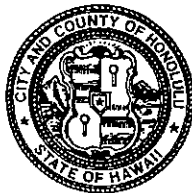


PETER B. CARLISLE
MAYOR



MICHAEL R. HANSEN
DIRECTOR

NELSON H. KOYANAGI, JR.
DEPUTY DIRECTOR

**Testimony of
MICHAEL R. HANSEN
Director of Budget and Fiscal Services
City and County of Honolulu**

**Before the House Committee on
HOUSING**

**Wednesday, February 1, 2012
8:45 a.m.
State Capitol, Conference Room 325**

**In consideration of
HOUSE BILL 2692
ESTABLISHING THE HOMEOWNERSHIP INITIATIVE PILOT PROGRAM WHICH
ALLOWS ELIGIBLE EMPLOYEES TO WITHDRAW FUNDS FROM THEIR
EMPLOYEES' RETIREMENT SYSTEM ACCOUNTS, TO BE USED EXCLUSIVELY
FOR A DOWN PAYMENT ON A QUALIFYING MULTIFAMILY RESIDENTIAL
PROPERTY THAT WILL BE USED AS A PRIMARY RESIDENCE**

The City and County of Honolulu (City) submits the following testimony in opposition to House Bill 2692. The City understands the intent of House Bill 2692 is to promote homeownership, however;

1. The City would incur significant administrative costs to meet the requirements of the bill. The City would be required to process payroll deductions from the wages of employees who participate in the pilot program. In addition, it is unclear whether the employers or the Employee Retirement System (ERS) would calculate the accumulated retirement benefits attributable to the employees' payroll deductions and the required employer match. Because the ERS is not a defined contribution plan with separate accounts for each employee, the accumulated retirement benefits would have to be calculated from each participant's payroll records.

2. In addition to the City's significant administrative costs, the ERS would incur even larger costs to administer the program. Because there is no provision to cover these costs, it is likely that ERS contributions will have to increase to cover the additional administrative costs.
3. Allowing ERS members to borrow from accumulated retirement benefits weakens the stability of the Employee Retirement System. There is no explicit provision for collecting interest from participants, to compensate for the investment returns that would have been earned on the money borrowed by the participants. It is also possible that collection efforts in cases of default would not completely reimburse the system. Both of these situations will cause the unfunded liability of the ERS to grow and require additional contributions in the future.

The City recognizes that promotion of homeownership is a worthy goal, however, funding sources other than the Employee Retirement System should be used for this purpose. Thank you for the opportunity to testify on House Bill 2692.

TESTIMONY BY WESLEY K. MACHIDA
ADMINISTRATOR, EMPLOYEES' RETIREMENT SYSTEM
STATE OF HAWAII
TO THE HOUSE COMMITTEE ON HOUSING
ON
HOUSE BILL NO. 2692

FEBRUARY 1, 2012

RELATING TO HOMEOWNERSHIP

Chair Cabanilla and Members of the Committee:

H.B. 2692 proposes a Homeownership Initiative Pilot Program which allows eligible employees to withdraw up to 60% of their accumulated retirement benefits from their Employees' Retirement System (ERS) accounts to be used for payment on a qualifying multifamily residential property that will be used as a primary residence.

The ERS Board of Trustees opposes this bill as it would jeopardize the tax qualification of the ERS and increase its administrative costs.

The ERS is intended to be a tax-qualified retirement plan under section 401(a) of the Internal Revenue Code of 1986, as amended (Code). Section 414(h)(2) of the Code provides for favorable tax treatment for employee contributions "picked up" (made by the employer on behalf of the employee) to a tax-qualified retirement plan established by a state or county or by an agency or instrumentality of a state or county.

The tax-qualified status of the ERS retirement plans would be jeopardized if members are allowed to withdraw all or part of their accumulated retirement benefits while still employed by the State or a county. "[I]n order for a pension plan to be a qualified plan under section 401(a) [of the Code], the plan must be established and maintained by an employer to provide systematically for the payment of definitely determinable benefits to its employees over a period of years, usually for life, after retirement or the attainment of normal retirement age." See Treasury Regulations § 1.401(a)-1(b)(1) [emphasis added]. Thus, a tax-qualified pension plan may not make a retirement distribution to a member while the member is still employed. See Revenue Ruling 56-693, 1956-2 C.B. 282, modified by Revenue Ruling 60-323, 1960-2 C.B. 148 ("[A]n employees' pension plan which permits participants, prior to any severance

of their employment or the termination of the plan, to withdraw all or part of the funds accumulated on their behalf, in times of financial need or otherwise, will fail to meet the requirements of section 401(a) of the Internal Revenue Code."); Revenue Ruling 74-254, 1974-1 C.B. 91 (ruling that a pension plan was not qualified under section 401(a) of the Code, "since it permits distributions to be made to participants prior to normal retirement and prior to termination of employment or termination of the plan.").

In order to preserve its tax-qualified status, the ERS must meet certain federal tax law requirements on an ongoing basis. As noted above, one of those requirements is that retirement benefits may not be paid until a member has retired or reached normal retirement age. Since H.B. No. 2692 would permit members of the ERS to withdraw up to 60% of their accumulated retirement benefits attributable to their payroll deductions and associated employer matching contributions while still employed, H.B. No. 2692 would violate the federal tax law requirement and would jeopardize the federal tax qualification of the ERS.

In addition, this bill will increase the administrative costs of the ERS. In order to implement the bill, the ERS would incur costs to administer the homeownership initiative program, including designing and processing applications, collecting repayments from members, and placing liens on properties in cases of default.

The ERS Board of Trustees strongly opposes this bill.

Thank you for the opportunity to testify on this important measure.

TESTIMONY BY KALBERT K. YOUNG
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
STATE OF HAWAII
TO THE HOUSE COMMITTEE ON HOUSING
ON
HOUSE BILL NO. 2692

February 1, 2012

RELATING TO HOMEOWNERSHIP

House Bill No. 2692 proposes to allow beneficiaries of the State of Hawaii Employees' Retirement System (ERS) to withdraw funds from the ERS for the purpose of funding their personal real property purchase.

The Department of Budget and Finance opposes this bill as being problematic for the stability of the ERS, in violation of the ERS's current tax-deferred status, and counter to the system's efforts to address its unfunded liability issues. The corpus funding of the ERS is developed through contributions made from employers and/or employees over the course of the beneficiary's employment. An assumed rate of investment earnings from those contributions are necessary and required in order for the ERS to achieve a large enough corpus to fund pensions of all retirees in the system. Allowing withdrawals or loans ahead of actual payments of retirement pensions jeopardizes the ability of the system to earn an adequate rate of return to fund those future pension payments.

Furthermore, the ERS is established as a tax-deferred program as designated by the U.S. Internal Revenue Service. A program such as the one proposed in House Bill No. 2692 will undoubtedly compromise that designation – meaning, that the ERS will likely be subject to a significantly major tax liability each year which

House Bill No. 2692 will undoubtedly compromise that designation – meaning, that the ERS will likely be subject to a significantly major tax liability each year which would further erode the system's ability to build its corpus. This would also jeopardize the pension earning potential for every individual beneficiary of the ERS.

The Department of Budget and Finance strongly recommends that the House Committee on Housing hold this measure as it is not financially prudent in the long-term viability of the State of Hawaii Employees' Retirement System.