asked how economic upturn and downturn are defined and determined. Mr. Bailey responded that evaluation can vary by state and also by whether the downturns were cyclical and driven by macroeconomic factors or by structural microeconomic factors.

Mr. Houghton pointed out that Delaware has never used its Rainy Day Fund and has simultaneously maintained its AAA credit rating. He also commented that other AAA rated states have maintained their ratings despite drawing on and replenishing their reserve funds as needed.

[UNKNOWN—16:20] asserted that the presentation seems to upend the conventional wisdom of not tapping into reserves in order to preserve a credit rating. Secretary Geisenberger noted that because the credit rating agencies look at several factors, it is worth bearing in mind that the strength of the untouched Rainy Day Fund as a credit factor offsets some of the state's negative factors.

Mr. Jackson asked if Mr. Bailey could follow up with information about the budgeting factors in other AAA rated states. He also asked what sort of budgetary adjustments other AAA states have made during economic downturns. Mr. Bailey replied that most other AAA states likely use a combination of reserves and budgetary adjustments during economic downturns. He stated that he would come back to the panel with a more complete answer on that subject.

Mr. Ratledge asked what rules typically exist for stabilization fund utilization, asserting that careful consideration should be given to those rules.

Representative Ramone asked if any states have both Rainy Day Funds and stabilization funds and how the respective funding policies might be connected.

Mr. Bailey responded that there are states that have both, and that would be discussed further later in the presentation.

Treasurer Simpler concurred with Secretary Geisenberger's earlier assertion that the Rainy Day Fund is key to the State's AAA rating and changes to the fund would have to be thoroughly explained to rating agencies. He also suggested that peer review of other AAA states isn't always the best tool for evaluating good fiscal behavior.

Senator McDowell observed that growth measurements can vary from state to state and are an important consideration.

Senator Delcollo asked how Moody's defined shock in the study that Pew referenced. Mr. Bailey defined shock as a time in which GDP is not at its prerecession peak of 100 each time.

Treasurer Simpler sought clarification that the shocks being discussed were measured and totaled over multi-year periods of a given downturn. Mr. Bailey confirmed that measurements were done on a multi-year basis.

Senator McDowell sought clarification on the amount needed in a reserve fund during a downturn year in order to avoid having to make other budgetary adjustments. Mr. Bailey responded that the amount would need to equal about 13.5% of annual general fund revenue. Secretary Geisenberger noted that the assumptions were based on drawing the reserve down to zero in a given year.

Secretary Bullock commented that drawing the reserve down to zero has never been done and could be detrimental to the State's credit rating.

Representative Ramone reiterated that there can be two separate funds and that drawing on one doesn't assume a draw on the other.

Senator McDowell stated that he is unsettled by the notion of drawing any fund down.

Senator Delcollo reiterated that the premise of the review was about reexamining the way the State saves money.

Secretary Bullock noted that all credit factors need to be examined, as the State has more control over the Rainy Day Fund than it does many other factors.

Treasurer Simpler alluded to Senator McDowell's earlier point that the Rainy Day Fund was not originally conceptualized as a budget stabilization fund and noted that changes would need to be adequately explained to the rating agencies.

Secretary Geisenberger noted that if the State builds a budget stabilization fund with strong fiscal controls in place that would demonstrate to ratings agencies the State's commitment to adhering to the same fiscal discipline as was demonstrated with the Rainy Day Fund.

Senator McDowell observed that the 2% leftover from the budget appropriation limit pushes a portion of the Rainy Day Fund out to be in the expenditures. \*Hard to paraphrase. Unclear on what he was saying—44:54\*

Mr. Houghton expressed his appreciation at the fact that the panel was having a broader discussion on whether or not the Rainy Day Fund *status quo* can be reasonably modified and whether there is value in having a free standing budget stabilization fund. He then asked the panel if they agreed with the fundamental objectives of a budget stabilization fund. Representative Johnson stated that he agreed with the objectives, provided the fund was used to stabilize the budget in times of cyclical downturn, rather than for reasons related to structural downturns.

Mr. Houghton agreed that "economic downturn" would need to be carefully defined but that the panel must first evaluate whether or not it makes sense to have a budget stabilization mechanism in the first place.

Senator Delcollo noted that the rating agencies might place different weights on different factors than those that are believed to be priorities.

Mr. Houghton observed that the rating agencies are likely to be more concerned with adherence to fiscal control structures rather than whether or not the structures simply exist.

Mr. Malfitano asked if Delaware is the only AAA state that has not drawn on its Rainy Day Fund. Mr. Bailey replied that the answer is likely yes when considering how old Delaware's fund is, but he would look into the question and confirm.

Mr. Bailey resumed the presentation to discuss states that have two separate stabilization funds.

Mr. Ratledge expressed his concern about whether there would be money available for replenishing a stabilization fund after it had been depleted during a downturn.

Treasurer Simpler noted that economic cycles, by nature, have periods of contraction followed by periods of expansion, so with proper fiscal control rules, there should always be means for replenishing.

[UNKNOWN (Johnson?)—53:52] commented that it took a very long time to recover from the most recent recession and that increasing liabilities could make it harder for there to ever be times of growth.

Secretary Bullock emphasized that the fundamental reason for having this conversation is that revenue growth doesn't keep up with the overall economic growth and that that issue must be solved for the State to then be in a position to plan for downturns.

Mr. Ratledge commented that other states have similar problems with growing liabilities.

Senator McDowell asserted that many of the State's revenue challenges are related to the fact that middle class wage growth has been flat.

Treasurer Simpler affirmed Secretary Bullock's assertion that the budget stabilization fund conversation is just one piece of overall revenue portfolio restructuring that needs to take place.

Senator McDowell stated that he agreed with Treasurer Simpler, but thought that the panel should just look at one piece at a time.

## **5. Department of Finance Presentation**

Mr. David Roose gave a presentation from the Department of Finance on budgetary smoothing mechanisms.

Treasurer Simpler asked if Mr. Ratledge's concerns were being addressed by the presentation slide regarding hypothetical fund balance modelling.

Mr. Ratledge responded that the hypothetical fund balance model would address his concerns, provided withdrawal rules are followed.

[UNKNOWN (Ratledge?)—1:12:00] pointed out that when fund balances get high enough in Delaware, they are often drawn upon to create special funds.

Secretary Bullock asked what the budget impact of the hypothetical fund balance models would be.

Mr. Roose responded that the amounts shown for each year are the amounts that would have needed to be cut in a given year.

Secretary Geisenberger clarified that the amounts shown are what would have needed to be cut without revenue reform.

Secretary Bullock noted that the group was only discussing the funding rules for fund balances and had yet to examine withdrawal rules. He then clarified that he would like to know the net difference between the model scenarios and actual results.

Treasurer Simpler pointed out that the presentation model for hypothetical scenarios begins in 2006, leaving out the years surrounding the tech bubble of the early 2000s.

Mr. Jackson expressed concern that the hypothetical Rainy Day Fund deposit models don't address changes in demand for services compared to revenue.

Treasurer Simpler stated that he had a differing view from Mr. Jackson's prior point, noting that the review needs to be thought of as a holistic exercise and that whatever the new fiscal control is, stability would be baked into it.

Secretary Bullock restated his earlier question of wanting to know what the net difference would be if the revised fiscal controls had been in place. Treasurer Simpler answered that the difference would have been that there would have been more certainty and diminished year over year volatility.

Secretary Bullock responded that he understood the underlying hypothetical framework, but implementing the framework would still require that tough decisions be made.

Treasurer Simpler affirmed Secretary Bullock's prior point and noted that more predictability would help provide a better sense of what level of service delivery could be sustained from year to year. Secretary Bullock added that he wanted to consider the importance of when a revised fiscal control policy would start.

Treasurer Simpler noted that it has been a challenge to put in place the kind of revenue reforms that would mitigate volatility.

Mr. Roose ended the presentation and invited questions.

Mr. Houghton noted that felt as though the presentation presented the Virginia option as the most viable option. He asked if that was true from the Finance staff's perspective. Mr. Roose responded that most of the presented options had merit.

Secretary Geisenberger pointed out that none of the Finance department's models make any assumptions about revenue revisions.

Mr. Houghton asked if it is realistic to assume that there will not be periodic revisions to the franchise tax. Representative Ramone observed that the right solution could be one that blends the options that have been presented. He also noted that public perception of fiscal policy needs to be considered. Mr. Houghton pointed out that crisis often drives reform and absent a crisis, fiscal control reforms might be a difficult sell.

Senator Delcollo stated the importance of accountability in getting to a grand bargain; Mr. Houghton agreed. Senator McDowell commented that peaks and valleys are not inherently bad. He asked if the model considers that Delaware has more expenditures at the state level than most states. Mr. Roose responded that overall budget growth should be considered with respect to fiscal control models. Treasurer Simpler asked if it might be beneficial for the group to meet again before Christmas. Mr. Houghton proposed that the group should review materials, draft proposals and circulate them in advance of the January meeting. The Finance Staff and OST would collaborate during that time to draft a short list of proposed paths forward.

#### **Public Comment**

No public comments.

**Adjournment**

Mr. Houghton adjourned the meeting.

