Honolulu (City & County), Hawaii

New Issue Report

Ratings

Long-Term Issuer Default Rating	AA+

New Issues

$223,835,000 General Obligation Bonds Series 2018A	AA+
$47,630,000 General Obligation Bonds Series 2018B	AA+
$4,090,000 General Obligation Bonds (Taxable Green Bonds) Series 2018C	AA+
$1,110,000 General Obligation Bonds (Taxable Green Bonds) Series 2018D	AA+
$2,140,000 General Obligation Bonds (Taxable Green Bonds) Series 2018E	AA+
$182,580,000 General Obligation Bonds (Taxable Green Bonds) Series 2018F	AA+

Outstanding Debt

General Obligation Bonds	AA+

Rating Outlook

Stable

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New Issue Summary

Sale Date: Week of Aug. 13

Series: 2018A (tax-exempt), 2018B (tax-exempt), 2018C (taxable green bonds), 2018D (taxable green bonds), 2018E (taxable green bonds), 2018F (taxable green bonds).

Purpose: To fund various capital needs and refund outstanding debt for interest savings.

Security: General obligation

Analytical Conclusion

The 'AA+' IDR reflects the city's strong revenue framework, affordable long-term liabilities, and robust operating performance, somewhat offset by its high carrying costs for debt service and retiree benefits.

Economic Resource Base: 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. Honolulu's population of 1 million represents approximately 70% of the statewide total.

Key Rating Drivers

Revenue Framework: 'aaa'
Property taxes account for nearly 85% of general fund revenues and policy-adjusted revenue growth has been moderate historically, exceeding inflation but below overall U.S. economic performance over the past 10 years. The city has unlimited legal authority to modify property tax rates and has made regular adjustments to increase revenues.

Expenditure Framework: 'aa'
Based on recent spending practices and continued strong revenue performance, Fitch expects that city expenditure increases will be in line with to marginally above revenue growth. However, carrying costs for debt service and retiree benefits are high relative to similarly-rated entities and could challenge the city's ability to reduce expenditures in a downturn.

Long-Term Liability Burden: 'aa'
Long-term liabilities for debt service and pensions are moderate relative to total personal income, but other post-employment benefits (OPEBs) liabilities are large and inflexible. Recent statewide reforms to retiree benefits will help slow the growth of related liabilities, but funded ratios remain relatively low.

Operating Performance: 'aaa'
The city is well-positioned to address economic challenges as a result of limited revenue volatility and substantial reserves.

Rating Sensitivities

Financial Flexibility: The rating is sensitive to continued strong operating performance and could be pressured by sustained reductions in reserves or uncontrolled expenditure growth. The Stable Rating Outlook reflects Fitch's expectation that such actions are unlikely.

Rating History (IDR)

Rating	Action	Outlook/ Watch	Date
AA+	Affirmed	Stable	8/07/18
AA+	Revised	Stable	4/30/10
AA	Affirmed	Stable	3/20/09
AA	Affirmed	—	10/26/07
AA	Affirmed	Stable	3/24/04
AA	Assigned	—	3/12/99

Credit Profile

Honolulu's economy has performed strongly in recent years with increasing diversification, steady growth in tourism and a continued substantial military presence. Tourism activity has been subject to periodic declines historically but has proven resilient over the long term, and unemployment rates have been consistently below the U.S. average. The city also appears likely to benefit from ongoing consolidation of U.S. military activity in the Pacific.

Honolulu's economic growth has been bolstered in recent years by substantial new construction activity. Major infrastructure projects include an $8 billion rail transit project as well as improvements to the local water and sewer system, airport, and harbors. Honolulu's Kaka'ako neighborhood has seen the recent completion of several residential towers, and large resort and master-planned residential developments are also underway in West Oahu.

Revenue Framework

Property taxes provide the chief source of general fund support for the city, with no other revenue source accounting for more than 5% of total revenues. Tax rates are set based on property type, allowing the city to limit the tax burden on residents relative to commercial and resort properties.

Fitch expects Honolulu's revenue growth, absent policy actions, to increase more rapidly than inflation but below U.S. GDP based on the city's resilient tax base and economy. While revenue gains may be affected by periodic economic shocks, solid growth is expected over the long term.

The city has unlimited legal authority to raise property tax revenues and has regularly adjusted tax rates and property classifications to serve its fiscal needs.

Expenditure Framework

The city provides a broad range of municipal services with the notable exception of elementary and secondary education, which are operated and funded at the state level. Public safety, with associated pension costs, accounts for about half of total general fund expenditures.

Fitch expects that the natural pace of spending growth will be in line with to marginally above expected revenue growth based on the city's current spending profile. The recent trend of steady expenditure growth will continue, but ongoing revenue gains are likely to maintain pace.

The city's ability to control personnel expenses is somewhat limited by negotiation of contracts at the state level and relatively strong labor protections, including binding arbitration. Carrying costs for debt service and retiree benefits are also notably high at 29% of governmental expenditures as of fiscal 2017, limiting the city's options for spending reductions in a downturn. However, recent increases in expenditures for retiree benefits are based partly on the city's efforts to accelerate pre-funding of other post-employment benefits (OPEBs).

Long-Term Liability Burden

Long-term liabilities for debt and pensions are affordable relative to the city's wealthy resource base at approximately 11% of personal income, but the city's unfunded OPEB liability is also substantial at $1.8 billion as of fiscal 2017, equivalent to an additional 3.3% of personal income. The city has made notable progress in funding its OPEB program, moving from pay-go to full funding of the annual required contribution within the span of several years, but has no ability to reduce accrued benefits.

Related Research

Fitch Rates Honolulu, HI's $462MM GOs 'AA+'; Outlook Stable (August 2018)

Related Criteria

U.S. Public Finance Tax-Supported Rating Criteria (April 2018)

The city's fiscal 2017 financial statements reported a 51% ratio of assets to liabilities for its largest pension plan based on its assumed 7.00% investment return rate; this level would fall to an estimated 45% based on Fitch's more conservative 6% return assumption. Actuarial contribution rates are determined by statute and adjusted periodically if the funding period exceeds 30 years. Fitch's supplemental pension metric, which estimates annual pension contributions based on a more conservative level dollar payment for 20 years with a 5% interest rate, indicates that contributions at the actuarial level would likely be insufficient to reduce pension liabilities over time.

In recent years the state legislature has lowered assumed investment returns, extended mortality assumptions, and phased in higher employer contribution requirements; these changes have increased the city's reported net pension liability and expenses but improve the longer-term sustainability of the plan.

The city is currently engaged in the construction of a major rail transit project supported by federal funding and a temporary 0.5% general excise tax (GET) surcharge. Project costs to date have been addressed through a combination of pay-go funding and short-term borrowing with longer term borrowing by the city on behalf of the project anticipated over the next several years. To address a widening funding gap for the project, Hawaii's legislature met in special session in late 2017 and agreed to extend the GET surcharge and increase the transient accommodation tax by one percentage point. Both tax increases expire in December 2030.

Operating Performance

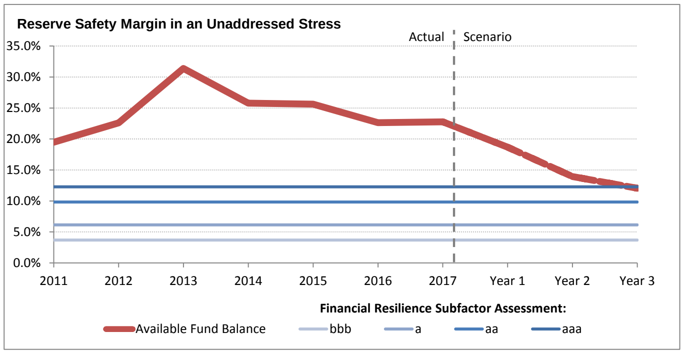
Substantial reserves and a history of limited revenue volatility provide the city with the highest gap closing capacity in a moderate economic downturn. For details, see Scenario Analysis, page 4.

The city's budget management is conservative and operations are consistently balanced. Unrestricted reserves increased substantially in the wake of the recession from 5% of general fund spending in fiscal 2009 to 23% in 2017. Modest reductions in fund balance between fiscals 2013 and 2016 largely reflect spending for one-time costs.

Honolulu (City & County) (HI)

Scenario Analysis

v. 2.0 2017/03/24



Analyst Interpretation of Scenario Results:

Substantial reserves and a history of limited revenue volatility provide the city with the highest gap closing capacity in a moderate economic downturn. Unrestricted reserves of $326 million in fiscal 2017 (equal to 23% of general fund spending) provide a considerable cushion against potential revenue declines.

Scenario Parameters:	Year 1	Year 2	Year 3
GDP Assumption (% Change)	(1.0%)	0.5%	2.0%
Expenditure Assumption (% Change)	2.0%	2.0%	2.0%
Revenue Output (% Change)	(2.5%)	1.2%	4.9%
Inherent Budget Flexibility	Midrange		

Revenues, Expenditures, and Fund Balance	Actuals							Scenario Output		
	2011	2012	2013	2014	2015	2016	2017	Year 1	Year 2	Year 3
Total Revenues	1,151,702	997,263	1,012,408	1,039,068	1,140,345	1,203,597	1,285,573	1,253,974	1,269,460	1,332,019
% Change in Revenues	-	(13.4%)	1.5%	2.6%	9.7%	5.5%	6.8%	(2.5%)	1.2%	4.9%
Total Expenditures	704,861	743,148	733,510	762,755	830,195	885,055	947,713	966,667	986,001	1,005,721
% Change in Expenditures	-	5.4%	(1.3%)	4.0%	8.8%	6.6%	7.1%	2.0%	2.0%	2.0%
Transfers In and Other Sources	106,607	114,435	135,950	146,729	137,372	182,247	158,670	154,770	156,681	164,403
Transfers Out and Other Uses	542,963	361,917	330,684	434,975	432,795	508,890	485,659	495,372	505,280	515,385
Net Transfers	(436,356)	(247,482)	(194,734)	(288,246)	(295,423)	(326,643)	(326,989)	(340,602)	(348,598)	(350,983)
Bond Proceeds and Other One-Time Uses	-	-	-	-	-	-	-	-	-	-
Net Operating Surplus(+)/Deficit(-) After Transfers	10,485	6,633	84,164	(11,933)	14,727	(8,101)	10,871	(53,296)	(65,139)	(24,684)
Net Operating Surplus(+)/Deficit(-) (% of Expend. and Transfers Out)	0.8%	0.6%	7.9%	(1.0%)	1.2%	(0.6%)	0.8%	(3.6%)	(4.4%)	(1.6%)
Unrestricted/Unreserved Fund Balance (General Fund)	243,225	249,858	334,022	308,849	323,576	315,475	326,346	273,050	207,911	183,227
Other Available Funds (Analyst Input)	-	-	-	-	-	-	-	-	-	-
Combined Available Funds Balance (GF + Analyst Input)	243,225	249,858	334,022	308,849	323,576	315,475	326,346	273,050	207,911	183,227
Combined Available Fund Bal. (% of Expend. and Transfers Out)	19.5%	22.6%	31.4%	25.8%	25.6%	22.6%	22.8%	18.7%	13.9%	12.0%

Reserve Safety Margins	Inherent Budget Flexibility				
	Minimal	Limited	Midrange	High	Superior
Reserve Safety Margin (aaa)	39.3%	19.7%	12.3%	7.4%	4.9%
Reserve Safety Margin (aa)	29.5%	14.7%	9.8%	6.1%	3.7%
Reserve Safety Margin (a)	19.7%	9.8%	6.1%	3.7%	2.5%
Reserve Safety Margin (bbb)	7.4%	4.9%	3.7%	2.5%	2.0%

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's downturn scenario assumes a -1.0% GDP decline in the first year, followed by 0.5% and 2.0% GDP growth in Years 2 and 3, respectively. Expenditures are assumed to grow at a 2.0% rate of inflation. Inherent budget flexibility is the analyst's assessment of the issuer's ability to deal with fiscal stress through tax and spending policy choices, and determines the multiples used to calculate the reserve safety margin. For further details, please see Fitch's US Tax-Supported Rating Criteria.

The ratings above were solicited and assigned or maintained at the request of the rated entity/Issuer or a related third party. Any exceptions follow below.