

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, October 7, 2015

Time: 10:00 a.m.

Place: State Capitol
415 S. Beretania Street
Conference Room 225
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
Neal Miyahira, Governor Appointment
Deanna Sako, County of Hawai'i Appointment
Ray Soon, City and County of Honolulu Appointment
Ronald Williams, Senate Appointment
Tina Yamaki, House Appointment
Kerry Yoneshige, Governor Appointment

Jan K. Yamane, Acting State Auditor, Office of the Auditor
Jayna Oshiro, Analyst, Office of the Auditor
Pat Mukai, Secretary, Office of the Auditor

John Kirkpatrick, Belt Collins Hawaii LLC
Michael Lim, Belt Collins Hawaii LLC
Joseph M. Toy, Hospitality Advisors LLC
James Mak, Ph.D
Representative Tom Brower, Chair, Committee on Tourism

Excused: Jesse Souki, Governor Appointment

- I. Call to Order: Chair Acoba called the meeting to order at 10:09 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).

The following agenda items were taken out of order.

- III. Chair's Report
 - a. Announcements, introductions, and correspondence

None
 - b. Minutes of September 2, 2015 meeting

It was moved by Member Yoneshige, seconded by Member Miyahira, and unanimously carried to approve the minutes of the September 2, 2015 meeting.

c. Minutes of September 16, 2015 meeting

It was moved by Member Yoneshige, seconded by Member Evans, and unanimously carried to approve the minutes of the September 16, 2015 meeting.

IV. Final Report to the 2016 Legislature

a. Revised draft Chapter 1 (handout)

ASA Yamane stated there were a number of comments and edits from the WG members that were incorporated into Chapter 1. There were earlier discussions on whether to include parts of Dr. Mak's background paper in Chapter 1; however, the issue has never been decided. She asked the WG to provide the office with instructions on whether to include all of it, some of it, or make reference to it.

Member Yamaki arrived at 10:14 a.m.

Chair Acoba asked if Chapter 1 could be accepted. ASA Yamane stated if the WG wants to include parts of Dr. Mak's report in Chapter 1, the WG should wait until the office receives instructions on what to do. The WG had indicated that Dr. Mak's paper might be useful in developing the background of Chapter 1.

Member Baz arrived at 10:15 a.m.

Member Case stated it looks like Chapter 1 is coming along just fine assuming the WG has the right to take a look at the final product at the end because some of it might be contextual. As far as Dr. Mak's paper, we may want to attach it as an appendix.

Member Soon arrived at 10:17 a.m.

Chair Acoba asked if there is an agreement on appending Dr. Mak's paper to the final report and asked if there is any part(s) of the paper that should be included in Chapter 1. There were no suggestions for further changes to Chapter 1.

b. Draft Chapter 2, Objective 1 (handout) – Discussion

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

Chair Acoba asked for any comments on the draft Chapter 2, objective 1.
Member Hunt provided the following numbers for Exhibit 9 on page 13:

- City and County of Honolulu = \$41.013 million;
- Maui County = \$21.204 million;
- Hawai'i County = \$17.298 million; and
- Kaua'i County = \$13.485 million.

Also, on page 14, question 3, add at the end of the question, "related to visitors." ASA Yamane said since we're discussing the three questions on page 14, these questions have not been revisited. She said the questions were included in a

summary of the investigative group's report but there was some indication they would be deferred until the WG discusses the allocation models, which it is doing now.

Member Baz referred to page 1, first paragraph, third sentence. He would like to reiterate the counties were under the same pressures of the State during the same economic downturn. It wasn't only the State that had financial problems, the counties had problems too. He suggested adding a sentence at the end of the third sentence: "While the counties were under similar economic downturn pressures and decreased real property values."

Member Evans stated she was under the impression the counties' economic pressure lagged at about two years and the State had to make these hard decisions. Member Baz stated by adding it at the end of the sentence, it is more relevant to the time period of the cap. Chair Acoba suggested deleting that clause and saying, "subsequently, the Legislature...." Member Baz stated it's an important context for the Legislature to make their decisions that they had to make decisions like this, increasing the TAT by 2 percent and setting caps because it was difficult financial times. Chair Acoba said the prior sentence says, "economic downturn...." Member Sako said she agrees with Member Baz and would like that sentence added. Chair Acoba asked Member Baz and Member Evans to draft their language in writing and will set it up for discussion to put on the agenda for the next meeting.

Member Baz had another comment on page 2, end of the first paragraph. He suggested adding a note saying, "however, the net effect has been that the counties are unable to share in the TAT revenues." Chair Acoba said when this chapter was distributed, it was simply to describe the actions that were taken. Whatever conclusions you draw on, may come later in the draft. These just describe the actions by the Legislature. Member Baz suggested deleting the sentence because you are describing the reasoning—not just a fact—it's important to apply the consequences of that reasoning. Member Miyahira stated that the reasoning is what's reflected in the legislative reports; it's reflected from the legislative records. Member Soon said it wasn't the highest share; it was really a lower share of the highest amount but not the highest share because the total net was so large, even though it was \$93 million, it was really a smaller share than the counties had collected earlier and there was no cap. If you change "share" to "amount," that would work. Share implies proportion and that is not true that we receive a higher proportion. ASA Yamane stated although there are no quotes around the language, it is taken from committee reports. Member Soon asked if quotes could be added and ASA Yamane said yes. She also said if the WG has any tech edits, feel free to pass them on to the Auditor's Office.

Member Soon wanted to reflect back and said when the WG went through the CAFR analysis and they decided on the nexus, they were all frustrated by that; that they didn't have enough information to do this really well. So, they were accepting the findings more as a guide than as precise percentages. It's not reflected in there; what's reflected gives the impression they were very precise in analyzing expenditures but they really weren't. Chair Acoba stated ultimately it was percentages based from models. ASA Yamane stated most of what's in the chapter was lifted from the final reports and what the minutes reflect. Some adjustments can be made but they have to fit within the context of the discussions. Chair Acoba asked to suggest some language for the WG to look at. ASA Yamane asked if the WG had any suggestions.

Member Soon said even when they started, if they had just looked at expenditures and not at revenues it may be a distorted picture. They also had frustrations that certain categories on the State side were so large that they overwhelm the counties because the State has huge programs. Twenty-five percent versus zero isn't fair. The 25 percent was huge and he remembers that conversation almost exactly and that's why they kept trying to push away from looking at expenditures (from the counties), because to be accurate would take too long. For example, airports, what parts of the airports are attributable to tourism; it's a high proportion but what is it? They didn't have the time to do that type of investigation. It's even harder when you get to social services and education. What proportion of the education budget has a nexus to tourism? Chair Acoba referred to the bottom of page 6, suggesting that "approximately" be inserted before the "closer to a 60/40 split...." Member Soon said that would be better. Member Yoneshige stated the word "reasonable" is the key word. Member Soon stated that's fine.

Chair Acoba referred to page, 6, third paragraph, second sentence, he's not sure if that sentence is necessary. ASA Yamane said it's up to the WG, it came entirely from discussions. Member Baz said it needs to be in context because we obviously are not subsidizing tourism. He suggested that the State and county expenditures on tourism-related activities or tourism-related impacts are subsidized from other general fund revenues versus TAT because the context of that sentence is that the TAT doesn't cover 100 percent of the expenditures of the State and counties on visitors. Chair Acoba suggested deleting that sentence.

Chair Acoba referred to page 12, first sentence. He said when looking at the graph, he thought Exhibit 3 indicated the differences rather than all of the graphs. He asked ASA Yamane to check on that and report back.

Chair Acoba referred to page 14, the three questions. He said the WG addressed the three questions: Question #1, the WG agreed that the 2 percent TAT revenues would not be excluded; question #2, the answer is, yes; and question #3, the WG did not decide.

- c. Sharing TAT revenues in Hawai'i: A Background Paper by Dr. James Mak (distributed at the September 16, 2015 meeting) – Discussion

This item was included in the revised Chapter 1 discussion.

V. Consultant's Report (handout)

- a. Models considered by the Working Group
- b. Ten year forecasts for selected models
- c. Consultant's preliminary findings
- d. Next Steps

Mr. Kirkpatrick referred to the Models handout, stating that he was asked to come up with definitions for the models. The handout covers all the models requested by the WG at the last meeting. He said they ran two versions of the ten-year forecasts. The first model is a slow-growth model provided by Hospitality Advisors on estimated future TAT revenues. It does not include timeshare occupancy tax (TOT) but does include the 2015 data from the Department of Taxation (DoTAX). Based on published data, he said they will go back to the model and make some tweaks and adjust the forecasts accordingly. Future forecasts will be a bit larger—about 2 to 3 percent larger—but it's not going to make that big of a difference.

Mr. Toy stated it's not clear what's being reported to DoTAX on taxes collected for individual vacation units and if TAT is collected on these units. These are unknown numbers for the TOT. Mr. Kirkpatrick stated there are occupancy and compliance issues; it would be interesting to know how DoTAX is tasked on these issues but we don't have that information.

Chair Acoba asked if the dollars are consistent in terms of revenues and does it allow for CPI. Mr. Kirkpatrick replied that all the forecasts for future revenues are given from the growth of the visitor industry on lodging revenues then they assume there will be no change in the size of the TAT. He also said inflation is in there, not implying the CPI inflation scale. The revenues are incorporating estimates of how visitor revenues will change over time.

Mr. Toy stated they also looked at changes in supply. They started with a base year, 2014-2015, and did a visitor plant inventory for the State through 2012 using Smith Travel Research data. They also did occupancy research, which also has its own visitor plant inventory for hotels and condos. They made a spreadsheet and looked at all the pipeline of supplies that's coming in and looked at all the retirements, re-purposing, and redevelopments. For certain projects that are in the planning phases may take 25 percent of the inventory being built. He said they did the same for timeshare inventory. However, part of the timeshare inventory, if it's not used by a timeshare guest, it is sold as a hotel room and the TAT is assessed.

Chair Acoba asked whether there's no anomaly in using current dollars and comparing it to expenses or the allocation based on CPI. Mr. Kirkpatrick replied the simple answer is no. If they combine the two and add the CPI escalator to the forecast, then you may get a double-count. Basically, any estimate of future visitor revenues includes assumptions specific to the industry that revenues will grow in certain ways. Mr. Toy stated that's correct and in some cases, they included the CPI factor.

Member Williams asked whether there's a sheet that shows inventory of growth because once you get into the numbers of the TAT, if you base it on the same inventory as today, you have to have rates that are so high because this assumes that the 9.25 percent stays at that number. The growth of inventory here has to be substantial. Mr. Toy stated growth in inventory, including condos and timeshare inventories, when individual units are sold as hotel rooms, is accounted for in the statewide numbers.

Member Hunt asked if they also looked at air load in terms of airlines—the capacity of the airlines to adapt to inventory. The inventory is there but you may not have the capacity to get visitors to the islands. Mr. Toy stated that they looked at airlines; however, the airlines can reposition their equipment in a short time. The demands may be seasonal or for campaigns.

Member Baz referred to the recessionary forecast and asked the consultant how they came up with that model. Mr. Kirkpatrick explained they took Dr. Mak's calculation of the tax base for the TAT. The tax base is independent of the different tax rates over the period studied. The model follows the changes in the tax base from 2004 to 2014, then applies the same annual changes to the forecast of TAT revenues, starting from the known amount for FY 2015. The recessionary forecast is a "what if" account of the past recession occurring again.

Chair Acoba asked if he didn't use the 20 percent number that was talked about at the last discussion. Mr. Kirkpatrick replied the problem with the 20 percent is what is it that you do from year-to-year? There was a discussion if 20 percent was a useful thing but that was for a version of a model the WG was not interested in.

Mr. Kirkpatrick referred to the *Implied TAT Tax Base, 2000-2014* bar graph on page 5 of the memorandum. He said they incorporated both a recessionary fall and the continued

reductions because this is year-over-year change. Even though you go from a -15 percent to -7 percent, you are still talking about reductions in total revenues. It's only when you get back up to the +15 percent, then you are looking at picking up again. Chair Acoba said it's also in the handout, *Appendix: Models for Review at October 7, 2015 Meeting*, on page 1. It shows the slow growth and the recession forecasts all on one page. The recession forecast was given those changes, starting off with the same starting point for FY2015, what happens.

Member Williams stated are we assuming the recession was the same type of recession that happened to us. It wouldn't take into effect that the market in Waikiki would be affected more by the recession that happens in Asia. Mr. Kirkpatrick replied there is no attempt of what would happen in a new recession. They took the background in annual changes in TAT taxable revenues. Member Williams stated when he reads it, we need to be cautioned on how aggressive you are on the TAT. Most people think you're going to get this, but you only get this, then that's when everyone turns around and says we need to do caps, etc. It's a much easier assumption if we do this and go above that, then, people are feeling a lot better. Mr. Kirkpatrick replied in the coming years, it could look quite different. Member Williams said it affects different markets in different ways and we need to take that into effect because the markets of all islands are all unique to themselves. When you put big numbers out on forecast years, some people might think that if we don't reach those numbers it becomes more of a, "how do we save it." We need to watch out on how we save because when we know that they want to save, if you went back into what the notes were, you do caps, you reduce, whatever you reduce, whatever you do is strong. He said for him, it's worrisome. These numbers are aggressive and it's an assumption that you can get the inventory and the plant and that spending will be the same; there are lots of assumptions. We need to be a little more conservative.

Member Case agrees with Member Williams and said he thinks the numbers are aggressive. If he were sitting in government and saying, is this actually going to happen, if he were to plan conservatively, he would have a different level of escalation. The relevance is not so much the top line of the recession, it's the gap between the two because if the top line is too aggressive, then maybe the recession is not that deep. But if the top line is aggressive, he's going to assume another great recession. It's going back to why we did the recession model because the WG wanted to stress test the general approach that there would be some guaranteed payments to the Tourism Special Fund (TSF). The counties wanted to stress test in a reasonably predictable model of recession on a base, whatever that base is, if the State could handle its side of the bargain or would the State get weird and do an increase in the TAT or imposing caps or diverting the guaranteed payments which was going away from the basic pull. That was his reason for assuming a fairly severe downturn. What would happen in that situation?

Dr. Mak stated it might be helpful to take a look at these forecasts relative to what we've experienced historically. If you take a look at the Hospitality Advisors forecasts, the ten-year forecasts, if you look at the endpoint and calculate the annual compound change, it's 5.1 percent. If you look at the past 10 years in Hawai'i, it comes to 5 percent if you measure from endpoint to endpoint. If you look at from 2000 to 2015, the annual compound change in the TAT revenue is 4.4 percent. In other words, the 5.1 percent is roughly in a ballpark. Looking at it from the bigger picture perspective historically, it looks like we are in the ballpark and maybe slightly on the high side.

Mr. Toy said Dr. Mak is exactly correct. The long-term average for hotel rates is slightly above 4 percent. When they did their forecasts, they recognize the new inventory will be the high-end condos.

Member Hunt asked does the supply side estimate the demand because if the demand is not there, if you're increasing the supply side, what you will see potentially is the inventory but softening of the prices for competition, possibly vacancies. Mr. Toy said we've lost a lot of the traditional hotel inventory and we've moved more into individual vacation units, that's really where the market is moving towards. You see a lot of proliferations that will be Kaka'ako. Those will be on the market with Airbnb. Member Hunt said in terms of compliance, are they collecting on the TAT or estimating growth in the inventory. Mr. Toy said they actually tried to look at that by asking DoTAX for information. They asked for the allocation of what represents TOT, hotels, condos, individual vacation unit licenses. Chair Acoba asked if Mr. Toy could draft something brief to set those parameters. Mr. Toy said it's just unfortunate that there's just not enough information. One of the questions they asked DoTAX was for the number of TAT licenses. There was a bill passed in June 2012 that required apartment associations to provide the number of years for rental units.

Chair Acoba stated there are five models and each model sets out forecast and recessionary forecast. Mr. Kirkpatrick presented the following information from the handout:

1. **Model A** = Simple Shares Model. Revenues divided into three shares (page 2):

Forecast:

20 percent = TSF

32 percent = counties

48 percent = State

Mr. Kirkpatrick explained that this replicates the 60/40 split. Once the 20 percent is taken out, TSF is defined as a shared model; it stays at 20 percent. At the end, you end up getting to \$135 million; the counties start at \$132 million up to \$216 million; the State starts at \$198 million and it goes up to \$324 million.

Recessionary Forecast: (page 3)

20 percent = TSF

32 percent = counties

48 percent = State

Mr. Kirkpatrick stated the TSF starts at \$83 million up to \$99 million; counties start at \$132 million up to \$159 million; and the State starts at \$198 million and end at \$238 million. Under recessionary forecast, it's simply a shared model, things get tight and things will slightly start to get better from where it first started off.

Chair Acoba asked if this is a simple percentage model, it doesn't account for set-asides. Mr. Kirkpatrick replied this is the first model because it's the simplest.

2. **Model B** = Shares Model, with TSF Protected against Downturns with a floor for the TSF (page 5)

Recession forecast:

Mr. Kirkpatrick stated in a recession, you want to be sure you can market tourism so the TSF is protected. In this model, the TSF has a floor of \$82 million and it increased according to CPI. He said they don't have a clear CPI for eight years out so they kept the CPI at the same level for a while. Under the regular forecast, growth forecast, the amount for tourism share is always way ahead of that floor; the allocation is the shared allocation; and remainder split between the State and counties.

Mr. Kirkpatrick explained that in the recession forecast it looks different because the shares for the TSF go down. When it goes below the floor the TSF gets the floor amount.

This means the amount to be shared between the State and counties is less. For example, if you look at 2021, because we are protecting the TSF share (\$96 million), it ends up actually being larger than the counties share (\$91 million) because we didn't protect the counties' share under a recession. Only one floor was created in this case.

Chair Acoba asked whether this model doesn't make any judgement or allocation with respect to present appropriation or set-asides. Mr. Kirkpatrick replied in this model, set-asides are assumed in the State's share, the State's slice of the pie.

3. **Model C** = Shares Model with Existing Special Funds Increasing with Inflation (page 6)

Forecast:

Mr. Kirkpatrick explained that in this model, it has all the existing special funds increasing with inflation. They did not include a floor. The floor is for the set-asides. TSF goes up and the other set-asides; the \$31 million includes the Convention Center, Turtle Bay, and DLNR moneys.

Member Baz stated the Turtle Bay and Convention Center are set debt service for this amount so it won't be increasing with CPI. Member Miyahira said Turtle Bay is fixed. Member Williams also said the Convention Center is fixed. Mr. Kirkpatrick said the other set-asides shouldn't be increased by CPI, it should be indexed. The other set-asides are: 2015 (\$31 million) and 2025 (\$40 million).

Member Hunt stated if DLNR is included, it may need to be indexed. Mr. Kirkpatrick said they can index the DLNR share. Chair Acoba asked ASA Yamane if there was another fund established in 2015. Some of the members voiced Turtle Bay. Mr. Kirkpatrick asked if the Convention Center fund is both capital and operating. Member Miyahira stated that they are adjusting the debt service to cover capital expenses and some operating costs. Member Williams said it never raised the amount given it just reduced the debt so the debt goes back to capitalizing projects. Member Miyahira said the total amount set aside for Convention Center will be \$26 million.

Mr. Kirkpatrick asked the WG what would be a good way for them being on the outside to estimate the breakout within the \$26 million. Member Williams suggested staying at the \$26 million and take the \$26 million up because the idea is being able to accomplish the things you want. Member Hunt said you make those assumptions based on enhancements that will potentially raise the revenues to offset escalating expenditures on the operational side. Member Miyahira said the \$26 million is set and the debt service is adjusted administratively to make room for other things. He said the technicality is they have the budget for debt service. Whatever revenue we get from the Convention Center special fund is non-tax revenue.

Mr. Kirkpatrick stated they will note that the Convention Center and Turtle Bay which will not increase with inflation. However, the special fund for DLNR will increase with inflation.

Chair Acoba asked in reference to Model C whether any provision was made for EUTF. Mr. Kirkpatrick replied the EUTF is a whole new ball game. If EUTF comes in, it is because the counties are not paying for health benefits and we are in a whole new world. The counties of course know that this is their existing obligation and an existing and future requirement. If they don't take it into consideration, it's going to be a very different ball game.

Member Baz explained the reason legislation was put in place was to assure that the State's EUTF system would receive the moneys from the counties. If for some reason the counties didn't pay their required portion, the counties wouldn't receive the TAT. The allocation is still

the same amount to the counties and it's still required to be paid. Whether it comes out of this pocket of money, or that pocket of money, it's still going to be the same amount of money. The counties are paying 100 percent of their EUTF requirement.

Chair Acoba stated these models should reflect the EUTF because EUTF is specifically mentioned in the statute. Member Sako said when we had the recessionary point that it gets so low, it wouldn't be enough to cover their entire share of EUTF's additional contributions. If it's at \$103 million this year, it will be barely enough to cover their 100 percent of EUTF. Member Hunt stated there are two portions to the EUTF, there's the pay as you go and the ARC (annual required contributions). Even under the stress test, there will be enough for the ARC but not with the total of pay as you go. Member Sako said it will barely cover their ARC because their ARC is \$16-17 million right now and that's what they are getting from TAT.

Member Baz suggested putting a recommendation in the report to remove the EUTF because it's confusing.

4. Model C = Shares Model, with Existing Special Funds Increasing with Inflation (page 7)

Recession Forecast:

Mr. Kirkpatrick explained that Special Funds start from where they are in 2015 and simply grows with inflation. The protected funds increase with inflation, however, the counties go down to \$77 million in 2021. The point that was made on CPI growth on the other set-asides will make a difference of \$4 to \$5 million; it's up to \$9 million at the end of the forecast period.

Chair Acoba asked whether this model takes into account all costs and allocations under the statute. Mr. Kirkpatrick suggested they go through it one-by-one.

5. Model D = Three-Stage Model, "Recommended" by Allocation Models Investigative Group (page 8)

Forecast:

Mr. Kirkpatrick stated the TSF starting point was at stage 1 and they added the indexing to inflation. After the TSF came out, it was 90 percent to the State and counties; 10 percent for legislative appropriations; and a floor for either the counties or the State. The floor grows with CPI and is indexed to inflation as well. The appropriations for counties and the State comes from either their share of 90 percent or from the floor; and in a growing economy, it comes from the 90 percent. When you get to the recessionary period, the floor becomes important again.

Member Hunt stated the WG had discussed trying to develop a model that will stand the test of time and the concern was having some fixed numbers. Once you adjust for time and value of money, it's not going to make any sense to the future to the degree they can tweak the model so that it stands the test of time so we may have to revisit this model.

Mr. Kirkpatrick stated that there is the 10 percent for legislative appropriations. In a growth economy, it starts at \$33 million and it goes up to \$57 million and there are no adjustments because there are no problems in the growth economy.

Chair Acoba asked if Model D sets out the set-asides and if all the set-asides are covered. Mr. Kirkpatrick answered, that's correct.

6. Model D = Three-Stage Model, "Recommended" by Allocation Models Investigative Group (page 9)

Recession Forecast:

Mr. Kirkpatrick explained in this model, the floor becomes important at the worst part of the recession for the counties but the State isn't doing much better. When we get to 2021, the amount left for the legislative appropriations is less than the 10 percent, -\$12 million. In order to make the counties whole at that year, it was necessary to reduce the legislative appropriations.

Member Baz stated when applying the CPI during recession, it is a fixed rate being applied for beyond a certain year. If you're applying the recessionary factors to the revenue, it should be applied to the CPI too otherwise we're increasing certain amounts beyond what it really would be if you applied CPI to it. If we are trying to add a CPI to the legislation, then these forecasts would be off. Mr. Kirkpatrick stated part of the problem of the current model the CPI increase is general. Under this recessionary forecast, things get difficult in 2020 to 2021. The amount remaining for legislative appropriations ends up being \$4 million in 2020 and a negative amount of \$12 million in 2021. At the start, it's \$33 million but in recessionary conditions, it disappears.

Chair Acoba asked under this model, they reduced the State's share in order to keep the floor for the counties. Mr. Kirkpatrick replied they first reduced the legislative share then the State's share. The Legislature ends up with nothing and the State's share is reduced. In order for the counties to stay at the floor, the State's portion gets reduced.

Member Baz stated part of the reason why they didn't apply the CPI either to the TSF or the floor was because of the situation. They thought it was a reasonable floor no matter what the CPI was. Member Case stated the level the State ends up with is lower than where he thought it was going to end up. He's wondering whether it was because when they went through the actual analysis, they weren't assuming a great recession scenario. Or they were assuming a specific amount that was a percentage of the actual TAT collection because they were trying to get to a point where the State's worst case scenario was cancelling out the 10 percent and not eroding into Stage 2. Member Baz stated if there was no CPI allotted to the floor, than it would be \$17 million more for the State.

Member Soon stated their worst case scenario, if they capped it at \$100 million for State and counties and that is as lowest it can go, the TSF would always be at \$82 or \$83 million. Unless they went beneath the \$282 million, they will all experience the floor which is \$100 million but if they dropped below the \$282 million that was the only time they said everyone would share. They wanted the TSF to always stay the same and never drop below the \$83 million unless we had a disaster. Member Case said wasn't the starting point that the last 10 percent to the Legislature would evaporate but it would not erode back to the top.

Member Hunt stated he thought it would always be 60/40 split regardless if they drop below the threshold of the \$282 million for some reason they didn't collect that much, the HTA will take their \$82 or 83 million and whatever's left, the split will be 60/40. Member Soon said that was important because if they were going to climb out, it would really depend on the TSF to be the driving point. Member Hunt said he likes the CPI floor concept. The end game on the recessionary model has to be the 60/40 split with HTA taken care of off the top. Member Evans would argue that if they are going with the 60/40 split, the debt obligation of \$26 million for the Convention Center should not be included in that because the 60/40 share, there's flexibility in operating but debt obligation has no flexibility.

7. Model E = Variant of "Recommended Model" (page 10)

Forecast:

Mr. Kirkpatrick explained in this model, CPI is included. The legislative appropriation was broken out to have a total legislative appropriation and including existing and new appropriations.

Member Baz stated this refers to Member Evans' prior comment and discussion on setting the debt service as non-CPI. Mr. Kirkpatrick stated that the way this was set up is they are putting the issues and concerns of the WG and putting it as existing appropriations under the first level of after legislative appropriations. What happens here is the State and counties are looking at the floors. The amount available for legislative appropriations goes down, the State ends up at the recessionary forecast (see page 11) in 2020 to 2021. It gets even worse so the State needs to go into its own pocket for a much larger amount. The State ends up being at \$122 million based on floor and growth but it would have to actually be cut because it needs to cover existing appropriations. The adjusted Stage 2 State amount goes down to \$74 million in 2021. So, this is why the State gets really hurt under the Recommended Model.

Member Yoneshige asked Mr. Kirkpatrick when he runs the models he would like to see a 10-year period, the cumulative total amount for TSF, State, counties, and legislative appropriations, so they can see the impacts of changes in the economy in the individual years and look at the aggregate relative to what is the total collections or total collections received. Member Baz said that would be good to see.

Chair Acoba asked for an explanation on the existing appropriations for 2021, which is \$36 million. Is that the amount that will be presented to the Legislature? Mr. Kirkpatrick replied the \$36 million was written into Model E because certain existing appropriations would be protected and it was treated in this version as increasing by CPI. It started at \$31 million and goes up to \$36 million in 2021. The amount that's available for the legislative appropriations is negative \$12 million which is not going to cover the \$36 million. The remains after the negative \$12 million and after taking out the \$36 million is negative \$49 million. The State would have to find the \$49 million to cover the existing appropriations and basically to deal with the fact that they are giving some protection to the counties, so, the State ends up being in trouble in this version.

Member Williams asked if it was \$36 million or \$31 million. Mr. Kirkpatrick replied it is \$31 million because in this version, it was escalated with inflation, so it went up to \$36 million. Chair Acoba asked, when it's legislative appropriations, the existing appropriations comes out of that. But the proposition is that \$36 million is coming out of the State, it's sort of a misnomer then because the \$36 million is coming out from the State, not from the 10 percent for the Legislature. Mr. Kirkpatrick said the 10 percent for the Legislature has disappeared at this point.

8. Model E = Variant of "Recommended Model" Recession Forecast (page 11)

Recession Forecast:

Mr. Kirkpatrick stated in the recessionary forecast, year 2021, \$323 million is to be divided up. First is the share for the TSF increasing with inflation to \$97 million; and then, there's the 90 percent of the remainder which gets split up between counties and State. Then the question becomes where are we in the relationship to a floor. The floor for either State or counties is \$117 million. The appropriation will be \$117 million for counties and State is \$122 million. But when you add it up plus the amount taken out for the TSF, there is nothing left, negative amounts left for the Legislature. Then it is said, the Legislature will cover the existing appropriations so the remnants of State moneys have to be adjusted down. The adjusted State moneys are \$74 million; the \$74 million plus the \$36 million is \$110 million.

Member Baz stated this model basically breaks at that point because the floor is no longer valid. Mr. Kirkpatrick said the floor breaks with the State. Member Baz asked if it broke for the State, how come it doesn't break for the counties. Member Hunt said he doesn't think the relationship shouldn't be different from the 60/40 split. The legislative appropriations are already dried up but it shouldn't be going below the floor of the 60/40 split. Chair Acoba stated the State will be below the CPI floor from 2019 to 2025.

Chair Acoba said referring to the bottom of the model, the adjusted Stage 2 State amount goes down. It's below the floor in 2019 through 2025. Member Baz said the floor is \$108 million. Chair Acoba said he's looking at 2025 which is \$208 million. Member Baz stated the floors for both State and counties are \$130 million for 2025; the State is getting \$210 million which is the 60 percent and the floor at \$130 million.

Member Williams asked what year does the \$323 million goes back to the recession model. Mr. Kirkpatrick said it goes back to 2009. Member Williams asked if in 2009, the collection was \$323 million. Mr. Kirkpatrick answered, what they did was they started with the same number for 2015 but put the rate of change from the old information. The annual change is from the old tax base.

Mr. Kirkpatrick stated in summary, they did do some comparisons and came up with preliminary findings. They ran the net expenditures and analysis using CAFR data and tried to keep as close as possible to the models that were presented by the various investigative groups and using the numbers in the CAFR for net revenues that leads them to say maybe a 55/45 split might be a better picture. Member Hunt said for the 60/40, throw in the debt for the Convention Center. Member Baz said that was part of the original discussion. The 60 percent for the State was including the existing appropriations. Mr. Kirkpatrick said that was the one piece of new information they wanted to get on the record.

Member Evans stated in the earlier forecast tables, the terms "set asides" and "after legislative appropriations (ALA)" were used and she asked to standardize that. Mr. Kirkpatrick said they used different kinds of language the WG was using. He asked for the WG to tell him what they want and they can do it. He also asked if they want the same language in all the models. Chair Acoba suggested having the same language. The titles are fine but when it comes to reporting to the Legislature, we could change that.

Discussion on the Various Models

Model A

Chair Acoba said for the first model, his thoughts were the consensus was that all of the information should be in the report. The first model would be a preliminary take on this particular model. He said maybe the WG can rank the models or have just one alternative or two or three models. This is a simple/shared model. He asked for any thoughts. Member Kam said his only thought was to keep the 20 percent with conditions instead of going with the CPI on HTA or TSF because when looking at the TAT, how do we use that to generate tourism rather than having it go into the general fund. The 20 percent should be used for some weighting for tourism-related activities.

Member Sako stated for the recessionary portion, the TSF really drops. If the economy changes, the comment made before, that's the time we need the fund. Member Kam said yes, the 20 percent is for when things go great but when the economy goes down, that's why he thought of the \$83 million ceiling and no less than \$83 million; it's directed for tourism-related. Member Miyahira stated categorizing Model A as the baseline because this is how the allocations were; this is what it should look like.

Member Soon said it's a really good point to give us the base and do variations on it; everybody does different variations. Chair Acoba asked if it's a little too simplistic based on the recommendation. Member Hunt said simplistic is related towards crafting language and implementing from the State's side so the more variations and tweaks, it provides a lot of the accounting responsibilities for the State to figure out how to account for funding. This is a very simple model so it is very easy to implement. There is that reality of implementation. Member Sako said it would be nice to see the numbers not below the CPI version but not any lower than the \$83 million.

Model B

Member Baz commented is the CPI itself increasing the TSF floor and with the understanding that CPIs will fluctuate with the economy as well. If we set it at a fixed amount, a floor no less than \$82 million, it's still simple but it provides that protection. Member Sako said she knows we have the \$82 million or the \$83 million for the final report, if we could have it consistently at either \$82 million or \$83 million. Chair Acoba said let's set it at \$82 million.

Chair Acoba wanted to put in a good word for CPI, it reflects reality that we should account for the fact that there are changes in the future. He said maintaining that specific dollar figure, acknowledging in the future there may be changes and it would be consistent with the recession forecast too because it reflects changes that were in the past. Everyone remembers the recession of 2008 and the Legislature could relate to that.

Member Williams referred to Models A and B and said he's not sure of the thinking of why the allocations versus just having set things that are needed to be paid for today. He said he likes it simple and we do have things we have to pay for today such as the Convention Center, DLNR, and Turtle Bay, if we just name those and forget about trying to predict the future on allocations and just split it up and simplify it. Member Soon stated the reason for that was because the money should come from whoever makes the decision. If the State is going to make a decision, today we can agree on those four, what about next year if they want to do something else such as the neighbor island ferry, it should come out of the State's portion. The thought was that these four items were decisions made by the State and that the shares should come out from the State's portion. When you just take it off from the top, both the State and counties are really funding it because if you didn't have it there, they would be getting more money.

Member Williams said if the fund or allocations grow to some phenomenal amount, you are encouraging more objects to be put in there. Member Baz stated 60 percent of the remainder, the State's portion, the Legislature has complete control over that whether it's already listed in the TAT bill or not. And that's what they are saying, they can take that 60 percent and designate that \$26 million to the Convention Center; \$0.5 million to Turtle Bay; \$1 million to DLNR; etc., and the balance goes to the general fund. But that's the State Legislature's purview—they have the ability to make that decision.

Member Kam asked Mr. Kirkpatrick isn't that what they were proposing—the 45/55 split, but keep the \$26 million as something that's already set in there. Mr. Kirkpatrick replied the 45/55 split is the analysis of expenditures for tourism in general; it's the net expenditure analysis rather than the 60/40 split. Where you plug it into the model, he's not sure and it's the WG's choice. Member Yoneshige stated the 45/55 split is net expenditures. He hasn't had a chance to see those numbers and he would like to see them and how they came up with those numbers. In the 60/40 split, everyone saw the numbers that came out and along the same lines, that's his expectation.

Member Soon said in both Models A and B, they don't talk about those items, from Model C on, they do. Chair Acoba said the 60/40 split, the group's strong inclination was the set-asides for tourism.

Dr. Mak commented that Member Soon is absolutely right and we need to emphasize the point that the 60/40 split works only if the TSF is in Stage 1 and nothing else is up there. Any time you move something up in the same line as the TSF, the 60/40 split no longer works. If you move the \$26 million to Stage 1, the counties will be paying for part of that because they will be losing 40 percent. If the counties were to receive the same amount of revenue as before, the 40 percent number will have to be increased. Any time you move a number from Stage 1, the counties lose out. The 60/40 split is not a permanent number, it changes every time you move something in Stage 1. In the end, you have to ask yourselves, what is it that we are trying to do. The argument is that anything that is legislative or a State element, it should be paid by State government and it cannot go into Stage 1.

Chair Acoba stated he doesn't want to disagree with the consultant; however, there are two things he would argue. One is that this whole theory of putting the burden on the State because of what happened in the past. The State paid for the North Shore project that was in the context of looking at TAT as a big pot of revenue that anybody could use in any way. It seems less than equitable if you take what happened in the past and put it as a limitation on what would be in effect, a new proposal. When the Legislature did that, it wasn't in the context of saying, if we do this, we will be subject to carrying those costs. It's difficult to say that, because the State appropriated the money, they should be the one to carry the cost. The second issue is you need to make the distinction between the State general fund and the Legislature; it's not one in the same. If you look at parity, the way the allocations go to the counties, they get those moneys and can use it for any purpose. His thoughts were that moneys to the State are actually going into the general fund. The State could do anything it wants; not that it would be the State's general fund burden to carry these past debt obligations. In that sense, everyone starts off on the same footage and argues for a proposition that all these fixed costs, nobody thought would be saddled on the State when it comes to allocation, would be taken off the top.

Dr. Mak stated he's not making a recommendation. Chair Acoba said he's trying to make a distinction with the legislative portion and the general fund. Member Kam said that was the premise for the 60/40 split. It depends on how you want to word it. Chair Acoba said he thinks that's what was stated; we were first asked to evaluate the State and county functions and by using the CAFR, they came out with 60/40 expenditure. Second, is how do we allocate and the WG looked at all the visitor statistics and came out with 40/60, 40/50, then said, 40/60 might be a good split. In other words, there are two ways they looked at the 60/40 split. Member Kam asked Member Yoneshige where does he think the \$26 million should go. He replied the most appropriate is from the legislative bucket, the 10 percent bucket and then the \$26 million is taken out from that amount. Member Kam said if that bucket is still there. Member Yoneshige said the one concept he hadn't thought about but brought up earlier was it comes out of the combined share of county and the State then it would be jointly shared in that scenario if there's no 10 percent.

Chair Acoba said one of the tests for equity, when you look at recession basis, when you cover all the costs, the State is significantly affected when it has to cover everyone else's costs in terms of the State, the State in terms of the general fund. It doesn't seem all that fair. Having to deal with a recession, the counties get what they should get but the State gets hit twice—once under recession and second, they have to pick up the costs that makes everybody else whole.

Model C and E

Member Baz stated Member Yoneshige requested the extra column and looking at aggregate amounts of receipts is important for the WG to understand because the \$121 million is worst case scenario situation and if we're going to base all decisions on worst case scenario then the WG will have a hard time making any decision. He said referring to Models C and E are very similar. Model E is way more complicated but you're getting the same result; if you take the set-asides,

strip out the CPI and then the county and State have a percentage of the remainder. The Legislature can then have the set-asides specifically for the amounts already included, the other portion goes into the general fund for decision making and if they decide to do something in the future to increase the set-asides, that's where the risks are. Chair Acoba asked if we remove the floor, we would be removing the impact on the State then it would look a lot more equitable. And this is why Member Baz prefers Model C than Model E. Member Evans stated she would like the opportunity to report back on what was said today and look at the revised numbers with the changes that were requested.

Model D

Member Case stated that Model D better reflects policy priorities. The plan in Model D is special fund and the counties are protected and in return, the State drives the up or down, it gives the State maximum flexibility to prepare for the worst when times are good and to handle the bad when times are bad. He's unsympathetic to envision that the State would not use some of the good times when it is possibly getting more money in the big picture to prepare for some of the dips. He does think some of the discussions they had, under the recession model, the flaw in Model D as it's projected, is the erosion of the 10 percent. If you were to fix that, you would want that contingency handled somehow so there was not a dollar-for-dollar reduction in the State's Stage 2 amount. There's a lot of good in the underlying assumptions in Model D and wouldn't want to get too far away from that trying to fix the problem in Model C.

Member Miyahira asked if we're looking at two models because a lot of things are variations of something. Member Baz said basically looking at two different models.

Member Hunt stated his concern about Model D is whether it could be implemented, that CPI typically comes out in February and not sure if the WG will be using prior year or the current year. Also, by having the State calculate last year plus CPI, there may be some challenges although the model itself has a lot of redeeming qualities. Implementation of this model could be a nightmare. Member Case agrees but it's starting to get away from the simplicity or workability premise. Model A is nice and simple but it's wrong. Model D might be the way to go and may not be. Member Yoneshige said he agrees and even with the CPIs, there are all different ones, you have first half of the year, back half of the year, and total for the year.

Member Case said he doesn't feel they should carve out the special funds and feels strongly it should be part of the State's share. Member Williams asked if the things that are carved out, if the State wants to do something, it should be out from the general fund. You have to think, marketing a product, the county has a product and you need to take care of marketing, but other appropriations should be done differently. Member Case said whether it was done in the past or for the future, it is still the State's lump sum. Member Kam expressed he likes Member Yoneshige's idea of the 10 percent.

Member Yamaki stated are we opening up ourselves if we do that, it's not going to be 10 percent. Let's say the counties get 30 percent, you're going to get less, 20 percent; you're opening it up when you do the extra 10 percent. Member Williams agrees and said don't open it up, keep it simple. You keep it simple, take care of what the past is but he doesn't think it's reasonable because if you do that, they are going to think that you are digging into their money. Take care the past and move forward.

Mr. Kirkpatrick said he will run the numbers for the next meeting. He has no problem running all possible numbers/variations as an appendix to the report.

Member Soon agreed with Member Case to go with Model D and the past be tucked into the State the way Member Yoneshige is suggesting, which is in the third Stage of Model D, part of the 10 percent which is legislative discretion. Member Soon said that although the Turtle Bay

decision was basically made entirely from the State, it cost the City and County of Honolulu an incredible amount of money. The money that went into the conservation easement no longer pays for property taxes and they had to throw in \$7.5 million for a park they don't need and don't want, but that was the only way to make the deal work and they had no say in it.

Chair Acoba stated Member Baz said Models C and E and Member Case said Model D. Member Yoneshige stated we need the consultants to run the numbers and the totals.

Chair Acoba said the consensus has been narrowed down to Models C, D, and E. Mr. Kirkpatrick said this is for the WG to decide so they can vote on it. Member Kam said no CPI. Member Soon stated it should be in the report and it's something we looked at.

VI. Allocation of TAT Revenues

a. Approval of allocation model(s)

This item was not discussed.

The following agenda item was also taken out of order:

II. Public Testimony

Mr. White, Chair of Maui County Council provided written testimony in his individual capacity. This item was deferred to the October 21, 2015 meeting.

VII. Adjournment: With no further business to discuss, Chair Acoba adjourned the meeting at 12:27 p.m.

Reviewed and approved by:



Jan K. Yamane
Acting State Auditor

[X] Approved as circulated.

TATWG/20151007