

COUNCIL ON REVENUES

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

Thursday, May 29, 2014
2 p.m.

PRESENT:

Council Members:

Marilyn M. Niwao (Vice-Chair), Carl S. Bonham, Elizabeth P. Cambra,
Jack P. Suyderhoud and, Kristi L. Maynard

Staff Members:

Department of Taxation (DOTAX): Donald Rousslang, Hamid Jahanmir, and
Jacquelyn Guitguiten

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

Others:

Dan Purcell, Member of the Public
Puna Chai, University of Hawaii
Titin Sakata, Department of Taxation
Marc Takei, House Minority
Eugene Tian, DBEDT
Sharon Kotaka, Budget and Finance
Nandana Kalupahana, House Finance
Susan Hirai, Senate Ways and Means
Ashley Advincua, Senate Ways and Means
Roderick Becker, Senate Ways and Means
Mike McGrane, City of Honolulu
Tu Pham, Member of the Public

ABSENT:

Council Members:

Kurt Kawafuchi (Chair)
Christopher Grandy

CALL TO ORDER:

Vice-Chair Niwao called the meeting to order at 2pm. A quorum was present.

COMMUNICATIONS TO THE COUNCIL:

Vice-Chair Niwao asked if there were any communications to the Council. There were none.

Mr. Purcell, a member of the public, asked the Vice-Chair what were "Communications to the Council". Vice-Chair Niwao said anybody that writes a letter to the Council. Dr. Bonham said it is usually from the Legislature, or the Governor's Office.

MINUTES OF THE MEETING OF MARCH 11, 2014:

Vice-Chair Niwao called for a motion to approve the minutes.

It was moved by Ms. Maynard and seconded by Ms. Cambra that the minutes of the March 11th meeting be accepted. The Vice-Chair called for the vote, and the motion passed with the following votes:

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

REVIEW OF RECENT LEGISLATION:

Dr. Rousslang told the Council that there were several bills that had been enrolled to the Governor that if signed, would affect the general fund tax collections in 2015. He said they are as follows:

HB 1671 HD 1, SD 1, CD 1, which raises the cap on TAT allocations to the counties for FY 2015 and FY 2016, reducing GF revenue by \$10 million in each of FY 2015 and FY 2016.

HB 1702 HD 2, SD 2, CD, which provides a tax credit of at most \$1.25 million per year per tenant displaced by the Kapalama container terminal project. He said the measure will take effect for taxable years beginning after December 31, 2013, and the GF losses will begin in FY 2015.

Dr. Rousslang said it was not expected that a lot of tenants will be taking advantage of this credit. Dr. Bonham asked why not. Dr. Rousslang said there are only a few tenants.

Ms. Maynard asked if the impact of the first bill was \$10 million dollars in each year. Dr. Rousslang said yes.

HB 2434, which is now Act 81, reduces TAT allocations to the Convention Special Fund by \$6.5 million and allocates \$3 million to the new Turtle Bay Fund, so the general fund gains \$3.5 million annually beginning FY 2015.

HB 2464 HD 1, SD 1, CD 1, which increases the tax credit for investments on "Important Agricultural Land," for taxable years after July 1, 2008 may cause a general fund revenue loss of from \$1 million to \$5 million per year, starting in FY 2015.

SB 2196 SD 2, HD 1, CD 1, which re-establishes the Energy Systems Development special fund, and extends the \$1.05 tax rate for the Environmental Response Tax and the allocations of the revenues to special funds and general funds from FY 2015 to FY 2030, will cause a general fund revenue loss of \$2.6 million in FY 2015 and general fund revenue gains of \$15.5 million per year for FY 2016 through FY 2030.

Dr. Bonham asked if the allocation was changed or made permanent. Dr. Rousslang said there was one environmental energy system development fund that was allowed to expire but has now been renewed, and that is why there is a loss in 2015. He said the \$1.05 tax rate was set to drop back to a nickel in 2016 and beyond, but the \$1.05 rate has been extended through FY 2030, along with the allocations to a number of special funds, but that the general fund is expected to get about \$15.5 million in 2016 through FY 2030.

SB 2542, SD 1, HD 1, CD 1, which restores the allocation of conveyance tax collections to the rental housing trust fund to 50% beginning July 1, 2014, will reduce general fund revenues by \$11.5 million annually beginning with FY 2015.

SB 2887 SD 1, now Act 44, eliminates a potential loophole in Hawaii's estate tax for decedents dying after December 31, 2013 and may provide potential general fund revenue gains of as much as \$10 million per year starting in FY 2015.

Mr. Purcell interrupted the meeting and asked the Council who Dr. Rousslang was, since he did not know his name and could not see his name tag, and why he was tasked in providing the legislative updates. He asked if Dr. Rousslang regularly provides a report to the Council.

Vice-Chair Niwao said Dr. Rousslang is the staff assigned to the Council on Revenues. Mr. Purcell said okay.

The Vice-Chair continued with the Council's agenda and said that she wanted to report on HB1924 that the Council discussed last time. She said the bill was passed by the House and then deferred by the Senate Ways and Means Committee, but was not heard after the first hearing.

GENERAL FUND REVENUE FORECAST:

The Vice-Chair asked Dr. Bonham if he wanted to start the discussion. Dr. Bonham said yes. He said the current tax revenue forecast for FY 2014 is zero percent, and asked Dr. Rousslang if he had any information about the May tax collections that he could share with the Council.

Dr. Rousslang said the May 28th collections might be down slightly, so there would be no May surprise, the big positive boost we had for the last two years.

Dr. Bonham said no growth in May, would not do anything to the year-to-date growth rate. He said he was concerned that the collections would be down year-over-year in May because May collections last year were so large. Dr. Rousslang said the TAT (Transient Accommodations Tax) to the general fund would also be smaller.

Mr. Purcell asked for a copy of the workbook Dr. Rousslang was discussing with the Council. He said what is distributed at the meeting should be shared with other members of the public. He also said that the agenda for the meeting was vague. Vice-Chair Niwao said it was her understanding that the Council's working papers were confidential. Mr. Purcell suggested that next time there should be someone from the Attorney General (AG) present in the meeting. Dr. Rousslang said the AG office has opined in the past that the Council's workbook is definitely confidential. Vice-Chair Niwao said the workbook is a work in progress. Dr. Rousslang asked Vice-Chair Niwao if she wanted to distribute the handout he had prepared for the Council. The Vice-Chair asked Ms. Guitguiten to pass out the handout.

Vice-Chair Niwao went back to discussing the forecast. She said the growth in general fund revenue collections to the end of April was negative 1% compared to the prior year. Dr. Suyderhoud asked if that reflected the one-time \$55 million that was allocated to the Hurricane Relief Fund. Dr. Rousslang said yes.

Dr. Bonham said he was comfortable with the mean Council forecast that came out of the models. He said he was more comfortable with model 1 than other models. Ms. Maynard asked if he meant the negative 0.4% growth rate. Dr. Bonham said yes. He said he did not think that there was any chance that the growth would be zero.

Vice-Chair Niwao said to get zero growth, we would have to have a 4% growth rate for May and June. Dr. Rousslang agreed.

Dr. Bonham said zero growth would not be likely. He said growth would be negative, but he did not know by how much. He thought that May was not too bad in terms of visitor arrivals and spending, and June may show a positive year-to-year growth.

Vice-Chair Niwao said the large county surcharge that was remitted to the city and county in July of 2013 caused us to have more general fund revenue in FY 2013. She said she has noticed that the State has become more aggressive collecting receivables.

Dr. Bonham said he was puzzled over the drop in revenues. He said in the last 30-something years, we have never had a down year of tax revenues when we did not also have either a good-sized drop in visitors or good-sized drop in the construction industry or a good-sized drop in jobs. He said we have never had a down year in tax revenues when job growth was 1.9%. He said it has not happened in 33 years, probably back to 1980. Dr. Bonham said his assessment was not on a fiscal year basis and it may be that the slowing in tourism and the slowing in job

growth may cause the economy to look weaker on the fiscal year basis. Dr. Suyderhoud asked Dr. Bonham if he looked at the visitor expenditures. Dr. Bonham said he looked at visitor arrivals and spending and said that the visitor industry turns down before the tax revenues go down.

Vice-Chair Niwao said for the last few months we have been trending down in the general fund collections. Dr. Bonham said it has been consistently negative but the size of the negative number had been declining for a while and reversed itself in April.

Vice-Chair Niwao asked if Dr. Bonham was saying that the growth will be negative, but he did not know how negative. She asked if he would be comfortable with a negative 0.5% growth forecast. Dr. Bonham said yes, because there was no material difference between -0.4% and -0.5%. Vice-Chair Niwao asked how about negative 1.0%. Dr. Bonham said it is still relatively little difference but he would rather trust the model. Ms. Maynard asked if the negative 0.4% that comes out of the model includes all the adjustments. Dr. Bonham and Dr. Rousslang said yes. Dr. Rousslang added that the number includes all the known adjustments, but not the effect that might have come from taxpayers moving income around in response to the federal tax rate changes.

Vice-Chair Niwao said it is unlikely that there will be a large surge of income like last year, because of the timing of the payments.

Vice-Chair Niwao asked Ms. Maynard if she thought that growth would be negative. Ms. Maynard said she would agree with Dr. Bonham about the negative 0.4%. She said it seemed like that would be in the ballpark. She said there are certainly some areas of concern like the U.S. GDP number that was released this morning and showed a negative growth of 1% for the first quarter of 2014. She said she was not sure how that would translate to Hawaii or to the future. She said there were also some tax issues in Japan that might affect that market. She said that is why she felt comfortable with the negative 0.4%.

Ms. Maynard asked if there was a new system in place for tax collections and if there was any administrative delays that might affect year-over-year comparisons. Dr. Bonham asked if she meant in tax refunds.

Dr. Rousslang said there should not have been any. He said checks are cashed immediately now and that he believed the Department was caught up with refunds this year, so there should be no refund delays like there was last year. He said there should not be any big allocations for county surcharge this year.

Dr. Suyderhoud asked to forecast the two months that were left in the current fiscal year. He asked the members to forecast 2014 and move on. Dr. Bonham agreed. Ms. Cambra made a motion that for fiscal year 2014, the Council forecast negative growth of 0.4%, down from the existing forecast of 0.0%. Ms. Maynard seconded the motion. Vice-Chair Niwao asked for all in favor. All members were in favor. The motion was carried.

Ms. Cambra made a motion that the general fund tax revenues growth rate be at -0.4% for FY 2014 (below-the-line). Ms. Maynard seconded. The Vice-Chair called for the vote, and the motion passed with the following votes:

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

Vice-Chair Niwao asked if the negative 0.4% was a below-the-line forecast. Dr. Suyderhoud said yes. Vice-Chair Niwao asked when the economy would turn around. Dr. Suyderhoud said according to the model, FY 2015 would be good. The Vice-Chair thought it was based on ongoing construction activities. She said there are a lot of people with permits but she was not sure exactly when the actual construction would take place. Dr. Bonham said when one flies in to Hawaii, it looks like the building crane is the State's bird. Vice-Chair Niwao said we were saying that next year was going to be the year that construction was going up. She said we have said that for a couple of years already and every year her construction clients say next year is the year it is going to go up, but it has not turned out that way. Dr. Suyderhoud said he agrees with regard to Maui, but Oahu is a different story. He thought that most of the people in the construction sector recognized that Maui is not growing as fast and if it was, it would be due to infrastructure spending. He said residential construction was very timid on Maui.

Dr. Suyderhoud asked the Council to focus on fiscal year 2015. He said they have the second half of this calendar year and the first half of next year to consider if the visitor sector is going to improve. He wondered if the visitor sector would improve in the second half of the calendar year 2014 and the first half of 2015. He said he knew that DBEDT has positive growth numbers for visitor arrivals.

Dr. Bonham said that UHERO (UH Economic Research Organization) did too. He said they have a very modest growth for spending, like 1.5% or 2.0%. But he thought they were optimistic. He said for visitor arrivals, they raised the calendar year forecast for 2014 from 0.7% to 1.0% based on the strength they expect to see in the summer. Dr. Suyderhoud asked if it was driven by seats (airline seats). Dr. Bonham said it is driven by demand. He said the economy is getting past the tax increases and the uncertainty from the furloughs and the government shutdown and all the other things that we saw in 2013. Dr. Suyderhoud asked Ms. Cambra what she thought was happening in the visitor sector. Ms. Cambra said that the cost to arrive to the islands is very reasonable compared to where it had been. She said it is elevated for the summer months but not above the seasonal norm. She said hotels have an extra inventory that they did not plan for this year.

Dr. Suyderhoud asked if they were talking about positive visitor spending growth. Vice-Chair Niwao asked Ms. Cambra if the hotels were filled as compared to last year or if the occupancy was down. Ms. Cambra said they were doing better than last year.

Vice-Chair Niwao asked if the growth compared to last year was in hotel rates. Ms. Cambra said the growth was in revenues since occupancy is healthy, but the industry has to work a little harder to get the business. She said Mexico is certainly doing better and that is probably the biggest geographic competitor for their industry at this point. Vice-Chair Niwao asked if there were some problems with crime rates in Mexico that made everybody want to come here was the reason why Alaska Airlines, for example, is flying to Maui instead of going to Mexico.

Ms. Cambra said Alaska has not pulled its flights to Mexico out. She said she believes the lift into Mexico has increased, but the safety concerns are definitely lower than they have been. She said they have become a more viable competitor for Hawaii.

Dr. Suyderhoud said the bottom line is the visitor numbers are slightly positive for fiscal 2015. He asked about construction. Dr. Bonham said it is up. Dr. Suyderhoud said he was only using 7% growth for 2015. He asked Dr. Bonham for his construction numbers for fiscal years 2015 and 2016. Dr. Bonham said his model's forecast for 2015 and 2016 were 6.35% and 7.95%. He said the figures include the effect of rising consumer prices (inflation), more in 2015 than in 2016.

Vice-Chair Niwao said the other thing that she was worried about was the federal funds flowing into Hawaii. Dr. Bonham said there is no data on federal spending at the State level since 2012, or maybe 2011.

Vice-Chair Niwao said that is the other big factor that might have an effect on the economy here and offset the construction growth. Dr. Bonham said there was a 3% drop in federal civilian workers last year. He asked Vice-Chair Niwao if she had any suggestion for revenue growth forecast for 2015. Vice-Chair Niwao said her concern was that the Council went down to a negative number. Dr. Bonham said he understood her concern that there are a lot of uncertainties there.

Mr. Purcell interrupted the Council and asked if at some point he could ask a question about the Council's track records in forecasting. He said he was curious to know what the model has provided over time and what the Council has predicted over time. He said the Council seems to see a report like that and kind of pontificate on all of that.

Vice-Chair Niwao said the Council has provided that information in testimonies to the legislature and with respect to its forecasting models.

Mr. Purcell asked if there was a chart for those three items he had just mentioned. He asked if he could see all three of those plotted over time. He said he was just curious because this time the Council is going with the projection from the model but his understanding was that the Council usually did not.

Dr. Bonham said in terms of the record, the Council on occasion has analyzed the forecast for a number of years. Dr. Rousslang said they looked at the accuracy of the May forecasts that based on a request by Dr. Grandy and that the results were presented in the testimony at the last Senate Ways and Means Committee hearing. Dr. Bonham said that means that some of it is in the public record already.

Mr. Purcell said he has a finance degree from American University in Washington, DC. He said he graduated at the top of his class and he was an investment advisor, but the Council's deliberations were not making sense to him. He said he did not see where the Council was going with its information and wondered if the Council did a self-assessment. He said the agenda is not really effective. He said these were just some comments and one last comment and he would be done. He said when you come to a meeting like this it is not helpful to look at the back of someone's head. He said you guys can sit however you want. He said he did a lot of boards and commissions but it would be better if people can see someone speaking. He said the seating should be improved and that he was done for today but he would be back next time.

The Council continued its discussion about the 2015 forecast. Dr. Bonham said they were talking about the bounce back vs. non-bounce back and, if they looked historically, we only had one period in the last 30-something years where we had two down years. He said that was the great recession. He said in the 1990s we had alternating positive and negative years, but following each year in which we had a downturn in tax revenues, the next year the smallest growth rate was 4.8%. He said you do tend to have bounce backs and the data is volatile. He said if our underlying assumptions about the macro-economy are correct and if the model works, then we should see growth rates of 5% or 6% next fiscal year.

Vice-Chair Niwao asked if he thought that the US economy that has gone down last quarter was going to be affecting Hawaii in the next fiscal year. Dr. Bonham said there is no indication in the GDP (Gross Domestic Products) report that you should expect some kind of a negative impact on Hawaii's economy over the next 6 months. He said consumers are not retreating from spending: they are increasing their spending as the job market improves and as they start to see some wide-spread income growth instead of just income growth in the top income tax brackets which was then taxed away. He said we will start to see some wide-spread growth in US visitors. He said he is not worried about the US economy. He said the US economy is in better shape now than it has been in the last couple of years.

Dr. Bonham asked Dr. Suyderhoud if someone wanted to make a motion. Dr. Suyderhoud said he was thinking of keeping his prior forecast. He said he thought 5.5% growth (for FY2015) and 5.0% growth (for FY 2016) were reasonable. He said he did not feel he had enough information to change that assessment.

Vice-Chair Niwao said she was concerned about Budget & Finance (B&F). She said B&F always starts the budgeting in the summer before the Council's personal income meeting and forecast and the Council should give them better information. Dr. Bonham said they can tell them the range of the forecast. He said they discussed this in the past that the Council has a wide

dispersion of forecasts. He said the dispersion grows to almost 2% in fiscal year 2015 and to 3% in fiscal year 2016. He said the dispersion provides a measure of uncertainty.

Dr. Bonham added that Dr. Paul Brewbaker (a previous Council Chair) trained B&F to accept that the dispersion was plus or minus 2%.

Vice-Chair Niwao asked if Dr. Bonham would be more comfortable going down to 5% growth rate for 2015 rather than 5.5%. Dr. Bonham said there was no material difference between 5.0% and 5.5%. Vice-Chair Niwao said they could just change the forecast in September. Dr. Bonham said hopefully not. Ms. Cambra said they could change it when they have more information.

Dr. Bonham said if we have a very strong summer in the tourism sector, they may be raising the forecast. Dr. Suyderhoud said he was still counting on a June surprise.

Dr. Suyderhoud asked if he could make a motion. Vice-Chair Niwao asked if he wanted to keep the same out year forecasts. Dr. Suyderhoud said yes, the same growth rates shown in table 5A of the workbook, which are the below-the-line numbers that were in Council's March 2014 forecast.

Vice-Chair Niwao said okay, that is 5.5%, 5.0%, 5.8%, 6.2%, 5.4% and 5.4%. Dr. Suyderhoud said yes, that was his motion. Ms. Cambra seconded the motion. Vice-Chair Niwao asked with respect to the out years, if any laws were put in place with regard to changing the tax rates. Dr. Bonham said that is in the below-the-line numbers already, because they know when the tax rates are scheduled to revert back to their previous levels. Vice-Chair Niwao asked if the Hawaii Hurricane transfer of \$55 million was going to be extended to any other years. Dr. Rousslang said it would happen next year, too. Vice-Chair Niwao asked if it goes beyond that. Dr. Rousslang said no.

Dr. Bonham said we have a motion and a second and asked if there was a call to question the motion. Vice-Chair Niwao asked who seconded the motion. Ms. Cambra acknowledged that she had seconded it. Vice-Chair Niwao said we have a motion and a second to keep the same growth rates that we had the last time for the out years, and asked for all in favor. The motion was carried unanimously.

Dr. Suyderhoud made a motion that the general fund revenue forecast for the remaining fiscal years remain the same: 5.50% (2015); 5.0% (2016); 5.8% (2017); 6.2% (2018); 5.4% (2019); 5.4% (2020). Ms. Cambra seconded. The Vice-Chair called for the vote, and the motion passed with the following votes:

Kurt Kawafuchi	Absent
Marilyn Niwao	Yes
Jack P. Suyderhoud	Yes
Carl S. Bonham	Yes
Christopher Grandy	Absent

Elizabeth P. Cambra	Yes
Kristi L. Maynard	Yes

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 March 2014 Report

Other than Special Fund Non-Tax Revenues

Federal Grants - the net increases in FYs 14-15 reflect additional federal grants for Temporary Assistance to Needy Families and the Medical Assistance Program in the Department of Human Services.

Charges for Current Services - the net increase in FY 14 is attributed to prescription rebates and insurance rate credits returned by insurance carriers to Employer Union Health Benefits Trust Fund.

Repayments - the increases in FY 14 and FY 16 reflect higher than anticipated revenues due to larger than anticipated loan repayments for projects funded by the Hawaii Housing Finance and Development Corporation (Department of Business, Economic Development and Tourism).

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

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

Mr. Purcell interrupted the meeting and said it was pointed out to him by one of the members that he was speaking out of order on a different item—when you look at the agenda, he would have liked to see how those items were listed and that they aren't separate items like item V. He said that he didn't appreciate being corrected on the fact that he's out of order on speaking on an item and, you were taking action on two different items last time. He said he was just making the point that this agenda is so vague and so sloppy and he hoped to see them do a critical self-assessment of this Council and try to make improvements going forward. He said his opinion is that this is wholly inadequate the way they are conducting themselves. Vice-Chair Niwao said okay they will note that.

NEXT MEETING:

The Council tentatively agreed to meet on Thursday, July 31, 2014 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 Vice-Chair asked for a motion to adjourn the meeting.

Dr. Suyderhoud made a motion to adjourn the meeting, seconded by Ms. Maynard. The Vice-Chair called for the vote and the motion passed with the following votes:

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

ADJOURNMENT:

The meeting adjourned at 3:26 p.m.