City and County of Honolulu, Hawaii

Rating Rationale

- The city and county of Honolulu’s tourism attraction is strong, and the city and state have solid tourism infrastructure to promote, maintain, and develop the tourism base. However, this sector by its nature is cyclical.
- The city’s role as the regional center and state capital adds diversity and stability; Honolulu accounts for 70% of Hawaii’s population, labor, and employment.
- Although declining for the second consecutive year in 2009, the city’s tourism sector appears to returning, albeit slowly, to growth, in 2010.
- In spite of recent fund balance use, the city’s financial position remains sound, aided by spending cuts and increased taxes when necessary.
- Due to the large commercial sector, the city’s per capita debt burden is moderate but low as a percentage of market value.
- Labor negotiations are handled at the state level, somewhat limiting the city’s ability to control costs.
- Rising pension costs will continue to pressure the city’s finances, although funding is driven by the state. However, the city has proactively set up an OPEB reserve.

Key Rating Drivers

- A return to structural budgetary balance and maintaining satisfactory reserves as economic conditions improve, and in the interim, cutting spending and raising revenues.
- Stabilization in the tourism sector as economic recovery continues.

Credit Summary

Honolulu’s visitor industry is showing signs of a return to growth so far in calendar year 2010, following two years of significant declines. The city’s non-tourism economy is substantial and continues to somewhat balance tourism’s inherent volatility. The city is

Considerations for Taxable Bond Investors

This sector credit profile is provided as background for investors new to the municipal market.

Local Government General Obligation Bonds

The unlimited taxing power of most local government general obligation pledges is the broadest security a U.S. local government can provide to the repayment of its long-term borrowing and, therefore, is the best indicator of its overall credit quality. The average local government general obligation rating is ‘AA’, with approximately 85% rated at or above ‘AA’ and 1% rated ‘BBB’ or below. The relatively high ratings reflect local governments’ inherent strengths: the authority to levy property taxes, nonpayment of which can result in property foreclosures; additional taxing power that can include sales, utility, and income taxes; and essentiality of and lack of competition for services provided by local governments. Those with low investment-grade or below-investment-grade ratings generally have a combination of a limited or highly volatile economic base, high levels of long-term liabilities, including debt and post-employment benefits, and/or unusually limited financial flexibility. For additional information on these ratings, see “U.S. Local Government Tax-Supported Rating Criteria,” dated Oct. 8, 2010 and available on Fitch’s Web site at www.fitchratings.com.
the state’s commercial and business center, state capital, and home of the University of Hawaii, and has a sizable U.S. military presence. The city accounts for 70% of Hawaii’s population, roughly 60% of visitors, and approximately one-half of the hotel rooms statewide. Notably, for the first three quarters of 2010, the visitor count and hotel occupancy rose over the same period in 2009, and the average daily room rate is at its highest since 2001. Also, the city’s second-quarter 2010 unemployment rate fell to 5.4% from 5.9% in second-quarter 2009, although remaining well above pre-2009 rates. Income levels remain well above the national average, although this is somewhat offset by the island’s high cost of living.

The city is coterminous with the island of Oahu, and the island’s tourism draw is based on sustainable elements such as natural beauty, diverse accommodations and activities, and proximity to sizable North American and Asian markets. Tourism activity exhibits volatility typical of the sector, currently showing stability and a return to growth, following 10% and 4% declines in 2008 and 2009, respectively. Hotel occupancy softened modestly and then dropped to a still good 73% in 2009, 110% of the state’s level, and rose to 78% through September 2010.

The real estate market had remained relatively steady until fiscal 2011’s 7.8% decline in assessed value. The apparent lag effect owes to the valuation date being Oct. 1, 2009. However, this loss is in line with city estimates as it was building its fiscal 2011 budget. The city’s vulnerability lies in the home price run-up prior to 2006 and the presence of second homes and vacation properties. Indications through June 2010 show median single family home sales prices rising moderately, although some of this impact likely is the result of federal tax credits. Property taxes make up about 80% of the city’s discretionary general fund revenues. Offsetting this concern somewhat is the city’s ability to raise the property tax rate as was done in fiscals 2010 and 2011.

Financial operations are still sound as the city continues to control spending to below budget levels. Despite running a 4% operating deficit in fiscal 2009, the unreserved fund balance was a good 5.7% ($67.8 million) of the fund’s $1.15 billion in spending. In addition to the general fund the city maintains a reserve for fiscal stability ($26 million), bringing the total financial cushion to about 8% of fiscal 2009 spending. For fiscal 2010, the city projects ending with about the same combined level. For fiscal 2011, the city’s budget is balanced with additional salary and other spending cuts as well as using a $50 million internally held OPEB reserve for capital expenses instead. Nonetheless, the city still has $40.1 million held by the state for OPEB, which Fitch views as a proactive step in managing rising retirement costs. The budget also adds $2.6 million to the reserve for fiscal stability.

Debt levels are moderate at about $2,998 per capita and 1.8% of market value. Amortization is about average with 48% of principal retired in 10 years. Rising pension unfunded liabilities remain a concern since the state controls local governments’ contributions, and keeps them to an annually determined percentage of payroll, rather than the actuarially required contribution needed to fully fund retirement costs over no more than 30 years.

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