COUNCIL ON REVENUES

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

Thursday, September 3, 2015
2 p.m.

PRESENT:

Council Members:

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

Staff Members:

Department of Taxation (DOTAX): Donald Rousslang

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

Others:

Eugene Tian, DBEDT
Brandon Asuka, Governor's Office
Nathan Eagle, Civil Beat
Joseph Kim, Department of Taxation
Titin Sakata, Department of Taxation
Sophie Cooke, Star Advertiser
Randy Hiyoto, House Finance
Calvin Azama, Senate Ways and Means

CALL TO ORDER:

Chair Kawafuchi called the meeting to order at 2pm. 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 JULY 30, 2015:

Chair Kawafuchi called for a motion to approve the minutes for the meeting of July 30. Ms. Maynard moved to approve the minutes. Dr. Suyderhoud and Ms. Cambra seconded the motion.

It was moved by Ms. Maynard and seconded by Dr. Suyderhoud and Ms. Cambra that the minutes of July 30th meeting be accepted. 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	**Yes**
Elizabeth P. Cambra	**Yes**
Kristi L. Maynard	**Yes**

REVIEW OF RECENT LEGISLATION:

Dr. Rousslang provided the Council with a report on legislation passed by the 2015 Legislature:

Act 23, SLH 2015 brings Hawaii's estate and generation-skipping transfer tax into conformity with the Internal Revenue Code (IRC) as of December 31, 2014. No material effect on General Fund (GF) revenues.

Chair Kawafuchi asked why there was a bill if there was no change. Dr. Rousslang answered that there may have been changes in the federal law, but that bringing ours into conformity didn't have any material effects on Hawaii tax collections. Chair Kawafuchi asked if it had to do with the date being December 31st versus January 2nd, because there was a federal law that was dated January 2nd several years ago that affected state legislation. Dr. Rousslang said that might have been, but whatever the changes were, they did not materially affect revenue.

Dr. Rousslang: Act 52, SLH 2015 brings Hawaii's income tax law into conformity with the IRC as of December 31, 2014. No material effect on GF revenues.

Chair Kawafuchi asked if the effect on revenue was minimal, or no impact at all? Dr. Rousslang said minimal. Dr. Grandy said this is largely because Hawaii's laws already conform to the federal in many areas. Dr. Rousslang said yes, this is just bringing Hawaii's law up to legislation passed by the feds the past year.

Dr. Rousslang: Act 84, SLH 2015 caps conveyance tax allocations to the land conservation fund and the rental housing trust fund and eliminates allocations to the natural area reserve fund starting in FY 2016. Annual GF gains of $19.7 million.

Chair Kawafuchi asked if it increased the revenue by close to $20 million per year starting with the current fiscal year. Dr. Rousslang said yes, by cutting allocations to the rental housing trust fund. Dr. Suyderhoud asked if it keeps more in the general fund and less into the special fund. Dr. Rousslang said yes.

Dr. Rousslang: Act 93, SLH 2015 increases the transient accommodations tax on timeshares from 7.25% to 8.25% for calendar year (CY) 2016 and to 9.25% for CY 2017 and thereafter. GF gains of $1 million in FY 2016, $3 million in FY 2017 and $4 million annually thereafter.

Chair Kawafuchi asked if there was a change to the base, or if it was the status of timeshares occupation. Dr. Rousslang said there was no below-the-line adjustment for this change, because the revenue change would be small, at most $2 million in any one year.

Dr. Rousslang: Act 95, SLH 2015 clarifies the period for which rental projects must remain affordable in order to be eligible for the GET exemption. The Act takes effect July 1, 2016 for projects with an initial certification date after June 30, 2015. No material effect on GF revenues.

Act 117, SLH 2015 allocates $3 million annually from the TAT to the special land development fund starting in FY 2017.

Dr. Suyderhoud said that seems to be the largest and asked about the below-the-line adjustment of $213 million. Dr. Rousslang said the $213 million was the total for tax for the allocations to the counties, to the tourism fund and to the convention center. Dr. Suyderhoud asked if before it was $210 million, and now it is $213 million, for example.

Chair Kawafuchi asked why was the change to the general fund the entire $213 million. Dr. Suyderhoud said it was because we always keep all the TAT allocations at the bottom. Dr. Rousslang said once the caps are hit, everything goes to the general fund, so if the caps change by a dollar, the general fund changes by a dollar. Chair Kawafuchi asked if previously, the below-the-line adjustment was $200 million and now it is $213 million. He said he was trying to reconcile the $213 million negative below-the-line adjustment with the effects of Act 117 and Act 212, which were being described. Dr. Rousslang said no, that we take the gross TAT and then subtract all the allocations to the counties, to the tourism special fund, now to the Turtle Bay fund and the convention center, and those subtractions, their total is $213 million. Chair Kawafuchi asked so this is the total subtractions, and previously in our forecasting this number was a negative roughly $200 million? Dr. Grandy said yes, if you look, for example, on page 10, table 5b, below-the-line for 2016 to 2018 now it is $213 million. Chair Kawafuchi asked why it was now a smaller amount, as opposed to being a bigger amount. Dr. Rousslang said it was because the convention center fund had been $33 million, which was cut to $26.5 million, but before they weren't allocating to the Turtle Bay fund, but those allocations have now started. Chair Kawafuchi asked if the net effect was causing the State to lose $5 million more. Dr. Rousslang said he hadn't looked at the issue for a while, but that he thought the allocations to the convention center went from $33 million to $26.5 million and then they took out $1.5 million for Turtle Bay and now an additional $3 million for the special land development fund, and that all those changes actually came in 2016. In 2015 they weren't allocating to Turtle Bay fund yet. Chair Kawafuchi said the net effect was a small change.

Dr. Rousslang: Act 120, SLH 2015 establishes a nonrefundable tax credit for upgrading a cesspool system to a septic system or for connecting to a wastewater system in tax years 2016 through 2020. GF revenue losses of $5 million annually from FY 2016 through 2021.

Dr. Suyderhoud asked if this gets to be a new below-the-line adjustment. Dr. Rousslang said yes.

Dr. Rousslang: Act 121, SLH 2015 allocates $1.5 million annually from the TAT to the Turtle Bay conservation easement special fund, starting in FY 2016.

Dr. Rousslang said this revenue change was included in the below-the-line adjustments, because it was included with other, larger changes in a single adjustment.

Chair Kawafuchi asked if it was a one-time $103 million loss in the current fiscal year. Dr. Rousslang asked if he was referring to the Turtle Bay allocation. Dr. Suyderhoud said that was only $1.5 million. Chair Kawafuchi said he was referring to a figure of $103 million. Dr. Grandy said that was the allocation to the counties, who got $93 million, except for 2015 and 2016, when they got $103 million.

Dr. Bonham said the Council does not actually forecast TAT (Transient Accommodations Tax) that the Tax department comes up with a forecast based on the members' visitor arrival numbers. Dr. Rousslang said the Department had been instructed by the Council to use the sum of growth in visitor arrivals and inflation. Ms. Maynard said that seemed reasonable. Dr. Bonham agreed, but said it also affects the general fund forecast, net of the below-the-line adjustments. He said the size of the TAT matters more now, since the allocations are all capped. Dr. Rousslang said yes. Dr. Suyderhoud said yes, if you increase the TAT growth, you increase the general fund growth dollar for dollar because all the allocations are capped. Dr. Bonham said he was concerned if there was something that was affecting the general fund forecast below-the- line that was based on something not being discussed. He said they never discussed the visitor forecast in any great detail. They discussed the current month and year, but they don't tend to talk about the 5-year forecasting period. He said looking at the forecast, for arrivals, the consensus forecast for arrivals over the next 5 years struck him as too high, even if they built what's planned right now, we would be running 95% occupancy with that kind of growth forecast. He said the consensus was something like 3% a year, every year for the remainder of this cycle (head counts). Dr. Suyderhoud said that was not his forecast.

Dr. Rousslang: Act 185, SLH 2015 applies the environmental response tax to fossil fuels (excluding petroleum products taxed under the barrel tax and coal used to fulfill a power purchase agreement in effect as of July 30, 2015) at a rate of 19 cents per million BTU's. Indeterminate effect on GF revenues (no material effect is anticipated).

Act 223, SLH 2015 amends the refundable food excise tax credit and makes it available for nonresidents. The changes are effective for tax years 2016 and 2017. GF revenues losses of $6.5 million in FY 2017 and 2018.

Dr. Suyderhoud asked if that meant we would get more non-resident filers. Dr. Rousslang said maybe. Dr. Suyderhoud asked if the credit was refundable. Chair Kawafuchi asked if it was only effective for those dates, and then it reverts back. Dr. Rousslang said yes, it expires.

GENERAL FUND REVENUE FORECAST FOR FISCAL YEAR 2016:

Chair Kawafuchi asked if the members received emails having to do with the $100 million in refunds previously expected to be postponed into the current year and also something about the online travel companies. He asked Dr. Rousslang to explain. Dr. Rousslang said for the refund issue, they had anticipated something like $490 million in total refunds in FY 2015 and refunds were very low at the time of the last meeting, about $126 million. He said total refunds for FY 2015, which are believed to be caught up by the end of the fiscal year, turned out to be only $420 million. Dr. Suyderhoud asked about the $430 million figure he saw. Dr. Rousslang said that was adjusted for an anomaly; $10 million in prior year refunds were cancelled in FY 2015, so the actual figure after the cancellations was $419 million. He said refunds actually paid were $30 million higher than forecast at the earlier meeting, which had assumed $170 million would be paid out in the last two months. He said also that the $490 million in expected refund claims never materialized. Dr. Suyderhoud asked if the bottom line was that relative to where they were in the last meeting, the refund story reduced some of the revenues that they thought would be in FY 2015. Dr. Rousslang said yes. Dr. Suyderhoud asked if the refunds that actually appeared in FY2015 had been expected to appear in 2016, and if now the story had to be changed to say the refunds would not occur in 2016, so that FY2016 would actually be a little better than we thought it would be. Dr. Rousslang said yes.

Chair Kawafuchi said he recalled being told that refunds of about $100 million would get delayed into the current fiscal year, so the members adjusted the projection at the May meeting. He said they then took a separate vote and decided that about half of the refund fraud activity would also continue to occur into the current fiscal year, so half of that, or $50 million of the current fiscal year's refunds, would be pushed into the following year. Dr. Rousslang said yes. Chair Kawafuchi said in other words, the net effect was that the members had expected $50 million less in the current fiscal year, because we would pay out $100 million more in refunds, but also postpone another $50 million to the next year, so there was going to be a $50 million dollar hit to the current fiscal year. He said that now the members were being told that the $100 million overhang from last fiscal year was gone, so we have two components to consider for adjustment. The first one is, we don't have (it seems like) the $100 million overhang. Dr. Rousslang said yes. Chair Kawafuchi asked Dr. Rousslang to explain the last page in the handout – the email that was sent previously. Dr. Rousslang said he had been asked about when the refunds were delayed, when that build-up occurred, so the material he prepared looked at the last three years. He said up until March, the refunds were not very far behind. He said 2013 was not a good year for the comparison, because the change over to the MeF slowed processing. He said looking at 2014, by March we were behind by $100 million and by April it was $170 million. Dr. Bonham asked if the purpose was to understand what happened last year. He said the low refund percentage of the general fund or of income actually happens more often if you go all the way back to the 80's or 90's and that it seemed to happen when the economy was doing well. He said he thought part of what happened last year might have been that people were earning more income and so had less coming in refunds. Dr. Rousslang agreed.

Ms. Niwao said she had a couple of clients that still hadn't gotten their refunds. She said she intended to ask what happened to their refunds, one of which was substantial. Dr. Bonham said he thought the refund issue wouldn't really affect the decisions about the current year if refunds were now caught up. Dr. Suyderhoud agreed. Ms. Maynard said the assumption last forecast was that we would not be caught up and that would affect the current 2016 fiscal year forecast. Dr. Grandy said the pattern of income tax refunds accelerating into the end of June seemed typical. Dr. Rousslang said yes, but only the cumulative figure. Chair Kawafuchi said it seemed like a lot of refunds are paid out in February, March, and April, because February is when people get their W-2s and a lot of refunds get filed, including for the refundable credits. But this year only $20 million paid out, versus $84 million in the prior years.

Dr. Suyderhoud asked to discuss the forecast. Ms. Niwao asked when the Department said they were caught up with the refunds, if they just meant the typical ones. Dr. Rousslang asked Deputy Director Joseph Kim if he wanted to address the question. Deputy Director Kim said the department still had refund processing through the end of the fiscal year, and the next big day of processing would be in October when extensions expired. He said that they were currently caught up with refunds. Chair Kawafuchi asked if we knew why refunds were about 1% lower - $419 million this year versus $478 million last year. He said he expected the numbers to be closer. Dr. Rousslang said there were a couple of things: First, the refunds in 2014 should have been $10 million lower ($468 million), because of the cancelled refunds. Second, the refunds for FY 2015 should have been $10 million higher without the effect of the cancelled refunds ($429 million). He said the low rate of refunds also happened in 2006, and that Dr. Bonham's explanation might be the reason. Chair Kawafuchi asked about managing refund fraud in terms of the current fiscal year and about the adjustment of about $50 million at the May meeting for the current fiscal year. Dr. Rousslang said the adjustment was based on an over-hang of $100 million this year and smaller over-hangs in subsequent years. He said there was no over-hang this year. He asked if Deputy Director Kim wanted to address overhangs in future years. Deputy Director Kim said the problem of fraudulent refunds was a growing phenomenon. Chair Kawafuchi said there was always some refund fraud.

Dr. Bonham asked to move the discussion to the economy. He said he had earlier overstated the consensus visitor forecast, and that it stays at around 2% annual growth in the out years. He said from table 3 the consensus forecast in growth of visitor arrivals was 2.7% for fiscal 2016 and then converges to about 2% pretty quickly and stays there. Ms. Maynard asked if his point was that we don't have enough hotel space. Dr. Bonham said yes, although it was hard to say for sure, because the data on the available accommodations were not good. He said thousands of new units would be coming on line over the next 5 years, including in Waikiki, the new timeshare on Maui, perhaps Turtle Bay may eventually be built. He said they were already at capacity in Waikiki, so it was largely a matter of the neighbor islands filling up. Ms. Maynard said given the high visitor count that adding 2% to that every year going forward is nearly impossible unless we have new capacity. Dr. Bonham agreed. Dr. Suyderhoud said that was what the members said when they said visitors were 7 million, but that people make adjustments, people find places to stay: if there's a shortage of places in Waikiki, there are other places. Dr. Bonham said the issue was really visitor days. He said the visitor arrivals could grow if the length of stay came down. Ms. Maynard said if there was enough demand, perhaps more hotels would be built, but that would take time. Dr. Bonham said the members should discuss this type of issue in the long run visitor forecast. He said the reason he was concerned about the economy is because of the stock market and because of what was happening in China, and that Canada may be in recession and Australia may be headed there as well. He said the changes in the global economy could impact Hawaii visitors. Ms. Niwao said the foreign currency exchange was also a factor, that she was just in Canada and Vancouver and it was like a discount on everything, including hotels and restaurants, because the Canadian dollar exchange rate was about .75 cents U.S. to $1.00 Canadian (CAD). She said people there said tourism has been picking up quite a bit, because the exchange rate is so favorable. Her concern was that Hawaii might become too pricey relative to foreign destinations offering alternative tourism options. She said the stock market decline and declines in oil and gas production might also cause people to reduce spending on a Hawaii vacation, although she said travel of very wealthy people would probably not be affected. She noted that some people expected benefits from lower oil prices, but that she hasn't seen prices of plane tickets come down proportionately. She said the U.S. was considering interest rate increases, whereas everybody else was reducing their interest rates, so that would cause the dollar to rise further. Dr. Suyderhoud said he wondered about Marilyn's position when things were looking up, rather than going down. Ms. Niwao said she asked early on whether it was possible that our economy would follow what happened in Japan. She said in Japan it was a bubble for real estate, and since it burst, they haven't been able to climb out to really positive territory. Dr. Suyderhoud said there were a lot of things going on in Japan beyond the bubble, such as basic demographics. He said he also worried about the strong dollar and the loss of wealth in the equity markets, but that he took a longer run view. He said he looked at the long run prospects and he thought those were still pretty decent. He said the concern over these effects should be reflected in her forecasts of economic variables and in her visitor forecasts.

Ms. Niwao said she thinks what is missing from their model is the federal funds spending and that when she was in Washington, DC August 3rd, she met with some senators (because the National Society of Accountants had a Tax Practitioners Bill of Rights that they are trying to promote) and the Senators were recommending a decrease of $838 million or a 7.7% cut to the IRS budget. She said she told them that the services from the IRS had already declined to the point where they don't answer telephone calls and they don't have staffing for a number of things. She said she was told by a senator on the Senate Finance committee that they were going to cut the IRS budget, and that basically they were going to continue federal funding cuts, because they have to worry about the budget deficit, the level of the debt and the path it's taking, and that there would be cuts rather than spending in line with inflation. She said she also looked at the Congressional Budget Office report on June 16th for the long-term outlook and it showed every year spending was higher than revenues. She said in Hawaii, we have a balanced budget. Dr. Bonham said every year since 1965, except for four years. Ms. Niwao said but now the debt is not proportionate. Dr. Suyderhoud said the deficit is shrinking. Ms. Niwao agreed. Dr. Suyderhoud said any time you have a deficit, the debt grows, but that the growth rate of the debt is slowing down. Ms. Niwao said yes, but they said the slowdown was temporary. They said the debt would be taking off again. Dr. Bonham said they had discussed the issue at the last meeting. Ms. Niwao said we also have to worry about the demographics. Dr. Bonham said that should be built into the forecast. Dr. Bonham said the Congressional Budget Office's analysis of spending doesn't show spending going down, but instead shows spending growing every year. When policy makers talk about cutting spending, they're talking about cutting spending vs. what it was going to be under the last plan. It's not an outright decline in nominal spending. He said he thought the biggest short-run risk is still from the federal government. He said the forecast he submits includes the effects of losing some military army personnel, of continuing to lose federal civilian workers, and of having very anemic growth in the federal civilian space. He said that was the only sector of Hawaii's economy that was not growing. Dr. Bonham said he thought it would probably stop shrinking, and when it does then everything will be growing. He said 2015 and possibly 2016 could be the best years that we've seen in this cycle because the construction industry is growing rapidly. He said residential permits growth in this year, which is a lagging indicator, was somewhere in the neighborhood of 40%. The commercial sector has been building hotels, and timeshares on Maui, to accommodate more visitors. The visitor industry is on pace for a record year. And in thinking about the exchange rates, most of what was discussed happened in 2014. Although the Canadian dollar slipped 10% or 15% over the last year, that's mostly an oil price issue (they're primarily an oil exporter). All of those things are relevant, but to put them in perspective, this time last year our forecast for the general fund was 3.5%. At the next meeting, we went to 4.5% and at the next meeting we went to 5.5% and then to 7.5% and we ended up at 6.8%. We started off low, because the year before was a weak year, mostly for technical reasons.

Ms. Niwao said okay, but if you look at 2016, the model is showing a 7.7% growth rate. Chair Kawafuchi said that number looked high. Ms. Niwao wondered how forecasts from the model got so high. She said shopping malls on Maui were still seeing businesses closing. Dr. Bonham said retail jobs were growing on Maui. Dr. Suyderhoud said it might be a change in the nature of retail, big box retailers displacing smaller businesses.

Dr. Bonham said retail jobs on Maui grew 1.5% in 2012; 2.6% in 2013; and 2.5% in 2014. Ms. Niwao said she thought that the big box stores were coming in to Maui and the smaller businesses were suffering and were moving out of the shopping centers, leaving vacant spaces. Dr. Bonham said year-to-date through July, retail trade jobs on Maui are up 5%, which is completely consistent with the kind of visitor growth that we've seen on Maui. Chair Kawafuchi asked to hear from others. Dr. Grandy said he thought the trends for visitor arrival growth, visitor expenditure growth and construction growth were all better than they have been recently. He said growth in visitor arrivals has been accelerating from a low of zero in 2014; growth in visitor expenditures isn't quite as strong but is also on an upward track that's been accelerating; the most recent 12-month average went to 2.6% from 2.55%. He said construction is measured by the contracting tax base (and there's an unfortunate lag there), we are still just under zero growth in the long run. But that growth rate has been rising for several months now. He said he thought those indicators for Hawaii's economy, were positive in general. He said for the US economy, nominal GDP (Gross Domestic Products) growth has been basically stuck at around 4% roughly and, there was a pop in real growth recently, but that was because the deflator fell and he was sure that was oil. Dr. Bonham noted that the real growth increased and low inflation prevented a similar growth in nominal income. Several members expressed surprise at how high the model growth rate was for FY 2016. Dr. Rousslang pointed out that 1% came from the cessation of allocations to the Hawaii Hurricane Relief Fund. He also pointed out that there was no below-the-line adjustment for the online travel company settlements, because the amount was too uncertain.

Chair Kawafuchi asked for Ms. Cambra's thoughts. Ms. Cambra said the indicators that the members focused on show no change from the last meeting. She said early indications so far are positive, the prices for air seats coming in so far are relatively reasonable. She said they continued to focus on other tropical destinations instead of Canada for competition for tourists, including Mexico and the Caribbean, but they didn't anticipate any major change there. She said all indications were positive. She said they considered the effects of the currency, consumer sentiment out of Australia, and the weather. She said the question is whether they would see a decrease in pace going forward. She said they haven't seen it yet, but continue to monitor. Chair Kawafuchi asked Ms. Maynard for her thoughts. Ms. Maynard said she was surprised by how strong the numbers looked in the model. She shared Ms. Cambra's concern about the weather and what it would do, but she said she didn't know how to forecast something like that.

Ms. Cambra said not everyone feels this way, but our bad weather is still better than many other areas and the tourists are just happy to be here. We may be miserable with the weather, but others are still pretty happy to be here. Dr. Suyderhoud said it's all relative. Ms. Maynard agreed, but said she had some comments from people saying "How do you stand it here?" She said she answered that it's not usually like this. She said she also shares concerns about the currency and the effect of the stock market. She said she didn't think the fed is as concerned about the stock market as everyone else and that it'll be interesting to see what they do when they meet. But she said she certainly would like to err on the side of not being too aggressive.

Chair Kawafuchi said the current growth forecast was 2.7%. Ms. Maynard said that seemed low given all the positives that we're seeing. Dr. Suyderhoud said that was in part because the refund story. Chair Kawafuchi said the net effect of the refunds was about a percentage point, or $50 million, which raised the growth forecast to about 3.7%, but he didn't see how we go from 3.7% to the numbers the models were generating. Dr. Suyderhoud said the average of the three models was 7.3% for the Council as a whole. Dr. Bonham said they had lowered the fiscal 2016 growth forecast to 2.7%, because of the refund issue and that without that issue the forecast was 5.5%, which he suggested was a starting point for discussion. Chair Kawafuchi asked if the refund adjustment happened at the March meeting or the May meeting. Dr. Bonham said it was the May meeting. He said the members raised the 2015 number because of the refunds, but also there was some economic growth. Ms. Maynard said the tourism growth was non-existent in the first quarter, but it really picked up from there. Ms. Cambra asked if Dr. Bonham had suggested a forecast. Dr. Bonham said 5.5% growth was an interesting place to start, but that he liked the model results from his forecast, which called for growth of 6.6%. Dr. Suyderhoud said his forecast was 6.0%.

Dr. Suyderhoud asked if anyone was in favor of keeping the old growth forecast of 2.7%. Chair Kawafuchi said it seems like an adjustment for the refunds was needed. He said he could not reconcile the growing economy with the drop in refunds from the previous year. Dr. Suyderhoud suggested that when people have more income, they have fewer refunds. Dr. Bonham said he thought it was because people took stock market profits, because they felt the market was overvalued. Ms. Niwao agreed.

Dr. Bonham moved to have a growth forecast of 6.5% for this fiscal year, and 6% for the next fiscal year. Dr. Grandy suggested doing one year at a time. Chair Kawafuchi agreed. Ms. Niwao noted that the growth rate was on a higher base from last year. Dr. Bonham said growth last year was 6.8% and that the forecast was 7.5%. Chair Kawafuchi asked how the members got to 6.5% from the old forecast of 2.7%. Dr. Bonham said that forecast was based on the assumption that we would still be catching up on refunds, but that the model was giving a number like 6%. Dr. Suyderhoud said we have a percentage point alone from the refund change. Dr. Rousslang said the way the model works is that a strong base provides a larger number for the next year, given the same growth rate projection. Dr. Grandy said he was not worried about being tied to the past forecast, because it was influenced by some odd factors. He said he would ignore the old forecast and look at the underlying economic factors, which suggested a range of 5.5% to 6%. Chair Kawafuchi asked where the market was in March, whether it was close to 18,000. Ms. Maynard said yes. Chair Kawafuchi asked if the oil price was higher at that time. He said those were two factors that go into the general fund base. Dr. Bonham questioned the statement. Chair Kawafuchi said oil prices, because we have gross receipts tax, but that it was a mixed bag, because the lower oil prices also put more money in people's pockets. He said he thought there was more uncertainty than when the members had forecast growth of 5.5%. Dr. Grandy said the economy was stronger. Dr. Suyderhoud said GET growth is 2.7%. Dr. Bonham agreed that international factors introduced uncertainty, but he did not agree that the stock market would have a large effect on growth. Chair Kawafuchi asked if inflation was weaker than expected. Dr. Bonham said it has been weaker than expected for the last three years. Ms.

Niwao asked how our growth rate could exceed the growth of GDP in China or India. Dr. Bonham asked if the question was how our revenue growth could exceed economic growth in China. Ms. Niwao said the projected growth for Hawaii looked very high. Dr. Bonham said 5.5% nominal growth is the long run forecast. Ms. Niwao said the amounts of the mean forecast were higher. Dr. Suyderhoud said the average growth was 7.3%, and that would have been 6.3% without the 1 point bump.

Dr. Rousslang said there were also increased general fund allocations from the conveyance tax of $20 million. Dr. Suyderhoud said that was 0.5% or less and the average of the 3 models showed growth of 7.3%, 5.9%, 6.2%, 5.5%, 5.6%, 4.8%, and 4.9% for the various members. Ms. Niwao said 7.3% seemed too high. Dr. Bonham said there was a motion on the table that was never seconded. Dr. Suyderhoud said he would second it, just for the sake of keeping it on the table. Ms. Maynard asked if people feel more comfortable with a number closer to 5.5. Ms. Cambra said that was 2 points below the model. Ms. Maynard said the number seemed out of line with economic growth for Hawaii. Dr. Grandy said it was nominal growth for general fund revenue. Ms. Niwao said as people start retiring, their pension income would not be taxable. Dr. Bonham said the forecast was for the next fiscal year. He said there was a motion on the table for growth of 6.5% that he believed was seconded. Ms. Niwao said she thought the number was too high. She said growth in collections was only 4% for the first month and growth of GET collections was not strong. Dr. Grandy said that for the year ending in July, we were growing at 6% or 7%. Dr. Suyderhoud said he came in at 6.8% last year. Dr. Grandy said he thought 6.5% was a little high and that he would be more comfortable with 6%. Dr. Bonham said the average general fund revenue growth from 1980 to 2014 is above 5.4%. Ms. Niwao said 5.5% sounded good to her. Dr. Suyderhoud said he thought this fiscal year would be better than average. Dr. Bonham agreed. Dr. Suyderhoud said there were other positive factors, including effect of the new conveyance tax allocations and the cessation of hurricane relief fund allocations and from the OTC settlement. Ms. Niwao asked how much of the travel money came in from the prior years and what the receivables are for the State. Dr. Rousslang said $39 million was expected from the OTC settlement for 2000 through 2011.

Ms. Cambra asked what was included in the average figure of 5.4% growth. Dr. Bonham said it was average general fund revenue growth since about 1980. Ms. Niwao said the July GET showed negative growth of 2.7%. Dr. Bonham said one month growth figures are volatile. Ms. Niwao said she was more uncomfortable about new market conditions owing to what's happened in China and with oil prices. Dr. Bonham withdrew his motion of 6.5% growth and replaced it with a 6%. Dr. Grandy seconded the motion. Dr. Suyderhoud said he first had to withdraw his second to the original motion. Chair Kawafuchi asked if the historic average was 5.5%. Dr. Bonham said from 1981 to 2014, the average was 5.33%, the high was 16.43% in 1987 and the low was minus 12% in 2009. Dr. Bonham said the period included the whole decade of the 90's when there was almost no growth in the Hawaii economy. Ms. Niwao said that from her practice she knew people were adversely affected by the drop in stock prices.

Ms. Cambra said there was a motion and a second for 6% growth for FY 2016. Chair Kawafuchi asked who seconded. Dr. Grandy said he did. Ms. Niwao asked how much would be added by the special adjustments for tax law changes and the online travel company settlements. Dr. Rousslang said $39 million was expected from the settlement for 2000 through 2011 and an additional $10 million to $15 million annually going forward. Dr. Bonham asked for an explanation and whether the settlement was appealed. Dr. Rousslang said the $39 million was from a final settlement, after refunds of amounts overpaid. Dr. Suyderhoud asked who got refunds from the fund. Chair Kawafuchi said the OTC got most of the money back, but the remaining (after attorney's fees), from the cases would be about $39 million that would be transferred to the general fund. Chair Kawafuchi said plus on a going forward basis, you're expecting to pick up about $10 million. Dr. Rousslang said yes, $10 million to $15 million. Chair Kawafuchi said that number seems high from what the defense attorneys said in a presentation, and that he thought the numbers were much smaller. Ms. Maynard said she would be comfortable with a growth forecast of 6%. Ms. Niwao agreed. Dr. Suyderhoud asked if a vote could be taken. Dr. Bonham asked if the $39 million was certain for this fiscal year and was not under appeal. Dr. Rousslang said he thought the settlement was final. Ms. Niwao asked if the settlement would amount to 1% of general fund revenues. Chair Kawafuchi said it was about two-thirds of 1%, but there would be a revenue stream going forward of about a tenth of a percent. He said that would get you from 5.3% (the historic average) to about 6%. Dr. Suyderhoud asked if the members could vote on the forecast of 6%. Chair Kawafuchi said yes. He asked if there was further discussion. He asked if the vote was unanimous. Dr. Suyderhoud said no and Dr. Bonham said it was too low. Ms. Niwao asked Dr. Bonham if he had made the motion for 6% and now was not going to vote for it. Dr. Bonham said with a historical average of close to 5.5% and 1% from the Hurricane Relief Fund, another $20 million from conveyance tax, another $40 million from the settlement of past OTC payments and probably another $10 or $15 million going forward, he thought 6% was too low. He said we might also get some revenues from the construction tax base increase. He thought growth would be at least 6.5%. Chair Kawafuchi asked if the vote was 6 ayes and 1 abstain. Dr. Bonham said the forecast should be at least a 6.5%. Chair Kawafuchi said next is the vote on the subsequent years.

Dr. Bonham made a motion that the general fund tax revenues growth rate be at 6.0% for FY 2016 (below-the-line). Dr. Grandy 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	**Abstain**
Christopher Grandy	**Yes**
Elizabeth P. Cambra	**Yes**
Kristi L. Maynard	**Yes**

GENERAL FUND REVENUE FORECAST FOR FISCAL YEARS 2017 THROUGH 2022:

Dr. Suyderhoud asked for the average of the models. Dr. Grandy moved for a growth forecast for the out years of 5.5%. Dr. Bonham and Ms. Maynard seconded the motion. Chair Kawafuchi asked for further discussion. Ms. Niwao said she thought growth in the out years would depend on what happened in the stock market. Dr. Suyderhoud asked if she had an opinion on what would happen with the stock market. Ms. Niwao said no. Dr. Suyderhoud said 5.5% is a long-term average. Dr. Bonham noted there was substantial uncertainty in the historic period, including Hurricane Iniki, the Gulf War, the oil embargoes, base closures in the 90's. Chair Kawafuchi asked whether the construction cycle would be strong beyond the next couple of years. Dr. Bonham said the consensus seemed to be the cycle has several more years to go, but a lot would depend on what the Supreme Court decides about Ho'opili and Koa Ridge, because things would start to slow down in Kaka'ako. Chair Kawafuchi asked about rising interest rates. Dr. Bonham said if interest rates rise as much as he thought they would, they would be about where they were at the beginning of last year. He said interest rates matter, but that we were so under-housed and had so much need for infrastructure and for hotels to house the tourists that there was good reason to expect construction to keep going for several more years. Chair Kawafuchi asked about the economic cycle. Dr. Bonham said we would have a recession. He said in his forecast, it would come at the end of 2021/2022, at least according to his model. Ms. Niwao asked about the Maunakea Observatory being built, for about $1 billion. Dr. Bonham said a lot of the cost was for materials. Dr. Bonham said the Big Island had second quarter permits of $150 million, he thought for luxury housing. Dr. Suyderhoud said most of it was in Kona. Dr. Bonham said Maui had some really big permit numbers for affordable housing, so the construction cycle seems to be becoming more widespread. Chair Kawafuchi asked if they increase the current year base to 6%, whether they would grow another 5.5% on top of that in the next year. Dr. Suyderhoud said he thought 5.5% would be low for the following years.

Dr. Suyderhoud said 5.5% growth was the forecast on the floor. Chair Kawafuchi said that was quite an increase, a billion dollars over the current year and the next six years. He said that was a big number. Dr. Suyderhoud said that is what happens when you have growth. Ms. Maynard asked Chair Kawafuchi if he thought the forecast for the out years was too high. Chair Kawafuchi said yes. Dr. Bonham said he could agree to adopt a lower growth rate in the out years. Ms. Maynard asked if 5.5% for 2017 and then 5% on the out years was better. Ms. Cambra said the 20-year average was 5.4%. Ms. Maynard said that Dr. Bonham was forecasting a recession. Dr. Bonham said that was from their model. Ms. Maynard said it was bound to happen sometime. Dr. Bonham agreed. Dr. Suyderhoud said yes, and that as a result, some of the growth numbers would be lower than 5% or 5.5% (and might even be negative) and some would be higher. Dr. Bonham said one reason for adopting a number lower than the long run average is that the long run average included very high growth periods, including the period in the 80s when we were building out all the hotels on the neighbor islands, which we were not likely to repeat. He said federal activity in the islands might also decline. He said job growth and population forecasts for the next 10 years wouldn't be as high as in the 80's. Dr. Grandy asked to withdraw his motion and replace it with a motion that says, 2017/2018, 5.5% growth, 2019, 5% growth, and 4.5% growth in the remaining years (2020 to 2022). Ms. Maynard seconded the motion. Ms. Niwao asked why the forecast for the last two years (2021/2022) was 4.5% the average of the Councils' forecasts in the model was for growth of 2.6% and 2.2%. The members discussed and found that Ms. Niwao had been looking at Dr. Bonham's forecast, which was the lowest of the forecasts for those years, rather than at the Council mean. The mean from all three models is 4.8% and 4.9%.

Ms. Niwao asked if it was possible to model the demographic change coming with retirement of the baby boomers in the next 5 to 10 years, to know how much of their income is not going to be taxed by Hawaii. Dr. Suyderhoud asked to share a story. He said his mother is 87 years old and she's in the retirement home in Nu'uanu paying $9,000.00/month which is more than her income, so she was drawing down on her investments, and that she paid excise tax on the full bill. He said she was paying more excise tax now than ever in the past. Dr. Suyderhoud said the State may start to tax retirement income. Ms. Niwao said maybe a below-the-line adjustment could be used to include the effect of the baby boomers retiring. Ms. Maynard said it was an interesting question. Dr. Grandy said the issue could be mentioned in the cover letter that talks about factors the members considered.

Dr. Grandy said as the retirements start to happen, their effect would start to show up in the data. Chair Kawafuchi said the members had a motion and a second and asked if they wanted to take a vote.

Dr. Grandy made a motion that the general fund revenue forecast for the remaining fiscal years be: 5.50% (2017); 5.50% (2018); 5.0% (2019); 4.50% (2020); 4.50% (2021); 4.50% (2022). Ms. Maynard 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	**Yes**
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:

Mr. Chun provided the Council with B&Fs report of revised projections of general fund non-tax revenues and non-general fund tax and non-tax revenues since the May 2015 meeting. He said that although the report includes a brief summary of significant changes, there are several significant changes that he would like to highlight:

General Fund Non-Tax Revenues

Charges for Current Services – net increase in FYs 15-22 includes an increase for reimbursement of health fund premiums from non-general fund programs to reflect actual revenues and to update the estimates (B&F). $21M +

Non-Revenue Receipts – the changes in FYs 15-22 is partially attributed to the change of the distribution of tobacco settlement monies (from 25.5% to 46.5%, pursuant to Act 118, SLH 2015) that are transferred to the general fund (Department of Health (DOH)). Tobacco Settlement – FY16 $12M, FYs17-22 $21M

Special Tax Revenues

Cigarette Stamp Tax – the increases in FYs 15-22 reflect the revenues transferred to the Hawaii Cancer Research Special Fund (University of Hawaii (UH)). FY15-22 $14.8M

Unemployment Compensation Tax – decrease in FY 15 reflects actual revenues which were less than originally anticipated due to a higher Unemployment Insurance Trust Fund balance resulting in a lower unemployment insurance rate (Department of Labor and Industrial Relations (DLIR)). FY15 $15.5M

Dr. Suyderhoud moved to accept the B&F report as submitted and Ms. Niwao 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	**Yes**
Elizabeth P. Cambra	**Yes**
Kristi L. Maynard	**Yes**

NEXT MEETING:

The Council tentatively agreed to meet on Monday, November 2, 2015 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 3:43 p.m.