

COUNCIL ON REVENUES

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

Tuesday, May 30, 2017
2:00 p.m.

PRESENT:

Council Members:

Kurt Kawafuchi (Chair), Marilyn M. Niwao (Vice-Chair), Carl S. Bonham,
Ed Case, Jack P. Suyderhoud, and Kristi L. Maynard

Staff Members:

Department of Taxation (DOTAX): (Cynthia) Ying Yao and J. Guitguiten

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

Others:

Frank Louterbur, Merrill Lynch
Craig Dussinger, Merrill Lynch
Katy Liu, Merrill Lynch
Dane Wicker, Senate Ways & Means
Michele Sansone, Senate Ways & Means
Robert Yu, HART
Mike McGrane, HART
Riley Fujisaki, House Finance
Nandana Kalupahana, House Finance
Sharon Kotaka, Budget & Finance
Robert Nishimoto, Senate Ways & Means
Alika Ke-Paloma, Senate Ways & Means
Maria Zielinski, Director of Taxation

EXCUSED:

Christopher Grandy, Member

CALL TO ORDER:

Chair Kawafuchi called the meeting to order at 2p.m. A quorum was present.

COMMUNICATIONS TO THE COUNCIL AND PUBLIC COMMENT:

Chair Kawafuchi asked if there were public comments or communications to the Council on Revenues (Council). There were no other comments or communications to the Council.

MINUTES OF THE MEETING OF MARCH 13, 2017:

Chair Kawafuchi asked if there was any discussion on any item in the minutes. There were none. Chair Kawafuchi called for a motion to approve the minutes for the meeting of March 13.

It was moved by Dr. Suyderhoud and seconded by Ms. Niwao that the minutes of the March 13th meeting be approved. The Chair called for the vote, and the motion passed with the following votes:

Kurt Kawafuchi	Yes
Marilyn Niwao	Yes
Jack P. Suyderhoud	Yes
Carl S. Bonham	Yes
Christopher Grandy	Excused
Ed Case	Yes
Kristi L. Maynard	Yes

GENERAL FUND REVENUE FORECAST FOR FISCAL YEAR 2017:

Next, the Council discussed the current year forecast for fiscal year 2017. Chair Kawafuchi asked if there's anything that the Tax department wanted to share with the Council. Director Zielinski said she will defer the question to Dr. Yao who is sitting in for Dr. Colby. Dr. Yao said that basically the State revenues are converging on the Council on Revenues forecast of 2.5% growth and the general fund preliminary revenue numbers (until April 2017) were up by 2.2%. She said the year-on-year growth rate had been steadily increasing since December 2016 with the exception of January 2017. The GET collections which represent nearly half of all general fund revenues had been steadily increasing from December 2016 at 0.0% to April 2017 at 0.7%. Dr. Yao said the one-off adjustment to the GET could be the cause of low collections growth in the first half of FY17.

Chair Kawafuchi asked for an update on the refunds. Dr. Yao said the refunds have been increased at 19% to this year to last year, according to the preliminary report of general tax revenues in April 2017. Chair Kawafuchi said cumulative year-to-date its 19% and he asked is that individual refunds or combined business? Dr. Yao said individual income tax. Chair Kawafuchi said by gross dollar its up by about 19%. Dr. Yao said yes. She said the refunds increased from last year \$314 million and this year is \$373 million. Dr. Suyderhoud said the refunds for April were \$81 million (\$73 million versus \$314 million) so that's a \$60 million dollar increase in refunds after that \$17 million more for corporate refunds. Director Zielinski said time-wise the refunds were about comparable to last year—we're running 8 to 9 weeks, that's at the peak and now starting to get less than that so she would say 8 weeks. She said it looks like the number of refunds, are less than what had been anticipated. She said there is no delay in processing of refunds. Ms. Maynard said the dollar amount is significantly higher. She said we're at \$77 million higher than last year. Director Zielinski said a lot of that was during the non-peak period and the department was processing a lot faster and currently at the same pace as last year. She said last year we were processing at 4 or 5 weeks processing refunds during non-peak period. She said now we're almost past the peak period—but still recovering from tax

season. Chair Kawafuchi said also the rates in 2016/2017 are capped 8.25% for individuals and previously 11%. Ms. Maynard said she's trying to figure out if there is a permanent difference and are refunds going to be higher for the year. Director Zielinski said at this point it would only be speculation and asked Dr. Yao if the Tax Research & Planning Office had done any calculations or had any estimates. Dr. Yao said yes and that it might be the carry-over effect that Ms. Niwao mentioned at last meeting and the other reason could be the increase in the income. Chair Kawafuchi said the individual rates are currently at (top rate) 8.25% versus 11%. He said when he looked at the individual tax patterns report – there's a lot of money at the top end.

Ms. Niwao said we're approaching April 15 and people are put on extensions and would probably make their estimated taxes equal to the actual prior tax year liability. She said you would expect to see some decrease in the estimated taxes paid in on an extension.

Ms. Niwao said the only offset she thought of to the decrease in collections would be the collection of Amazon money from the month of May. The online retail taxes collected would relate only to Amazon products, not to products of third party vendors sold through Amazon. Dr. Bonham said they started to collect it on April 1st. Ms. Niwao asked if the Tax department could provide the Council with that information.

Director Zielinski said she believed that the estimate from Tax Research & Planning was about \$10 million so it's not going to have a whole lot of impact on taxes, per month. Dr. Bonham said he would say that's on the low-end. He said you have to know how big of a share Amazon is of total online sales; you have to know how much online sales are for Hawaii. Chair Kawafuchi agreed. Dr. Bonham said he would guess that online sales are bigger a deal in Hawaii than they are on average nationally.

Director Zielinski responded with a yes that for the Amazon type of cases, it was only Amazon that agreed to pay (one taxpayer) and not all the online companies. She said it is believed taxes would be collected as of April 1st but we probably wouldn't see it until the following month.

Ms. Niwao said the GET collections are a lot faster with checks being cashed in 4 days. Director Zielinski said that's our new system. Chair Kawafuchi said they're doing a tremendous job. Dr. Bonham said in contrast his check just cleared (6 weeks). He said so all those writing checks on the last day, that's all going to be coming in May and June.

Dr. Suyderhoud said just as a data point for June 2016, the total individual refunds for that entire fiscal year was \$436 million, which means that we're ahead of pace, he would imagine at this point (corporate refunds was \$106 million) and we're ahead of that at the present time because now it's \$118 million).

Dr. Bonham said there was \$122 million in the last two months. Chair Kawafuchi asked Dr. Suyderhoud what he thought about Hawaii's economy. Dr. Suyderhoud said except for the slowdown in construction it's pretty much documented--the underlying economy seems pretty vibrant. He said if you look at the visitor counts, they're relatively good.

Chair Kawafuchi asked Mr. Case if that was consistent with what he sees. Mr. Case said he

thought it's the same pattern that he's discussed the last couple of meetings which there's a little bit of a divergence between the actual visitor arrivals and visitor spending, it's not huge. He said that's a very, very highly correlated number and it's not quite as correlated as it was although visitor counts may be going up. He said spending is not necessarily going up at the same pace, so there's a little bit of caution there.

Chair Kawafuchi asked if there were any thoughts about why there's a divergence and the correlation is not as strong as it's been historically? Mr. Case said just because more visitors come here doesn't mean the hotel rates are necessarily going up. He said you have more supply in Waikiki with 3 or 4 new hotels—most of that supply has been with occupancy--a combination of more supply but not necessarily the same level of demand and not necessarily the same price points.

Dr. Bonham said that was certainly the case for the last year and a half but if you look at the start of this year, where visitor spending has been stronger than visitors' arrivals growth--double digits visitors' spending growth through April and single-digit (2.5% to 3%). Dr. Bonham said we're looking at raising our visitors' spending forecast, which we already have for the year because it's been so strong.

Dr. Bonham said our forecast has been declining in real visitor spending while it continues growth in arrivals. He said he agrees completely with the big picture if we're talking first half of this year and the next two months going into summer. He said the expectation is we're going to have a very strong April, May and June in the visitor industry and in spending, particularly TAT (Transient Accommodations Tax).

Ms. Niwao invited the members to come to Maui to see all the shopping centers that are almost empty. She said it seems as though there is a decline in the actual retail stores. Dr. Bonham said but you have more people working in retail jobs on Maui than a year ago and a year ago before that. He said something's happening and there's transition.

Chair Kawafuchi asked Dr. Yao if the Tax department had any statistics on the purchases of durables and the trends. Dr. Yao said no. Chair Kawafuchi said at the national level some of the lenders are cutting back on auto financing. He said sometimes that's a sign the economy may be slowing. He said before the last Great Recession purchases of durables started to decline quite a bit. Dr. Yao said she could check but doesn't think the Tax department has this kind of data. Dr. Bonham said the BEA (Bureau of Economic Analysis) data might exist now because we have consumption data for the State.

Ms. Niwao said except for the last few years retail has not performed as high as personal income growth, etc. and we're not seeing the retail GET revenue keeping up with everything else. She said she's wondering whether the Council's model should incorporate retail.

Dr. Bonham said possibly, that's consistent with National trends as well. Ms. Maynard said perhaps savings or investing or deleveraging. Ms. Niwao said retail is a significant part of GET tax collections.

Dr. Bonham said it could contribute some to that slowdown in excise tax collections and now with taxing Amazon. He said we don't have the total retail picture and all we have is retail tax base of those who actually pay their taxes in the State. Mr. Case said 2.5 is our current projection and thought it's more than 2.5. He said in order for it to be 2.5, we would have to continue with growth of 3.7 and didn't think there would be fundamentally anything that would change the economy in May or June.

Dr. Bonham said he didn't see a particular reason to change it from 2.5 and he's comfortable. Dr. Suyderhoud agreed.

Dr. Suyderhoud moved 2.5%. Mr. Case seconded. Chair Kawafuchi asked if there was any further discussion.

Ms. Maynard said the last two months of last year were very high. So the concern is we would have to be as high or higher in order to get to that 2.5.

Chair Kawafuchi took a vote at 2.5% for 2017. The vote was unanimous.

It was moved by Dr. Suyderhoud that the general fund tax revenues growth rate remain at 2.5% for FY 2017 (below-the-line). Mr. Case seconded. The Chair called for the vote, and the motion passed with the following votes:

Kurt Kawafuchi	Yes
Marilyn Niwao	Yes
Jack P. Suyderhoud	Yes
Carl S. Bonham	Yes
Christopher Grandy	Excused
Ed Case	Yes
Kristi L. Maynard	Yes

GENERAL FUND REVENUE FORECAST FOR FISCAL YEARS 2018 THROUGH 2023:

Next, the Council discussed the general fund revenue forecast for the out years. Mr. Case said he wanted to talk about construction because he thought that might be an important part of the equation.

Mr. Case said he thought 2018 has a pretty healthy growth rate. Dr. Suyderhoud said he has 6% for 2018. Mr. Case said he has 7% and thought that was high. Dr. Bonham said his is 4% and forecasting construction is like forecasting the stock market—something you shouldn't do. He said that for the first quarter this year, residential permits were up 126% mostly because the 1st quarter of last year. He said there's this dynamic of big projects ending on Oahu not being completely replaced by new single-family homes. He said in his mind the real question is, 'are we going to start seeing more building on the neighbor islands?' He said he's not convinced it's happening. He said some new projects on Kauai and some activity on Maui and the Big Island and it's just not making up for the slowdown in high rise stuff.

Dr. Bonham said our forecast is for more of a flattening out. He said the reason that it's such a

dynamic mover is because it has the ability to swing a great distance and when it does it's not just the building—people move in to the new houses and the new units and they buy new furniture and this multiplier effect that is larger for construction than other activities which is why it shows up in such a big effect in the tax revenues.

Chair Kawafuchi asked Ms. Maynard what she saw in housing as far as construction. Ms. Maynard said there are certainly a lot of things that her agency HHFDC (Hawaii Housing Finance & Development Corporation) has in the pipeline. She said there are still high costs of construction because of the demand that's out there, but they seem to have stabilized.

Mr. Case asked if there was any data and what is projected for fiscal 2017 year-on-year? He said the Council's mean is 7.47. Dr. Bonham said we're done with 2017. Mr. Case said he's trying to say the out years are roughly where they're ending up.

Dr. Bonham said we're up 126% in the 1st quarter because they finally issued a permit on a building that's being built for the last year. Ms. Maynard said it's a concern.

Dr. Bonham said they have to issue it so people can move in. He said building permits aren't the leading indicator—they're a lagging indicator.

Dr. Bonham said we actually haven't seen high yet but relatively speaking yes, the growth rate was strong for a few years and actually last year it was probably down. Dr. Suyderhoud said according to the COR workbook, fiscal 2015 was 6.1% and fiscal 2016 was 7.4%. Dr. Suyderhoud asked the Council if anyone feels a strong need to change fiscal years 2018 and 2019.

Ms. Niwao asked about the rail's administrative costs that are being paid by the City and County of Honolulu out of GET collections. She thought any adjustments are pending until a special legislative session. Director Zielinski said the costs are about \$24 million.

Dr. Bonham said *if* you efficiently spend that on construction (construction does have a much bigger multiplier). He said the simple model would tell you that would be stimulative in the near-term.

Mr. Case asked Dr. Bonham why a reduction in his growth rate in construction. Mr. Case added that it's not because rail is continuing, it's because nobody is building high rises in Kaka'ako in those years. Dr. Bonham said we haven't been explicitly forecasting rail for the last couple of years because it's basically become unpredictable. He said it's been so on again, off again.

Mr. Case said that he wants to be a little more cautious. Dr. Bonham said he's written two academic papers. He said there are three academic papers by James Mak & Edwin Fujii, himself (Dr. Bonham) and Byron Gangnes all trying to disentangle whether or not an increase in the TAT (from when they first imposed it and when they increased it) had a negative impact on hotel room revenues. And, none of those papers were ever able to statistically identify a negative impact.

Mr. Case said you've talked about the TAT but you've made the same arguments on the GET, right? Dr. Bonham said yes. Mr. Case asked if there is a direct correlation between the GET increase and economic growth. Dr. Bonham said you would think that there would be and certainly the realtors

would argue not to increase it but he has a hard time buying it. He said he didn't think there's much good international evidence that high tax rates cause slower growth. He said he knows that's counter-intuitive. Ms. Niwao said when people travel they look at cost and it would affect travel. Mr. Case said maybe you spend more for hotel rooms and less for your visitor spending and that's in the retail.

Dr. Bonham said the reason that you generally can't find the evidence is because there's too much else going on. He said if the US economy grows at the lofty 3% projected in the budget, none of this will matter and everybody will be happy.

Dr. Bonham said he doesn't have a problem with the forecast they have now. Dr. Suyderhoud proposed to keep 2018 through 2023 forecasts the same. Dr. Bonham asked if it was a motion to leave the current forecast unchanged for 2018 to 2023. Dr. Suyderhoud said yes. Dr. Bonham seconded.

Dr. Bonham said in September we'll know how the fiscal year ended and we'll know what tax laws are in effect. Chair Kawafuchi asked if there was any further discussion and that he would take a vote. Chair Kawafuchi said the motion was to keep the forecast for the out years the same (2018 through 2023), pending the new tax laws to be passed, which Council will revisit in its September meeting.

A motion was made by Dr. Suyderhoud that the general fund revenue forecast remain at 4.0% (2018); 4.0% (2019); 4.5% (2020); 4.5% (2021); 4.5% (2022); 4.5% (2023). Dr. Bonham seconded. The Chair called for the vote, and the motion passed with the following votes:

Kurt Kawafuchi	Yes
Marilyn Niwao	Yes
Jack P. Suyderhoud	Yes
Carl S. Bonham	Yes
Christopher Grandy	Excused
Ed Case	Yes
Kristi L. Maynard	Yes

**REPORT BY THE DEPARTMENT OF BUDGET & FINANCE ON OTHER REVENUES:
Significant Changes from March 2017 Report**

Mr. Chun provided the Council members with Budget & Finance's report of revised projections of general fund non-tax revenues and non-general fund tax and non-tax revenues since the September 2016 meeting. Mr. Chun said the report includes a brief summary of significant changes and that there are several significant changes highlighted:

General Fund Non-Tax Revenues

Charges for Current Services – the net increases in FYs 17-23 reflect projected increases for reimbursements from the federal government, mainly for Medicaid (Department of Human

Services), \$125.0M.

Special Fund Non-Tax Revenues

Non-Revenue Receipts – the increase in FY 17 reflects a transfer from the general fund to the Emergency and Budget Reserve Fund as required by Section 328L-3(3), HRS, and the Hawaii State Constitution (B&F), \$51.3M.

Other Than Special Fund Non-Tax Revenues

Non-Revenue Receipts – The net decrease in FY 17 reflects a delay in bond proceeds deposited into the Housing Project Bond Revolving Fund/Multifamily Fund and less activity in the Single Family Mortgage Purchase Program at the Hawaii Housing Finance and Development Corporation (HHFDC), DBEDT. The net increases in FYs 18-23 reflect plans for floating bonds for additional affordable rental housing projects at the HHFDC. (-\$62M in FY17, +\$206M in FY18, and +\$24.5M in FY19)

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

Kurt Kawafuchi	Yes
Marilyn Niwao	Yes
Jack P. Suyderhoud	Yes
Carl S. Bonham	Yes
Christopher Grandy	Excused
Ed Case	Yes
Kristi L. Maynard	Yes

NEXT MEETING:

The Council tentatively agreed to meet on Tuesday, August 1, 2017 at 2 p.m.; 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 3:12 p.m.