

Tax Supported
New Issue

City and County of Honolulu, Hawaii

Ratings

New Issue

General Obligation Bonds,
Series 2005E and 2005F AA

Outstanding Debt

General Obligation Bonds AA
Rating Outlook Stable

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New Issue Details

About \$400,000,000 General Obligation Bonds, Series 2005E and 2005F, are scheduled to sell on or about Nov. 1 via negotiation by UBS Financial Services Inc. and Merrill Lynch & Co.

Security: The bonds are secured by the City and County of Honolulu's full faith and credit unlimited ad valorem tax pledge.

Purpose: Bond proceeds will be used to refund \$250 million in general obligation bonds, series 2001C, and \$150 million in commercial paper.

■ Outlook

Honolulu's credit strength rests in the sound fundamentals of its tourism-based economy, good financial operations and reserves, low debt burden, and strong fiscal management. The island's tourism base has adapted to a shift to more domestic-based visitors, as well as reduced activity, while the area's role as the commercial center and state capital and a sizable military presence add stability. Tourism on the island is highly developed and has strong underpinnings, providing continual demand. The city has restrained spending growth to keep in line with revenues, resulting in prudent general fund balances. The low debt burden reflects Hawaii's sizable role in financing capital needs. Expected annual issuance will increase debt levels, although they will remain affordable.

■ Rating Considerations

Honolulu 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, reflected in a surge in 2004 following a long decline. Total visitors rose to a very strong 9.1% in 2004, and results through August 2005 suggest about an 8% gain. If the results for 2005 continue at this rate, the total year-end visitor count will exceed the 2000 peak. The recent rise follows a precipitous drop in 2001 and relative stability through 2003 at about 10% below the high. Visitor levels from the U.S. rose faster than international, largely Asian, visitor levels, as has been the case in most recent years. Domestic visitors now make up about 58% of total visitors. Other tourism indicators were strongly positive in 2004, as well, with hotel occupancy rising for the second consecutive year to nearly 80%, the highest level experienced in 10 years. The increase is notable given the rise in average hotel room rate to above the 1998 peak. Results so far in 2005 suggest strong gains in both occupancy and room rate.

Honolulu's nontourism economy is substantial and adds balance, as the state's commercial and business center, state capital, and home of the University of Hawaii. U.S. military also is a major economic element, taking advantage of the island's strategic location. Federal defense spending makes up about 8% of the gross state product, with most of the activity on Oahu. Honolulu has 72% of the population, about two-thirds of the visitors, and about one-half of the hotel rooms in the state. The real estate market has returned to strong activity, with taxable valuation rising considerably since recovery began in 2002. Building permits have risen steadily, reaching \$1.32 billion in 2004, suggesting continued tax base gains. Honolulu's unemployment rate fell to 3.2% in 2004, its lowest rate in several years.

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Financial operations are sound, relying primarily on property taxes. Honolulu's revenue base includes only a small amount that is directly reliant on tourist activity. The general fund ran operating surpluses in four of the past six fiscal years, including estimates for positive results for fiscal 2005. Fiscal 2004 included an operating deficit, reducing the fund balance to \$62.3 million, which equaled an above-average 8.5% of spending. While this level was below fiscal 2003's 11.0%, it was near the 8.8% annual average over the past five years. In addition, the city maintains \$5.0 million in a rainy day fund. City officials expect the fund balance to rise considerably once audited results for fiscal 2005 are available. Fitch Ratings views the current reserve levels as prudent for a tourism-based economy during a strong economic period.

Honolulu's strong financial position primarily reflects expenditure growth kept to low levels through organizational restructuring and employee reductions. Operations in fiscal years 2002–2004 also benefited from a nonrecurring sizable capital spending reimbursement. The positive preliminary results for fiscal 2005 come from sound property tax revenue gains and some spending restraint, offsetting rising employee costs and the capital reimbursement loss. Honolulu's fiscal future should continue to be sound but will be challenged by a general trend of

sizable increases in pension costs, as well as ongoing salary raises.

■ Strengths

- Tourism-based economy has strong underpinnings, such as physical beauty, public and private infrastructure, and location.
- Role as regional economic center and state capital provides some diversity and stability.
- Financial operations benefit from sound management actions, resulting in preservation of satisfactory reserves.
- Prudent management actions in recent years, including tax rate and fee increases, organization consolidation, and spending controls.
- Low debt burden (average including state bonds).

■ Risks

- Economic volatility inherent in tourism-based economies.
- Ongoing financial pressures, including labor and pension cost increases.

For more information, see Fitch Research on "City and County of Honolulu," dated May 17, 2005, available on Fitch's web site at www.fitchratings.com.