City and County of Honolulu, Hawaii
General Obligation Bonds
New Issue Report

New Issue Details


Security: Full faith and credit, supported by an unlimited pledge of ad valorem property tax.

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

Final Maturity: Nov. 1, 2037.

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 Flexibility: Ample reserves and demonstrated revenue-raising ability provide the city and county with the flexibility to manage both expenditure pressures and economic cyclicality.

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

Mixed Long-Term Obligations: Debt levels are low on a per capita basis and as a proportion of taxable assessed value, due in large part to the absence of overlapping entities, but funding levels for the state-sponsored pension system are notably low.

Related Research

Fitch Rates Honolulu, HI Wastewater System Senior Revs ’AA’; Outlook Stable (September 2012)
Fitch Rates Honolulu, HI’s GOs ‘AA+’; Outlook Stable (July 2011)

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Credit Profile

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 remarkably stable over the longer term. Honolulu’s visitor industry is showing strong growth in 2012, following declines during the recent recession. Visitor arrivals and days have risen steadily since mid-2009, and both average daily room rates and hotel occupancy levels continue to grow. The city’s nontourism economy is also substantial and balances tourism’s inherent volatility. The city is the state’s commercial and business center, a regional transportation hub, and the state capital. In addition, Honolulu retains a sizable U.S. military presence due to its strategic Pacific location, and its economy reflects substantial defense-related investments.

More than 70% of Hawaii’s population and jobs are in Honolulu, and more than one-half of all tourist expenditures statewide are made in the city. Unemployment rates have consistently remained lower than mainland averages, and the July 2012 rate of 5.7% was well below the national average despite recent fluctuations. Wealth and income levels also 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 2011’s 7.6% decline in assessed value, and returned to modest growth in fiscal years 2012 and 2013. Housing starts remain well below peak levels, but residential properties retain much of their prerecession value, with median home prices in 2012 just 7% below peak levels. Commercial and residential investments show strong signs of growth in 2012, with a variety of large projects under way or in planning stages. These results bode well for the city’s finances, as property taxes provide 82% of discretionary general fund revenues.

Strong Financial Flexibility

Honolulu maintained its strong financial position during the recent downturn, with operating surpluses after transfers in four of the past five audited fiscal years. Unreserved fund balances increased by 53% in fiscal 2010, and with GASB 54 consolidations, the unrestricted fund balance rose by a remarkable 134% (to 19.5% of general fund spending) in fiscal 2011. Management expects further improvements in fund balance for fiscal 2012, which Fitch Ratings considers likely based on the city’s record of conservative budgeting.

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 nonresidential property allow the council to limit the impact of tax increases upon residents, as do substantial homeowner exemptions.

Property taxes are reserved for county government under Hawaii’s constitution, and competing demands for such revenues are limited by the state’s unique distribution of municipal responsibilities. All local services are provided at the county level, but K-12 education, health, and welfare are overseen and financed by the state government. Hawaii’s counties receive 100% of property tax revenues as a result, reducing their reliance on more economically sensitive tourism revenues. The county’s most direct exposure to tourism is through the transient accommodation tax (TAT), a levy upon hotel and rental properties. Hawaii’s legislature has capped county shares of TAT through
In response to recent operating pressures, but such revenues represent less than 4% of general fund spending for Honolulu.

Substantial Carrying Costs

General fund expenditure requirements include somewhat high shares for debt service, pension contributions, and other post-employment benefits (OPEB), at approximately 28% of general fund spending in fiscal 2011. Excluding debt service payments supported by highway taxes, this ratio declines to a still substantial 23% of general fund spending. Management has made some progress in reducing the rate of growth for future debt service, but spending requirements are expected to continue to increase due to additional GO issuances planned through 2018. Pension spending is also likely to increase to offset investment losses in the state-sponsored pension plan. Overall carrying costs will likely rise over the next several years due to these higher debt service and pension requirements 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 due in large part to the absence of overlapping taxing entities. Overall debt is equal to 1.2% of gross assessed value and $2,300 per capita. The tax burden on residents is further reduced by the high proportion of parcels (up to two-thirds) with offshore ownership. Capital plans for Honolulu’s proposed $5 billion rail line rely on a voter-approved temporary excise tax surcharge and are not anticipated to require general fund support; the fate of this controversial project likely will become clearer following the November 2012 mayoral election.

Honolulu participates in a state-sponsored cost-sharing multiple-employer pension plan, which is poorly funded. Actuarially valued assets represented just 59% of reported liabilities at the end of 2011, or 55% under Fitch’s alternate assumption of 7% investment returns. Recent pension reforms have sought to improve funding levels through a reduction in benefits for new hires and restrictions on pension spiking, but will also increase the city’s pension contributions over the next several years. OPEBs are funded on a pay-as-you-go basis, and the city has begun to address this liability with recent contributions to an irrevocable trust.

### Debt Statistics

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
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</thead>
<tbody>
<tr>
<td>This Issue (Approximate)</td>
<td>890,400</td>
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<tr>
<td>Outstanding Direct Debt — Net of Refunding</td>
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<tr>
<td>Self-Supporting</td>
<td>(794,084)</td>
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<tr>
<td><strong>Total Net Direct Debt</strong></td>
<td><strong>2,216,664</strong></td>
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<tr>
<td>Overlapping Debt</td>
<td>0</td>
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<tr>
<td><strong>Total Overall Debt</strong></td>
<td><strong>2,216,664</strong></td>
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</tbody>
</table>

### Debt Ratios

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Direct Debt Per Capita ($)</td>
<td>2,300</td>
</tr>
<tr>
<td>As % of Gross Assessed Value</td>
<td>1.2</td>
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<tr>
<td>Overall Debt Per Capita ($)</td>
<td>2,300</td>
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<tr>
<td>As % Gross Assessed Value</td>
<td>1.2</td>
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The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.