

NEIL ABERCROMBIE
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HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
OFFICE OF THE PUBLIC DEFENDER
PUBLIC UTILITIES COMMISSION

ADMINISTRATIVE AND RESEARCH OFFICE
BUDGET, PROGRAM PLANNING AND
MANAGEMENT DIVISION
FINANCIAL ADMINISTRATION DIVISION
OFFICE OF FEDERAL AWARDS MANAGEMENT

September 29, 2014

FINANCE MEMORANDUM

MEMO NO. 14-12

TO: All Department Heads

FROM: Kalbert K. Young
Director of Finance

SUBJECT: Fiscal Biennium 2015-17 Executive Budget Request and the Program and Financial Plan for the Period 2015-21

The following policies and guidelines shall be used in preparing the Executive Budget Request for FB 2015-17 and the Program and Financial Plan for the period 2015-21.

General Background

After two years of significant general fund tax revenue growth in FY 12 and FY 13, in large part due to the strong expansionary phase of the visitor and hospitality industry, it was generally expected that growth levels would taper off to more sustainable levels as Hawaii's tourism market reached saturation and the construction industry began to show steady gains. A slower than anticipated rise in construction activity and spending, however, further tempered by declining visitor expenditures and the impact of federal fiscal austerity on the spending of Hawaii's residents caused the Council on Revenues (COR) to lower its FY 14 general fund tax revenue growth rate forecast from 0% to -0.4% in its June 2, 2014 report.

Preliminary actual general fund tax revenues for FY 14 were 1.4% less than the COR's projection. Two uncommon events in FY 14 negatively impacted general fund tax revenue growth: 1) the allocation of \$55.5 million to the Hawaii Hurricane Relief Fund in August of FY 14; and 2) an unusually large allocation to the County Surcharge on State Tax in July of FY 14 compared to an unusually small allocation in July of FY 13. Even so, the State ended FY 14 with a healthy general fund balance of nearly \$665 million.

Despite lower than projected revenue collections for FY 14, the COR believes that the U.S. and Hawaii economies are still growing. However, there is uncertainty about the future and, in light of this uncertainty, the COR lowered its general fund tax revenue

growth forecast for FY 15 from 5.5% to 3.5% in its September 10, 2014 report. The COR also adjusted its forecast for FY 16 to FY 21 to a growth rate of 5.5% for each year. It should be noted that while the COR's forecast for FY 15 was 5.5%, it was applied to a forecast for FY 14 that turned out to be too high. When applied to the *actual* collections for FY 14 (which were down by -1.8% instead of -0.4%), the COR's June 2nd forecast implied a growth in collections of 7.0% for FY 15. Thus, the effective reduction of the COR's forecast for FY 15 is from 7.0% to 3.5%, or a reduction of approximately \$190 million.

The State's Fiscal Condition

Preliminary actual general fund tax revenues for FY 14 were \$74.4 million less than previously estimated by the COR in its June report. Because the COR's growth forecast is being applied against a lower base, the impact of the COR's September forecast is a reduction of projected general fund tax revenues of \$186.3 million for FY 15, \$167.8 million for FY 16 and \$195.2 million for FY 17. In total for the period from FY 15 to FY 19, projected general fund tax revenues are reduced by about \$1.1 billion based on the COR's latest forecast.

As can be expected, the lower revenue forecasts will necessitate adjustments to spending levels and/or enhancements to revenues in order to maintain a positive general fund ending balance through the financial planning period from FY 15 through FY 21 as required by the State Constitution and Chapter 37, HRS. Based on the COR's latest tax and nontax revenue forecasts and current budget expenditure projections, budget adjustments and/or revenue enhancements amounting to \$40.0 million per year beginning in FY 16 will be necessary.

There is a possibility that the extent of the required budget adjustments could be lessened if current actual tax revenue collection trends continue for FY 15. For the first two months of FY 15, actual tax revenue collections are at 6.0%, as compared to the projected 3.5% growth rate. However, any consideration of reducing the budget adjustment targets will have to await the COR's next forecast which is due January 10, 2015.

Budget Approach for FB 2015-17

We approach the development of the Executive Biennium Budget for FB 2015-17 mindful of the fact that the Administration will change in December before the budget process is completed. Due to the timing of the change and the need to put in place budget adjustments and/or revenue enhancements in order to maintain a positive general fund balance, two budget submittals to the Legislature are envisioned.

The first budget submittal on December 22, 2014 (to meet constitutional and statutory budget submittal requirements) will be a "status quo" budget that will reflect the FY 15 budget less non-recurring expenses, plus collective bargaining allocations and additions for: trade-off and transfer requests; selected fixed cost and entitlement requirements; selected non-general fund requests; selected federal fund adjustment requests; and adjustments to non-recurring items identified by the Legislature. The budget

adjustments needed to maintain a positive general fund balance will be shown as a lump sum line item on the general fund financial plan and will not be part of the "status quo" budget. The second budget submittal in the February-March time frame will contain specific budget adjustments and possibly other types of budget and/or revenue enhancement proposals as determined by the incoming Administration. The intent is to provide the incoming Administration with the flexibility to make appropriate budget adjustments that are in line with its policy and budget priorities, and to minimize departments having to do duplicative staff work.

"Status Quo" Budget Submittal

As mentioned, the initial FB 2015-17 budget will be focused on maintaining the status quo. Only the following types of requests will be considered for inclusion in the FB 2015-17 operating budget: 1) trade-off and transfer requests that do not result in an increase in general fund support; 2) selected fixed cost and entitlement expense requirements; 3) selected non-general fund requests; 4) selected federal fund adjustment requests; and 5) adjustments to non-recurring items identified by the Legislature. Departments may submit operating budget requests for other items besides those enumerated above; however, please be aware that these requests will not be considered for inclusion in the initial FB 2015-17 budget. These non-includable operating requests will be provided to the incoming Administration for consideration in the second budget submittal. The "status quo" operating budget approach will apply to all means of financing.

In addition, departments must identify possible operating budget adjustments to programs and/or services to meet the Tier 1, 2 and 3 target levels set for each department. The target levels have been set high to facilitate evaluation of each of the proposed budget adjustments on a statewide basis, thereby providing the incoming Administration with meaningful options to choose from in deciding on where and how much to adjust the "status quo" operating budget. These possible operating budget adjustments will not be included in the initial FB 2015-17 budget, but will also be provided to the incoming Administration for consideration in the second budget submittal. The identification of possible operating budget adjustments will apply only to general funds.

With respect to capital improvement projects (CIP), the intent is that the CIP budget follow a "status quo" approach by concentrating the initial FB 2015-17 CIP budget on: 1) addressing the R&M backlog; 2) addressing health and safety requirements; and 3) completing ongoing projects that were previously authorized. Debt service has been included in the budget to accommodate a total of \$500 million in new G.O. Bond authorizations for FB 2015-17. While the amount may appear large, in reality it is modest compared to CIP budget requests made in the recent past. Departments can submit budget requests for new CIP; however, please be aware that these requests will not be considered for inclusion in the initial FB 2015-17 budget. Instead, these new CIP requests will be provided to the incoming Administration for consideration in the second budget submittal. The "status quo" CIP budget approach will apply to all means of financing.

Second Budget Submittal

The timing and focus of the second budget submittal will be dependent on the direction of the incoming Administration. More than likely, further instructions will await the COR's next forecast in early January 2015. This will provide a more definitive indication of the developing general fund revenue picture and give the incoming Administration time to take stock and make its own assessment of the State's fiscal situation.

It is envisioned that the work started by this Administration in terms of identifying possible budget adjustments and non-trade off and non-fixed costs budget requests will become a large part of the considerations in putting together the second budget submittal by the incoming Administration.

We are undertaking this approach to ensure that we leave the State in a better condition than when we entered office. As we have done throughout this Administration, we will continue to focus on making sound fiscal decisions and improving the State's long-term fiscal stability.

The following general policies are hereby provided for the development of the Executive Budget Request for FB 2015-17.

I. General Policies

1. For operations, the Biennium Budget will be based on FY 15 appropriations from Act 134, SLH 2013, as amended by Act 122, SLH 2014, minus non-recurring costs and plus collective bargaining and Commission on Salaries adjustments, as applicable. Individual departmental budget ceilings are established for all departments by the Department of Budget and Finance (B&F). Under their respective budget ceilings, departments are authorized and encouraged to recommend trade-offs and transfers within and among programs under their purview to reflect the department's current priorities and changing conditions.
2. General fund budget reductions are, in all likelihood, going to be implemented in the near future. Consequently, departments should exercise prudence and restraint in submitting any requests for general fund increases.
3. The Federal Funds Information for States projects a -0.1% decrease in federal funding for most major, recurring discretionary awards for FFY 2015 versus FFY 2014 funding. Major mandatory federal awards such as Medicaid are expected to increase 7.1% for the same time period. The reduced funding for a majority of the federal awards the State receives is a result of the limits on federal spending put in place by the Budget Control Act of 2011 and the Bipartisan Budget Act of 2013. The imposition of these federal spending caps is expected to be in place until 2023. Therefore, all departments should consider that future reductions in federal-aid moneys are a distinct possibility. Departments should not assume that State funds will be available to support program costs if federal funds are reduced or no longer available.

4. Non-general fund programs should plan for the fringe benefit assessment rate increasing to 52.0% for FY 16 and FY 17. This is an increase of approximately 10% from the current rate and is primarily due to the projected costs for the prefunding of other post-employment benefits. The rate is expected to remain at 50.0%+ levels for FY 18 and beyond.
5. Departments should continue to maximize their efforts to use non-general funds, as appropriate, to support their programs. Federal funds, special funds, and other available funding sources should be considered as a replacement for general funds. Departments should not, however, assume that general funds will be available to support program costs if non-general (special, federal, etc.) funds are no longer available.
6. Pursuant to Section 37-68(1), HRS, any proposal for new programs, regardless of funding sources, must demonstrate that such programs are appropriate functions of State government and can be implemented by government as cost-effectively as by the private sector.
7. Departments should be prepared to initiate necessary enabling legislation, or appropriate rule changes, to coincide with budget requests, as applicable. (Form A, *Request for Operating Budget Adjustment Requests*, should be used to provide the necessary information to justify the request.)

II. Submission Requirements and Format

1. Biennium Budget requests shall be submitted according to the requirements and formats as specified in the attachments.
2. All budget submissions will be subject to review and evaluation by B&F and the Governor. Worksheets and other supporting details may be requested and should be made available upon request.

III. Due Dates

The following must be provided to this office:

1. By Monday, October 27, 2014, the following must be submitted, reflecting your budget submission:
 - Two copies of Forms A, A-Attachment, B, C, and FF (relating to the operating budget); and Tables P, Q, and R, and Forms CIPOp, PAB and S (relating to CIP budget).
 - Electronic files should be transmitted to your B&F analyst.
2. By Monday, November 10, 2014, the following must be submitted, meeting your Tier 1, 2 and 3 budget adjustment levels:

- Two copies of Forms X and Y (relating to the operating budget).
 - Electronic files should be transmitted to your B&F analyst.
3. By Friday, December 5, 2014, the following must be submitted, reflecting the Governor's budget decisions:
- Updated BJ Summary Tables in eBUDDI or, for departments with their own budget systems, other electronic files. Totals (by cost elements and means of financing) must match. Department totals must be equal to or less than the budget ceiling amounts.
 - Two copies of each Budget Narrative, with electronic file(s) transmitted to your B&F analyst.
 - Updated Performance Measures in eAnalytical.
 - Two copies of Tables P, Q, and R (as updated in eCIP), Form PAB and Form CIPOp.
4. By Friday, January 9, 2015, updated BJ Details in eBUDDI or, for departments with their own systems, other electronic files, as authorized by B&F.

Departments will be notified later of the timetable for B&F recommendations and Governor's decisions on the Biennium Budget.

Attachments

- Attachment 1: FB 2015-17 "Status Quo" Operating Budget Ceilings and Tiers
- Attachment 2: General Budget Guidelines for Operating and CIP FB 2015-17 and the Planning Period
- Attachment 3: Additional Operating Budget Detail Guidelines FB 2015-17 and the Planning Period
- Attachment 4: Operating Budget Submission Forms (Forms A, A-Attachment, B, C, FF, X, Y)
- Attachment 5: CIP Submission Tables & Forms (Tables P, Q, R; Forms CIPOp, PAB, S)
- Attachment 6: Instructions for Completing Program and Financial Plans and Program Budget Request Forms (September 2014)
- Attachment 7: Suggested Program Review General Approach and Process (Form PR)
- Attachment 8: Major, Recurring Federal Funds for State FB 2015-17