Moody's Investors Service

Global Credit Research
New Issue
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**New Issue:** Honolulu (City & County of) HI

## MOODY'S UPGRADES HONOLULU'S G.O. BONDS TO Aa2 FROM Aa3; CREDIT OUTLOOK STABLE

### Aa2 RATING APPLIES TO $1.76 BILLION OF G.O. DEBT, INCLUDING CURRENT OFFERING

Municipality
HI

**Moody's Rating**

| ISSUE | RATING |
|---|---|
| General Obligation Bonds, Series 2003A | Aa2 |

**Sale Amount** $250,000,000
**Expected Sale Date** 07/28/03
**Rating Description** General Obligation Bonds

**Opinion**

NEW YORK, Jul 22, 2003 -- Moody's Investors Service has upgraded the City and County of Honolulu's general obligation bond rating to Aa2 from Aa3; the city's credit outlook is stable. The upgrade applies to approximately $1.52 billion of outstanding general obligation bonds and the Aa2 rating has been assigned to the city's current $250 million offering of general obligation bonds. The bonds are secured by an unlimited property tax pledge; debt service payments represent a first charge on the city's General Fund. Proceeds of the current offering will be used in part to retire $145.3 million of outstanding commercial paper as well as to fund a variety of projects included in the city's capital plan. The upgrade to Aa2 primarily reflects the city's economic rebound following post-9/11 lows in the tourism industry, improving real estate values on Oahu which have spurred steady growth in assessed valuation, the city's improving financial performance which reflects management's ability to control spending and raise property tax rates when needed, and the city's manageable debt profile.

HONOLULU'S ECONOMY RECOVERS FROM POST-9/11 LOWS; PERFORMING QUITE WELL RELATIVE TO NATION

In contrast with the national economy, Honolulu's economy has performed remarkably well in recent years, particularly given the sharp declines in travel to Hawaii following the 9/11 terrorist attacks. Unemployment remains relatively low in Honolulu at 3.1% in April 2003 compared with 3.5% for the State of Hawaii and 6.0% for the nation. Rising real estate values have had an important influence on the local economy, but a variety of other factors have contributed as well. Visitor traffic has stabilized following the steep declines suffered immediately following the 9/11 terrorist attacks. Eastbound (primarily Asian) and other international traffic remain down, but Westbound traffic (primarily from the U.S. West and East coast markets) has largely offset these losses. Hawaii remains a unique and attractive tourist destination and officials have been successful in niche marketing the island. Examples include sports- and eco-tourism as well as a growing inter-island cruise business, all of which attract a higher percentage of first time visitors and stimulate longer average stays. Moody's notes that airline capacity serving the Hawaii tourism market relies on the health of the financially troubled airline industry. Moody's also notes improving economic diversity in the Honolulu economy which includes the military, health care, and banking sectors as important contributors to the local economy. Despite the moderating influence of many tourism-related service jobs, wealth indicators in Honolulu are also favorable with per capita and median family income at 101.9% and 120.1% of the U.S., respectively.

STRONG OAHU REAL ESTATE MARKET SUPPORTS CONTINUING TREND OF ASSESSED VALUATION GROWTH

An important element of Honolulu's economic stability has been the rather robust Oahu real estate market which has led to steadily growing assessed values since 2001. Following a period of rapid escalation in property values in the late 1980s and early 1990s Honolulu's tax base experienced significant erosion from 1996 through 2001, losing almost one-fifth of its value during that period. However, since bottoming out in 2001, assessed valuation has grown by an average of 4.9% annually, achieving a substantial $79.2 billion in 2004. Residential, commercial and industrial real estate have all contributed to the growth, which should continue to translate into rising taxable values over the near term given the lag between real estate prices and assessed valuation. Moody's also notes that the current real estate market shows no signs of the type of speculative bubble which occurred in the early 1990s. Honolulu's 2004 assessed value per capita totals an impressive $90,343 and points to an unusually wealthy tax base.

IMPROVING FINANCIAL PERFORMANCE REFLECTS CITY'S DISCIPLINED APPROACH TO SPENDING AND A WILLINGNESS TO INCREASE TAXES

The city's financial performance has improved notably in recent years, due in large part to management's willingness to raise property tax rates as needed, combined with the city's successful multi-year effort to control expenditures. Recent growth in assessed valuation is particularly significant to the city's credit profile in that property tax revenues represent approximately two-thirds of operating revenues. Just as important, however, is the city's willingness to raise tax rates to fund increasing fixed costs such as pension, health and debt service expenditures. In addition, a variety of cost cutting measures such as workforce reductions, department consolidations, hiring freezes and increasing self-support for enterprise activities, have resulted in relatively flat expenditure growth over time. As a result, management's commitment to maintaining budget balance and improving reserves has been increasingly evident and continues to be an important factor in Moody's credit evaluation of Honolulu.

Audited financial results for fiscal 2002 indicate a $12.8 million operating surplus in the General Fund which resulted in total fund balance of $54.4 million, or 8.3% of General Fund revenues; unreserved fund balance totaled $35.2 million, or 5.3% of revenues. Though the city lacks a formal reserve policy, city staff targets a minimum 5% unreserved General Fund balance. The city's favorable fiscal 2002 performance follows an understandably difficult 2001 which included 9/11-related declines in transient accommodations tax receipts as well as higher spending requirements, especially for public safety. Nevertheless, the city has posted significant operating surpluses in three of the four audited years since 1999. Estimated fiscal 2003 results reflect continuation of this positive trend; unreserved General Fund balance is projected to grow to approximately $50 million, due in large part to a combination of underspending and growth in property tax revenues. The city also maintains a $5 million rainy day fund outside the General Fund, providing additional flexibility.

Going forward, Moody's believes that the city's financial position should remain stable as it benefits from a combination of growing tax revenues and the ongoing savings associated with structural spending reforms implemented in recent years. Nevertheless, it remains likely that Honolulu will continue to face its share of budget challenges in the near term, in part due to the rising pension and health costs mentioned above. The city's fiscal 2004 budget includes a property tax rate increase to fund such cost increases. Despite these ongoing budget issues, Moody's believes that the city's demonstrated ability to manage its finances well under difficult circumstances bodes well for future financial stability, especially in light anticipated revenue growth.

MANAGEABLE DEBT POSITION MODERATED BY REASONABLE BORROWING PROGRAM AND GROWING TAX BASE

Moody's expects that Honolulu's debt levels will continue to remain manageable given reasonable borrowing assumptions and the expectation of continued tax base growth in the near term. In addition, Honolulu's debt levels should remain manageable given the active role the state government plays in financing the capital needs for municipal activities more typically funded at the local level throughout the rest of the country including transportation, health, justice, and education.

Management has begun to fund the construction activities of various enterprise systems from system rates rather than property taxes. As a result, future borrowings will emphasize revenue bond offerings rather than general obligation issuances. Debt burden measures compare favorably to other cities and counties in the U.S. with overall debt representing only 1.8% of fiscal 2004 taxable values. Including the current offering, the city has approximately $1.76 billion of outstanding general obligation bonds and about $586 million of remaining unissued authorization. Officials expect the next general obligation borrowing to total approximately $150 million sometime in 2004. Moody's also notes that 60.5% of the city's outstanding general obligation debt is retired in ten years, which is above average for large U.S. cities, and will contribute to further moderation of future debt levels.

**Outlook**

The stable rating outlook for Honolulu reflects Moody's expectation that the city's economy will continue to perform well and that assessed valuation will grow further in the near-term. The stable credit outlook also incorporates Moody's expectation that city management will continue to take the actions necessary to ensure fiscal stability in light of rising pension and health costs over the near- to medium-term.

KEY STATISTICS

2000 population: 876,156

1999 per capita income: $21,998 (101.9% of U.S.)

1999 median family income: $60,118 (120.1% of U.S.)

2004 full valuation: $79.2 billion

Direct and overall debt burden: 1.8%

Payout of principal, 10 years: 60.5%

FY 2002 total General Fund balance: $54.4 million (8.3% of General Fund revenues)

FY 2002 unreserved General Fund balance: $35.2 million (5.3% of General Fund revenues)

**Analysts**

Matthew Jones
Analyst
Public Finance Group
Moody's Investors Service

Kenneth Kurtz
Backup Analyst
Public Finance Group
Moody's Investors Service

**Contacts**

Journalists: (212) 553-0376
Research Clients: (212) 553-1653