City and County of Honolulu, Hawaii

New Issue Report

Ratings

Long Term Issuer Default Rating	AA+
New Issues	
$86,605,000 General Obligation Bonds Series 2016A	AA+
$37,240,000 General Obligation Bonds Series 2016B	AA+
$98,435,000 General Obligation Bonds Series 2016C	AA+
$6,600,000 General Obligation Bonds (Taxable Green Bonds) Series 2016D	AA+
$354,845,000 General Obligation Bonds (Taxable Green Bonds) Series 2016E	AA+
Outstanding Debt	
General Obligation Bonds	AA+

Rating Outlook

Stable

Analysts

Stephen Walsh
+1 415 732-7573
stephen.walsh@fitchratings.com

Shannon Groff
+1 415 732-5628
shannon.groff@fitchratings.com

New Issue Summary

Sale Date: Week of October 3, 2016

Series: 2016A, 2016B, 2016C, 2016D, and 2016E

Purpose: 2016A and 2016B proceeds will fund various capital projects. 2016C, 2016D, and 2016E will refund all or a portion of several outstanding general obligation (GO) bond issues for interest savings

Security: Full faith and credit and supported by an unlimited pledge of ad valorem property tax

The ‘AA+’ Issuer Default Rating (IDR) reflects the city and county of Honolulu’s (the city) strong revenue framework, affordable long-term liabilities, and robust operating performance, somewhat offset by its high carrying costs for debt service and retiree benefits.

Key Rating Drivers

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. Population and labor force growth have exceeded U.S. medians over the past 10 years, and personal income levels are relatively high, although below average in real terms as a result of the state’s high cost of living.

Revenue Framework ('aaa' factor assessment): Property taxes account for more than 80% of general fund revenues, and total revenue growth has been strong historically, exceeding overall U.S. economic performance over the past 10 years. The city has unlimited legal authority to modify property tax rates and has made periodic adjustments to increase revenues.

Expenditure Framework ('aa' factor assessment): 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' factor assessment): Long-term liabilities for debt service and pensions are low relative to total personal income, but other post-employment benefits (OPEBs) liabilities are exceptionally large and inflexible. Recent statewide reforms to retiree benefits have helped slow related liabilities growth, but funded ratios remain relatively low.

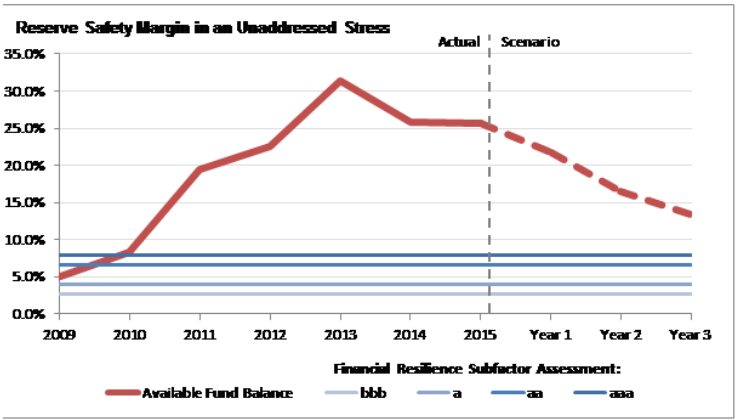
Operating Performance ('aaa' factor assessment): The city is well-positioned to address economic challenges as a result of limited revenue volatility and substantial reserves. Financial management is conservative, and budgets have been consistently balanced.

Rating Sensitivities

Balanced Operations: The IDR and GO bond rating are sensitive to continued strong operating performance and could be pressured by sustained reductions in reserves or uncontrolled expenditure growth. The Stable Outlook reflects Fitch’s expectation that such actions are unlikely.

Honolulu (City & County) (HI)

Scenario Analysis v. 1.10 2016/06/22



Analyst Interpretation of Scenario Results:

Substantial reserves and a history of limited revenue volatility contribute to an assessment of strong financial resilience in a moderate economic downturn. Based on historical results, Fitch estimates that a 1% decline in U.S. GDP would reduce city revenues by 2.6% in the first year of a recession, with a return to growth in subsequent years. Unrestricted reserves of $324 million in fiscal 2015 (equal to 25.6% of general fund spending) provide a considerable cushion against revenue declines anticipated in a moderate recession.

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)	(2.6%)	0.7%	4.0%
Inherent Budget Flexibility	High		

Revenues, Expenditures, and Fund Balance	Actuals							Scenario Output		
	2009	2010	2011	2012	2013	2014	2015	Year 1	Year 2	Year 3
Total Revenues	1,201,875	1,185,786	1,151,702	997,263	1,012,408	1,039,068	1,140,345	1,110,217	1,117,578	1,161,912
% Change in Revenues	-	(1.3%)	(2.9%)	(13.4%)	1.5%	2.6%	9.7%	(2.6%)	0.7%	4.0%
Total Expenditures	698,080	691,050	704,861	743,148	733,510	762,755	830,195	846,799	863,735	881,010
% Change in Expenditures	-	(1.0%)	2.0%	5.4%	(1.3%)	4.0%	8.8%	2.0%	2.0%	2.0%
Transfers In and Other Sources	95,595	102,339	106,607	114,435	135,950	146,729	137,372	133,743	134,629	139,970
Transfers Out and Other Uses	648,773	563,749	542,963	361,917	330,684	434,975	432,795	441,451	450,280	459,286
Net Transfers	(553,178)	(461,410)	(436,356)	(247,482)	(194,734)	(288,246)	(295,423)	(307,708)	(315,651)	(319,315)
Bond Proceeds and Other One-Time Uses	-	-	-	-	-	-	-	-	-	-
Net Operating Surplus(+)/Deficit(-) After Transfers	(49,383)	33,326	10,485	6,633	84,164	(11,933)	14,727	(44,290)	(61,808)	(38,413)
Net Operating Surplus(+)/Deficit(-) (% of Expend. and Transfers Out)	(3.7%)	2.7%	0.8%	0.6%	7.9%	(1.0%)	1.2%	(3.4%)	(4.7%)	(2.9%)
Unrestricted/Unreserved Fund Balance (General Fund)	67,824	104,053	243,225	249,858	334,022	308,849	323,576	279,286	217,478	179,065
Other Available Funds (Analyst Input)	-	-	-	-	-	-	-	-	-	-
Combined Available Funds Balance (GF + Analyst Input)	67,824	104,053	243,225	249,858	334,022	308,849	323,576	279,286	217,478	179,065
Combined Available Fund Bal. (% of Expend. and Transfers Out)	5.0%	8.3%	19.5%	22.6%	31.4%	25.8%	25.6%	21.7%	16.6%	13.4%

Reserve Safety Margins	Inherent Budget Flexibility				
	Minimal	Limited	Midrange	High	Superior
Reserve Safety Margin (aaa)	42.3%	21.1%	13.2%	7.9%	5.3%
Reserve Safety Margin (aa)	31.7%	15.9%	10.6%	6.6%	4.0%
Reserve Safety Margin (a)	21.1%	10.6%	6.6%	4.0%	2.6%
Reserve Safety Margin (bbb)	7.9%	5.3%	4.0%	2.6%	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.

Rating History: IDR and GO Bonds

Rating	Action	Outlook/ Watch	Date
AA+	Affirmed	Stable	9/26/16
AA+	Revised	Stable	4/30/10
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.

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 continue to increase more rapidly than U.S. GDP based on the city's resilient economy and above-average population growth. 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. Most recently, a new property type classification targeting high value second homes was introduced in fiscal 2015, increasing revenues by approximately 4.5%.

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, including related 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 should continue, but ongoing revenue gains are likely to keep 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 28% of governmental expenditures as of fiscal 2014, limiting the city's options for reductions in a downturn. However, Fitch notes that recent increases in expenditures for retiree benefits are based partly on the city's efforts to accelerate pre-funding of OPEBs.

Long-Term Liability Burden

Long-term liabilities for debt and pensions are affordable relative to the city's wealthy resource base at approximately 9% of personal income, but the city's unfunded OPEB liability is also substantial, at $1.8 billion as of fiscal 2015, equivalent to an additional 3.6% of personal income. The city has made notable progress funding its OPEB program, moving from pay-as-you-go to nearly full funding of the annual required contribution within the span of several years, but has no ability to reduce accrued benefits.

The city reported a 64% ratio of assets to liabilities in its pension plan for fiscal 2015 under an assumption of 7.65% investment returns. Based on an alternate assumption of 7% returns, Fitch estimates a funded ratio of 59%. Contribution rates are determined by statute and adjusted

Related Research

Fitch Rates Honolulu, HI's $583.7MM GOs 'AA+'; Outlook Stable (September 2016)

Related Criteria

U.S. Tax-Supported Rating Criteria (April 2016) periodically if the funding period exceeds 30 years. The most recent adjustments to contribution rates were adopted by the state legislature in 2011 with a package of pension reforms, including reduced benefits for new hires and anti-spiking provisions. Investment assumptions have also been reduced incrementally, raising liabilities. Such efforts have helped slow the growth of pension obligations, but material reductions in this liability will likely require both adherence to current contribution practices and achievement of investment return assumptions over the long term.

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 surcharge. Project costs to date have been addressed through a combination of pay-go funding and short-term borrowing, but the city expects to eventually issue general obligation debt supported by reimbursements from its rail authority. Recent increases in construction costs could affect the timing and scope of the project, which appears likely to exceed its current budget of $6.9 billion, and borrowing plans remain uncertain.

Operating Performance

Substantial reserves and a history of limited revenue volatility contribute to an assessment of strong financial resilience in a moderate economic downturn. For details, see Scenario Analysis, page 2.

The city's budget management is conservative, and operations have been consistently balanced. Unrestricted reserves increased substantially in the wake of the recession from 5% of general fund spending in fiscal 2009 to nearly 26% in 2015.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.