MOODY'S INVESTORS SERVICE

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New Issue

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City & County of Honolulu, HI

New Issue: Moody's assigns Aa1 rating to Honolulu, HI's GO Bonds 2017. Outlook is stable

Summary Rating Rationale

Moody's Investors Service has assigned a Aa1 rating to the City and County of Honolulu's General Obligation Bonds, Series 2017A (Tax-Exempt), Series 2017B (Tax-Exempt), Series 2017C (Tax-Exempt Refunding Bonds), Series 2017D (Tax-Exempt Refunding Bonds), Series 2017E (Tax-Exempt Crossover Refunding Bonds) , Series 2017F (Taxable Crossover Refunding Bonds), Series 2017G (Taxable Green Bonds) to be issued in the aggregate amount of approximately $411 million.

Moody's Investors Service has assigned a Aa1 rating to the City and County of Honolulu's General Obligation Bonds, Series 2017H (Tax-Exempt) (Honolulu Rail Transit Project Index Floating Rate Bonds) to be issued in the approximate amount of $350 million.

At this time, Moody's also affirms the Aa1 rating on the city's approximately $2.97 billion of outstanding general obligation bonds. The long-term ratings carry a stable outlook.

The city's Aa1 rating reflects a very large and growing property tax base, a strong economy supported by continued growth in tourism numbers, large private and public construction projects and a significant, stable military presence. Financial operations benefit from a strong management team and prudent conservative budgeting policies. Operating reserve levels remain generally stable and comparable to similarly-rated large cities. Our review also takes into account the city's high and escalating budgetary burden from the combination of debt service, pension and employee and retiree healthcare costs.

Credit Strengths

» Large tax base; low unemployment rates; healthy growth in tourism industry; stable military presence

» Prudent fiscal management demonstrated by conservative budgeting practices and recently improved reserve levels

» Demonstrated willingness to raise revenues and reduce spending to achieve budget balance

» Commitment to and progress toward reducing pension and OPEB liabilities, including plans to fund fully the OPEB ARC

Credit Challenges

» High cost of living and vulnerability to shifts in tourism sector

» High fixed cost burden from pensions, debt and retiree medical costs will continue increasing because contribution requirements to statewide pension system are rapidly escalating

» Uncertainty surrounding timing of light rail construction completion, final construction costs and level of enterprise risk exposure to the city, especially during construction and ramp-up phases

Rating Outlook

Moody's outlook on Honolulu's long-term ratings is stable. The stable outlook reflects the city's healthy economy and our expectation that the city will maintain solid reserve levels while continuing to make planned progress in funding its pension and OPEB liabilities and also challenges related to construction of the light rail.

Factors that Could Lead to an Upgrade

» Increased local economic diversification and improvement in socioeconomic wealth indices

» Significant improvement in funding OPEB and pension liabilities

» Sustained financial and debt characteristics consistent with higher-rated entities

» Greater certainty regarding rail costs and potential impact on City

Factors that Could Lead to a Downgrade

» Economic weakening and prolonged declines in assessed valuation

» Deterioration of financial operations and reserve levels

» Inability to manage escalating fixed cost burden

Key Indicators

Exhibit 1

Honolulu (City & County of) HI	2012	2013	2014	2015	2016
Economy/Tax Base					
Total Full Value ($000)	$ 153,592,621	$ 155,333,754	$ 159,095,726	$ 174,335,550	$ 187,718,834
Full Value Per Capita	$ 160,794	$ 161,021	$ 163,060	$ 177,138	$ 189,117
Median Family Income (% of US Median)	131.0%	132.0%	131.2%	130.8%	130.8%
Finances					
Operating Revenue ($000)	$ 1,236,829	$ 1,259,422	$ 1,284,977	$ 1,387,777	$ 1,444,691
Fund Balance as a % of Revenues	20.2%	26.5%	24.0%	23.3%	21.8%
Cash Balance as a % of Revenues	21.9%	29.3%	21.6%	28.9%	27.4%
Debt/Pensions					
Net Direct Debt ($000)	$ 2,570,807	$ 2,755,948	$ 2,624,168	$ 2,891,752	$ 2,749,028
Net Direct Debt / Operating Revenues (x)	2.1x	2.2x	2.0x	2.1x	1.9x
Net Direct Debt / Full Value (%)	1.7%	1.8%	1.6%	1.7%	1.5%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	1.9x	1.9x	1.9x	1.8x	1.8x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	1.5%	1.5%	1.6%	1.4%	1.4%

Source: Moody's Investors Service

Recent Developments

Recent developments are incorporated in the Detailed Rating Considerations below.

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Detailed Rating Considerations

Economy and Tax Base

Honolulu's economy remains strong and continues to be supported by its large tourism industry with record visitor volumes, as well as numerous, large public and private construction projects and finally, anchored by the military's significant and expanding presence. The City/County (the "City") is coterminous with the island of Oahu with an area encompassing 597 square miles, including Waikiki beach and Pearl Harbor. Population growth has been relatively flat in recent years and as of July 2016, the city was home to an estimated 992,605 residents (2016), or about 69% of the state's population.

According to Moody's Economy.com (April 2017), employment cutbacks in sectors including financial activities, wholesale trade, education/healthcare and government were offset by steady growth in construction and manufacturing, resulting in still very low unemployment rates. As of June 2017, the city's 3.1% unemployment rate remains very low compared to the nation (4.5%). The forecast from Moody's Economy.com projects that Honolulu's economy will expand at a gradual pace in the short term as rising tourist traffic supports consumer industries while the military presence continues to anchor the economy as defense spending increases. Longer term, high business costs and slow population growth will constrain its prospects to below the U.S. average.

Between 2013 and 2018, assessed valuation (AV) increased an average of 6.4% annually, including healthy growth of 6.3% (2017) and 6.0% (2018) in recent years; AV adjustments lag the market by 18 -24 months. The city's AV is very large at $211.6 billion. Moody's notes Honolulu historically has not experienced much foreclosure activity given the relative rarity of sub-prime financing in Hawaii. The 2015 estimated median family income was a healthy 131% of national levels and the city's full value per capita is strong at $211,570.

Real estate has been an important element of Honolulu's economic growth. Single family home prices increased 11.1% as of the first quarter of 2017. However, these rising prices add to the island's CPI growth and slows population growth as Honolulu is one of the least affordable housing markets in the nation. Aside from the tourism and military sectors, Honolulu is also anchored by a significant public sector while health care, banking and agriculture add further diversity.

HONOLULU RAIL

The city, through the Honolulu Authority for Rapid Transportation (HART) continues construction of the new 20-mile mass transit system along Oahu's east-west corridor. An estimated 60% of the city's population lives within this corridor and the city projects that population growth within this area will outpace the balance of Oahu. To date, more than $2.8 billion has been expended for planning and design, site acquisition and guideway and track construction and HART notes that roughly 50% of the guideway is complete. Construction of the light rail system is expected to be completed in 2025, compared to original estimates of a 2019 completion.

Costs related to construction of the system, which have increased from its original estimate of $5.2 billion to $8.2 billion, are expected to be funded primarily with revenue generated by the 0.5% general excise and use tax surcharge (the surcharge) implemented by the city on January 1, 2007. The surcharge's original expiration was extended another five years and by the expiration date (2027) is projected to generate a total of $4.9 billion. Additional funding is expected from a $1.55 billion grant from the U.S. Department of Transportation, Federal Transit Administration under a full funding grant agreement (FFGA) dated December 2012. Cost increases have been a result of various factors including lawsuits in earlier years and rapid growth in construction prices.

As of July 2017, the city had received $1.98 billion from the surcharge, net of administrative fees charged by the State, and have drawn down on $794 million of $806 million that had been obligated by the Federal Transit Administration (FTA) under the full-funding grant agreement dated December 19, 2012; the US Congress has appropriated the remaining $744 million as part of the FFGA, but the FTA has not yet obligated this amount. The FTA has requested an updated financial plan from HART due September 15, 2017 and HART management notes they are on track to meet this request. Importantly, a special state legislative session is scheduled to begin August 28, 2017 to discuss possible funding options to provide needed funding for the project. HART will submit a full recovery plan to the FTA after the close of the special state legislative session.

Funding options being considered are (i) an extension of the general excise and use tax surcharge beyond 2027, (ii) an increase in the Transient Accommodation Tax, (iii) additional sources of governmental funding and/or public/private partnerships such as transit oriented development, and (iv) modifications to the project scope such as reducing the number or changing the configuration of stations.

In anticipation of receiving future surcharge revenue through the current sunset of 2027 and receipt of the balance of the federal grant, construction of the project is expected to be financed with a combination of general obligation commercial paper notes, bond anticipation notes, and general obligation bonds issued by the city; the Series 2017H bonds are the first issuance for rail construction. Notably, the city and HART have entered into a memorandum of understanding prior to any debt issuance that would entitle the city to reimbursement from HART for debt service and other costs associated with such obligations.

Given the current capital plan and scheduled expiration of the surcharge in 2027, it is projected that the city would need to subsidize rail system operations with approximately $80 million per year beginning in fiscal 2020 to offset operating costs not paid from passenger fares. The additional budgetary burden from the operating subsidy in the out years will further constrain the city's financial flexibility given already escalating fixed costs from debt, pension and retiree health costs.

We will continue to monitor the likelihood and potential magnitude of the costs associated with the construction and operation of the rail on the city. Given the city's intent to provide contingent support for rail construction and operation, we will incorporate rail- related debt into the city's debt profile to gauge the potential strain on the city's operations. We will also monitor the rail's need for financial support from the city; we would consider continued construction cost overruns, below average surcharge collections and/or operational subsidies above current projections as red flags. Finally we also monitor changes in public and political support and the willingness of the city to continue to provide contingent support.

Financial Operations and Reserves

The city is well managed and operating reserve levels provide the city sound operating flexibility. The city's fiscal 2016 available operating reserve dropped slightly and was equal to a still healthy 21.8% of revenue, below the fiscal 2016 Aa1-rated large city median fund balance of 26.1%. The city's General Fund balance includes a Reserve for Fiscal Stability (RFS) Fund that was established back in fiscal 2010. Since 2012, the city has increased the RFS Fund annually and in fiscal 2016 the fund totaled 7.4% of general fund revenues ($103 million). Operating funds include the city's General, Highway and Debt Service Funds, although nearly all resources flow through the General Fund. In 2016, the city maintained flat tax rates for all property classes and combined with growth in AV, collections grew a similar 8% over the prior year. General Fund resources are comprised primarily by property taxes which totaled 88% of General Fund revenues in fiscal 2016.

In fiscal 2017 the city again maintained flat property tax rates for each of the nine property classifications which, when combined with solid AV growth, increased property tax collections by a healthy 8%. The city's unassigned general fund balance declined to an estimated $128 million, down from $140 million in fiscal 2016 (10% of general fund revenues) due to various one-time needs. However, the city increased the Reserve for Fiscal Stability slightly to $103 million (estimated/unaudited), equal to about 7%, which is at the high end of the city's targeted RFS Fund balance.

The city's zero-based budgeting approach balanced the 2018 budget after identifying another comparatively small budget gap. For the third year, the city maintained flat tax rates and estimates year-end property tax collections will grow by about 7%. The city budgeted another $7 million increase to the RFS and does not expect any draw down of reserves.

Despite the city's demonstrated ability to maintain healthy and stable reserve levels, the city's financial profile will continue to be challenged by high fixed obligations and likely operational subsidies in the out years from the city's rail system. In fiscal 2016, debt service, pension and OPEB costs represented about 30% of operating revenues. Going forward, Moody's will monitor annual revenue increases and the city's ability to absorb these costs. The city's commitment to maintaining budget balance and adequate reserve levels has been an important factor in Moody's credit evaluation of Honolulu.

LIQUIDITY

General fund cash equaled 24.4% of revenues in fiscal 2016, similar to prior years but below the Aa1-large city median (33.9%). The city does not anticipate any material reductions to available cash.

Debt and Pensions

The city's debt position is average with a net direct debt burden of 1.3%, which approximates the median for large Aa1-rated cities nationally. Honolulu benefits from the active role the state government plays in financing traditional municipal capital needs more typically funded at the local level throughout the rest of the country including transportation, health, justice, and education.

Including the current offering, the city has approximately $3.6 billion of outstanding general obligation bonds. Approximately 61% of the city's general obligation debt is retired in ten years. The city has typically borrowed about $250 million annually for its CIP, however, specific future borrowing amounts and timing are uncertain at this time.

For the Series 2017E and 2017F Bonds, until the crossover date of September 1, 2019, which represents the current callable date for the Series 2009E (BABs), the bonds are additionally secured by an escrow funding at closing sufficient to pay debt service on the bonds. The escrow is expected to be funded with non-callable, direct federal securities and/or federally guaranteed securities. Following the crossover date, the bonds will be secured by an unlimited property tax pledge; debt service payments represent a first charge on the city's General Fund.

The proceeds from the Series 2017H bonds will fund a portion of the rail construction project and represent the only variable rate debt for the city. The city has no derivative instruments in its G.O. borrowing program. The 2017H bonds bear a variable interest rate based on a spread to the tax-exempt SIFMA index and pose a modest level of interest rate risk to the city. As the notes are not associated with an interest rate swap, increases in SIFMA would impose higher debt service costs on the city. The interest rate cap is 8%. Even in a worst-case scenario where the interest rate spikes to that level just after issuance, the additional debt service would represent a still manageable risk. The nominal maturity range from 2022 through 2028 coincides with construction completion and the current General Excise and Use Tax surcharge sunset date of 12/31/2027. The surcharge is budgeted to total $237 million in the current fiscal year (2018) then increase annually by about 3% - 3.5% annually through fiscal 2022 ($271 million).

DEBT STRUCTURE

The city has $3.6 billion in general obligation bonds outstanding, post-sale, with the latest maturity in 2042. About 20% of the city's general obligations are reimbursable from non-tax revenues. Total debt service increases slightly through 2020 before declining through final maturity.

DEBT-RELATED DERIVATIVES

The Series 2017H bonds will be the city's only variable rate debt outstanding.

The city has no debt-related derivatives.

PENSIONS AND OPEB

Honolulu has an average defined-benefit pension burden, based on unfunded liabilities for a multi-employer plan and for its Moody's estimated share of a cost-sharing plan administered by the state. Reported unfunded liabilities in fiscal 2016 were approximately $1.5 billion, or 63% funded. Pension and OPEB budgetary pressures have been growing and will continue increasing because contribution requirements to statewide pension system are rapidly escalating. The next five years will be critical in how the city addresses these rising costs given the multiple budgetary tools it has available, including the legal flexibility to raise revenue or to trim other operating expenses. Net of reimbursements from the city's self-sufficient enterprises, the city's fiscal 2016 contribution was approximately $129 million, or 11% of operating revenue. Fixed costs have gradually consumed a greater proportion of the city's budget and in fiscal 2016, pension contributions, debt service and PAYGO costs for OPEB benefits represented 29% of operating revenues. Looking forward, fixed costs could grow to a high, estimated 34% of operating revenue by fiscal 2022, primarily as a result of a four-year phase-in of higher employer contributions (discussed below).

Net of proportional shares allocated to business enterprises based on actual contributions from those entities, the three year average Moody's adjusted net pension liability (ANPL) for the city, under our methodology for adjusting reported pension data, is $2.7 billion. In the three years through fiscal 2016, the ANPL has averaged a moderate 2.29 times annual operating revenue and 1.4% of full valuation. Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. The adjustments are not intended to replace Honolulu's reported liability information, but to improve comparability with other rated entities.

The latest, fiscal 2016, system valuation resulted in an increase in the statewide UAAL from $8.7 billion to $12.4 billion and a reduction in the funded ratio from 62.4% to 51.3% based on market value of assets, primarily as a result of a reduction in the discount rate from 7.65% to 7.00% and revisions to the mortality table. The legislature recently enacted higher employer contribution rates to address the increased liability. Employer contributions will increase from 25% to 41% for police and fire and from 17% to 24% for general employees over a four year phase-in period. The new rates are projected to eliminate the UAAL by 2045.

The city's OPEB liability is sizeable and remains a challenge. As of July 1, 2017 the unfunded OPEB liability was $1.77 billion or 1.5 times fiscal 2016 operating revenues. Importantly, in the 2013 legislative session, the state adopted a plan to require phasing in higher annual required contribution (ARC) payments by all counties and the state beginning in fiscal 2015. By fiscal 2019, the payments would reach 100% of the ARC. Honolulu began setting aside amounts to pre-fund its OPEB liability beginning in 2008, and is currently ahead of the required schedule and the 2018 operating budget reflects continued increases in payments which are estimated to equal 80% of its annual OPEB ARC.

Hawaii is the only state that has adopted a plan to fully fund its OPEB ARC payments. While the pension and OPEB actions are credit positive, they will substantially increase all local government's (including Honolulu) annual fixed costs relative to budget.

Management and Governance

Hawaii counties have an institutional framework score of Aa, or strong. Revenues, mainly property taxes and state distributed transient accommodations taxes, are highly predictable and counties have a strong ability to raise property tax revenues. However, state mandated benefits present a high exposure to the state budget and limits counties' expenditure flexibility which weakens the institutional rating somewhat.

Legal Security

The bonds are secured by an unlimited property tax pledge; debt service payments represent a first charge on the city's General Fund.

For the Series 2017E and 2017F Bonds, until the crossover date of September 1, 2019, which represents the current callable date for the Series 2009E (BABs), the bonds are additionally secured by an escrow funding at closing sufficient to pay debt service on the bonds. The escrow is expected to be funded with non-callable, direct federal securities and/or federally guaranteed securities. Following the crossover date, the bonds will be secured by an unlimited property tax pledge; debt service payments represent a first charge on the city's General Fund.

Use of Proceeds

The Series 2017A ($177.9 million) and 2017B ($35.1 million) bonds will finance various capital improvement needs. The 2017C ($3.5 million) and 2017 D ($137.6 million) will refund previously issued general obligation bonds for debt service savings. The Series 2017E ($32.9 million) and 2017F ($3.74 million) for estimated savings. The 2017G ($20.1 million) will finance various needs for the City's H-Power waste disposal facility.

The Series 2017H ($350 million) will fund a portion of the capital costs of the City's rail transit project.

Obligor Profile

Honolulu, the capital and principal city of the State of Hawaii was incorporated in 1907 and is coterminous with the island of Oahu. The City and County of Honolulu has an area of 597 square miles and includes the entire island of Oahu.

Methodology

The principal methodology used in this rating was US Local Government General Obligation Debt published in December 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Ratings

Exhibit 2

Honolulu (City & County of) HI

Issue	Rating
General Obligation Bonds, Series 2017A (Tax-Exempt)	Aa1
Rating Type	Underlying LT
Sale Amount	$177,895,000
Expected Sale Date	08/16/2017
Rating Description	General Obligation
General Obligation Bonds, Series 2017B (Tax-Exempt)	Aa1
Rating Type	Underlying LT
Sale Amount	$35,095,000
Expected Sale Date	08/16/2017
Rating Description	General Obligation
General Obligation Bonds, Series 2017C (Tax-Exempt Refunding Bonds)	Aa1
Rating Type	Underlying LT
Sale Amount	$3,500,000
Expected Sale Date	08/16/2017
Rating Description	General Obligation
General Obligation Bonds, Series 2017D (Tax-Exempt Refunding Bonds)	Aa1
Rating Type	Underlying LT
Sale Amount	$137,600,000
Expected Sale Date	08/16/2017
Rating Description	General Obligation
General Obligation Bonds, Series 2017E (Tax-Exempt Crossover Refunding Bonds)	Aa1
Rating Type	Underlying LT
Sale Amount	$32,925,000
Expected Sale Date	08/16/2017
Rating Description	General Obligation
General Obligation Bonds, Series 2017F (Taxable Crossover Refunding Bonds)	Aa1
Rating Type	Underlying LT
Sale Amount	$3,740,000
Expected Sale Date	08/16/2017
Rating Description	General Obligation
General Obligation Bonds, Series 2017G (Taxable Green Bonds)	Aa1
Rating Type	Underlying LT
Sale Amount	$20,065,000
Expected Sale Date	08/16/2017
Rating Description	General Obligation
General Obligation Bonds, Series 2017H (Tax-Exempt) (Honolulu Rail Transit Project Index Floating Rate Bonds)	Aa1
Rating Type	Underlying LT
Sale Amount	$350,000,000
Expected Sale Date	09/06/2017
Rating Description	General Obligation

Source: Moody's Investors Service

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