Strengthening New York City's Rainy-Day Fund

Highlights

- Setting aside resources for unexpected needs and controlling their use to ensure they are available when needed are fundamental components of sound fiscal policies and management strategy.
- Until recently, legal constraints had prevented the City from utilizing the resources in a rainy-day fund. The City effectively maintained a substantial budgetary cushion through other means.
- In early 2021, the City established a rainy-day fund after these constraints were lifted.
- These changes enable a prudent practice of setting aside reserves, however, the changes also require enhancements to the City's reserve policy to ensure funds are set aside systematically and used only when truly necessary.
- The City does not currently have a published policy defining the purpose of its rainy-day fund, the target level of reserves, or how resources would be replenished after a drawdown.
- Recent reviews by credit rating agencies suggest that governments that develop and maintain robust fiscal reserve policies may receive improved ratings compared to their peers.
- Reserve policies reflect the unique circumstances of each government that put them in place, and certain elements used by other cities may not be appropriate for New York City. However, OSC recommends that the City consider certain best practices based on policies of other large U.S. cities.

Reserves are an important tool for managing fiscal uncertainty, enabling governments to avoid counterproductive tax increases or service cuts. Local governments across the nation, including in New York State, set aside funds and establish policies that dictate how to build, maintain and use funds so that they are available to weather economic volatility and other emergencies.

In early 2021, the City of New York established a key component of its reserves strategy, known as a rainy-day fund (also called the Revenue Stabilization Fund), which was authorized by changes in State law and the City Charter. This move made available $499 million in resources that had not been able to be used to balance the City's budget prior to fiscal year (FY) 2020. A State law enacted in 2020 removed legal constraints imposed on the City under the New York State Financial Emergency Act (FEA) for the City of New York as a result of its fiscal crisis.

Until the change in State law, the City effectively maintained a substantial budgetary cushion through other means, including prepaying future-year expenses, a necessary practice that nevertheless clouded actual spending in the presentation of the City's budget.

The City appears committed to making the rainy-day fund an integral part of its reserve strategy, and approved a deposit of $500 million in FY 2022, which will bring the total reserve to $1 billion. The City's plan to build up the fund so soon after its creation is prudent. However, recent actions also revive past questions about the rationale for depositing funds, their purpose, and their eventual use and plans for replenishment, which the City has not laid out in a written policy. This report compares the City's reserve practices to those of other large U.S. cities, and outlines where the City may consider strengthening its reserve policy.

History of the City's Reserves

The Government Finance Officers Association (GFOA), which represents public officials throughout the United States and Canada, recommends that each government establish a formal policy on the level of unrestricted fund balance (i.e., reserves) that should be maintained in its general fund (the primary operating fund of governmental entities).[1]

Until recently, New York City was unable to utilize its general fund reserves as a rainy-day fund, a source of budgetary cushion. Beginning with the adoption of the FY 1981 budget, the City has balanced its budget in accordance with Generally Accepted Accounting Principles (GAAP), one year earlier than required by the FEA, with limited waivers permitted by State law in later years. (In general, a budget balanced under GAAP means that the City's current-year revenues equal current-year expenditures).

The City gradually increased its reserves through deposits of small "post-audit" surpluses in the years since then.[2] However, any withdrawal of these resources could not be recognized as current-year revenue on a GAAP basis since they were recorded in prior years, and therefore, were unavailable to help close budget gaps.[3]

Notwithstanding the legal constraints of the FEA, the City also effectively maintained a budgetary cushion through other means. In every fiscal year since 1981 the City has generated "pre-audit" surplus resources, which were recognized after the annual budget was adopted and were transferred to future fiscal periods (mostly to prepay debt service). Since these surplus resources were obligated prior to the close of each fiscal year (and became unavailable for any other purpose before July 1, the first day of the City's fiscal year), this practice has not prevented the City from maintaining budget balance as of the end of each fiscal year. Last year, for example, the City transferred $6.1 billion in surplus resources to FY 2022 to prepay debt service and a portion of retiree benefits.

In addition, in FY 2006 the City established the Retiree Health Benefits Trust (RHBT) to help fund the future cost of other post-employment benefits. Since then, the City has periodically deposited surplus resources generated during periods of economic expansion, but also effectively used the RHBT as a means to weather downturns.[4]

Recent developments have made it possible for the City to create an actual rainy-day fund. Pursuant to the New York City Charter Section 1528, which was created under charter revisions approved in the general election on November 5, 2019, the City's reserves were reclassified to "committed" (i.e., a type of unrestricted fund), making it available for use as a budgetary cushion, with State approval. In June 2020, the State amended the FEA to authorize the City to establish a Revenue Stabilization Fund, or rainy-day fund, and to exempt its deposits and withdrawals from deficit determinations.

On February 11, 2021, the Mayor established the fund by executive order and deposited $493.2 million into it, using City surpluses accumulated in past fiscal years (through FY 2020). The City recorded a "post-audit" surplus of $5.3 million in FY 2021, which was deposited into the rainy-day fund as required by State law.

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1 Government Finance Officers Association, "Fund Balance Guidelines for the General Fund," September 2015, at https://www.gfoa.org/materials/fund-balance-guidelines-for-the-general-fund

2 The term "post-audit" refers any operating surplus resources recognized between the City's last forecast and the publication of the City's audited annual financial statements. The surplus excludes restricted fund activity such as health stabilization fund transfers.

3 As they had to remain legally intact under the FEA, the City's general fund reserves were classified as "nonspendable," the highest level of spending constraint that can be placed on a fund balance under GAAP.

4 The RHBT held $4.2 billion as of June 30, 2021. The City also maintains annual budgeted reserves (currently $300 million in FY 2022, and $1.25 billion annually thereafter). The budgeted reserves do not carry over into future fiscal periods but could be used to help close budget gaps in those years if not needed for any other purpose.

Furthermore, the City announced in June 2021 that, only a few months after the fund's establishment, it would make a discretionary deposit (for the first time) of $500 million into the fund in FY 2022, raising the balance to $999 million.

The FEA of 1975 introduced a high standard for its time by requiring that the City's budget, not merely its accounting, be balanced in accordance with GAAP. This standard helped to eliminate inappropriate budgetary and accounting practices that had distorted the City's true financial condition. The recent changes to the FEA and the City Charter enable a prudent practice of setting aside general fund reserves, however, the changes also require enhancements to the City's reserve policy, including new guardrails to ensure funds are set aside systematically and are used only when truly necessary.

Purposes of Reserve Policies

Setting aside resources for unexpected needs and controlling their use to ensure they are available when needed are fundamental components of sound fiscal policies and management strategy. OSC's Division of Local Government and School Accountability has published a management guide on the types of reserve funds that certain local governments in New York can establish and maintain, which generally do not apply to New York City.[5] Our report focuses on the prerequisite development of general fund reserve policies and on considerations for improvement in New York City.

According to a recent publication from the National Association of State Budget Officers, many states first established rainy-day funds in the early 1980s in response to the fiscal challenges encountered during successive recessions from 1980 through 1982.[6] Such resources are intended to be used to support essential public services during revenue declines. As of today, all 50 U.S. states and the District of Columbia have established rainy-day funds.

While the primary concern then was the financial risk associated with an economic downturn, in recent decades it has become clear that significant financial risks are also associated with emergencies, including increasingly frequent and intense weather-related disasters (e.g., Superstorm Sandy and Hurricane Ida) and other extraordinary events such as terrorism attacks and global pandemics. Reserves can be used to respond quickly to such events.

Reserve policies guide long-term financial planning.The policies may specify the resources set aside for other future needs, such as capital construction, climate mitigation and even processes for providing tax relief. In addition to identifying appropriate purposes in writing, reserve policies also may designate a target reserve threshold or thresholds, and establish guidelines or requirements for the deposit, withdrawal and replenishment of funds.

Reserve policies reflect the great variation among the entities that adopt them, but a number of common practices ensure that funds are built up during growth cycles and are used prudently to manage emergencies and adverse economic conditions. (For additional information on the components of reserve funds, see Appendix A.)

Recent reviews by credit rating agencies suggest that governments that develop and maintain robust fiscal reserve policies may receive improved ratings compared to their peers. The improved ratings are based on higher scores associated with their financial management

[5] OSC, Division of Local Government and School Accountability, *Local Government Management Guide: Reserve Funds*, January 2010, at https://www.osc.state.ny.us/files/local-government/publications/pdf/reservefunds.pdf.

[6] National Association of State Budget Officers, "States Saving for A Rainy Day," January 2019, at https://community.nasbo.org/budgetblogs/blogs/kathryn-white/2019/01/03/states-saving-for-a-rainy-day

policies and improved unrestricted fund balance and cash reserves. Higher ratings generally result in lower interest expenses, reducing long-term debt service costs. (see Figure 1, page 7).

While the rating agencies give strong marks to the components of the rating associated with management and policies in New York City, reserves are generally noted as an area in need of improvement. In commenting on the City's Environmental Social and Governance factors, S&P Global noted that "the city established a formal rainy-day reserve in fiscal 2021, which bolsters our view of the city's governance, but the city has not yet created a plan to contribute to the reserve following the deposits made in fiscal 2021 and fiscal 2022."[7]

Moody's opined that one of the factors that could lead it to upgrade the City's general obligation bonds was "Stronger reserves, at levels similar to higher rated peers," noting that the City's reserves are "typically much lower than the sector and so provided limited financial resilience to its other exposures."[8] Fitch commented that "the ability to maintain a satisfactory financial cushion without overreliance on nonrecurring measures once [American Rescue Plan Act] funds are exhausted will drive future assessments of this key rating driver and potential changes in the future."[9]

Policies Among Largest Cities

The Office of the State Comptroller (OSC) reviewed the fiscal reserve policies of New York City and the next 9 largest U.S. cities by population to gain a better understanding of the shared features of such policies (for more detail, see Figure 2, page 8).

Our review found that other large cities typically adopt the practices detailed below.

- Publish, on a public-facing website, a statement of the reserve policy.
- Include as part of the reserve policy statement a section defining the purpose(s) of the unrestricted general fund reserves, including each account (e.g., an emergency and contingency reserve account, and a stabilization account to accumulate excess resources during periods of economic expansion).
- Define, in a policy target, the total amount of reserves to be set aside and the methodology to be used to determine reserve adequacy. The target is based on factors such as the volatility and diversity of revenue sources and other risks.
- Make annual deposits required until the policy target is achieved, and mandate that they be appropriated prospectively during the annual budget process (rather than restrospectively after a fiscal year has ended). This creates fiscal certainty of the amount to be deposited into the fund each year. Some cities have a policy to set aside or return excess reserves beyond the policy target.
- Provide a strong legislative check on the drawdown of emergency reserves by additional legislative approval. In addition, mayors are required to provide written justification for drawdowns before legislatures act on requests. Policies clearly define conditions that would constitute emergencies or otherwise

[7] S&P Global, "New York City; General Obligation," August 2021, at https://comptroller.nyc.gov/wp-content/uploads/2021/08/SP-Report-NYC-GO-2022A-2022-1.pdf.

[8] Moodys, "Rating Action: Moody's Assigns Aa2 to NYC GO Fiscal 2022 Series A, Subseries A-1 & A-2 and Fiscal 2022 Series 1; Outlook Stable," August 2021, at https://comptroller.nyc.gov/wp-content/uploads/2021/08/Moodys-Report-NYC-GO-2022A-2022-1.pdf.

[9] Fitch Ratings, "Fitch Rates New York City, NY's $1.2B GOs 'AA-'; Outlook to Stable," August 2021, at https://comptroller.nyc.gov/wp-content/uploads/2021/08/Fitch-Report-NYC-GO-2022A-2022-1.pdf.

necessitate withdrawals (such as declines in receipts compared to levels anticipated at the time of budget adoption).

- Require replenishment of all resources drawn down from the reserves over the shortest period of time that is practicable.

By comparison, the City of New York does not currently have a published policy defining the purpose(s) of its rainy-day fund, the policy target, or how resources would be replenished after a drawdown.

While New York State law requires surplus resources accumulated by the City to be deposited into the rainy-day fund as soon as is practicable after the end of a fiscal year (i.e., retrospectively), the City is not required to deposit the surplus resources that it uses to help balance the budget prior to the fiscal close (i.e., prospectively, as part of the annual budget adoption process).

As previously mentioned, for example, the City transferred $6.1 billion in surplus resources from FY 2021 to FY 2022 by prepaying certain expenses (mostly debt service). Much of these resources could have instead been deposited into the rainy-day fund under the recently enacted State and local laws.

The City may withdraw up to 50 percent of the resources in the rainy-day fund without cause, including in years when revenues exceed the City's initial projections. A larger share can be withdrawn if the Mayor certifies a compelling fiscal need, such as: a national or regional recession; a reduction in the City's revenues from the preceding fiscal year; a natural or other disaster; or a declared state of emergency in the City or in the State.

While the City does not have a policy target for minimum reserves, some cities have a policy to gradually increase their reserves by intercepting a portion of excess revenues they generate during periods of economic expansion. For illustrative purposes, OSC estimates that the City could have deposited an additional $452 million into its rainy-day fund since FY 2010 if the fund had been established then for each 1 percent of its annual "pre-audit" surplus generated in each of those years.

The appropriate amount of reserves would depend on the City's assessment of its risk and any other potential fiscal uncertainties.

In March 2018, the City Council published an estimate of reserves needed to mitigate fiscal risks during fiscal years 2018 through 2021 by simulating a variety of budgetary outcomes.[10] It was suggested at that time the City set aside between $2.6 billion and $20.7 billion (an implied target of 2.5 to 20.5 percent of spending in FY 2021), depending on the level of risk the City is willing to accept while avoiding raising taxes or cutting any services as a result.

The City Comptroller recommends the City set aside 12 percent to 18 percent of the operating budget (adjusted for surplus transfers) as budgetary cushion.[11]

Conclusion

Recent changes in the City Charter and New York State law have provided the City more reserve flexibility with the creation of a rainy-day fund, and the City has already made a significant down payment to increase its reserves. The new mayoral administration and the City Council have an opportunity not only to further build these reserves, but also to shape the City's fiscal reserve policy to ensure funds are available to manage uncertainties for years to come.

[10] New York City Council Finance Division, "Budget Reserves: How Much Does New York City Need?." March 2018.

[11] City Comptroller, "Measuring New York City's Budgetary Cushion: How Much is Needed to Weather the Next Fiscal Storm?,"August 2015, at https://comptroller.nyc.gov/wp-content/uploads/documents/PARR_Report_Final.pdf

Based on our review of the reserve policies and practices of other large U.S. cities, OSC recommends that the City consider implementing additional guardrails as part of its revised general fund reserve policy. Enhancements could include:

- Defining the purpose(s) of the rainy-day fund, the conditions for withdrawal and the order in which accounts would be drawn; and earmarking a portion of reserves for emergencies.
- Establishing policy targets for the amount of resources to be set aside in the rainy-day fund (expressed as a share of operating revenues or spending) based on an analysis of revenue volatility and other uncertainties, and setting forth a mechanism for determining annual deposits.
- Modifying State law and the City Charter, as needed, to require annual deposits into the fund until the targets are met.
- Requiring the Mayor to provide a clear rationale for any amount withdrawn (based on need), and requiring additional legislative approval to withdraw resources from any emergency account (the uses of and modifications to other accounts would continue to be subject to a simple majority approval).
- Adding a provision which requires that amounts drawn down be replenished over the shortest period of time that is practicable.

FIGURE 1

Credit Ratings and Management Scores, Ten Largest U.S. Cities

(Unrestricted General Fund Balances and Operating Expenses Reported as of Local Fiscal Year 2020)

City	Ratings (S&P / Fitch / Moody's)	Characterization of Reserve Levels (S&P / Moody's)	Unrestricted Fund Balance as Share of General Fund Operating Expenses	10-Year Change in Unrestricted Balance (p.p.)
New York	AA / AA- / Aa2	Strong / A	0.6%*, ($493M)	0.6 p.p.
Los Angeles	AA / AAA / Aa2	Very Strong / Aa	17.0%, ($929M)	4.4 p.p.
Chicago	BBB+ / BBB- / Ba1	Strong / A	8.9%, ($328M)	(1.3 p.p.)
Houston	AA / AA / Aa3	Very Strong / Aa	15.7%, ($335M)	7.5 p.p.
Phoenix	AA+ / AAA / Aa1	Very Strong / Aa	28.7%, ($363M)	(2.2 p.p.)
Philadelphia	A / A- / A2	Strong / A	8.7%, ($414M)	10 p.p.
San Antonio	AAA / AA+ / Aaa	Very Strong / Aa	28.8%, ($335M)	2.5 p.p.
San Diego	AA / AA / Aa2	Strong / A	12.5%, ($215M)	3.4 p.p.
Dallas	AA- / AA / A1	Very Strong / Aa	24.9%, ($321M)	14 p.p.
San Jose	AA+ / AAA / Aa1	Very Strong / Aaa	41.5%, ($458M)	17.3 p.p.

Note: Notation "p.p." refers to percentage points. Dollars are in millions. Ratings are based on the implied underlying issuer rating or issuer default rating from each of the major credit rating agencies. Fitch's assessment of reserves considers more components than fund balance levels in deriving its sub-score and has been excluded from the analysis in the second column for this reason.

*Unrestricted fund balance on its own is not an accurate comparison of flexibility, as New York City developed alternative tools to remain compliant with GAAP and statutes. Rating agencies generally give credit for these alternative forms of flexibility in assessing the City's budgetary cushion compared to its peers. S&P, Moody's and Fitch have assessed reserves at about 8 percent of spending in FY 2020.

Sources: Municipal General Fund Reserve Policies of each city (if published); S&P Global; Moody's Investors Service, Inc.; Fitch Ratings, Inc.; Comprehensive Annual Financial Reports of each city; OSC analysis

FIGURE 2
Components of General Fund Reserve Policy, Ten Largest U.S. Cities

City	Purpose	Targets	Deposits	Withdrawals	Replenishment
New York	**No Defined Purpose**	**No Policy Target**	Required for Annual Surpluses but Determined Retrospectively. May make discretionary deposits	Authority to Withdraw and Acceptable Use Defined. **Any amount subject to simple majority approval; no justification required for first 50 percent**	No Written Policy
Los Angeles	Purpose Clearly Defined	Has Policy Target (5 percent of operating revenues)	Budgeted Prospectively	Authority to Withdraw and Acceptable Use of Reserves Defined	Required and Determined Prospectively
Chicago	Purpose Clearly Defined	Has Policy Target (Implied target of 16.7 percent of operating expenses)	No Written Policy	No Written Policy	No Written Policy
Houston	Purpose Clearly Defined	Has Policy Target (7.5 percent of operating spending)	Budgeted Prospectively	Authority to Withdraw and Acceptable Use of Reserves Defined	Required and Determined Prospectively
Phoenix	Purpose Clearly Defined	Has Policy Target (5 percent of operating spending)	Budgeted Prospectively	Authority to Withdraw and Acceptable Use of Reserves Defined	No Written Policy
Philadelphia	Purpose Clearly Defined	Has Policy Target (6 to 8 percent of operating revenues)	Budgeted Prospectively	Authority to Withdraw and Acceptable Use of Reserves Defined	No Written Policy
San Antonio	Purpose Clearly Defined	Has Policy Target (15 percent of operating revenues)	Budgeted Prospectively	No Written Policy	No Written Policy
San Diego	Purpose Clearly Defined	Has Policy Target (Implied 16.7 percent of three-year rolling average of operating revenue)	Budgeted Prospectively	Authority to Withdraw and Acceptable Use of Reserves Defined	Required, But Replenishment Period Is Discretionary
Dallas	Purpose Clearly Defined (except for "residual" reserves)	Has Policy Target (Implied target of 11 percent of operating spending)	Budgeted Prospectively	Authority to Withdraw and Acceptable Use of Reserves Defined	Required, But Replenishment Period Is Discretionary
San Jose	Purpose Clearly Defined	Has Policy Target (10 percent of operating spending)	Budgeted Prospectively	Authority to Withdraw and Acceptable Use of Reserves Defined	Required and Determined Prospectively

Note: Includes the 10 largest U.S. cities by population. Determined Prospectively means the amounts set aside for deposits or replenishment are appropriated during the annual budget process. Determined Retrospectively means the amounts set aside for reserves are calculated after the close of a fiscal year. The purpose of New York City's rainy-day fund is implied under the General Municipal Law and City Charter but not explicitly stated in a formal policy. The City also does not have a policy target for minimum reserves. In the past, however, the City Comptroller has recommended a reserve target of 12 to 18 percent of operating spending.
Sources: Municipal General Fund Reserve Policies of each city (if published); Comprehensive Annual Financial Reports of each city; OSC analysis

Appendix A: Key Components

Reserve policies reflect the unique circumstances of each governmental entity that put them in place, and certain elements used by other cities may not be appropriate for New York City. However, OSC recommends that the City consider some best practices, including those issued by the GFOA, of key components of general fund reserve policy.

Purpose

A statement of the objective or objectives of the rainy-day fund and each constituent account. For example, such a statement may include the intent that reserves be used to mitigate state or federal actions that reduce categorical aid to the City; or to mitigate economic downturns.

Policy Target

A statement of the target size of the reserves and the government's rationale behind the target level of funding. The GFOA recommends, at minimum, that governments maintain an unrestricted budgetary fund balance in their general fund of no less than two months of operating revenues or spending, which is an implied target of one-sixth (16.7 percent) of such revenues or spending.

The GFOA acknowledges, however, that an unrestricted fund balance significantly lower than the recommended minimum may be appropriate for large governments because such entities are in a better position to predict contingencies, and because their revenues and expenditures often are more diversified, which may reduce budgetary volatility.

Deposits

A description of the budget process and the analytical approach to be used to determine the amount of resources to be added to the fund each year to reach the policy target. The amounts may be determined prospectively through the annual budget process and appropriated in time for budget adoption, or retrospectively during the annual process for closing the fiscal year. The reserve policy specifies the entity or entities responsible for calculating the deposits, and the data and methods used to determine the amounts to be appropriated. The document may also include a policy for excess resources held in the fund to go to taxpayers, or a process to hold the excess resources in a stabilization account during periods of economic expansion.

Withdrawals

A description of the process the government entity will use to draw down the reserves for a purpose prescribed within the reserve policy. This should include a description of the acceptable uses of reserves and the identification of decision makers who may authorize the use of the reserves. In cases where the use is subject to approval of the legislative body (which is typical), the policy describes whether a simple majority or supermajority is required for each account within the fund. The Mayor may be required to submit written justification before a drawdown may be authorized.

Replenishment

A description of the process to replace any reserves, which were previously drawn down for a purpose prescribed within the reserve policy, within the minimum amount of time that is practicable to do so.

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