The Rainy Day Fund

Louisville Metro Government has a Rainy Day Fund of $69.4 million – the smallest Rainy Day Fund we have had since merger, when measured as a percentage of revenue; and has been noted by credit agencies as low compared to cities receiving the same rating. Rainy Day Funds are to be used for one-time emergency expenditures. Use for ongoing expenses is considered fiscally irresponsible and would mean LMG has less funding in the case of real one-time emergencies and likely would lessen our credit rating and therefore our ability to borrow funds for critical infrastructure and economic development investments.

Background

"Rainy Day" Funds" or Unassigned Fund Balance. are funds set aside for an emergency or unexpected event. The Unassigned Fund Balance provides Louisville Metro Government (LMG) the ability to pay bills when cash inflows fall below cash outflows, thus avoiding liquidation of investments. Several of LMG revenues are cyclical, such as property taxes, and yet our operating expenses tend to remain constant. This naturally draws on cash balances faster than revenue is received. Metro must maintain a constant cash reserve to draw on without incurring any additional costs. Conversely, when LMG revenues exceed outgoing expenditures, the Unassigned Fund Balance provides additional investment income as planned investments are managed to match these cyclical cash funds. The Unassigned Fund Balance provides a stabilizing effect on cash flows, effectively reducing borrowing costs and provide investment income when not being used.

The Government Finance Officers Association recommends that, at a minimum, governments should maintain an Unassigned Fund Balance of no less than one to two months of regular general fund revenues or general fund expenditures, whichever provides the best predictability. Other factors to consider when determining the appropriate amount include perceived exposure to large one-time outlays such as disasters or immediate capital needs; dependable Intergovernmental Revenue; the potential drain from other funds to address deficits; liquidity; and the amount of commitments and assignments.

As of June 30, 2018, our last audit, LMG Unassigned Fund Balance is $69.4 million. While this is the largest balance since merger, as a percentage of revenue it is at 10.7%, the lowest since merger.

Purpose of a Rainy Day Fund

Backstop to Risk Funds: Metro has two risk funds that provide insurance for health, workers compensation, liability, property, auto and other various coverages. While these pools are currently funded sufficiently, they are not funded at 100 percent. So, if the city were to incur multiple large losses, the Unassigned Fund Balance, meant to serve as one means of a backstop, could be insufficient.

One-Time Emergencies: LMG has utilized Rainy Day funds for this purpose once since merger – to cover a court-ordered payment relating to a Firefighter's settlement. LMG used multiple funding sources for the settlement and still had a shortfall. The Unassigned Fund Balance was utilized based on the criteria of current policy. It took four years to restore the Unassigned Fund Balance to a level greater than the amount at withdrawal.

> **Pew Says the Decision to Use Rainy Day Funds for Structural Imbalances Only Delays Fundamental Decisions.** In a 2017 report by the Pew Charitable Trusts on state Rainy Day Funds, which they refer to as "budget stabilization funds," the authors noted that, "The money set aside in a budget stabilization fund is, by definition, a one-time revenue source. Money taken out of the fund during one fiscal year will not be available to balance the following year's books. Therefore, using these savings to address a budget gap caused by a cyclical economic downturn—by definition, temporary—is sensible. However, using them to cover a shortfall caused by ongoing structural imbalances in a state's budget— specifically, the difference between ongoing revenue and spending commitments—only delays fundamental policy decisions about taxes and spending.[i]

Rainy Day Fund and impact on debt

The ability to maintain adequate levels of fund balance is key point of evaluation when LMG goes to secure new debt, as well as how we maintain the financial stability that current bond holders desire. Credit rating agencies will monitor the financial reports for any material shifts in Unassigned Fund Balance. During each issuance, agencies such Moody's or Fitch will look at this key indicator and assess the fund levels as compared to peer cities.

Louisville Already Has a Small Rainy Day Fund Compared to Other Cities in our Rating Category: In Moody's most credit rating of Louisville Metro Government, they noted that we had "lower reserves and liquidity compared to national peers" and that our "operating fund balance is. . .below the national Aa1 median." Therefore, a smaller Rainy Day Fund would almost certainly lower our rating.

Replenishment Plan

In order to ensure stability, and highlight that stability to credit rating agencies, LMG policy requires that there be a plan when an Unassigned Fund Balance is utilized, that states how and when the fund will be replenished. Typical means are dedicated revenues or changes in inputs and outputs to fund the gap in fund balance.

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[i] https://www.pewtrusts.org/~/media/assets/2017/04/when-to-use-state-rainy-day-funds.pdf