Delaware Economic and Financial Advisory Council
Advisory Panel Meeting

Budget Stabilization Fund Use and Fund Size
Stephen Bailey, Associate Manager
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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

Balance as a percent of state spending

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

<table>
<thead>
<tr>
<th>Recession level</th>
<th>Tax revenue shortfall</th>
<th>Medicaid spending increase</th>
<th>Combined fiscal shock</th>
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</thead>
<tbody>
<tr>
<td>Moderate</td>
<td>7.0%</td>
<td>0.8%</td>
<td>7.8%</td>
</tr>
<tr>
<td>Severe</td>
<td>8.3%</td>
<td>1.4%</td>
<td>9.7%</td>
</tr>
</tbody>
</table>

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

- Analyze fluctuations above and below trend
- Calculate downturn durations

Annual GF Revenue Fluctuations
GF Revenue Growth Trend
Possible Savings Targets for DE Reserves
Based on Minnesota “Optimal Size” model analysis

Percentage of Potential Downturns That Could Be **Fully** Covered
Delaware's Reserve Balances
As percent of general fund revenue, MN savings targets added
Delaware's Reserve Balances
As percent of general fund revenue, MN savings targets added
States with more than one “rainy day fund” for general fund use