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# Delaware Economic and Financial Advisory Council

## Advisory Panel Meeting

Budget Stabilization Fund Use and Fund Size  
Stephen Bailey, Associate Manager  
Airlie Loiaconi, Associate I  
November 28, 2017

# Rainy Day Funds and State Credit Ratings

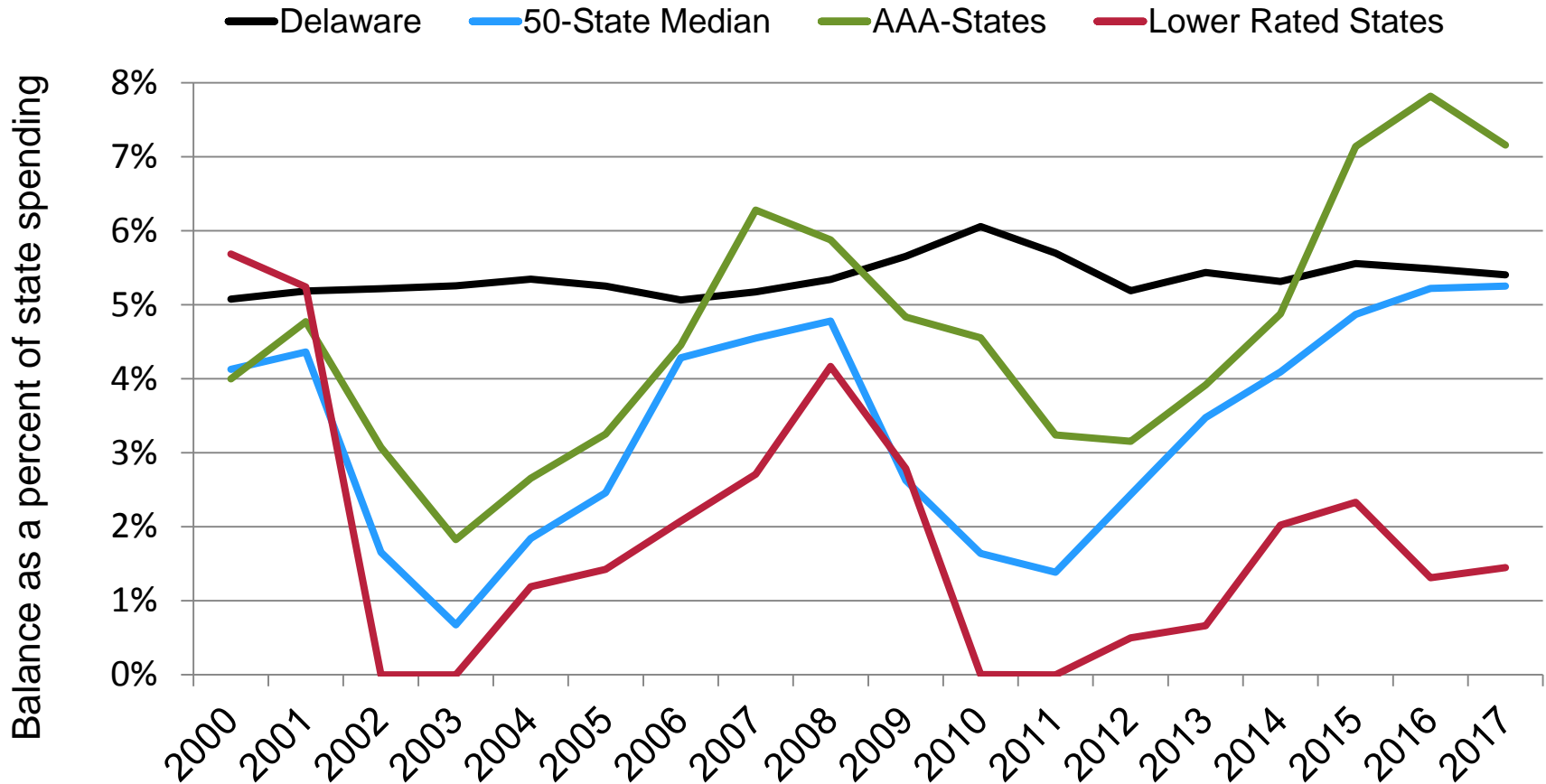
## May 2017 report



- Clearly designate goals and objectives for rainy day funds
- Bring the rainy day fund in line with the economy
- Comply with rainy day fund policies
- Withdraw reserves, when necessary, during downturns
- Prioritize building reserves during economic expansion

# Budget Stabilization Fund Size Over Time

## Comparing states by credit rating



Sources: The Pew Charitable Trusts, NASBO

# Optimal Size for a Reserve Fund

## How large should a budget stabilization fund grow?



- The traditional “5 percent rule” has been revamped
- S&P gives top scores for those with a formula-based reserve that can reach at least 8 percent
- Fitch and Moody’s says reserve size should be tailored to economy, tax structure, degree of revenue volatility, and financial flexibility
- Recent approaches include the Moody’s Analytics “stress test” and Minnesota’s “optimal size” analysis

# Stress Testing Reserves



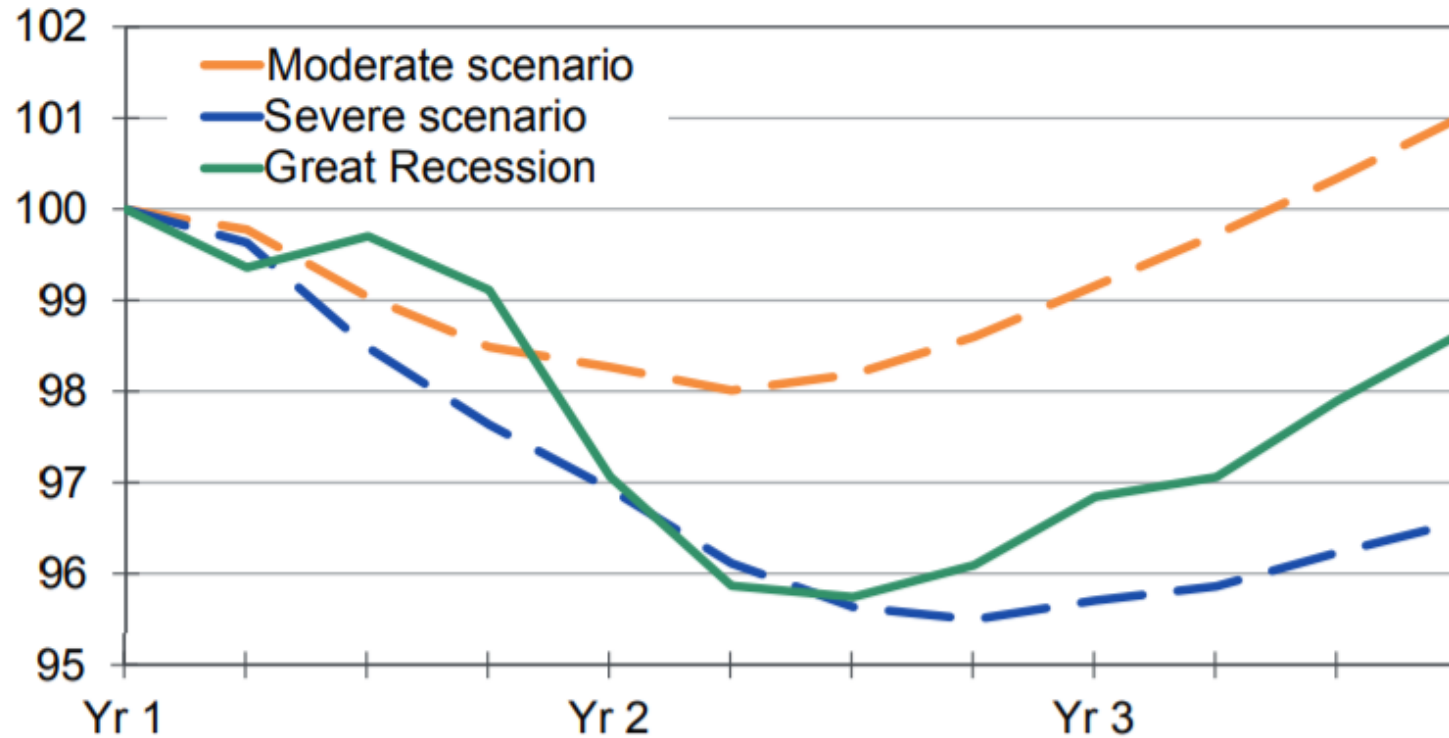
- Calculate reserve size needed to cover different levels of recession (e.g. mild, strong)
- More severe recessions require more savings
- State decides what recession level they want to guard against
- Decide to what degree reserves should be used to cover a revenue downturn

# Moody's Analytics "Stress Test" Model

## Forecasting alternative economic scenarios



Real GDP, prerecession peak=100



Source: graphic from Moody's Analytics "Stress-Testing States," October 2017

# Moody's Analytics "Stress Test" Model

Fiscal shock from moderate and severe recession scenarios in Delaware, as percent of 2017 revenues

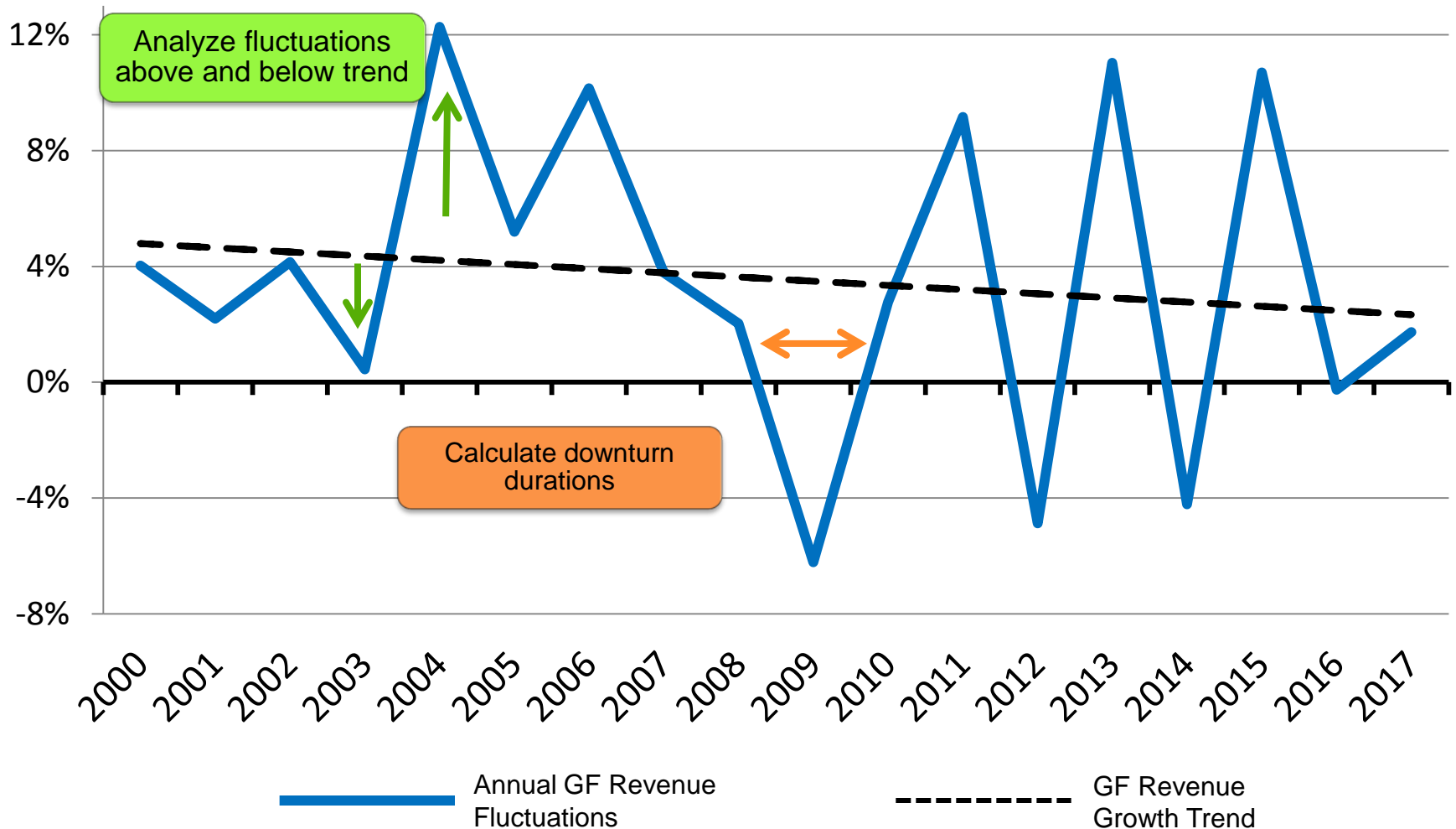


Recession level	Tax revenue shortfall	Medicaid spending increase	Combined fiscal shock
Moderate	7.0%	0.8%	<b>7.8%</b>
Severe	8.3%	1.4%	<b>9.7%</b>

Source: Analysis by Moody's Analytics "Stress-Testing States," October 2017

# Minnesota "Optimal Size" Model

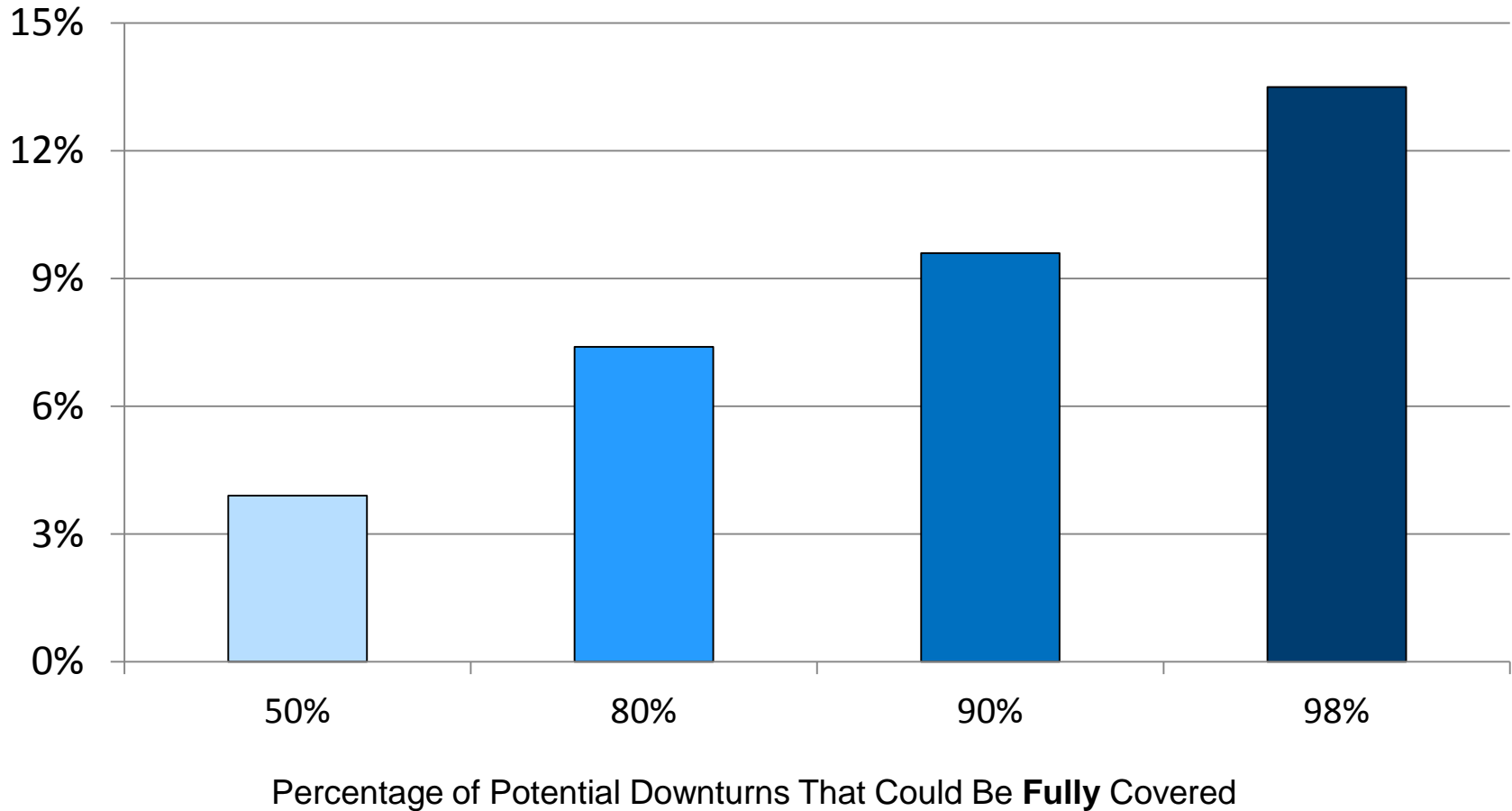
Steps for calculation as shown through Delaware's general fund revenue fluctuations, 2000-2017





# Possible Savings Targets for DE Reserves

Based on Minnesota “Optimal Size” model analysis

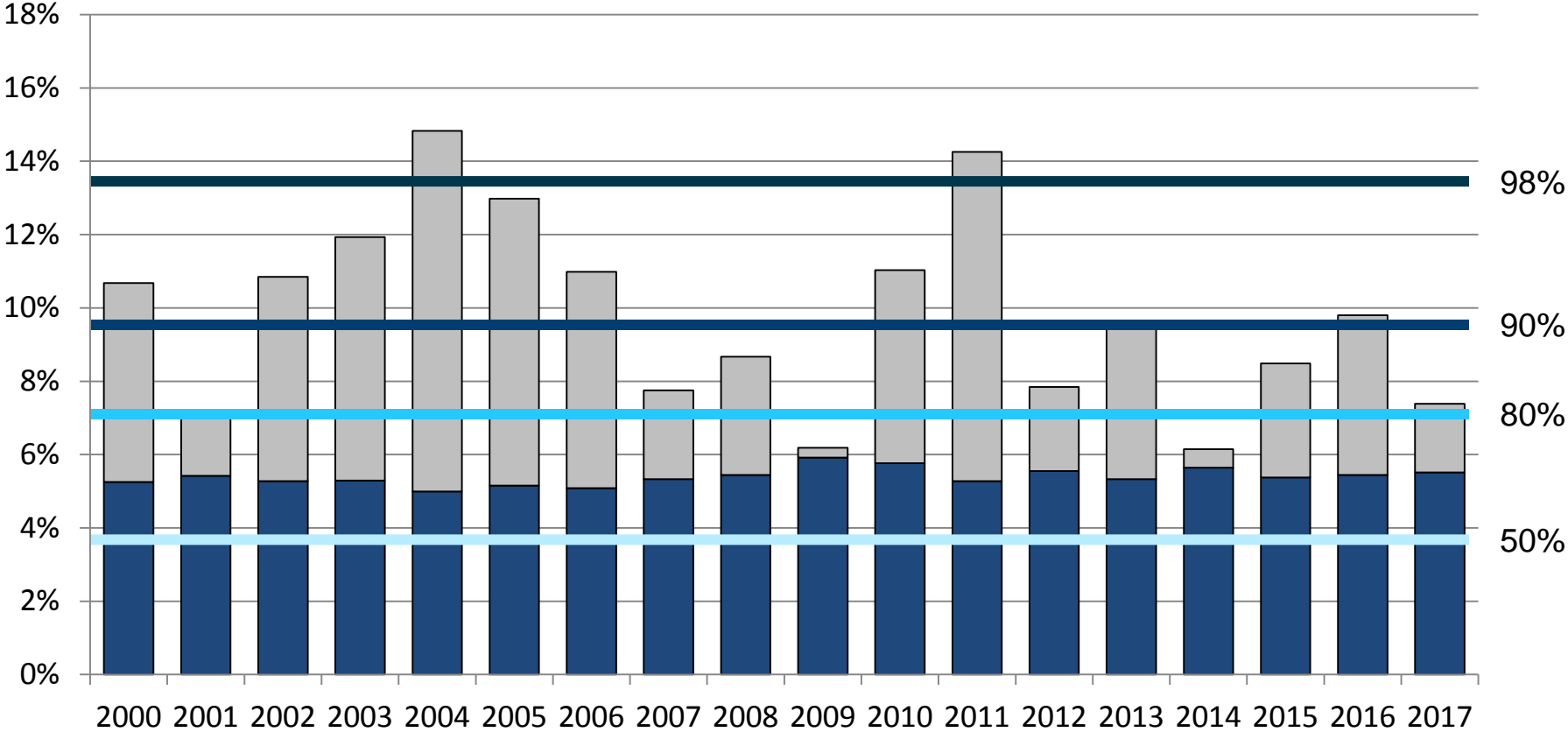


# Delaware's Reserve Balances

As percent of general fund revenue, MN savings targets added



■ Budget Reserve Account    ■ Unencumbered cash

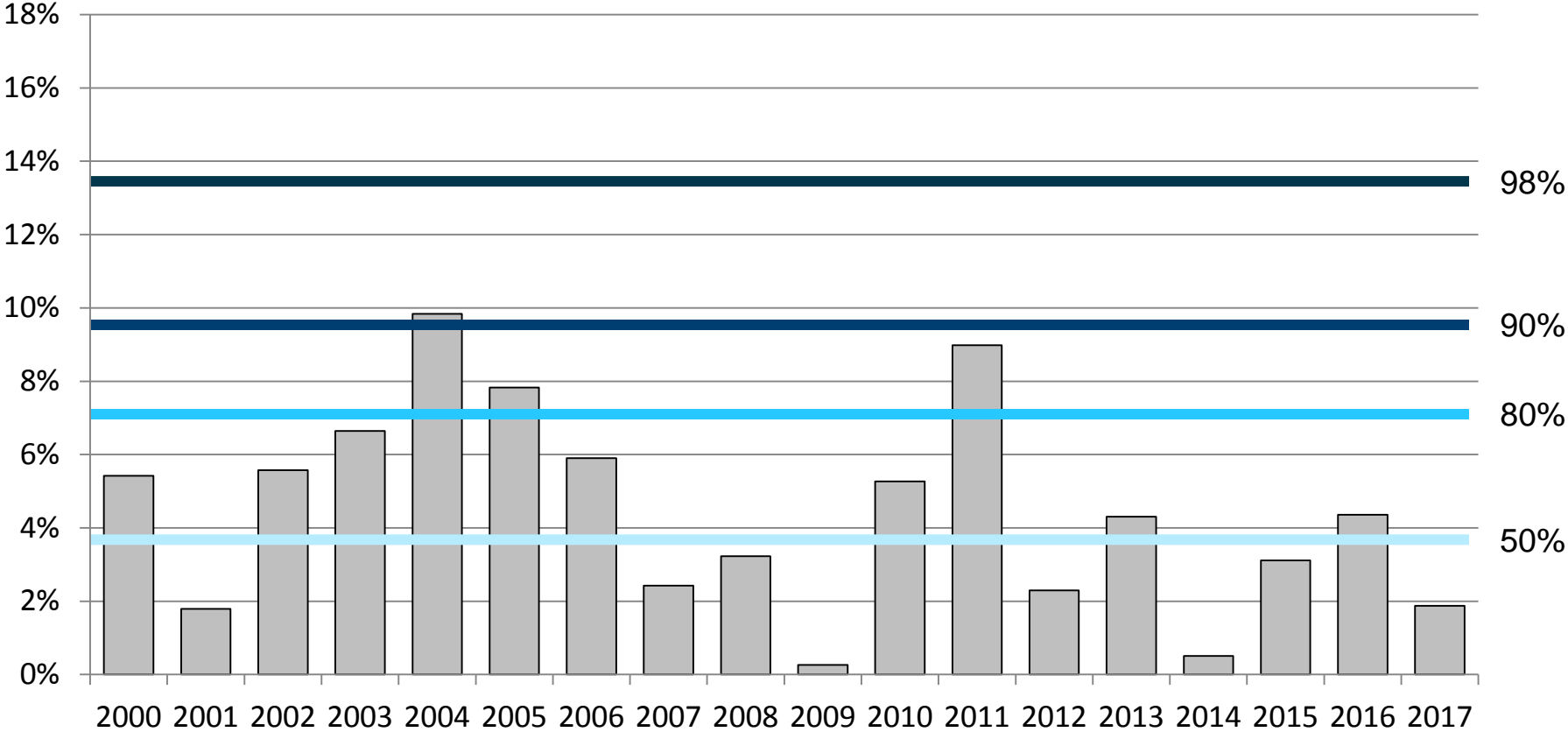


# Delaware's Reserve Balances

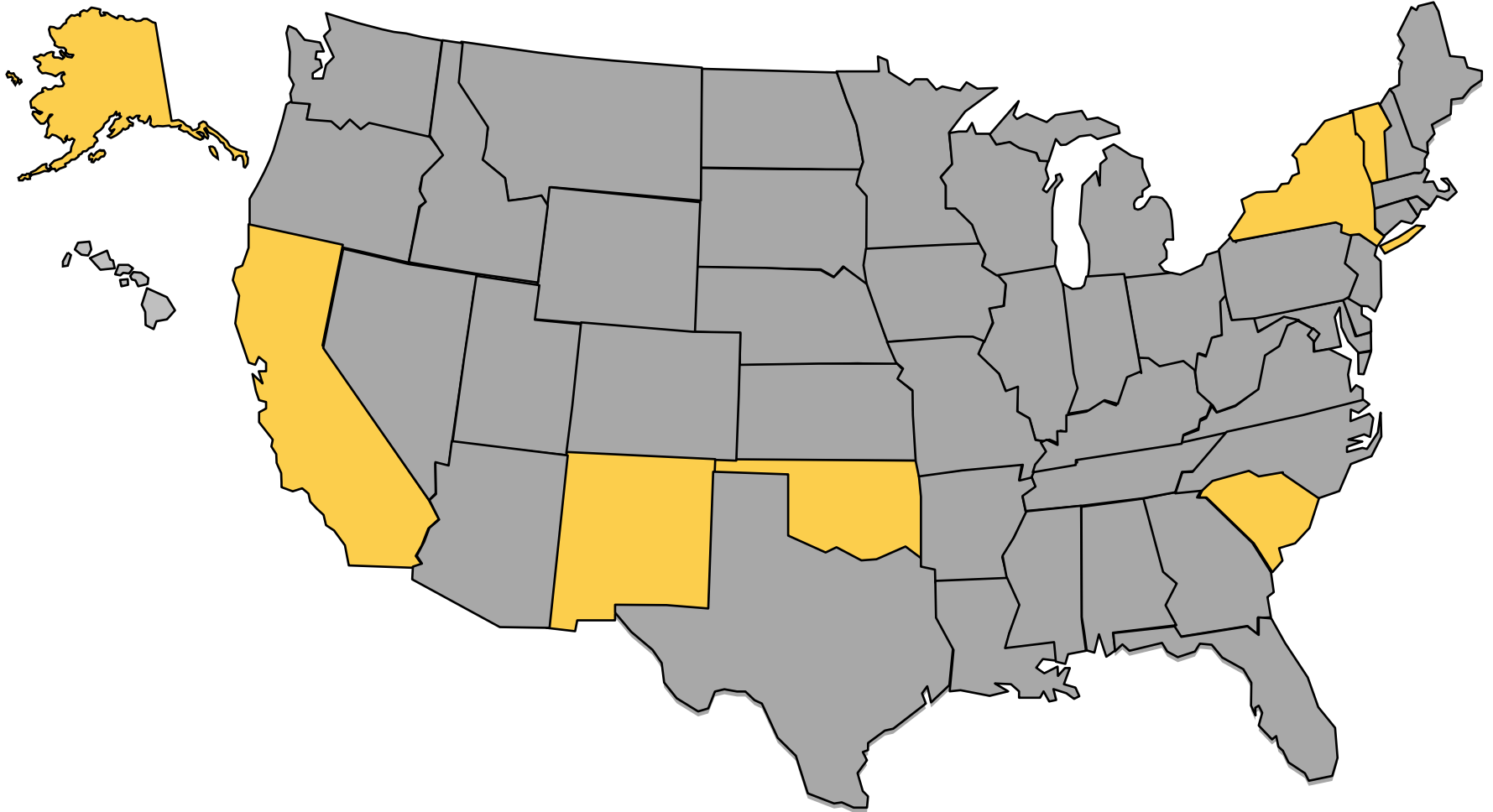
As percent of general fund revenue, MN savings targets added

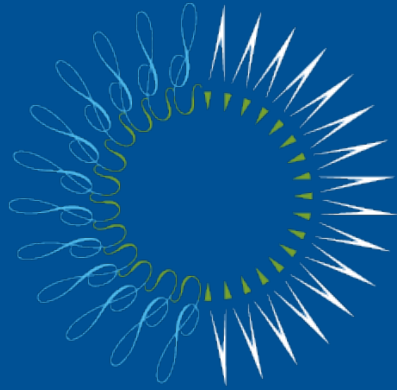


■ Unencumbered cash



# States with more than one “rainy day fund” for general fund use





THE  
**PEW**  
CHARITABLE TRUSTS

Stephen Bailey

[sbailey@pewtrusts.org](mailto:sbailey@pewtrusts.org), 202.540.6650

Airlie Loiaconi

[ahenrich@pewtrusts.org](mailto:ahenrich@pewtrusts.org), 202.540.6748