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

August 26, 2016

FINANCE MEMORANDUM

MEMO NO. 16-12

TO: All Department Heads

FROM: Wesley K. Machida *Roderick Becker*
for Director of Finance

SUBJECT: Fiscal Biennium 2017-19 Executive Budget Request and the Program and Financial Plan for the Period 2017-23

The following policies and guidelines shall be used in preparing the Executive Budget Request for FB 2017-19 and the Program and Financial Plan for the period 2017-23.

General Background

Due to the fiscal uncertainty which has overshadowed many of the past fiscal years, the Administration has been cautious in its approach to the State's budget. Although Hawaii's economy has been growing, general fund tax revenue growth has not always been a clear indicator of economic activity, especially when measured against prior year fluctuations.

Preliminary general fund tax revenue growth for FY 16 showed the strength of Hawaii's economy, which rallied to 8% by the end of the year. However, in the month since then, general fund tax revenue growth dropped to -2.2% (preliminary July 2016). Despite lower than projected revenues for FY 17 thus far, however, the State's economy has continued to show strength.

Hawaii's visitor industry – a significant component of the State's economy – has been leading the way with four straight record setting years of visitor arrivals and visitor expenditures. The trend continues in 2016, with year-to-date visitor arrivals up by 4.2% and visitor expenditures up by 4.3% for the first half of the year.

In February 2016, the State's unemployment rate dipped to 3.1%, the lowest since November 2007. Although there has been a slight uptick to 3.3% (seasonally adjusted preliminary June 2016), the State has experienced its lowest rates of unemployment since beginning of the Great Recession this calendar year, due in large part to the

expansions of the visitor and construction industries. In comparison, the State's unemployment rate is much better than the national rate of 4.9% (seasonally adjusted June 2016).

While we are optimistic about Hawaii's economy, the Department of Business, Economic Development and Tourism has cautioned that there are many potential challenges:

- The economies of most countries worldwide are experiencing slowdowns;
- Many Hawaii industries are still recovering;
- The Counties of Hawaii and Kauai have just recovered;
- Air seat growth is slowing down significantly, which will lead to a slowing down of visitor industry growth; and
- Construction industry momentum is weakening.

Economic downturns are part of every economic cycle. Whether they are dramatic and swift or happen gradually, we must be prepared. Thus, we are continuing our efforts to build up our State budget reserves and maintain them at adequate levels to ensure the State's fiscal stability when the economy turns.

To implement the build up of resources, the Governor issued Administrative Directive (A.D.) No. 16-03, State Reserve Policy. The A.D. establishes that the State should maintain an amount equal to at least 10% of general fund revenue in the emergency budget and reserve fund and an amount equal to at least 5% of general fund revenue as a general fund balance.

Consequently, we plan to maintain at least a 5% general fund balance at the end of each fiscal year and will propose to provide funding in FY 18 for the Emergency and Budget Reserve Fund. We must also keep in mind that the State's expenditures are anticipated to outpace revenues substantially in FY 17.

The State must also meet significant financial commitments to address our unfunded liabilities in the Employees' Retirement System and Employer-Union Health Benefits Trust Fund in the coming years. It is fiscally responsible to aggressively address these commitments while we are in the position to do so.

We will propose to pay the Other Post-Employment Benefits (OPEB) annual required contribution (ARC) at the 100% level in FY 18 which should result in significant savings for the State. The ARC amortizes the OPEB \$9.06 billion unfunded liability over a 30-year period.

Collective bargaining (CB) negotiations for all of the bargaining units (BU) for FB 2017-19 are also underway. Taken together, these factors all reinforce the need to continue to be fiscally prudent and responsible with our expenditures to ensure the State's fiscal stability in FY 17 and beyond.

Therefore, we will continue a cautious approach in developing the FB 2017-19 Executive Budget. All budget requests must be sustainable and reasonable.

The State's Fiscal Condition

In its most recent report of June 1, 2016, the Council on Revenues (COR) lowered its projected FY 16 general fund tax revenue growth rate from 6.7% to 6.1%. The decrease in the growth rate was based primarily on the COR's concern with the declining rate of growth of overall general fund tax collections in earlier months, despite strong economic data. The COR retained its previously forecasted growth rates of 5% for FY 17 through FY 19 and 4.5% for FY 20 through FY 22.

Preliminary actual general fund tax collections for FY 16 increased by 8.0% compared to FY 15, 1.9% more than the COR's forecast. For the first month of FY 17, however, preliminary general fund tax collections are -2.2%, which demands a cautious outlook to start the fiscal year.

Fostering Sustainability

The Administration is focused on the long-term picture, looking at what we can do today to improve State government and the lives of Hawaii's people and what can be sustained going forward. We recognize that there is a lot that needs to be done but our resources are limited.

It is our responsibility to make the best use of our resources and to ensure that public funds are spent wisely. Strengthening the foundation and improving the efficiency of State government to enable our programs to best serve the public should start from within. We encourage departments to realign their budgets to accommodate the current needs of their programs.

Where realignment cannot address those needs, departments may consider requests which are reasonable and sustainable. Again, bear in mind that the State is projected to spend more than it is taking in this fiscal year and is facing significant increases in funding pension and OPEB liabilities, in addition to other demands on our limited resources. Departments must consider the long-term impact to the State's resources when building their budget requests.

There are many priority needs that are compelling and we will be forced to make hard choices. We cannot possibly address them all at the levels that are desired. These priorities include:

Education, which is fundamental to our children and our future. Our schools must be able to provide suitable learning environments.

Affordable housing, which is in great need for Hawaii's families to rent or buy.

Homelessness, which continues to significantly impact our communities. We need to provide shelters and social services.

Our 100% clean energy future, which will reduce the State's reliance on fossil fuels.

Correctional facilities, where we must alleviate overcrowding.

The Administration will also continue to look at other critical program needs which have been long passed over, in addition to improvements to generate program savings and enhance the transparency and efficiency of our operations. We must all be committed to improving our operations and how we serve the public because we are all responsible to ensure that the State's budget is sustainable.

Budget Transparency

Departments should review their FY 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

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.

Consequently, it is highly recommended that all departments review their unbudgeted positions to determine which positions are not exempt under Act 160. Such positions which are critical and on-going should be incorporated into the budget.

Additional funding will not be provided for these requests because they are currently funded within existing budgets; as such, in order to reflect necessary changes, departments should submit the following:

1. "Conversion of Unbudgeted Positions" requests to authorize unbudgeted positions; or
2. Trade-off and transfer adjustment requests necessary to correct negative amounts, fully fund underfunded or unfunded positions, or realign the budget to expenditures; or
3. Base adjustment requests to delete underfunded or unfunded positions.

Act 160 also requires that permanent and temporary position ceilings for each program be provided in the budget documents. As such, departments must provide permanent and temporary position counts in their BJ Summary tables for the FB 2017-19 Executive Budget.

Federal Fund Budgeting

In 2013, the State began a process to change the way federal awards were budgeted and expended, with the intent of increasing transparency and improving the State's ability to meet anticipated federal reporting requirements. Since then, the Federal Fund Information for States list of major, recurring federal awards was used to determine which federal awards were appropriated as means of financing (MOF) "N" (federal funds). All other federal awards which were anticipated to be received in FY 16 or FY 17 were appropriated as MOF "P" (other federal funds).

Each operating federal grant award anticipated to be received was provided a unique appropriation symbol and an extended lapse date (operating federal funds lapse after three fiscal years, instead of one fiscal year) to accommodate the difference between the State and the federal fiscal years and performance periods which extend beyond one year. Also, CIP federal fund appropriations which have been deemed necessary to qualify for federal aid financing and reimbursement will lapse five fiscal years after the fiscal biennium to encourage the timely implementation of federally-funded projects and expenditure of federal grant awards.

Each department will begin the FB 2017-19 budget process with federal fund and other federal fund ceiling amounts, which must be appropriately allocated by program ID. Departments should submit requests to adjust the FY 18 and FY 19 ceiling amounts to more accurately reflect anticipated federal award amounts or to correct the MOF of recurring awards, if necessary, as reflected on each program's corresponding list of "Federal Awards for FB 2017-19" (**Form FF**). For planning purposes, it should not be assumed that State funding will automatically replace federal funding in situations where federal funding is disrupted or discontinued.

This department's Office of Federal Awards Management (OFAM) will be introducing an online electronic workflow process, which should be used to complete your department's Form FF for the FB 2017-19 budget process. OFAM will provide information and training on the new process shortly (departments will be notified under separate cover).

A. General Policies

The general policies for the development of the FB 2017-19 Executive Biennium Budget are as follows:

1. For operations, the Executive Budget will be based on FY 17 appropriations from Act 119, SLH 2015, as amended by Act 124, SLH 2016, minus non-recurring costs and plus CB, as applicable. Individual departmental budget ceilings are established for all departments by the Department of Budget and Finance (B&F).
2. 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, changing conditions and to improve efficiency.

3. Non-general fund programs should plan for the fringe benefit assessment rate increasing to 60% for FY 18 and FY 19. This increase is primarily due to the projected costs for the prefunding of OPEB. The rate is expected to remain at around 60% for FY 20 and beyond.
4. According to the Congressional Budget Office (CBO), under current federal law, total federal discretionary spending for non-defense programs would decline by 0.6% in federal fiscal year (FFY) 2018, and then increase 2.7% in FFY 2019. This category includes most of the discretionary grant programs states receive. A newly elected Congress could amend these spending caps. The table below summarizes the CBO data.

Estimates of Revised Caps Under the Budget Control Act and Subsequent Legislation
(\$ in billions)

	2017	2018	2019	2020	2021
Nondefense	\$519	\$515	\$529	\$542	\$555
Percent change from prior year		-0.6%	2.7%	2.5%	2.3%
Defense	\$551	\$549	\$562	\$576	\$590
Percent change from prior year		-0.4%	2.4%	2.5%	2.4%
Total	\$1,070	\$1,064	\$1,091	\$1,118	\$1,145
Percent change from prior year		-0.5%	2.5%	2.5%	2.3%

Source: Congressional Budget Office August 2016

CBO estimates that federal spending for Medicaid will increase 5.6% in FFY 2018 and 5.3% in FFY 2019. Medicaid spending will be affected by changes in a state's Medicaid matching rate and the state contribution for the Affordable Care Act expansion.

Under current law, mandatory programs subject to sequestration under the Budget Control Act (including the Social Services Block Grant, Promoting Safe and Stable Families, and Vocational Rehabilitation State Grants) will be reduced by 6.9% on October 1, 2016. Reductions for future years have not been calculated, but should be similar to the FFY 2017 amount.

Given the uncertain nature of future federal funding levels and the likelihood that an increase in federal funds, besides for Medicaid, will be limited, programs should not assume that State funds will be available to support program costs if federal funds are reduced or no longer available.

5. 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.
6. Departments should be prepared to initiate necessary enabling legislation, or appropriate rule changes, to coincide with budget requests, as applicable. Legislative proposals shall be coordinated with the Governor's Office. Additionally, the B&F analyst assigned to your department should be informed of the applicable proposals as part of the budget review. **(Form A, Request for**

Operating Budget Adjustment, should be used to provide the necessary information to justify the related request and indicate the required legislation.)

B. Submission Requirements and Formats

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.

C. Due Dates/Other Requirements

The following must be provided to this office:

1. By Friday, September 23, 2016, the following must be submitted, reflecting your budget submission:
 - a. Two hard copies of Forms A, A-Attachment, B, C, and FF (relating to the operating budget); and Tables P, Q, and R, and Forms CIPOp, CIPOpB, PAB and S (relating to CIP budget).
 - b. All Excel files which reflect your department's budget submission of Forms A, A-Attachment, B, and C (relating to the operating budget); and Forms CIPOp, CIPOpB, PAB and S (relating to CIP budget) should be transmitted to your B&F analyst.
2. By Wednesday, November 30, 2016, the following must be submitted, reflecting the Governor's final budget decisions:
 - a. For all departments except DOE, UH, and the Department of Transportation (DOT): Updated BJ Summary Tables in eBUDDI. Totals (by cost element and MOF) must match the grand totals on the Form B for the Governor's decision.
 - b. For DOE, UH, and DOT: Hard copies, Excel files, or other electronic files of the updated BJ Summary tables. Totals (by cost element and MOF) must match the grand totals on the Form B for the Governor's decision.
 - c. All departments: Two copies of the updated Budget Narratives; Forms PAB, CIPOp and CIPOpB.
 - d. All departments: Updated Tables P, Q, and R in eCIP and Tables A, B and C (Performance Measures) in eAnalytical.

- e. All departments: All Excel files which reflect the Governor's final budget decisions of Forms A, and A-Attachment (relating to the operating budget); and Forms CIPOp, CIPOpB, and PAB (relating to CIP budget) should be transmitted to your B&F analyst.
3. By Wednesday, November 30, 2016: Two copies of Form DMC (additional requirement for deferred maintenance costs): The Excel file of Form DMC must be transmitted to your B&F analyst.
4. By Friday, December 30, 2016: The BJ details updated in eBUDDI reflecting the Governor's final budget decisions, for all departments except DOE, UH, and DOT for which Excel or other electronic files are required.

Attachments

Attachment 1: FB 2017-19 Operating Budget Ceilings

Attachment 2: Guidelines for the Operating and Capital Improvement Program Budgets for FB 2017-19 and the Planning Period

Attachment 3: Additional Operating Budget Detail Guidelines FB 2017-19 and the Planning Period

Attachment 4: Operating Budget Submission Forms (Forms A, A-Attachment, B, C, FF)

Attachment 5: CIP Submission Tables and Forms (Tables P, Q, R; Forms CIPOp, CIPOpB, PAB, S, DMC)

Attachment 6: General Budget Information and Instructions for Completing Program Budget Request Forms (August 2016)

Attachment 7: Major, Recurring Federal Funds for State FB 2017-19