STANDARD & POOR'S Global Credit Portal RatingsDirect

Research

Summary:

Honolulu City And County, Hawaii; Water/Sewer

14-Oct-2010

Current Ratings

Credit Profile

US$175.995 mil wastewtr sys rev bnds (BABs) sr ser 2010B due 07/01/2041		
Long Term Rating	AA/Stable	New
US$104.55 mil wastewtr sys rev bnds (Tax-Exempt) jr ser 2010A due 07/01/2029		
Long Term Rating	AA-/Stable	New
US$32.04 mil wastewtr sys rev bnds (Tax-Exempt) sr ser 2010A due 07/01/2021		
Long Term Rating	AA/Stable	New
Honolulu City & Cnty wastewtr sys (Junior Ser) (2nd Bnd Res) (AGM) 2008A		
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded
Honolulu City & Cnty sr lien wstwtr		
Unenhanced Rating	AA(SPUR)/Stable	Upgraded

Rationale

Standard & Poor's Ratings Services raised its long-term rating and underlying rating (SPUR) to 'AA' from 'AA-' on the **City and County of Honolulu**, Hawaii's senior-lien wastewater revenue bonds and its rating and SPUR to 'AA-' from 'A+' on the city's junior-lien wastewater revenue bonds. The raised ratings are based on our opinion of the positive impact of the proposed consent decree on the city's ability to plan and manage its long-term capital needs. At the same time, Standard & Poor's assigned its 'AA' rating to the city's series 2010A and 2010B senior-lien wastewater revenue bonds and its 'AA-' rating to the city's series 2010C junior-lien wastewater revenue bonds. The ratings reflect our opinion of the system's:

- Broad and diverse customer base on Oahu, Hawaii's most populous island;
- Recent agreement to a proposed consent decree, which we believe removes uncertainty as the system's potential liability and facilitates more predictable long-term planning of capital requirements and costs needed to bring the system into regulatory compliance at the state and federal level;
- Active rate increases and practice of setting a fixed component of the rate structure to support operating costs;
- Good projected coverage on all long-term obligations supported by system net revenue; and
- Strong liquidity, which has grown from about four months of cash on hand in fiscal 2005 and is projected by management to remain around two years in the five-year forecast.

The rating strengths are somewhat offset by our view of a consent decree-driven capital plan of over $3 billion through 2020, which we believe will continue to pressure already-elevated user rates. Additionally, the sizeable capital plan, which doubles the amount of debt currently outstanding over the next five years, could potentially pressure operations.

The bonds are secured by a pledge of net operating revenues of the wastewater enterprise. The lower rating on the junior-lien bonds reflects the leverage position and management's plans to continue to issue debt secured by the senior lien. The city may issue a portion of the 2010senior-lien bonds as taxable Build America Bonds and elect to receive a direct federal subsidy. We understand that the senior-lien bond proceeds will be used to fund a portion of the city's 10-year capital plan, and the junior-lien proceeds will be used to refund outstanding bonds.

The system's long-term capital plan has been largely driven by consent decrees, administrative orders, and regulatory requirements related to wastewater spills and treatment. The city recently reached an agreement with the U.S. Environmental Protection Agency and the State of Hawaii Department of Health on a proposed consent decree, which outlines required system improvements and implementation deadlines to bring the system into compliance with sewage discharge treatment standards under the Clean Water Act and National Pollutant Discharge Elimination System permit requirements. The proposed consent decree will become effective if after review of comments received during the 30-day public comment period the U.S. Department of Justice decides to move the court for entry of the consent decree and the court decides to grant the motion. The proposed consent decree requires the collection system improvements be completed by June 30, 2020, and extends the timeline for upgrading the Honouliuli and Sand Island treatment plants to secondary treatment standards to 2024 and 2035, respectively, from what management had previously anticipated would be a 10-year deadline. Additionally, it resolves several lawsuits related to sewer spills and overflows and eliminates uncertainty related to the city's ability to receive approval for five-year secondary treatment waivers. We understand that the last application for a waiver was denied but has been addressed as part of the proposed consent decree.

The current long-term capital improvement program (CIP), initiated in 2001, runs through 2020. Capital costs outlined for fiscals 2011 through 2020 total $3.65 billion, primarily for capital costs to support all of the collection system improvements required under the proposed consent decree. The city has estimated that the potential cost to upgrade to secondary treatment is $480 million-$675 million, with completion beyond the current forecast period. The five-year CIP totals $1.55 billion of appropriations and will require significant debt financing: About 75% of the CIP will be funded with revenue bonds, which doubles the amount of long-term obligations supported by system net revenue. The CIP will also be supported by system net revenue (19%) and facility charges and state revolving fund loans. For fiscals 2016 through 2020, future revenue bonds represent about 80% of funding requirements and 15% from net system revenues. The system's leverage is moderately high, as demonstrated by a 0.73 debt-to-plant ratio for fiscal 2009. Debt includes outstanding revenue bonds, general obligation (GO) bonds supported by system net revenue, and state loans.

The system provides wastewater services for the Island of Oahu, which had an estimated population of 907,574 for 2009. We believe that the system's 10 treatment plants have adequate capacity to support demand: The system's reported average daily flow for 2010 was at or below 77% of design capacity at eight of its treatment plants, and two operated at about 85% of capacity. Management had projected that the average daily flow would exceed capacity at the largest plant by 2020, but has since extended that projection due to slower growth, water conservation efforts, and system improvements to reduce inflow and infiltration. Management currently projects equivalent single-dwelling unit growth to increase at an annual rate of less than 1%.

The customer base is primary residential, generating about 70% of annual revenue. The 10 largest customers are diverse, representing 7.5% of sewer service charges for fiscal 2010. The largest customer, the University of Hawaii, produced about 1.5% of fiscal 2010 sewer service charges. The monthly bill for single-family and duplex dwellings is what we consider to be elevated at $84.23 for 7,500 gallons; this amount includes a $68.39 base charge and $2.88 per 1,000 gallons of metered water over 2,000 gallons, effective July 1, 2010. The city-county of Honolulu's median household effective buying income was strong at 124% of the nation for 2009. However, the cost of living far exceeds the nation, as evidenced by a median home value that measures 320% of the nation.

In support of the system's financial requirements, largely driven by the CIP, the Honolulu City Council adopted a package of rate increases in fiscal 2005, as well as an incremental increase in fiscal 2007 that is in effect through fiscal 2011. Management also adopted a 15% rate increase for fiscal 2011, and projects annual rate increases of 4% and 5% will be needed in fiscal 2012 through fiscal 2014 and fiscal 2015, respectively. These rate increases are required to support management's projected coverage of annual debt service between fiscals 2010 and 2015: what we consider to be strong senior-lien debt service of 5.2x, declining to 1.8x, and combined senior- and junior-lien revenue bond debt service of between 3.1x and 1.4x. If also including management's projected one-time system facility charges and other obligations such as state revolving fund loans and GO bonds repaid with net revenues of the system, coverage ranges from 2.23x to 1.32x. The decline in coverage over the forecast period reflects the annual issuance of additional parity bonds. The forecast also reflects an annual increase of 3% and 6% to operating expenses and personnel costs, respectively. The city's pro forma debt service for combined senior- and junior-lien outstanding and these 2010 bonds shows maximum annual debt service to occur in fiscal 2025 at $109.3 million, excluding federal subsidies. However, with additional projected debt, the combined annual debt service grows more rapidly to $108.3 million by fiscal 2012 and to $170.4 million by fiscal 2015. The bond resolution's additional bonds coverage ratios are 1.2x for the senior lien and 1.1x for the junior-lien. Management has reported that its financial policies include a requirement to maintain at least 1.6x coverage on the senior-lien debt and 1.25x coverage on combined senior- and junior-lien debt.

Adopted financial policies include an operating reserve policy to maintain at least three months of annual operation and maintenance expenses. Liquidity has been strong, exceeding the reserve policy minimum: The system's cash on hand totaled 128 days in fiscal 2005, growing to nearly four years in fiscal 2009. Management attributes the growth in the cash balance to rate increases and actual results outperforming the budget. During the forecast period, fiscals 2011-2015, management has projected that cash will be lower, but still strong, in our opinion, at about two years' cash on hand, net of planned capital outlay for the CIP.

Outlook

The stable outlook reflects our expectation that the proposed consent decree will become effective, allowing the city to solidify its long-term capital requirements and debt financing needs. Concern related to the sizeable capital plan and strict implementation deadlines within the consent decree is somewhat mitigated by our expectation that the city will continue to be proactive in financial and capital planning, and regularly review the rate structure such that coverage remains at good levels. The stability of the rating also partially depends on the city's maintenance of strong liquidity to support unplanned sewer system repairs and contingencies for the sizable capital plan.

Related Criteria And Research

- USPF Criteria: **Key Water And Sewer Utility Credit Ratio Ranges**, Sept.15, 2008
- USPF Criteria: **Standard & Poor’s Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds**, Sept. 15, 2008

Ratings Detail (As Of 14-Oct-2010)

Honolulu City & Cnty wastewtr sys rev bnds (second resolution) jr ser 1998, 2003, and 2009A		
Long Term Rating	AA-/Stable	Upgraded
Honolulu City & Cnty wastewtr sys rev bnds (First Resolution) sr ser 2007C, ser 2009A, and ser 2009B		
Long Term Rating	AA/Stable	Upgraded
Honolulu City & Cnty wastewtr sys (Sr Series) (First Bond Resolution) ser 2007A wrap of insured (MBIA) (BHAC) (SEC MKT)		
Unenhanced Rating	AA(SPUR)/Stable	Upgraded
Honolulu City & Cnty wastewtr (wrap of insured) (FGIC & AGM) (SEC MKT) 2005A		
Unenhanced Rating	AA(SPUR)/Stable	Upgraded
Honolulu City & Cnty Wastewtr Sys Rev Bnds (BABs/RZEDs) (First Resolution) Senior ser 2009C		
Long Term Rating	AA/Stable	Upgraded

Honolulu City & Cnty sr wstwtr

Unenhanced Rating	AA(SPUR)/Stable	Upgraded

Many issues are enhanced by bond insurance.

Complete ratings information is available to RatingsDirect subscribers on the Global Credit Portal at www.globalcreditportal.com and RatingsDirect subscribers at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.

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