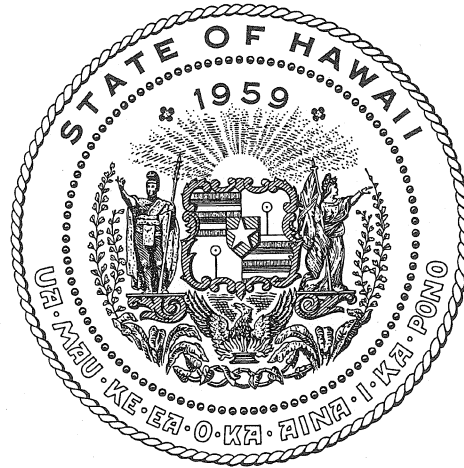


STATE OF HAWAII



EXECUTIVE SUPPLEMENTAL BUDGET (Budget Period 2011-2013)

Submitted to the Twenty-Sixth State Legislature
December 2011

EXECUTIVE CHAMBERS
State Capitol
Honolulu, Hawaii 96813

**GOVERNOR'S MESSAGE TO THE 26TH STATE
LEGISLATURE OF HAWAII MEETING IN THE REGULAR
SESSION OF 2012**

In compliance with Article VII, Section 9, of the Hawaii Constitution, I hereby submit to the State Legislature the Executive Supplemental Budget for Fiscal Biennium (FB) 2011-13 and the updated Program and Financial Plan for the period 2011-17.

OVERVIEW

The proposed FY 2013 Executive Supplemental Budget reflects our Administration's continued quest to provide a secure and promising future for the people of Hawaii. Since last December, our Administration has been working towards our common goals outlined in the New Day in Hawaii plan.

We worked to make the best use of limited resources and improve efficiency in every department. We successfully negotiated an end to employee furloughs so that State offices remained open and services to the public were continued without interruption. We pursued opportunities to fortify State funding with federal funding and optimize the federal funds coming into our State. We worked in cooperation with the private sector to establish public-private partnerships for programs that will benefit many in our State, including our precious keiki, who hold the key to Hawaii's future.

In March 2011, we witnessed the effects of Japan's devastating earthquake and tsunami and knew that their impact would be far reaching; as such, we instructed all departments to be cautious with their expenditures. At my request, the Council on Revenues (COR) held a special

meeting; the COR changed its FY 2011 growth rate from 0.5% to -1.6%, which reflected the anticipated impact of the events in Japan as well as the slowdown in the economy that was already occurring.

To meet this further budgetary deficit, we immediately imposed a 2% restriction on general fund discretionary allocations for the remainder of FY 2011 and borrowed from the Rainy Day and Hawaii Hurricane Relief Fund. **Due to our fiscal prudence, we ended the fiscal year with a general fund balance of \$126 million, ending on a positive note for the first time in three years. Our financial strategy in FY 2011 and FY 2012 has transformed the State's financial structure and condition.**

THE ECONOMY

Since taking office, we have continued our efforts to strengthen Hawaii's economy, though we recognize that Hawaii's recovery from the Great Recession, which ended in June 2009, has slowed. Nonetheless, the visitor industry, although down from the double-digit increases experienced earlier this year, experienced 2.3% growth in the number of visitor arrivals in October 2011, compared to October 2010, buoyed by strong growth in the Canadian market. While visitor arrivals have decreased, total visitor expenditures have grown by 14.8%, resulting in an additional \$1.3 billion flowing into Hawaii's economy this year.

We have added 4,600 jobs to our economy compared to December 2010. Unemployment claims have declined by 12% compared to December 2010.

Total Personal Income (TPI) is expected to increase by 4.5% this year. However, the COR has set the figure at 4.0% in 2012, to account for any decline that may result from national and European economic uncertainties potentially affecting Hawaii's visitor industry.

REVENUE PROJECTIONS

At its September 6, 2011 meeting, the COR increased its forecast for FY 2012 general fund tax revenue growth from 11.0% to 14.5%. The COR also increased its forecast for FY 2013 from 6.0% to 6.5%, while slightly decreasing growth rates for FY 2014 from 6.0% to 3.0% and for FY 2015 through FY 2018 from 6.0% to 5.0%.

The increases in the forecasts for tax revenue growth in FYs 2012 and 2013 primarily reflect the estimated 5% impact of new tax laws that went into effect this fiscal year. The forecast for FY 2012 would have otherwise been reduced to 9.5% due to uncertain economic conditions and visitor numbers. However, within the 9.5%, only 5.2% is attributed to anticipated economic growth, as the remaining 4.3% is the lingering impact of the previous Administration's delay in paying income tax refunds.

Despite somewhat positive projections, we will take a cautious approach in the requested FY 2013 Executive Supplemental Budget. While we are optimistic about our Administration's role in our recovery, we are mindful of the national and worldwide economic factors to which Hawaii remains vulnerable. The sluggish improvement of the national economy, combined with looming cuts to federal programs and the economic turmoil in the European Union, may continue to adversely impact Hawaii. Therefore, the FY 2013 Executive Supplemental Budget continues our commitment to the need

for solid fiscal management of our resources and expenditures combined with modest increases in areas of high concern and priority.

THE FY 2013 EXECUTIVE SUPPLEMENTAL BUDGET

Having achieved a positive general fund balance, we have the opportunity to take essential actions necessary to support Hawaii's recovery, provide a secure future for all of Hawaii's people, and rebuild the State's financial footing. The FY 2013 Executive Supplemental Budget supports the implementation of these key elements:

- Growing a sustainable economy and accelerating our economic recovery with immediate jobs and opportunities;
- Transforming government and restoring the functions of government beginning with the most basic public needs; and
- Investing in Hawaii's people, saving money and lives.

The Executive Supplemental Budget requests for FY 2013 propose a number of changes and adjustments to Act 164, SLH 2011, the General Appropriations Act of 2011, which authorized funding for the two-year fiscal period that began on July 1, 2011 and ends on June 30, 2013. These changes are summarized below:

	FY 13 <u>Appropriations</u> (\$million)	FY 13 <u>Adjustments</u> (\$million)	FY 13 <u>Requests</u> (\$million)
Operating Budget			
All means of financing (MOF)	10,919.1	188.6	11,107.7
General Fund	5,556.2	34.0	5,590.2
Capital Improvements			
All MOF	994.0	1,221.2	2,215.2
General Obligation Bonds	397.7	300.0	697.7

THE OPERATING BUDGET

Transforming and Restoring the Functions of Government

The FY 2013 Executive Supplemental Budget includes proposed amendments that total \$188.6 million in FY 2013 from all means of financing for operating costs. This represents an increase of 1.7% over FY 2013 in the FB 2011-13 Executive Budget. Of this amount, the net request for general funds totals \$34.0 million in FY 2013, resulting in an increase of less than 1.0%. Additional information on funding distribution by means of financing and department may be found on pages 4-9.

The FY 2013 Executive Supplemental Budget includes the following adjustments pursuant to Sections 96 and 97, respectively, of Act 164, SLH 2011, which are necessary to fund non-discretionary costs:

1. **Labor cost savings adjustments due to collective bargaining agreements.** Section 96 requires \$88.2 million in labor savings to be transferred to the Department of Budget and Finance (BUF) for the Retirement Benefits – State program (BUF 741) in FY 2013. \$88.2 million in general funds is proposed to be transferred, as follows:

- \$69.1 million in general funds for labor savings will be transferred from other departments to BUF 741.
- \$11.5 million to be transferred from other BUF programs to BUF 741.
- \$7.6 million, the remaining amount, is available within the program (no transfer required).

The program savings is based on updated projected requirements for Federal Insurance Contributions Act (FICA) and pension accumulation payments using the current payroll base.

2. **Program review adjustments.** Section 97 requires \$50.0 million from identified program reductions to be transferred to BUF for the Health Premium Payments - State program (BUF 761).

Earlier this year, we completed a systematic review of State programs and services. This review was the first step in the Administration's more global effort to reprioritize and retool State government as envisioned in the New Day Plan.

Through this review, we identified \$50.8 million (difference due to rounding) in general fund program adjustments:

- \$29.6 million of which will be transferred from other departments to BUF 761.
- \$1.1 million to be transferred from other BUF programs to BUF 761.
- \$20.0 million in savings already within BUF 761 (no transfer required).

The considerable health premium savings is due to:
1) lower than anticipated projected premium rates for

actives and retirees; 2) the original projection assuming two premium increases instead of one, as per the current medical plan contracts; and 3) updated enrollment projections.

Investing in Hawaii's People

The FY 2013 Executive Supplemental Budget includes \$100.7 million in general fund requests to:

1. **Restore the safety net.** A total of \$46.4 million is being requested for the Department of Human Services:
 - \$6.9 million for purchase of service (POS) contracts for the Child Protective Services program.
 - \$1.5 million for POS contracts for domestic violence programs.
 - \$8.1 million for Medicaid capitation payments.
 - \$0.7 million for the State Supplemental Payments program which compliments Social Security's Supplemental Security Income program.
 - \$23.4 million for the Temporary Assistance for Needy Families program.
 - \$5.8 million to fund critical positions.
2. **Provide for education.** Requests totaling \$46.1 million are included for the Department of Education (DOE) and the University of Hawaii (UH):
 - \$13.6 million for the DOE's Weighted Student Formula.
 - \$25.0 million for the DOE's Student Transportation program.

- \$2.5 million for the DOE's Community School for Adults program to meet maintenance of effort requirements.
- \$5.0 million for the UH's enrollment increases.

3. **Maintain essential services.** Highlights of \$8.2 million requested to maintain essential State services include:

- \$0.9 million for critical Legal Services and Child Support positions for the Department of the Attorney General.
- \$2.4 million for Army National Guard facility maintenance for the Department of Defense.
- \$1.4 million for expansion of the Department of Taxation's electronic filing program.
- \$1.2 million for inmate Hepatitis C treatments to be provided by the Department of Public Safety.

NEW DAY INITIATIVES

Additionally, the FY 2013 Executive Supplemental Budget includes \$19.2 million in requests that will make vital investments in the State's information technology (IT) infrastructure and watersheds as well as provide valuable support for our future - our keiki - and our treasured kupuna.

Growing a Sustainable Economy

Hawaii must invest in its infrastructure and workforce to keep up with and meet the emerging demands of technology. We must also nurture and protect our precious environment, not only because it is pono, but it is an economic investment towards ensuring that we remain a progressive tourism destination.

- \$10.4 million for IT improvements to include business process and IT/Information Resource Management reengineering, IT integration pilot projects, Hawaii State Digital Archives, and technology triage to ensure mission critical business operations.
- \$1.4 million for the State's Broadband Initiative to include E-government upgrades and a demonstration project to upgrade high schools to high speed broadband.
- \$5.0 million for the Watershed Initiative to be spearheaded by the Department of Land and Natural Resources.

Investing in Hawaii's People

Hawaii must invest in its future - our keiki - while taking care of those who have already sacrificed and deserve our care - our kupuna.

- \$1.0 million for the Early Childhood Initiative to include funding for the Early Learning Council, an outreach program for the junior kindergarten transition and development of early childhood obesity and diabetes prevention programs.
- \$1.4 million for an Aging and Disability Resource Center, a resource for kupuna and their families.

The aforementioned general fund requests are offset by requests totaling \$85.9 million (difference due to rounding) in general fund reductions to reflect projected savings:

- \$24.9 million for debt service payments savings due to the general obligation (G.O.) bond sale delay and refunding of prior G.O. bond issuances.
- \$22.5 million due to FICA and pension accumulation payment savings due to updated projected requirements

(amount in addition to labor cost savings adjustment amount).

- \$38.4 million for health premium payments savings due to lower than projected rates and enrollments (amount in addition to project review adjustment amount).

THE CAPITAL IMPROVEMENTS PROGRAM (CIP) BUDGET

Growing a Sustainable Economy

Our New Day Work Projects will develop the infrastructure necessary to grow a sustainable economy. These investments will continue to create jobs and help stimulate Hawaii's economy now and in the future. Departments were encouraged to pursue projects that would address critical infrastructure needs and were ready to go, in order to provide the most immediate impact.

For the CIP budget, an additional amount of \$1,221.2 million in FY 2013 has been recommended. This represents an increase of 123% over the FY 2013 in the FB 2011-13 Executive Budget. Of these amounts, the request for G.O. bonds is \$300.0 million, resulting in an increase of 75% in FY 2013. Additional information on funding distribution by means of financing and department may be found on pages 10-15.

The proposed \$300.0 million in G.O. bond requests include:

- \$15.5 million for the State irrigation system safety improvements.
- \$17.0 million for renovation and asbestos removal for the Kamamalu building.
- \$8.0 million for resealing the State Capitol roof.

- \$15.0 million for statewide financial system enterprise reengineering.
- \$7.3 million for low income housing tax credit loans.
- \$5.0 million for the Kalaeloa East energy corridor.
- \$5.0 million and \$10.0 million for infusions to the Rental Housing Trust Fund and Dwelling Unit Revolving Fund, respectively.
- \$1.5 million for an Environmental Impact Statement for transpacific cable landing sites.
- \$3.4 million for National Guard Armory upgrades and improvements.
- \$50.0 million for DOE projects including various lump sum projects, completion of Ewa Makai Middle School, and fire safety improvements at McKinley High School.
- \$8.0 million for the Honokowai water system.
- \$18.8 million for various improvements for Hawaii Public Housing Authority properties, including Punchbowl Homes, Kahale Mua and Palolo Valley Homes.
- \$6.0 million for health and safety improvements at Department of Health facilities.
- \$20.0 million for various improvements at Hawaii Health Systems Corporation facilities, including Maui Memorial Medical Center, Hilo Medical Center, Leahi Hospital and Samuel Mahelona Memorial Hospital.
- \$7.0 million for dam safety maintenance and remediation.

- \$59.6 million for UH Systemwide health and safety improvements and capital renewal and deferred maintenance.
- \$10.0 million for Kapiolani Community College Culinary Institute of the Pacific.
- \$8.9 million for Coconut Island improvements.

Additionally, the CIP budget includes:

- \$654.1 million (\$534.0 million in revenue bonds, \$14.5 million in federal funds, and \$105.6 million in other funds) for airports modernization and runway improvements, statewide.
- \$161.5 million (\$25.0 million in special funds, \$136.5 million in revenue bonds, and \$5,000 in federal funds) for harbors modernization projects, statewide.
- \$95.0 million (\$28.0 million in revenue bonds, \$66.0 million in federal funds, and \$1.0 million in private funds) for highway repair and maintenance projects, statewide.

COMMITTED TO OUR FUTURE

During the upcoming legislative session, we intend to submit legislation to begin recapitalizing our emergency reserves - the Hawaii Hurricane Relief Fund and the Emergency and Budget Reserve Fund. Money from these funds was used to help meet the FY 2011 shortfall, but now as a result of our fiscal management policies, we have the resources to recapitalize these reserves.

Funding will not be general funds diverted from other worthy programs; it will be general funds realized from premium payments received from our recent successful bond sale. This is not debt, but rather additional proceeds beyond par that investors were willing to pay for Hawaii's bonds. Good fiscal

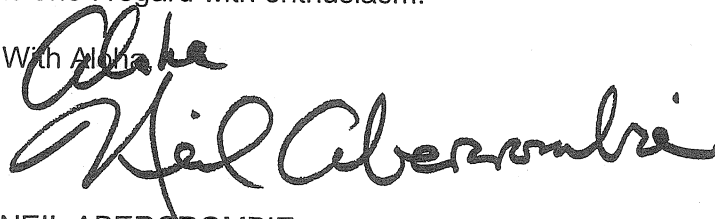
management dictates that we replenish these reserves expeditiously using these proceeds for our future.

We are determined to be focused in our mission, to further Hawaii's recovery and revitalization, while being fiscally responsible. Hawaii's people – the backbone of our State, the backbone of our economy – are central to the success of this mission.

Let us work together to give everyone the opportunity to achieve their highest potential, to support their future promise. Let us work together to take care of our keiki and kupuna, and lend a hand when they need one. Let us work together towards providing a sustainable environment for everyone in Hawaii, so that our children and visitors will enjoy the Hawaii that we hold dear.

Your consideration of these proposals is deeply appreciated. The opportunity to work with you in achieving these objectives is one I regard with enthusiasm.

With Aloha

A handwritten signature in black ink, reading "Neil Abercrombie". The signature is written in a cursive, flowing style. Above the main signature, the word "Aloha" is written in a smaller, more decorative cursive script.

NEIL ABERCROMBIE
Governor, State of Hawaii

APPENDIX TO THE GOVERNOR'S MESSAGE

A. THE FY 2013 EXECUTIVE SUPPLEMENTAL BUDGET RECOMMENDATIONS

THE OPERATING BUDGET

All Means of Financing

For **FY 2013**, total proposed adjustments to the operating budget amount to a net increase of \$188.6 million, or 1.7%, from all means of financing, as shown below:

Means of Financing	FY 13 Act 164/2011 Appropriation (\$)	FY 13 Proposed Adjustment (\$)	FY 13 Recommended Appropriation (\$)
General Funds	5,556,181,624	34,003,992	5,590,185,616
Special Funds	2,622,820,598	148,372,527	2,771,193,125
Federal Funds	1,991,394,272	25,224,958	2,016,619,230
Private Contributions	433,067	52,760	485,827
County Funds	674,179	.....	674,179
Trust Funds	238,538,408	(25,596)	238,512,812
Interdept. Transfers	80,383,217	(11,780,538)	68,602,679
Federal Stimulus Funds	20,877,861	(37,788)	20,840,073
Revolving Funds	396,954,105	(12,959,112)	383,994,993
Other Funds	<u>10,828,223</u>	<u>5,770,764</u>	<u>16,598,987</u>
Total	10,919,085,554	188,621,967	11,107,707,521

The distribution by department and the significant changes in the Operating Supplemental Budget by department are presented in the sections that follow.

General Fund

For **FY 2013**, total proposed general fund adjustments to the operating budget amount to a net increase of \$34.0 million, or less than 1.0%, more than the current appropriation level. The distribution by department is presented in the sections that follow.

It should be noted that net increase of \$34.0 million is a result of \$120.0 million in new requests which are offset by requests for budget reductions due to program savings totaling \$85.9 million (difference due to rounding).

THE CAPITAL IMPROVEMENT (CIP) BUDGET

For **FY 2013**, total proposed CIP adjustments amount to an increase of \$300.0 million in general obligation (G.O.) bond funds, increasing the current G.O. bond appropriation level from \$397.7 million to \$697.7 million.

For **FY 2013**, total proposed CIP adjustments amount to \$1,221.2 million, to be funded from the following sources:

Means of Financing	FY 13 Act 164/2011 Appropriation (\$)	FY 13 Proposed Adjustment (\$)	FY 13 Recommended Appropriation (\$)
General Funds	.....	.....	.....
Special Funds	200,085,000	25,000,000	225,085,000
G.O. Bonds	397,731,000	300,000,000	697,731,000
G.O. Reimbursable	.....	.....	.....
Revenue Bonds	94,660,000	698,528,000	793,188,000
Federal Funds	285,416,000	88,535,000	373,951,000
Private Contributions	.....	1,000,000	1,000,000
County Funds	.....	2,500,000	2,500,000
Interdept. Transfers	.....	.....	.....
Federal Stimulus Funds	.....	.....	.....
Revolving Funds	.....	.....	.....
Other Funds	<u>16,100,000</u>	<u>105,599,000</u>	<u>121,699,000</u>
Total	993,992,000	1,221,162,000	2,215,154,000

The distribution by department and the highlights of the CIP program by department are presented in the sections that follow.

The New Day Work projects will provide valuable improvements to the State's infrastructure, while providing economic stimulus with projects that are ready to go.

B. THE GENERAL FUND FINANCIAL PLAN

The General Fund Six-Year Financial Plan shows positive balances for FY 2012 and FY 2013, as well as the four subsequent years. The primary actions contributing to the positive balances include:

- Budget reductions for retirement and health insurance that resulted from updated wage, enrollment and rate data and a change in the employer/employee contribution ratio for health insurance.
- Savings in debt service that resulted from a recent refunding of G.O. bonds.
- Increase in tax revenues resulting from recent tax law changes.

The Administration is taking a cautious approach towards current and future expenditures due to the economic uncertainties which could adversely affect the State's revenues.

C. THE GENERAL FUND EXPENDITURE CEILING

By law, general fund appropriations must comply with the expenditure ceiling requirements that are set forth in Section 9 of Article VII of the State Constitution and Section 37-92 of the Hawaii Revised Statutes.

At the aggregate level that includes all branches of government, the total proposed appropriations from the General Fund are within the expenditure ceilings for both FY 2012 and FY 2013.

For the Executive Branch, the total proposed appropriations from the General Fund (which include the Executive Supplemental Budget for FB 2011-13 and other specific appropriation measures to be submitted) exceed the appropriation ceiling by \$371.5 million (or 7.2%) in FY 2012 and by \$12.3 million (or 0.2%) in FY 2013. These excesses are due to the substantial costs of social assistance entitlements, support for public education, and other critical requirements identified in the previous sections.

D. THE DEBT LIMIT

Section 13 of Article VII of the State Constitution places a debt limit on G.O. bonds that may be issued by the State. It has been determined that the total amount of principal and interest calculated on: a) all bonds issued and outstanding; b) all bonds authorized and unissued; and c) all bonds proposed in the Supplemental Budget (including State guaranties) will not cause the debt limit to be exceeded at the time of each bond issuance.

The Declaration of Findings with respect to the G.O. bond debt limit is presented in the sections that follow.