Tax Supported
New Issue

City and County of Honolulu, Hawaii

Ratings

New Issues

General Obligation Bonds, Series 2009A	AA
General Obligation Bonds, Series 2009B (Taxable)	AA
General Obligation Bonds, Series 2009C	AA

Outstanding Debt

General Obligation Bonds	AA

Rating Outlook

Stable

Analysts

Karen Ribble
+1 415 732-5611
karen.ribble@fitchratings.com

Amy S. Doppelt
+1 415 732-5612
amy.doppelt@fitchratings.com

Ken Weinstein
+1 212 902-0527
ken.weinstein@fitchratings.com

New Issue Details

Sale Information: $394,035,000 General Obligation Bonds, Series 2009A, $33,975,000 General Obligation Bonds, Series 2009B (Taxable), and $50,050,000 General Obligation Bonds, Series 2009C via negotiation on April 8.
Security: General obligations of the city and county of Honolulu (the city), secured by the full faith and credit and first charge on the general fund of the city, which is obligated to levy unlimited ad valorem property taxes.
Purpose: Series 2009A: to fund about $150 million in projects for the city's CIP and refund $153 million in GO commercial paper. Series 2009B (taxable): to pay costs related to the acquisition of an existing waste disposal facility. Series 2009C: to current refund certain outstanding series 1999 bonds.
Final Maturity: April 1, 2034.

Rating Rationale

- The city and county of Honolulu's (the city) tourism attraction is strong, and the city and state have solid tourism infrastructure to promote, maintain, and develop the tourism base.
- The city's role as regional center and state capital adds diversity and stability; Honolulu accounts for 72% of Hawaii's population, labor, and employment.
- The city's financial management is sound, demonstrated by the successful implementation of spending controls and enactment of tax and fee increases, when necessary, combined with strong reserve levels.
- The city's debt burden is low, resulting from its judicious use of long-term financing and the state's central role in infrastructure investment.
- The city's economy is inherently volatile due to its large tourism component; however, its revenue base has only minor direct exposure to volatile tourism revenues such as sales and hotel taxes.
- Labor negotiations are managed at the state level, somewhat limiting the city's ability to control costs.
- Pension and OPEB funding will continue to pressure the city's finances.

Key Rating Drivers

- The city's ability to maintain available reserves (including the fiscal stability reserve) throughout the recession by cutting spending and raising revenues will be key to maintaining its financial flexibility and high credit quality.

Credit Summary

The 'AA' rating reflects the city's good financial operations and reserves, low debt burden, highly developed tourism economy, stable nontourism economic base, and strong fiscal management, balanced by rising labor costs, vulnerability inherent in the leisure and hospitality sector, and exposure to taxable valuation declines as home prices soften and the sharp rise in new construction has ended. However, economic stability is aided by the area's role as the state's commercial center and capital and home to a sizable military presence. Also, the city's revenue base relies heavily on property taxes, thereby limiting financial exposure to tourism fluctuations. The city's ability to maintain available reserves (including the fiscal stability reserve) throughout the recession by cutting spending and raising revenues will be key to maintaining its financial flexibility and high credit quality.

The city is coterminous with the island of Oahu, and the island's tourism draw is based on sustainable elements such as natural beauty, diverse accommodations and activities, and proximity to sizable North American markets. Tourism activity exhibits volatility typical of the sector, surging in recent years following a long decline. The level of total visitors peaked in 2005, declined modestly in 2006 and 2007, then dropped 9% in 2008. Domestic visitors make up about 60% of total visitors, and the level declined more precipitously in 2008 than did the level of international arrivals. Other tourism

Related Research

- *Department of Hawaiian Home Lands, March 17, 2009*
- *Local Government General Obligation Rating Guidelines, March 22, 2007*

Rating History

Rating	Action	Outlook/ Watch	Date
AA	Affirmed	Stable	3/20/09
AA	Affirmed	Stable	11/8/07
AA	Affirmed	Stable	5/12/05
AA	Affirmed	Stable	3/24/04
AA	Affirmed	Stable	7/21/03
AA	Affirmed	—	2/12/01
AA	Affirmed	—	5/23/00
AA	Assigned	—	3/12/99

indicators held up well in 2008, with average daily room rates flat compared with 2007 and the occupancy rate down only minimally, to 75% from 77% in 2007. Early indications of hotel occupancy in 2009 are about 68%, while the average room rate was still steady at about $170.

The city's non-tourism economy is substantial and adds balance as the state's commercial and business center, state capital, and home of the University of Hawaii. The U.S. military also is a major economic element. The city makes up 72% of Hawaii's population, about 62% of visitors, and about one-half of hotel rooms statewide. Employment rose strongly through 2006 before increasing less than 1% in 2007. The unemployment rate also ticked up to 5.2% in January 2009, compared with 2.8% for January 2008, but it is still well below the national average. Income levels remain above the national average, and market value per capita is a high $183,677.

The real estate market has also remained fairly steady but is still vulnerable to decline. Taxable valuation rose an average 17.8% annually from fiscal years 2003–2008 but has been flat for both fiscal years 2009 and 2010 as market values stabilized and new construction slowed. Median home prices have only declined about 5% since 2006 but at $610,000 remain well above the 1990s average and result in a well-above-average price-to-income ratio. Also, the level of residents' use of nonstandard mortgages is about one-half that of the U.S. average as are home foreclosure rates. Nonetheless, Fitch Ratings believes the city's vulnerability lies in the home price run up prior to 2006 and the presence of second homes and vacation properties. In fiscal 2008, property taxes made up about 80% of the city's general fund revenues, not including the new excise tax adopted for a large transit project.

As a result of rapidly rising property tax revenues, the city posted surpluses in four consecutive fiscal years, adding $10.3 million to the fund balance in fiscal 2008, bringing the unreserved balance to $107 million, or a strong 8.6% of spending. Fitch notes that this sound result is net of a $7.5 million transfer to the fiscal stability reserve and $40 million to an internal OPEB reserve to prefund its OPEB liability. Including the fiscal stability and OPEB reserves, the city's financial cushion would rise to 10% of spending.

Financial operations are still sound, despite very limited revenue increases in fiscal 2009 coupled with increasing fixed labor and pension costs. The city expects to reduce its general fund reserve by about $50 million in fiscal 2009 as a result of transferring funds to reserves outside the general fund, as noted above. The city's fiscal 2009 budget includes a transfer of another $7.5 million to the fiscal stability reserve and an additional $52 million to its OPEB reserve. At fiscal 2009 year end, the resulting reserves (including those reserved for OPEB and fiscal stability) are expected to total about $174.5 million, or a sound 13.9% of fiscal 2009 spending. To balance future budgets amidst flattening AV gains and the city's dependence on property taxes, the city is evaluating a property tax rate increase and other revenue-raising options in addition to reducing its budget by keeping positions unfilled. Furthermore, in planning for fiscal 2011, the city is assuming a 10% decline in property tax revenues absent an increase in tax rates. Given the city's demonstrated willingness to pursue tax rate increases and its prudent spending decisions, Fitch expects the city will act to retain its solid fund balance levels.

The city's strong financial position primarily reflects effective management response to revenue performance, with expenditure growth kept to low levels through organizational restructuring and employee reductions. Management is proactively setting aside funds for retiree health care, a program that is handled at the state level for all government employees. The city will continue to be challenged by sizable increases in pension and retiree health care costs as well as salary raises, all expenditures controlled by statewide actions, limiting the city's fiscal autonomy.

Debt and Other Long-Term Obligations

The series 2009 bonds are being issued in three series. Series 2009A will be approximately $294.0 million, consisting of $150 million to finance a portion of the city's ongoing CIP and $152.7 million to refund the city's GO CP notes, which the city regularly uses for interim capital financing. The series 2009B (taxable) bonds are being issued to acquire HPower, an existing waste disposal facility, to retain control over waste disposal and flow control. Proceeds from the series 2009C bond issuance will be used to refund the city's outstanding series 1999C bonds.

Debt Statistics

($000)

This Issue	378,060
Outstanding Debt[a]	1,834,550
Direct Debt	**2,212,610**
Overlapping Debt	0
Total Overall Debt	**2,212,610**
Debt Ratios	
Direct Debt Per Capita ($)[b]	2,443
As % of Market Valuation[c]	1.3
Overall Debt Per Capita ($)[b]	2,443
As % of Market Valuation[c]	1.3

[a]Net of self-supporting GO bonds. [b]Population: 905,601 (2008 estimate). [c]Market valuation: 166,337,947,000 (fiscal 2009).
Note: Numbers may not add due to rounding.

The city's outstanding debt consists mostly of GO bonds, including for the sewer system, solid waste, and housing enterprises. The sewer system remains self-supporting, but the housing and solid waste enterprises are not entirely self-supporting. The resulting debt burden is moderate, at $2,443 per capita and 1.3% of market valuation. There are no overlapping entities with outstanding tax-supported debt. The city amortizes its debt quickly, with 55% repaid within 10 years, enhancing its financial flexibility.

One of the city's major capital projects is the construction of a high capacity transit corridor. In 2007, the city implemented an additional 0.5% excise tax surcharge to be dedicated to the construction of the rail transit project, which will serve the 60% of the city's population living along the island's east-west corridor. The 20-mile project is estimated to cost about $5.3 billion and will be funded, in addition to the excise tax, from GO bond proceeds and federal transportation funding.

All city employees are part of the state retirement system (SRS). As of June 30, 2008, the SRS's estimated unfunded actuarial accrued liability (UAAL) was $5.2 billion. The UAAL is not broken out by county; however, historically the city has made up about 15% of total employer contributions (determined pro rata by covered payroll). The city's contribution to SRS for fiscal 2008 was $73 million, not including the water enterprise. In addition, the city contributes small amounts to three pension funds established prior to the SRS in 1926.

The city's estimated OPEB liability, assuming prefunding, is $1.24 billion with an annual required contribution (ARC) of $101.4 million. For fiscal years 2008 and 2009, the city transferred $52 million and $40 million, respectively, to its OPEB reserve fund from its general fund to begin addressing its OPEB liability.

Finances

General Fund Financial Summary

($000, Audited Fiscal Years Ended June 30)

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Taxes[a]	399,115	380,098	407,270	411,043	458,116	528,793	621,741	727,015	805,174
Other Revenue[b]	189,094	172,741	167,369	159,249	164,154	176,254	181,848	251,446	367,121
Total Revenue	**588,209**	**552,839**	**574,639**	**570,292**	**622,270**	**705,047**	**803,589**	**978,461**	**1,172,295**
Expenditures	380,213	406,447	459,583	456,297	478,143	514,065	544,096	584,202	629,708
Net Transfers and Other Sources/(Uses)	(198,880)	(163,575)	(102,242)	(95,529)	(154,626)	(176,133)	(238,051)	(337,065)	(532,314)
Net Income/(Deficit)	**9,116**	**(17,183)**	**12,814**	**18,466**	**(10,499)**	**14,849**	**21,442**	**57,194**	**10,273**
Total Fund Balance	58,859	41,536	54,350	72,816	62,317	77,166	98,608	155,802	166,075
As % of Expenditures, Transfers Out, and Other Uses	9.3	6.7	8.4	11.2	8.5	9.8	11.6	15.5	13.2
Unreserved Fund Balance	38,176	23,347	35,159	51,496	41,479	57,364	76,604	128,035	107,281
As % of Expenditures, Transfers Out, and Other Uses	6.1	3.8	5.5	7.9	5.7	7.3	9.0	12.7	8.6
Reserve for Fiscal Stability (Outside the General Fund)	N.A.	N.A.	N.A.	N.A.	5,000	5,000	5,034	10,034	18,098
As % of Expenditures, Transfers Out, and Other Uses[c]	N.A.	N.A.	N.A.	N.A.	1.3	1.1	0.9	2.5	3.1

[a]Primarily property taxes. [b]Includes the new excise tax for the rail transit project, which totaled approximately $196 million in fiscal 2008. [c]Net of the estimated excise tax.
Note: Numbers may not add due to rounding. N.A. – Not applicable.

The city's discretionary revenues are concentrated in property taxes. Not including the new excise tax for the rail transit project, property taxes made up about 80% of general fund revenues in fiscal 2008. Since fiscal 2004, the weighted average property tax rate has been declining as AV has been increasing. Nonetheless, the levy still increased about an average 15.5% annually from fiscal years 2003–2008. For fiscal 2009, the levy only increased about 1.8%, resulting in limited growth in general fund revenues.

The city's direct reliance on tourism-dependent taxes, such as sales taxes and transit accommodation taxes (TAT), is limited. Its share of state TAT decreased to just 4% of discretionary general fund revenue in fiscal 2008. Strong fiscal discipline has resulted in good overall operating results and good year-end balances; however, without raising its revenues, the city's financial operations in the coming years will be challenged by fixed costs (including labor, retirement benefits, and debt service). Labor agreements are negotiated at the state level and for fiscal years 2010 and 2011 include a 6% increase for police and a 5% increases for fire.

Fiscal 2009 operations are expected to be about break-even, net of transfers to the OPEB and fiscal stability reserves noted above. For fiscal 2010, the general fund budget shortfall was initially $128 million due to declines in investment income, TAT, and fuel tax revenues coupled with fixed cost increases. The adopted balanced budget includes a hiring freeze, limited travel, and not filling 800 funded positions valued at about $35 million. In addition, management plans to raise some fees for services, but this would have only a modest effect since charges for services account for only $5 million in the general fund. The fiscal 2010 shortfall was also addressed, in part, by budget restrictions in place in fiscal 2009. Additional proposals include raising fees for service, increasing motor vehicle weight tax, and a 9% increase in the residential property tax rate. The fiscal 2010 budget notably includes a $1 million transfer to the fiscal stability fund from an executive salary cut. The city will also temporarily return to pay-as-you-go funding for OPEB.

The city has strong management practices, including its fiscal stability fund created in 2006. The fund is available for use under certain emergency or economic and revenue triggers. The economic triggers include proscribed levels of change but generally are increases in unemployment; a decline in net taxable real property, general fund and highway fund revenue, or TAT; or an increase in nondiscretionary expenditures. Deposits to the fiscal stability reserve are made from surpluses, and its balance is targeted at between 5% and 8% of expenditures.

Economy and Tax Base

The city's economy remains driven by tourism, with some stability provided by the large government presence (including all branches of the military and state and local governments). The number of visitors in 2008 was 4,177, down about 9% from the 2007 level and about 6% below the 10-year average. Most of that decline was in domestic visitors. The average room rate was essentially the same in 2008 as in 2007 at $170, compared with a 10-year average of $133. Finally, the hotel occupancy rate was down to 75% in 2008 from 77% in 2007, compared with a 10-year average of 76%.

The city's redevelopment of Waikiki Beach (the city invested about $535 million) was supplemented by $1 billion in private investment in renovations and new hotels. The investment was spurred by a tax incentive for qualifying hotels, whereby the city did not tax improvements for seven years.

Several hotels expanded or completed significant renovations, including the Royal Hawaiian, Hilton Grand Waikikikan Resort, Trump Hotel, Outrigger Reef on the Beach, and Moana Surfrider. Additional projects planned or underway in Honolulu include a Walt Disney Parks and Resorts, a Marriott Hotel and Timeshare, an Ala Moana retail center, an international mixed use resort destination shopping center, and a renovation of the Aloha Stadium, which will host the 2011 and 2012 Pro Bowl.

The city's' tax base is quite diverse, with the top 10 taxpayers representing just 4.4% of AV; however, some concentration exists in the hotel/resort industry. Growth in the fiscal 2010 AV (set as of October 2008) is basically flat for the third consecutive year after experiencing very steep growth from fiscal years 2005–2008. While AV growth has stalled, generally the property markets are showing some signs of stability, although they are vulnerable to declines as home prices still result in very high price-to-income ratios. Nonetheless, to date median home prices have only declined about 5% since the second quarter of 2006, and foreclosure rates and the incidence of riskier mortgage types are below average. According to the city, its office vacancy rate is still near historic lows, and rents increased through 2008.