MOODY'S INVESTORS SERVICE

New Issue: **MOODY'S ASSIGNS Aa1 RATING AND STABLE OUTLOOK TO CITY AND COUNTY OF HONOLULU'S G.O. BONDS**

Global Credit Research - 23 Nov 2010

Approximately $2.6 Billion of Debt Affected, Including Current Offerings

Municipality
HI

Moody's Rating

ISSUE		RATING
General Obligation Bonds, Series 2010A (Build America Bonds)		Aa1
Sale Amount	$151,685,000	
Expected Sale Date	12/02/10	
Rating Description	General Obligation	
General Obligation Bonds, Series 2010B (Non-AMT)		Aa1
Sale Amount	$187,830,000	
Expected Sale Date	12/02/10	
Rating Description	General Obligation	
General Obligation Bonds,Series 2010C (Tax-Exempt)		Aa1
Sale Amount	$120,270,000	
Expected Sale Date	12/02/10	
Rating Description	General Obligation	

Opinion

NEW YORK, Nov 23, 2010 -- Moody's Investors Service has assigned a Aa1 rating and stable outlook to the City and County of Honolulu's General Obligation Bonds, Series 2010A Build America Bonds (Taxable), Series 2010B Bonds (Non-AMT), and Series 2010C Bonds (Tax-Exempt), expected to be issued in the aggregate amount of approximately $460.0 million. The Series 2010A taxable bonds ($151.7 million) will finance ongoing capital improvement needs and takeout portion of previously issued commercial paper notes; the Series 2010B bonds ($187.83 million) will fund a portion of the expansion of the city's H-Power facility, which is a city-owned renewable energy plant, as well as takeout a portion of the city's commercial paper notes; the Series 2010C taxable bonds ($120.3 million) 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 $2.3 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.

RATINGS RATIONALE

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

HONOLULU'S ECONOMY BEGINS TO RECOVER, ALTHOUGH VISITOR TRAFFIC IS DOWN; ASSESSED VALUE WILL DECLINE AGAIN IN 2012

Honolulu's economic recovery is beginning to outpace the nation as construction, house prices and unemployment indicators slowly improve. The tourism industry began to soften in calendar year 2006 and remained relatively stagnant until recent 2010 data suggest year-to-date increases of approximately 6%. Nevertheless, Honolulu remains a unique and attractive tourist destination and officials have been successful in niche marketing the island. Moody's notes that airline capacity serving the Hawaii tourism market relies on the health of the financially volatile airline industry. Moody's also notes improving diversity in the Honolulu economy which includes the military, health care, and banking sectors as important contributors.

Real estate has been another important element of Honolulu's economic success, leading to strong growth in assessed values in the period from 2001 to 2008. However, between 2007 and 2009 home prices declined, although modestly relative to the rest of the nation and since then has recovered gradually; as of the second quarter 2010, home prices are up 9.1% from the prior year. It is notable that Honolulu has not experienced high foreclosure activity given the relative rarity of sub-prime financing in Hawaii. Following a period of rapid escalation in property values in the late 1980s and early 1990s Honolulu's tax base experienced significant erosion from 1996 through 2001, losing almost one-fifth of its value during that period. Between 2006 and 2011, assessed valuation (AV) has grown by an average of 6.1% annually, including a significant decline of 7.8% in 2011 to a still sizeable $153.1 billion and management projects 2012 AV may decline slightly. Over the near-to-medium term horizon, several public and private large-scale projects have begun construction in calendar year 2010. In addition, the city's successful efforts to finance light rail development through a general excise tax surcharge should help stimulate further housing and business development in west Oahu, especially in the Kapolei and Ko Olina areas. Further, the city's economy will benefit from the stability provided by ongoing, substantial military activity. Despite the moderating influence of many tourism-related service jobs, wealth indicators in Honolulu are favorable with per capita and median family income at 107.1% and 149.3% of the U.S., respectively. The city's full value per capita totals an impressive $168,702, indicating an unusually wealthy tax base.

Honolulu's employment base has held up reasonably well during this recession, due in part to the significant presence of government and military jobs mentioned above. Unemployment in Honolulu improved year-to-date to 5.6% (August, 2010) from 6.0% (2009) and remains favorable compared to 6.6% for the state and 9.5% for the nation. Honolulu's economic activity represents roughly three-fourths of statewide economic output, so local figures mirror those of the state fairly closely.

GENERAL FUND BALANCE DECLINES IN FY 2008 AND FY 2009; INCREASED PROPERTY TAX RATE AND PRUDENT BUDGETING EXPECTED TO IMPROVE FINANCIAL OPERATIONS

Over the last two audited fiscal years the city's reserve levels have declined, but to still satisfactory levels and recent data suggest prudent budgetary and revenue enhancement measures resulted in an improvement to the general fund and other available reserves. However, Moody's notes the city will continue to face significant financial challenges from increasing fixed costs such as pension, health, benefits and debt service expenditures. Management's commitment to maintaining budget balance and adequate reserve levels has been an important factor in Moody's credit evaluation of Honolulu.

Audited results for fiscal 2008 showed a $10.3 million operating surplus in the General Fund which resulted in total fund balance of $166.1 million, or 13.1% of General Fund revenues; unreserved fund balance totaled $107.3 million, or 8.5% of revenues, which exceeds the city's target range of 5% to 8% of expenditures. Fiscal 2009 reserves declined due to sluggish revenue growth combined with increased salaries and retirement system contributions, a higher transfer amount to the city's OPEB reserve as well as small increase to the city's Reserve for Fiscal Stability Fund. The FY 2009 unreserved General Fund balance was 5.2% of general fund revenues ($67.8 million); combined with the Reserve for Fiscal Stability Fund ($26.1 million), available reserves totaled 7.2% of general fund revenues ($93.9 million).

Going into FY 2010, although management implemented aggressive spending restrictions, department cuts and a hiring freeze to offset a significant budget gap (approximately $127 million), the budget also indicated a sizeable drawdown of the unreserved general fund balance. Positively, unaudited results indicate management outperformed budgeted expectations which will result in an improved general fund reserve and additional contributions to other available reserves. The FY 2010 general fund reserve and the Reserve for Fiscal Stability are expected to have increased slightly relative to FY 2009. For the current fiscal year (2011) management continued various spending restrictions and prudently increased the residential non-homeowner property tax rate from $3.42 to $3.58 per $1,000 AV. In addition, management will again contribute to its Reserve for Fiscal Stability Fund.

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 $1.95 billion (with no prefunding), with an associated annual cost of $142.4 million. As mentioned above the city contributed $40.1 million to its OPEB liability and plans to resume fully funding the annually required contribution when economic conditions improve.

MANAGEABLE DEBT POSITION REFLECTS MODEST BORROWING PROGRAM AND SIZEABLE TAX BASE

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, management has begun 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 1.4% of fiscal 2011 taxable values. Including the current offering, the city has approximately $2.6 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 52.0% 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 city's gradual economic recovery will continue, albeit slowly, over the medium-term supported in part by the large and stable government and military sectors. The stable credit outlook also incorporates Moody's expectation that city management 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 would make the rating go - UP

-Significant diversification of economic base

-Significant and sustained increase in reserve levels

What would make the rating go - DOWN

-Deterioration of financial operations and reserve levels

-Prolonged declines in assessed valuation

KEY STATISTICS:

2010 population: 907,574

2007 per capita income: $28,033 (107.1% of U.S.)

2007 median family income: $74,667 (149.3% of U.S.)

2011 full valuation: $153.1 billion

2011 full value per capita: $168,702

Direct and overall debt burden: 1.4%

Payout of principal, 10 years: 52.0%

FY 2009 total General Fund balance: $116.7 million (9.0% of General Fund revenues)

FY 2009 unreserved General Fund balance: $67.8 million (5.2% of General Fund revenues)

FY 2009 unreserved GF balance and other available reserves: 93.9 million (7.2% of general fund revenues)

The last rating action with respect to the City and County of Honolulu's long-term rating was on October 30, 2009, when a General Obligation bond rating of Aa2 was assigned. That rating was subsequently recalibrated to Aa1, Stable Outlook on May 1, 2010

The principal methodology used in this rating was General Obligation Bonds Issued by U.S. Local Governments rating methodology published in October, 2009.

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Information sources used to prepare the credit rating are the following: parties involved in the ratings, public information, and confidential and proprietary Moody's Analytics information.

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