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Budget Information Brief / 2020-3

Oregon Budget Reserve Funds

Typically, states build an ending balance into their budget plans by not spending all forecasted available resources for the upcoming fiscal period. An ending balance provides a cushion to be used if actual revenues are lower than anticipated at the time the budget was adopted. An ending balance is not the same as a budget stabilization or reserve account, which is typically known as a "rainy day fund." An ending balance reflects revenue that the state expects to receive based on the most recent revenue forecast but that has not been approved by the Legislature to be spent. As revenue forecasts are adjusted during the interim period between sessions, the ending balance goes up or down as the revenue forecast goes up or down. Rainy day funds, on the other hand, are dedicated accounts made up of money specifically set aside for use if needed. While both an ending balance and a rainy day fund are protections against potential declining revenues, there are typically specific requirements that must be met to access rainy day funds. Rainy day funds became common during the 1990s and exist in some form in almost every state.

The existence of a budget reserve fund, otherwise known as a rainy day fund, is desirable for several reasons. During economic downturns, savings can be used to avoid reducing existing programs or raising taxes, thereby reducing uncertainty concerning program or service availability and quality, as well as tax liability. By using savings, a state can help "smooth" out revenue or expenditure fluctuations during economic downturns and assist the economy in weathering a recession. The fiscal benefits to states with properly structured reserve funds include:

- Increased economic stability by using reserves to avoid budget cuts in the case of a revenue shortfall.
- More in-depth analysis and discussion to ensure informed decision making.
- Reduced need to use one-time revenues or accounting actions to fund ongoing costs.
- Assurance to bond-rating agencies that prudent fiscal management practices are in place.
- A "savings" rather than "spend it all" mentality.

Despite the challenge of having a highly volatile revenue system based primarily on income taxes and the existence of the kicker provision, Oregon has established two reserve funds, the Education Stability Fund and the Rainy Day Fund.[1]

[1] The kicker law, which is unique to Oregon and requires the return of income tax surpluses to taxpayers in biennia where actual collections exceed forecasted revenues by 2% or more, made it more challenging to establish sufficient budget stabilization funds. Since the creation of the kicker, approximately $5.1 billion in personal income taxes and $0.5 billion in corporate taxes have been returned to taxpayers due to this law.

Education Stability Fund (ESF)

The ESF was established in September 2002, when voters amended the Oregon Constitution to convert an existing education endowment fund into a reserve fund.[2] The ESF is composed of 18% of the net proceeds from the lottery and is capped at 5% of the amount accrued in General Fund revenues during the prior biennium. Once the cap is reached, 15% of net lottery proceeds are deposited into the School Capital Matching Fund authorized under Section 4, Article XI-P of the Oregon Constitution to provide state matching funds to school districts that have received voter approval for local bonds to finance capital costs (defined as costs of land and other assets with a useful life of more than one year). The Fund can also be used to pay off state-issued Article XI-P bonds. Since the ESF cap has never been reached, no funds have been transferred to the School Capital Matching Fund.

The Legislature may spend the ESF principal for public education if there is an economic downturn and the expenditure is approved by at least three-fifths of the members of each chamber. For this purpose, public education is defined as K-12 and post-secondary education (community colleges and public universities). There is indication that some public early learning programs may be eligible for ESF resources, but the largest expenditure of General Fund in the Education program area is for K-12, followed by post-secondary education.

In order to access the ESF principal, three-fifths of each chamber of the Legislature must approve the action. In addition, the expenditure must be for public education and one of the following conditions must be met:

- The last quarterly economic and revenue forecast for a biennium indicates that moneys available to the General Fund for the next biennium will be at least 3% less than approved appropriations from the General Fund for the current biennium.
- There has been a decline in seasonally adjusted nonfarm payroll employment for two or more consecutive quarters in the last 12 months.
- A quarterly economic and revenue forecast projects that General Fund revenues in the current biennium will be at least 2% below the amount that was projected in the revenue forecast on which the legislatively adopted budget for the current biennium was based. It should be noted that it does not need to be the most recent forecast for this trigger to be met. Article XV, Section 4 (6), requires that "a" forecast in the current biennium must meet the 2% threshold.

If none of these triggers are available, the Governor can declare a state of emergency and the ESF can be accessed with a three-fifths majority of each chamber of the Legislature for an expenditure of funds for public education.

ESF interest or investment earnings are retained in the Fund and used for the following purposes:

- Up to 75% are transferred to the Oregon Education Fund to pay for any education lottery bond debt service.[3]
- At least 25% are dedicated to the Higher Education Coordinating Commission (HECC) for the Oregon Opportunity Grant program to provide financial assistance to post-secondary students.

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[2] See Oregon Constitution, Article XV, Section 4(4)(d) – Section 4(7) and ORS 348.696 – 348.716.
[3] These earnings were used to pay debt service on bonds for schools approved during the 1997 and 1999 sessions.

In 2015, the Legislature amended ORS 348.696 to ensure that transfers to the Oregon Education Fund not required to pay for debt service on bonds are transferred to HECC for the Oregon Opportunity Grant program. It is anticipated that any financial obligation relating to lottery bonds will end after the 2019-21 biennium and no further transfer to the Oregon Education Fund will be required. While the retention of earnings in the Fund and the requirement that the earnings be used for public education are constitutional requirements, the actual distribution is outlined in statute.

The Oregon Growth Account (OGA) is established by statute within the ESF. Funds in the OGA are invested by the State Treasurer under the direction of the OGA Board. From the creation of the ESF through June 2009, 10% of the funds transferred from the state lottery to the ESF were deposited in the OGA (1.8% of overall lottery proceeds). During the 2009 session, the Legislature temporarily reduced the dedication of lottery proceeds to the OGA from 10% of the ESF deposits to 5% for the period of July 2009 to June 2013 and specified that declared earnings from the OGA are to be deposited into the ESF instead of the Commercialized Research Fund which was repealed during the 2019 legislative session. The OGA is used primarily to provide seed capital to Oregon venture and emerging growth businesses. The Oregon Business Development Department reports that $55.3 million in OGA investment earnings has been distributed to the Oregon Education Fund and to the Oregon Opportunity Grant program.

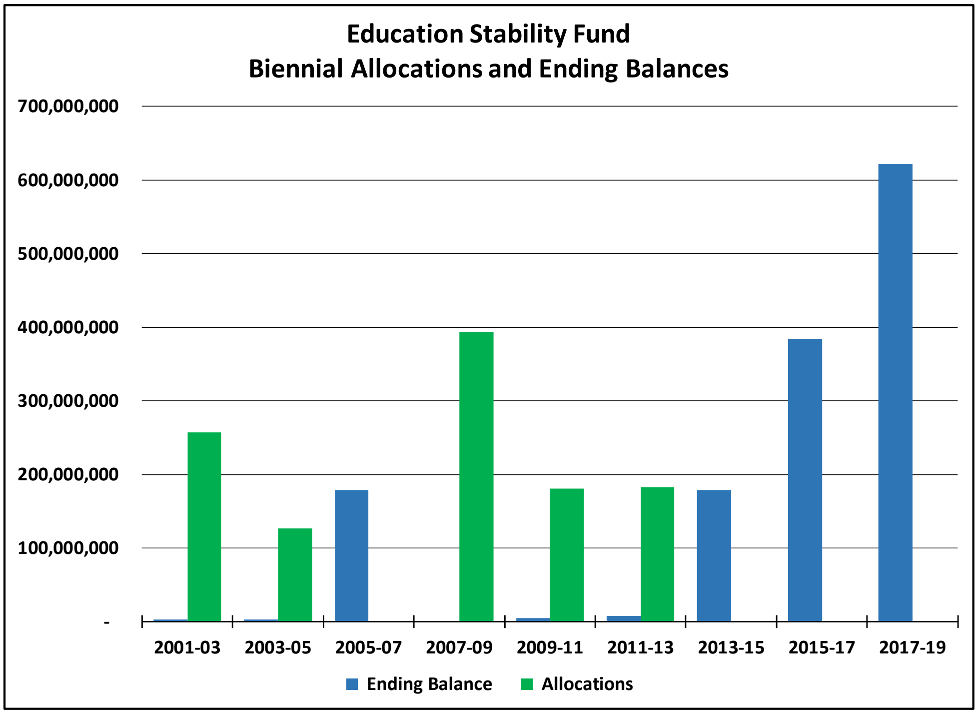
The ESF has been used several times to balance or rebalance a biennial budget. Although the ESF must be used for expenditures on public education, K-12 through post-secondary comprises a significant portion of the state's budget. Using ESF resources for public education allows General Fund dollars that would otherwise be allocated for these purposes to be redirected to other parts of the budget. Details of allocations from the ESF are provided in the following table. There have been no allocations made from the ESF since the 2011-13 biennium.

Allocations from the Education Stability Fund*

Biennium	Amount	Comments
2001-03	$150.0 million	Initial transfer of ESF resources to the State School Fund (SSF) included in the constitutional amendment establishing the ESF freeing up General Fund for other purposes.
2001-03	$107.4 million	Part of the final 2001-03 budget rebalance during the 2003 session.
2003-05	$126.5 million	2003 Legislature prospectively transferred 90% of lottery revenues due to the ESF directly to the SSF.
2007-09	$393.8 million	2009 Legislature transferred all the funds in the ESF at the time to rebalance the 2007-09 budget.
2009-11	$84.3 million	During a February 2010 special session, a transfer was made as a commitment to maintain a $6 billion SSF.
2009-11	$96.4 million	Transfer as part of a rebalance of the 2009-11 budget and to address federal special education and post-secondary maintenance of effort requirements.
2011-13	$100.0 million	Transfer to 2011-12 School Year Subaccount of the SSF that school districts must use to reduce class-size or enhance learning opportunities.
2011-13	$82.2 million	Additional amount approved to enhance SSF funding and for several education-related programs.

*Amounts reflect the values in the state budget system (ORBITS).

Without any further allocations since 2011-13, the balance in the ESF has grown considerably, from $7.4 million at the end of 2011-13 to $621.1 million at the end of 2017-19, as demonstrated in the graph below. The June 2020 economic and revenue forecast by the Department of Administrative Services, Office of Economic Analysis indicates the current ESF balance is $732.9 million, which is projected to grow to $800.1 million by the end of the 2019-21 biennium. The projected balance is a decrease of $60 million from the March 2020 Forecast, likely due to the 2020 COVID-19 emergency and the temporary shutdown of video poker as bars and restaurants are closed. The graph below shows the change in available ESF resources for 2001-03 through 2017-19, as well as the allocations to the SSF.



Oregon Rainy Day Fund (ORDF)

The ORDF was established by the 2007 Legislature as a general purpose reserve fund. The ORDF was originally capitalized with a deposit of approximately $319 million from the retention of the majority of the corporate income tax "kicker" that was due to be refunded to corporate taxpayers in the fall of 2007. Deposits into the ORDF are to be taken from the General Fund ending balance in an amount of up to 1% of General Fund appropriations each biennium. If a biennial ending balance is greater than 1% of the General Fund appropriations for that biennium, then an amount equal to 1% is transferred to the ORDF and the remainder is retained as part of the General Fund. If a biennial ending balance is less than 1% of the General Fund appropriations for that biennium, then the entire ending balance amount is transferred to the ORDF. Due to the time needed to make final determinations on biennial expenditures, this transfer from the ending balance normally occurs at the time of the March economic and revenue forecast in the year following the conclusion of a biennium.

During the 2009 session, the Legislature passed a measure providing for the deposit of all revenue collected from corporate income and excise taxes above the 6.6% tax rate into the ORDF, beginning with the 2013 tax year. At the time the measure was enacted, the Legislative Revenue Office estimated that $69 million would be collected under the law for deposit on or before June 30, 2015. However, during the 2013 special session, the law was amended to increase the rate above which revenue flows to the ORDF from 6.6% to 7.5% for tax years 2013 to 2016, and to 7.2% for tax years 2017 and beyond.

Another condition of the ORDF is that if its balance, at the time of the ending balance transfer, is greater than 7.5% of the General Fund revenue collected during the prior biennium, then the ending balance transfer is not made, and the money remains in the General Fund. The full transfer amount is made to the ORDF if its balance does not equal 7.5% of the General Fund revenue collected during the prior biennium, even if the transfer amount results in the ORDF balance being over the cap.

Like the ESF, approval by a three-fifths majority of both chambers of the Legislature is required to authorize expenditures from the ORDF. In addition, the ORDF has the same trigger mechanisms as the ESF as described above, with two exceptions:

- There is no allowance for a declaration of emergency by the Governor.
- The Legislature can change existing triggers by passing a new law since the ORDF is a statutory rather than constitutional creation.

As noted above in the discussion of the ESF, it does not need to be the most recent forecast for the 2% trigger threshold to be met. Article XV, Section 4 (6) for the ESF and ORS 293.144(2)(c) for the ORDF requires that “a” forecast in the current biennium must be at least 2% below the amount that was projected in the revenue forecast on which the legislatively adopted budget for the current biennium was based. This 2% trigger amount is not automatically nullified if, for example, a future forecast for the current biennium projects less than a 2% reduction in revenue.

The Legislature is limited each biennium to appropriating no more than two-thirds of the amount in the ORDF at the beginning of that biennium. However, given that the limitation is in statute, the Legislature could modify this statutory restriction to spend more of the ORDF in a single biennium. If the appropriation is for a future biennium, the Legislature may use the most recent forecast of the beginning balance of the ORDF for the biennium for which the appropriation is to be made. The ORDF retains all interest earned by the Fund, which is calculated and transferred monthly by the Department of Administrative Services. The ORDF has been used three times to balance or rebalance a budget as described below.

Allocations from the Oregon Rainy Day Fund

Biennium	Amount	Comments
2009-11	$225.3 million	During the 2009 session, the Legislature transferred two-thirds of the balance of the ORDF to the General Fund to finalize the 2009-11 legislatively adopted budget.
2009-11	$115.7 million	To provide a $6 billion State School Fund for the 2009-11 biennium, the Legislature established a $200 million “trigger” during the 2009 session. The trigger amount was to come from a combination of the projected General Fund ending balance and the ORDF, with amounts determined at the time of the June 2010 economic and revenue forecast.
2009-11	$10.0 million	This amount was approved by the Legislature during the February 2010 special session to be transferred to the General Fund for general governmental purposes.

The Legislature has not authorized any transfers from the ORDF since the 2010 special session. As of the June 2020 forecast, the current balance is $877.8 million, and it is projected that the amount in the Fund at the end of the 2019-21 biennium will be $949.4 million.

In summary, Oregon's two budget reserve funds have been used to continue programs and services during economic downturns, to stabilize and improve the state's bond rating in the credit markets, and to serve as a hedge against cash flow deficits at the state level. Oregon is noted as a state that has done a good job establishing and protecting reserves. A challenge the state will face is how best to use reserve funds so that actions needed to balance the budget for the long term are not unnecessarily postponed. It is anticipated that the reserve funds may be needed to help balance the budget as a result of the economic consequences of the COVID-19 crisis. As of the June 2020 forecast, the total amount projected to be available at the end of the 2019-21 biennium in both the ESF and ORDF is just under $1.75 billion; however, if future forecasts further reduce projected revenues for the biennium, that amount will likewise be adjusted downward.