

# City and County of Honolulu, Hawaii

## General Obligation Bonds New Issue Report

### Ratings

#### New Issues

|  |     |
|--|-----|
| General Obligation Bonds, Series 2015A | AA+ |
| General Obligation Bonds, Series 2015B | AA+ |
| General Obligation Bonds, Series 2015C | AA+ |
| General Obligation Bonds, Series 2015D | AA+ |
| General Obligation Bonds, Series 2015E | AA+ |

#### Outstanding Debt

|                          |     |
|--------------------------|-----|
| General Obligation Bonds | AA+ |
|--------------------------|-----|

### Rating Outlook

Stable

### New Issue Details

**Sale Information:** \$878,805,000 General Obligation Bonds, Series 2015A, 2015B, 2015C, 2015D, and 2015E, selling the week of Mar. 16 via negotiation.

**Security:** The full faith and credit of the city and county of Honolulu supported by an unlimited pledge of ad valorem property tax.

**Purpose:** To fund various capital improvements and refund outstanding debt.

**Final Maturity:** June 30, 2040.

### Key Rating Drivers

**Stable Economy:** Honolulu's economy has proven its stability over the long term, with ongoing growth in tourism activity despite periodic downturns. The city also benefits from its position as the state's political and business center in addition to substantial defense-related investments.

**Strong Financial Position:** Ample reserves and demonstrated revenue-raising ability provide the city with the flexibility to manage both expenditure pressures and economic cyclicalities.

**Substantial Carrying Costs:** Fixed costs for debt service and retiree benefits comprise a high and growing share of general fund spending.

**Mixed Long-Term Obligations:** Debt levels are low to moderate on a per capita basis and as a proportion of taxable assessed value due in large part to the provision of some typically municipal functions by the state. Funding levels for retiree benefits are notably low, but recent reforms appear likely to reduce unfunded liabilities in coming years.

### Rating Sensitivities

**Debt and Retiree Benefits Key:** Projected increases in debt service requirements and expenses for retiree benefits could result in downward rating pressure if not matched by revenue growth or expenditure reductions elsewhere. Conversely, material improvement in pension and other post-employment benefit funding levels, in combination with continued strong credit fundamentals, would increase upward rating pressure.

### Related Research

Fitch Rates Honolulu, HI's \$878.8MM GOs 'AA+'; Outlook Stable (March 2015)

Fitch Assigns 'AA+' Rating to Honolulu (HI) Water Revenue Bonds; Outlook Stable (November 2014)

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### Rating History

| Rating | Action   | Outlook/ Watch | Date     |
|--------|----------|----------------|----------|
| AA+    | Affirmed | Stable         | 3/13/15  |
| AA+    | Affirmed | Stable         | 10/9/14  |
| AA+    | Affirmed | Stable         | 10/17/12 |
| AA+    | Affirmed | Stable         | 7/6/11   |
| AA+    | Affirmed | Stable         | 11/18/10 |
| AA+    | Affirmed | Stable         | 5/21/10  |
| AA+    | Revised  | Stable         | 4/30/10  |
| AA     | Affirmed | Stable         | 10/27/09 |
| AA     | Affirmed | Stable         | 3/20/09  |
| AA     | Affirmed | Stable         | 10/26/07 |
| AA     | Affirmed | Stable         | 10/24/05 |
| AA     | Affirmed | Stable         | 5/12/05  |
| AA     | Affirmed | Stable         | 3/24/04  |
| AA     | Affirmed | Stable         | 7/21/03  |
| AA     | Affirmed | Stable         | 2/12/01  |
| AA     | Affirmed | Stable         | 5/23/00  |
| AA     | Assigned | Stable         | 3/12/99  |

### Credit Profile

The city and county of Honolulu encompass the island of Oahu, Hawaii's third- largest island with an area of approximately 600 square miles. Honolulu's approximately 1 million residents account for about 70% of the state's population and jobs.

### Stable Economy

Honolulu's economy benefits from a resilient visitor industry that has maintained its strength throughout periodic downturns. Tourism levels have fluctuated in recent decades in response to both natural disasters and financial crises, but have proven stable over the longer term. Honolulu's visitor industry continues to show moderate growth following declines during the last recession. Visitor arrivals and related tourism metrics have risen steadily over the past five years.

The city's non-tourism economy is also substantial and balances tourism's inherent volatility. Honolulu is the state's commercial and business center, a regional transportation hub, and the state capital. In addition, the city retains a sizable U.S. military presence due to its strategic Pacific location and its economy reflects substantial defense-related investments.

An improving economy has helped spur substantial new investment in the city, with numerous retail, residential, and hotel projects planned or underway in downtown Honolulu. In addition, ongoing construction of the city's new fixed guideway transit system has encouraged plans for several large-scale residential developments along its 20-mile route.

Unemployment rates have consistently remained lower than mainland averages and the December 2014 rate of 3.4% was well below the national average. Employment growth has been fairly steady following the national recession and total employment exceeds the pre-recession peak. Wealth and income levels compare favorably to national averages, although this advantage is somewhat offset by the island's high cost of living.

The property tax base in Honolulu remained relatively stable in the recession until fiscal the 7.6% decline in assessed value in fiscal 2011. The tax base grew modestly in the following three years and recorded strong gains of 9.6% and 7.7% in fiscal years 2015 and 2016. Home values rose by 8.5% year-over-year as of December 2014 according to Zillow.com and now exceed pre-recession peaks by nearly 10%. Continued gains in the value of existing homes, in combination with new commercial and residential construction, bode well for the city's finances, as property taxes provide about 80% of general fund revenues.

### Related Criteria

[U.S. Local Government Tax-Supported Rating Criteria \(August 2012\)](#)

[Tax-Supported Rating Criteria \(August 2012\)](#)

### Debt Statistics

| (\$000)   |                  |
|---|------------------|
| This Issue (Approximate)  | 878,805          |
| Outstanding Direct Debt — Net of Refunding  | 2,139,904        |
| Self-Supporting   | (562,575)        |
| <b>Total Net Direct Debt</b>  | <b>2,456,134</b> |
| Overlapping Debt  | 0                |
| <b>Total Overall Debt</b>   | <b>2,456,134</b> |
| <b>Debt Ratios</b>  |                  |
| Net Direct Debt Per Capita (\$) <sup>a</sup>  | 2,501            |
| As % of Gross Assessed Value <sup>b</sup>   | 1.3              |
| Overall Debt Per Capita (\$) <sup>a</sup>   | 2,501            |
| As % Gross Assessed Value <sup>b</sup>  | 1.3              |
| <sup>a</sup> Population: 983,429 (2013 estimate). <sup>b</sup> Gross assessed value: \$184,338,798,000 (fiscal 2014). |                  |

### Strong Financial Position

Honolulu's strong financial position is supported by good reserve levels, balanced operations, and demonstrated revenue flexibility. The city finished fiscal 2014 with \$309 million in unrestricted fund balance, equivalent to 25.8% of general fund spending. This amount

represents an 8.0% decline relative to fiscal 2013, when year-end balances were boosted by the city's decision to eliminate a \$50 million subsidy to its solid waste disposal facility for one year.

The 2015 budget is balanced and provides for a \$10 million deposit to the city's fiscal stability fund, which is accounted for as unrestricted fund balance. The proposed 2016 budget calls for an additional deposit of \$30 million, which would raise the balance to approximately \$100 million. If adopted by the city council this action would raise the city's fiscal stability fund to the top end of its targeted range for the first time since adoption of this policy in 2006.

Honolulu's financial flexibility is aided by its large tax base and flexible provisions for increasing property tax revenue. The city council has a strong track record of approving and modifying tax rates, with adjustments made on an annual basis. Differential rates for residential and non-residential property allow the council to limit the impact of tax increases upon residents, as do substantial homeowner exemptions. Property tax rates are low relative to national averages, in part due to the state's responsibility for funding grades K–12 education, and delinquencies are also consistently low.

The city's most direct financial exposure to tourism is through the transient accommodation tax (TAT), a levy upon hotel and rental properties. Hawaii's legislature recently extended a cap on county shares of TAT that was established during the downturn, but such amounts represent less than 4% of general fund revenues for Honolulu.

### **Substantial Carrying Costs**

General fund expenditure requirements include high shares for debt service, pension contributions, and other post-employment benefits (OPEB), at approximately 30% of governmental expenditures in 2013. New debt issuances and rising pension and OPEB contribution requirements appear likely to increase this ratio over the next several years and could limit the city's ability to meet other spending demands if revenues do not keep pace.

### **Mixed Long-Term Obligations**

Debt ratios for Honolulu are low to moderate. Overall debt is equal to 1.3% of taxable assessed value and \$2,501 per capita.

The city anticipates substantial new GO issuances for its new rail transit project system and other capital needs over the next several years. The rail project is supported by federal funding and a 0.5% general excise tax surcharge authorized through 2022. Recent increases in construction costs and shortfalls in estimated revenues have prompted new legislative proposals to extend the surcharge and could affect the timing and scope of borrowing for this project, which appears likely to exceed its original \$5.2 billion budget. Additionally, the city has large borrowing needs for wastewater, estimated at \$3.5 billion through 2020, which are expected to be met with future revenue bond issuances. Debt amortization for GOs is about average with 50% of principal repaid in 10 years and new issuances are limited to a maximum maturity of 25 years.

Honolulu participates in state-sponsored pension and OPEB plans that have seen significant reforms over the past several years. Revisions to the pension plan include lower benefit levels for new hires and higher contribution rates as well as reductions in assumed investment returns. OPEB reforms have focused on improved funding, with participating employers required to make 100% of actuarially-determined annual required contributions (ARC) by 2019. The city is

on pace to beat this deadline after contributing approximately three-quarters of its OPEB ARC in 2013, 2014, and 2015.

The city's pension and OPEB plans appear likely to remain challenged for some time. Under an assumption of 7.0% investment returns, Fitch estimates that pension assets represented a low 55.0% of liabilities at the end of 2013. Reported OPEB pre-funding was equal to 6.9% of liabilities for the same period. Recent revisions to retiree benefits and contributions have improved the sustainability of these programs, but material improvement in funding ratios will likely take many years and require continued discipline on the part of plan sponsors and employers.

### General Fund Financial Summary

(\$000, Audited Fiscal Years Ended June 30)

|   | 2010             | 2011             | 2012             | 2013             | 2014             |
|---|------------------|------------------|------------------|------------------|------------------|
| Property Tax Revenue                                | 852,294          | 800,913          | 805,352          | 822,980          | 841,949          |
| Other Tax Revenue                                   | 49,393           | 37,999           | 47,842           | 52,444           | 53,108           |
| <b>Total Tax Revenue</b>                            | <b>901,687</b>   | <b>838,912</b>   | <b>853,194</b>   | <b>875,424</b>   | <b>895,057</b>   |
| License and Permits                                 | 34,686           | 34,258           | 35,811           | 38,335           | 42,797           |
| Fines and Forfeits                                  | \$562            | \$551            | \$395            | \$590            | \$847            |
| Charges for Services                                | 5,521            | 6,008            | 6,215            | 6,318            | 7,867            |
| Intergovernmental Revenue                           | 198,142          | 224,526          | 49,168           | 41,062           | 41,060           |
| Other Revenue                                       | 45,188           | 47,447           | 52,480           | 50,679           | 51,440           |
| <b>General Fund Revenue</b>                         | <b>1,185,786</b> | <b>1,151,702</b> | <b>997,263</b>   | <b>1,012,408</b> | <b>1,039,068</b> |
| General Government                                  | 128,576          | 121,733          | 127,084          | 124,601          | 131,740          |
| Public Safety Expenditures                          | 312,443          | 325,480          | 330,766          | 324,357          | 344,315          |
| Public Works Expenditures                           | 2,086            | 0                | 1,805            | 2,818            | 2,550            |
| Health and Social Services Expenditures             | 6,040            | 2,430            | 8,032            | 7,672            | 9,044            |
| Culture and Recreation Expenditures                 | 58,826           | 51,000           | 56,921           | 58,031           | 59,277           |
| Capital Outlay Expenditures                         | 1,548            | 0                | 0                | 0                | 2,561            |
| Debt Service Expenditures                           | 985              | 359              | 898              | 922              | 922              |
| Other Expenditures                                  | 180,546          | 203,859          | 217,642          | 215,109          | 212,346          |
| <b>General Fund Expenditures</b>                    | <b>691,050</b>   | <b>704,861</b>   | <b>743,148</b>   | <b>733,510</b>   | <b>762,755</b>   |
| <b>General Fund Surplus</b>                         | <b>494,736</b>   | <b>446,841</b>   | <b>254,115</b>   | <b>278,898</b>   | <b>276,313</b>   |
| Transfers In  | 102,267          | 106,172          | 113,104          | 134,457          | 146,673          |
| Other Sources                                       | 72               | 435              | 1,331            | 1,493            | 56               |
| Transfers Out                                       | 563,749          | 542,963          | 361,917          | 330,684          | 434,975          |
| <b>Net Transfers and Other</b>                      | <b>(461,410)</b> | <b>(436,356)</b> | <b>(247,482)</b> | <b>(194,734)</b> | <b>(288,246)</b> |
| <b>Net Surplus/(Deficit)</b>                        | <b>33,326</b>    | <b>10,485</b>    | <b>6,633</b>     | <b>84,164</b>    | <b>(11,933)</b>  |
| Total Fund Balance                                  | 150,018          | 243,225          | 249,858          | 334,022          | 308,849          |
| As % of Expenditures, Transfers Out, and Other Uses | 12.0             | 19.5             | 22.6             | 31.4             | 25.8             |
| Unreserved Fund Balance <sup>a</sup>                | 104,053          | —                | —                | —                | —                |
| As % of Expenditures, Transfers Out, and Other Uses | 8.3              | —                | —                | —                | —                |
| Unrestricted Fund Balance <sup>b</sup>              | —                | 243,225          | 249,858          | 334,022          | 308,849          |
| As % of Expenditures, Transfers Out, and Other Uses | —                | 19.5             | 22.6             | 31.4             | 25.8             |

<sup>a</sup>Pre-GASB 54. <sup>b</sup>Reflects GASB 54 classifications: sum of committed, assigned, and unassigned. Note: Numbers may not add due to rounding.

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