MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns Aa1 rating to City and County of Honolulu's General Obligation Bonds Series 2012

Global Credit Research - 17 Oct 2012

Outlook is stable

HONOLULU (CITY & COUNTY OF) HI
Counties
HI

Moody's Rating

ISSUE		RATING
General Obligation Bonds, Series 2012F (Taxable)		Aa1
Sale Amount	$60,785,000	
Expected Sale Date	10/24/12	
Rating Description	General Obligation	
General Obligation Bonds, Series 2012B (Tax-Exempt)		Aa1
Sale Amount	$276,135,000	
Expected Sale Date	10/24/12	
Rating Description	General Obligation	
General Obligation Bonds, Series 2012C (Tax-Exempt)		Aa1
Sale Amount	$27,735,000	
Expected Sale Date	10/24/12	
Rating Description	General Obligation	
General Obligation Bonds, Series 2012A (Tax-Exempt)		Aa1
Sale Amount	$249,960,000	
Expected Sale Date	10/24/12	
Rating Description	General Obligation	
General Obligation Bonds, Series 2012D (Taxable)		Aa1
Sale Amount	$18,090,000	
Expected Sale Date	10/24/12	
Rating Description	General Obligation	
General Obligation Bonds, Series 2012E (Taxable)		Aa1
Sale Amount	$75,060,000	
Expected Sale Date	10/24/12	
Rating Description	General Obligation	
General Obligation Bonds, Series 2012G (Taxable)		Aa1
Sale Amount	$182,590,000	
Expected Sale Date	10/24/12	

Rating Description General Obligation

Moody's Outlook STA

Opinion

NEW YORK, October 17, 2012 --Moody's Investors Service has assigned a Aa1 rating and stable outlook to the City and County of Honolulu's General Obligation Bonds, Series 2012A (Tax-Exempt), 2012B (Tax-Exempt), 2012C (Tax-Exempt), Series 2012D (Taxable), Series 2012E (Taxable), Series 2012F (Taxable), and Series 2012G (Taxable) to be issued in the aggregate amount of approximately $890 million. The Series 2012A ($249.96 million) will finance various capital improvement needs. The remaining bonds (Series 2012B - Series 2012G) will refund outstanding general obligation bonds for debt service savings. In conjunction with the current credit review, Moody's has also affirmed the Aa1 rating and stable outlook on the city's approximately $2.6 billion of outstanding general obligation bonds. The bonds are secured by an unlimited property tax pledge; debt service payments represent a first charge on the city's General Fund.

SUMMARY RATINGS RATIONALE

The Aa1 rating primarily reflects the city's large economic base, above average resident wealth, and sound financial operations with recently improved reserve levels, as well as a manageable debt profile. Although the local economy has begun to recover slightly, Moody's will continue to monitor the city's ability to prudently address long-term fixed costs, improve reserve levels, and maintain overall fiscal stability.

STRENGTHS

-Large economy with strong tourist appeal complemented by substantial military and government sectors

-Prudent fiscal management demonstrated by conservative budgeting practices and recently improved reserve levels

-Demonstrated willingness to raise revenues and reduce spending to achieve budget balance

-Above average amortization of debt

CHALLENGES

-Above average cost of living and vulnerability to shifts in tourism-based economy

-Rising pension, health and benefit costs

-Uncertainty surrounding sequestration and possible downsizing of military presence

DETAILED CREDIT DISCUSSION

HONOLULU'S MODEST ECONOMIC RECOVERY CONTINUES, SUPPORTED IN PART BY SOLID VISITOR VOLUMES; ASSESSED VALUE INCREASES AGAIN IN 2013

Honolulu's modest economic recovery continues to be supported by a steady influx of tourists and expanding construction activity while potential federal defense cuts introduce near-term uncertainty. Total visitor arrivals began increasing in 2010 (6%) followed by a 4% increase in 2011. As of the second quarter of 2012 visitor arrivals are well above levels observed in the same period last year. Although historically comprising a smaller percentage of total visitor volume, international visitors are gradually making up a larger number of total visitors to Honolulu and this trend is expected to continue over the medium term. Similarly, hotel occupancy percentages also improved beginning in 2010 and have continued to improve through the first half of 2012.

Although federal cuts are a potential uncertainty, the military's emphasis on the Pacific ensures Honolulu is in better shape relative to other defense-heavy areas. Still, if the additional cuts required by sequestration come to fruition, they could be a significant drag on the economy. Also, Moody's notes a statewide push toward renewable energy should help to create jobs and push the local economy away from oil dependence over the long-term, while employment diversity continues to be supported by several sectors including the film and television industry, sustainable agriculture projects and traditional economic anchors including the military, health care, and banking sectors.

Real estate has also been another important element of Honolulu's economic success although the median price for single family homes continues to fluctuate. After peaking in 2007 single family home prices declined in 2008 (3.6%) and again 2009 (7.3%) before experiencing a modest increase in 2010 (3.1%). However, the increase was short-lived as the median price declined 3.0% in 2011. Positively, prices appear to have rebounded as of the second half of 2012 with a 6.9% increase.

Construction activity continues to expand as hotels and resorts move toward completion of new facilities and make improvements to existing property. Increasing multifamily development activity is also supporting construction payrolls and should provide further support for assessed value growth going forward. Between 2006 and 2011, assessed valuation (AV) increased an average of 7.4% annually, despite a significant decline of 7.6% in 2011. Positively, assessed values increased modestly in 2012 (0.3%) and again 2013 by a slight 1.1% to a very large $155.3 billion. Moody's notes Honolulu has not experienced high foreclosure activity given the relative rarity of sub-prime financing in Hawaii. Despite the moderating influence of many tourism-related service jobs, wealth indicators in Honolulu are favorable and the city's full value per capita totals an impressive $161,200.

Honolulu's unemployment rate continues to be a credit strength and as of June 2012, on an unadjusted basis, stood at 6.4%, compared with 7.1% for the state and 8.4% for the nation. The substantial military and government presence provides a stable employment base while business services as well as education/ healthcare and leisure /hospitality sectors have provided some job growth.

Construction of the $5.2 billion, 20-mile rail transit system will likely be delayed pending ongoing litigation concerning an environmental impact study. In addition, management has noted the city will incur general obligation debt on behalf of the Honolulu Authority for Rapid Transportation to construct the rail, but the bonds will be fully repaid from the proceeds generated by the General Excise Tax Surcharge. Moody's expects the new rail, when completed, should help to boost new development in the western portion of the island.

PRUDENT REVENUE ADJUSTMENTS AND CONTROLLED SPENDING ENABLE CITY TO MAINTAIN SOUND RESERVE LEVELS; FISCAL 2013 RESERVES EXPECTED TO IMPROVE SOMEWHAT

The city's financial operations are characterized by recently improved reserve levels, conservative budgeting practices and prudent revenue enhancement measures. The city improved reserve levels in the last two audited fiscal years and estimates for fiscal 2012 indicate reserve levels approximated the prior year. For the current fiscal year (2013) the city is confident reserve levels will improve somewhat. The city's commitment to maintaining budget balance and adequate reserve levels has been an important factor in Moody's credit evaluation of Honolulu.

Fiscal years 2009, 2010 and 2011 represented a particularly challenging financial period for the city as the slowing economy resulted in flat to declining property tax revenues, the city's primary operating revenue source, which was addressed through a combination of aggressive spending restrictions, department cuts and to a lesser extent, through certain revenue adjustments. Following a drawdown of general fund reserves in fiscal 2009, the city outperformed budgeted expectations and increased the fiscal 2010 unreserved general fund balance to equal 8.1% of general fund revenues, including transfers-in (or $104.0 million); combined with a slight increase to the Reserve for Fiscal Stability Fund (RFSF) available reserves equaled 10.2% of general fund revenues, including transfers-in ($130.9 million). For fiscal 2011 the city continued various spending restrictions and prudently increased the non-homeowner property tax rate from $3.42 to $3.58 per $1,000 AV and again contributed to its RFSF which totaled approximately $29.9 million (or 2.4% of general fund revenues). As a result of the GASB 54 requirements the RFSF, along with several other smaller funds, is now included in the committed general fund balance. The total general fund balance was equal to 19.3% of general fund revenues ($243.2 million) including an unassigned fund balance equal to 12.6% of revenues ($158.6 million). Moody's notes these reserve levels indeed demonstrate a long-term commitment to sound financial operations, but remain below the median for similarly-rated cities and counties nationally.

Estimates for fiscal 2012 indicate the city again outperformed budgeted expectations and reserves remained similar to the prior year. The stable reserve position was supported in part by a slight improvement in property tax collections as AV improved over the prior year combined with conservative budgeting and various cost saving measures including, for example, savings from an ongoing hiring freeze and continuation of furlough days as well as other expenditure controls. For fiscal 2012, the city also collapsed the non-homeowner and homeowner classifications back into one 'residential' tax rate; the change did not significantly impact collections. To close its own budget deficit in 2011, the state capped transient accommodation taxes distributed to counties, including Honolulu, through FY 2015. Given the small amount of the distribution relative to other operating revenues, the city notes this has not resulted in any significant impact to financial operations.

For the current fiscal year (2013) the city budgeted conservatively and despite expenditure increases associated with higher energy costs and increased pension contributions, reserve levels are anticipated to increase over the prior year. Prudently the city controlled salary costs by continuing an across-the board reduction of 5% within each city agency and made various revenue adjustments to recover service delivery costs. Additionally, the city should also benefit from an increase in property tax collections as new developments and improvements to existing property support AV growth.

Moody's believes prudent budgeting measures will support both preservation and gradual improvement of reserve levels in the near term. Nevertheless, similar to most major municipalities, Honolulu will continue to face its share of budget challenges in the near-term, in part due to the rising pension, health and benefit costs. The city faces a substantial OPEB liability, currently estimated at $1.74 billion (with no prefunding), with an associated annual cost of $139.7 million (fiscal 2011). As mentioned above the city contributed $40.1 million to its OPEB liability in fiscal 2011 and $40.0 million in fiscal 2012 with plans to resume fully funding the annually required contribution when economic conditions improve.

MANAGEABLE DEBT POSITION; AVERAGE PAYOUT

Moody's expects that Honolulu's debt levels will continue to remain manageable given reasonable borrowing assumptions and a relatively conservative debt structure. In addition, Honolulu benefits from the active role the state government plays in financing traditional municipal capital needs more typically funded at the local level throughout the rest of the country including transportation, health, justice, and education. In addition, in fiscal 2013 the city is building on efforts initiated in the 2012 budget to slow the rapid growth of general debt service. For example, efforts include increased cash funding for various projects and continuing to fund the construction activities of various enterprise systems from system rates rather than property taxes. As a result, future borrowings will emphasize revenue bond offerings in addition to general obligation issuances. The city's debt burden compares favorably to other cities and counties in the U. S. with overall debt representing only 1.7% of fiscal 2013 taxable values, although debt per capita is above average ($2,332). Including the current offering, the city has approximately $2.8 billion of outstanding general obligation bonds; the city has no exposure to long-term variable rate debt or derivative instruments in its G.O. borrowing program. Approximately 47.2% of the city's general obligation debt is retired in ten years.

Outlook

The stable rating outlook on Honolulu's general obligation bonds reflects Moody's expectation that the modest recovery underway for the city's economy will continue over the medium-term supported in part by increased tourism activity and buttressed by improvement in construction payrolls and supported as well by the large government and military presence. The stable credit outlook also incorporates Moody's expectation that the city will continue to take the actions necessary to ensure fiscal stability in light of flat revenue growth and rising pension, health and benefit costs over the near- to medium-term.

What could change the rating - UP

-Substantial local economic diversification and improvement in socioeconomic wealth indices

-Resolution of funding OPEB and pension liabilities

-Sustained financial and debt characteristics consistent with higher-rated entities

What could change the rating - DOWN

-Deterioration of financial operations and reserve levels

-Prolonged declines in assessed valuation

-A significant increase in debt

KEY STATISTICS:

2011 population: 963,607

2013 full valuation: $155.3 billion

2011 full value per capita: $161,200

Direct and overall debt burden: 1.7%

Payout of principal, 10 years: 47.2%

FY 2011 total General Fund balance: $243.2 million (19.3% of General Fund revenues)

FY 2011 unassigned General Fund balance: $158.7 million (12.6% of General Fund revenues)

The principal methodology used in this rating was General Obligation Bonds Issued by U.S. Local Governments published in October 2009. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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