DEPARTMENT OF BUDGET AND FISCAL SERVICES
CITY AND COUNTY OF HONOLULU
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MARY PATRICIA WATERHOUSE
DIRECTOR

CITY COUNCIL
HONOLULU, HAWAII

MARK K. OTO
DEPUTY DIRECTOR

April 15, 2008

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CITY CLERK
HONOLULU, HAWAII

The Honorable Todd K. Apo, Chair
and Members of the Budget Committee
Honolulu City Council
530 South King Street, Room 202
Honolulu, Hawaii 96813

Dear Chair Apo and Councilmembers:

We would like to address some of the major changes introduced in Bill 18 (2008), CD1. Some of the proposals will create severe challenges for departments in terms of staffing and operations as well as the City's ability to fulfill its obligation to its current employees and retirees to have their health benefits guaranteed and not subject to the uncertainty of future budgets.

We are very concerned with the unspecified proposal to lower the improved residential tax rate. Real property values have already begun to pull back in some Oahu neighborhoods. Current market sales data shows that the City will encounter flattened revenue growth or a decline in revenue. If the economy continues on its slide, it will be extremely difficult to increase property tax rates, regardless of the need for revenue. The reality is that during a time of economic slowdown, the ability to increase tax rates, regardless of what happens to the tax base, is difficult and severely diminished. We do not view carryover balances to be negative or lost opportunities. It is a very realistic way of ensuring that financial resources will be available, especially when it is clear that financial challenges lay ahead.

The second major area of concern is with the proposed reduction of funding for Other Post-Employment Employment Benefits (OPEB). The discount rate applied to the City to calculate the Annual Required Contribution (ARC) will be adversely affected due to the City's intent to not fully fund the ARC. Applying the 8% discount rate to the City's calculation is dependent upon the City demonstrating that funds are either being set aside for or paid to the EUTF. Without full funding of the ARC, a lower discount rate will be applied by the actuaries, and in turn, will result in a higher ARC, thereby increasing the liability on the City's books. Eventually, the liability will be viewed negatively by bond rating agencies.

The OPEB budget that was proposed in the Mayor's FY 2009 budget was allocated by fund and is determined by the current payroll allocation between funds (general, sewer, golf, etc.). All cuts proposed by the City Council to OPEB involve General Funds only. Reductions to only General Funds will create an imbalance where the special funds will be subsidizing the General Fund for OPEB costs. This imbalance could create audit issues if special funds, such as the Sewer Fund, are overpaying its share of OPEB relative to the payroll allocation.

Hawaii County intends to fully fund their OPEB obligation and both Maui and Kauai counties should be close to funding their full amount. For Honolulu, due to the reduction in the

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amount set aside for the OPEB Fund in the FY2008 budget, Honolulu is under-funded by $13 million in FY 2008 and, as a result of the latest actuarial projection, is short $2.2 million for FY 2009.

The reductions to the Fiscal Stability Reserve appear to contradict the rationale for additional effort to reduce the City's carryover balance. Parallel effort is being made to both reduce the amount contributed to the Fiscal Stability Reserve and reduce the level of carryover balance in the budget. The lack of a growing Fiscal Stability Reserve or having a lower carryover balance will be detrimental to the City's financial position. These two parallel actions, combined with the intent to not fully fund our OPEB obligations, will put the City in a far less desirable financial position when it comes time for bond rating agencies to review the City's financial position.

Taking into account the current municipal bond market condition and economic forecasts, we are already anticipating higher interest rates in future bond issues. Without the benefits of having a strong Fiscal Stability Reserve and healthy carryover balance, we will be in a weaker financial position compared to other jurisdictions and their respective bond issuances. These cuts will have long-term implications on our debt service payments.

We believe that some of these proposals in Bill 18, CD1 are drastic and do not help in our efforts to create more efficient government. We are willing to work with the City Council on your greatest concerns and would like to find solutions that will enable our City to provide the services that the public demands, while being financially responsible.

Sincerely,

Mary Patricia Waterhouse, Director
Department of Budget and Fiscal Services

APPROVED:

Wayne M. Hashiro, P.E.
Managing Director