FitchRatings

Public Finance
Tax-Supported
U.S.A

Honolulu (City & County), Hawaii

New Issue Summary

Sale Date: The GO bonds, series 2020 C, D, E and F are scheduled to sell via negotiation on July 21–22, 2020.

Series: $189,335,000 General Obligation Bonds, Series 2020C; $54,265,000 General Obligation Bonds, Series 2020D; $41,155,000 General Obligation Bonds, Series 2020E (Taxable); $68,855,000 General Obligation Bonds, Series 2020F (Refunding).

Purpose: To finance the capital costs of various projects and equipment purchases, and to refund the majority of Honolulu's (the city and county)s series 2010A Build America Bonds for savings.

Security: The bonds are backed by the city and county's full faith and credit and supported by an unlimited pledge of ad valorem property tax.

The 'AA+' Issuer Default Rating (IDR) and Stable Rating Outlook reflect the city and county's solid revenue framework, which is dominated by stable property taxes, low long-term liabilities and robust operating performance. The rating is constrained by the city and county's elevated fixed carrying costs for debt service and retiree benefits, limiting expenditure flexibility.

Key Rating Drivers

Revenue Framework: 'aa': Property taxes account for the majority of general fund revenues, providing a stable revenue source. Fitch expects solid revenue growth, exceeding inflation but below nominal U.S. GDP growth. The city and county has unlimited independent legal ability to raise property tax revenues.

Expenditure Framework: 'aa': Based on recent spending practices and continued solid revenue performance, Fitch expects that expenditure increases will be in line with to marginally above revenue growth. While fixed carrying costs for debt service and retiree benefits are elevated, potentially challenging the city and county's ability to reduce expenditures in the current and future downturns, they also reflect the city and county's ongoing commitment to address accrued pension and other post-employment (OPEB) liabilities.

Long-Term Liability Burden: 'aaa': Long-term liabilities for debt service and pensions are low relative to the tax base and at the low end of the moderate range relative to personal income. While OPEBs liabilities are large and inflexible, statewide reforms to retiree benefits are expected to slow the growth of related liabilities.

Operating Performance: 'aaa': The city and county is well positioned to address economic challenges as a result of its high ability to raise revenues and substantial reserves. Financial management is typically conservative and budgets are consistently balanced.

Rating Sensitivities

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Stronger revenue growth prospects and lower fixed carrying costs and improved expenditure flexibility.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Financial flexibility, particularly in the face of ongoing expenditure increases to address pension and OPEB liabilities, could be pressured by sustained reductions in reserves or expenditure growth that outpaces revenues.

Ratings

Issuer Default Rating	AA+

New Issues

$189,335,000 General Obligation Bonds, Series 2020C	AA+
$54,265,000 General Obligation Bonds, Series 2020D	AA+
$41,155,000 General Obligation Bonds, Series 2020E (Taxable)	AA+
$68,855,000 General Obligation Bonds, Series 2020F (Refunding)	AA+

Outstanding Debt

General Obligation Bonds	AA+

Rating Outlook

Stable

Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (March 2020)

Related Research

Fitch Rates Honolulu, HI's $353MM 2020 GOs 'AA+'; Affirms IDR at 'AA+'; Outlook Stable (July 2020)

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- An inability to address the fiscal challenges triggered by the expected short-term but severe economic contraction, as evidenced by insufficient budget adjustments, leaving the city and county less financially resilient at the end of the recovery period.
- Economic contraction extending well into the second half of the year or beyond, consistent with Fitch's coronavirus downside scenario, which triggers sustained and deep revenue declines and materially erodes the city and county's gap-closing capacity.

Economic Resource Base

The city and county includes the entire island of Oahu. While a significant portion of the city and county's economy is driven by tourism, it is also the state's center for business services, trade, transportation, healthcare, defense and government. Additionally, Honolulu is home to a large military presence that adds a degree of diversification to the economy. The city and county's population of around 975,000 is approximately two-thirds of the statewide total. Median household income is strong at 138% of the national level and unemployment rates have typically been below the U.S. average. Proportionately less of the city and county's non-agricultural workforce is in the leisure and hospitality sector (16%) than is the case for the state as a whole (20%).

Fitch Ratings recently revised the state's Rating Outlook to Negative due to the potential for coronavirus-related economic pressures to adversely affect the state's financial resilience in the medium term. The revenue profiles of the state and the city and county are quite different. The state is much more exposed to volatile revenue sources such as general excise tax and transient accommodation tax (TAT). By contrast, property tax collections are the largest single source of city and county revenues, at over 75% of general fund revenues, transfers in and other sources in fiscal 2019, and the most stable. The payment of property taxes is not closely tied to the decision-making of out-of-state visitors and the owners of tourism businesses.

Overall tax base growth has been strong, with annual increases of between 2% and 10% during fiscal years 2014 to 2020. Ongoing tax base growth in fiscal 2021, tied to taxable assessed valuations set prior to the pandemic, has been almost entirely offset by an increase in the residential homeowner's exemption, so taxable assessed valuation is flat this fiscal year.

The city and county estimates that 52% of its fiscal 2021 property tax revenues will come from residential properties, which represent almost 78% of the tax base and are predominantly primary residences, with proportionately fewer second homes or vacation rentals than in other counties. Meanwhile, hotels and resorts are projected to generate 16% of property tax revenues, despite being only 7% of the tax base. The city and county can unilaterally adjust its various property tax rates as necessary to meet its policy and fiscal goals and has historically demonstrated its willingness to do so. The city and county is not projecting a significant increase in property tax delinquencies in fiscal 2021. However, a prolonged economic downturn could put downward pressure on taxable assessed valuations and property tax payments in fiscal 2022 onwards.

The expenditure profiles of the state and the city and county are also quite different. While the city and county provides a broad range of municipal services, the state provides cost-intensive education and health and human services. Therefore, while the city and county of Honolulu is clearly a key driver of the state economy, Fitch expects its medium-term financial resilience to be less directly impacted by volatile revenue streams and expenditure pressures than the state's.

Current Developments

Sectorwide Coronavirus Implications

The ongoing outbreak of coronavirus and related government containment measures worldwide create an uncertain global environment for U.S. state and local governments and related entities in the near term. While the city and county's most recently available fiscal and economic data may not fully reflect impairment, material changes in revenues and expenditures are occurring across the country and likely to worsen in the coming weeks and months as economic activity suffers and public health spending increases. Fitch's ratings are forward-looking in nature, and Fitch will monitor developments in state and local governments as a result of the virus outbreak as it relates to severity and duration and incorporate revised expectations for future performance and assessment of key risks.

Rating History

Rating	Action	Outlook/ Watch	Date
AA+	Affirmed	Stable	7/10/20
AA+	Revised	Stable	4/30/10
AA	Affirmed	Stable	3/24/04
AA	Assigned	—	3/12/99

In its baseline scenario, Fitch assumes sharp economic contractions hit major economies in the first half of 2020 at a speed and depth that is unprecedented since World War II. Sequential recovery is projected to begin from third-quarter 2020 onwards as the health crisis subsides after a short but severe global recession. GDP is projected to remain below its fourth quarter 2019 level until mid-2022. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the report entitled, "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases - Update" (https://www.fitchratings.com/site/re/10120570), published April 29, 2020 on www.fitchratings.com.

Honolulu Economic Impacts

Pandemic mitigation efforts are having a negative impact on the city and county's economy. Tourism has been particularly affected. Many of the city and county's major hotels were closed through June. Oahu hotels' occupancy dropped 72% year over year in April and 84% year over year in May. Short-term rentals and bed and breakfast homes were ordered to close. Mandatory 14-day self-quarantine requirements for travelers entering the state have been extended through July 31. While the current intention is to waive self-quarantine requirements from Aug. 1 onwards for travelers with proof of a negative coronavirus test result within 72 hours of travel, this timeframe could be delayed if mainland coronavirus caseloads continue to worsen. Non-essential interisland travel without quarantine has been permitted since mid-June. Since mid-May, most medium-risk non-essential businesses have gradually been permitted to reopen.

The city and county's unemployment rate shot up to an unprecedented 21% in April from 2% in March, not seasonally adjusted. Over 200,000 people filed claims for unemployment compensation. In May, there were approximately 87,400 fewer jobs than in February, an over 18% decline. The most dramatic reduction was in the leisure and hospitality sector, which lost approximately 44,700 jobs during the same period, an almost 59% decline. The trade, transportation and utilities sector also took a sizable 17% hit. While the surge of unemployment has been severe, it was somewhat less than experienced by the other counties. In May, the seasonally unadjusted unemployment rates for Honolulu, Maui, Kauai and Hawaii counties were 20%, 33%, 30% and 23%, respectively.

The city and county is currently anticipating that out-of-state visitors will start to return from Aug. 1 onwards, generating solid tourism-related tax revenues, due to pent-up demand. Demand for flights has begun increasing. Nevertheless, the economy remains exposed to broad tourism and air travel dynamics and the city and county anticipates that it will take some years for its tourism industry to fully return to pre-coronavirus levels.

Honolulu Budget Impacts

The city and county is projecting relatively small revenue losses from property tax, TAT, fuel tax, vehicle-related taxes, parking fees and bus system revenues of approximately $15 million in fiscal 2020 (less than 0.5% of budgeted operating resources) and $62 million in fiscal 2021 (less than 2% of budgeted operating resources). The fiscal 2020 losses have been largely offset by reduced expenditures for departments and certain facilities.

The state is currently suspending distribution of the counties' share of TAT. For the city and county, a full year suspension would mean a loss of $45 million annually. However, the city and county is budgeting the eventual receipt of $22 million in TAT revenues from the state given the assumed resumption of statewide tourism from Aug. 1 onwards. If those revenues do not eventuate, city and county officials advise that they will make offsetting expenditure reductions.

The city and county received a $387 million allocation under the Coronavirus Aid, Relief and Economic Security (CARES) Act ($62 million spent or encumbered to date) and $132 million in additional coronavirus-related federal aid. The city and county expects to spend all of this federal aid on coronavirus-related expenses such as increased public safety services and programs that provide direct loans and grants for households, child care, small businesses and community services for at risk groups. The fiscal 2021 budget only includes $91 million in federal transit grants; the remaining federal assistance is treated as special purpose moneys outside of the budget. The city and county does not expect to receive any financial assistance from the state.

Despite the pandemic, the city and county's $2.9 billion operating budget for fiscal 2021, enacted on June 17, is only $64 million (2%) less than the one submitted by the mayor on March 2, prior to the pandemic. The city and county's council decided to maintain as much as possible of the earlier budget's proposed spending in case revenues turn out better than projected. If not, they intend to restrict departmental spending during the fiscal year. While some vacant positions have been cut, there are no employee furloughs or layoffs. There are no tax increases, just relatively minor revenue increases related to fees for municipal golf courses and planning and permitting service charges. The city and county does not currently plan to spend down any of its reserves; instead it has budgeted to add $7 million to its $130 million reserve for fiscal stability, which is held outside the general fund.

The fiscal 2021 budget fully funds the city and county's full mandatory pension system and OPEB contributions, including an $88 million prefunding contribution to the city and county's OPEB trust.

FAST Analysis for Honolulu

The Fitch Analytical Stress Test (FAST) scenario analysis tool, which relates historical tax revenue volatility to GDP to support the assessment of operating performance under Fitch's criteria, has now been adjusted to reflect GDP parameters consistent with Fitch's global coronavirus forecast assumptions. FAST is not a forecast, but it represents Fitch's estimate of possible revenue behavior in a downturn, based on historical revenue performance. Hence, actual revenue declines will vary from FAST results and Fitch expects the city and county will implement decisive corrective actions to offset them. FAST does provide a relative sense of the risk exposure of a particular local government entity compared to other local government entities.

The city and county's unaddressed FAST results under both the coronavirus baseline and downside scenarios indicate pressure on the city and county's financial resilience in the medium term, absent policy interventions. The level of pressure is comparable to that shown in the state's unaddressed FAST results under both scenarios. Fitch anticipates the city and county will absorb this downward budget pressure by utilizing a combination of expenditure cuts and revenue-raising, utilizing its high independent legal ability to raise revenues, particularly through property tax rate adjustments. It will be less reliant than the state on consumption-related taxes to solve budget gaps. The city and county will also have the option to make reserve draws if necessary. Given the array of budgetary solutions available to it, the city and county will be well positioned to rebuild its financial resilience through the eventual recovery period, while continuing to meet its obligations to reduce its pension and OPEB liabilities.

The unrestricted general fund balance of almost $426 million in fiscal 2019 (equal to 26% of general fund spending), which the city and county expects to maintain at fiscal 2020 year end, provides a useful cushion against revenue declines, particularly given the city and county's high level of budget control. While the city and county currently does not have a formal minimum general fund balance policy, Fitch does not anticipate the city and county drawing down its reserves to a level below a 'aaa' reserve safety margin, particularly given its express intention to add to its $130 million reserve for fiscal stability.

Honolulu Liquidity Update

The city and county estimates that it currently has access to more than $3 billion in liquid investments. The city and county have implemented a one-time property tax payment deferral program for taxpayers who have experienced economic hardship due to the coronavirus pandemic. The program allows semi-annual property tax payments due on Aug. 20, 2020 to be paid in four equal installments payable on Aug. 20, Sept. 20, Oct. 20 and Nov. 18, 2020 without penalties or interest. Although property tax collections are the largest single source of city and county revenues, officials do not expect the payment deferral program to have a significant adverse impact on city and county revenues or liquidity in fiscal 2021.

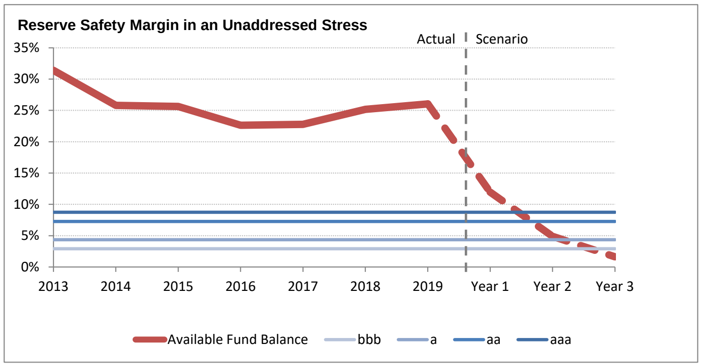
ESG Considerations

Unless otherwise disclosed in this section, the highest level of environmental, social and governance (ESG) credit relevance is a score of ‘3’ — ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity.

For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Honolulu (City & County) (HI)

Scenario Analysis



Analyst Interpretation of Scenario Results:

The Fitch Analytical Stress Test (FAST) scenario analysis tool, which relates historical tax revenue volatility to GDP to support the assessment of operating performance under Fitch's criteria, has now been adjusted to reflect GDP parameters consistent with Fitch's global coronavirus forecast assumptions. FAST is not a forecast, but it represents Fitch's estimate of possible revenue behavior in a downturn, based on historical revenue performance. Hence, actual revenue declines will vary from FAST results and Fitch expects the city and county will implement decisive corrective actions to offset them. FAST does provide a relative sense of the risk exposure of a particular local government entity compared to other local government entities.

Scenario Parameters:		Year 1	Year 2	Year 3
GDP Assumption (% Change)		(5.6%)	4.3%	2.5%
Expenditure Assumption (% Change)		0.0%	2.0%	2.0%
Revenue Output (% Change)	*Min Y1 Stress:* **-5%** *Case Used:* **Baseline**	(16.6%)	10.6%	6.0%
Inherent Budget Flexibility			High	

Revenues, Expenditures, and Fund Balance	Actuals							Scenario Output		
	2013	2014	2015	2016	2017	2018	2019	Year 1	Year 2	Year 3
Total Revenues	1,012,408	1,039,068	1,140,345	1,203,597	1,285,573	1,367,297	1,493,311	1,244,839	1,376,792	1,459,551
% Change in Revenues	-	2.6%	9.7%	5.5%	6.8%	6.4%	9.2%	(16.6%)	10.6%	6.0%
Total Expenditures	733,510	762,755	830,195	885,055	947,713	997,137	1,068,640	1,068,640	1,090,013	1,111,813
% Change in Expenditures	-	4.0%	8.8%	6.6%	7.1%	5.2%	7.2%	0.0%	2.0%	2.0%
Transfers In and Other Sources	135,950	146,729	137,372	182,247	158,670	173,272	192,766	160,692	177,725	188,408
Transfers Out and Other Uses	330,684	434,975	432,795	508,890	485,659	494,558	567,008	567,008	578,348	589,915
Net Transfers	(194,734)	(288,246)	(295,423)	(326,643)	(326,989)	(321,286)	(374,242)	(406,316)	(400,623)	(401,507)
Bond Proceeds and Other One-Time Uses	-	-	-	-	-	-	-	-	-	-
Net Operating Surplus(+)/Deficit(-) After Transfers	84,164	(11,933)	14,727	(8,101)	10,871	48,874	50,429	(230,117)	(113,844)	(53,769)
Net Operating Surplus(+)/Deficit(-) (% of Expend. and Transfers Out)	7.9%	(1.0%)	1.2%	(0.6%)	0.8%	3.3%	3.1%	(14.1%)	(6.8%)	(3.2%)
Unrestricted/Unreserved Fund Balance (General Fund)	334,022	308,849	323,576	315,475	326,346	375,220	425,649	195,532	81,688	27,918
Other Available Funds (GF + Non-GF)	-	-	-	-	-	-	-	-	-	-
Combined Available Funds Balance (GF + Other Available Funds)	334,022	308,849	323,576	315,475	326,346	375,220	425,649	195,532	81,688	27,918
Combined Available Fund Bal. (% of Expend. and Transfers Out)	31.4%	25.8%	25.6%	22.6%	22.8%	25.2%	26.0%	12.0%	4.9%	1.6%

Reserve Safety Margins	Inherent Budget Flexibility				
Moderate	Minimal	Limited	Midrange	High	Superior
Reserve Safety Margin (aaa)	46.6%	23.3%	14.6%	8.7%	5.8%
Reserve Safety Margin (aa)	34.9%	17.5%	11.6%	7.3%	4.4%
Reserve Safety Margin (a)	23.3%	11.6%	7.3%	4.4%	2.9%
Reserve Safety Margin (bbb)	8.7%	5.8%	4.4%	2.9%	2.0%

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's scenario analysis assumes the GDP and expenditure growth sequence shown in the 'Scenario Parameters' section. 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.