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With Rainy Day Fund Filling Up Fast, It's Time to Invest in Community Needs

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> ### Key Takeaways
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> - The state's rainy day fund is fast approaching its capped "allowable balance." It could exceed the cap at the end of Fiscal Year 2024.
> - Once the cap is reached, any dollars above the cap must be returned to tax filers.
> - With so many unmet needs for revenue throughout the Commonwealth, lawmakers should ensure the fund's value remains below the cap.
> - Lawmakers should avoid making deposits to the fund in Fiscal Year 2024. Instead, they should invest these tax dollars in communities with the greatest needs.

Over the past several years, state lawmakers have authorized regular, large deposits into the state's Stabilization Fund. The fund, sometimes called the "rainy day" fund, is the state's savings account for hard times. These deposits have helped push the fund to its highest level ever. As of mid-February 2023, the fund had a balance of $7.1 billion.

By law, however, the amount that can be saved in the rainy day fund is capped - and we are fast approaching that cap. Automatic deposits into the fund come from several sources (see breakout box on page 2). If lawmakers do not act to suspend these automatic deposits – as they have done at other times in the last ten years - it is possible we could reach the cap at the end of Fiscal Year 2024 (FY24). Once the cap is reached, the amount above the cap is refunded to tax filers thru an increase in the state's personal exemption amounts for the next tax year. With many urgent needs across the Commonwealth currently going unmet – think housing and healthcare, school programming and school buildings; early education and childcare; roads, bridges, the T, and more – lawmakers need to begin planning now in order to avoid breaching the cap in the next year or two. Instead of authorizing additional, large deposits into the fund in FY24, lawmakers should invest these tax dollars in communities with the greatest needs.

How close are we to the cap?

By law, the "allowable balance" permitted in the state's rainy day fund is capped at an amount equal to 15 percent of budgeted revenue collections (adjusted for interfund transfers). Budgeted revenues include tax collections, federal grants and reimbursements, and revenue from other sources that help fund the state budget. As determined by the Office of the Comptroller, for FY22 the allowable balance was $9.313 billion. The rainy day fund's FY22 year-end total of $6.938 billion was a little more than 11 percent of adjusted budgeted revenue collections. While there was still $2.375 billion of "headroom" below the cap at the close of FY22, that is only a little more than the rainy day fund grew during FY22. Based on official revenue forecasts, the current fiscal year (FY23) and the one to follow (FY24) are likely to bring year-end rainy day fund totals much closer to the cap. To avoid breaching the cap, lawmakers should suspend deposits to the fund in the coming fiscal year (FY24).

Whether the rainy day fund approaches its cap or moves farther away depends on the relative size of deposits into the fund versus that year's budgeted revenue collections. If deposits to the fund grow more quickly than budgeted revenue collections, the fund gets closer to its cap. We've moved closer to the cap over the last several years as large deposits have been made to the fund. It is also possible to move closer to its cap even when deposits to the fund are more modest. This can happen when growth in budgeted revenue collections slows. If budgeted revenue collections actually *decline* from one year to the next, this will *lower* the cap, reducing the headroom between the fund's value and the cap, even if no additional deposits to the fund are made.

Rainy Day Funds Come From Many Sources

Several types of revenue are dedicated, by statute, to the rainy day fund. The largest of these dedicated sources typically are capital gains tax collections above an annually-adjusted threshold and revenue from a "sweep" of unspent dollars remaining in budgeted funds at year's end (known as the "consolidated net surplus"). Smaller amounts also flow to the fund from other sources, including taxes on casinos, earnings on fund investments, above-average collections from especially large tax settlements and judgements, and revenue from abandoned property.

The Executive Office for Administration and Finance projects that total tax collections in FY23 will decline by more than 3 percent relative to FY22 tax collections. Because tax collections typically make up about 60 percent of all budgeted revenue collections (adjusted for interfund transfers), it is likely that a decrease in tax collections will result in a decrease in the rainy day fund's allowable cap. Meanwhile, the FY23 state budget passed by lawmakers at the end of July 2022 designates a total of $1.468 billion for deposit to the rainy day fund as FY23 comes to an end (on June 30, 2023).

Notably, this projected FY23 deposit does not include possible additional deposits from several sources that can feed significant sums into the rainy day fund. The most important of these is the consolidated net surplus, which can deliver hundreds of millions of dollars to the fund at year's end.[1] Another is revenue from especially large tax settlements and judgements, which can result in deposits to the fund of several tens of millions in a given year.

Taking into account the projected decline in FY23 tax collections and the sizeable amount budgeted for deposit to the fund, it appears likely that the fund will be considerably closer to its cap at the close of FY23 than at the close of FY22. If the consolidated net surplus and large tax settlements and judgements add several hundred million more to the fund's total, there could be less than $1 billion of headroom remaining below the cap at the close of FY23.

Looking ahead, we can use official projections and some reasonable assumptions to build a picture of how things might look at the close of FY24. The recently issued FY24 Consensus Revenue Estimate (CRE) anticipates 1.6 percent tax growth in FY24. Such growth would help push the fund's cap modestly higher. Any declines in other important budgeted revenue streams, however—for example, federal grants and reimbursements—would dampen the impact that tax growth would have on raising the cap.

[1] Driven in large part by unexpected, large increases in tax collections during the last few years, the annual consolidated net surplus (CNS) was much higher at the end of FY21 and FY22 than is typical. In FY21, the CNS was $1.5 billion and in FY22 it was $4.8 billion. However, rather than allow these CNS amounts to be deposited automatically into the rainy day fund, lawmakers directed these large year-end surpluses to the newly created Transitional Escrow Fund. It is unclear whether the CNS will be so large in FY23 or FY24, though it seems unlikely revenue forecasts will be as far below actual collections as was true in FY21 and FY22.

At the same time, the FY24 CRE also projects a year-end deposit to the fund of [$525 million](#) in above-threshold capital gains tax collections. If we assume that deposits from other sources (such as the consolidated net surplus) could total another few hundred million dollars, we could see the fund's value rise by $700 million or more in FY24. Under these conditions, it is not hard to imagine scenarios in which the rainy day fund gets extremely close to or even exceeds its cap at the close of FY24.

How can lawmakers avoid overfilling the rainy day fund?

Every community in the Commonwealth is wrestling with a long list of expensive, pressing needs that will require substantial state-level support to address. Low-income and BIPOC communities are facing the largest gaps between critical needs and available local resources - gaps that state support should help close. In response to public demand, lawmakers have been seeking ways to provide better childcare subsidies, affordable housing supports, improved access to higher education, infrastructure improvements and more. Providing the necessary funding for these and other investments will require more, not fewer, state resources. Accordingly, lawmakers must take steps to ensure that the rainy day fund, while maintaining a healthy balance, remains safely below its cap. Otherwise, they risk sacrificing a substantial amount of revenue that could be used to support communities across the Commonwealth. Fortunately, there are several concrete steps lawmakers can take to remain below the cap:

- Budget writers should plan on forgoing FY24 year-end deposits into the rainy day fund. Instead, these dollars should be used to make investments throughout the Commonwealth, wherever the needs are greatest, and particularly in low-income and BIPOC communities. Over the last dozen years, lawmakers often have included language in the annual state budget suspending one or more statutorily required year-end deposits to the rainy day fund. With the fund approaching its cap, suspending deposits to the fund for FY24 makes sense.

- Lawmakers should clarify, in statute, that all revenue generated by the new millionaire income surtax be deposited into a separate fund, dedicated to the support of public education and transportation throughout the Commonwealth. Surtax revenues should be explicitly excluded from deposits into the rainy day fund. In particular, it should be made clear that all surtax revenue collected on capital gains income, whether above or below the annual capital gains collections threshold, should be excluded from deposit into the rainy day fund. The analysis presented in this factsheet assumes that no surtax dollars will be deposited into the rainy day fund. Were any surtax revenue to be deposited into the fund – in particular, all surtax revenue from above-threshold capital gains taxes – the fund would be far more likely to exceed its cap at the close of FY24.

- The possibility of the rainy day fund exceeding its cap will not disappear after a single year of forgone deposits to the fund. Therefore, budget writers should remain vigilant about not exceeding the rainy day fund cap as they craft budgets beyond FY24.