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September 14, 2012

FINANCE MEMORANDUM MEMO NO. 12-12

TO: All Department Heads

FROM: Kalbert K. Young
Director of Finance

SUBJECT: Fiscal Biennium 2013-15 Executive Budget Request and the Program and Financial Plan for the Period 2013-19

The following policies and guidelines shall be used in preparing the Executive Budget Request for FB 2013-15 and the Program and Financial Plan (PFP) for the period 2013-19.

General Background

It is a long road back from the recession which began in late 2007. Though the recession ended in mid-2009, general fund tax revenue collections finally surpassed the level reached in FY 08 this past fiscal year (FY 12).

Much of the strength of the State's recovery has come as a result of the Administration's commitment to tackle the potential $1.3 billion budget shortfall for FB 2011-13. Each day, we made prudent decisions and were able to end FY 12 with a $275 million general fund balance.

The State also received a welcome boost from the tourism and hospitality industry, which is on pace to have a record year. 1,800 more visitors visited Hawaii each day through July 2012 as compared to the same period last year and spent an additional $17 per person daily. Visitor spending through the first seven months of the year has helped to generate an estimated $915 million in general fund tax revenues and will help to sustain over 160,000 jobs this year.

Much of this strong expansionary phase of the visitor and hospitality industry has been focused on Oahu. In July, however, growth was spread across all major islands, which is necessary for continued growth as Oahu reaches its saturation point.

The remarkable growth of the visitor and hospitality industry, a major economic driver of the local economy, has had positive statewide impact, yet, other sectors of the economy are taking longer to recover. Gains from the visitor and hospitality industry have been offset by job losses in the government sector and the slower than expected recovery of the construction industry. However, current conditions may be favorable for the construction industry to end its downward cycle.

Hawaii's seasonally adjusted unemployment rate of 6.4% for July 2012 reflects a gradual but inconsistent decrease from 6.8% in July 2011. For many years prior to 2009, however, Hawaii's annual average unemployment rate had remained below 5%. Similarly, the nation's seasonally adjusted unemployment rate reflects uneven improvement, although the rate has decreased from 9.1% in July 2011 to 8.3% in July 2012. Before 2009, the nation's seasonally adjusted annual average unemployment rate had not exceeded 8.3% for over 25 years and had ranged from 4.0% to 6.0% since 1995.

The State's economy continues to feel the impact of the sluggish national economic improvement and uncertainties regarding the looming issues of deficit reduction and cutbacks to federal programs in our nation's capital. On a broader scale, the U.S. and State economic recoveries are vulnerable to the potential fallout from the economic volatility in Europe and continued unrest in the Middle East.

The State's Fiscal Condition

Actual general fund tax revenues for FY 12 grew by 15%, 3% more than the 12% general fund tax revenue growth rate projected by the Council on Revenues (COR). In its September 10, 2012 report, the COR reduced its general fund tax revenue projections from 5.3% to 4.9% for FY 13, 4.0% to 3.9% for FY 14, 6.2% to 5.0% for FY 15, 4.0% to 1.2% for FY 16, and 5.0% to 4.2% for FY 17. The COR also increased its FY 18 projection from 5.0% to 5.1%. While these changes, resulting primarily from the sunset of several tax law changes and the impact of the renewable energy tax credit, through FY 15 are expected to result in a $127 million decrease in general fund tax revenues, we must also be cognizant of the longer term impact as we anticipate a $1 billion decrease in general fund tax revenues through FY 18.

The State must also be prepared to handle the impact of federal sequestration - the "fiscal cliff," as it has been called. These potentially significant cuts to federal programs may impact many core State services provided for defense, education and social services. Although the details regarding this proposed contraction in federal spending have not yet been finalized by Congress, we must nevertheless be prepared for reduced levels of federal support.

We also have a continuing commitment to recapitalize our reserve funds and address our unfunded liabilities in the Employees' Retirement System and Employer-Union Health Benefits Trust Fund. These are significant demands on our already limited resources.

Budget Focus for FB 2013-15

The State is in a much better position today than a year ago. However, in developing the Executive Biennium Budget for FB 2013-15, we must bear in mind the numerous uncertainties and demands on our resources as we view the State's economic recovery and sustainability with cautious optimism. We must continue to move forward with a fiscally balanced approach, clear in our goals and intentions.

A New Day in Hawaii

There is still much to be done to bring a New Day in Hawaii and our work to maintain and improve the State's economic situation and well-being demands our utmost attention. The FB 2013-15 Executive Budget should reflect the Administration's commitment and focus to:

- Provide immediate job growth as we shift Hawaii's economy to a sustainable foundation.

  We must work with determination to accelerate economic recovery in all sectors of the State's economy. Our continuing efforts to expedite New Day Work Projects must continue, as the energy and expenditures generated by moving our CIP quickly and purposefully will support our infrastructure needs while producing job growth and stimulating Hawaii's economy.

- Invest in the education, skills and well-being of Hawaii's people.

  Hawaii's most valuable asset, its people, must be provided the opportunity to reach and live their lives to their fullest potential. Early childhood education is a vital stepping stone for our keiki and we are committed to ensure that resources for public schools are used appropriately to best serve all students.

- Transform State government into an efficient and effective enterprise.

  State government must be able to service its customer, the public, in the most proficient manner. Our ongoing task is to makeover State government operations to best manage our resources. Technology improvements that will take place through the proposed Enterprise Resource Planning program will greatly assist in this endeavor.

Elimination of Negative Budget Adjustments

We must also address the requirements of Section 133.4 of Act 164, SLH 2011, as amended by Act 106, SLH 2012, which provides that:

> ". . . to the extent practicable, the Director of Finance shall require that, except for labor savings adjustments assumed for collective bargaining savings, the personal services budget journal details developed for fiscal year 2012-2013 appropriations and developed for the fiscal biennium 2013-2015 not contain any

negative amounts; provided further that the negative personal services amounts shall be allocated to positive personal services amounts; provided further that the budget journal details shall reflect planned expenditures for fiscal year 2012-2013 and fiscal biennium 2013-2015, as applicable."

As applicable, tradeoff and transfer adjustment requests necessary to correct remaining negative amounts and to fund unfunded positions or base adjustment requests to delete unfunded positions shall be submitted, as allowable by these budget policies.

Federal Fund Budgeting

To more clearly enable the State to meet federal fund reporting requirements, changes must be made to the budgeting of federal funds. Formula grants and competitive grants shall be budgeted separately under different means of financing. Federal fund ceilings shall be adjusted, if necessary, to more accurately reflect anticipated federal award amounts.

The following general policies are hereby provided for the development of the Executive Budget Request for FB 2013-15.

I. General Policies

1. For operations, the Biennium Budget will be based on FY 13 appropriations from Act 164, SLH 2011, as amended by Act 106, SLH 2012, minus necessary adjustments, and plus restoration of labor savings amounts, specific recurring costs and collective bargaining for Unit 7 (University of Hawaii Professional Assembly), as applicable. Individual departmental budget ceilings are established for all departments by the Department of Budget and Finance (B&F). Under their respective budget ceilings, departments are authorized and encouraged to recommend trade-offs and transfers within and among programs under their purview to reflect the department's current priorities and changing conditions.

2. Departments should continue their efforts to maximize efforts to use non-general funds, as appropriate, to support their programs. Federal funds, special funds, and other available funding sources should be considered as a replacement for general funds. Departments should not, however, assume that State funds will be available to support program costs if federal funds are no longer available.

3. Except as otherwise provided by law, special or other funds authorized to receive general revenue receipts, or general fund appropriations, should consider the feasibility of discontinuing such general fund support. As necessary, draft legislative proposals should be prepared to discontinue such general fund support.

4. Pursuant to Section 37-68(1), HRS, any proposal for new programs, regardless of funding sources, must demonstrate that such programs are appropriate functions of State government and can be implemented by government as cost-effectively as by the private sector.

5. Departments should be prepared to initiate necessary enabling legislation, or appropriate rule changes, to coincide with budget requests, as applicable. However, bear in mind that only legislative proposals that have been coordinated with the Governor's Policy Office should be proposed at this time. The B&F analyst assigned to your department should be informed of the applicable proposals as part of the budget review. (Form A, *Request for Operating Budget Adjustment*, should be used to provide the necessary information to justify the request.)

II. Submission Requirements and Format

1. Biennium Budget requests shall be submitted according to the requirements and formats as specified in the attachments.

2. All budget submissions will be subject to review and evaluation by B&F and the Governor. Worksheets and other supporting details may be requested and should be made available upon request.

III. Due Dates

The following must be provided to this office:

1. By Friday, October 12, 2012, the following must be submitted, reflecting your budget submission:

   - Two copies of Forms A, A-Attachment, B, C, and FF (relating to the operating budget); and Tables P, Q, and R, and Forms S, FF and PAB (relating to CIP budget).

   - Electronic files of Forms B, C, FF and S should be transmitted to your B&F analyst.

2. By Friday, December 7, 2012, the following must be submitted, reflecting the Governor's budget decisions:

   - Updated BJ Summary Tables in eBUDDI or, for departments with their own budget systems, other electronic files.

   - Two copies of each Budget Narrative, with electronic file(s) transmitted to your B&F analyst.

   - Updated Performance Measures in eANALYT.

- Two copies of Tables P, Q, and R (as updated in eCIP) and Form PAB.

3. By Thursday, January 3, 2013, updated BJ Details in eBUDDI or, for departments with their own systems, other electronic files.

Departments will be notified later of the timetable for B&F recommendations and Governor's decisions on the Biennium Budget.

Attachments

Attachment 1: Current Services Operating Budget Ceilings

Attachment 2: General Budget Guidelines for Operating and CIP

Attachment 3: Additional Operating Budget Detail Guidelines

Attachment 4: Operating Budget Submission (Forms A, A-Attachment, B, C, FF)

Attachment 5: CIP Submission (Tables P, Q, R; Forms FF, S, PAB)

Attachment 6: Instructions for Preparing Program and Financial Plans and Program Budget Requests (September 2012)