



Do you need to adjust your liquidity during the economic recovery?

Typically, best practices for liquidity planning have included a combination of analyzing historical trends and factoring in known future spending. However, we're not in a typical situation. Given the huge disruption in norms and behavior caused by the pandemic and the increased economic uncertainty, local agencies can no longer rely on historical patterns or current capital plans with a high degree of confidence. This means that liquidity buffers once considered adequate should be revisited with your staff or investment advisor.

Firstly, local agencies should create a "base case" for liquidity. What do we think we know right now? Prior liquidity scenarios are a good foundation for the base case. Confirm all previous data points from each department and update them with the most recent information. For example, if you've adjusted your budget in response to the pandemic, apply those updates to your base case. If you haven't, perhaps you need to revisit your budget model. A better view of the budget means a better understanding of your agency's overall cash position.

Secondly, you want to apply a set of shocks to your base case. Where are you most at risk? Let's consider some scenarios to help reveal vulnerabilities. Assume, for example, that grant funding goes to 0%; or expected reimbursements are delayed by 6-18 months. Assume interest rates remain in the current range of 0-25 basis points through 2023; or, worse, interest rates go negative. Apply the same rigor to multiple data points within your liquidity case. Create multiple scenarios with varying degrees of confidence. These exist as your alternate cases. You'll eventually have a base case (what we reasonably know), your worst case, and your best case.

Lastly, evaluate your agency's risk tolerance. Similar to how the base case needs to be reevaluated, risk profiles need to be reevaluated as well. Based on the cases created, what is a manageable and comfortable level of liquidity for your agency? This looks a little different for each agency and is best determined through guided discussion. We wish you and all public agencies the best of scenarios and are here to help if you need us!

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