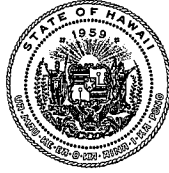


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HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND  
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ADMINISTRATIVE AND RESEARCH OFFICE  
BUDGET, PROGRAM PLANNING AND  
MANAGEMENT DIVISION  
FINANCIAL ADMINISTRATION DIVISION  
OFFICE OF FEDERAL AWARDS MANAGEMENT (OFAM)

September 24, 2015

FINANCE MEMORANDUM

MEMO NO. 15-11

TO: All Department Heads

FROM: Wesley K. Machida  
Director of Finance

SUBJECT: Supplemental Budget Policies and Guidelines for Fiscal Biennium 2015-17

The policies and guidelines included herein shall apply to the preparation of the Executive Supplemental Budget for FY 17 (FB 2015-17).

General Background

The State's fiscal situation has fluctuated rapidly in recent years. Since FY 14, the monthly tax collection growth rates of the State's general fund revenues have been quite inconsistent, ranging from highs of 8.1% and 20.7% and lows of -11.9% and -15.8% in FY 14 and FY 15, respectively, on a year-over-year basis. Because general fund revenue growth trends have not been clearly reflective of economic activity, this uncertainty has been a factor in the Administration's cautious approach to the State's budget.

While our approach has positively impacted the general fund balance, which was a healthy \$828.1 million at the end of FY 15, fiscal year end balances are still expected to decrease through FY 17 due to annual spending in excess of annual revenues. Thus, as we move further into FY 16, which has exhibited positive revenue growth in its first two months, we are optimistic about the State's financial and economic condition but mindful of our obligations and the changes which can happen all too swiftly.

The State has commitments that must be addressed while we are in the position to do so. We will propose to pay Post-Employment Benefits (OPEB) annual required contribution (ARC) at the 100% level in FY 17. The ARC amortizes the OPEB \$8.52 billion unfunded liability over a 30-year period. We will also propose to provide funding in FY 17 for the Emergency and Budget Reserve Fund, which will help to ensure the State's fiscal stability in future downturns.

The State's economy has continued to show strength, with the current economic expansion expected to last a few years. Much of this expansion is a result of the strong performance of the visitor industry, the single largest driver of the State's economy. The industry has continued to experience high levels of visitor arrivals and expenditures, with year-to-date growth in visitor arrivals increasing by 4.2% and visitor spending increasing by 3.6% through July 2015.

The increase in construction jobs and the value of private building permits reflect the growth of Hawaii's construction industry. Through the first half of 2015, the number of construction jobs grew by 3.1%, the second highest level of growth across all industries. Compared to the same period last year, the value of private building permits issued through the first half of 2015 increased by over 36%. Commercial, industrial and residential construction are leading this industry's growth.

The continually decreasing unemployment rate is also a favorable indicator, with unemployment declining from 3.7% in July 2015 to 3.5% in August 2015 (seasonally adjusted). The current rate of 3.5% is the lowest since 3.4% in March 2008, which is due, in large part, to the expansions of the visitor and construction industries.

On the national level, there are again concerns about potential economic and fiscal impact due to the absence of a federal budget for the upcoming federal fiscal year. Without a federal spending plan in place, the State could be significantly impacted by a federal government shutdown. Even if a federal budget is passed, there may be reductions to programs which will adversely impact Hawaii. The U.S. and the State's economic health also remain vulnerable to the potential impact of the unrest in the Middle East and economic volatility in China and Europe.

### **The State's Fiscal Condition**

For FY 15, preliminary actual general fund tax revenues were less than the Council on Revenues' (COR) projection, primarily due to faster than anticipated processing of tax refunds by the Department of Taxation. Tax revenues came in at 6.8% higher than FY 14 instead of the 7.5% projected by the COR.

In its September 10, 2015 report to the Governor, the COR revised its May 2015 general fund revenue forecast significantly. The FY 16 projection was increased from 2.7% to 6.0%, the FY 17 projection was decreased from 6.4% to 5.5%, the projections of 5.5% for FY 18 and 5.0% for FY 19 were left unchanged, the projections for FY 20 and FY 21 were lowered from 5.0% to 4.5% and 4.5% growth was forecast for FY 22. The estimated impact of the COR's revisions to general fund tax revenues for the current and two upcoming biennium total \$255.6 million for FB 2015-17, \$227.6 million for FB 2017-19, and \$141.0 million for FB 2019-21.

The COR's rationale for the adjustments for FY 16 were the strong performance of economic indicators (labor, tourism, construction) and decreased impact of the slower processing of tax refunds in FY 15. The out-year projections were reduced slightly to reflect the eventual cyclical slowing of the economy.

Additionally, non-tax revenues are projected to increase significantly primarily due to correction of underreporting of non-general fund reimbursements for Hawaii Employer-Union Health Benefits Trust Fund (EUTF) premiums. For FB 2015-17, the increased non-tax revenues total \$108.3 million; for FB 2017-19, the increased non-tax revenues total \$160.3 million; and for FB 2019-21, the increased non-tax revenues total \$224.1 million.

### **Strengthening Our Foundation**

Going into this supplemental budget, we recognize that while we must strengthen the foundation of our State government, we must balance these efforts with maintaining the State's fiscal sustainability. We must always strive to make the most efficient use of our resources and ensure that public funds are judiciously spent.

Again, we must remain mindful that the State is projected to spend more than it is taking in on an annual basis and is facing significant increases in funding pension and OPEB liabilities. Thus, while there are many needs to be met, this supplemental budget process should be viewed as a means to provide critical enhancements to State programs, after thoughtful consideration of the resources which are already available to your department.

Our efforts must be focused on high priority needs, those which most significantly impact our State programs and the residents of our State. For example, the Administration supports additional funds for the Department of Education's (DOE) Weighted Student Formula so that more funding can be made available at the school level. We must also ensure that suitable learning environments are provided for Hawaii's students.

The Administration also recognizes the need to address housing and homelessness. This growing concern is far reaching in its impact to all of our communities. This initiative will consider both the operational and capital improvement program (CIP) resource requirements so we can work towards short- and long-term solutions.

We will be requesting funding to continue ongoing State services for which second year funding for FB 2015-17 Executive Budget requests was not approved by the Legislature. Additionally, specific appropriations which were funded in FY 16 but require funding for program continuation into FY 17 will be considered.

We will strive to provide the most appropriate funding for State programs. As such, we will be proposing to convert general obligation (G.O.) bond funded CIP staff costs to general funded.

We must lead the way to support our renewable energy goals for the State of Hawaii. As such, energy efficiency projects to decrease the State's reliance on fossil fuels will be considered for the Administration's CIP package.

The Administration will be requesting funding for other critical program needs which have been long passed over. The improvement or replacement of our correctional facilities in the State of Hawaii is necessary to alleviate current overcrowded conditions.

Such improvements could generate program savings. We must also provide for a forensics facility at the Hawaii State Hospital to reduce overcrowding and to address the safety concerns of the public and the hospital's staff.

### ***Budget Transparency***

Departments should review their FB 2015-17 operating budget details for items which do not align with anticipated expenditures and can be addressed immediately. Each department's review should include, but should not be limited to, the following, as applicable:

- Negative adjustments
- Underfunded, unfunded or unbudgeted positions
- Specific budget line items which do not align with anticipated expenditures

Be aware that Section 128 of Act 119, SLH 2015, prohibits the expenditure of funds to fill any position not authorized by the Legislature, with specific exceptions. For the purpose of complying with Section 128, positions authorized by a General or Supplemental Appropriations Act item or proviso are generally positions reflected in the budget details as:

- Permanent or temporary positions (also positions vicing into authorized positions).
- Lump-sum funding authorizations for hourly or casual employees.
- Lump-sum CIP funding for project-funded positions.

This prohibition does not apply to positions established by specific legislation or pursuant to the HRS. All other positions currently funded by departments are considered unbudgeted.

Additionally, Act 160, SLH 2015, provides that, effective July 1, 2017, no funds shall be expended to fill a permanent or temporary position if the filling of that position causes the position ceiling to be exceeded, with specified exceptions. "Position ceiling" is defined as the maximum number of permanent and temporary positions that an expending agency is authorized for a particular program.

Thus, it is imperative that all departments review their unbudgeted positions. All unbudgeted positions that are critical and on-going must be identified and incorporated into the budget. Additional funding will not be provided for these positions because they are currently funded within existing budgets; as such, only requests for "Conversion of Unbudgeted Positions" which are cost neutral but may increase temporary or permanent position counts may be submitted.





















