January 28, 2026

The Honorable Michael J. Rodrigues
Chair, Senate Committee on Ways and Means
State House, Room 212
Boston, MA 02133

The Honorable Aaron Michlewitz
Chair, House Committee on Ways and Means
State House, Room 243
Boston, MA 02133

Dear Chairs Rodrigues and Michlewitz:

Pursuant to Section 5 of Chapter 214 of the Acts of 2024, we are transmitting to you this report of the Stabilization Fund and Long-Term Liability Financing Task Force. The Task Force was charged with reviewing the Commonwealth's financing policies around its long-term liabilities and reserves.

The following report outlines the work of the Task Force and accompanying recommendations.

Sincerely,

Secretary Matthew J. Gorzkowicz
Executive Office for Administration and Finance

Executive Summary

Among the most critical considerations for a state's fiscal health are the adequacy of its budgetary reserves, its commitment to mitigating long-term liabilities, and its mechanisms for doing so. In recent years, Massachusetts has made significant strides in building the Commonwealth Stabilization Fund, the state's main budgetary reserve. Going into Fiscal Year (FY) 2025, the fund balance stood at more than $8.1 B, compared to $670 M in FY 2010, the last fiscal year before the state began implementing major policies to grow the fund. In addition, the Commonwealth has continued to prioritize paying down its unfunded pension liability – currently on track to pay off its legacy liability ahead of the FY 2040 statutory deadline.

Despite this progress, it is essential that the Commonwealth continues to examine its fiscal policies on a regular basis. Ongoing consideration of best practices around reserve building and liability reduction will help ensure a more stable fiscal environment, particularly during economic downturns. These reviews can also help pinpoint new long-term liabilities that may require fiscal support in the future, such as natural disaster relief, planning, and mitigation.

The Stabilization Fund and Long-Term Liability Financing Task Force was established in 2024 to examine the current state of the Commonwealth's policies around these issues. Given the importance of long-term planning and vigilant analysis of the state's fiscal strengths and weaknesses, the work of this group is an important first step in refreshing certain policies while maintaining others that have been successful over the years.

About the Stabilization Fund and Long-Term Liability Financing Task Force

The Stabilization Fund and Long-Term Liability Financing Task Force was mandated by Section 5 of Chapter 214 of the Acts of 2024, signed into law in September 2024. The underlying legislation established a Commonwealth Federal Matching and Debt Reduction Fund, which was to be capitalized with interest earnings from the Commonwealth Stabilization Fund.

The Task Force was charged with reviewing the Commonwealth's financing policies around its long-term liabilities and reserves. The enabling section required that the Task Force make recommendations regarding the following:

1. The appropriate long-term level of funding for the Commonwealth Stabilization Fund established in section 2H of chapter 29 of the General Laws;
2. The appropriate level and means of funding for long-term financial liabilities of the commonwealth;
3. Amendments to the mechanisms that provide funding for the Commonwealth Stabilization Fund and other long-term financial liabilities, including the provisions of section 5G of said chapter 29.

In addition, the section required the Task Force to review the following topic areas:

1. The statutory threshold for excess capital gains collections established in said section 5G of said chapter 29 in consideration of historical and estimated future capital gains collections;
2. The disbursement percentages required under said section 5G of said chapter 29;
3. Best practices related to the funding of long-term financial liabilities among states;
4. Best practices related to the funding and size of stabilization funds among states;
5. The impacts of relevant fiscal policies on the commonwealth's credit ratings;
6. Any other relevant fiscal factors to ensure the most prudent use of state revenues.

Task Force Process

The Task Force convened five times between September 2025 and January 2026. The Task Force partnered with the Pew Charitable Trusts to support its work around state best practices on the discussed topics. The full presentations from these meetings are linked in Appendix 3 of this report. The meetings were structured as follows:

- Meeting 1: Task Force background and charges; review of capital gains collections; overview of Section 5G of Chapter 29 of the General Laws and its impact
- Meeting 2: Stabilization Fund policies, including deposit, withdrawal and fund sizing policies, and stress-testing
- Meeting 3: Stabilization Fund stress-testing (continued) and recession planning; pension liability financing and stress-testing
- Meeting 4: Disaster relief and resiliency financing; credit rating agency consideration; initial recommendations
- Meeting 5: Recommendations and report review

This report represents the discussions of the Task Force and has general support from the members of the Task Force, though no vote was taken.

Task Force Members

- Matthew Gorzkowicz, Administration and Finance Secretary, Chair
- Sue Perez, Deputy Treasurer for Debt Management – Office of the Treasurer (Treasurer Appointee)
- Thomas Smith-Vaughan, Chief Operating Officer – Office of the Comptroller (Comptroller Appointee)
- Timothy Rooney, Chief Financial Officer – Department of Revenue (Commissioner of Revenue Appointee)
- Henry Dormitzer, Managing Partner and Trustee – Choate, Hall & Stewart LLP (Governor Appointee)
- June Matte, Retired Managing Director – PFM Financial Advisors LLC (Treasurer Appointee)

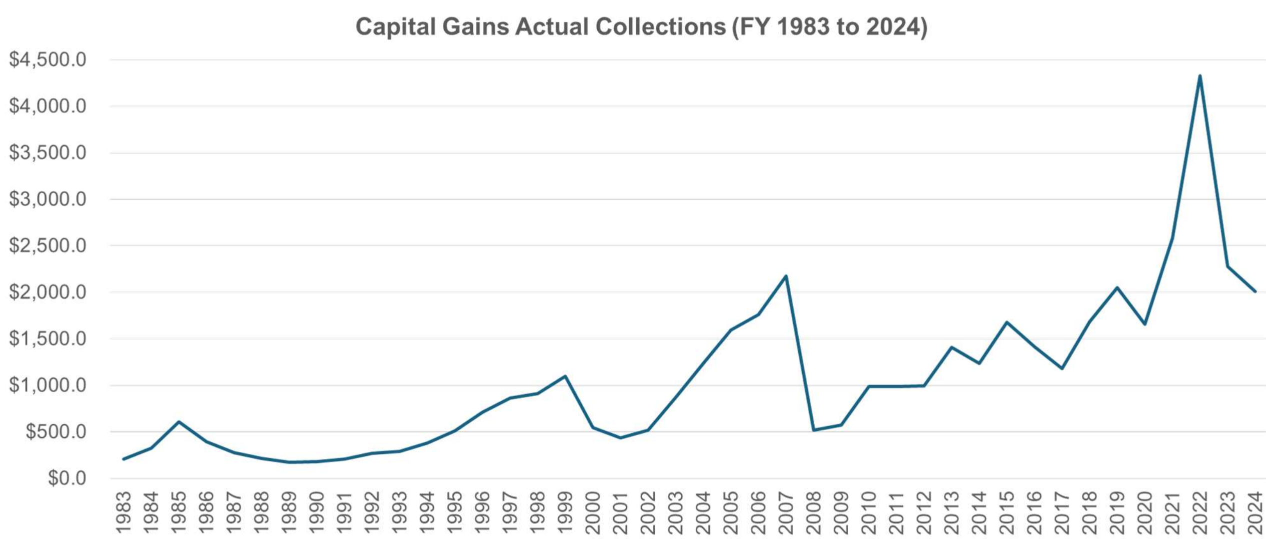
Background

The Task Force's legislative mandate includes several specific areas of review. Two of the overarching areas of interest are Section 5G of Chapter 29 of the Massachusetts General Laws and the Commonwealth Stabilization Fund. This section will therefore provide a summary of those two subjects before outlining the specific considerations and recommendations of the Task Force.

<u>Section 5G of Chapter 29 of the General Laws</u>

Section 5G of Chapter 29 of the General Laws, established in Fiscal Year (FY) 2011, implemented a threshold to cap the amount of capital gains tax revenue that can be used for the state's operating budget and depositing any collections over that threshold to the Stabilization Fund, the Pension Liability Fund, and the State Retiree Benefits Trust Fund.

The threshold was first proposed by Governor Deval Patrick, in light of significant capital gains declines caused by the Great Recession. After collections nearly doubled between FY 2004 and FY 2008, they declined from $2.2 B in FY 2008 to $554 M in FY 2009, contributing significantly to the state's budget shortfall. Because the tax applies to increased asset value at the time of sale, capital gains collections have historically been volatile and particularly susceptible to economic downturns.



Specifically, the policy inserted through Section 5G of Chapter 29 created a $1 B threshold for excess capital gains to be used in the budget. Beginning in FY 2014, the threshold has been adjusted annually to reflect the average annual rate of growth in United States gross domestic product (GDP) over the preceding 5 years based on the most recently available data published by the Bureau of Economic Analysis in the United States Department of Commerce.

Section 5G of Chapter 29 also specifies that any collections in excess of the threshold are distributed as follows:

- 90% to the Commonwealth Stabilization Fund
- 5% to the Pension Liability Fund

- 5% to the State Retiree Benefits Trust Fund

Commonwealth Stabilization Fund

Massachusetts established a Stabilization Fund in 1986 as a part of a larger fiscal reform package. Originally, the funding mechanism for the fund was limited to portions of year-end surpluses and interest earnings. The fund was created to help the state weather unanticipated fiscal challenges. More specifically, Section 2H of Chapter 29 of the Massachusetts General Laws, the fund's enabling statute, allows for the use of the fund:

(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.

The statute further articulates that such events may include "a substantial decline in economic indicators which result in severe reductions in state revenues or state financial assistance to local governmental units, or court ordered or otherwise mandated assumptions by the commonwealth of programs or costs of programs previously borne by local governmental units."

Over the course of time, several additional means of capitalizing the Stabilization Fund have been adopted:

1. **Excess Capital Gains**
    - As noted above, in FY 2011, Section 5G of Chapter 29 dedicated 90% of any excess capital gains to the fund
2. **Casino Gaming Revenue**
    - 10% of casino gaming tax revenue is dedicated to the fund via an expanded gaming law in 2011
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 are dedicated to the fund

Since its implementation in FY 2011, Section 5G's excess capital gains policy has contributed to nearly 75% of the Stabilization Fund's growth. Year-end budget surpluses have been the second-highest mechanism for supporting the fund; however, those instances are naturally inconsistent, as said surpluses have recently been diverted to support unexpected spending needs. For example, during the COVID-19 pandemic, the state deposited surplus revenues into a Transitional Escrow Fund to support economic recovery and public health supports. This fund has continued to be used to support unanticipated spending needs outside of the normal operating budget development process.

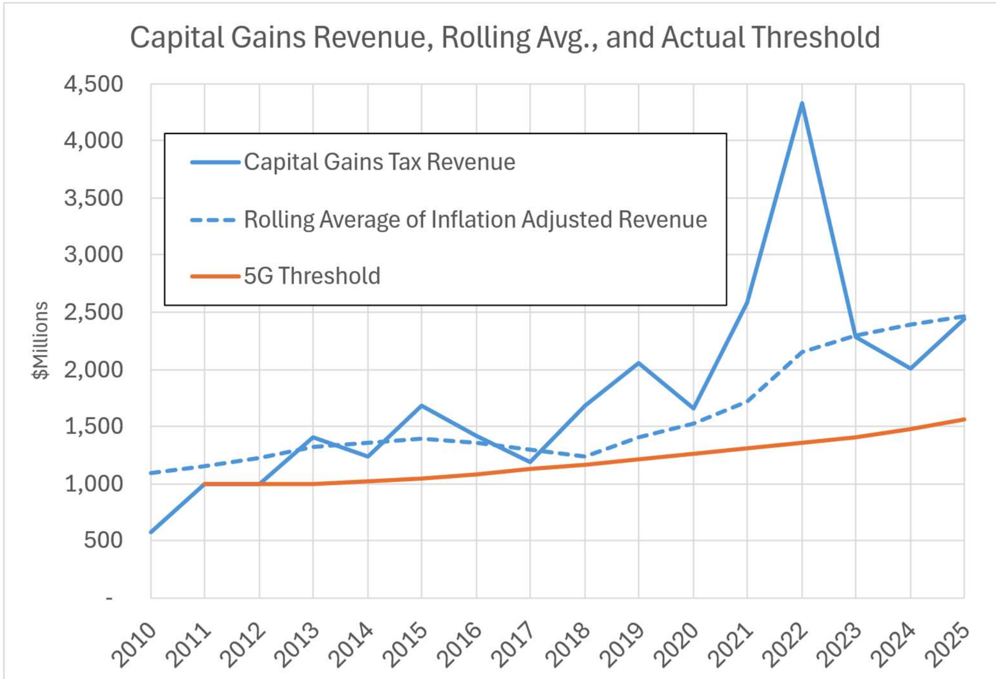
Task Force Considerations

The Task Force meetings were primarily focused on the main issues impacting the state's long-term liabilities: excess capital gains, Stabilization Fund, pension liability, and disaster relief. Within each of those broader conversations, the Task Force was able to directly consider the legislative mandate:

1. Excess Capital Gains Threshold
   As noted above, the FY 2011 budget established a $1 B threshold for capital gains taxes available for the budget. Beginning in FY 2014, the threshold was increased annually to reflect the average annual rate of growth in United States GDP over the preceding 5 years based on the most recently available data published by the Bureau of Economic Analysis in the United States Department of Commerce.

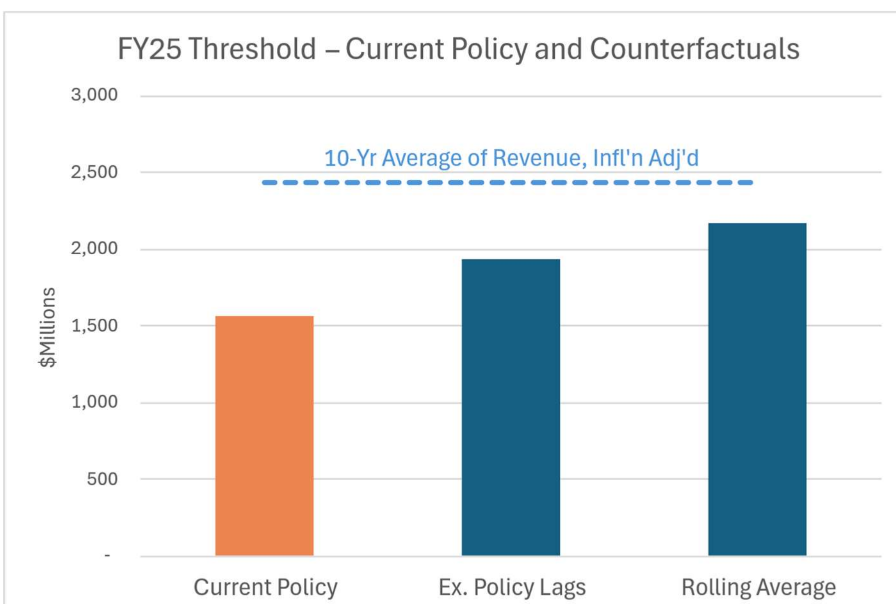
   Based on analysis reviewed by the Task Force, the original $1 B threshold was a reasonable starting place, based on historical collections at that time; however, the threshold has fallen behind actual economic and revenue growth for a few reasons.

   First, the threshold remained flat at $1 B from FY 2011 to FY 2014. Second, the threshold uses a 5-year compound annual growth rate of GDP to adjust – meaning each adjustment is delayed in capturing critical economic data. Third, capital gains growth has outpaced GDP growth since the implementation of the threshold.



Source: Analysis by The Pew Charitable Trusts

Pew's analysis suggests that the initial delay in regularly adjusting the threshold and the compound annual growth rate methodology used to adjust it have caused the threshold to lag economic and revenue growth. Therefore, this analysis indicates that a one-time $300 M to $600 M prospective upward adjustment to the threshold may be warranted



Source: Analysis by The Pew Charitable Trusts

2. <u>Excess Capital Gains Disbursement Percentages</u>

As stated above, the current Section 5G policy transfers 90% of excess capital gains to the Stabilization Fund, 5% to the Pension Liability Fund, and 5% to the State Retiree Benefits Trust Fund. This has been an effective policy for building up the Stabilization Fund to historic levels. Excess capital gains transfers are the predominant financing mechanism for the Stabilization Fund – representing nearly 75% of the fund's growth since the introduction of the Section 5G policy. Meanwhile, the Pension Liability Fund receives an annual pre-budget transfer, based on a triennial funding schedule (totaling $4.93 B in FY 2026), and the State Retiree Benefits Trust Fund receives an annual budgetary transfer (totaling $450 M in FY 2026).

Excess capital gains transfers are effectively supplemental for the Pension Liability Fund and the State Retiree Benefits Trust Fund, while it is the chief resource for building up the Stabilization Fund. Additionally, there is sense in primarily utilizing the Section 5G mechanism to build reserves, given the noted volatility on a year-to-year basis.

Capital gains taxes are extremely volatile. During strong economic times, collections tend to be strong, whereas they typically falter during economic downturns. Building reserves when the economy is strong is a good practice. Using capital gains as a more prominent method for funding pensions or retiree benefits could lead to challenges in meeting our funding obligations when the economy hits turbulence.

3. <u>Long-term Liability Best Practices</u>
   Budget Stress Testing
   In its discussions, the Task Force coalesced around the importance of stress testing to best understand the state's general fiscal resilience and ability to meet its long-term liability obligations. Stress tests are budgetary models that evaluate a given entity's resilience to moderate or severe economic shocks, such as recessions.

   According to Pew, at least 20 other states have implemented stress tests for their budgets to better understand their structural vulnerabilities, as well as the reserves necessary to manage an economic shock. While Massachusetts conducts informal comprehensive budget forecasting, a formal stress test, examining both revenue and spending scenarios, was discussed by the Task Force as a worthwhile addition to the state's budgeting practices.

   The Task Force also discussed the importance of establishing a reasonable fiscal toolkit for recessionary periods to ensure the state has a comprehensive response plan. This toolkit will ensure transparency and serve as a guide to state fiscal officials, the legislature, and constituents. While each economic downturn will look different, such a toolkit can help promote best practices and set reasonable expectations for the types of measures that should be prioritized, including the appropriate use of reserves.

   Pension Liability Fund

The Commonwealth's unfunded pension liability is funded via an annual pre-budget transfer. By statute, the state is required to reach full funding of the liability by FY 2040. Based on the recent funding schedules (increasing the annual transfer by 9.63%), the state is on track to meet this obligation ahead of the statutory deadline.

The Commonwealth has made significant progress in funding its pension liability, as demonstrated by two key factors identified by Pew and backed by the Public Employee Retirement Administration Commission, which oversees the state's pension system. First, the state has achieved positive amortization, which measures whether member contributions are sufficient to meet current obligations and pay off outstanding liabilities. Second, the fund's ratio of operating cash flow to plan assets has improved from -3.2% in FY 2014 to -1% in FY 2023. This factor demonstrates the plan solvency if investment returns underperform plan assumptions.

The table below highlights three main best practices amongst the states, identified by Pew. Notably, similar to the budget stress testing noted in the last section, 28 states have also implemented pension fund stress testing to identify potential risks and their funds' ability to withstand various economic shocks.

Policy Goal	Key Concept	Standard of Practice
Fiscal Sustainability	Net Amortization	Annual contributions under state policy are sufficient to reduce pension debt (aka "positive amortization"). **Stated policy goal for PERAC. Tracked by Moody's ("tread water" indicator).**
Planning for Uncertainty	Risk Reporting	Routine stress testing to assess impact of investment risk on pension funding levels and the budget. **28 states have adopted. Recommended practice by National Association of State Treasurers (NAST).**
Cost Predictability	Managing Contribution Volatility	Funding policy is designed to respond to economic shocks, avoiding unaffordable spikes in annual required contributions. **Conference of Consulting Actuaries (CCA) and Government Finance Officers Association (GFOA) have outlined best practices for predictable funding.**

Pew also identified a creative pension liability financing mechanism being employed by other states called layered amortization. With layered amortization, legacy unfunded liabilities can be kept on the existing payment schedule, while losses or gains in subsequent years are assigned a new payment period, helping to keep pension costs more stable and predictable over time. This mechanism is recommended by the Conference of Consulting Actuaries and the Government Finance Officers Association and has been adopted more recently by peer states in Connecticut, Maryland and Minnesota.

4. Stabilization Fund Best Practices

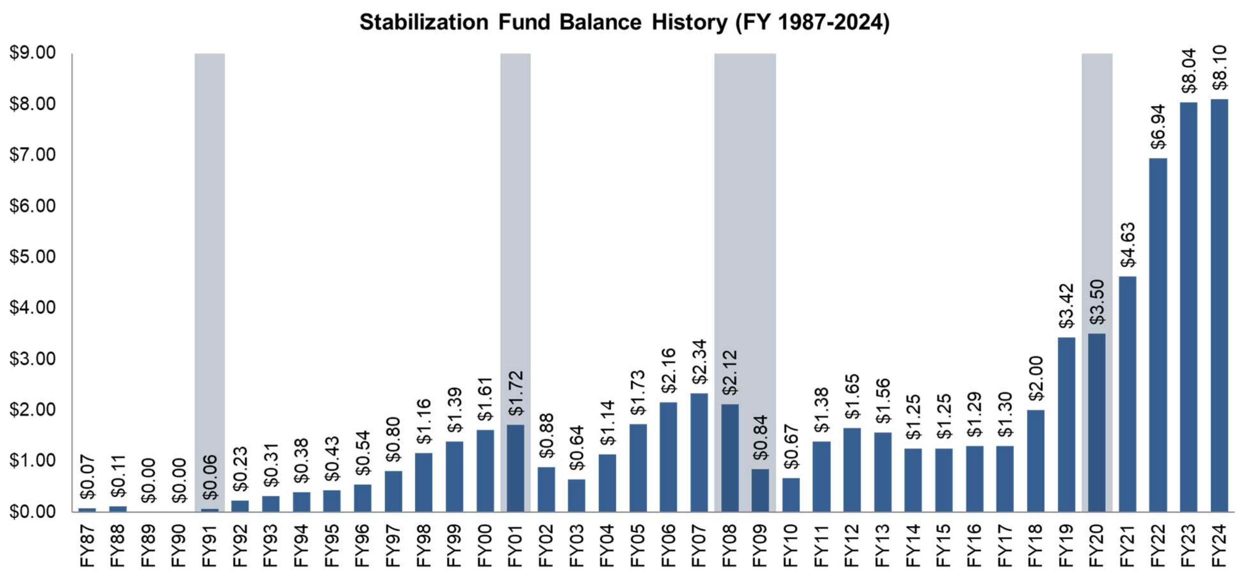
Deposits

Regarding funding policies for budgetary reserves, Massachusetts is relatively strong compared to other states. There is a wide range of methodologies used by states; however, Massachusetts is on a relatively short list of states that use a combination of year-end surpluses and dedicated revenue streams to build its reserve. Our volatility-based practice of dedicating excess capital gains is also a best practice, because it insulates the budget from unpredictability in collections.

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

Sizing

Since FY 2011 when the Section 5G policy was first implemented, the Stabilization Fund has grown by 487%.



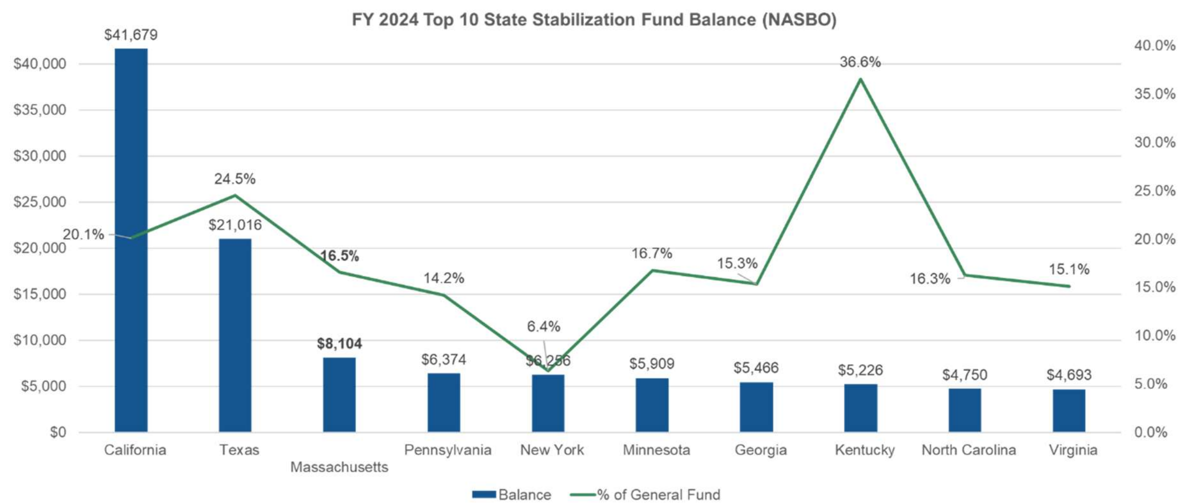
There have been several metrics used to demonstrate a well-funded reserve fund[1]:

- 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

[1] https://www.bostonfed.org/publications/research-department-working-paper/2014/saving-for-a-rainy-day-estimating-the-appropriate-size-of-us-state-budget-stabilization-funds.aspx

- The Government Finance Officers Association makes its recommendation based on operating runway – suggesting approximately two months of general fund operating expenses (totaling ~16.7% of general fund expenditures).

Based on these metrics, Massachusetts performs well. Based on data from the National Association of State Budget Officers (NASBO) from FY 2024, Massachusetts had the third highest overall balance, representing 16.5% of General Fund operating expenses.[2]



While the state performs well against typical standards, the Task Force discussed the importance of budget stress tests as a best practice to evaluate the Stabilization Fund's appropriate size. It was noted that Massachusetts' Stabilization Fund may be stretched further than other states' reserves during a recession, given the import the state places on health care and education, amongst other priorities, and the costs necessary to preserve core services.

In addition, the Task Force noted that a one-size-fits-all rule for reserve balances does not account for each state's relative revenue volatility, which can dramatically affect the impacts of an economic downturn.

Pew noted for the Task Force that peer states with models worth emulating include Minnesota and North Carolina. Both states use annual, statutorily required stress tests to automatically adjust their stabilization fund target balances.

Withdrawals

The Task Force also reviewed best practices around withdrawal policies. Massachusetts' policies are relatively broad but require Legislative approval and an attestation of other tools being deployed before going to the Stabilization Fund. Eligible fund uses include:

[22] https://higherlogicdownload.s3.amazonaws.com/NASBO/9d2d2db1-c943-4f1b-b750-0fca152d64c2/UploadedImages/Fiscal%20Survey/NASBO_Spring_2025_Fiscal_Survey_Full_Report_S.pdf

- 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
- To replace the state and local loss of federal funds; or
- 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

Other states utilize more complicated processes before they can use their reserves. For example, New York employs a monthly economic index, using a series of labor statistics, that must decline for five consecutive months before a withdrawal is allowed. The Task Force discussed the benefit of the current, less restrictive policy for drawing on the fund but did agree that having more prominent best practices and guidelines for when to draw on the Stabilization Fund would be prudent. As mentioned previously, the Task Force also discussed the importance of establishing a reasonable fiscal toolkit for responding to recessionary periods. Again, this toolkit would be critical for ensuring a transparent response and serve as a guide for all parties involved in the fiscal decision-making process.

5. Credit Rating Considerations

Each of Standard & Poor's (S&P) latest credit rating adjustments for the Commonwealth have revolved around Section 5G and the Stabilization Fund.

In 2012, S&P upgraded Massachusetts from 'AA' to 'AA+' due in large part to the establishment of the Section 5G policy.

- *"We raised the commonwealth's rating in September of 2011, reflecting its ongoing progress in improving financial, debt, and budget management practices while implementing cost-control and reform measures associated with its long term liabilities. The upgrade also reflected the commonwealth's commitment to its stabilization fund…"*[3]

In 2017, S&P downgraded MA bonds back to 'AA' due to continuously circumventing the Section 5G policy and therefore not building the Stabilization Fund. More important in this review than not building the Stabilization Fund was the fact that the state was not following its own fiscal policies.

- *"The downgrade reflects what we view as the commonwealth's failure to follow through on rebuilding its reserves as stipulated through its own fiscal policies aimed at mitigating the state's propensity for revenue volatility."*[4]

In 2023, S&P upgraded the state's status back to 'AA+', citing good fiscal management and attention to reserves.

[3] https://www.spglobal.com/ratings/en/regulatory/article/-/view/type/HTML/id/967875
[4] https://www.spglobal.com/ratings/en/regulatory/article/-/view/sourceId/10130813

- *"The upgrade reflects our view that the Commonwealth's commitment to strengthen its budget management practices supported by the state's improved reserves and strong economy will be sustained through near-term recessionary pressures."*[5]

The Task Force discussed that, based on recent experience, it is critical that we are consistent with the policies that we implement to ensure sustainability. As it related to Section 5G, for example, the credit rating agencies viewed it unfavorably when the state used excess capital gains to consistently balance the budget while the Stabilization Fund was inadequate.

While the state has made significant progress in building the Stabilization Fund (primarily via the excess capital gains policy), it is still critical that we maintain good fiscal practices moving forward. Establishing standing multi-year budget forecasts and stress tests are examples of tools that can help the state better assess the needs of our reserves and long-term liabilities to avoid downgrades. Additionally, creating best practices and guidelines around the use of the Stabilization Fund would be another opportunity to demonstrate strong fiscal planning to rating agencies and help the state navigate future fiscal uncertainty.

6. <u>Other Relevant Fiscal Factors</u>
Disaster Preparedness and Resiliency
One of the growing long-term liabilities that states must confront is the rising cost of natural disasters, exacerbated by the growing impacts of climate change. According to data gathered by the National Centers for Environmental Information, Massachusetts has experienced at least 45 disasters totaling $1 B or more in losses and damages across public and private entities since 1980. More concerning is that the frequency of these high-cost events has been increasing. Between 1980 and 1999, the state experienced 18 of these events; since 2020, the state has already experienced 14 such events.[6]

$1 B+ Disasters Impacting MA from 1980-2024 ($ CPI Adjusted)					
Disaster Type	**Events**	**Events/Year**	**Percent Frequency**	**Total Costs**	**Percent of Total Costs**
Winter Storm	15	0.3	33.3%	$5.0B-$10.0B	46.5%
Tropical Cyclone	9	0.2	20.0%	$2.0B-$5.0B	33.1%
Flooding	4	0.1	8.9%	$1.0B-$2.0B	11.8%
Severe Storm	15	0.3	33.3%	$500M-$1.0B	7.9%
Freeze	1	0.0	2.2%	$5M-$100M	0.5%
Drought	1	0.0	2.2%	$5M-$100M	0.2%
Wildfire	0	0.0	0.0%	$0	0.0%
All Disasters	**45**	**1**	**100.0%**	**$10.0B-$20.0B**	**100.0%**
Source: National Centers for Environmental Information (NCEI)					

[5] https://www.spglobal.com/ratings/en/regulatory/article/-/view/sourceId/12702585
[6] https://www.ncei.noaa.gov/access/billions/summary-stats

Time Period	Billion-Dollar Disasters	Events/Year	Cost	Percent of Total Cost
1980s (1980-1989)	5	0.5	$250M-$500M	2.60%
1990s (1990-1999)	13	1.3	$5.0B-$10.0B	48.20%
2000s (2000-2009)	1	0.1	$100M-$250M	1.20%
2010s (2010-2019)	12	1.2	$2.0B-$5.0B	30.80%
2020-2024	14	2.8	$1.0B-$2.0B	17.20%
Source: National Centers for Environmental Information				

In the FY 2025 budget, the state took an important step to better prepare for increased natural disasters by creating a Disaster Relief & Resiliency Fund. Currently, the fund can receive funding transfers from the operating budget but otherwise does not have a permanent recurring revenue stream. In FY 2025, the fund was capitalized on a one-time basis via year-end surplus funds.

Given its relation to the Commonwealth's long-term liability planning, the Disaster Relief & Resiliency Fund remains a strong candidate to receive a portion of any excess capital gains pursuant to Section 5G. The Governor's FY 2025 budget proposal adjusted the excess capital gains distribution to add this fund, and there may be even more sense to the policy today given the uncertain future of the Federal Emergency Management Agency (FEMA).

In addition, the Task Force discussed the benefits of establishing a healthy balance to allow a portion of the fund to support proactive resiliency planning and projects to mitigate the impacts of natural disasters. According to research conducted by Pew, other states have elected to formulaically allow portions of their disaster funds to support resiliency. For example, Montana allows a portion of its wildfire suppression fund to support preparedness and mitigation activities if the balance of the fund exceeds 3% of its total general fund expenditures. Similarly, Utah allows the greater of $10 M or $3 M plus 10% of unspent deposits into its wildfire prevention fund to support fire prevention costs.

Task Force Recommendations

The Task Force was charged with making three explicit recommendations. Each of the areas reviewed during the Task Force's meetings, focused on the topics reviewed in the previous section, helped to define the broader recommendations from the Task Force. While there was not a formal vote on the recommendations, there was general support across the membership.

1. <u>Appropriate Stabilization Fund Size</u>
   Key Takeaways
   The Commonwealth Stabilization Fund performs well against historic measures for a sufficiently funded reserve. Based on FY 2024 year-end totals, the Stabilization Fund represents 16.5% of General Fund expenditures. This exceeds the Center on Budget and Policy Priorities recommendation of 15% of said expenditures and is relatively close to the Government Finance Officers Association recommendation of two months of General Fund operations, or ~16.7% of general fund expenditures.

While the state performs well against these standards, the Task Force noted that a one-size-fits-all rule for reserve balances does not account for each state's relative volatility or prioritized core programs, such as healthcare and education in Massachusetts.

Recommendations
The Task Force agreed that the more formal establishment of a multi-year budget forecast and stress test of the Stabilization Fund would strengthen the state's policies around the appropriate size of the fund. Given the unpredictability of tax revenues and the ever-changing landscape of spending pressures, a stress test will create more specific metrics for what Massachusetts may need from its reserves, rather than using a one-size-fits-all measure.

The Task Force also coalesced around the idea that the group should be reconvened regularly to ensure that the state is consistently using best practices and collectively monitoring where the Stabilization Fund stands compared to our needs.

2. <u>Appropriate Level and Means of Funding Long-Term Liabilities</u>
Key Takeaways
The current distribution of capital gains over the statutory threshold established by Section 5G remains reasonable (90% to the Stabilization Fund; 5% to the Pension Liability Fund; 5% to the State Retiree Benefits Trust Fund). This mechanism is the primary source for building the Stabilization Fund, while it provides a supplement to the other liabilities' primary funding sources. Section 5G has contributed nearly 75% of the resources that have built the Stabilization Fund since the Section 5G policy went into effect in FY 2011.

The state is statutorily required to amortize its unfunded accrued actuarial pension liability by FY 2040. Annually, a pre-budget transfer is made to the Pension Liability Fund, based on a triennial schedule submitted to the Legislature by the Executive Office for Administration & Finance. The Task Force's review of the state's progress in funding this outstanding liability demonstrated that significant progress has been made. This is reflected in current forecasts projecting amortization of the liability by FY 2038 (based on the most recently adopted triennial pension schedule) compared to the required FY 2040.

Recommendations
Consistent with one of the recommendations in the previous section, the establishment of an annual multi-year budget forecast in tandem with budget stress testing can help determine reasonable adjustments to long-term liability financing policies. For example, budget stress testing can help the state determine adequate Stabilization Fund balances to manage various recessionary scenarios. While the current Section 5G transfer structure remains reasonable, forecasting and stress testing would allow the state to be more intentional with the use of the policy to meet current needs.

Similarly, the adoption of a regular pension risk reporting and stress testing process would help policy makers better plan for economic downturns and assess the sufficiency of the annual pre-budget transfer to pay down the liability. In addition, based on Pew analysis of other states, layered amortization was identified as a policy worth considering in the future. The methodology pays down the actuarial and investment losses experienced each year over a fixed payment schedule. Losses or gains in subsequent years are assigned a new payment period rather than being funded over a decreasing number of years. The state's existing unfunded liability would still be amortized by FY 2040. Connecticut, Maryland, and Minnesota are peer states that have more recently switched to this approach.

3. <u>Amendments to the Mechanisms Funding the Stabilization Fund and Other Long-Term Liabilities</u>

   Key Takeaways

   Pew analysis indicates that the Section 5G threshold dictating capital gains taxes available for the budget has fallen behind actual economic and revenue growth – indicating that a $300 M to $600 M prospective upward adjustment may be warranted. Additionally, adjusting the threshold based on annual GDP growth, versus the 5-year compound annual growth rate, or utilizing an inflation-adjusted moving average of actual capital gain receipts to set the threshold each year could help the threshold better keep pace with real-time economic activity.

   The Task Force also discussed that better definition around Stabilization Fund withdrawal polices could strengthen the state's efforts to ensure the fund's long-term sustainability. Pairing stronger definitions of the appropriate use of the funds with a fuller recession tool kit can ensure that the state has best practices to guide planning during economic downturns.

   In addition, the Task Force determined that, in light of disaster response, relief and mitigation continuing to be a growing liability, establishing a recurring financing mechanism for the Disaster Relief and Resiliency Fund would be impactful. Within this review, there was also agreement that allowing the fund to be used for more meaningful disaster resiliency and planning efforts could help mitigate future liabilities.

   Recommendations

   Data reviewed by the Task Force confirms that the current Section 5G capital gains threshold has not kept up with actual economic and revenue growth by between $300 M to $600 M. Therefore, it would be reasonable to adjust the threshold on a one-time basis by some amount within that range. This would be a more sustainable and fiscally prudent mechanism for supporting the budget than the use of excess capital gains over the threshold to support recurring spending – which was adopted in both the FY 2025 and FY 2026 budgets. Additionally, adjusting the threshold based on annual GDP growth or a rolling average of actual collections, versus the 5-year compounded annual growth in GDP, would help the threshold stay in line with actual economic and revenue trends. Regular review of the threshold would also be appropriate to better understand its relationship with actual capital gains collections.

Alongside more regular multi-budget forecasting and stress testing, the state should establish more formal best practices around Stabilization Fund withdrawal policies. While these best practices may not necessarily require statutory changes, developing strong guiding principles for the use of the fund will ensure that the state uses the best information to support its decision making.

The Task Force also coalesced around reconsidering the inclusion of the Disaster Relief and Resiliency Fund in the Section 5G excess capital gains distribution. Given the growing cost of natural disasters impacted by climate change, the establishment of a recurring funding mechanism for the fund could pay dividends in the future. Additionally, the allowance for the fund to support preemptive disaster mitigation and planning efforts could have major returns on investment by mitigating the need for future relief.

Lastly, the Task Force recommends that the group be deployed on a regular basis to evaluate the state's long-term liability financing policies. Convening the Task Force on a regular cadence would allow it to review the policy changes it had previously proposed, as well as evaluate additional amendments to improve processes and the Commonwealth's fiscal health.

Next Steps

Implementing the Task Force's recommendations would require a mix of legislative actions and administrative policy actions. For example, an adjustment to the Section 5G capital gains threshold and future adjustment policy will require statutory changes. Meanwhile, establishing best practices and guidelines for Stabilization Fund withdrawals and better formalizing a recession toolkit can be done via non-statutory planning efforts.

In terms of next steps for the Task Force itself, it will be critical for the Administration, Legislature, and key fiscal partners to determine an appropriate cadence for re-establishing the group. A regular conversation around reserves and long-term liabilities will help the state's future fiscal health and allow the group to evaluate previous policy recommendations.

Conclusion

The state's policies around financing the Stabilization Fund and other long-term liabilities have positioned Massachusetts well. The Massachusetts Stabilization Fund is positioned near the top of all states and puts us in a relatively strong position to manage any future economic downturns. The Commonwealth has also made significant strides to amortize its unfunded pension liability ahead of the statutory deadline of FY 2040.

With that in mind, the state's active review and management of its resources, via multi-year budget forecasting and stress testing, will ensure that the most fiscally prudent policies are upheld as conditions and best practices change. By implementing best practices, actively reviewing our funding strategies, and making appropriate adjustments periodically, the Commonwealth can optimize its preparedness for any future fiscal uncertainty and ensure that it can uphold its top priorities in all circumstances.

Appendices

Appendix 1 – Recommendation

Topic	Recommendation
1. Appropriate Stabilization Fund Size	1. Formally establish a multi-year budget forecast and stress test of the Stabilization Fund to inform fund balance adequacy 2. Regularly reconvene the Task Force to reevaluate adequacy of the Stabilization Fund, as well as other policies regarding long-term liability financing
2. Appropriate Level and Means of Funding Long-Term Liabilities	1. Use regular multi-year budget forecast and stress test to determine adequacy of funding levels for long-term liabilities and possible adjustments to funding policies 2. Consider introduction of regular pension fund stress testing to understand impact of varying risk scenarios 3. Evaluate benefits of a layered amortization model to pay down the actuarial and investment losses experienced each year over a fixed payment schedule
3. Amendments to the Mechanisms Funding the Stabilization Fund and Other Long-Term Liabilities	1. Potentially adjust the excess capital gains threshold prospectively on a one-time basis by between \$300 M to \$600 M, which was determined as a reasonable range based on actual economic and revenue growth since the threshold's establishment 2. Introduce a more dynamic methodology for adjusting the capital gains threshold (e.g., annual GDP growth, portion of rolling average of actual capital gains collections) 3. Consider the use of excess capital gains as a more recurring revenue stream for disaster relief and resiliency efforts, given the extraordinary rise in high-cost natural disasters

Appendix 2 – Enabling Statute

Section 5 of chapter 214 of the acts of 2024:

SECTION 5. There shall be a task force to review and make recommendations relative to: (i) the appropriate long-term level of funding for the Commonwealth Stabilization Fund established in section 2H of chapter 29 of the General Laws; (ii) the appropriate level and means of funding for long-term financial liabilities of the commonwealth; and (iii) amendments to the mechanisms that provide funding for the Commonwealth Stabilization Fund and other long-term financial liabilities, including the provisions of section 5G of said chapter 29. The task force shall review: (i) the statutory threshold for excess capital gains collections established in said section 5G of said chapter 29 in consideration of historical and estimated future capital gains collections; (ii) the disbursement percentages required under said section 5G of said chapter 29; (iii) best practices related to the funding of long-term financial liabilities among states; (iv) best practices related to the funding and size of stabilization funds among states; (v) the impacts of relevant fiscal policies on the commonwealth's credit ratings; and (vi) any other relevant fiscal factors to ensure the most prudent use of state revenues. The task force shall consider said disbursement percentages in consideration of the relative size or funding level of the Commonwealth Stabilization Fund, the State Retiree Benefits Trust Fund established in section 24 of chapter 32A of the General Laws, the Commonwealth's Pension Liability Fund established in subsection (e) of subdivision 8 of section 22 of chapter 32 of the General Laws and other long-term financial liabilities of the commonwealth. The task force shall consist of the secretary of administration and finance, who shall serve as chair; the state treasurer or a designee; the comptroller or a designee; the commissioner of revenue or a designee; 1 individual appointed by the governor who shall be an expert in public finance and who shall be a resident of the commonwealth; and 1 individual appointed by the state treasurer who shall be an expert in state public finance. The task force shall report on its analysis and issue recommendations to the clerks of the senate and house of representatives not later than June 1, 2025 *[Note: reporting date extended in subsequent legislation]*

Appendix 3 – Task Force Meeting Materials

Task Force meeting materials can be found here: The Stabilization Fund and Long-Term Liability Task Force Webpage