



New Issue: Honolulu (City & County of) HI Sewer Enter.

**MOODY'S ASSIGNS Aa3 RATING AND STABLE OUTLOOK TO HONOLULU'S SENIOR LIEN WASTEWATER SYSTEM REVENUE BONDS**

**A1 RATING AFFIRMED ON JUNIOR LIEN BONDS**

Water/Sewer  
HI

**Moody's Rating**

ISSUE	RATING
Wastewater System Revenue Bonds (First Bond Resolution), Senior Series 2007A, 2007B, and 2007C	Aa3
<b>Sale Amount</b>	\$237,640,000
<b>Expected Sale Date</b>	07/23/07
<b>Rating Description</b>	Senior Lien Wastewater System Revenue Bonds

**Opinion**

NEW YORK, Jul 16, 2007 -- Moody's Investors Service has assigned an Aa3 rating and stable outlook to the City and County of Honolulu's Wastewater System Revenue Bonds (First Bond Resolution), Senior Series 2007A, 2007B and 2007C, expected to be issued in the approximate amount of \$237.64 million. At this time, Moody's also affirms the Aa3 rating on the system's approximately \$552.20 million of outstanding senior lien bonds and the A1 rating on the system's approximately \$457.08 million of outstanding junior lien bonds. The ratings are based primarily on satisfactory coverage of debt service provided by existing revenues, the City's recent approval of substantial multi-year rate increases to support system obligations, continuing progress on the system's sizable capital improvement plan which will require additional borrowing in the coming years, and the favorable economic base served by the wastewater enterprise. The stable rating outlook is based on Moody's expectation that, despite the presence of significant future borrowing plans, the wastewater system will continue to maintain favorable financial performance consistent with the City's conservative financial and debt policies.

**SYSTEM NET REVENUES PROVIDE SOUND DEBT SERVICE COVERAGE; CITY APPROVES REVISED MULTI-YEAR RATE INCREASES**

The City has been careful to adopt substantial rate increases in advance of debt issuance, enabling system revenues to keep pace with growing debt service requirements and provide satisfactory overall coverage. In fiscal 2006, first lien coverage was high at 5.90 times, while coverage of first and second lien bonds combined was 3.13 times. Including reimbursable general obligation bonds and SRF loans, 2006 coverage of all system obligations was 2.37 times, though this total coverage figure is expected to decline somewhat in the coming years as total debt service requirements ramp up from recent and planned borrowings. The City's long-term financial projections indicate that coverage levels will continue to comply with its adopted policy calling for a satisfactory 1.6 times on senior lien bonds and 1.25 times on combined senior and junior lien bonds; including reimbursable general obligation bonds and SRF loans, projected coverage of all system obligations is expected to comfortably exceed the City's target of 1.05 times coverage on all system obligations. At the Aa3 and A1 rating levels on the senior and junior lien bonds, respectively, Moody's believes that it will continue to be important for the City to maintain debt service coverage levels in excess of established policy levels.

An important consideration in the assigned ratings is the City's adoption of substantial multi-year wastewater system rate increases in 2005, and again in 2007. As part of his inaugural budget in 2005, the Mayor proposed rate increases of 25% in fiscal 2006 and 10% annual increases thereafter through fiscal 2011; in June 2005, the City Council passed an ordinance adopting these increases. More recently, in June 2007, the City approved another round of rate increases to take effect in 2008 through 2011. Under the newly adopted structure, rates will increase by 25% in 2008 (15% higher than originally adopted in 2005) 18% in 2009 and 2010 (8% higher than the rates approved in 2005) and 15% in 2011 (5% higher than previously approved). Even after the 25% rate increase in fiscal 2006 and the 10% increase in 2007, wastewater rates remain comparable to the rates of other major urban systems on the mainland. Moody's believes these rate actions represent important achievements in ensuring adequate bondholder security going forward.

## LARGE CAPITAL PLAN COULD EXPAND WITH RECENT REGULATORY CONCERNS

As with other wastewater treatment systems, the City and County of Honolulu faces evolving state and federal regulations on treatment and discharge standards. The potential for stricter standards in the future adds a measure of uncertainty to the system's future capital needs and additional borrowing plans beyond those currently contemplated by management. For example, in March 2007, EPA issued a tentative decision to deny application for a renewed variance from secondary treatment at the City's Honouliuli wastewater treatment plant. The City also expects EPA, in October 2007, to issue a similar denial for a variance from secondary treatment at the larger Sand Island treatment plant. Though the City has undertaken efforts to reach a global settlement on these matters with EPA, Moody's believes that the outcome of these negotiations will result in substantial additional capital requirements not currently included in the capital improvement plan. Moody's will monitor the progress of these negotiations and comment as warranted. To maintain the system's current ratings, Moody's anticipates that the City will continue to raise rates as necessary to maintain satisfactory debt service coverage even if additional borrowing expands beyond currently planned levels to address these regulatory issues.

The system provides wastewater services for approximately 74% of the island of Oahu's population which includes Honolulu (general obligation bonds rated Aa2/stable). The customer base is diversified with residential users representing 77.0% of the system's fiscal 2006 revenues while the ten largest customers accounted for only 6.05% of 2006 revenues. The system operates eight wastewater treatment plants serving an area of almost 600 square miles.

Since 1991, the Environmental Protection Agency (EPA), the State of Hawaii, and several environmental groups have filed various legal and regulatory actions against the City and County of Honolulu alleging violations of the federal Clean Water Act and several of the permits held by the wastewater department. Honolulu has entered into four consent decrees in connection with the settlement of these actions which establish a required compliance schedule for project implementation. Among other things, the consent decrees require that Honolulu rehabilitate and expand certain existing facilities and construct new facilities. In addition to actions taken to date, the wastewater department has developed capital improvement plans covering periods of five, ten and twenty years, in part to comply with the existing consent decrees. The long-range capital program will also address safety and public health, permit compliance, system expansion and reliability issues. Capital expenditures over the 2008-2012 period are estimated to total \$1.64 billion, approximately \$1.28 billion of which is expected to be funded from the proceeds of additional senior and junior lien bonds, including the current offering. As a result, the system's 2006 debt ratio of 58.5% is expected to grow over time, but remain manageable.

## ROBUST ECONOMY BENEFITS FROM STRONG PERFORMANCE OF TOURISM SECTOR

Honolulu's economy has performed remarkably well in recent years, particularly given the sharp declines in travel to Hawaii for a brief period following the 9/11 terrorist attacks. Unemployment in Honolulu, at 2.3% in April 2007, remains among the lowest in the nation. Rising real estate values have had an important influence on the local economy, but a variety of other factors have contributed as well. Visitor traffic has improved significantly since the steep declines suffered immediately following the 9/11 terrorist attacks. Eastbound (primarily Asian) and other international traffic still lags historical performance, but Westbound traffic (primarily from the U.S. West and East coast markets) has more than offset these losses. Hawaii remains a unique and attractive tourist destination and officials have been successful in niche marketing the island. Examples include sports- and eco-tourism as well as a growing inter-island cruise business, all of which attract a higher percentage of first time visitors and stimulate longer average stays. 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. The City's successful efforts to finance light rail development through a recently-authorized general excise tax should help stimulate further housing and business development in west Oahu, especially in the Kapolei and Ko Olina areas. Despite the moderating influence of many tourism-related service jobs, wealth indicators in Honolulu are also favorable with per capita and median family income at 101.9% and 120.1% of the U.S., respectively.

## STANDARD LEGAL PROVISIONS BOLSTERED BY ADOPTION OF FORMAL FINANCIAL POLICIES

Legal provisions include covenants to maintain a Debt Service Reserve Fund, equal to maximum annual debt service, on both liens of bonds and stipulate the maintenance of rates and charges sufficient to generate net revenues at least equal to 1.20 times the amount needed to pay debt service on the senior lien bonds and 1.10 times on combined senior and junior lien debt service. A similar covenant is provided for the issuance of additional parity bonds under both liens although officials report that most future borrowing is expected to be issued through the senior lien. The reimbursable general obligation bonds, as well as the debt service on the system's state revolving fund loans, are secured by a lien on net system revenues which is subordinate to the lien created by the junior lien bonds.

Legal provisions are significantly bolstered by the formal adoption of conservative debt and financial operating policies by the City Council which require compliance with annual targets of 1.6 times coverage on the senior lien bonds and 1.25 times on first and second lien bonds combined. In addition, the City Council resolution incorporates a favorable three month operating and maintenance reserve fund policy which will

serve to insulate the system from unexpected events. Moody's expects that the system will comply with these more stringent operating policies as opposed to the levels stipulated by the legal covenants of the bond documents.

## Outlook

The stable rating outlook is based on Moody's expectation that, despite the presence of significant future borrowing plans, the wastewater system will continue to benefit from approved rate increases and maintain favorable financial performance consistent with the City's financial and debt policies.

## KEY STATISTICS:

Service area population, 2005: 876,156

Operating ratio, 2006: 60.2%

Senior lien debt service coverage, 2006: 5.90x

Combined senior and junior lien debt service coverage, 2006: 3.13x

Debt service coverage of all system obligations (including G.O. and SRF loans), 2006: 2.37x

Peak senior lien debt service coverage by FY 2006 net revenues: 1.5x

Peak senior and junior lien debt service coverage by FY 2006 net revenues: 0.9x

Debt ratio, 2006: 58.5%

Net working capital as % of gross revenues, 2006: 69.3%

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