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BUDGET, PROGRAM PLANNING AND
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FINANCIAL ADMINISTRATION DIVISION
OFFICE OF FEDERAL AWARDS MANAGEMENT (OFAM)

WRITTEN ONLY

TESTIMONY BY CRAIG K. HIRAI
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
TO THE HOUSE COMMITTEE ON LABOR & TOURISM
ON
HOUSE BILL NO. 2240

FEBRUARY 10, 2022
9:30 A.M.
Via Videoconference

RELATING TO OTHER POST-EMPLOYMENT BENEFITS.

The Department of Budget and Finance (the "Department") supports the intent of House Bill No. 2240 which authorizes the director of finance to issue an unspecified amount of general obligations (G.O.) bonds and makes an appropriation of the same to pay or prepay the State's other post-employment benefits (OPEB) liability. Unencumbered appropriation would lapse on June 30, 2024. The measure allows the director of finance to issue the bonds provided that: 1) to determine the annual required contribution, a preliminary annual required contribution be developed that treats the outstanding bond balance as part of the plan's unfunded actuarial accrued liability and that the net cash contribution required to be contributed to the plan shall equal the preliminary annual required contribution minus the bond repayment for the respective year; 2) the all-in true interest cost of the bonds must be at least three hundred basis points less than the assumed rate of return of the respective system; 3) the general obligation bonds shall not be issued as a means for addressing budget shortfalls related to contributions required by law; and 4) the general obligation bonds may only be issued as a means to produce long-term savings.

The Department appreciates the strong support of the legislature in addressing the State's unfunded pension and OPEB liabilities. The State's OPEB funding requirement is now among the strongest, if not the strongest, in the nation. Nonetheless, the State's OPEB unfunded actuarial accrued liability as of July 1, 2021, stood at $8.125 billion, projected to be paid down through the year 2044.

State and local jurisdictions generally issue pension bonds or OPEB bonds because they expect to achieve greater returns on investments than the cost of the bonds over the long-term, providing arbitrage, and thus value for the taxpayer. However, there is risk that the investments can earn less than the cost of the bonds or even lose value, especially over the short-term. This measure addresses the additional risks involved by recognizing the savings from the targeted arbitrage as they happen, which increases the probability of achieving savings, reduces the risk of loss, and maintains a consistent funding progress.

The requirement to consider OPEB bond debt in the calculation of the annual required contribution will ensure continued strength of the OPEB funding policy and mitigate additional investment risk. The Department requests that the committee consider including a requirement to include the OPEB bond debt in the determination of the annual required contribution in Section 87A-42(f)(2), HRS as follows:

"(2) An amortization payment, which is a catch-up payment for past service costs to fund the unfunded actuarial accrued liability over the next thirty years. <u>If the state issues general obligation bonds to pay or prepay the state's</u>

unfunded actuarial accrued liability and contributes the proceeds to the trust fund, the outstanding balance of such general obligation bonds shall be considered part of the state's unfunded actuarial accrued liability for purposes of the determination of the preliminary annual required contribution. The annual required contribution would be the preliminary annual required contribution less the related general obligation bond repayment."

Also, while in the long-term, pension and OPEB system investment programs are already highly likely to outperform bonds, requiring that the all-in true interest cost of OPEB bonds be a full 300 basis points, or three percent, less than the expected return the systems further increase the prospects for arbitrage and reduces long-term risk of loss, should conditions permit the issuance of the bonds.

The long-term expected returns for EUTF investments have been determined, with the expertise of the plan’s investment advisors and actuary, to be 7%. All-in true interest costs on the State's recent G.O. bond sales have been under 3%. This measure would currently permit the issuance of OPEB bonds if the all-in true interest cost on the bonds is 4% or less. Arbitrage earned through this approach could reduce future funding requirements and corresponding burden on taxpayers.

We are available to work with the Committee and the Employer-Union Health Benefits Trust Fund (EUTF) on this measure.

Thank you for considering our testimony.

HAWAII GOVERNMENT EMPLOYEES ASSOCIATION
AFSCME Local 152, AFL-CIO

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The Thirty-First Legislature, State of Hawaii
House of Representatives
Committee on Labor and Tourism

Testimony by
Hawaii Government Employees Association

February 10, 2022

H.B. 2240 – RELATING TO OTHER POST-EMPLOYMENT BENEFITS

The Hawaii Government Employees Association, AFSCME Local 152, AFL-CIO supports the purpose and intent of H.B. 2240 which authorizes general obligation bonds for the payment of other post-employment benefits liability.

We view this proposed legislation as a novel approach and viable option to ensure the state meets its financial obligations for other post-employment benefits payments. We respectfully defer to the Department of Budget and Finance to suggest an appropriate amount of GO bonds that would comport with the state's financial plan.

Thank you for the opportunity to provide testimony in support of H.B. 2240.

Respectfully submitted,

Randy Perreira
Executive Director

House Committee on Labor & Tourism

Written Testimony By Wesley K. Machida on HB2240

February 10, 2022

Chair Onishi, Vice Chair Sayama, and Members of the House Committee on Labor & Tourism:

I am in support of HB2240, as it provides a viable financing option (with appropriate safeguards) to be considered for addressing and managing the increasing employer contributions and unfunded actuarial accrued liability (UAAL) of the Hawaii Employer-Union Health Benefits Trust Fund (EUTF).

The State's annual general fund employer contribution requirement to the EUTF is projected to increase to over a billion dollars in the near future, with over $8 billion in UAAL to the State and a total UAAL of over $10 billion that includes the counties and their appropriate water supply agencies. As taxpayer monies are used to pay for these contributions and to pay down the liability, it may be appropriate to consider financing options that can help to reduce the future financial strain on the State, counties, and taxpayers.

There are financial risks with any financing opportunities; however, provisions in this proposal seeks to minimize risk such as requiring that the issuance be permissible if the all-in true interest cost of the bonds is at least three hundred basis points (3%) less than the assumed rate of return of the system, which currently stands at 7%. Furthermore, these bonds shall not be issued to address budget shortfalls, but as a means to produce long-term savings. For reference, the EUTF over the last 10 years has averaged about 9% in investment returns and over 8.4% since the inception of the EUTF (period in which included the Great Recession and current pandemic), and could have derived savings over these time periods.

Thank you for the opportunity to provide my testimony and for your consideration of this important proposal. I will be happy to clarify any of the above or provide any additional information that the committee needs.