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## Research:

### Honolulu City & County, Hawaii; Appropriation, General Obligation Equivalent Security; Tax Secured, General Obligation

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#### Credit Profile

US\$190.875 mil GO bnds ser 2005A due 07/01/2029	AA-
Sale date: 19-MAY-2005	
US\$68.605 mil GO bnds ser 2005B due 07/01/2021	AA-
Sale date: 19-MAY-2005	
US\$73.42 mil GO bnds ser 2005C due 07/01/2024	AA-
Sale date: 19-MAY-2005	

#### OUTLOOK REVISED

	To	From
\$1.492,792 bil. Honolulu City & Cnty GO	AA-	AA-
\$100.000 mil. Honolulu City & Cnty GO (FGIC)	AAA/AA-(SPUR)	AA-
\$3.000 mil. Honolulu City & Cnty GO (FSA)	AAA/AA-(SPUR)	AA-
\$5.705 mil. Honolulu City & Cnty GO (MBIA)	AAA/AA-(SPUR)	AA-
\$117.715 mil. Honolulu City & Cnty GO (MBIA)	AAA/AA-(SPUR)	AA-
\$123.065 mil. Honolulu City & Cnty go unlt'd tax imp rfdg bonds ser 2004A (MBIA)	AAA/AA-(SPUR)	AA-
\$123.400 mil. Honolulu City & Cnty go unlt'd tax imp rfdg bonds ser 2004B (MBIA)	AAA/AA-(SPUR)	AA-

OUTLOOK: POSITIVE

#### Rationale

Standard & Poor's Ratings Services revised its outlook to positive and affirmed the 'AA-' rating on Honolulu, Hawaii's \$1.945 billion outstanding GO debt. In addition, Standard & Poor's assigned its 'AA-' rating to the city's \$332.9 million series 2005 A-C GO bonds.

The outlook revision reflects improved economic conditions, led by significant increases in property values. The rating additionally reflects:

- The city's presence as the service, trade, and government center for the state of Hawaii;
- A solidly rebounding tourism sector, with improving tourism statistics after some declines following Sept. 11, 2001;
- Strong increases in property values;
- Adequate financial performance despite steady declines in property values during much of the mid- to late-1990s; and
- A manageable debt burden.

These strengths are tempered by a history of volatility in property values prior to the current rebound, due primarily to a concentration of Japanese capital in the real estate market and reliance on tourism as the primary driver for economic growth.

The bonds are secured by the full faith, credit and unlimited ad valorem taxing authority of the City and County of Honolulu. The bonds are being issued to refinance outstanding debt.

With 876,230 residents, or 72% of the state's total population, Honolulu is Hawaii's economic center and the center of government, transportation, finance, and education. Tourism accounts for about 25% of the gross state product, and Honolulu accounts for over 50% of the state's hotel rooms. Waikiki, located on Oahu, remains the state's most visited destination. Honolulu's tourism market has rebounded strongly along with the rest of the state. The city and island are additionally anchored by the presence of the U.S. military; there are 33,799 active service men and women on the island, and nearly 15% of the total island population is either employed by or a direct dependent of one of the four branches of the armed services. Unemployment has been steadily declining and is currently at 3%, below the state level and one of the lowest rates for a U.S. city with a population above 750,000. Effective buying income levels are above the state but average overall, at 105% and 90% of the nation on a household and per capita basis, respectively.

The recent economic rebound on Oahu has been led by a strong real estate market, driven by strong appreciation in property values and new construction after an extended period of weakness during the mid- and late-1990s. Since 2001, total assessed value has increased 34.6%, to \$92.4 billion in 2005. This is a high \$105,000 per capita and includes a 16.7% increase in fiscal 2005 alone. Single-family homes and condominiums account for 56% of this valuation, followed apartments (22%), commercial (10%), industrial (5%), and hotel and resort properties (only 5%).

Financial performance has been adequate with modest improvements in fund balances after a period of revenue contraction prior to fiscal 2001. At the end of fiscal 2004, the city reported a total general fund balance of \$62.3 million, or 8.5% of expenditures after transfers, with \$41.5 million, or 5.7% of expenditures, unreserved. Staff currently anticipates an essentially balanced result for fiscal 2005. The current and recent fund balance position has been only adequate, given historical revenue volatility and the need to reduce services without significantly increasing property tax rates. The new mayoral administration has stated its intent to tighten fund balance policies and other financial controls to provide additional stability during periods of potential economic or financial contraction due to a potentially volatile tourism base.

The city's debt burden is moderate, at \$1,810 per capita and 2.0% of assessed value, excluding self-supported GO debt. The current issuance will refund existing obligations, and the anticipated ongoing capital plan is manageable. Annual general fund-related capital expenditures over the past two years have been \$134 million and \$147 million, respectively, lower than in prior years. In practice, the city's capital plan has been between 4% and 20% cash-funded, and annual debt service carrying costs have been relatively high, at approximately 19% of total general fund expenditures.

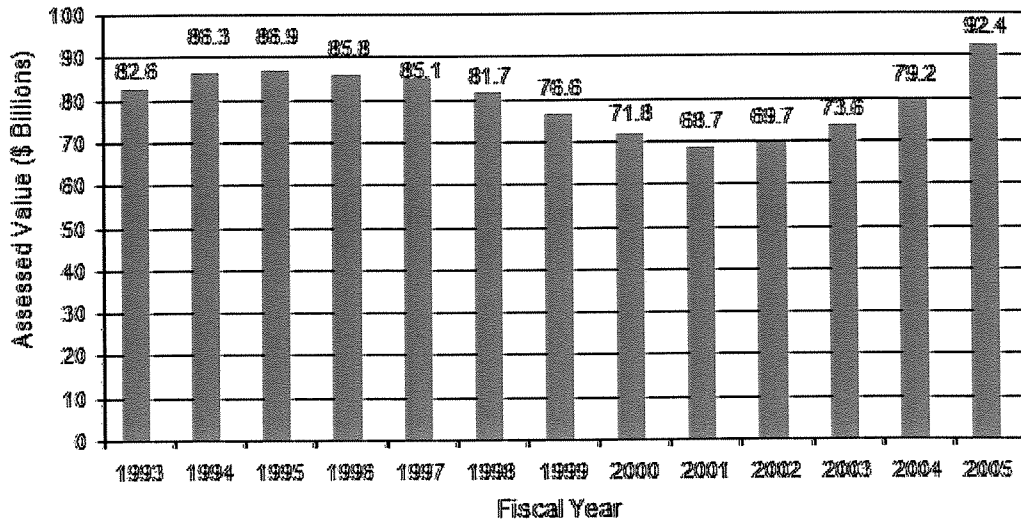
## ■ Outlook

The positive outlook reflects the recent rebound of the Honolulu and Oahu economies, led by strong growth in property values leading to property tax growth. The outlook also reflects the stated intent of a new mayoral administration to tighten financial controls and reserve targets to provide stability in case of future revenue volatility. Should the recent growth continue, with a demonstration of less potential for volatility, and the administration be successful in implementing and acting on conservative planning practices and reserves, a rating revision may be justified.

## ■ Economy

From 1995 to 2001, property values dropped 23% cumulatively due primarily to the aftermath of a boom in construction and property values in the late 1980s driven by Japanese investment. After the departure of this capital, beginning in 1990, the property market weakened significantly. While the tax base has demonstrated this historic volatility, the rating and outlook reflect Standard & Poor's expectation that the current expansion is more sustainable than the one experienced during the late 1980s, due to a more stable source of investment, strong demand characteristics, and more limited housing supply. Appeals on existing properties, however, have increased moderately, and political pressure may increase to lower property tax rates in the face of recent appreciation. Total AV is anticipated to reach \$114 billion in fiscal 2006.

Chart 1  
Honolulu, HI Assessed Value



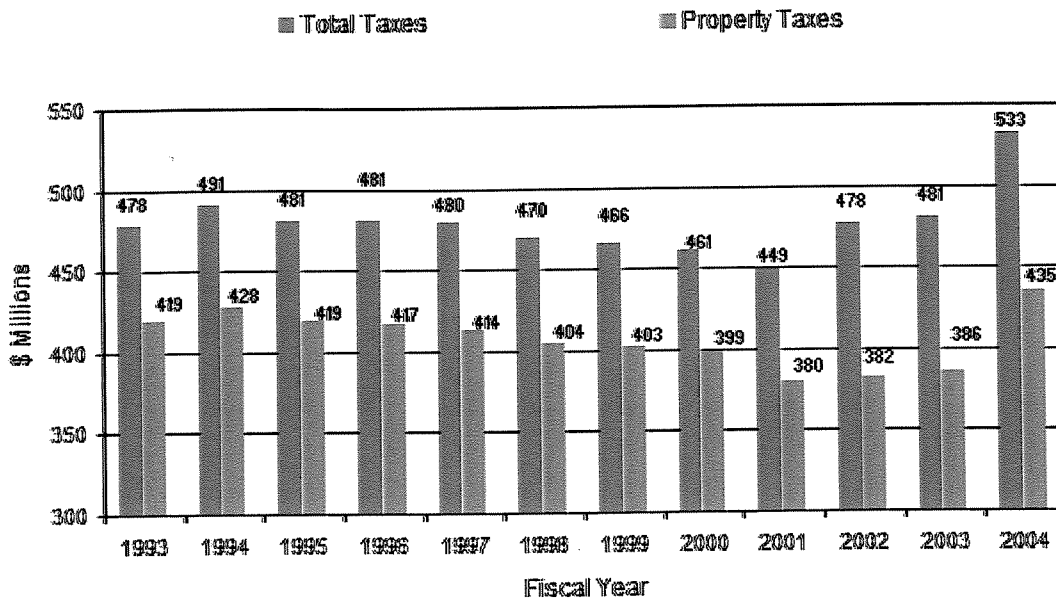
## Finance

Property taxes are the city's primary discretionary revenue source, accounting for 70% of total general fund revenues. As a result, city revenues experienced significant pressure during the 1990s but have rebounded strongly. The average property tax rate was increased in 2004 after several years of reductions and was maintained at the 2004 level for the 2005 budget. The new city administration, elected in November 2004, has stated its intent to maintain property tax rates in order to support current service levels. Property taxes in Honolulu and in Hawaii in general are currently among the lowest in the nation, as is the state's 4% sales tax. The city does not collect a sales tax but is distributed a portion of the state-collected transient occupancy tax (TOT), another major revenue source. Property tax delinquencies are currently at record lows.

The city maintains a 'rainy day' fund of \$5 million that the current mayoral administration plans to build-up further through one-time sales of under-utilized city land and other assets, as appropriate. The city general fund has delivered cumulative surpluses totaling \$20.8 million after transfers from fiscals 2002 through 2004, though it reported a \$10.5 million deficit in fiscal 2004 due to a budgeted use of a portion of the existing unreserved fund balance. In practice, the city budgets the unreserved fund balance for use during the following fiscal year but does not expend the entirety of those appropriations. These cumulative surpluses have been achieved through some service cuts and strong recent revenue trends.

Chart 2

## Honolulu, HI Tax Revenues



### Debt

In the late 1990s, the city restructured some of its debt profile to extend maturities and reduce some annual debt service carrying costs. The current amortization schedule achieves 59% payout of principal over the next 10 years. Upon taking office, the new city administration eliminated approximately \$60 million in anticipated capital expenditures during fiscal 2005 deemed less essential than other core needs, such as road improvements. Additionally, fees and user charges have been increased substantially for the city's wastewater fund. This ensures that the wastewater enterprise will continue to be self-supporting both for operations and for additional debt anticipated to upgrade the treatment facility to meet current environmental requirements.