Commonwealth of Massachusetts

Executive Office for
Administration and Finance

Stabilization Fund & Long-Term Liability Financing Task Force

October 16, 2025

Agenda

- Roll Call
- 09/25 Meeting Recap
- Stabilization Fund Review
  - Deposit Policies
  - Fund Sizing
  - Withdrawal Policies
- Pew Analysis
- Key Takeaways
- Next Meeting Preview

09/25 Meeting Recap

Key Takeaways

- Task Force created to examine financing of the state's long-term liabilities, including our current capital gains policy and policies around Stabilization Fund funding and sizing
- In FY11, Massachusetts established a cap on excess capital gains available for the budget due to its volatility
  - The cap started at $1 B and then adjusted in future fiscal years based on economic growth
  - Collections over the cap were diverted to the Stabilization Fund (90%), Pension Liability Fund (5%) and State Retiree Benefit Fund (5%)
- The policy has been effective; however, there is evidence that it has fallen behind actual economic growth – indicating that a **$300-$600 M** upward adjustment may be warranted
  - In addition, anchoring the threshold to the rolling average of revenue may help it keep better pace with actual economic activity

Task Force Charter: Stabilization Fund

Task Force charter explicitly requires certain aspects of our Stabilization Fund policies be reviewed

- While each of the topics outlined in the statute relates to policies critical to the Stabilization Fund, there are several specific aspects explicitly called out that we will review today:

1. The appropriate long-term level of funding
2. Best practices related to the funding and size of stabilization funds among states

- These considerations are in addition to the larger questions around the review of Section 5G discussed last week, as well as general best practices for funding long-term liabilities

Deposit Policies

State Deposit Policies Overview

Massachusetts is one of a handful of states that use both year-end surpluses and dedicated special revenues to support its Stabilization Fund

- According to the Tax Policy Center and the National Association of State Budget Officers (NASBO), most states direct at least some portion of their year-end surpluses to their stabilization funds, while some require a flat contribution from total revenue or a special revenue source
  - Like Massachusetts, California dedicates a portion of its capital gains tax revenue to its main reserve
  - Oil-rich states, such as Texas and Louisiana, dedicate a share of oil extraction revenues
  - A few states tie their deposit amounts to economic growth. For example, Arizona has a personal income growth formula that dictates its deposits
- Some states even include discretionary appropriations to replenish reserves through the budgetary process

Deposit Mechanism (as of 2021)	States
All or portion of year-end surplus	Arkansas, Georgia, Kansas, Kentucky, Minnesota, Mississippi, Montana, New Jersey, New Mexico, New York, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, South Dakota, Utah, Vermont, West Virginia, Wisconsin
Portion of total or special revenues	Alaska, California, Rhode Island, Wyoming
Tied to revenue or economic growth	Arizona, Idaho, Illinois, Indiana, Michigan, North Carolina, Tennessee, Virginia
Required minimum balance	Colorado, Florida, Iowa, Missouri, South Carolina
Combination	Connecticut, Delaware, Hawaii, Louisiana, Maine, Maryland, Massachusetts, Nebraska, Nevada, New Hampshire, Texas, Washington
No required payments	Alabama

Massachusetts Deposit Policies

The Stabilization Fund has been primarily funded by excess capitals; however, additional policies have been added to contribute to its growth

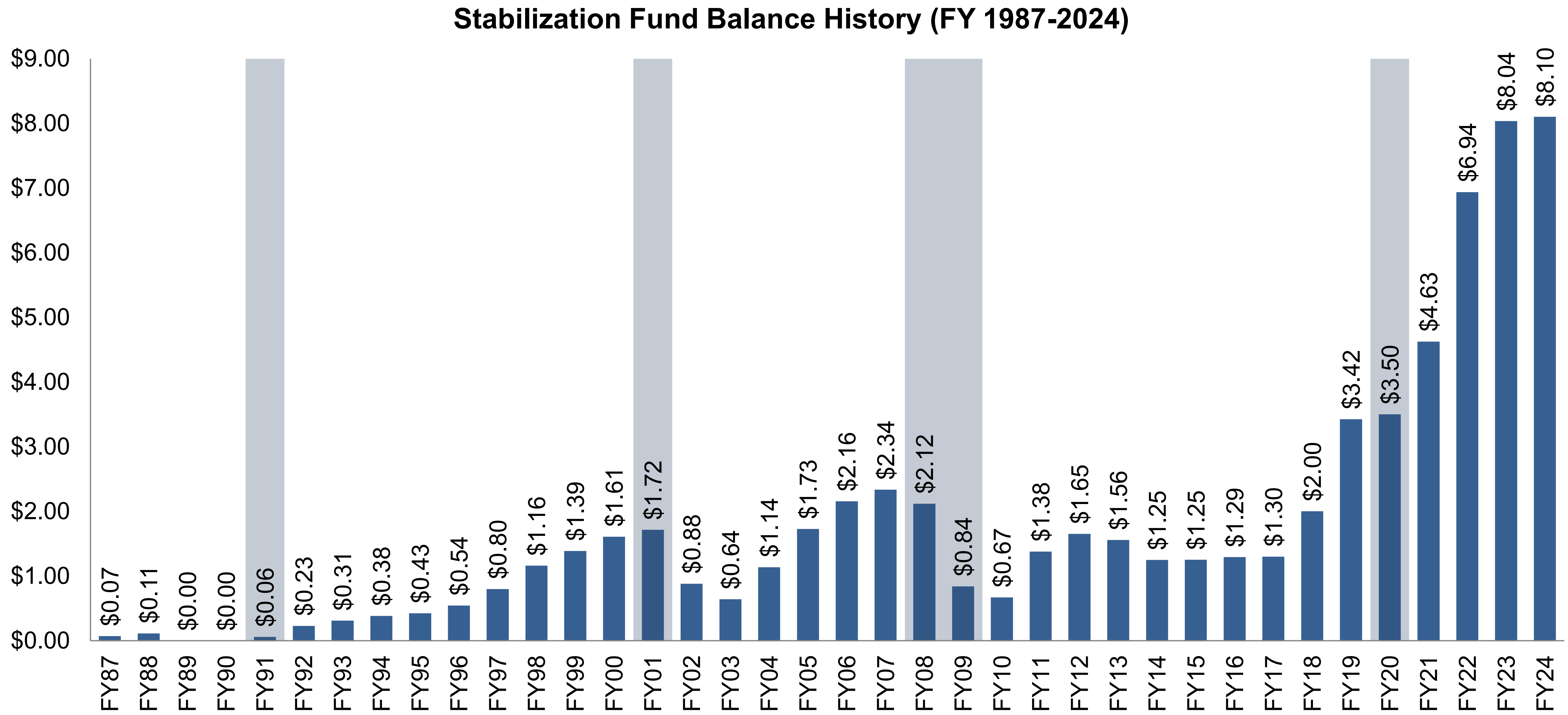
- When the fund was first created, the Legislature only dedicated any **year-end surpluses from budgeted funds** to support it
- Since then, several other revenue stream have been established to support the fund
- Massachusetts policies meet best practices of using one-time, volatile revenue to build reserves

1. **Excess Capital Gains**
   - In FY 2011, Section 5G of Chapter 29 dedicated 90% of any excess capital gains to the fund
   - This policy has accounted for more than 70% of the fund's growth since the policy's establishment
2. **Casino Gaming Revenue**
   - 10% of casino gaming tax revenue is dedicated to the fund via the 2011 expanded gaming law
3. **Abandoned Property**
   - 75% of net abandoned property revenue growth over the prior year is transferred to the fund
4. **Certain Tax Collections**
   - Tax judgments and settlements over $10 M that exceed the previous 5-year average and a portion of withholding income from Lottery prizes

- In addition, interest earned on the fund has generally been retained; however, interest earning are temporarily being used for federal fund matching and pay-go capital opportunities

Fund Sizing

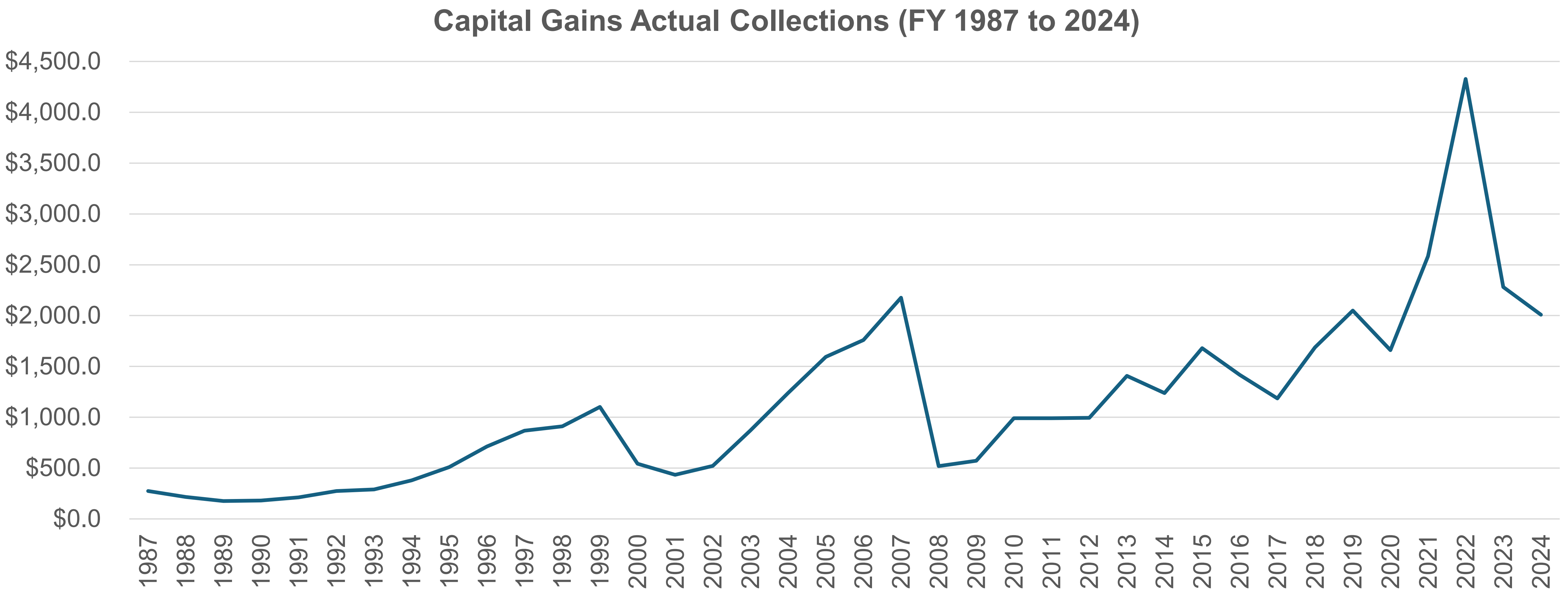
Stabilization Fund Balance History



CONFIDENTIAL DRAFT: FOR POLICY DEVELOPMENT PURPOSES

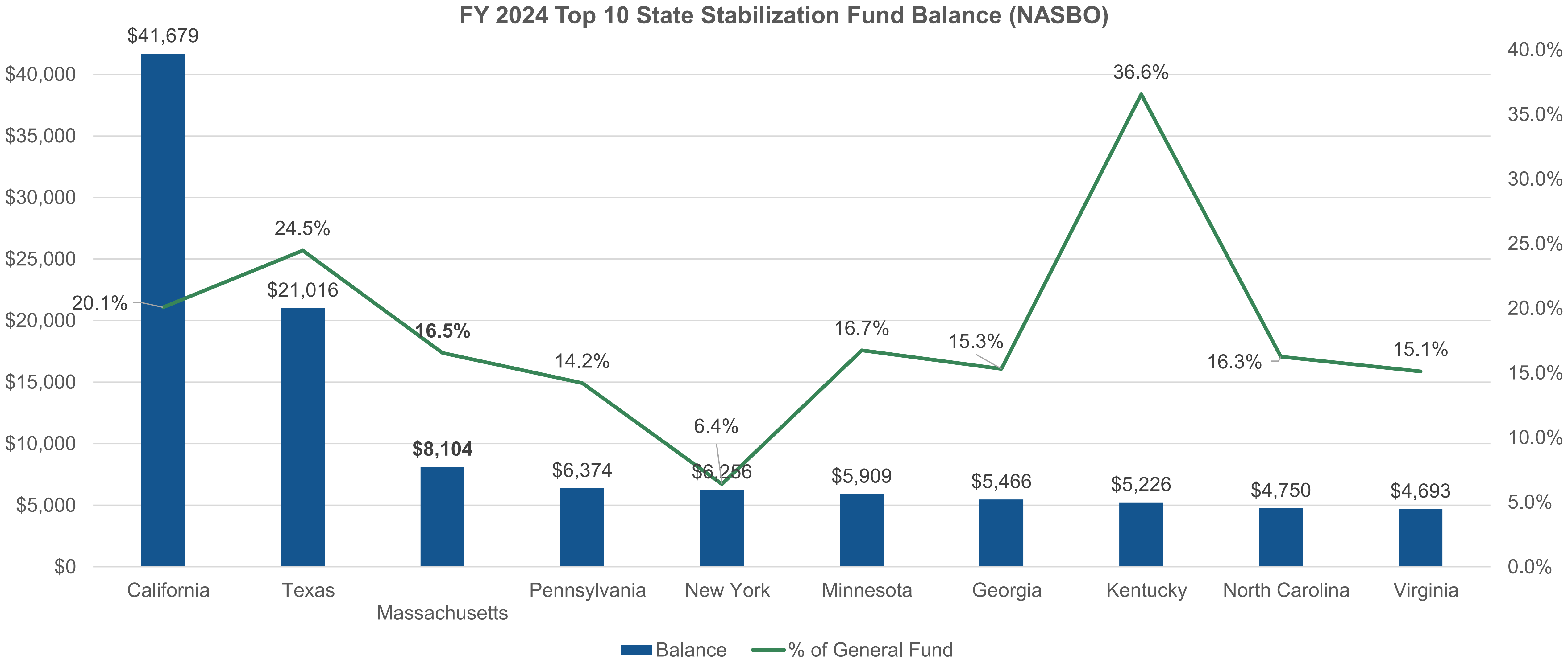
Capital Gains Collection History

Capital gains has been the primary driver for Stabilization Fund growth – the balance has grown by more than 130% since the pandemic, during a historic stock market period



Stabilization Fund Balance: State Comparisons

State stabilization fund balances averaged $3.5 B and 16.5% of general fund expenditures in FY24



CONFIDENTIAL DRAFT: FOR POLICY DEVELOPMENT PURPOSES

Best Practices on Fund Size

While there are several common metrics used to size up fund balances, Massachusetts performs well against the typical measuring sticks

- According to the Boston Federal Reserve, rules of thumb around stabilization fund balances have varied over time
  - The National Conference of State Legislatures previously recommended **5%** of annual general fund expenditures
  - The Center on Budget and Policy Priorities has suggested **15%** of annual general fund expenditures
  - The Government Finance Officers Association makes its recommendation based on operating runway – suggesting **approximately 60 days** of general fund operating expenses (totaling **~16.7%** of annual operating expenditures)
- While these ranges are helpful for anchoring, many policy experts support a more dynamic measurement by using a **budget stress test**
  - These stress tests allow states to forecast how tax revenues might perform in recessionary environments
  - Particularly important because states vary in terms of revenue volatility
  - States can then use these forecasts to model out how much would be needed from their stabilization funds to manage through these scenarios

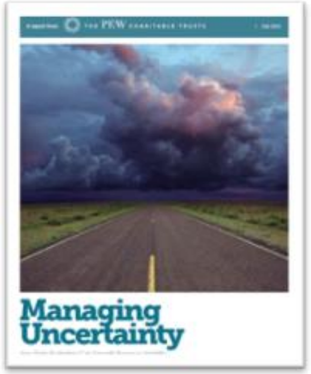
Withdrawal Policies

Massachusetts Withdrawal Policies

Massachusetts currently matches most states with more broadly defined scenarios for drawing down reserve

- Like most states, Massachusetts requires a majority vote from the Legislature before any transfers can be made from the Stabilization Fund
  - Further, the statutory language requires a hearing before the Joint Committee on Ways and Means and a comprehensive analysis of other tools prior to a withdrawal
- Eligible uses for the Stabilization Fund include:
  1. To make up any difference between actual state revenues and allowable state revenues in any fiscal year in which actual revenues fall below the allowable amount
  2. To replace the state and local loss of federal funds; or
  3. For any event which threatens the health, safety or welfare of the people or the fiscal stability of the commonwealth or any of its political subdivisions
- Further, the statute notes that these events may include "a substantial decline in economic indicators" that may disallow the state from paying for obligatory programs or services
- These broader definitions allow the state to remain flexible, while the required proceedings between the Executive Branch and the Legislature create a consensus approach for the fund's use

Pew's Research on Rainy Day Funds



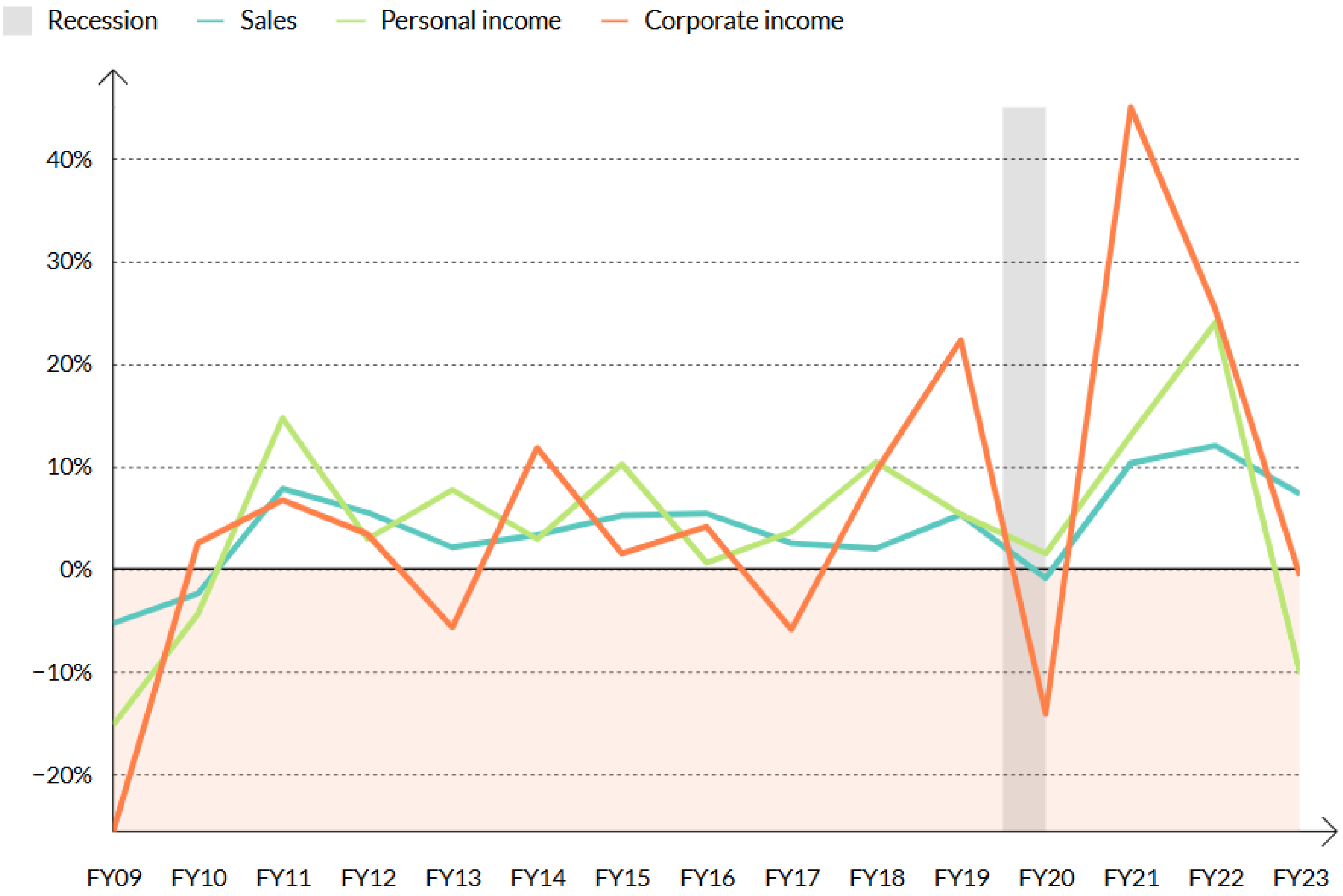
Why States Save

Because states' major taxes are sensitive to economic conditions, states are prone to boom-and-bust revenue cycles.

By saving during periods of unusually high revenue, states can build reserves to maintain consistent public services when revenues decline.

Year-Over-Year Percent Change of Major Tax Revenue Sources

Massachusetts, 15 years ending fiscal year 2023



Source: The Pew Charitable Trusts, [Fiscal 50]

Best Practices: Deposit Rules

Policy Question	Recommended Practice	Massachusetts' Approach
What revenue should be directed to the rainy day fund and when?	Deposit a portion of one-time revenues and the volatile portion of ongoing revenue sources in the rainy day fund	Deposits revenue from taxes on capital gains above a threshold; portion of year-end surpluses; and portions of revenue from casinos, abandoned property, and legal settlements

Considerations for following best practices:

- The capital gains deposit rule is in line with the recommended practice. Consider whether the capital gains rule is well-designed to save temporary revenue spikes and achieve target stabilization fund levels.

Best Practices: Withdrawal Rules

Policy Question	Recommended Practice	Massachusetts' Approach
In what circumstances should lawmakers be allowed to appropriate money from the rainy day fund?	Allow withdrawals only or primarily during temporary revenue downturns or economic downturns	Withdrawals permitted to address economic downturns, budget shortfalls, the loss of federal funding, and other conditions

Considerations for following best practices:

- If policymakers intend for the stabilization fund to be available primarily for downturns or temporary revenue declines, restrict withdrawals to that purpose or create a high bar for withdrawals for other purposes.

Withdrawal Conditions Used in Other States

- **Louisiana:** Withdrawals permitted if there is a forecasted decline in the next year's recurring revenue, if a current-year deficit is projected, or if a federal disaster is declared.

- **New York:** Commissioner of labor produces a monthly economic index that includes private sector employment, average weekly hours of manufacturing workers, and the unemployment rate. Withdrawals are permitted if the index declines for five consecutive months.

- **Oregon:** Withdrawals permitted after one of the following conditions are met: the latest quarterly economic and revenue forecast for the biennium projects that next year's revenue will be at least three percent less than current biennium general fund appropriations; there has been a decline for two or more consecutive quarters in the last 12 months in seasonally adjusted nonfarm payroll employment; a quarterly forecast indicates that general fund revenue for the current biennium will be at least two percent below the forecast on which the current budget was based.

Sources: Louisiana, New York, and Oregon

Best Practices: Savings Targets

Policy Question	Recommended Practice	Massachusetts' Approach
How much money does the state need to save in the rainy day fund?	Use budget stress tests to set savings targets	No formal savings target; stress test under development. The stabilization fund has a cap, but it isn't necessarily an evidenced-based target

Considerations for following best practices:

- Budget stress tests estimate the size of temporary budget shortfalls that would result from recessions and other economic events and then gauge how prepared states are to weather those events.

- The stress test required in the FY 2026 enacted budget offers an opportunity to set a savings target.

How States Use Stress Tests to Inform Savings Targets

- A first stress test should allow Massachusetts to develop an initial target, but the target is likely to change over time.

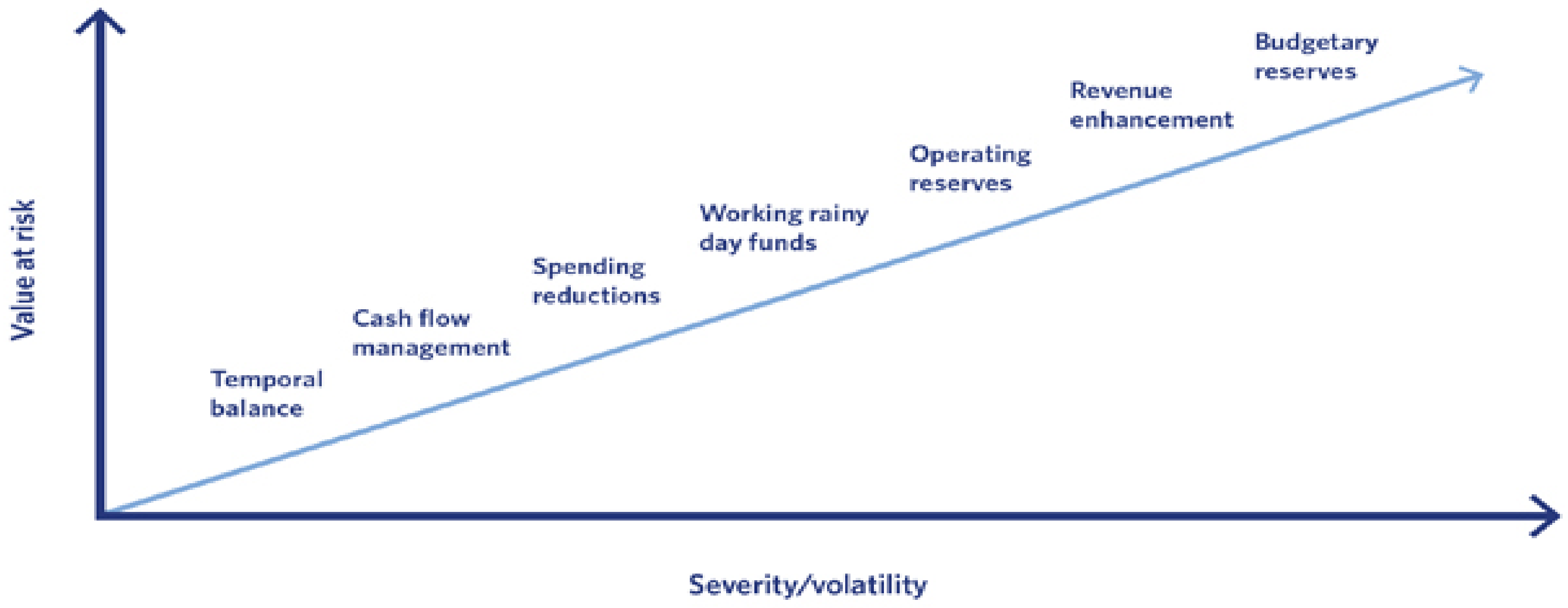
- Pew recommends that states conduct stress tests regularly, prior to the development of each new budget.

- Minnesota and North Carolina are potential models for this approach: both use regular, statutorily-required stress tests to automatically adjust target balances for their rainy day funds.

Stress Tests and Other Budget Contingencies

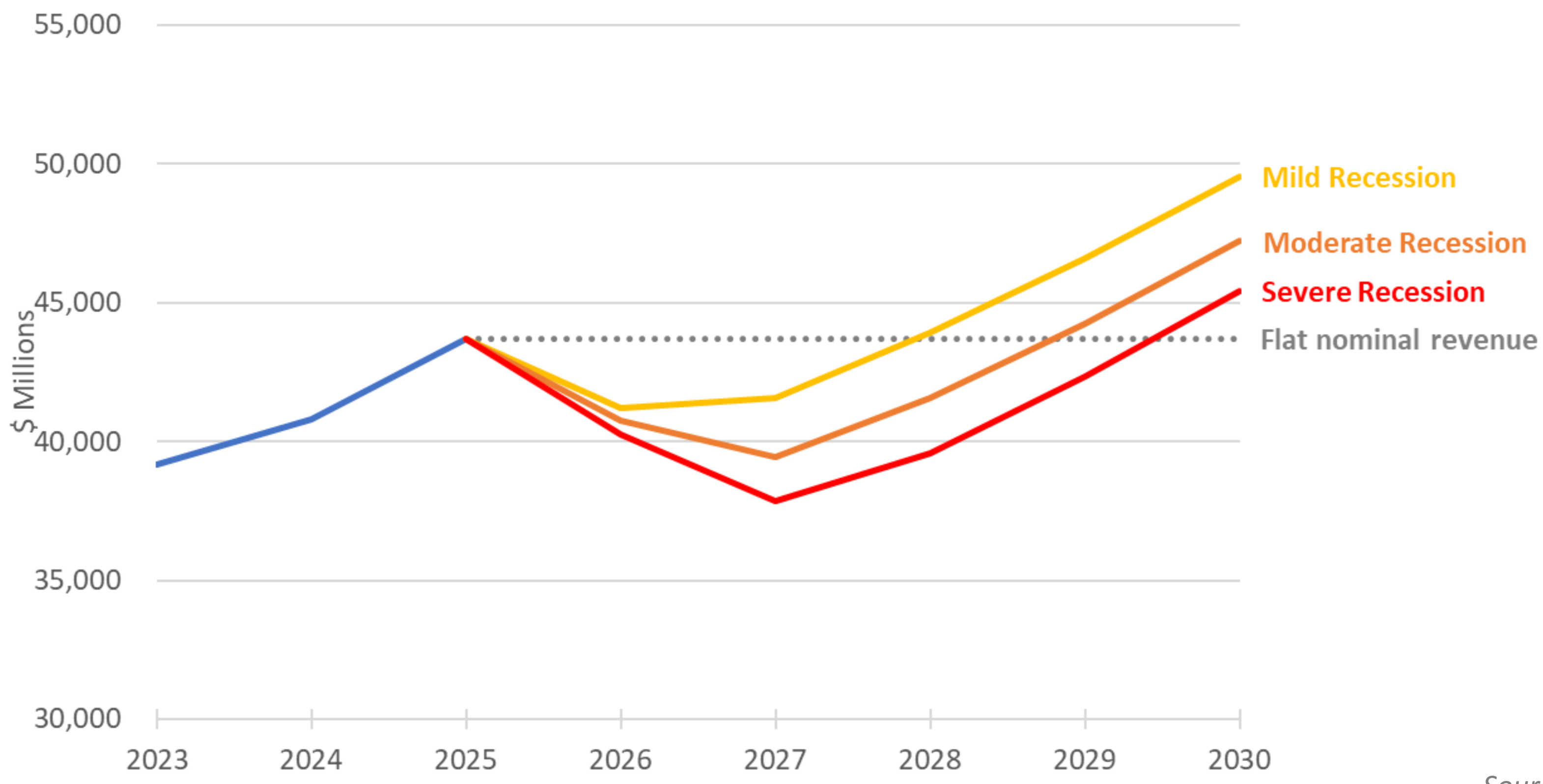
Utah's Fiscal Toolkit

Cataloging and ordering options help policymakers plan for different scenarios



Source: Utah's Office of the Legislative Fiscal Analyst

Massachusetts' Budget Stress Test



Revenue shortfall compared to…

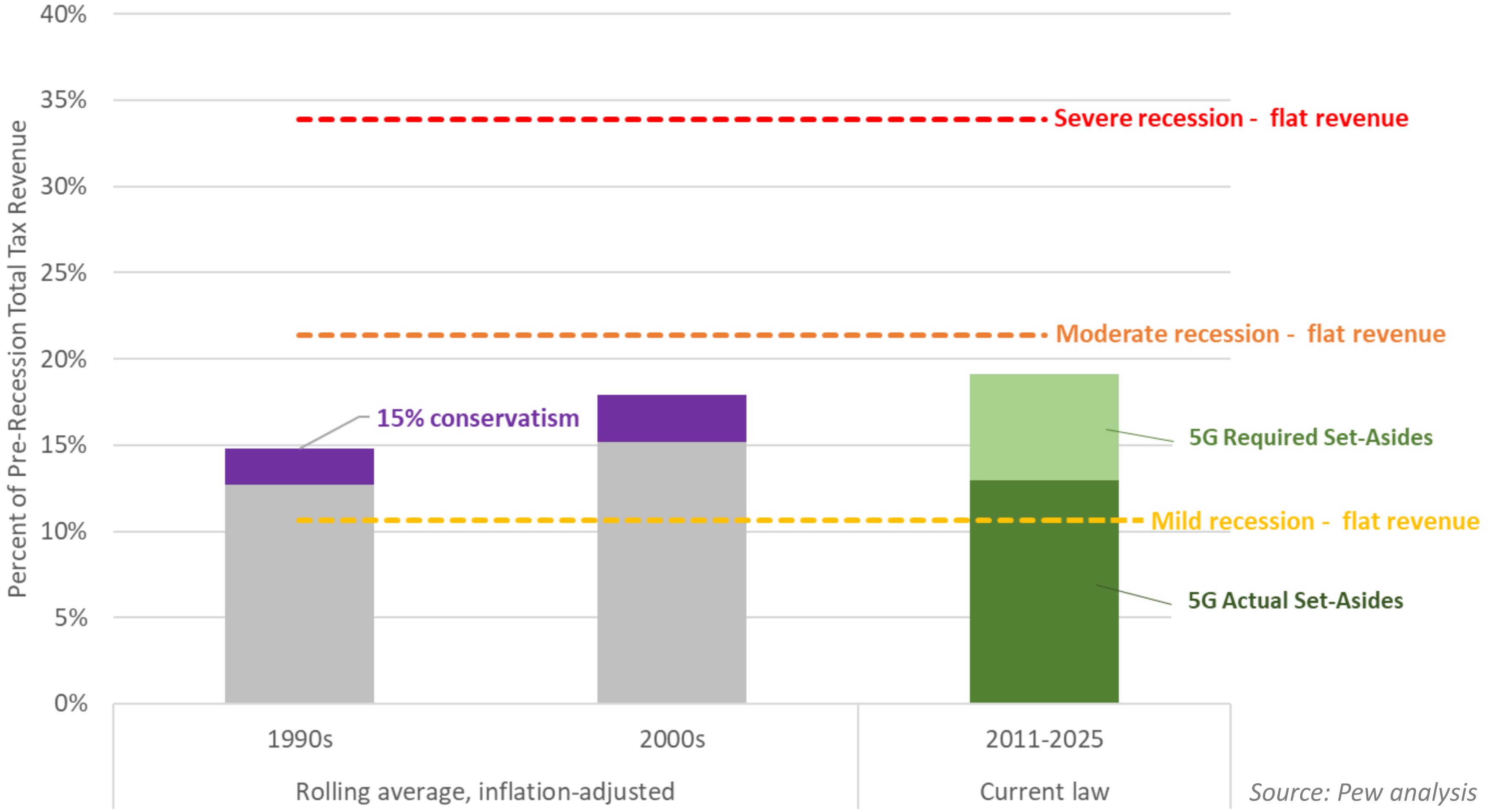
…baseline revenue	…flat revenue
26%	11%
48%	21%
65%	34%

Source: Pew analysis of Department of Revenue calculations.

Questions for Translating Stress Tests into Savings Targets

- What severity of recession/revenue decline should the state be prepared for?
- What are the state’s goals for maintaining services during a recession?
- Beyond the stabilization fund, what budget tools are available to close gaps?
- How much savings are likely to result from different savings policies?

Excess Cap Gains from Previous Revenue Surges vs. Revenue Declines



Source: Pew analysis

- 5G has helped the state be relatively well prepared to cover revenue loss in a moderate recession.
- Saving enough to cover revenue losses in a severe recession would likely require significant changes to section 5G (e.g. saving a portion of total revenue each year).
- The proposed changes to 5G are unlikely to materially affect recession preparedness.
- Reserves are best viewed as part of a package of tools that can address revenue losses and cost pressures during recessions.

Pew

Upcoming Schedule/Topics

Upcoming Topics

- Week of November 3 - Pension Liability Fund: unfunded liability; market performance; stress testing; next triennial schedule
- Week of November 17 – OPEB: liability; best practices; other long-term liabilities (i.e., disaster relief funding); ratings agency considerations
- Week of December 1 – discussion on key considerations/recommendations
- Week of December 15 – file report

Key Takeaways

Key Takeaways

1. Our current deposit policies – notably its excess capital gains rules – are relatively strong compared to other states

2. While we checks box on most standard metrics, the introduction of a regular stress test would help inform policymaking

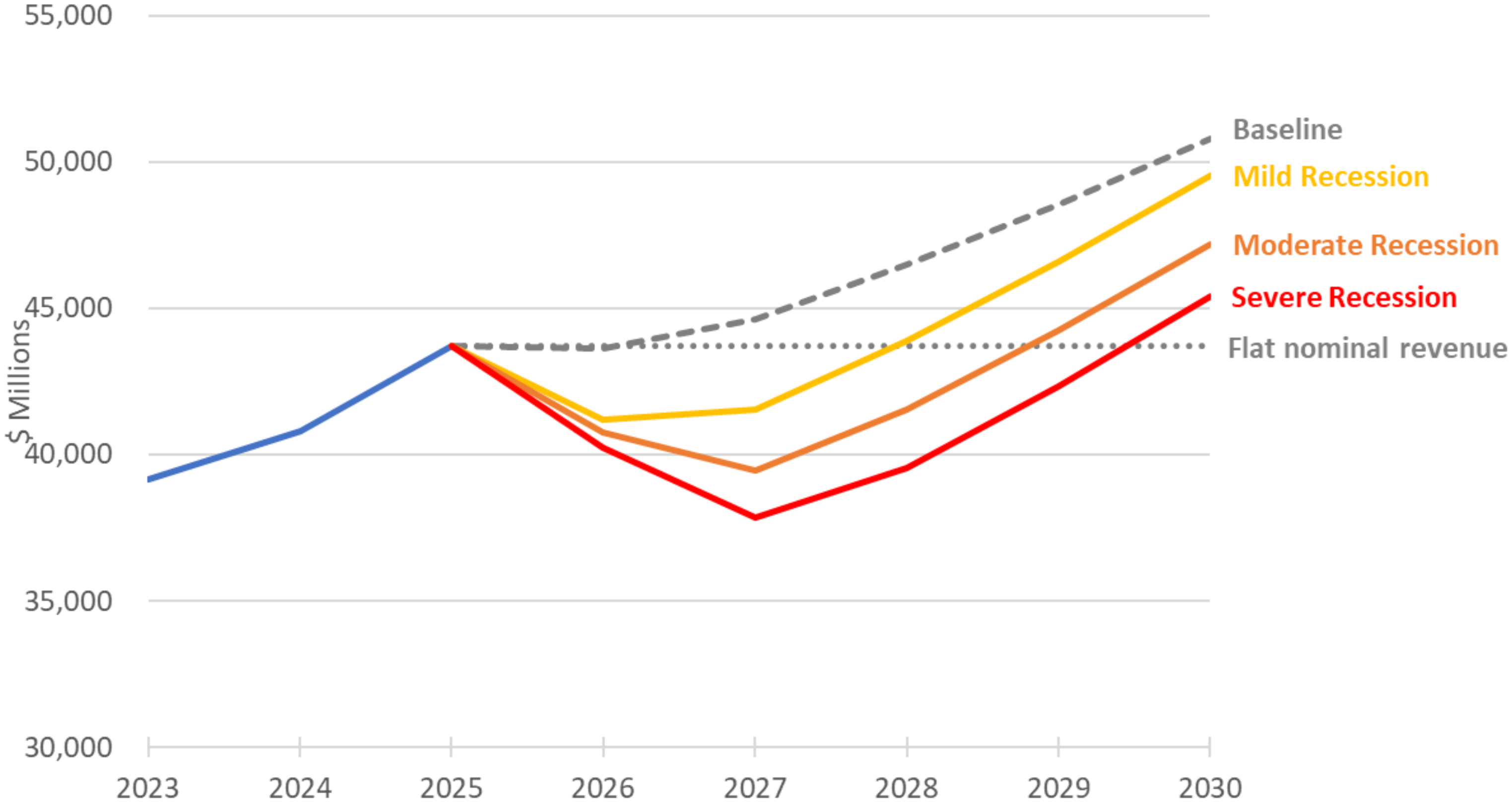
3. Our state withdrawal parameters could be strengthened – even if by just establishing best practices – to ensure clear metrics guide fund use

Appendix

Relevant Resources

- Task Force Enabling Statute (Section 5) – An Act to Provide for Competitiveness and Infrastructure Investments): https://malegislature.gov/Laws/SessionLaws/Acts/2024/Chapter214
- Capital Gains Threshold and Excess Capital Gains Transfer (Section 5G of Chapter 29 of the General Laws): https://malegislature.gov/Laws/GeneralLaws/PartI/TitleIII/Chapter29/Section5G
- Initial FY 2011 Capital Gains Threshold Policy Brief: https://budget.digital.mass.gov/bb/h1/fy11h1/exec_11/hbudbrief15.htm

Massachusetts’ Budget Stress Test – Including Surtax



Revenue shortfall compared to…

…baseline revenue	…flat revenue
26%	11%
48%	21%
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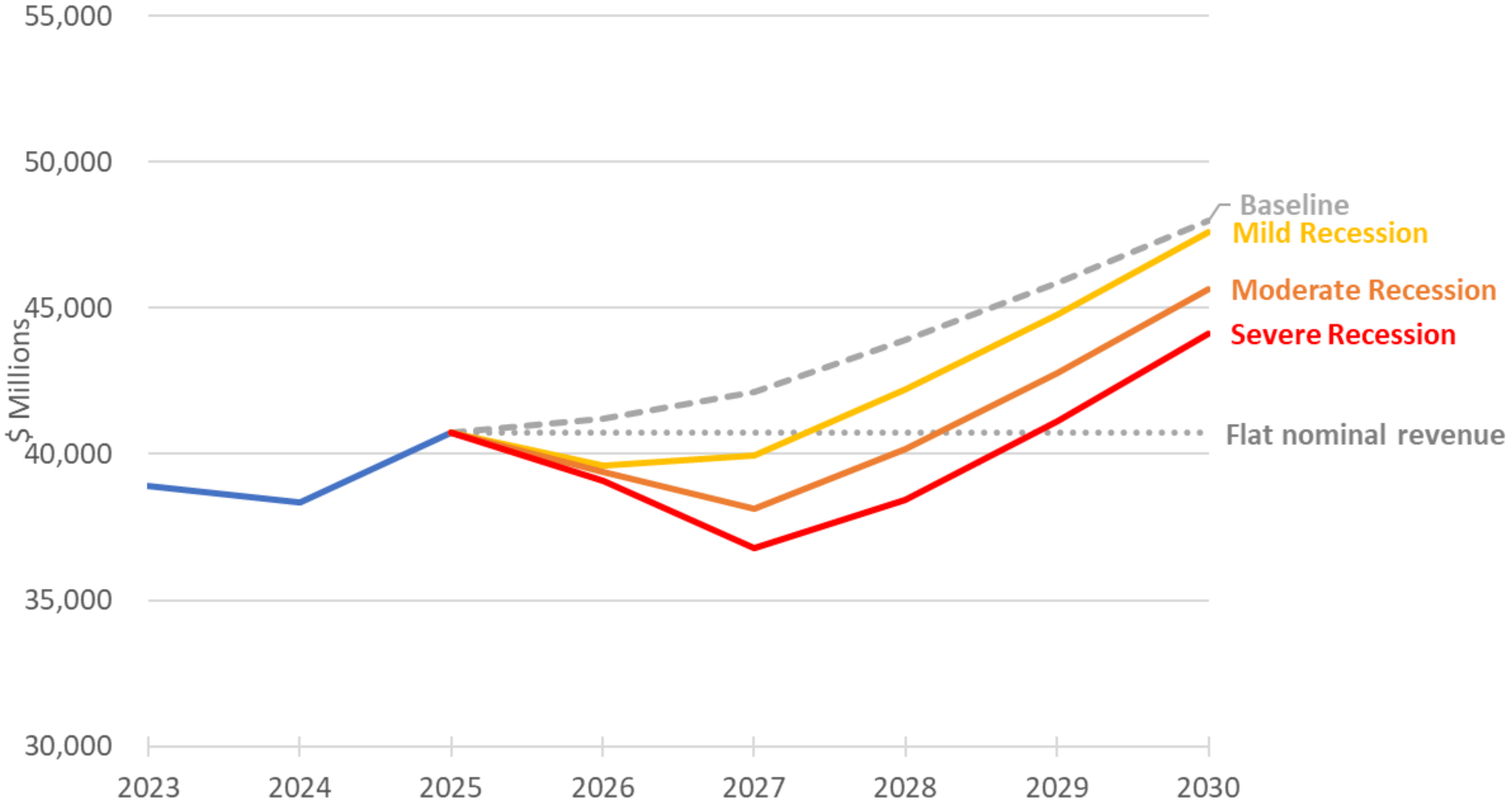
Source: Pew analysis of Department of Revenue calculations.

Massachusetts' Budget Stress Test – Excluding Surtax



Revenue shortfall compared to…

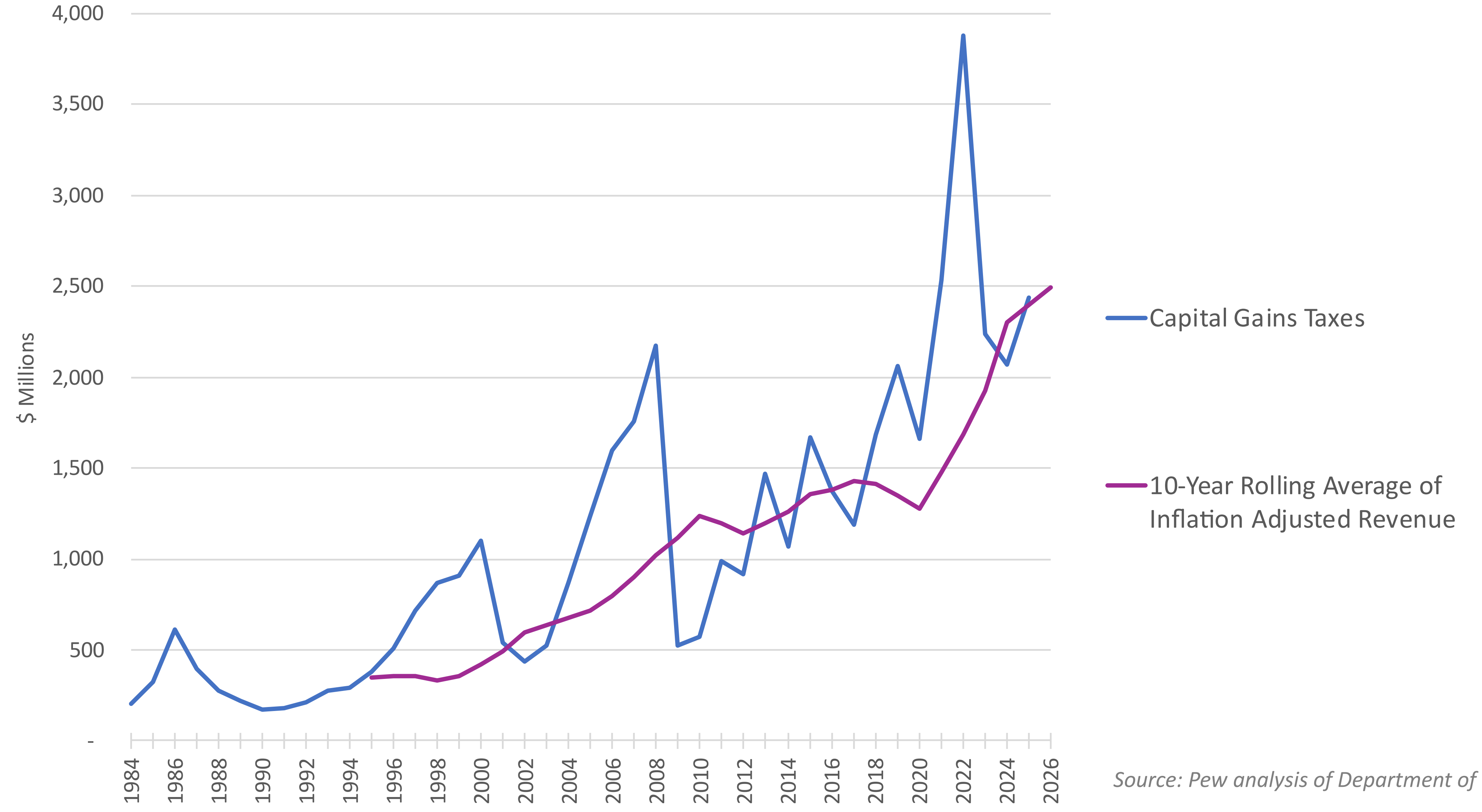
…baseline revenue	…flat revenue
17%	5%
37%	11%
53%	19%

Source: Pew analysis of Department of Revenue calculations.

Stress Test Results: Include vs Excluding the Surtax

	Including Surtax: Revenue shortfall compared to…		Excluding Surtax: Revenue shortfall compared to…	
Scenario:	**…baseline revenue**	**…flat revenue**	**…baseline revenue**	**…flat revenue**
Mild	**26%**	**11%**	**17%**	**5%**
Moderate	**48%**	**21%**	**37%**	**11%**
Severe	**65%**	**34%**	**53%**	**19%**

Source: Pew analysis of Department of Revenue calculations.



Source: Pew analysis of Department of Revenue data.