Tax Supported
New Issue

City and County of Honolulu, Hawaii

Rating
General Obligation Bonds .... AA

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New Issue Details
$141,500,000 General Obligation Bonds, Series 2001A, and $8,500,000 General Obligation Bonds, Series 2001B, scheduled to sell through negotiation on or about Feb. 28 through a syndicate led by PaineWebber Inc. Series 2001A bonds mature serially Sept. 1, 2005–2024, and series 2001B bonds mature serially on Sept. 1, 2004 and 2005. Series 2001A bonds are subject to optional redemption at dates and prices to be determined closer to pricing. Series 2001B bonds are noncallable.

Security: Bonds are secured by the city and county of Honolulu's full faith and credit unlimited ad valorem tax pledge.

Purpose: Proceeds from series 2001A will finance various capital projects. Proceeds from series 2001B will finance or refinance equipment acquisitions.

■ Outlook
Honolulu's credit strength rests on the sound fundamentals of its tourism-based economy, satisfactory financial operations, and good year-end cushion despite current economic weakness. Also, the state capital and federal military presence provide stability. The city's low debt burden, partially a result of the state's broad role, is a positive rating factor. Economic activity is improving, with tourism rising and building activity stimulated by property tax credits. While short-term recovery of Asian tourist trade is not expected, Honolulu's tourism industry is highly developed and has strong underpinnings, such as physical beauty, substantial tourist infrastructure, and proximity to mainland U.S. markets.

■ Rating Considerations
Encompassing the entire island of Oahu, the City and County of Honolulu encompasses much of the state's economic activity. About 71% of Hawaii's residents live in Honolulu and generate 78% of the state's personal income. About 70% of all visitors to the state stay on Oahu for all or part of their trip, and the island has one-half of the state's hotel rooms. Tourism dominates the economic base, with some depth added by the island's military presence, the state capital, the University of Hawaii, and other government employment. Federal defense spending statewide, but primarily in Honolulu, consistently makes up about 10% of Hawaii's gross state product. The strategic Pacific location and the shutdown of military bases elsewhere benefit Honolulu, and the outlook is for stability in the island's military's presence.

Tourism activity is beginning to recover from a nearly decade-long decline. The number of visitors to Honolulu in 2000 rose 1.0%, following a smaller 0.3% rise in 1999. Average length of stay rose significantly for both international and domestic (mainland U.S.) tourists. The average hotel occupancy rate rose in 2000 as well, for the first time in four years. The average room rate increased too, following three years of declines. Building activity has picked up and includes sizable hotel, timeshare, and retail developments and expansions. Much of this development results from the city's seven-year property tax abatement program from all non-residential projects begun by June 30, 2003. Residential property sales also show strength, and prices are beginning to stabilize. As a result, the city is expecting fiscal 2002 to show the first assessed value gain in seven years. The recent economic improvement, albeit slow, evidences Honolulu's strong tourism underpinnings, primarily its physical beauty and location. Also, the island's visitor industry is highly developed, with substantial private sector infrastructure (hotels, shopping, restaurants, recreation, and entertainment) and sizable public investment.

Previously, tourism levels had declined as the island suffered first from a prolonged recession in California and, more recently, from weakness in the economies of Japan, South Korea, and other Asian countries. Asian tourists made up 48% of Honolulu's visitors last year, down from 55% in 1997. However, Asian tourists spend substantially more than mainland U.S. visitors. The tourism decline weakened real estate markets, resulting in a cumulative 21.0% assessed value decline over six consecutive years.

Financial operations are strained but satisfactory, mirroring the economy. Property value declines presented city officials with sizable budgetary challenges. Balance has been achieved through offsetting tax rate increases, fee and charge rises, and expenditure control. Balancing measures in recent years included a major government restructuring, which consolidated 26 departments into 17. The city continues to implement additional operating and structural efficiencies, resulting in a 7% workforce reduction since 1994. Budget balance also was assisted by a reduction in the city's contributions to the statewide employees' retirement funds, enabled by the funds' strong performance. However, these payments will return to higher levels in 2002.

The general fund's unaudited fiscal 2000 ending balance was a sound 9.3% of expenditures and transfers out, its highest level in several years. The general fund ran its second consecutive operating surplus in fiscal 2000, based on unaudited results. Despite the consistent tax base declines, the city has run operating surpluses in three of the last four fiscal years. Financial operations to date for the current fiscal year suggest continued satisfactory operations and a good year-end fund balance. The property tax rate for fiscal 2001 was not increased, following two consecutive years of rises.

Honolulu's debt burden is low, largely reflecting the state's major role in capital funding and operations. Excluding general obligation bonds sold for various self-supporting enterprises, overall debt after this issue is $1,401 per capita and 1.76% of market value. These figures are up substantially from two years ago, reflecting greater new issuance, as well as the tax base decline. Nonetheless, the ratios are reasonable, and future issuance plans should keep the debt burden affordable. Principal payment for the new bonds is deferred until fiscal 2005 to provide budget relief. Amortization of all debt is slightly above average, with 57% of outstanding par maturing in 10 years.

Strengths

- Tourism-based economy has strong underpinnings, such as physical beauty, public and private infrastructure, and location.
- Role as state capital provides some economic stability.
- Sound financial operations, despite strained revenues, and good ending balances.
- Prudent management actions in recent years, including tax rate and fee increases, organization consolidation, and spending controls.
- Low debt burden (average including state bonds).

Risks

- Tourism-based economy's stagnant performance in the past decade.
- Affect of Asian countries' weakness, reducing tourist visits and spending. Recovery in the near term not expected.
- Tax base losses and other revenue declines.

Debt

Proceeds from series 2001A and 2001B bonds will finance facilities and equipment, respectively, in the city's six-year capital improvement program. The city expects to continue its trend of annual debt issuance, ranging from $100 million–$150 million per year. The debt burden should remain affordable given the city's declining debt service schedule and recent plans to gradually refund general obligation bonds paid from enterprise fund resources with revenue bonds.

Honolulu's debt repayment schedule is slightly above average, with 57% of outstanding par (after this issue) maturing in 10 years. The current schedule is slower than in earlier years, as a result of a debt restructuring

Debt Statistics

($ Mil.)

This Issue	150
Outstanding General Obligation Bonds	1,493
Other Direct Debt	74
Less: Self-Supporting Bonds	(505)
Total Direct Debt	1,212
Overlapping Debt	—
Total Overall Debt	1,212

Debt Ratios

Direct Debt Per Capita ($)*	1,401
Overall Debt Per Capita ($)*	1,401
As % of Market Value**	1.76

*Population: 864,571 (1999).
**Market value: $68,676,198,500 (2001).

General Fund Financial Summary
($000, Audited Fiscal Years Ended June 30)

	1997	1998	1999	2000*
Property Taxes	413,844	404,415	402,827	399,115
Intergovernmental	43,357	45,450	38,302	33,680
Reimbursements and Recoveries	66,289	65,893	77,880	88,716
Other	60,508	57,082	62,773	58,285
Total Revenues	583,998	572,840	581,782	579,796
General Government	73,498	81,639	87,197	83,464
Public Safety	170,036	172,605	186,325	178,544
Retirement and Health Benefits	91,088	93,028	76,462	53,663
Other	118,765	109,407	107,799	64,542
Total Expenditures	453,387	456,679	457,783	380,213
Results	130,611	116,161	123,999	199,583
Transfers and Other Uses/(Sources)	(125,500)	(131,011)	(114,522)	(190,467)
Net Income/(Deficit)	5,111	(14,850)	9,477	9,116
Total Fund Balance	46,964	40,266	49,743	58,859
As % of Expenditures/Transfers Out	7.0	5.7	7.5	9.3
Unreserved Fund Balance as % of Expenditures/Transfers Out	4.0	3.5	4.6	6.1

*Unaudited.

in fiscal 1999 and principal retirement from this issue maturing in fiscal 2004 and beyond. Prior to the fiscal 1999 refinancing, 70% of all general obligation bond par matured in 10 years. The restructuring and current issue's principal deferral are designed to provide budget relief while the economy and, hence, property tax collections recover. The fiscal 1999 restructuring reduced debt service payments through fiscal 2003 and extended the final maturity by three years to fiscal 2021. While both of these results are acceptable, given the city's overall debt structure, they are indicative of financial pressures.

Honolulu's overall debt burden is low, at $1,401 per capita and 1.76% of market value. These figures are net of general obligation debt paid from water, wastewater, solid waste, and housing funds. Total outstanding debt includes $150 million in variable-rate bonds sold last year and making up just under 10% of the city's gross debt portfolio, a reasonable level.

The current ratios represent a significant increase over the last two years, rising 18% for debt per capita and 35% for debt relative to market value. The gain reflects $150 million in new debt in both this year and last. The market value measure's increase also results from the continued property value declines. The debt ratios also reflect the fiscal 1999 refunding of wastewater general obligation bonds with revenue debt. Fitch rates Honolulu's wastewater system first and second bond resolution revenue bonds 'AA–' and 'A+', respectively.

The low debt burden partially results from the highly centralized nature of Hawaii's state government. The state finances and performs many functions usually done by local governments, including capital financing for schools.

■ Finances

Honolulu's financial operations are strained but improving as stagnant revenues are offset by reductions in spending. The city's main source of revenue, property taxes, continues to decline, along with state-shared tourism revenue and certain other revenues. Tax increases, higher fees and charges, and new revenue sources have somewhat compensated for these declines. Meanwhile, the city continues to limit and, where possible, reduce spending through greater operational efficiency and reduced contributions to the statewide employees' retirement fund.

The Hawaiian State government assumes several functions normally the responsibility of local government, including education, health and welfare, judicial operations, and operation and maintenance of all airports and harbors. Honolulu's operational responsibilities are limited to functions such as public safety, highways and streets, sanitation, culture and recreation, planning and development, several utilities, and general administrative services.

Despite lower tax revenue, the general fund has run operating surpluses in four of the last five fiscal years. As a result, fund balances continue to provide a sound

Honolulu Selected Tourism Statistics

	1997	1998	1999	2000*	% Change 1999–2000
Eastbound Visitors (000s)	2,739	2,435	2,261	2,284	1.0
Westbound Visitors (000s)	2,280	2,283	2,471	2,492	0.9
Total Visitors (000s)	5,019	4,718	4,732	4,776	0.9
Eastbound Average Days Stay	N.A.	N.A.	4.8	5.8	19.7
Westbound Average Days Stay	N.A.	N.A.	7.2	7.5	4.1
Honolulu Hotel Occupancy (%)	78.6	73.8	73.1	76.1	5.8
Hawaii Hotel Occupancy (%)	74.0	72.0	73.1	77.9**	6.6

*Through November, annualized. **Full year figure. N.A. – Not available.

financial cushion. The fiscal 2000 general fund balance totaled $58.9 million, or 9.3% of expenditures and transfers out, its highest level since the early 1990s. The unreserved balance ended the fiscal year at a healthy 6.1% of expenditures and transfers out, or $38.2 million, up from 4.6% in fiscal 1999 and 3.5% in fiscal 1998. In addition to growing balances in the general fund, the city recently set aside an additional $5.0 million "rainy-day fund" reserve.

The general fund's primary revenue source is property taxes. Total property tax revenue for fiscal 2000 was $399.1 million, or 68.8% of general fund revenues, a decrease of $3.7 million from fiscal 1999 and the sixth consecutive year in decline. Six consecutive years of declining assessed values, marked by a record 6.3% ($4.8 billion) decrease in fiscal 1999, continue to reduce property tax revenues. The city opted to increase tax rates in both fiscal 2000 and fiscal 1999 to partially offset property value losses. The weighted average tax rate per $1,000 in taxable value for fiscal 2000 was $5.59, up 5.5% from fiscal 1999 and 12.5% above the fiscal 1998 rate. However, the current rate remains well below the fiscal 1990 rate of $7.42.

Allocations from the state transient accommodation tax are another important general fund revenue source. Effective Jan. 1, 1999, the state increased the rate to 7.25% from 6.00%. However, the state allocation formula was changed, reducing the share distributed to the city. As a result, transient accommodation tax (TAT) revenues, recorded as intergovernmental revenue, decreased by 15.2% ($6.7 million) in fiscal 1999 and an additional 11.0% ($4.1 million) in fiscal 2000. Overall, intergovernmental revenues totaled 5.8% of fiscal 2000 general fund revenue, down from 7.4% in fiscal 1997. Reimbursements and recoveries revenues, 15.2% of general fund revenue in fiscal 2000, rose 13.9% as a result of enhanced collection efforts on reimbursements from the state for services provided by the county. Other general fund revenue sources include licenses and permits (4.5%) and interest revenue (2.2%). Major non-general fund revenues include a fuel tax, vehicle weight tax, and public utility franchise tax (each levied to support the highway fund), user charges (such as the sewer service charge), and specified licenses, permits and other fees.

General fund expenditures decreased dramatically in fiscal 2000 both as a result of planned program reductions and an accounting change related to sanitation expenditures. Fiscal 2000 general fund expenditures totaled $380.2 million, a decrease of 16.9% from fiscal 1999. However, around one-half of the reduction may be attributed to a transfer of sanitation expenditures to a new solid waste special fund. The largest expenditure item, public safety (47.0%), was reduced 4.2% to $178.5 million as a result of controls placed on overtime and enhanced operating efficiencies. Substantial reductions were realized in retirement and health benefits spending following a determination that strong earnings in the statewide employees' retirement fund could offset the city's annual contributions in fiscal 2000 and fiscal 2001. Reductions in fiscal 1999 came as a result of early retirement incentive costs being spread out over a longer period. General government spending also fell, benefiting from operating efficiencies and headcount reductions through attrition, which have totaled 7% countywide since fiscal 1994.

Current estimates for fiscal 2001 suggest that revenues will exceed budgeted levels with higher than anticipated property tax collections (although still below fiscal 2000 totals), TAT revenues projected at $2.0 million above budget, and growth in building permit fee receipts. Meanwhile, expenditures are estimated to end fiscal 2001 below budget as a result of further spending control measures.

Labor negotiations among the city's major bargaining units, the United Public Workers and Hawaiian Government Employees Association, are unresolved and will remain so until all local and state agency negotiations are complete. However, a four-year agreement is under discussion between the city and unions for fiscal years 2000–2003 that includes flat salaries in fiscal 2000 and fiscal 2001 and increases for fiscal 2002 and fiscal 2003. Labor settlements are negotiated for members across all local and state government agencies at once. Furthermore, no payments are required until both the state assembly and each local government board approves funding for prior agreements. Lack of consensus among the various government entities and certain non-county labor unions have prolonged the negotiations.

■ Economy

Honolulu's economy is dominated by well developed tourism, with an element of diversity and stability added by a strong military presence and the city's role as Hawaii's capital and business and commercial center. Tourism activity is recovering from nearly a decade-long decline, suffering first from economic weakness in California and, more recently, by economic troubles in Japan and throughout Asia.

Visitors from Asia and other areas requiring eastbound travel to Hawaii made up 48% of all visitors in 1999 and 2000, declining from 55% of Oahu's total in 1997. Statewide eastbound visitors (referred to as "international" beginning in 2000) make up about 34% of all tourists. Total visitors to the island have risen 1.2% in the last two years, reversing a dramatic 6.0% decline in 1998. However, eastbound tourist visits rose only last year; westbound activity (now known as "domestic" and counting only mainland U.S. travelers) rose in both years, totaling 9.2%. Honolulu's 1998 decline was greater than that experienced statewide, reflecting the higher share of eastbound tourists to this island. Most notably, estimates for 2000 (based on data through November) show a significant rise in average length of stay, rising 4.6% for domestic travelers and 19.7% of international.

While the number of eastbound and westbound visitors is about equal in the city, average spending by Japanese and other Asian tourists well exceeds that of westbound travelers. On average, eastbound tourists spend nearly twice that of mainland U.S. visitors. This figure is down from nearly triple in 1988, with the relative decline reflecting the Asian economic weakness and the better U.S. economy.

The number of visitors to Honolulu has been cyclical, peaking in 1990 and recovering to nearly that level by 1997. The 2000 estimated visitor count, while improved, remains 4.8% below the 1997 peak. Visitors dropped annually through 1993, reflecting the U.S. recession and its particularly strong effect in California. The visitor count rose steadily between 1994–1997, reaching 99% of the 1990 peak.

Estimates for 2000 show the first improvement for the hotel industry in several years. Average occupancy in Honolulu is estimated at 76.1%, up from 71.9% in 1999 but below the state's recently released actual figure, 77.9%. The 2000 occupancy rate gain is particularly notable in light of a $3, or 2.8%, rise in the average room rate, to $112 per night. This is the first gain in three years and is only $1 below the 1997 rate. In recent years, despite the visitor declines, hotel occupancy remained satisfactory, hitting a 71.9% low in 1999. While the 2000 estimate represents a sizable gain, it remains below the 1990 peak, 93.6%. Most of the loss reflects the visitor decline, although a portion results from new construction stimulated by the very high occupancy rate in the late 1980s and early 1990s.

Honolulu's economy benefits from elements that add diversity and stability: a large military presence; the state capital; the University of Hawaii; and being the business and commercial center of the state. About three-quarters of all state jobs are located in Honolulu. Government is the largest source of earnings for Honolulu residents at 33%, followed by services with 27%, and trade at 14%. However, government is the third largest employer, at 22% of all jobs. Honolulu's job base is led by services, with 30%, and trade, with 22%. While a substantial portion of the services and trade employment is generated by tourism, a portion also meets the needs of the city's residents.

The sizable military presence results from Honolulu's strategic Pacific location, as well as the historic significance of Pearl Harbor. While military employment declined through 1993, it has been relatively stable since and is expected to remain at about the current level. The Army, Navy, Air Force, Marine Corps, and Coast Guard all have a presence on Oahu. The U.S. Pacific Fleet's commander-in-chief is located at Pearl Harbor, as is the headquarters of the Third Fleet. Pearl Harbor's tourist appeal is enhanced with the permanent berthing of the battleship USS Missouri. A bridge now connects Pearl Harbor with the Navy's Ford Island. Plans are under way for a mixed-use development there. The Navy is seeking special legislation to allow private developers to participate.

Honolulu's employment base has exhibited small but consistent declines, falling a total 2.1% from 1995–1999. Given the dramatic losses in other economic indicators, these small annual losses evidence the government sector's stabilizing influence. Also, the annual declines have gotten smaller every year, beginning at 0.9% in 1996 and reducing to 0.3% in 1999. A small gain is expected when final figures for 2000 are released. The labor force responded more slowly to the economic weakness, resulting in rising unemployment through 1998. However, the level remained moderate and below the state average. Unemployment declined to an estimated 3.5% in 2000 from 4.9% in 1999.

The city and state aggressively market themselves as a convention site and tourist destination and continue to invest in tourism-generating facilities. The state opened a sizable convention center in Honolulu in 1998, and bookings extend to 2010. Also, the city recently renovated a smaller exhibition facility. As a result, the number of convention visitors rose 20% in 2000. Other city improvements include the recently completed reconstruction and improvements to the Waikiki promenades, natatorium, bandshell, and zoo. The recent economic weakness has had a significant affect on taxable property value, which declined for the sixth consecutive year in fiscal 2001.

The recent economic weakness has dramatically affected the tax base, with assessed value declining for six consecutive years through fiscal 2001. However, the city now expects assessed value to rise 1.5% for fiscal 2002. The fiscal 2001 net value, $68.7 billion, is 20.9% below the fiscal 1995 peak. The annual value declines, ranging from 0.7% for fiscal 1997 to 6.3% for fiscal 2000, reflect property sales at lower values, reductions through appeals, and reassessments made based on general market declines. The assessed value figures are net of an allowance for appeals, equal to 50% of the disputed value. Taxpayers must fully pay their current taxes before filing an appeal, and the city prudently deposits one-half of this payment into an escrow account. Funds are released from the account once the appeal is settled.

The city's real estate market is showing signs of improvement. Office space began the recovery first, with the vacancy rate in downtown Honolulu falling to 12.7% for fiscal 2000's third quarter from 14.1% for fiscal 1999 (full year.) Historically, the downtown area has performed better than the city overall. Rental rates are increasing slowly, and this trend should continue. The residential real estate market has also improved, as continued annual gains in number of sales finally is having a positive impact on price. Median sales prices for both single-family homes and condominiums rose in fiscal 2000 for the first time since fiscal 1993. However, the average sale price for single-family homes remains 12.2% below that of fiscal 1995, and the average condominium sale price is 29.9% fiscal 1995. Experts expect prices to continue to rise since the increase in sales has reduced resale inventory significantly. In fact, existing homes for sale now are approaching the low level that Honolulu experienced in 1990, a very strong market year.

Population grew 3.2% during the 1990s, with gains occurring through 1997. Since then, however, the population declined by 1.0% to 864,571. Income levels are 11% above the state average and 20% greater than the nation. Exceeding the national average partially reflects the high cost of living on the island. Despite the recent and prolonged downturn, per capita income has risen every year since 1990.