

TERM REPORT

Financial Security

Office of the Governor
State of Hawai'i



Financial Security

Overview

Governor Ige took office in December 2014, assuming responsibility for state finances marked by a dwindling general fund balance that was largely committed for future non-discretionary programs. The state was spending about \$200 million more per year than the revenue generated. Worse, it was projected to do so for years. In fact, the state's general fund cash balance was projected to be spent all the way down to just \$35 million while supporting annual expenditures of well over \$6 billion at the time, and the state did not even have \$100 million put away in its rainy-day fund.

Additionally, the state's efforts to address its unfunded retirement and health benefit liabilities, the later also known as other post-employment benefit (OPEB) liabilities, were simply not adequate. This placed the burden of paying for benefits – estimated to cost tens of billions of dollars owed to prior and current generations of state workers – on our children and future generations.

And, as another indication of a broken system, Annual Comprehensive Financial Reports – widely used by the Legislature, investors, and credit rating agencies to inform decisions – were repeatedly completed late.

On top of this, the state's tax system was inefficient. Fifty-five percent of the tax returns were filed by paper, and tax deposits took an average of 45 days to clear.

Governor Ige committed to building a strong financial foundation for today and for the future. The fiscal policies his administration developed and implemented put the state on track to achieve its current, exceedingly strong, financial condition. And these efforts sufficiently strengthened the state's financial footing to enable it to weather the initial impacts of the COVID-19 pandemic. Despite the aftermath of a crippling pandemic – and in part, because of the federal funding received to mitigate its impacts, the State of Hawai'i has emerged in the strongest financial position it has ever held as measured by several metrics.

The administration's efforts to improve the state's condition first centered on the development of strong and effective financial policies. Debt and reserve studies were commissioned to inform the development and implementation of related policies. Governor Ige also made it clear that he would honor the state's retirement obligations for its public servants and ensure that the unfunded pension liability is paid down and not simply pass on to future generations. Gov. Ige recommended, and the Legislature enacted, laws to improve funding of the retirement system. He increased annual funding of the pension system so that unfunded liabilities, currently standing at \$14 billion and previously not on track to be addressed, are now expected to fully paid down by 2044. Much like a mortgage, paying more up front will result in significant savings in the future.

Gov. Ige's efforts to address the unfunded other post-employment benefits (OPEB) liability which consist of costs for health benefits owed to employees and retirees began while he was a state senator. During his last year in the Legislature, he authored and achieved passage of a law that requires the state and the counties to put money aside every year to pay for health benefits promised to its workers and retirees, rather than pass that bill on to our children as well. Further, that law requires that the massive unfunded liability that had accumulated after decades of using a pay-as-you-go funding scheme be amortized over a 30-year period and paid.

Now, in the span of eight years, we've taken that pay-as-you-go system that had no money set aside and simply passed massive bills on to future generations, to being funded to the tune of about \$3.5 billion, or about 30% of the OPEB liability. While an unfunded OPEB liability of about \$8.1 billion remains, what we have already saved to pay these debts is momentous, and the administration's funding plan puts us on track to also eliminate the OPEB unfunded liability in 2044.

The administration also moved to strengthen budget reserves by depositing additional funds into the Emergency and Budget Reserve Fund to ensure the state's fiscal stability in the event of future economic downturns. We've now built the state's rainy day fund to \$831 million, achieved in part by transferring \$500 million from the general fund balance, another historic high. Additionally, the State anticipates making another deposit of approximately \$130 million to the EBRF tentatively scheduled for 2Q FY 2023.

The state ended fiscal year 2022 with a historically high general fund balance of \$2.6 billion.

For more efficiency, security, and compliance in the collection of revenue, Governor Ige championed the tax system modernization program, which was completed during his administration. This technical investment improved the state's ability to fairly, consistently, and efficiently administer Hawaii's tax laws to provide the funds needed for state services.

Governor Ige also pledged to make better use of federal funds, and the departments rose to the challenge. In the first year of the administration, the Department of Transportation's Highways Division reduced the Federal Highway Administration unexpended federal obligation balance ("pipeline") by \$101 million. After the first two years, the pipeline was the lowest it had been in 16 years. As a result, the state got tens of millions more in funding from the federal government for highways projects.

Federal funds, and the state reserves built up by the administration, played a critical role in the state's financial recovery during and following the worst of the COVID-19 pandemic. Billions of federal dollars allowed the state to help those hit hardest by the pandemic, with unemployment, Medicaid, SNAP, childcare and other essential services. Federal funding, along with the measures Gov. Ige took during the pandemic to protect the health of Hawaii's people, helped to accelerate the economic recovery.

The actions Governor Ige took to strengthen the state's financial position resulted in credit rating improvements issued by the credit rating agencies. There may be no more credible and revealing assessment of the state's financial actions and condition than that provided by independent credit rating agencies.

The administration's actions have helped earn the highest collective general obligation bond ratings in the state's history. We've also completed the largest bond issue and achieved the lowest interest costs on general obligation bonds in the state's history.

Higher bond ratings and strong investor demand for the bonds help the state achieve lower borrowing costs. This frees up funds that can be used for high-priority programs and capital projects that have a broad and positive economic impact on our communities while supporting jobs – particularly in the construction industry. The improved ratings and positive assessments also validate the administration’s stewardship of the state’s finances.

During the Ige Administration, the state has paid down its debts, earned improved bond ratings, invested prudently, and increased government efficiency to ensure financial stability and enable future growth. And the annual comprehensive financial reports are now filed on time, and why not? We all have a lot to be proud of.

Governor Ige's Mission

Build a strong financial foundation for Hawaii's kūpuna, ourselves and our children.

Commitments

During his first address to the Hawai'i state Legislature, Gov. Ige committed to building a strong financial foundation by taking these actions:

- Eliminate unfunded liabilities (pension and health benefits)
- Balance state income/expenses
- Ensure sound and long-term financing
- Focus available resources on strategic investments that grow our economy
- Use state funds more efficiently and leverage them whenever possible
- Aggressively seek federal funds for a wide array of projects/services
- Do a better job of collecting taxes already on the books

Governor David Ige, State of the State 2015

Progress and Milestones

2015

Improved government efficiency pays off

The administration has improved efficiency, reduced waste, and is making better use of public funds:

- Overtime was reduced by 16 percent in the Department of Public Safety, saving the state \$1.4 million.
- Received \$660,422 from the federal government to acknowledge that Hawaii's Supplemental Nutrition Assistance Program (SNAP) program has dramatically improved the timeliness of its application processing.
- Freed up \$100 million to work on improving our highways, adding lanes, and making other improvements so we spend less time in traffic.
- The federal Environmental Protection Agency has determined that our state Department of Health is now in compliance in spending down the Drinking Water Fund. As a result, the remaining balance totaling \$8 million for Fiscal Year 2015 is being released for use locally.

Because of these initiatives, the administration was able to balance the state budget by June, even though the state was projected to close the fiscal year in the red.

Tax system transformation on track to reduce return delays and save state money

In December 2015, the Department of Taxation successfully implemented the first of five rollouts planned for the Tax System Modernization Program. The first rollout went into operation ahead of schedule and within budget. Three IT systems that were old, unreliable, and costly to maintain were replaced with modern scanning and mail-opening equipment that will reduce tax-return processing delays caused by aging machines. The new equipment also supports processing automation features that will lead to greater efficiency in future phases of the department's modernization effort.

Addressed a major unfunded liability for state health benefits***Implemented payments for annual required contributions required under Act 268, SLH 2013 (Act 268) that are expected to eliminate the state Other Post-Employment Benefits (OPEB) unfunded liability***

Fiscal year 2015 marked the first year that a statutorily required annual required contribution (ARC) was required to be paid by the state and counties under Act 268 for OPEB costs consisting of health benefits owed to retirees; terminated, vested employees; and current employees. Act 268 requires that beginning in Fiscal Year 2015, the state began making ARC payments under Act 268. The ARC includes 1) the amount needed to pay the normal cost (the current employees' fiscal year expense related to their future retiree health benefits) and 2) an amortization payment intended to eliminate the OPEB unfunded liability over the next 30 years.

Act 268 allowed for the phasing in of the full payment of the ARC, starting with a required payment of 20% of the ARC for Fiscal Year 2015 and an additional 20% each year until the full ARC was required to be paid for Fiscal Year 2019 and beyond. The state achieved full payment of the ARC by Fiscal Year 2019 and has also made additional payments beyond the statutory funding requirements that further reduce the state's unfunded OPEB liability and the burden on future taxpayers.

In the past, the state funded its OPEB costs on a "pay as you go" basis. This meant that the state paid only the current year's health benefit obligations (i.e. premiums) for its retirees. By pre-funding OPEB costs, the state will save billions of dollars to the benefit of future generations of Hawai'i residents and taxpayers. The state's unfunded OPEB liability stood at \$13.6 billion as of July 1, 2011, prior to the pre-funding commitment under Act 268. As of July 1, 2021, that unfunded OPEB liability had been reduced to \$8.1 billion and the funded ratio (i.e. actuarial value of assets divided by the actuarial accrued liability) was 30 percent and the unfunded OPEB liability was expected to be eliminated in 2044. At that time payments to fund state OPEB costs will drop from what is projected to be over \$1.7 billion per year in 2044 to \$678.6 million. Further, OPEB costs borne by the state and its residents are expected to be less than half they would be if the state had continued to just fund the "pay as-you-go" premiums", saving several hundreds of millions of dollars each year in perpetuity.

Then state senator David Ige was the architect and chief proponent of Act 268 which he drafted and steered through the legislative process as chair of the senate's Ways and Means committee in 2013. Act 268 was groundbreaking legislation and to this day has no peer. The State of Hawai'i now has one of the strongest OPEB funding policies in the nation. Addressing the state's unfunded liabilities and implementation of Act 268 has been central to efforts to reduce financial burden on future generations and to ensure that the state's health benefits system is solvent so that its health benefits obligations are met, and the state is financially sound and has capacity to address other important priorities.

Ensured that the issuance of state debt is governed by a formal debt management policy and informed by studies on appropriate state debt levels

Enacted Act 149, SLH 2015 directing the Director of Finance to develop a state debt management policy and biennial debt affordability studies

To promote both transparency in budget-making and more informed decisions on capital improvement program projects and debt issuance authorizations, Governor Ige signed into law a requirement that a debt management policy be developed and that a debt affordability study be conducted every two years. The purpose of the policy is to ensure that all debt issuances undertaken by the Hawai'i are completed in an efficient manner and in accordance with best practices. The study focuses on financing programs to review outstanding debt, legal limitations, callable bonds, project and analyze multi-year capital plans, and measure affordability based on pertinent metrics and credit and peer considerations.

The state achieves a positive outlook from Moody's on its GO bond rating

Moody's: Aa2 (change to positive outlook)

S&P: AA stable

Fitch: AA stable

Moody's Investors Service (Moody's) improved the outlook on its rating of the state's general obligation (GO) bonds from stable to positive in October 2015. The positive change and rating assignment of Aa2 recognized the state's recovery from the Great Recession including restoration of reserves and proactive measures to improve the funding of its pensions and other post-employment benefits liabilities (OPEB). Of particular note, the rating agency acknowledged the positive impacts of the landmark legislation Act 268, SLH 2013 (Act 268) to require the phasing-in (from

FY 2015 through FY 2019) of the full funding of OPEB employers' annual required contributions. The legislation is credited with materially strengthening the OPEB funding position and enhancing the state's ability to meet its commitments to retirees. The state's other rating agencies, Standard & Poor's Ratings Services (S&P) and Fitch Ratings (Fitch), affirmed the state's GO bond rating at AA with stable outlooks, citing the state's adherence to sound fiscal policies, financial management and demonstrated commitment to building and maintaining strong reserve levels. In November, the state completed a \$750 million state bond sale—the first for this administration—and refinanced some of the state's bonds. This resulted in savings of about \$61 million in our debt service requirement.

2016

Established formal policies to ensure prudent use of state debt and availability of state resources during times of need

Conducted research to determine appropriate reserve levels and established the state's first formal State Reserve Policy

To ensure greater financial stability and capacity to handle future economic downturns, Governor Ige initiated actions to establish the first formal reserve policy for Hawai'i. Financial flexibility has been at the core of discussions surrounding fiscal solutions and especially during recessions. The impact of recessions, the stature of Hawaii's tourism industry, and exposure to hurricanes, underscored the state's need to have a formal and well-reasoned reserve policy. The Department of Budget and Finance analyzed policy considerations concerning the state's reserve funds and evaluated best practices among municipal industry associations, rating agency criteria and methodology with respect to reserve levels and other state reserve levels, policies, and related implications. The state's Emergency Budget and Reserve Fund (EBRF) along with the available ending balance in the general fund as budget stabilization or rainy day funds were evaluated and Hawai'i Hurricane Relief Fund (HHRF) as a natural disaster fund was also considered.

Following consideration and analysis of prudent reserve levels, Governor Ige issued Administrative Directive 16-03 establishing the state of Hawaii's first reserve policy. The policy establishes state goals of maintaining an amount of at least 10 percent of general fund revenue in the emergency budget and reserve fund and at least five percent of general fund revenue as a general fund balance. The amounts are consistent with state law and are intended to provide the state with financial

flexibility to mitigate the consequences of future emergencies and recession. The policy also addresses building state reserves as well as the reasons the reserves should be used.

Established the first state Debt Management Policy

Established a Debt Management Policy is to ensure that all debt issuances undertaken by the state of Hawai'i are completed in an efficient manner and in accordance with best practices. The policy enables the state to foster consistency and optimize the use of its limited resources to meet its long-term capital needs. The policy also establishes clear criteria for decision making with regards to debt issuance and debt management, determining reasonable thresholds and guidelines for issuance of debt, providing justification for the structure of debt, and reflecting constitutional provisions and statutory limitations on debt to a larger audience and stakeholders.

Conducted the first state Debt Affordability Study

The Director of Finance undertook the first biennial Debt Affordability Study to optimize the use of limited debt capacity while meeting public spending goals and to ensure the prudent use of debt and to preserve sufficient future debt capacity. The study summarizes and analyzes the current debt outstanding and future capital plans of the state and state departments as it evolves over time. The study aids decision making with respect to the state and state department multi-year capital plans and to understand trade-offs while evaluating projects and debt alternatives. The study also seeks to identify affordability metrics to measure debt burden, assess affordability of proposed debt issuances, ensure the state does not over leverage, and assess overall adequacy of revenues to pay for all obligations including pension and other post-employment benefits (OPEB) costs. Subsequent studies are conducted every two years.

S&P improves its outlook to positive for the state GO bond rating

March 2016

Moody's: Aa2 positive

S&P: AA (change to positive outlook)

Fitch: AA stable

In March 2016, S&P revised its outlook for the state GO bond credit to positive from stable and affirmed its AA bond rating. The agency cited strong revenue trends, which enabled the state to build “impressive general fund ending and reserve balances”, which eclipsed \$1 billion in 2015 and 2016. S&P also noted the state’s well-established, proactive budget monitoring practices, including frequent revenue forecast updates and the Governor’s prudent use of his executive authority to restrict expenditures mid-year as needed to balance the State budget.

The state achieves a new high with upgrades from Moody’s and S&P

September 2016

Moody's: Aa1 stable (rating upgrade)

S&P: AA+ stable (rating upgrade)

Fitch: AA stable

In September 2016, the state reached its strongest credit position in its history with upgrades from Moody’s from Aa2 to Aa1 and S&P from AA to AA+. The rating upgrades reflected a multi-year effort during which the state effectively exhibited its improved financial position and continued commitment to fiscal prudence and budgetary stability. With these rating actions, Hawai’i became the only state in 2016 to achieve multiple rating upgrades and the only state to receive a rating upgrade from Moody’s. In 2016, the state demonstrated continued progress in OPEB funding commitments by exceeding its Act 268 pre-funding requirement of \$163 million by an additional \$86 million and funding its OPEB annual required contribution ahead of the statutory requirement. Rationale for the state’s upgrades also included the formalization of the state’s Reserve Policy in August 2016, which established specific and defined minimum general fund and emergency and budget reserve fund (“Rainy Day”) balances targets. The state also developed its state Debt Management Policy in December 2016 and a Debt Affordability Study, which reflected the strong management practices and policies underpinning the Ige Administration. While Fitch maintained its current AA rating and stable outlook, its

report also cited the State's solid operating performance, strong revenue growth, rising reserves and a resilient economy.

2017

Enacted reforms to address deteriorating funding progress of the state pension liability

Strengthened funding of pension costs paid by the employees' retirement system (ERS)

Governor Ige signed into law Act 17, SLH 2017, which incrementally increases the rates for employer contributions to the Employees' Retirement System. Under funding requirements and policies in place prior to Act 17, funding progress of Hawaii's public pension liabilities was in jeopardy, with actuarial reports indicating the funding period of the pension unfunded liability to be 66 years, well more than the statutorily indicated 30-year period. Act 17 strengthened the funding commitment to the pension system by requiring an increasing amount of employer contributions of employee compensation from 17% in Fiscal Year 2017 to 24% in Fiscal Year 2021 and beyond for general employees, and from 25% in Fiscal Year 2017 to 41% in Fiscal Year 2021 and beyond for police officers, firefighters, and corrections officers. The new funding requirement brings the expected funding period of the unfunded pension liability within the desired 30-year funding paydown period.

Required stress tests of the ERS to better inform decision making

Governor Ige signed into law Act 85, SLH 2017 which requires the ERS actuary to conduct annual stress tests of the system and directs the ERS board to submit annual reports of the tests to the legislature. The test is to project the effect of certain unfavorable scenarios on the system's assets, liabilities, funded ratio, and other specified benchmarks.

Fitch assigns the state GO bonds a positive outlook

Moody's: Aa1 stable

S&P: AA+ stable

Fitch: AA (change to positive outlook)

In April 2017, Fitch affirmed the state's AA rating on the state's GO bonds and changed the outlook to positive. According to Fitch, the state's outlook change reflected ongoing improvements in the state and Ige administration's management of its substantial long-term liabilities, as well as a history of strong revenue growth, rising reserves as well as a resilient economy. In 2017, the state continued its commitment to OPEB funding by contributing 87% of the annually required contribution (as compared to the minimum requirement of 60% under ACT 268) and by the end of 2017, the State was on target to contribute nearly \$800 million towards OPEB pre-funding, \$318 million more than required. The state also deposited an additional \$200 million into the rainy-day reserves, bringing total reserves to nearly \$500 million, and more than double the amount when Governor Ige took office.

Moody's Analytics reported that Hawai'i is one of only 16 states with enough cash reserves to weather the "stress test" of another recession. The state has been smart about managing taxpayer dollars and is in a better position should the economy change.

2018

Follow-up-Action on Pension Liabilities

Implemented the Act 17 Funding Plan for the Pension System

Fiscal Year 2018 marked the first of several step ups in employer contribution levels made by the state. The state succeeded in meeting the requirements of Act 17 and is making the fully increased contributions required under the act. Due to the strengthened funding requirement and adherence to the payment schedule the pension system is now on a clear path to eliminating the state and local public pension liability.

Under the 2018 actuarial valuation results, achievement of the Act 17 funding plan was expected to pay down the state and local public pension unfunded liability of \$13.8 billion over the next 25 years.

Ratings agencies acknowledge continued fiscal prudence and progress in strengthening the state pension system

Moody's: Aa1 stable

S&P: AA+ stable

Fitch: AA positive

All three rating agencies affirmed the state's ratings in 2018 and continued to acknowledge the state's fundamental credit strengths and financial prudent. Rating agencies specifically cited the state's healthy economy, positive revenue trends, strong financial governance practices, above average reserves, and continued commitment to reducing pension and OPEB liabilities. In particular, the agencies noted the significance Act 17, SLH 2017 that Governor Ige signed into law to restore the pension system to full funding within the statutorily required 30-year timeframe by phasing in higher system-wide employer contribution rates from 17% to 24% for the general plan and 25% to 41% for police and fire by FY 2021.

The increase to employer contributions was the latest of several enhancements to the pension system including a moratorium on benefit enhancements until the funded ratio reaches 100%, reducing the actuarially assumed rate of return down to 7% (thereby increasing required payments) and reducing the "spiking" of final compensation.

The combined impact of these changes was anticipated to fundamentally strengthen the state's pension system including a funded ratio expected to reach 100% within 30 years. Rating agencies acknowledged that these changes are expected to contribute to improving the funding levels of the state's retirement system over the long term have been considered a major credit positive.

2019

Further prepared the state for economic uncertainty and other unforeseen events

Built the State's reserve to a historically high level

Following the establishment of the State Reserve Policy in 2016, a major focus of Governor Ige's Administration had been to increase reserve levels to prepare for emergencies and other unforeseen events and economic downturns. By 2019 the state had achieved the highest ever balance in its Emergency and Budget Reserve Fund (EBRF), also known as the Rainy Day Fund of \$378 million as compared to \$83 million in 2014.

Additionally, while not a formal part of state reserves, the balance of the Hawai'i Hurricane Relief Fund had been drawn down during a previous economic recession. While that fund had been partially restored to \$127 million by 2014, the fund was subsequently fully recapitalized and stood at \$184 million in 2019.

The balances of these two funds, in addition to a strong general fund carryover balance of \$752 million that substantially exceeded the reserve policy goal permitted the state to take thoughtful and prudent action regarding the coming COVID-19 pandemic and its substantial impacts.

Fitch upgrades the state GO bond rating, bringing Hawaii's credit ratings to the highest level in state history

December 2019

Moody's: Aa1 stable

S&P: AA+ stable

Fitch: AA+ (rating upgrade)

Fitch upgraded the state's GO bond rating from AA to AA+, based on the state's resilient economy and continued strong performance. The upgrade, along with the then-current ratings from Moody's at Aa1 and S&P at AA+, raised Hawaii's GO bond credit ratings to the highest levels ever achieved in state history (and eclipsed that distinction previously achieved by this administration in 2016). The agency again cited Hawaii's strong financial and operating performance, diversified economic base, and the state's overall fiscal prudence. Fitch also acknowledged that the state has made strides in growing its emergency and budgetary reserves, which is a key

step in improving overall financial stability. With the upgrade from Fitch, all three of the state's GO bond ratings were one notch away from the highest rating possible.

2020

Addressed the impacts of COVID-19

Used state reserves and other resources and took other financial precautions to mitigate the impacts of the COVID-19 pandemic

The economic impacts of the COVID-19 pandemic were quickly reflected in the state's Council on Revenues general fund revenue projections, initially reflecting the loss of billions of dollars of state revenue. The existence of state reserves permitted the state to take a reasoned approach. While the State did implement targeted spending reductions and hiring freezes, the Rainy Day fund and the general fund carry over balance gave the state the time it needed to forgo the most impactful budgetary solutions the state has used in the past, such as larger scale layoffs, elimination of important state programs, debt restructuring, and payment deferrals.

Subsequently, the state's receipt and use of federal aid greatly assisted the state's efforts to address COVID-19's significant economic and health impacts.

Improved state treasury operations

Implemented the analytical tools to better inform treasury investment decisions

The Department of Budget and Finance implemented analytical treasury investment tools to better permit the state treasury to pursue portfolio goals and simplify operational processes. The tools help achieve state goals and facilitate the integrate custodian feed to create portfolio holdings daily, compile investment offerings into one centralized candidate list, compare securities at the quoted offer price to meet policy and liability needs, screen out securities excluded by policy, maintain investment policy compliance, meet liability cash flow needs, measure, and optimize cash flow yield. The state has experienced material gains in its ability to manage the state treasury and increase treasury yields while meeting policy constraints.

Amid COVID challenges, rating agencies cite administration efforts to protect health and pursue efforts to drive economic growth

Moody's: Aa2 stable

S&P: AA+ negative

Fitch: AA stable

(Moody's and Fitch ratings lowered due to impacts of COVID and S&P placed on negative outlook)

Following the severe negative impacts of COVID-19 on the global economy, effectively shutting down tourism to Hawai'i and materially reducing state revenues, rating agencies acted nationally to lower ratings, including on Hawaii's GO bond ratings. Nevertheless, by the end of 2020, rating agencies acknowledged the steps the administration had taken to protect health in Hawai'i, shore up the state's finances and drive economic recovery. Rating agencies cited the state's financial strength and increased reserves entering the pandemic, as well as the administration's control over a broad array of budget balancing options, and the state's sound financial position. During the pandemic, the state took proactive and timely actions to preserve its financial position. The administration developed multiple revisions to the General Fund Financial Plan, and in conjunction with the Legislature, took timely actions to reduce expenditures, preserve liquidity and continue critical state functions.

Governor Ige's efforts to protect the health of Hawai'i residents, which was later recognized as among the best responses by any state in the nation, coupled with the efforts to develop Hawaii's Safe Travels Program beginning in October 2020, set the foundation for rapid economic recovery. Of key importance to rating agencies, following the receipt of robust federal funding, improving economic conditions, rebounding revenues and a more positive revenue forecast, the state made prudent decisions to begin restoring reserves and continued funding for its pension and OPEB commitments.

2021

Prudently used federal aid to bolster state initiatives to address the pandemic

The state received substantial sums of federal assistance that were used strategically to mitigate current impacts and address longer-term needs

Federal aid was critical in permitting states across the country to manage the impacts the COVID-19 pandemic. The state of Hawai'i used its share of federal aid strategically to ensure continuity of critical state functions and statewide for several purposes, including to slow the spread of COVID-19 and provide other health related efforts. Funding was also used to address the economic impacts of the pandemic. The state also used a substantial amount of aid to repay the US Department of Labor for advances to the Unemployment Insurance Fund. Given the closure and repeated shutdown of business through much of the pandemic, especially early on, the state's Unemployment Insurance balances had been drawn down and were in debt to the US Department of Labor. The state's use of Coronavirus State Fiscal Relief Funds to repay the US Department of Labor mitigated the impact of that advance, which would otherwise have needed to be repaid over time by businesses in the state. Additionally, the state used substantial sums of Elementary and Secondary School Emergency Relief Funds to bolster educational programs.

Rating outlooks improve following economic recovery and improved finances

Moody's: Aa2 (change to positive outlook)

S&P: AA+ (change to stable outlook)

Fitch: AA stable

In September 2021, Moody's revised the outlook for the state to positive, and S&P revised its outlook from negative to stable. The improved outlooks reflected a significant turnaround in the state's economic and financial position, according to Moody's. The agency also cited the better-than-expected return of tourism, which exceeded pre-pandemic levels from the US mainland, the substantially improved labor market and general fund revenue outlook, expected to exceed FY 2019 levels by double-digit growth.

Of significance, the state continued to meet its obligations to address liabilities, including continuing its pension funding, phasing in the final increase of Act 17

employer contribution requirements, and continuing its retiree healthcare prefunding efforts. This included contributing more in 2020-2021 than was required by Act 268 for the state's OPEB funding.

The state also took steps to increase its reserves, including increasing the balance of the rainy-day fund to \$320 million in 2021 versus \$60 million in 2020.

2022 YTD

Gov. Ige first proposed a tax refund in his 2022 State of the State address given the strong revenue projections, and the state Legislature was able to increase the amount that will be returned to Hawai'i taxpayers.

Act 115 provides a tax refund of \$300 for taxpayers who earn less than \$100,000 a year (or couples earning less than \$200,000), and \$100 for taxpayers who earn \$100,000 or more (or couples earning \$200,000 or more). This will help to bring the people of Hawai'i some relief as we continue to recover from the two-year pandemic.

Rebuilt state reserved to new record levels

Following the use of its reserve the administration determined to quickly replenish it to again meet the needs of future events

While the state had depleted the Rainy Day Fund down to a level of about \$58 million in 2020 from the high of \$378 million the prior year, the state has already worked to recapitalize the fund. The Rainy Day Fund now stands at an all-time high of \$831 million, an amount more than double the previous funding level.

Additionally, the Fiscal Year 2022 general fund carry over balance stood at a record \$2.6 billion (inclusive of \$500 million being used to recapitalize the Rainy Day Fund). Additionally, the State anticipates making another deposit of approximately \$130 million to the EBRF (tentatively scheduled for 2Q FY 2023) pursuant to Section 328L-3, Hawaii Revised Statutes, which requires a transfer to the EBRF if two years of general fund revenues exceed the respective previous years' general fund revenues by more than 5%, and the EBRF balance for the prior fiscal year is less than 10% of prior year general fund revenues. State fund balances are at record levels and the state is better prepared than it ever has been to address the needs of its residents and what may come.

2022 sees materially improved credit conditions

Moody's: Aa2 positive

S&P: AA+ stable

Fitch: AA stable

In 2022 year-to-date, the state's credit quality continues to improve and has returned to or has exceeded pre-pandemic levels in several instances. The Hawai'i economy, aided by the governor's efforts to protect the health of Hawai'i residents and safely return tourism, has drastically improved, and is expected to exceed US growth in 2022 and 2023. While tourism is recovering, the administration is focused on regenerative and more sustainable tourism that also looks to protect the quality of life of Hawai'i residents.

The state's finances have also emerged stronger than before COVID, with the current biennial budget developed with over \$2 billion of additional revenue given the extraordinarily strong tax revenue performance. This has allowed the state to pursue the restoration of prior budgetary reductions and continued investments in important state programs while continuing to address liabilities.

State reserves now stand at over \$1 billion, and the FY 2022 general fund ending balance was estimated at over \$2.6 billion. The state has continued its commitment to address its long-term liabilities, with the pension liability declining for the first time since 2007 in each year during 2021 and 2022 and the health benefits system's funding at its strongest position ever.

While the last eight years have seen some of the largest economic challenges in state history, the state's financial position has emerged stronger than ever and has never been better positioned for future prosperity for the benefit of all of Hawai'i and its residents.

Looking Ahead

Governor Ige focused on ensuring the state's financial stability by prudently using state resources and identifying ways to make investments that would reap big benefits. Many factors contribute to the financial stability of a state, and the governor also focused on efficiently delivering core services, such as public education and social services. Additionally, providing affordable housing and ensuring that our way of life is sustainable were also major priorities of the Ige administration, all needed and intended to improve the lives of Hawaii's people.

Over the past eight years, dramatic improvements have been made on every major financial issue the State has faced. The State's use of debt and its reserves are now governed by prudent policies that had not previously existed, with reserves currently at their highest levels, ever. Tens of billions of dollars of unfunded liabilities related to pension and health benefit obligations that were growing and approaching perilous levels are now on a clear path to be paid off in a manner that both honors our commitments to our employees and takes the burden of paying these major costs off of future generations.

The COVID-19 pandemic continues to have an impact on the state's economy, but the health measures taken to keep people safe, such as the Safe Travels program, also helped to speed the economic recovery. Despite the challenges, this administration made fiscally responsible decisions that provided for the state's priority program needs while honoring near- and long-term financial commitments and building the budget reserves. As a result, the state is now on a solid financial foundation.

Importantly, the fiscal discipline that helped guide Governor Ige's actions and has enabled the important financial achievements across his two terms in office will persevere in the laws and policies he both recommend and implemented. A comprehensive and prudent framework of laws and policies now exists to help keep the State on the right financial path. The State of Hawai'i now has all of the tools it needs to maintain the impressive financial strength it has achieved, and to keep improving going forward.