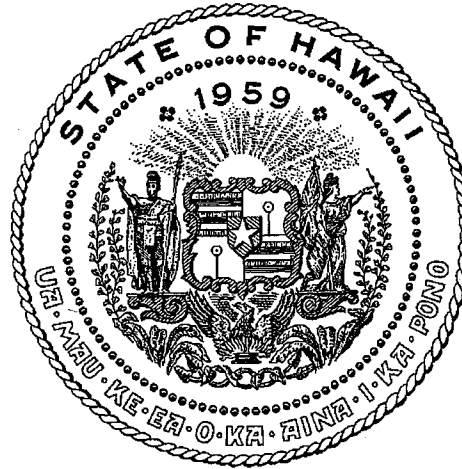


STATE OF HAWAII



THE MULTI-YEAR PROGRAM and FINANCIAL PLAN and EXECUTIVE BUDGET For the Period 2015-2021 (Budget Period 2015-2017)

Submitted to the Twenty-Eighth State Legislature
December 22, 2014

EXECUTIVE CHAMBERS
State Capitol
Honolulu, Hawaii 96813

**GOVERNOR'S MESSAGE TO THE 28TH STATE
LEGISLATURE OF HAWAII MEETING IN THE REGULAR
SESSION OF 2015**

In compliance with Article VII, Section 8, of the Hawaii Constitution, I hereby submit to the State Legislature the Executive Budget for Fiscal Biennium (FB) 2015-17 and the Program and Financial Plan for the period 2015-21.

OVERVIEW

One of the most important responsibilities that I have, as Governor of the State of Hawaii, is to deliver a balanced budget to the Legislature and to the people of our State. To that, I am fully committed.

We will not propose new programs when we cannot afford to pay for them - we will live within our means, just like Hawaii's families. We will spend public funds wisely to avoid raising taxes.

State government should be run like a business, striving to increase efficiency and reduce waste and costs. Accountability and transparency will be the core principles upon which we provide services to our customers, the people of Hawaii.

As government, we must focus our energies to nurture a sustainable economy - a healthy economy to support Hawaii's families and allow them to thrive. There is hard work to be done but we expect no less of ourselves than the public expects of us.

A STARTING POINT

Due to the short time between the start of my Administration and the statutory deadline to submit the Executive Budget to the Legislature, the Executive Budget was primarily compiled by the previous Administration. We have briefly reviewed the budget but, although a few changes have been made, these requests have not been thoroughly vetted by my Administration.

The Executive Budget was developed as a baseline budget by the previous Administration to ensure the continuation of State services at their current level and to provide this Administration with the flexibility to make budget adjustments that are in line with our policy and budget priorities. As such, we consider this Executive Budget to be a starting point from which my Administration can build.

THE EXECUTIVE BUDGET REQUEST FOR FB 2015-17

The Operating Budget

The development of the Executive Budget for FB 2015-17 began with an operating base budget amount for each department, equivalent to their FY 15 appropriation, less non-recurring expenses and plus collective bargaining and Commission on Salaries allocations, as applicable. These base budget amounts were adjusted by requests for:

- Trade-offs and transfers to align the budget with current program operational requirements;
- Selected fixed costs and entitlements;
- Non-general funds, including federal funds; and
- Restoration of justifiable non-recurring items which had been identified by the Legislature.

For FY 2015-17, the budget includes \$12.633 billion in FY 16 and \$13.143 billion in FY 17 from all means of financing for operating costs. This represents an increase of 4% and 8.2%, respectively, over the current level. Of these amounts, the request for general funds is \$6.479 billion in FY 16 and \$6.8 billion in FY 17, resulting in increases of 4.7% and 9.9%, respectively.

Limited general fund requests were included as part of the baseline budget, with the majority of the funds targeted for non-discretionary costs.

Significant general fund requests include:

- \$18.9 million in FY 16 and \$18.4 million in FY 17 for Behavioral Health Services for mentally ill Medicaid recipients (\$34.9 million in FY 16 and \$35.1 million in FY 17 in federal funds also recommended).
- \$4.6 million in FY 16 and \$58.8 million in FY 17 for debt service for capital improvement projects for Department of Education (DOE), University of Hawaii (UH) and other State programs.
- \$87.4 million in FY 16 and \$216.3 million in FY 17 for health premium payments for DOE, UH and other State programs.

- \$65.5 million in FY 16 and \$99.8 million in FY 17 for retirement benefit payments for DOE, UH and other State programs.
- \$18.8 million in FY 16 and \$36.0 million in FY 17 for collective bargaining costs for the UH Professional Assembly (\$1.5 million in FY 16 and \$2.9 million in FY 17 in special funds, \$0.5 million in FY 16 and \$0.9 million in FY 17 in federal funds and other federal funds, and \$0.1 million in FY 16 and \$0.2 million in FY 17 in revolving funds also recommended).
- \$9 million for FY 16 and FY 17 for increased utility costs for DOE.
- \$9.6 million for FY 16 and FY 17 for administrative and operating expenses for the Department of Hawaiian Home Lands.

The Capital Improvements Program Budget

For the Capital Improvements Program (CIP) budget, a total of \$1,136.5 million in FY 16 and \$683.4 million in FY 17 has been recommended. Of these amounts, the requests for general obligation (G.O.) bonds total \$290.8 million (includes \$4 million in reimbursable G.O. bonds) and \$255.9 million, respectively.

A substantial portion of the recommended G.O. bond funded projects address health and safety issues or provide major repair and maintenance and other improvements throughout the State. Timely implementation of these projects will help to reduce project backlogs and prevent future requirements from becoming more significant in the forthcoming years.

These projects are necessary to maintain and improve our State facilities, including public schools and the UH, and will address facility requirements that will allow State programs to better service Hawaii's people.

Major G.O. bond funded CIP requests include:

- \$12 million in FY 16 and FY 17 for maintenance of existing State facilities, Statewide.
- \$4 million in reimbursable G.O. bond funds in FY 16 for design of the Kakaako Makai parking structure, Oahu.
- \$38.1 million in FY 16 for reauthorization of funding for transfers to the State Educational Facilities Improvement Special Fund to support previously authorized CIP projects for the DOE.
- \$100 million for FY 16 and FY 17 for the maintenance and improvement of Hawaii's public school facilities, Statewide.
- \$2.5 million for FY 16 and FY 17 for health and safety improvements for public libraries, Statewide.
- \$3 million in FY 16 for decommissioning and restoration of four dams in Anahola, Kauai.
- \$1.8 million in FY 16 and \$3.0 million in FY 17 for sewer improvement on Hawaiian Home Lands in Papakolea, Oahu.
- \$2.2 million in FY 16 and FY 17 for the Department of Health's (DOH) Wastewater Treatment Revolving Fund (\$10.9 million in federal funds also recommended each year) and \$1.8 million in FY 16 and FY 17 for the Safe Drinking Water Revolving Fund (\$8.8 million in federal funds also recommended each year).
- \$3.6 million in FY 16 and \$59,000 in FY 17 for DOH's health and safety projects for facilities, Statewide.
- \$12 million in FY 16 and FY 17 for Hawaii Health Systems Corporation (HHSC) projects, Statewide.
- \$5 million in FY 16 and FY 17 for public housing development, improvements, and renovations, Statewide.
- \$3 million in FY 16 and FY 17 for rockfall and flood mitigation, Statewide.
- \$5 million in FY 17 for dredging of the Ala Wai Canal, Oahu.
- \$4 million in FY 16 for the Department of Land and Natural Resources' (DLNR) Maui Office Annex Building, Maui.
- \$8.5 million in FY 16 and \$12.5 million in FY 17 for repair and improvements for Department of Public Safety facilities, Statewide.
- \$36.1 million in FY 16 and \$27.4 million in FY 17 to correct health, safety and code deficiencies for UH facilities, Statewide.
- \$13.9 million in FY 16 and \$27.6 million in FY 17 for capital renewal and deferred maintenance at UH campuses, Statewide.
- \$20.1 million in FY 16 and \$20.4 million in FY 17 for CIP staff costs for the Department of Accounting and General Services (\$8.5 million in FY 16, \$8.7 million in FY 17); Department of Business, Economic Development and Tourism (\$1.9 million both years); DOE (\$6.5 million both years); and DLNR (\$3.2 million in FY 16, \$3.3 million in FY 17).

Significant projects funded by other means of financing include many to maintain and improve the State's airports and harbors. These projects will enhance the operation and safety of these major gateways to and from our islands. Other major projects will provide highway improvements necessary for the safety of all who travel our roadways.

These facilities and highways must be maintained not only for our residents but, also, for our visitors, as they are the welcoming face to our island State and help to support Hawaii's economic vitality. Another notable request will help to support development of Hawaiian Home Lands by providing the necessary federal fund ceiling.

Major CIP requests funded by other means of financing include:

- \$9.8 million in revenue bond funds and \$20.3 million in federal funds in FY 16 for runway widening and lighting improvements at Honolulu International Airport, Oahu.
- \$2.3 million in revenue bond funds in FY 16 and \$24 million in revenue bond funds in FY 17 for aircraft apron reconstruction at Honolulu International Airport, Oahu.
- \$5 million in revenue bond funds in FY 16 and \$36 million in revenue bond funds and \$20 million in federal funds in FY 17 for a regional Aircraft Rescue and Fire Fighting training facility at Kona International Airport at Keahole, Hawaii.
- \$5.5 million in revenue bond funds and \$14.5 million in federal funds in FY 16 for airfield improvements at Lihue Airport, Kauai.
- \$189,000 in revenue bond funds and \$1.9 million in federal funds in FY 16 and \$1.3 million in revenue bond funds and \$11.3 million in federal funds in FY 17 for Part 139 improvements at Hana Airport, Maui.
- \$74.8 million in special funds and \$129.1 million in revenue bond funds in FY 16 for rental car facility improvements, Statewide.
- \$250 million in revenue bond funds in FY 16 for Kapalama Military Reservation Improvements at Honolulu Harbor, Oahu.
- \$17 million in revenue bond funds in FY 16 for land acquisition and improvements and an additional \$10.5 million in revenue bond funds in FY 16 for other improvements at Kahului Harbor, Maui.
- \$50,000 in revenue bond funds and \$200,000 in federal funds in FY 16 and \$3.4 million in revenue bond funds and \$13.6 million in federal funds in FY 17 for Kipapa Stream Bridge rehabilitation and/or replacement, Kamehameha Highway, Oahu.
- \$3 million in revenue bond funds and \$12 million in federal funds in FY 17 for replacement of Wainiha Bridges Nos. 1, 2 and 3, Kauai.
- \$6 million in revenue bond funds and \$24 million in federal funds in FY 16 and FY 17 for major pavement improvements, Statewide.
- \$2.8 million in special funds and \$125,000 in other funds in FY 16 and FY 17 for the Airports Division, \$1.7 million in revenue bond funds in FY 16 and FY 17 for the Harbors Division, and \$16 million in special funds and \$8 million in federal funds in FY 16 and FY 17 for the Highways Division for CIP staff costs for the Department of Transportation.
- \$20 million in federal funds for the Department of Hawaiian Home Lands' Native American Housing Assistance and Self Determination Act of 1996 development projects, Statewide.

ADDITIONAL BUDGET AND FINANCIAL PLAN CONSIDERATIONS

In the coming weeks, my Administration will be reviewing the operating and CIP budget requests that were submitted by the previous Administration to determine what can be funded. These budget requests will be reviewed with the appropriate department heads and submitted to the Legislature by Governor's Message. We are aware that there may also be FY 15 funding shortfalls which will require our immediate attention. There are indications that, for example, HHSC and DOH's Emergency Response Revolving Fund may require additional funds to support their FY 15 operations. Additionally, the Office of the Governor will require funding due to the gubernatorial transition. Consequently, it will be necessary for the Administration to request emergency appropriations for critical situations or request the reallocation of resources currently going to the general fund.

We will exercise prudence by reserving \$300 million of the State's bond margin for priority projects which may require authorization in FY 17, the supplemental year of the budget. I feel it would not be in the State's best financial interest to appropriate the maximum amount of G.O. bonds under the current bond margin, as these projects would be put out to bid in a crowded, and less favorable, construction market.

THE ECONOMY

From December 2007 to June 2009, the nation experienced its longest and severest recession since the Great Depression, commonly known as the "Great Recession." Over five years after the end of the recession, the nation still has not fully recovered.

The national Gross Domestic Product (GDP), which increased by 2.5% in calendar year 2010, grew at lesser rates in 2011 through 2013. Due to the extremely cold weather in the beginning of 2014, the first quarter began with a 2.1%

decrease in the GDP. The 3.9% increase in the third quarter reflect increases in consumer and business spending, as well as government spending, which had its highest quarterly increase since 2009. The recent growth in government spending, which had been dragging, bodes well for the nation's economic recovery.

Another positive is the decrease in the nation's unemployment rate from 7% in November 2013 to 5.8% in November 2014. Further, nonfarm payroll increased by 321,000 in November, lead by growth in professional and business services, retail, health care and manufacturing.

While the health of the U.S. economy undoubtedly impacts Hawaii, the State has been faring better. Hawaii's economy, as measured in real GDP, is projected to increase by 2.6% in 2014 and by 2.8% in 2015.

The State's October 2014 unemployment rate of 4.1%, the sixth lowest rate in the nation, has not yet matched the pre-recession low of 2.3% but has shown consistent improvement since the summer of 2009, when unemployment peaked at 7.1%. The 1.3% increase in civilian non-agricultural jobs in the third quarter of 2014, capping 16 quarters of continued job growth, is expected to continue through the fourth quarter.

In regard to Total Personal Income (TPI), the Council on Revenues (COR) reduced its projections in its November 5, 2014 report, from 4% in calendar year 2014 and 4.7% in 2015 to 3.5% and 3.5%, respectively. The COR's revisions considered the downward trend of the nation's TPI growth rate, growth trends in the tourism industry, and the impact of recent changes in oil prices and housing rentals on inflation. Additionally, the COR discussed the impact of tax law changes in Japan and the depreciation of the Japanese yen and slower than anticipated growth of the construction sector.

The tourism industry, a major economic driver, brings billions of dollars into Hawaii's economy and supports thousands of jobs. After a slow start this year, summer and fall visitors to the State contributed to positive year-to-date growth for the visitor industry of 0.7% growth in visitor arrivals and 2.2% growth in visitor spending through October 2014 as compared to the same period last year.

Hawaii consistently ranks among the top visitor destinations in the world as evidenced by the positive growth in all but two quarters since the third quarter of 2009. But, as recent industry growth has been slowing, we must address the need to keep the tourism industry vital for its continued growth.

As such, my Administration will work with the visitor industry to facilitate growth by increasing hotel capacity and airline seats to Hawaii. We will also work with our Congressional team to make travel to Hawaii easier for international travelers.

The construction industry, another major factor in Hawaii's economy, was off to a strong start this year but showed unevenness during the summer. Government construction contracts awarded decreased \$86.5 million in the third quarter of 2014 but private construction permit value increased \$101.2 million during the same period.

While we are optimistic about Hawaii's economy, we recognize that there will always be outside influences which could quickly turn things around such as the continued instability in the European and Japanese economies and unrest in the Middle East. We will remain mindful of these influences to ensure the State's economic stability.

REVENUE PROJECTIONS

In its September 10, 2014 report, the COR lowered its general fund tax revenue forecast for FY 15 from 5.5% to 3.5%. The revision was due to lower than anticipated actual collections

for FY 14, which were down 1.8% instead of 0.4%, as had been forecast by the COR.

The COR also adjusted its forecast for FY 16 through FY 21 to 5.5% growth each year. Previously, growth rates were 5% in FY 16, 5.8% in FY 17, 6.2% in FY 18, 5.4% in FY 19, and 5.4% in FY 20 (there was no forecast for FY 21). The COR believed that the U.S. and Hawaii economies were still growing but expressed uncertainty about the future.

Preliminary general fund tax collections through November 2014 are up 7.1%, ahead of the projected growth rate of 3.5% for FY 15, buoyed by increases in general excise tax (+8.7%), individual income tax (+9.4%) and transient accommodations tax (+7.5%) collections as compared to the same period in FY 14.

SETTING THE PATH

We have a unique opportunity to change Hawaii's future. To work together, with the community, with those we know and those we have yet to meet, to make Hawaii a place we are proud to call home.

Here in Hawaii, we are not strangers to hard work. Our families worked hard to provide for us, just as we work hard today to provide for our children. Working together, there are no limits to what we can accomplish. Let's make good things happen.

Sincerely,



DAVID Y. IGE
Governor of Hawaii

APPENDIX TO THE GOVERNOR'S MESSAGE

A. THE EXECUTIVE BUDGET RECOMMENDATIONS

The Operating Budget

All Means of Financing

For FB 2015-17, total operating budget requests from all sources of funding amount to \$12.633 billion in FY 16 and \$13.143 billion in FY 17, resulting in increases of 4% and 8.2%, respectively.

Means of Financing	FY 15 <u>Appropriation</u> (\$million)	FY 16 <u>Request</u> (\$million)	FY 17 <u>Request</u> (\$million)
General Funds	6,189.2	6,478.9	6,800.3
Special Funds	3,122.8	3,053.0	3,149.1
Federal Funds	2,062.5	2,324.2	2,415.3
Other Federal Funds	180.6	189.1	185.3
Private Contributions	0.4	0.4	0.4
County Funds	0.2	0.2	0.2
Trust Funds	86.9	82.4	86.3
Interdept. Transfers	94.6	93.5	93.4
Federal Stimulus Funds	0.3	-	-
Revolving Funds	398.4	398.7	399.3
Other Funds	<u>11.3</u>	<u>12.9</u>	<u>13.3</u>
Total*	12,147.2	12,633.3	13,143.0*
Increase over FY 15		486.1	995.8*
Percentage increase		4.0%	8.2%

* - Totals differ due to rounding

The increases are primarily due to escalating non-discretionary costs (general funds for debt service; health premium payments; retirement benefit payments; and federal and general funds for Medicaid). Also contributing to increases in various means of financing are collective bargaining costs for the University of Hawaii Professional Assembly.

General Fund

Total requests from the general fund amount to \$6.479 billion in FY 16 and \$6.8 billion in FY 17, which represents an increase of \$289.7 million (4.7%) in the first year and \$611.1 million (9.9%) in the second year over the FY 15 appropriation level. Increased non-discretionary (debt service, health premium payments, retirement benefit payments, and Medicaid) and collective bargaining costs are also the primary reasons for these differences.

The Capital Improvement Program Budget

For FB 2015-17, total requests for capital improvements amount to \$1,136.5 million in FY 16 and \$683.4 million in FY 17, to be funded from the following sources:

Means of Financing	FY 16 Request (\$million)	FY 17 Request (\$million)
General Funds	-	-
Special Funds	108.2	33.0
G.O. Bonds	286.8	255.9
G.O. Reimbursable	4.0	-
Revenue Bonds	564.9	201.3
Federal Funds	172.5	193.1
Other Federal Funds	-	-
Private Contributions	-	-
County Funds	-	-
Interdept. Transfers	-	-
Revolving Funds	-	-
Other Funds	<u>0.1</u>	<u>0.1</u>
Total	1,136.5	683.4

B. THE GENERAL FUND EXPENDITURE CEILING

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

At the aggregate level, including all branches of government, total proposed appropriations from the general fund are within the expenditure ceilings for both FY 16 and FY 17.

For the Executive Branch, total proposed appropriations from the general fund (which include the Executive Budget for FB 2015-17 and other specific appropriation measures to be submitted) are within the appropriation ceiling for the Executive Branch in FY 16 but will exceed the appropriation

ceiling by \$118.0 million (or 1.8%) in FY 17. The reasons for this excess are the substantial costs of social assistance entitlements, support for public education, debt service and fringe benefits and other critical requirements.

C. TAX REFUND OR CREDIT AND DEPOSIT TO THE EMERGENCY AND BUDGET RESERVE FUND

Article VII, Section 6, of the Hawaii State Constitution, requires that whenever the State general fund balance at the close of each of two successive fiscal years exceeds 5% of general fund revenues for each of the two fiscal years, the Legislature must provide for a tax refund or tax credit to the taxpayers of the State or make a deposit into one or more emergency funds, as provided by law. Section 328L-3, Hawaii Revised Statutes, provides that whenever general fund revenues for each of two successive fiscal years exceeds revenues for each of the preceding fiscal years by 5%, 5% of the general fund balance shall be deposited into the Emergency and Budget Reserve Fund (EBRF).

For FYs 13 and 14, general fund balances were greater than 5% of general fund revenues and FY 13 general fund revenues were greater than 5% of the previous year's revenues; however, general fund revenues for FY 14 were not greater than 5% of the previous year's revenues. Accordingly, the 2015 Legislature must provide for a tax refund or tax credit but need not make a deposit into the EBRF.

D. THE DEBT LIMIT

Section 13, Article VII of the Hawaii 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 Executive Budget, including State guaranties, will not cause the debt limit to be exceeded at the time of each bond issuance.