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September 26, 2024

FINANCE MEMORANDUM MEMO NO. 24-10

TO: All Department Heads

FROM: Luis P. Salaveria /s/
for Director of Finance

SUBJECT: Fiscal Biennium 2025-27 Executive Budget Request and the Program and Financial Plan for the Period 2025-31

The following policies and guidelines shall be used in preparing the Executive Budget Request for FB 2025-27 and the Program and Financial Plan for the period 2025-31.

General Background

Over a year has passed since the deadly wildfires on Maui scorched thousands of acres and destroyed nearly all of Lāhainā. The State has made significant progress with the help of our county, federal and community partners but there is so much more to be done to help Maui recover from the worst natural disaster in the State's history. Thus, we must maintain our flexibility and adaptability, including in the planning and execution of the State's budget, to ensure that adequate resources are available.

As Maui continues to recover, the tourism sector has continued to grow in other markets around the State. Year-to-date (YTD) visitor spending through July 2024 increased for Oʻahu (2.6%), Kauaʻi (10.6%) and Hawaiʻi Island (12.4%), though YTD visitor arrivals through July 2024 have decreased for all islands except Oʻahu, which is generally in line with our focus of having a more sustainable tourism sector.

The State's unemployment rate has steadily improved in 2024. From January 2024 through July 2024, the unemployment rate has decreased from 3.1% to 2.9%. The State's labor force, however, has decreased by about 20,000, compared to pre-COVID highs of about 690,000.

The State's Fiscal Condition

At its September 5, 2024 meeting, the Council on Revenues (COR) lowered its FY 25 general fund tax revenue growth rate forecast from 4.8% to 3.5% and reduced its forecasts of 4.5% to 2.2% for FY 26; 4.0% to 3.5% for FY 27; 3.5% to 3.1% for FY 28 and FY 29; and 3.5% to 1.9% for FY 30. The COR also added its projection for FY 31 of 3.1%. The COR expects that the recovery of tourism on Maui, a gradual return of Japanese visitors, a strong construction outlook, and the stimulative effects from the anticipated cuts to the Federal Reserve's benchmark rate make for a more favorable economic outlook for the State in the coming years that will provide a temporary boost to revenue growth in FY 25 and FY 26, followed by a gradual reversion to the State's long-term average rate of growth.

Despite the expected growth, the COR has revised its projections downward to reflect the impact of Act 46, SLH 2024 (Act 46), Relating to Income Tax, which incrementally increases standard deduction amounts and widens income tax brackets, and Act 47, SLH 2024, Relating to the General Excise Tax (GET), which exempts medical and dental services provided by health care providers to patients who receive Medicaid, Medicare, or TRICARE benefits from the GET. While these tax relief measures will be beneficial to Hawai‘i's residents, <u>the estimated revenue loss from these measures is considerable; as such, there is a serious concern that the COR's projections may be overly optimistic</u>.

For the first two months of FY 25, actual preliminary general fund tax revenues have increased by 2.4%, which is 1.1% below the COR's projection for FY 25. GET collections and Transient Accommodations Tax collections – which are the most reflective of the State's economic activity – have respectively increased by 8.1% and decreased by 4.8% compared to the same period of FY 24. Pursuant to Act 46, lower individual income tax (IIT) withholding rates will take effect in January 2025. This will decrease IIT withholding collections, which are already flat and, thus, may make it difficult to achieve the COR's projected 3.5% rate of growth.

As we develop the Executive Biennium Budget for FB 2025-27, we must keep in mind that there are significant risk factors that could have appreciable negative revenue impact, including the national economy and possibility of a recession, the unrest in Eastern Europe and the Middle East, tensions with China, risks in the banking sector, continued labor shortages, supply chain disruptions, sustained travel hesitancy from Asian markets, and the reduction in Federal stimulus spending. In addition, the outcome of the upcoming 2024 presidential election and the ongoing instability in Congress could result in possible stalemates regarding the federal budget and the debt ceiling, as well as federal fund reductions in the future. These challenges could result in significant general fund impact and reinforce the need to be fiscally responsible with our expenditures to ensure the State's fiscal stability in the next biennium and beyond.

<u>**Budget Approach for FB 2025-27 – Addressing Our Priorities Sustainably**</u>

The highest priority of the Administration has been and continues to be improving the overall quality of life of Hawai‘i's people. We have prioritized Maui's recovery and are committed to fund the settlement agreements for Maui property and personal injury damages.

Another significant issue that we must address is the rapidly increasing cost of condominium insurance, which is putting the homes of many condominium owners at risk. We also remain focused on improving opportunities for educational equity, improving government responsiveness and transparency, increasing housing opportunities and access to health care, and protecting our environment and natural resources.

Budget preparation for FB 2025-27 must take into consideration the COR's recent projections and underlying factors that could negatively affect resources. Non-general funded programs shall also consider potential stressors when determining the sustainability of their budget requests. The long-term impact to the State's resources must be considered when building budget requests.

In addressing the Administration's priorities and other critical program needs, it is our responsibility to ensure that we are making the best use of the State's resources. As such, departments are encouraged to realign their budgets to best meet their current needs, including eliminating long-term vacancies.

Elimination of Long-term Vacancies

The State must be able to adapt to changes and ensure that our workforce is aligned to address current priorities and challenges. This is crucial so that the State can respond to emerging issues and ensure that government services remain relevant and effective.

The latest reports indicate that nearly one-third of the State's civil service positions are vacant. As priorities, mandates, and strategic objectives of departments change over the years, some vacant positions may no longer serve the departments as intended.

It is not the Administration's intention to drastically resize departments, but rather to ensure that all State resources for all means of financing (MOF) are being used to the best extent possible in order to serve the public. Thus, while many of the more recent vacant positions need to be filled to perform key governmental operations, or are required due to legal, policy or federal compliance reasons, other long-term (older than four years) vacant positions and funds should be deleted from the budget.

Maintaining unfilled vacant positions can be a significant drain on public resources. By removing these positions, the State can redirect funds to more pressing needs, such as public health, education, and infrastructure. This reallocation of resources ensures that taxpayer money is used efficiently.

With the assistance of the Department of Human Resources Development, the Department of Budget and Finance (B&F) has compiled a list for each department of budgeted positions that have been vacant since July 1, 2020. The identified vacant positions and funds shall be included for deletion in your FB 2025-27 budget request. Requests for reconsideration of the deletion of vacant positions and funds may only be submitted through the rebuttal process with the Governor.

Constitutional and Statutory Requirements

In preparing the Executive Biennium Budget, the Executive Branch is bound by constitutional and statutory requirements, including, but not limited to, the following:

- Article VII, Section 8, of the State Constitution provides that "[w]ithin such time prior to the opening of each regular session in an odd-numbered year as may be provided by law, the governor shall submit to the legislature a budget in a form provided by law setting forth a complete plan of proposed expenditures of the executive branch. . ."

- Section 37-71(b)(4), HRS, prescribes that the information provided in the budget be formatted such that "[p]rogram costs shall include all costs, including research and development, operating and capital, regardless of the means of financing. . ."

- Section 37-71(c)(3), HRS, requires a summary listing of all capital improvement projects by program, at the lowest level of the program structure, which shows for each project, by investment cost elements, the amount of new appropriations and authorizations proposed. Under Section 37-62, Definitions, HRS, "cost elements" means the major subdivisions of a cost category. The category "capital investment" includes plan, land acquisition, design, construction, and equipment and furnishing.

Budget Transparency

Departments should review their FY 25 operating budget details for items that 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 that do not align with anticipated expenditures

Be aware that Section 37-74(f), HRS, as amended, prohibits funds from being expended to fill a permanent or temporary position for the lowest level of a program if the filling of that position causes the position ceiling for that level of the program to be exceeded. "Position ceiling" is defined as the maximum number of permanent and temporary positions that an expending agency is authorized for a particular program.

Consequently, all departments should 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.

Departments should submit the following for changes necessary to align their budgets in FB 2025-27, as applicable:

1. “Conversion of unbudgeted positions” requests to authorize unbudgeted positions through trade-off and transfer of funding and position counts (if necessary, permanent or temporary position counts may be requested).

2. Trade-off and transfer adjustment requests necessary to fully fund underfunded or unfunded positions if the positions are deemed critical.

3. Trade-off and transfer adjustment requests necessary to correct negative amounts or realign the budget to expenditures.

4. Base adjustment requests to delete underfunded or unfunded positions and funds, as applicable.

Federal Fund Budgeting

As State agencies wind down their spending of the monumental amounts of federal funds that were provided in response to the impact of COVID-19, federal funds will still play a significant part in the State’s budget and supporting State programs. In general, federal awards are budgeted and expended by grant award on a one-to-one (grant award to appropriation symbol) basis to ensure transparency and support the State’s ability to meet federal reporting requirements.

Each operating federal grant award anticipated to be received will be assigned a unique appropriation symbol. To accommodate the difference between the State and the federal fiscal years and performance periods that extend beyond a single State fiscal year, federal fund appropriations will lapse after three fiscal years. Federal fund capital improvement program (CIP) appropriations 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.

The attached listing of “Major, Recurring Federal Awards for FB 2025-27,” based on information provided by Federal Funds Information for States (based on the federal FY 24 budget), shall be used to determine the appropriate MOF for all federal awards anticipated to be received and appropriated in FY 26 and FY 27. All federal awards on the list for FB 2025-27 should be considered MOF “N” (federal funds). All other federal awards that are not on the list but are anticipated to be received in FY 26 or FY 27 should be requested as MOF “P” (other federal funds).

For planning purposes, it should not be assumed that State funding will automatically replace federal funding should federal funding be disrupted or discontinued, nor should it be assumed that State funding will be increased to qualify for increases in available federal matching funds. Agencies receiving federal funds for operational purposes shall review such operations in case there are changes to anticipated federal grants or other federal funding agreements. The use of discretionary federal funds for positions is discouraged and should be minimized.

Departments should submit requests to adjust the former fiscal year federal fund ceilings to reflect anticipated federal award amounts more accurately or to correct the MOF, if necessary, for FB 2025-27.

The Federal Award Management System electronic workflow, which is part of Datamart, shall be used to update your department's **Form FF** *(Federal Awards for FB 2025-27)* that should include all anticipated grants to be received in FY 26 and FY 27 and should be used to determine MOF "N" and MOF "P" ceiling adjustments. The appropriate budget request **Form A** *(Operating Budget Adjustment Request)* should be submitted to reflect all adjustments; all requests should also be included on **Form B** *(Department Summary of Operating Budget Adjustment Requests)*.

This department's Office of Federal Awards Management will send out further information on the online electronic workflow process which should be used to complete your department's Form FF for the FB 2025-27 budget process.

The following general policies and submission requirements are hereby provided to guide the development of the Executive Biennium Budget for FB 2025-27.

A. General Policies

1. For operations, the Executive Biennium Budget for FB 2025-27 will be based on FY 25 appropriations from Act 164, SLH 2023, as amended by Act 230, SLH 2024, minus non-recurring costs and plus CB, as applicable. Individual departmental budget ceilings are established for all departments by B&F.

2. Program goals and objectives are generally expected to be accomplished within authorized funding levels, as applicable.

3. 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.

4. Existing positions must be funded for the full year; new positions shall be funded for a maximum of six months for the first year then for the full year thereafter. Positions vacant since July 1, 2020 shall be deleted. Other vacant positions must be funded for the full year; partially funded or unfunded positions should be eliminated.

5. Increases to non-general fund appropriation ceilings may be requested if there is sufficient basis for the department's revised estimates and if such increases will not require additional general fund appropriations. A financial plan for the fund supporting the request must also be submitted. Changes in receipts must be reflected in the Quarterly Update of Revenue Estimates.

6. 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 instead of general funds, when feasible. 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.

7. Except as otherwise provided by law, special or other funds authorized to receive general revenue receipts or general fund appropriations should consider the feasibility of discontinuing such general fund support as funds of this type should generally be self-sustaining. As necessary, draft legislative proposals should be prepared to discontinue such general fund support.

8. Non-general fund programs should plan for a fringe benefit assessment rate of 64% for FY 26 through FY 31.

9. Departments should not assume that State funds will be available to support program costs if federal funds are reduced or no longer available or that State funding will be increased to qualify for increases in federal matching funds. All agencies receiving federal funds for operational purposes shall review such operations for possible changes to anticipated federal grants or other federal funding agreements. <u>At this time, the use of discretionary federal funds for positions is discouraged and should be minimized</u>.

10. 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.

11. 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 Office of the Governor. 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. <u>Submission Requirements and Formats</u>

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. <u>Due Dates/Other Requirements</u>

1. By <u>Friday, October 11, 2024</u>, your department's budget submission shall be submitted, as follows:

    a. The following must be submitted via email in PDF format from your department's designated email account to B&F at DBF.DOCS@hawaii.gov:

        i. Transmittal memorandum from department head.

        ii. Operating Forms A, A-Attachment, B, C, and FF.

        iii. CIP Tables P, Q, and R, and Forms CIP Details, CIPOp, CIPOpB, PAB, and S.

        iv. Financial plans to support non-general fund requests.

    b. The following must be submitted via email in Excel format to your B&F analyst. These files must match the PDF files being submitted.

        i. Operating Forms A, A-Attachment, B, and C.

        ii. CIP Forms CIP Details, CIPOp, CIPOpB, and S.

2. By <u>Wednesday, November 27, 2024</u>, the following must be submitted, reflecting the Governor's final budget decision. Please notify your B&F analyst and Mr. Gregg Hirohata-Goto (gregg.h.hirohata-goto@hawaii.gov) via email when online updates have been completed.

    a. For all departments except the Department of Education (DOE), the University of Hawaiʻi (UH), and the Department of Transportation (DOT): Updated BJ Summary Tables and Budget Narratives 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: Excel or other electronic files of the updated BJ Summary Tables must be submitted via email to your B&F analyst. Totals (by cost element and MOF) must match the grand totals on the Form B for the Governor's decision. Updated Budget Narratives in eBUDDI.

    c. All departments: Updated Tables P, Q, and R in eCIP and Tables A, B and C (Performance Measures) in eANALYTICAL. Total (by cost element and MOF) for all Table Ps must match the grand total on the Form S for the Governor's decision.

d. 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 CIP Details, CIPOp, and CIPOpB, and PDF files of Form PAB (relating to CIP budget) should be emailed to your B&F analyst.

3. By Wednesday, November 27, 2024: Form DMC (additional requirement for deferred maintenance costs) with a cover letter from your department head submitted via email in PDF format from your department's designated email account to B&F at DBF.DOCS@hawaii.gov. The Excel file of Form DMC must be transmitted to your B&F analyst.

4. By Friday, December 27, 2024: 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 2025-27 Operating Budget Ceilings

Attachment 2: Guidelines for Operating and Capital Improvement Program Budgets for FB 2025-27 and the Planning Period

Attachment 3: Additional Operating Budget Detail Guidelines for FB 2025-27 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 (September 2024)

Attachment 7: Major, Recurring Federal Funds for State FB 2025-27