

## **COUNCIL ON REVENUES**

Princess Ruth Keelikolani Building  
DLIR Conference Rooms Third Floor  
Rooms 310-313  
Honolulu, Hawaii 96813

Thursday, March 10, 2016  
1 p.m.

### **PRESENT:**

#### Council Members:

Kurt Kawafuchi (Chair), Marilyn M. Niwao (Vice-Chair), Carl S. Bonham,  
Christopher Grandy and Kristi L. Maynard

#### Staff Members:

Department of Taxation (DOTAX): Donald Rousslang, Yvonne Chow,  
J. Guitguiten

Department of Budget and Finance (B&F): Neal Miyahira, Terri Ohta,  
Gregg Hirohata-Goto, and Donovan Chun

#### Others:

Titin Sakata, Department of Taxation  
Alicia Burnham, Department of Taxation  
Sharon Kotaka, Budget & Finance  
Jared Fontaine, Senator Slom's Office  
Paul Harleman, Senate Minority Research Office  
Heather Schulz, Senate Ways and Means  
Dean Seki, Judiciary  
Nandana Kalupahana, House Finance  
Joe Roos, DBEDT  
Kevin Dayton, Star Advertiser  
Joseph Kim, Department of Taxation

### **ABSENT:**

#### Council Members:

Elizabeth P. Cambra  
Jack P. Suyderhoud

### **CALL TO ORDER:**

Chair Kawafuchi called the meeting to order at 1pm. A quorum was present.

### **COMMUNICATIONS TO THE COUNCIL AND PUBLIC COMMENT:**

Chair Kawafuchi asked if there were any public comments or communications to the Council.  
There were none.

**MINUTES OF THE MEETING OF JANUARY 7, 2016:**

Chair Kawafuchi called for a motion to approve the minutes for the meeting of January 7. Dr. Grandy moved to approve the minutes. Ms. Maynard seconded the motion.

**It was moved by Dr. Grandy and seconded by Ms. Maynard that the minutes of January 7<sup>th</sup> meeting be approved. The Chair called for the vote, and the motion passed with the following votes:**

<b>Kurt Kawafuchi</b>	<b>Yes</b>
<b>Marilyn Niwao</b>	<b>Yes</b>
<b>Jack P. Suyderhoud</b>	<b>Absent</b>
<b>Carl S. Bonham</b>	<b>Yes</b>
<b>Christopher Grandy</b>	<b>Yes</b>
<b>Elizabeth P. Cambra</b>	<b>Absent</b>
<b>Kristi L. Maynard</b>	<b>Yes</b>

**GENERAL FUND REVENUE FORECAST FOR FISCAL YEAR 2016:**

Chair Kawafuchi referred to the next agenda item, the general fund forecast for the fiscal year ending June 30, 2016. He said the current forecast was for growth of 6.7%. He said model 1 was forecasting 8.9%, model 2 was forecasting 8.8%, and model 3 was forecasting 6.9%. He said the preliminary statement for February showed cumulative revenue growth so far this year of 7.4%.

Ms. Niwao asked for the Council Mean Forecast. Dr. Bonham said there was no real difference between the input and the output means. Dr. Grandy said that he thought Ms. Niwao had asked about the model results. Dr. Rousslang said those could be found on tables 6A, 6B, 6AA and 6BB. Chair Kawafuchi asked for the table for model 3. Dr. Rousslang said there was none, because it was just one equation with no breakdown by tax type. Ms. Maynard asked if there is a table showing the individual forecasts. Dr. Bonham said that came in a separate email.

Chair Kawafuchi asked Dr. Bonham how he saw the economy developing. Dr. Bonham said he saw little reason to change the current fiscal year forecast of 6.7%. He said revenue growth is currently stronger than that and that the growth needed for March through June was modest (only 5.4%). He moved to leave the current fiscal year forecast unchanged. Ms. Maynard seconded. Chair Kawafuchi asked Dr. Bonham if tourism was pretty constant since the last meeting. Dr. Bonham said things change constantly, but he thought there were more reasons to be concerned with the longer term forecast than with the near-term forecast. Ms. Maynard agreed. Dr. Bonham also noted that the forecast from the Council's last meeting was below all of the model forecasts for pretty much the entire forecast horizon, implying that the members had already done a downward adjustment from the model results, which are based on the members' economic forecasts. Chair Kawafuchi asked Dr. Grandy how he saw things. Dr. Grandy said there has been some leveling off in a number of measures. He said that for example, Hawaii real personal income and the contracting tax base have dipped down, based on the change in the 12-month-to-date average. He also said visitor arrivals seem to be stabilizing at roughly 5% growth, with

growth in visitor expenditure about half of that. So he saw no big movements up or down. He said he was a little surprised at what the model is reporting based on his economic forecasts. He said the model forecasts were much higher than he expected. He said if he were just forecasting general fund revenue, he would probably forecast growth of about 6%, but he said that was not very different from the current forecast of 6.7%. Dr. Bonham asked if the model forecast based on his inputs was much higher than that. Dr. Grandy said he believed so. Dr. Bonham said that was true for him as well. Chair Kawafuchi asked Dr. Grandy if 6.7% growth is from the Council's mean forecast, or if that is what is being implied by his own inputs? Dr. Grandy said the Council's forecast is 6.7%, but his personal forecast would be closer to 6%.

Dr. Bonham said the forecast that comes out of the model that he runs independently is actually 6.7% and the forecast that comes from using essentially the same inputs in the Council's model is 10.8%. Dr. Grandy and Chair Kawafuchi agreed that that was a big difference. Dr. Bonham said his inputs actually generated results of 10.8%, 8.6% and 10.2%, depending on which of the Council's models is used. He said he thought his forecast was probably the highest. He said he had by far the highest construction forecast. Chair Kawafuchi asked why he thought the Council's models produced such a different result. Dr. Bonham said he thought it was because he had by far the highest construction forecast. He said he knows the Council mean, but not those of the individual members. Dr. Grandy asked if the Council mean for the construction forecast came from table 3. Dr. Bonham said yes.

Ms. Niwao said she thought the model put too much weight on construction. Dr. Bonham said that was an empirical question. He said that he didn't think the model he used for his general fund forecast had construction as a separate indicator. He said in his model, construction drives the income forecast. Ms. Niwao asked if his figures considered government jobs, such as from military spending. Dr. Bonham said UHERO (UH Economic Research Organization) makes forecasts for federal civilian and federal military, but does not separately forecast contracts. He said their forecasts include all the labor income that's flowing in, plus all the transfer payments. He said those things should also be included in the members' economic forecasts.

Ms. Niwao said the variables in their models did not consider those factors. Dr. Bonham disagreed. He asked how members could submit a forecast for income for the State if those factors were not taken into account. Ms. Niwao said that's correct, but she wondered, for example, if the visitor arrivals variable included local people who fly back and forth between to the mainland. Dr. Bonham said the trips by residents were netted out, because they were not visitors. Ms. Niwao said she thought a lot of weight was being given to tourism and construction, but not much to other industries since the input variables specifically included tourism and construction figures, in addition to income. Dr. Bonham said income was the biggest indicator that the members forecast for the tax model. He asked if the parameters for the models were shown in any of the tables. Dr. Rousslang said no. Dr. Bonham said that he thought income would be a heavily weighted factor in the models. Dr. Rousslang said income was a parameter in model 1, but not in the equation for the individual income tax in the UCLA-Anderson model. Dr. Bonham asked if employment was in the equation. Dr. Rousslang said no. He said construction was in the equation, but he forgot what else was in it. Chair Kawafuchi asked if the equation included income. Dr. Rousslang said it did not include total personal

income. He said that was the biggest difference between the equations for the individual income tax in the UCLA model and in model 1.

Ms. Maynard said the members provided forecasts for Hawaii gross domestic product, total personal income growth and, total wages. Dr. Bonham agreed and said the question was what variables were included in the various equations in the models and why they gave different forecasts.

Chair Kawafuchi asked Ms. Maynard how she saw the economy. Ms. Maynard said she looked at some of the longer term trends and thought that at some point the economy had to turn. She said they had been expanding since the great recession, but the expansion couldn't go on forever. Dr. Bonham said the traditional leading indicators didn't indicate a recession at this time. He said there was perhaps a 10% or 20% probability of recession. He said neither the yield spreads nor initial claims for unemployment insurance indicated that a recession might be looming. He said jobs were still being added. He said stock market volatility was of some concern, but that it had improved recently. He said there was probably more uncertainty today than there was 6 months ago or a year ago, but he said he wasn't sure it was much different from the conditions at the last meeting. He said he expected a recession before the end of the forecast horizon. Several Council members agreed.

Dr. Bonham said he thought the Council mean forecast for visitor arrivals was too high. He said that with average growth rates over 2% every year we would have close to 10 million visitors at the end of the forecast period. He said he thought the forecast growth rates would have to come down. Chair Kawafuchi asked Ms. Niwao how she saw the economy. Ms. Niwao said she has a different perspective, because she lives on Maui. She said the HC&S is shutting down their sugar cane industry, laying off about 675 workers on Maui, which she said would affect the unemployment rate for Maui. She mentioned that she recently put out an ad for an administrative assistant and got a lot of applications from college graduates. She said that indicated to her that although the unemployment rate suggests full employment, it is not really full employment for a lot of younger people.

Ms. Niwao said she also thought the economy on Maui may not be as robust this year as it was last year. It seemed like the smaller businesses were starting to feel a slowdown in the economy. For example, certain contractors were soliciting for jobs by cold-calling private individuals, and she had never seen that before. She said she thought that it might be worse on Maui because they have so many workers that are going to be laid off. Dr. Bonham said Maui last year saw 10% growth in construction jobs. He said it was still low relative to its previous peak. Ms. Niwao said perhaps the bigger construction companies were growing, but the smaller ones seemed to her to be less robust than last year. Ms. Niwao said she had observed and also heard from business community members that HC&S (Alexander & Baldwin) paid very well and had a union and pension plans, but the workers now would be looking for jobs on Maui where there would be less pay and not many alternative employers in agriculture. She said Dr. Suyderhoud had mentioned to her that "diversified agriculture" didn't seem to hold much promise, because there has been a lot of land available for agriculture on Maui that has sat empty since Maui Land & Pineapple Co. shut down its pineapple operations. Ms. Niwao said a lot of big agricultural businesses on Maui have shut down, and that HC&S was profitable in the past, but then ran into

problems. Dr. Bonham asked how far back Ms. Niwao was going. Ms. Niwao said Maui Land & Pineapple Co. ran into financial difficulties perhaps about 10 years ago, but for HC&S just recently. She said Maui didn't have much of a diversified economy such as on Oahu with the announced layoffs from HC&S, Ms. Niwao had asked for an informal figure for unemployment from DBEDT (Department of Business, Economic Development & Tourism), and it wasn't "very pretty." Dr. Bonham said that 600 jobs represented less than 1% of Maui's total employment. He noted total employment grew by over 1% in each of the last two years. He said there will be a transition period (after the HC&S layoffs) where people will be unemployed, but the Maui economy has been growing fast enough to absorb them. He said the high skilled workers who had been operating heavy equipment could find work in the construction industry or maybe relocate to Oahu where the demand is higher. He said people in the visitor industry can't get skilled workers who show up for work on time and do a good job.

Chair Kawafuchi asked if there might be an indirect impact beyond the 600 jobs. Ms. Niwao said she had asked Dr. Eugene Tian at DBEDT to do some rough calculations and he found that it would affect unemployment on Maui by perhaps 1%. Dr. Bonham said that was about the size of the loss in employment, so the estimate seemed to assume that none of the people would find jobs. Dr. Bonham said that since employment has been growing by more than 1% a year, it was not clear that they would see much change. Ms. Niwao said at the end of this year, when the rest of the workers are laid off, it would impact Maui. She said Honolulu has more diversified industries than on the neighbor islands. She said there was not a big military presence on Maui, and felt there were more hurdles for businesses on the neighbor islands.

Chair Kawafuchi asked if there was more discussion of macroeconomic issues. Ms. Niwao stated she thought the stock market volatility reflected uncertainty in the economy. She said that the slowing global economy, such as in Europe, and the rise of the dollar relative to other currencies would hurt exports. In addition, U.S. banks have loaned a lot of money to the oil and gas industry and that some of the oil and gas businesses would go bankrupt, which would hurt the banks.

Ms. Niwao also mentioned that the Financial Accounting Standards Board (FASB) is proposing changes to early loan loss recognition that may impact how much the banks loan to U.S. businesses. She said FASB is planning to require the banks to increase loan loss reserves faster. In addition, government accounting rules have changed recently requiring governments to report their long-term obligations for pension benefits on their financial statements as a liability for the first time. She said that when you require future retirement benefits to be brought on to the balance sheets of entities, it can cause problems for entities, because in the past it wasn't required. Dr. Bonham asked when the rule changed. Ms. Niwao said for businesses, it happened right before GM declared bankruptcy. She said the rules applying to businesses many years ago were not applicable to state and local governments, and so state and local governments did not recognize the future retirement liabilities on their books. Dr. Bonham asked if the change was made about 5 years ago. Ms. Niwao said no, the government reporting change is a more recent change that would be applied soon, and likely applied to the reporting for the last fiscal year in 2015. She said people will be able to see the government balance sheets with the net pension liability, and she thought that might cause lenders to think twice.

Dr. Grandy said he thought the concerns about bank exposure to oil and gas companies were already factored in to the financial markets. He said he thought the recent rise in oil prices explained a fair amount of the recent increase in the stock indices. Ms. Niwao mentioned Iran and predicted that we won't have \$100 dollar barrel oil prices in the foreseeable future. Dr. Bonham said that is a good thing. Ms. Niwao said that depends on whether you're an oil and gas person or not. Dr. Bonham said we don't produce much oil in Hawaii. Ms. Niwao said she was considering the national effects. Dr. Bonham said some sectors would get hurt. Ms. Niwao said some sectors that are getting hurt may affect the economy. She mentioned her recent visit to Silicon Valley and said that on local television they were talking about a slowdown. Dr. Bonham said he thought there was a motion on the floor.

Chair Kawafuchi said he wanted to ask Dr. Rousslang a couple of questions to make sure the Council covered any potentially significant issues. He asked if any more big payments from the online travel company settlements were expected before the end of the fiscal year. Dr. Rousslang said we already got the full \$39 million from the settlement for 2001 through 2011. Chair Kawafuchi asked if there were any more payments and said in a previous COR meeting there was still \$10 million or so expected. Deputy Director Kim said the settlement offer has been extended but not finalized. Chair Kawafuchi said then it was not known when it would come in.

Chair Kawafuchi asked about refunds. He said last year a big adjustment was made for the delay in refunds and that in his experience every year people came up with new refund schemes. He asked for any update on refunds. Dr. Rousslang said the preliminary monthly report showed that the cumulative individual income tax refunds were \$50 million higher this year than they were last year at this time. He said the Deputy Director may have a comment. Deputy Director Kim said the Department had a team in place and that processes are better this year to make sure we don't have too much in impending refunds. He said refunds were flowing out faster, but he said they were still communicating a delay of up to 16 weeks. Chair Kawafuchi said it was still early for the individual filing season, except perhaps for people with refundable credits. Deputy Director Kim agreed. He said in terms of the fraud processes, the Department was more mature and more adaptable and expected to be quicker this year with the refunds. Chair Kawafuchi asked if there was any significant delay yet in refunds this year. Deputy Director Kim said no, that they were watching the workflow more closely this year. Ms. Niwao said the State is auditing the large photovoltaic credits and that they weren't paying out the refundable credits until after the audits, so there has been a lot of delay in paying out those credits.

Chair Kawafuchi asked if there was any significant change in processing the incoming revenue. He said that he knows that sometimes it was faster than other times. Deputy Director Kim apologized and said he doesn't have the collections data handy, but that he wasn't aware of any significant changes from prior years. Chair Kawafuchi asked if there were any significant changes to the general fund revenue stream. Deputy Director Kim said no.

Chair Kawafuchi said he thought the Council had deliberated sufficiently. He asked Dr. Bonham if there was a motion that was seconded by Ms. Maynard. He said the motion, if he understood correctly, was to keep the current year's growth forecast at 6.7% and he asked for a vote. The vote was unanimous to keep the forecast at 6.7%.

**It was moved by Dr. Bonham to keep the general fund tax revenues growth rate 6.7% for FY 2016 (below-the-line). Ms. Maynard seconded. The Chair called for the vote, and the motion passed with the following votes:**

<b>Kurt Kawafuchi</b>	<b>Yes</b>
<b>Marilyn Niwao</b>	<b>Yes</b>
<b>Jack P. Suyderhoud</b>	<b>Absent</b>
<b>Carl S. Bonham</b>	<b>Yes</b>
<b>Christopher Grandy</b>	<b>Yes</b>
<b>Elizabeth P. Cambra</b>	<b>Absent</b>
<b>Kristi L. Maynard</b>	<b>Yes</b>

**GENERAL FUND REVENUE FORECAST FOR FISCAL YEARS 2017 THROUGH 2022:**

Chair Kawafuchi asked for discussion. He said he thought people were expecting a slowing in the out years and that Dr. Bonham had made a comment about it. Dr. Bonham said his comment was specifically about the visitor forecast in table 3, which showed the Council average growth in visitor arrivals starting at 3.4% this fiscal year and remaining above 2% every year all the way out to 2022. He said that represented an increase in total visitors of about 1.6 million people by 2022. He said we could build some resorts between now and then and that there was a fair amount of construction planned for Oahu, but he thought the forecast was about 1% too high. Ms. Maynard agreed. Dr. Grandy said he thought UHERO had sharply lowered its forecast for visitor arrivals. Dr. Bonham said he was not sure it was sharply lower, but it was lower. He said their forecast for last year was too low. He said the growth last year surprised everybody. He said that was part of the reason why their growth rates are now lower. Ms. Niwao said there have always been economic cycles and she felt that there would be a slowdown sometime, but she didn't know when. She said it might come from an external event. Dr. Bonham said it was hard to find a recession in Hawaii that wasn't related to an external event, such as US recession, a Japanese recession, a hurricane, a war, terrorist activity followed by a war followed by a US recession. Ms. Niwao asked if there were any regular cycles. Dr. Bonham said no. Ms. Niwao asked Dr. Bonham if he knew what she was referring to. Dr. Bonham said charting doesn't work, that there is no fixed cycle, because things like wars, US recessions and hurricanes didn't come at specific intervals. Ms. Maynard said that according to historical averages, we were way past the time when we should have had a recession. She said we came from a point that was unusually low. Dr. Bonham agreed and said they had talked a lot internally at UHERO about whether the expansion has been anemic. He said typically a recession for the U.S. is caused by imbalances that build up, such as inflationary imbalances or bubbles in asset markets, and it's unclear that those really exist right now. He said they might exist in China, but they were not showing up strongly in the U.S. He said that was partly due to the slowness of the recovery. He said one question specifically for Hawaii was that given that almost no housing has been built, he wondered if this construction cycle could have longer to go than normal. He said home prices have gone from 570 at the previous peak to roughly 700 on Oahu. He said that was a small movement in home prices during a normal construction cycle. So he thought the question was whether pressures from rising construction costs or rising home prices would kill off the expansion, or whether new building would continue for an extended period of time.

Dr. Grandy asked to go back to the visitor arrivals. He said he thought that at the last meeting, Dr. Bonham had pointed out that visitor arrivals would be limited because there would be no place to put them. He said that argument had been made for a number of years, but we found places to put them. Dr. Bonham agreed. Dr. Grandy asked Dr. Bonham if he thought that we would finally stop finding places. Dr. Bonham said their forecast still had growth, which implied there would be places to put them. He said they have toned down that story, because it has been proved wrong. He said you can see how many apartments, second homes and other non-traditional rental units were being used by looking at the room counts and the occupancy rates to calculate how many people are not staying in hotels. He said that presumably there is some limit to that growth. He said we were also filling up the neighbor islands. He said the neighbor islands were reaching occupancy rates that are near their previous peaks. He said there are significant plans for building on Oahu that may or may not come to fruition, depending on when the next recession happens. He said their models used visitor spending, but he hadn't looked at those numbers. Dr. Grandy said growth in visitor spending was around 2.25% to 2.5%. Dr. Bonham said the spending numbers looked reasonable, because they were falling in real terms for the next four years, which is probably what you would expect. He said you tend to see growth in the recovery phase of the cycle, but that the trend for the last 30 years or 35 years had been declining. He said that he was raising the issue for people to think about. He said he didn't have a real problem with the Council's out year forecasts. He said he was perfectly happy with the entire forecast stream if it didn't change.

Chair Kawafuchi asked for other thoughts. Ms. Niwao said she thought we were probably due for a recession. She said there are problems with debt. Dr. Bonham asked if any fundamental factor had changed since the last meeting that would cause the members to change their forecast. Ms. Maynard wondered if the 5.5% growth should be reduced to 5%. Ms. Niwao said there are a lot more economists who are pessimistic about the economy than there were in the past. Dr. Bonham asked Ms. Niwao if she could quantify her statement. Ms. Maynard asked Dr. Grandy if he thought 5.5% was too high. Dr. Grandy said his personal forecast for the out years was 5.5% for 2017 and he thought the path was reasonable. Dr. Bonham said to keep in mind that the member forecasts of economic indicators, when plugged into the tax models, gave higher forecasts than were adopted at the last meeting. He said the members had already gone through the discussions about a U.S. recession coming, and about other uncertainties, such as the possibility of recession in China or Europe. He said the yen has appreciated since their last meeting. Ms. Niwao said tourism in Japan skyrocketed last year. Dr. Bonham said he thought it was because the yen had depreciated so much. Ms. Niwao said she thought it was because of Chinese tourists. She said for example Japanese department store announcements are now made in Chinese since there are so many Chinese customers. She said Japan is recovering after the low from the tsunami and their tourism growth rate is high. Dr. Bonham said that should be good for Hawaii, because it will increase Japanese tourism in Hawaii. Ms. Niwao said if you look around for places to travel, Europe's euro is at an all time low, but there is terrorism. And in Mexico or South America, you have to worry about the Zika virus. Canada seems pretty safe, as well as Japan. She said Hawaii is pretty good as long as we keep the disease (Zika virus) out of Hawaii. She said that our visitor industry is fragile in the sense that we have to have a safe environment for the tourists to enjoy themselves on vacation. Dr. Bonham said that disease may be the cause of the next recession. Ms. Niwao agreed. Dr. Bonham moved that the Council adopt the previous forecast for 2017 through 2022. Dr. Grandy seconded. Chair Kawafuchi asked if there was more discussion.



Ms. Niwao said she wanted to review the numbers. Chair Kawafuchi asked if the motion was to keep all the out years the same. Dr. Grandy said yes. Ms. Maynard asked Chair Kawafuchi how he felt about keeping the out years the same. Chair Kawafuchi said he thought it was likely that we would have a recession in the out years, but there was no certainty about when it would happen. He said he didn't know if it would come two years from now or might be further out. Dr. Grandy suggested including the point in the letter to the Governor. Ms. Niwao said it depends on whether we could keep Hawaii a safe environment for the tourists. Chair Kawafuchi said that there is a lot of uncertainty globally, whether in China or Europe. Dr. Bonham said one of the out years from 2017 to 2022 is likely to be much lower than the Council's forecast. Chair Kawafuchi said he thought the recession would be more than just one year. Dr. Bonham said the typical recession was one year and then growth after the recession would be stronger, because the average growth rate on an annual basis for the total general fund is over 5%. He said if you go back the last 34 years the average annual growth rate for the general fund revenues is 5.17%. Chair Kawafuchi said we have never had two negative years consecutively. Dr. Bonham said that he suspected we did in 2008 or 2009. Dr. Grandy said at a fiscal year level, he didn't see consecutive negative years, but he saw a negative, a positive and then a negative. Dr. Bonham said yes, in the 90's the economy went up and down. He said the average is probably pretty close to zero (on a calendar year basis), for the negative growth in the '08 and '09 calendar years, and the very positive growth in 2010. He said that might have been when they raised taxes.

Ms. Niwao said she thought that the Council hadn't factored in the income we had this year that we won't have next year from the OTC (online travel companies) lawsuit. Dr. Bonham said that was included in the below-the-line adjustments. Chair Kawafuchi asked if the total settlement was less than \$55 million. Dr. Rousslang said it was \$39 million. He said the amount is not included in either the above-the-line nor in the below-the-line figures in the model, although it is included in the actual collections. Chair Kawafuchi said there was a one-time pop for the settlement for the prior years, but then there was a smaller amount that continues in the out years, because the taxpayers are now paying taxes on the hotel rates. He said the effect is \$39 million, which is two-thirds of one percent (of the general fund collections), less the additional revenue you get in the out years, which is expected to be about \$10 million or \$15 million. Deputy Director Kim said it was about \$15 million. Chair Kawafuchi asked why the settlement, which covered 10 years, was so small if the amount going forward would be \$15 million per year. Deputy Director Kim said he would get back to the Council with that information.

Ms. Niwao referred to the growth rates on the bottom lines of tables 6AA and 6BB, which showed growth rates of 5.7%, 6.1% and 5.4%. Ms. Maynard and Dr. Grandy said that they were the results from the model.

Chair Kawafuchi asked whether significant amounts of the renewable energy credits were being held up through audits or further scrutiny. Deputy Director Kim said he didn't have the data. Chair Kawafuchi said he thought that one year the renewable credits were over \$100 million, close to \$200 million. Dr. Rousslang said he wasn't sure, but he thought it was about \$170 million. Chair Kawafuchi asked if he had an idea how much was being held up. Ms. Niwao said a couple of her clients had large commercial credits that had not been refunded. Dr. Bonham asked if it was enough to move the forecast. Ms. Niwao said she didn't know, but she had an amount of about \$100,000 for one client. She asked if the State is conducting audits, perhaps of bigger companies with more

credits, and so were holding up refunds that might later be paid out. Chair Kawafuchi said he thought some of the refunds might be released in the future, but others might be denied or go to tax court or to the Board of Taxation Review. Ms. Niwao agreed and said if they were later approved, then there would be more refunds than expected in the future.

Dr. Bonham said they were discussing the forecast of 5.5% growth that the members had adopted at their January meeting. He said the forecasts from the models were: Model 1, 5.7%; Model 2, 6%; Model 3, 6.7%; and the average for all three models was 6.1%. He said a lot of things could happen between now and next fiscal year and he asked if the tax credits and settlements being discussed were bigger than the difference between the tax models results and the forecast, which they had already lowered in their last meeting to 5.5%. Ms. Niwao said yes, because there were timing differences with respect to the refunds. Dr. Bonham asked if they would be bigger than a half percent of total general fund revenue growth. Ms. Niwao said that she would have to ask the Tax Department. Dr. Bonham said they already had done that and the department told them they don't have the data. Chair Kawafuchi agreed that the department didn't know. Dr. Bonham asked if there was any new information, or whether members were just more worried about future prospects. Chair Kawafuchi said he didn't know if they had any new information, but he thought the amount claimed had one year been about \$200 million, or close to that amount.

Dr. Bonham moved that they adopt 5.5% for the growth forecast and that the Council put language in their letter to the Governor about their concerns. He said if the forecast came within 1% or 1.5%, they were doing really good. Dr. Grandy and Ms. Niwao agreed. Ms. Niwao said she was worried about the next fiscal year. Ms. Maynard said all the members except Dr. Grandy were worried. Ms. Niwao said Dr. Grandy was a very positive person. Dr. Grandy said he was just a happy economist and asked for a vote. Chair Kawafuchi said asked if anyone wanted further discussion. Ms. Maynard said she preferred a growth forecast of 5% instead of 5.5% for 2017 and 2018, but said she recognized that was not a significant difference. Chair Kawafuchi said it was half a point for each year. Ms. Niwao said she thought that at the last meeting, a figure of 4.9% was presented as the underlying growth if you take away the additional state tax revenues from the OTC lawsuits and took away the effect of the Hurricane Relief Fund. Dr. Bonham asked Ms. Niwao if she was talking about last fiscal year. Dr. Rousslang said the general fund growth rate so far this year was 4.8% if you remove the effects of Hawaii Hurricane Relief Fund allocations and the OTC settlements on the cumulative February collections and he thought the figure was the same at the last meeting. He said if you take out the effect of the refunds, which were an additional \$50 million this year, the growth rate increases to 6%. Chair Kawafuchi asked whether there were adjustments for refunds at the last meeting or the meeting before that. Dr. Rousslang said there were no adjustments for refunds in the last meeting, because they were too small, but that now they were \$50 million, or 50% higher than last year. Chair Kawafuchi asked what the growth of 50% referred to. Dr. Rousslang said that was growth from \$100 million cumulative refunds last February to \$150 million this February.

Ms. Maynard said last year refunds were caught up by the end of the year anyway, so perhaps they didn't need to consider the issue. Dr. Grandy agreed. Chair Kawafuchi asked if refunds paid out to individuals were about \$600 million for the fiscal year. Dr. Rousslang said last year they were \$420 million and the year before they were \$478 million. Chair Kawafuchi said it could be just a timing thing at this point. Dr. Rousslang agreed and said the Deputy Director's statement that the department would be faster this year implied that perhaps refunds would be lower for the rest of the

year and growth would be higher. Dr. Bonham said they were playing catch-up at the end of last year. Chair Kawafuchi agreed. Ms. Maynard also agreed and said refunds last year were unusually low. Dr. Grandy said he was ready to vote.

Chair Kawafuchi said he was waiting to see if Ms. Maynard and Ms. Niwao wanted to join the vote. Dr. Bonham said they could vote on the present motion and if it were voted down, they could start over again. Chair Kawafuchi said he trying to work toward a consensus. Ms. Niwao said she preferred a forecast of 5% for 2017. She asked Ms. Maynard what she thought. Ms. Maynard said she also preferred a growth forecast of 5%, but that she thought there was not a lot of difference between the two numbers. Ms. Niwao said it would be harder to later lower next year's forecast to 5% once they got into next year. Dr. Bonham said they were meeting in May and will have more information about the current fiscal year and also will have the benchmark jobs and the visitor data. Dr. Grandy said they should also have personal income for another quarter. Dr. Bonham agreed. He said he didn't agree that it would be harder to change the forecast if the things that they were worried about continue to be worrisome three months from now. Chair Kawafuchi said the motion may or may not pass, but he was not yet prepared to break a tie. Dr. Grandy said there was a motion and a second and suggested taking a vote to see what would happen. Dr. Bonham agreed. Ms. Niwao asked if he would be willing to revisit the out years at the May meeting. Dr. Bonham said yes. He said the issue now was that two members didn't feel there was enough reason to change the forecast for those years from the last meeting. He said if their information changed by the May meeting, he would be open to changing his mind. Ms. Niwao said cumulative growth in collections for December was 9.6% and for February it was 7.4%. Dr. Bonham said he thought the 9.6% was more strongly influenced by the end of the Hurricane Relief Fund transfers. He said that was an issue for the present fiscal year, but they were forecasting the out years. Ms. Niwao said she understood.

Chair Kawafuchi said there were only two yes votes and that the motion would not carry unless there was a third yes vote. Dr. Bonham asked for a vote. Ms. Niwao asked if there was a tie whether Chair Kawafuchi would have to vote. Chair Kawafuchi said he'd have to break the tie. He asked for a vote to keep the forecast unchanged for the out years. The vote was taken and there were two yes votes, Dr. Bonham and Dr. Grandy, so the motion failed. Dr. Bonham asked if there should be an "all opposed" vote. Chair Kawafuchi said he thought there were two opposed and one abstain for now. Dr. Bonham said it was a tie then. Chair Kawafuchi said he votes no then.

Chair Kawafuchi asked if there was another motion. Ms. Maynard suggested changing the forecast from growth of 5.5% to growth of 5% for fiscal years 2017 and 2018 and keeping the forecasts for the remaining years the same. Ms. Niwao said she favored the change. Chair Kawafuchi asked if that was a motion. Ms. Maynard said yes. Ms. Niwao seconded the motion. Dr. Bonham asked if there would be further discussion. He said he thought the difference between 5.5% and 5% was small and that he could agree to the change in forecast. Dr. Grandy said he had nothing further to add. Chair Kawafuchi called for the vote on the motion to change the growth forecast from 5.5% to 5% for fiscal years 2017 and 2018 and to keep the growth forecast the same for fiscal years 2019 through 2022. The vote was unanimous.

**It was moved by Ms. Maynard that the general fund revenue forecast be 5.0% (2017); 5.0% (2018) and keep the same for the remaining fiscal years: 5.0% (2019); 4.50% (2020); 4.50% (2021); 4.50% (2022). Ms. Niwao seconded. The Chair called for the vote, and the motion passed with the following votes:**

<b>Kurt Kawafuchi</b>	<b>Yes</b>
<b>Marilyn Niwao</b>	<b>Yes</b>
<b>Jack P. Suyderhoud</b>	<b>Absent</b>
<b>Carl S. Bonham</b>	<b>Yes</b>
<b>Christopher Grandy</b>	<b>Yes</b>
<b>Elizabeth P. Cambra</b>	<b>Absent</b>
<b>Kristi L. Maynard</b>	<b>Yes</b>

Mr. Chun from Budget & Finance provided the Council with the following revenue updates.

**REPORT BY THE DEPARTMENT OF BUDGET & FINANCE ON OTHER REVENUES:**

**Significant Changes from January 2016 Report**

Good afternoon Chair and Council members. My name is Donovan Chun and I am with the Department of Budget and Finance.

Mr. Chun said that he would like to start by providing the Council with some information in response to two questions raised at the last Council on Revenues meeting.

1) **General Fund Non-Tax Revenues - Charges for Current Services** – the increase in FY 16 reflects increases for reimbursements from the federal government (Department of Human Services (DHS)) (primarily for MedQuest). \$170,500,000

Dr. Suyderhoud asked why is this the case--is it more families being covered? Is it the cost of coverage has gone up?

Answer: The increase was due to the Affordable Care Act, which increased both the MedQuest program participation and the federal reimbursement rate.

So, normally we expend general funds and the federal government normally reimburses us about 54%. Due to the Affordable Care Act, they bumped that reimbursement rate up to approximately 80%. That is what caused the increase but it also wasn't only due to a single year, there was over a three year period – the first two years it crept-up and it was an accumulation of the three prior years. And, that's what caused that extreme rise.

2) There was a second question – it wasn't something Mr. Chun reported but it was just something that occurred and that was regarding the Unemployment Insurance Fund. At the last meeting, Dr. Suyderhoud said he heard they had reduced the [unemployment insurance] tax rate and his question was in regards to fund balances and asked if it shows up anywhere.

Answer: The fund balances do not show up in our reports, only changes in revenues. In regards to the unemployment insurance fund revenues, the program is reflecting a reduction in the amount of estimated revenues due to the reduced unemployment insurance rate. FYI the fund balance for the Unemployment Insurance Special Fund as June 30, 2015, was reported at \$435,363,280.

There are fund balance limits that trigger rate adjustments (to revisit that rate that they charged) so on their report for this month, they did reduce their projected revenues because that tax rate went down.

Mr. Chun moved on to the current report. He said we have provided you with our report of revised projections of general fund non-tax revenues and non-general fund tax and non-tax revenues since the January 2016 meeting. Our report includes a brief summary of significant changes, and there are several significant changes that I want to highlight:

### **General Fund Non-Tax Revenues**

**Charges for Current Services** – the increases in FYs 16 and 17 reflect increases for reimbursements from the federal government (Department of Human Services) (primarily for MedQuest).

### **Special Tax Revenues**

**Unemployment Compensation Taxes** – the decreases in FYs 16-22 are based on the FY 15 actual and adjusted to reflect the ending of the emergency unemployment compensation funding as well as the reduction of the unemployment insurance tax rate (Department of Labor and Industrial Relations).

### **Other than Special Fund Non-Tax Revenues**

**Non-Revenue Receipts** – the net increase in FY 16 and net decreases in FYs 17-22 reflect the revised projections in employer and employee contributions necessary by the State, City and County of Honolulu, City and County of Honolulu Board of Water Supply, County of Hawaii, Kauai County, Maui County, Hawaii Department of Water and Honolulu Authority for Rapid Transit to EUTF (B&F) to meet minimum contributions required by Act 268, SLH 2013, which requires the State and other public employers in Hawaii to contribute for their employees' future health care benefits liabilities. These revised projections match the most recent actuarial calculations.

Dr. Grandy asked if this might be due to something like rate of return on assets being stronger than expected? Mr. Chun said it's a big adjustment in the current year on return (EUTF). Dr. Grandy said that's good news. Mr. Chun said it increased in this year but there's decreases the public entities would have to pay based off the actuarial report. That is updated every two years.

Chair Kawafuchi asked if there was some kind of change to Medicare that impacts general fund

(\$170 million)? Mr. Chun said there was Medicaid that he mentioned earlier. The reflected increase in reimbursement but it was a ramp up – although it was a three-year period, initial years didn't see as many people being pushed into that MedQuest program due to the Affordable Care Act. It supposed to settle down since everybody supposed to be under healthcare. Chair Kawafuchi asked how does that impact the general fund? Mr. Chun said it's a reimbursement to the general fund. Dr. Bonham said it's about half percent higher.

**Ms. Niwao moved to accept the B&F report as submitted and Ms. Maynard and Dr. Grandy seconded. The Chair called for the vote, and the motion passed with the following votes:**

<b>Kurt Kawafuchi</b>	<b>Yes</b>
<b>Marilyn Niwao</b>	<b>Yes</b>
<b>Jack P. Suyderhoud</b>	<b>Absent</b>
<b>Carl S. Bonham</b>	<b>Yes</b>
<b>Christopher Grandy</b>	<b>Yes</b>
<b>Elizabeth P. Cambra</b>	<b>Absent</b>
<b>Kristi L. Maynard</b>	<b>Yes</b>

Dr. Grandy announced that the next meeting will be his last meeting through June 2017 because he will be going on sabbatical. Dr. Grandy said he notified the Governor by letter and Chair Kawafuchi received a copy of the letter as well.

**NEXT MEETING:**

The Council tentatively agreed to meet on Tuesday, May 24, 2016 at 2pm; however, the date and time will be confirmed by e-mail. The Council staff will attempt to secure the DLIR Conference Rooms 310-313.

The Chair adjourned the meeting.

**ADJOURNMENT:**

The meeting adjourned at 2:26 p.m.