**State-County Functions Working Group (Transient Accommodations Tax)**
(Established by Act 174, Session Laws of Hawai'i 2014)
State of Hawai'i
http://auditor.hawaii.gov/task-forceworking-group/

**Minutes of Meeting**

Date: Wednesday, June 3, 2015

Time: 10:00 a.m.

Place: State Capitol
415 S. Beretania Street
Conference Room 414
Honolulu, Hawai'i

Present: Simeon R. Acoba, Chair, Chief Justice Appointment
Sananda Baz, County of Maui Appointment
Ed Case, House Appointment
Mary Alice Evans, Governor Appointment
Steven Hunt, County of Kaua'i Appointment
George Kam, Senate Appointment
Ray Soon, City and County of Honolulu Appointment
Jesse Souki, Governor Appointment
Kerry Yoneshige, Governor Appointment

Jan K. Yamane, Acting State Auditor, Office of the Auditor
Kathleen Racuya-Markrich, General Counsel, Office of the Auditor
Jayna Oshiro, Analyst, Office of the Auditor
Pat Mukai, Secretary, Office of the Auditor
Leanda Santos, Secretary, Office of the Auditor

Excused: Neal Miyahira, Governor Appointment
Deanna Sako, County of Hawai'i Appointment
George Szigeti, House Appointment
Ronald Williams, Senate Appointment

I. Call to Order: Chair Acoba called the meeting to order at 10:02 a.m., at which time quorum was established. The agenda for this meeting was filed with the Office of the Lieutenant Governor, as required by Hawai'i Revised Statutes, Section 92-7 (b).

II. Public Testimony

None

III. a. Announcements, introductions, correspondence, and additional information

ASA Yamane announced that a formal request has been made to Speaker Souki's office for a new appointment to replace Member Szigeti. Speaker's Office will let us know as soon as an appointment is made.

b. Minutes of May 6, 2015 meeting

It was moved by Member Baz, seconded by Member Evans, and unanimously carried to approve the minutes of the May 6, 2015 meeting.

c. TAT Legislation – Discussion (no handout)

ASA Yamane stated there are no handouts because bills relating to TAT have yet to be signed by Governor Ige. The governor must indicate his intent to veto by June 29, 2015, and veto or sign bills by July 14, 2015. Thereafter, bills will become law without his signature. A handout will be provided when act numbers are assigned to the measures being followed by the WG.

ASA Yamane introduced Ms. Leanda Santos, Secretary, of the Office of the Auditor, who is attending this meeting for cross-training purposes.

Chair Acoba asked about HB1214, the WG budget bill. ASA Yamane said it is still pending Governor's signature.

Member Souki arrived at 10:05 a.m.

IV. Consultant Services – RFP Status (no handout)

ASA Yamane reported that no proposals were received in response to the RFP posted on May 1, 2015 with a call back on June 1, 2015. With the WG's approval, she recommended proceeding to issue the scaled back version of the RFP (Option 2) with a call back on June 17, 2015. If any responses are received, selection could be made on June 18th. Ms. Racuya-Markrich is checking with the State Procurement Office about shortening the response time to two weeks. Member Soon asked if the scaled back version is dramatically less work. Ms. Racuya-Markrich stated it has fewer objectives; basically to develop model options and to facilitate with report writing. Chair Acoba asked for a motion to accept the recommendation to post the RFP Option 2. It was moved by Member Evans, seconded by Member Yoneshige, and unanimously carried to approve the recommendation.

Member Case arrived at 10:11 a.m.

<u>State-County Functions Working Group Significant Dates and Deadlines, 2015-2016 (Handout)</u>

ASA Yamane explained that the handout with significant dates and deadlines was drafted to help the WG stay on track. Compilation of the work will primarily be done by the Office of the Auditor. She referred to key dates in green, highlighting the WG meetings with deadlines and milestones. The WG will have to meet these deadlines in order for the final report to be issued by December 30, 2015.

The schedule requires outline approval at the July meeting with the distribution of an introduction and background for Chapter 1 to the WG by the August meeting; a preliminary draft of Chapters 1 and 2 by the October meeting; and a final draft of the report by the November meeting. The Office of the Auditor will compile the WG work, including the reports of the investigative groups, and rely heavily on the minutes and the WG discussions.

ASA Yamane explained that she and her staff would not be doing any independent or new work because all of the conclusions and recommendations will come directly from the WG's discussions. In terms of staffing, Ms. Oshiro will continue with the TAT WG work as well as her currently assigned audit project responsibilities.

The investigative groups' reports are extremely important because the guts from those reports and the WG discussions will be extracted and likely attached as appendices. For example, referring to last month's minutes, as the counties were walking through their methodology, very specific data will be extracted and the information compiled. This makes the minutes that much more important because Member Hunt did a very good job of marching through all the columns, explaining how he got all the data, and how the group approached it. That kind of information would be put into the report. For all of the other investigative groups turning in their reports—the allocation models group, the visitor industry group, and the State duties and responsibilities group —final discussions on those reports will become the guts of the report. The schedule may change a bit, with a consultant.

Chair Acoba asked if the December 2nd meeting is for the final approval. ASA Yamane answered "yes." She explained that the draft will be approved in its final form at the November meeting. If the WG wants to present certain kinds of data we may ask for DBEDT's assistance to ensure accuracy. She stated now is the time to create investigative groups because it takes several meetings to do the work, report back, and accept the IG's report.

Member Souki asked if the final report would be approved prior to December. ASA Yamane said hopefully yes. She referred to November 12th (at the bottom of the handout on page 1) where report production begins. She explained that this schedule was built into our overall office production schedule. For all our work, the Legislature has a call back date of 20 days before the start of the next session; it's the same for this report. All report production is done in-house.

Member Souki asked what is the drop-dead date for the office. ASA Yamane replied the deadline (December 30, 2015) is highlighted in yellow (handout – page 2). Once pieces are approved, the office can drop it into format early. The office uses a standard format for all reports. The front of the report typically will have the WG letterhead with the State seal. The report itself will be formatted in our usual office style.

Member Baz asked, if the report is finalized on December 2nd, is that enough time for the office to publish. ASA Yamane said the WG approval of the final report draft is scheduled for the November meeting and copies will be distributed at the December meeting. The office anticipates a heavy production load. This schedule is for planning purposes and to keep the investigative groups on task. It's also to push the WG's discussions and conclusions and recommendations early so those pieces can be documented and dropped into the draft report.

Member Souki asked what happens if we get a consultant with Option 2. Ms. Racuya-Markrich replied the time schedule and time limitations in the RFP match the deadlines in the handout, including the WG process for discussion and approval. The first submittal is July 29th; September 2nd is the presentation to the WG for discussion; submittal of a proposed outline and preliminary report draft date is September 30th; presentation to the WG is October 7th; submittal of the final report draft including WG discussions and recommendations is October 28th; and presentation for WG approval is November 4th. These are the deadlines for production purposes.

Member Souki asked if the outline is the work plan for approval. ASA Yamane answered, because this is largely a compilation, it reflects the work already done and it would be in anticipation of the delivery of the allocations piece. The work plan would be something delivered at the time of the RFP. The office usually develops a very detailed outline for each report, including all section headings, etc. We can start putting it together because we know where the WG is going based upon the discussions over the last few months. If we get a consultant, we would blend their work and maybe leave a space for the allocation models because that work has begun with the investigative groups. Ms. Racuya-Markrich stated that the timeframe in the RFP provides for August 26th as the first date for submittal of the preliminary allocation models and the preliminary findings and recommendations; assuming a consultant comes on board in July. It's a very short window of time.

Chair Acoba asked if December 30th is the date we deliver the report. ASA Yamane said "yes," that is the deadline but we will deliver as soon as it's ready to go.

Chair Acoba stated the consultant would basically be gathering the data. ASA Yamane believes it's more focused on the TAT allocation models. He asked if the Auditor's office will be writing the report. ASA Yamane stated, at this point, yes. We will try to do whatever work we can. Chair Acoba stated that even if we get a consultant, he doesn't know if their function is to primarily augment, supplement, and verify for the WG. A lot of the writing needs to be done before that. ASA Yamane stated that she will be managing the contract, working closely with the consultant to share a preliminary outline and thoughts on how this report is going to look, then target their work to be dropped in. We can work on the introduction, they can drop in their analysis, and then the conclusions and recommendations would come from the WG. Chair Acoba said he likes the idea that we already have a format; we have a lot of data to start dropping in and modifying. ASA Yamane suggested using this meeting to identify which data the WG wants.

Chair Acoba asked, if there is time, would the WG be able to call back the Department of Taxation (DoTax) for more information. ASA Yamane said, provided DoTax attends as a resource to the WG and is not asked to independently compile data. The same is probably true for the Department of Business, Economic Development and Tourism (DBEDT). Member Evans stated DBEDT's Resource and Economic Division functions very much like the Office of the Auditor—the menu of reports provided to the Legislature every year is on a schedule and staff time is allocated accordingly. Member Evans stated ASA Yamane is correct, any request for compilation would need to be made pretty far in advance and the scope would need to be narrow enough for the existing staff resources. Member Evans underscored that the WG needs to identify exactly what it wants.

Chair Acoba stated that different investigative groups can identify the data.

V. Investigative Groups – Status, discussion, and adoption of report(s)

   a. Visitor Industry Investigative Group – Adoption of report, *Visitor Industry Views on Visitor-Related Needs for State and County Services* (handout).

      Chair Acoba asked for discussion to adopt the report. This report was presented and discussed at the April 1 and May 6, 2015 meetings.

      Member Soon asked if the WG can hold off on adopting the report or does adopting the report mean it's final, cannot be modified, and the group won't meet again. In the course of working with the consultant, the WG may want to look at it with different eyes and therefore, may have a different final report. Chair Acoba stated that this is a first preliminary adoption that may be modified as all the documents are put together because it's assumed the WG will go through several drafts, comment, and make changes.

      Member Souki suggested not adopting but recognizing the report has been submitted. Member Evans agreed with Members Souki and Soon and suggested using a different word to acknowledge submittal of the report. ASA Yamane suggested the WG move to "accept" the report for now and adopt at a later date to allow for changes.

      It was moved by Member Case, seconded by Member Kam and unanimously carried to accept the Visitor Industry Investigative Group report.

b. County Duties and Responsibilities Investigative Group – Adoption of report, *County Expense Summary with Nexus to Visitors* (handout)

Member Hunt reported that there's a more detailed level that rolls up into this summary. His understanding from Member Baz is Maui included only those expenditures that have some sort of nexus that are additional expenditures beyond the $337.6 million, which could be added to the total spending but may have no additional nexus. The $51 million may still stand but the total expenditures may change. Member Baz stated $477 million of expenditures is in Maui's CAFR so there's a significant amount that's not included and it may change the nexus amount and will definitely change the total amount.

Referring to the counties' expense summary with a nexus to visitors, Member Hunt explained the following:

1) <u>County Expenditures on Visitors to Total Operating Expenditures</u>

City and County – 5.77 percent
Maui – deferred – numbers will change
Hawai'i – 7.99 percent
Kaua'i – 19.06 percent
Overall – about 8 percent

To arrive at the percentages above, the investigative group used the same methodology as the State. It took the total operating expenditures for visitors (second column) for each county, no CIP, and divided it by the total operating expenditures (first column) for each county. Resources from HTA and DBEDT are footnoted.

2) <u>Individual County Expenditures to the Aggregate Expenditures of All Counties</u>

City and County – 69.45 percent
Maui – 11.70 percent
Hawai'i – 13.39 percent
Kaua'i – 5.47 percent
Overall – 100 percent

To arrive at the percentages above, the investigative group took the total operating expenses of each county and divided it by the total operating expenses ($2,886,555,173) of all four counties.

3) <u>Individual County Expenditures on Visitors to the Aggregate Expenditures on Visitors for All Counties</u>

City and County – 50.61 percent
Maui – 22.72 percent
Hawai'i – 13.51 percent
Kaua'i – 13.16 percent
Overall – 100 percent

To arrive at the percentages above, the investigative group took the total operating expenses for visitors (second column of each county) and divided it by the total visitor operating expenses for all four counties ($228,573,305).

4) Percentage of Total County TAT Allocation – The listed percentages are from the statute and reflect what the counties are currently receiving under the uncapped amount.

   City and County – 44.10 percent
   Maui – 22.80 percent
   Hawai'i – 18.60 percent
   Kaua'i – 14.50 percent
   Overall – 100 percent

5) Total TAT After Debt Service and HTA – The listed percentages of each county reflect the counties' portion after debt service and HTA. The percentages are calculated by multiplying the total percentages each county is currently receiving under the uncapped amount (see #4 above) by 0.448.

   City and County – 19.76 percent
   Maui – 10.21 percent
   Hawai'i – 8.33 percent
   Kaua'i – 6.50 percent
   Overall – 44.80 percent

From an internal consistency perspective and referring to the FY2014 CAFR Expenditures list, Member Case asked why there were no numbers under public works and public welfare for Honolulu and Maui, but numbers for Hawai'i and Kaua'i. Member Hunt said it's internally consistent with some exceptions. Each county has their own way of reporting the standardized CAFR. For example, Maui has public works included with highways and streets, so public works is not reported. If it's not reflected in the CAFR, it's reflected in another category. Public welfare for Kaua'i includes transportation and bus service.

Member Case asked wherever it's located whether the "low," "moderate," "high," or "none," would be standard for all counties. Member Hunt said within "General Government," there are all the different categories—finance, the different county mayor's offices, county councils, the group included the "low," "moderate," "high," or "none." Because their roll up is so long, they wanted to have the categories standardized. The common remainder is as tight as it could be distilled. Member Case asked if this is consistent with the State. Member Hunt answered with the exception for the line item level. Under "General Government" there will be a lot of no nexus, but there may be a "low," "moderate," or "high," and then the total figure that's rolled up is the calculation done by each county individually and brought forward to the category. Member Soon said the methodology may be the same, but what Honolulu might consider as moderate may be a little different from what Kaua'i does. They didn't compare what's in the "high," "moderate," or "low." The category may have the same exact function but it's rated differently.

Chair Acoba asked whether the different percentages as compared among the counties are on separate sheets. Member Hunt said he may have presented it that way the first time, but it was too lengthy so they were asked to distill it. Member Soon said they approached it the same way as the State because there are too many line items. ASA Yamane stated that the methodology described during the WG meetings were confirmed within the minutes and checked for accuracy. Member Hunt said there were requests from the prior meeting to have a total column added and to not use some of the nomenclature for ratios used elsewhere. He tried to make it a little more explicit for each item.

Member Souki reiterated that drilling down from the large topics listed is probably the better way to do it. The State should do it for the same reasons that Member Soon mentioned, because coordinating statewide agencies is very difficult. There are so many functional areas, programs, reporting differently, it's a big project so that might be a recommendation.

Member Baz said it really depends on what the outcome of this is and what the Legislature wants to accept. As far as our determination of an allocation model, these are the State and county functions and the distribution of those functions. Our recommendation of an allocation model may or may not be based on this information. The Legislature can take the same idea and our allocation model, to review, tweak, or throw out the window and do their own thing again, but at least we provided our recommendations. He didn't know whether a model like this will be ever done again.

Chair Acoba asked if this chart indicates the "high," "low" rating. Member Hunt said, "yes." Chair Acoba asked if this needs to be amended. Member Hunt said, "yes." Chair Acoba said this is deferred. Member Soon added that some of the content is really good. For example, the importance of visitor industry to Kaua'i and Maui counties, and how big of a chunk of their expenditures are allocated to the visitor industry relative to the Big Island and City and County of Honolulu. The group keeps arguing about re-examining the county distribution. When you look at expenditures, it comes pretty close to how the money is distributed; yes, we're short 6 percent; Big Island about 5 percent, but Kaua'i and Maui are right on the spot. We are really close to the expenditures.

c. State Duties and Responsibilities Investigative Group – Adoption of report, *Report on Visitor Allocated CAFR Expenses (May 2015)* (handout)

Member Yoneshige reported the group met twice to: 1) identify and calculate CAFR expenditures in relation to tourism; and 2) evaluate the level of visitor nexus—high, moderate, low. Members of the State Investigative Group included four State members—Member Evans, Member Souki, Member Miyahira, and Member Yoneshige; Member Case from the Visitor Industry Investigative Group; and Member Hunt from the County Investigative Group. The group convened with all of the participants so that everyone could see that the process followed was consistent. Member Yoneshige had concerns about the methodology, but at the prior meeting the WG asked the group to use the counties' methodology. Is it accurate? No, but it gives the WG an idea as to how much of the State expenditures have a relationship to tourism. It's not an end in itself and neither are the counties' numbers, but it provides a basis for discussion.

At its first meeting, the group went through the 2014 State CAFR expenditure lines that have relationships to tourism and identified expenditures directly and indirectly related to tourism. When it was presented at the WG's May meeting, the group was asked to evaluate the CAFR expenditures to determine the level of nexus (high, moderate, and low) to tourism using the same methodology as the counties. The spreadsheet previously submitted includes the same percentages relative to the amount of expense to be allocated to the nexus of tourism: low – 25 percent; moderate – 50 percent; high – 100 percent. The percentages were applied to the visitor/resident ratio percentage or 12.63 percent. The net result: State expenditures relative to tourism is $450,000, and relative to overall State expenditures, it's 4.4 percent. This represents an idea of the amount of State expenditures relative to tourism using the same methodology as the counties.

Member Hunt stated that his role was to understand the process used by the State group. In the two processes, the counties' submittal is a roll-up into broad categories, but the roll-up is actually the summary of individual line items. Specifically, there's no general government, public safety, and no high, low, level of nexus assigned to the broad categories, yet, on the line items, below that category, there is. Some areas in general government that have no nexus were not included; some may have high, moderate, and low, and so the blended rate could end up being moderate or low; but certain areas were high and it's important because when you look at the categories of welfare, lower education, and higher education, the majority of the State's budget of expenditures (60.74 percent) is from those three categories. Even at a low level of nexus, it actually produces a very high expense ratio.

Because there's no breakout, Member Hunt would concur that welfare moneys that are spent for homeless has an impact on tourism. There is going to be some line items that may have high levels of nexus, or moderate, or low, within that category. But there may be other areas that have no nexus and to blend it to low, he does not know what the relationship of expenditures would be for specifics like homeless compared to the entire welfare budget. To put a low level may be overstated. If you factored out welfare, lower education, and higher education, it is about $197.6 million, or 43.6 percent, of the total $553 million in expenditures. Would we do that function if we didn't have visitors? Would we stop lower education, if we didn't have tourism? That was his struggle with overstatement of potential expenditures having a nexus to the visitors.

Member Souki said the group found certain areas not related at all, such as unemployment compensation, non-major proprietary fund, and interest expense, which were taken out.

Member Baz asked whether the counties should re-analyze their report to make it more similar to the broad categories used by the State. When reviewing the same information and the development of Maui's section for the county version, he didn't include some of the functions as the State. There should be some kind of nexus. They can re-analyze that from a county's perspective. He had the same concern as Member Hunt—how can 25 percent of the expenditures for welfare be included as tourist expenses? Because the counties went to a lower, more detailed level of expenditures than the State, the counties' information is very different. Since the State did not drill down to analyze expenditures related to tourism at a more detailed level, the counties should be going up to the more general level.

Member Souki stated maybe this is one area we could use the help of a consultant. Drilling down on these numbers is next to impossible. If you break down the programs carried out all across the State, getting a precise measurement is difficult.

Member Hunt stated he wasn't clear with these general categories, whether the debt services for the Convention Center and the moneys to HTA are already incorporated into this budget or whether expenditures are being counted twice.

Member Evans asked Member Hunt if we're possibly confusing the allocation models discussion with the evaluation of the distribution of State and county services. In the allocation model discussion, they looked at where the HTA share and Convention Center debt payments might fall. In the evaluation of services, she doesn't see an opportunity to count anything twice. Member Hunt stated she is correct so long as the results of these are not directly compared without considering that they may be incorporated into the allocation. This is the determination of the ratio between the State and counties, but if we take out the top line item before the distribution, you can see why it would be skewed.

Chair Acoba stated, he keeps going back to the first question—evaluate the division of services between the State and the counties. It makes no connection to tourism and this affirms that they both have different functions but share certain functions. Looking at the legislative history, the first step talks about equity, population, etc. but doesn't say anything about nexus. The statute requires that we first determine and evaluate the division of functions between the State and counties, and a proxy for that was to look at the CAFR. That's one allocation model. The second step is to determine the TAT allocation and that involves the nexus. By looking at this, for purposes of a model, there are differences but the categories are very similar—general government, public safety, highways and streets, human services, culture, and recreation. Maybe footnotes are needed when talking about debt services.

Member Case agreed with Chair Acoba and said this was a very good exercise. Both the State and counties attempted commonality in the categories and applied the same standards and percentages to those categories. Both sides deliberated on the nexus and and came up with the same allocation. At the end of the day, what is the ratio between the State and the counties of total tourism expenditures? Is it close to a ballpark we would recommend? Is the formula backed up by some analysis? The WG established early on that there was no legislative history on the original allocations. Member Case agreed with Member Hunt, that the one major skewing is to take the 25 percent figure to the $2.2 billion category on the State side. You can see this coming to a reasonable, logical conclusion that backs up a recommended split of the TAT. If the WG needs to meet again to footnote, refine, or go through one more reiteration to try and get some commonality, it is a worthwhile effort for both working groups. Member Case asked what the State group thinks about the 25 percent of expenditures for welfare related to tourism.

Member Hunt stated if they were to remove those three items (welfare, lower education and higher education) completely, the result is roughly 53 percent State and 47 percent counties. Member Case stated that removal altogether is going too far because some basis for education is valid. Member Soon said the devil is in the details and should be included in the allocation models. The counties may want to take a second pass and refine the percentages and drill down over time. Part of the recommendation has to be moving forward and there has to be some money allocated.

Chair Acoba stated that it was not necessary, but a basis for discussion. He asked if there is agreement, using the CAFR and recognizing there are differences between the State and counties, can the WG at least exclude nexus in the State-county functions evaluation, but include nexus when the WG talks about TAT allocation. Member Evans preferred taking up the question of whether we can accept this as a preliminary draft at this point. Doing so doesn't lock the WG into accepting it as a final piece for the report, but allows the WG to take another look at it, particularly in light of allocation models. Chair Acoba asked in terms of comparing the CAFR, can that be done as the first issue.

Member Yoneshige answered "yes." The group used the CAFR expenditures like the counties, applied the same methodology, and came up with the same numbers and percentages. The precision on that type of analysis is very wide. For discussion purposes, the State's share serves as a range between 53 percent and 66 percent. Member Yoneshige said that the right number is probably somewhere in between, which is good enough to start discussions and cross out the first question. He is comfortable accepting both the county and the State's report so they can move forward because they used the same methodology and audited numbers.

Member Souki stated Member Hunt identified some good areas to explore. Member Hunt concurs with Member Yoneshige as they have very similar approaches overall. The only difference is the counties drill down to the actual line item which may not roll up to high, moderate, or low at the general item. He stated it's somewhere in between depending on the individual nexus for each line item. The only major difference that could shed more light is if the group could drill down into welfare or maybe even education, but that may be very challenging to do.

Chair Acoba asked if the group can agree with respect to the first question, that the CAFR is used for analysis and would be acceptable preliminarily. Member Soon agreed, provided it's not used for establishing a percentage; and articulates what the State and counties do, and how much money is spent. He said if you use the non-nexus numbers, 22 percent to 78 percent, that's a huge difference. He asked if anyone thinks that its a reasonable allocation. Chair Acoba asked, wouldn't that be acceptable to the legislators because they all accept the CAFR, which all the counties used.

Member Baz asked Member Yoneshige, whether all of the items in the State report, is the complete CAFR. Member Yoneshige answered "yes." Member Baz said what he presented may need to be re-analyzed because it did not include Maui's complete CAFR. Member Yoneshige said it should be CAFR expenditures because the State is right off the CAFR report and ties into the actual item. The most fundamental basis is to use expenditures that have been audited and published; everything is all calculated the same.

Chair Acoba asked whether the WG wants to come up with a version of the CAFR based on functions of the counties and the State. Member Yoneshige said he's unclear. Chair Acoba stated to Member Yoneshige to "x" out the column that says visitor nexus percentage. Member Baz asked whether they need to present separate reports or are similar reports sufficient; and then during the analysis of the functions, that first question, present from the data in this report.

Member Yoneshige stated the allocations report and the different methodologies used is very well done. He noted that the allocation of tourism-related expenditures is not a precise number. As the group goes through and starts coming up with the eventual recommendation of the hybrid method, that a good recommendation to the Legislature is, 60/40. If the Legislature wants to move forward with it, they understand at that point, that number needs to be refined. The report doesn't even have to have the 60/40, it can just be a more precise method and the calculation needs to be done. Breaking up the TAT to be allocated to the State, counties, HTA, and a portion for the Legislature, is a methodology that is workable. Member Yoneshige asked, before we start drilling down into all these numbers, what is the point of it relative to the overall recommendation that's going to be made. He's going to come up with the way he analyzes. The counties will come up with the way they analyze it. They can get into endless discussions of what's right and what's wrong. The counties know their business better than he does; and he knows there's somebody in the State who knows their business better. But where do you draw the line. If you're going to use a model like this, perhaps having an independent third person come up with a methodology and ask for data from both sides, come up with a number independently, may probably be the best way to look at it, so there's no going back and forth.

Chair Acoba asked if the group can settle the first question, which is to evaluate the differences between the State and the county functions using the CAFR without going into models and allocations. Member Yoneshige said "yes." Chair Acoba said the second question has to do with allocations. Member Yoneshige stated using the data going forward, he doesn't have a problem with that. Chair Acoba said talking about nexus is a good starting point but not sure about the counties, do the counties have nexus built in already. Member Baz said "yes."

ASA Yamane summarized her understanding of the WG's discussion. All of the expenses are from the State CAFR and the list is complete. The counties' list is not a complete list of the CAFR. Based on the methodology, the counties might want to list every CAFR expenditure in the same way as the State. With respect to the report, in the end, the Legislature is looking for legislation and language within the law that directs by percentage, etc., how the TAT is to be allocated. She said it's unrealistic to think the Legislature, namely the money committees, will go through a similar exercise of doing the math and drilling down to figure out the State CAFR expenditures and the nexus to tourism. The Legislature will look at the law and what is proposed, put it into the provision, and execute it according to the percentage to allocate to HTA, the Convention Center, and whatever arrangement is made as to the State and counties. It's the charge of this group to deliver that final recommendation, as opposed to expressing it to the Legislature in terms of how to arrive at the allocations.

Member Souki asked who would crunch the numbers and run the model, if the WG recommended a methodology for figuring out the numbers. ASA Yamane said if the TAT is collected by DoTax, they would apply the distribution. Member Souki asked what if the WG presented a recommendation and a model, and the Legislature is not comfortable, could they task DoTax to refine it. ASA Yamane said she doesn't know, but thinks DoTax will view it as a policy question for the Legislature, not the department.

Regarding Turtle Bay, Member Hunt asked ASA Yamane whether funding is coming from the State allocation or another top line item in terms of the debt service, or added to HTA. ASA Yamane answered, it's a separate line item but it's only $1.5 million. Member Hunt stated that comes before the net distribution, it's already deluding the percentage. ASA Yamane said the way she understands it, it is in priority order. The first line item gets paid, second one, and so on until you get to the end, and any excess goes to the general fund. Member Hunt said it has some bearing when looking at the percentage, the expenditures, if it continues to delude then all of a sudden we're looking at the overall State CAFR may include those expenditures. Member Soon said that's how it's written now, our charge is to recommend a new allocation model. Member Hunt thinks that if they're looking at the raw numbers to come up with a percentage, but from that you get deluded, because you're taking off a big chunk.

Chair Acoba asked if there's anything more for the State report. Member Soon doesn't disagree with Member Yoneshige. He would like the minutes to note that the methodology is the same, but there are some detailed facts within the model with which the WG is struggling.

It was moved by Member Yoneshige, seconded by Member Hunt and unanimously carried to accept the State's Investigative Group report.

d. Allocation Models Investigative Group – Discuss progress (handout)

Referring to the handout, Member Soon reported on the group's four different TAT allocation models:

1) <u>Allot the TAT funds according to the proportionate share of tourism expenses incurred by the Counties and the State</u> – The basic concept is to figure out the total public expenditures (operating) and the proportionate share of the total attributable to the State and counties. Then allocate all TAT by those percentages.

2) <u>Allot the TAT funds according to the historical intent of the TAT legislation passed over the years</u> – The basic concept is to look at the historical intent of the legislation. However, the group struggled with this model because there are a lot of gaps as to legislative intent.

3) <u>Use the current allotments as a guide, and account for the political reality that the State Legislature will want to fund other uses out of the TAT</u> – The basic approach is to lock in a set amount of funds for the counties, the Convention Center, the HTA,

and DLNR (each year add inflation). There would be an implied commitment that these allotments would never go down. Set aside an additional 2% to the State to cover the costs of collection, management and distribution. Take the remainder and leave it in the pot for the Legislature to appropriate according to the needs of the current time.

4) Not change the allocation models, and authorize counties to tax visitors
The basic concept is to have the State and the county both tax the industry, much like both currently collect a fuel tax.

Member Soon explained that based on the pros and cons of all the models, the group developed three recommendations:

1) Take the first $83 million and allocate it to the HTA for their purposes - This gives the industry some certainty that their taxes will go directly to a body over which they have some control.

2) Take 90 percent of the balance and allocate it 60 percent to the State and 40 percent to the counties, but in either case, no less than $100 million - This would give the counties the opportunity to enjoy any upside, with some certainty that the downside will be limited and certain. The funds for the Convention Center and for any legislative set asides (e.g. those to DLNR) would come from the State pot.

   Member Soon stated the split could be based on whatever formula yields a comfortable number, but the State and the counties are guaranteed $100 million. This assumes collectint $283 million. If not, then $100 million has to drop.

3) Take the remaining funds and leave it for Legislative discretion, with the recommendation that it be spent on visitor related expenditures – This reflects the political reality the problems that cannot be anticipated arise and that the Legislature will go to the TAT to help solve those problems.

   Member Soon stated the final 10 percent of the balance would be the Legislature's discretionary pot to address the visitor industry issue of the day.

Member Soon explained the philosophy behind the recommendations was to give the visitor industry comfort and first priority since the TAT money is coming from them. Visitors get the first shot and the last shot if we only collect $100 million and $83 million goes to HTA for advertising, etc. and support for the industry. The final piece was to accept the political reality that the Legislature will keep looking to TAT. And the bulk of it is to split whatever formula makes sense, 60/40, 66/37, 30/40 in the current allocation, 60/40 is a comfortable number we can all live with. What it does say is State expenditures come out of the State pot. So, expenditures for the Convention Center, the purchase of conservation easement for developing private properties, and DLNR would go into the State pot.

Member Evans stated the discussion is valuable to help define possible approaches and get it down on paper. The WG has been focusing on allocating the distribution of public services. This moves to the other major charge from the Legislature which is to recommend a TAT allocation model. This gets the model right out on the table. Member Soon suggested to continue looking at the 60/40 and refine it.

Member Hunt stated if we're looking at the CAFR, and that becomes the basis for the 60/40, then the first $200 million is 50/50; both the State and the counties are guaranteed a floor of $100 million. If you go to 66/37, it starts deluding the 50/50 and becomes close to 60/40 as revenues grow. But at least your base point is covered and doesn't go below the floor. The risk is if you don't make the $283 million. He asked whether both floors go equally below the $100 million or does one floor drop and one floor stays. Assuming we don't go below the $283 million, a model like this will be useful.

Member Case observed there are advantages to this model. We don't want DoTax figuring this out every year. It provides some certainty of your income stream, which is important to the tourist industry, HTA, and for the State and counties to know they will get at least $100 million, so they can depend on it. Another advantage is the credit rating because at the end of the day, the political reality is the State will want a discretionary fund. If you go in the direction of this model, what it essentially provides is a down cycle. Right now we're coming over the top, that's great if we stay up there, but nobody in the visitor industry thinks it will keep going up. So, in a down cycle, there's a guaranteed level of income to the State, the counties, and HTA. The State gets the up side but not necessarily the counties.

Member Souki stated having a predictable budget to implement programs that may or may not have an impact on tourism is important. He appreciates the $100 million floor. His concern is the 90/10 split because it appears the Legislature gets two discretionary pots—the 60 percent and the 10 percent. As a former agency manager, he would rather see more predictability on the 60 percent and let the Legislature fool around with the 10 percent. Using DLNR as an example, he would rather see Kawela Bay come out of the 10 percent. When you look Kawela Bay and Turtle Bay in the context of programs, DLNR's mission, and the amount of land they could purchase that has higher market value, the money may have been spent differently. But DLNR has no discretion on spending; it was the Legislature's discretion. Taking it out of the 60 impacts all the DLNR programs.

Member Case said he's not following Member Souki. The WG is not micro-managing where the State money goes. Member Souki said the Legislature will micro-manage. Member Case said yes they will, but we're not suggesting that there be a directive where the 60 or the 10 goes. Presumably, it's a discussion every year at the Legislature as to where the State moneys are going. The 10 percent is intended to be the Legislature's discretionary money. Member Souki said he would like to see more discipline in the budgeting for the 60 percent.

Member Soon stated if you took the 10 percent and threw it into the 90, every time they make a cut at the counties, they see a dilution. The counties don't want dilution. Member Baz stated the 60 percent is more the general fund type of revenue to the TAT money coming in, where the 10 percent would be more for special projects that the Legislature allocates all of it wherever they want to. So yes, the Legislature gets two pots of money. But the hope is that the 60 percent would be set aside that goes into the general fund and that's revenue; whereas, the 10 percent could be used for the Legislature's issue of the day.

Member Hunt stated the $83 million for HTA stays in effect for ten years. That allows for no growth. If there are COLA (cost of living allowance) adjustments he would like to see HTA have their percentage built in as part of this, too; not getting less than the $83 million and 2 percent or whatever the number is of potential growth to cover that. That $83 million ten years from now, assuming it sticks, may not be sufficient. Member Case said they did talk about adjustments. He would like to see some upside, not capped out and not go down every year the Legislature fusses around with it. HTA gets some predictability as well as the counties and the State at a certain level. Then there's the unpredictability side which mostly affects the State. Maybe it's a deal with the visitor industry you get some uncertainty and predictability.

Member Hunt stated you want a formula that will work for the long haul. The WG needs to find a model that can stand the test of time. Member Kam stated from a HTA perspective, if the economy goes down, you want to fund more into HTA. Member Case said you can argue to the Legislature every year to supplement the $83 million.

Chair Acoba asked how did the group arrived at $83 million. Member Kam said that's in the budget now. Member Soon said the counties get a fixed budget of $103 million. Member Hunt said they are starting with a base of $283 million; and if another $10 million comes in that's $293 million, then 90 percent gets split 60/40 between State and counties; 10 percent or $1 million goes into the pot at the State's discretion; $9 million gets cut between the counties 60/40. Right now, nothing else goes to HTA, just the $83 million.

Chair Acoba observed that is no different from Act 174 which provides a certain amount for the HTA, the State and counties, and then the Legislature does what it wants, such as using it for hospitals, etc. There are proposals from this past legislative session. It seems $83 million is asymmetrical when considering 90/10 to take care of contingencies would make more sense.

Member Baz stated he did some analysis. Based on calendar year 2014 TAT revenue of $408 million with HTA allocation of $83 million, leaves $325 million available for distribution. The Legislature has 10 percent = $32,500,000; the counties 40 percent = $117 million; and the State 60 percent = $175,500,000. He also did an analysis of a 10 percent decrease in revenues assuming tourism goes down; and then a 25 percent decrease, would be below the $100 million minimum, so if these kicked in, it would be another scenario.

Chair Acoba stated even the statute sets out an annualized percentage based on the last three years or projection for the next three years in terms of getting more of a basis tied to fact than history using 2014. Member Baz said if we set a model up, it wouldn't be based on averages, it would be each year's allocation distributed by that model. If you want to provide a report saying this model was applied to the last three years, this is the outcome.

Member Yoneshige said when you look at the minutes in the discussion where Member Hunt talks about the State's analysis, 2/3 of 67 percent, Member Hunt did that quick calculation, 60 percent is right in the middle.

Member Baz indicated they are not done with the allocations model, this was just for discussion. Member Soon suggested the group will want to work with the consultant, since the focus will be on the allocation. The group's report is not yet final.

e. Establishment of other investigative groups – Discussion

No additional groups were established at this time.

VI. Evaluate the division of duties and responsibilities between state and counties relating to the provision of public services

This item was not discussed.

VII. Allocation of TAT Revenues

This item was not discussed.

VIII. Adjournment: With no further business to discuss, Chair Acoba adjourned the meeting at 12:00 p.m.

Reviewed and approved by:

Jan K. Yamane
Acting State Auditor

[ X ] Approved as circulated.

TATWG/20150603