

State of Hawaii

General Obligation Bonds New Issue Report

Ratings

New Issues

General Obligation Bonds of 2016, Series FB	AA
General Obligation Bonds of 2016, Series FC	AA
General Obligation Refunding Bonds of 2016, Series FD	AA
General Obligation Refunding Bonds of 2016, Series FE	AA
General Obligation Refunding Bonds of 2016, Series FF	AA

Outstanding Debt

General Obligation Bonds	AA
Appropriation-Backed Debt	AA-

Rating Outlook

Stable

Related Research

[Fitch Rates Hawaii's \\$851MM GO Bonds 'AA'; Outlook Stable \(March 2016\)](#)

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New Issue Details

Sale Information: \$500,000,000 General Obligation Bonds of 2016, Series FB; and \$25,000,000 Taxable General Obligation Bonds of 2016, Series FC, via competitive sale on March 15. Additionally, \$6,000,000 General Obligation Refunding Bonds of 2016, Series FD; \$182,385,000 General Obligation Refunding Bonds of 2016, Series FE; and \$137,165,000 General Obligation Refunding Bonds of 2016, Series FF, to sell on March 31 via negotiation.

Security: The full faith and credit pledge of Hawaii.

Purpose: To finance various capital improvements, refund outstanding GO bonds and pay costs of issuance.

Final Maturity: Oct. 1, 2036.

Key Rating Drivers

Sound Financial Management: Hawaii's fiscal management practices are sound and include frequent revenue forecast updates, long-term financial planning and a commitment to maintaining budget balance when revenues underperform. Fitch also views positively the state's commitment to building and maintaining financial reserves and prepaying long-term liabilities.

Resilient Economy Despite Concentration: Hawaii's well-established tourism infrastructure underpins an economy dominated by leisure and hospitality, and the state's federal military exposure is significant. Despite this concentration, Hawaii's overall economic growth trend has proved relatively stable.

Elevated Debt Burden: Hawaii's debt levels are high for a U.S. state government, and Fitch Ratings expects them to remain so. This largely reflects the state's direct responsibility for many functions delegated to local governments in other states, particularly K-12 education.

High Retirement Liabilities: The state's unfunded pension liability as a percentage of personal income is at the high end for U.S. states, and other post-employment benefit obligations (OPEB) are also significant. The state has prioritized addressing these liabilities through benefit and contribution reforms, including prefunding OPEB. Despite these efforts, the liability burden is expected to remain well above average for the foreseeable future.

Rating Sensitivities

Fiscal Management: The 'AA' rating is sensitive to shifts in the state's fundamental credit characteristics, particularly its prudent fiscal management.

Rating History — GO Bonds

Rating	Action	Outlook/ Watch	Date
AA	Affirmed	Stable	3/3/16
AA	Affirmed	Stable	10/9/15
AA	Affirmed	Stable	10/24/14
AA	Affirmed	Stable	10/11/13
AA	Affirmed	Stable	11/8/12
AA	Affirmed	Stable	11/4/11
AA	Downgraded	Stable	6/15/11
AA+	Revised	Negative	4/5/10
AA	Affirmed	Negative	2/2/10
AA	Affirmed	Negative	6/3/09
AA	Upgraded	—	2/16/06
AA-	Assigned	—	10/29/98

Rating History — COPs

Rating	Action	Outlook/ Watch	Date
AA-	Affirmed	Stable	3/3/16
AA-	Affirmed	Stable	10/9/15
AA-	Affirmed	Stable	10/24/14
AA-	Affirmed	Stable	10/11/13
AA-	Affirmed	Stable	6/4/13
AA-	Downgraded	Stable	6/15/11
AA	Revised	Negative	4/5/10
AA-	Assigned	Negative	10/8/09

Fitch recently published exposure drafts of state and local government tax-supported criteria (Exposure Draft: U.S. Tax-Supported Rating Criteria, dated Sept. 10, 2015, and Exposure Draft: Incorporating Enhanced Recovery Prospects into U.S. Local Tax-Supported Ratings, dated Feb. 2, 2016). The drafts include a number of proposed revisions to existing criteria. If applied in the proposed form, Fitch estimates the revised criteria would result in changes to less than 10% of existing tax-supported ratings. Fitch expects that final criteria will be approved and published in the first quarter of 2016. Once approved, the criteria will be applied immediately to any new issue and surveillance rating review. Fitch anticipates the criteria to be applied to all ratings that fall under the criteria within a 12-month period from the final approval date.

Related Criteria

- Exposure Draft: U.S. Tax-Supported Rating Criteria (September 2015)
- Tax-Supported Rating Criteria (August 2012)
- U.S. State Government Tax-Supported Rating Criteria (August 2012)

Credit Profile

Hawaii's 'AA' GO rating reflects the state's sound financial management practices, a concentrated but resilient economy, comparatively high debt levels for a U.S. state and a large but manageable burden of retirement liabilities. Economic performance during the current expansion has generally been solid. State revenue growth coupled with prudent budget management has stabilized Hawaii's financial position, as evidenced by strengthened reserve balances. Retirement liabilities are likely to remain high, although Hawaii has prioritized lowering the burden through benefit reforms and accelerating prefunding of obligations.

The 'AA-' rating on the COPs is linked to the state's GO rating, as lease payments are subject to legislative appropriations for essential state facilities.

Hawaii — Basic Demographics

	Population				Population Growth (%)		
	1990 Census	2000 Census	2010 Census	2015	1990–2000	2000–2010	2010–2015
Hawaii	1,108,229	1,211,537	1,360,301	1,431,603	9.3	12.3	5.2
U.S.	248,765,170	281,421,906	308,745,538	321,418,820	13.1	9.7	4.1
	Population Age (%) ^a				Education (%) ^a		
	Median	Under 5	18–64	65+	High School Degree	Bachelor's Degree	
Hawaii	37.9	6.4	62.2	16.1	90.7	30.5	
U.S.	37.7	6.2	62.4	14.5	86.3	29.3	
	Individuals in Poverty (%) ^a						
Hawaii		11.3					
U.S.		15.6					

^aBased on estimates from the most recent Census American Community Survey.

Economic Strengths Anchored by Tourism

Hawaii's economy includes a substantial leisure and hospitality sector, as well as a large governmental component that reflects a significant federal military presence. Together, these sectors accounted for nearly one-third of the state's 2014 real GDP. Although subject to external shocks and broader economic cycles, the tourism sector in Hawaii is resilient and has tended to recover quickly, providing an important cornerstone for the state's economic growth.

During the current expansion, the tourism industry has exhibited strong growth. Two key indicators, visitor arrivals and visitor expenditures, reached historical highs in 2014 and 2015. The state forecasts ongoing growth for 2016 and beyond.

Hawaii's large military presence makes it vulnerable to federal deficit reduction, although the state has benefitted from recent military consolidations and serves a strategic role that limits downside risk. The negative impact of any near-term federal cuts should be manageable given expectations of offsetting military investment.

Labor market conditions are very strong at present, having benefitted from several consecutive years of growth after the last recession. The unemployment rate of 3.2% in December 2015 was well under the 5% national rate and well below the 4% level reported by the state one year earlier.

Employment gains have continued through the current expansion. December 2015 employment was up 2.5% in Hawaii versus one year ago, and above the 2% rate for the U.S. overall. Growth picked up more recently relative to 2014, when employment in Hawaii for the year rose only 1.1%

versus 1.9% nationally. Hawaii surpassed its pre-recession jobs peak in August 2014 and, to date, has regained approximately 131% of the jobs lost in the last recession.

Personal income growth outpaced that of the nation for the last decade, increasing 51.7% versus 46.1% for the U.S. overall. Per capita personal income (PCPI) growth has been closer to the national trend, reflecting Hawaii's above-average population growth over that span. PCPI in 2014 equaled 100% of the U.S. level, ranking Hawaii 22nd among the states.

Hawaii Nonfarm Employment

(Monthly, Seasonally Adjusted)



Source: Bureau of Labor Statistics, National Bureau of Economic Research.

Reserves Provide Flexibility

A key component of Hawaii's sound fiscal management has been its practice of setting aside resources in several reserves to protect against future fiscal uncertainties, including economic and revenue cyclicity, as well as negative shocks such as hurricanes.

Prior to the recession, the state built up a sizable cushion, with total reserves (including the general fund ending balance, the emergency and budget reserve fund [EBRF], and the Hawaii hurricane relief fund [HHRF]) peaking at \$786 million (16% of total general fund resources) in fiscal 2006.

During the recession, economic and revenue contraction required the state to implement corrective actions, including boosting revenues, cutting expenditures and drawing from reserves. After hitting a low in fiscal 2011 of \$157 million (3.1% of general fund resources), Hawaii's commitment to rebuilding reserves has led to steady improvement. Fiscal 2015 ended with \$1.1 billion in the state's reserve funds, or 16.7% of general fund revenues; together the EBRF and HHRF held \$273 million.

Fiscal Gains Resume

Fiscal 2015 general fund tax revenues rose 6.8%, with increases of 5.9% and 13.9% for general excise tax (GET) and personal income tax (PIT) revenues, respectively. Expenditures, meanwhile, rose 2.2%. Fiscal 2015 general fund revenues exceeded expenditures by \$163 million, with the carryover balance rising to \$828 million.

Going forward, the state's council on revenues projects continued steady gains, with fiscal 2016 and 2017 general fund tax revenue rising 6.7% and 5.5%, respectively; these gains appear reasonable in Fitch's view, assuming currently favorable economic trends continue.

Meanwhile, expenditures are forecast to rise 7% in fiscal 2016 and 12% in fiscal 2017 due to the implementation of recent labor agreements and planned increases in reserves. Reserve increases include EBRF deposits of \$10 million and \$100 million in fiscal years 2016 and 2017, respectively, and \$164 million in fiscal 2017 to fully fund the state's OPEB ARC. Fitch views the state's willingness

to prioritize the rebuilding of reserves and prefunding retiree obligations to be a notable credit positive for the state.

Budgetary Basis Financial Projections

(\$000, Fiscal Years Ending June 30)

	General Revenue Funds						CAGR (%)
	2016	2017	2018	2019	2020	2021	
Personal Income Tax	2,085,500	2,190,098	2,329,500	2,480,039	2,584,943	2,734,629	5.6
Sales Tax (General Excise Tax)	3,197,573	3,373,680	3,536,407	3,690,803	3,823,016	3,969,277	4.4
Corporate Income Tax	82,683	85,684	95,972	96,181	144,250	141,500	11.3
Transient Accommodation Tax	225,906	251,937	272,073	292,168	312,903	334,449	8.2
Liquor and Cigarette Taxes	137,730	141,869	145,383	149,407	153,410	157,622	2.7
Total Taxes	6,119,395	6,455,962	6,811,040	7,151,592	7,473,414	7,809,718	5.0
Other Revenues	850,306	708,068	728,218	747,409	767,220	788,307	(1.5)
Total Revenues	6,969,701	7,164,030	7,539,258	7,899,001	8,240,634	8,598,025	4.3
Ending Fund Balance	973,600	524,900	488,100	596,200	843,700	1,310,500	6.1
As % of General Fund Revenues	14.0	7.3	6.5	7.5	10.2	15.2	—
Reserves ^a	290,400	398,300	404,300	410,400	416,400	422,500	7.8
As % of General Fund Revenues	4.2	5.6	5.4	5.2	5.1	4.9	—

^aConstitutionally dedicated budget reserve fund. CAGR – Compound annual growth rate. Note: Numbers may not add due to rounding. Source: Preliminary official statement for the 2016 series FB, FC, FD, FE and FF bonds.

High Bonded Debt

Hawaii's state government is directly responsible for many functions, such as K-12 education, that are routinely delegated to the local level in other states. Generally, as a result, debt is comparatively high for a U.S. state and expected to remain so. On a pro forma basis (inclusive of \$525 million in new money for the series FB and FC GO bonds), Hawaii's net tax-supported debt totaled approximately \$6.7 billion, equating to 10.3% of 2014 personal income. Principal is retired at a rapid pace, with 67% of GO principal to be repaid within 10 years. The vast majority of the state's debt is in GO bonds.

Focus on Controlling Retirement Liabilities

The state's obligations for both retiree pensions and healthcare are significant, but it has repeatedly pursued corrective actions in recent years to reduce the liabilities over time, including devoting significant contributions to prefund OPEB.

Debt Statistics

(\$000, As of March 1, 2016)

GO Debt	5,891,070
GO Debt (Reimbursable)	(249,232)
Pro Forma 2016 Series FB, FC (New Money)	525,000
Pro Forma 2016 Series FD, FE, FF, Net of Refunding	9,750
Total GO Debt	6,176,588
COPs and Leases	96,175
Tax-Supported Highways Debt	421,530
Gross Tax-Supported Debt	6,694,293
Less: Self-Supporting Debt	—
Net Tax-Supported Debt	6,694,293
Per Capita (\$) ^a	4,676
As % of Personal Income ^b	10.2
Amortization of GO Bonds	
% Due in Five Years	36
% Due in 10 Years	67
Authorized but Unissued Bonds	2,919,394
Debt Service as % of Revenues	N.A.
Adjusted State-Supported Pension Unfunded Actuarial Accrued Liability (UAAL) ^c	7,514,097
Net Tax-Supported Debt plus Adjusted State-Supported Pension UAAL as % of Personal Income	21.6

^aPopulation: 1,431,603 (2015 Census Official Population Estimates Program). ^bPersonal Income: \$65,348 (2014 Bureau of Economic Analysis estimate). ^cUAAL reported by state as of June 30, 2015. Fitch adjustment assumes an 11% increase in actuarial liabilities for every 1% variance between 7% and the plan's investment return assumption, and estimates the state's share of total system liability at 72%. Note: Numbers may not add due to rounding.

The funded ratio of the Employees' Retirement System of the State of Hawaii (ERS), the pension system covering state and local employees, has stabilized in recent years after weakening during the downturn. Despite a recent history of making contributions near the actuarially calculated level, the funded ratio remains low, at 62.2% on a reported basis as of June 30, 2015. Using Fitch's 7% discount rate assumption rather than the 7.65% used by the system, the ERS was only 58.1% funded. On a combined basis, net tax-supported debt and the state share of adjusted unfunded pension obligations represent a high 22.3% of personal income, among the highest of the states.

Recent pension reforms include an additional tier for new hires, increased employer contribution rates and a phased reduction in the discount rate to 7.5% by fiscal 2017.

Commitment to Prefunding OPEB

The state's OPEB obligations are substantial but have improved following statutory adoption of a prefunding plan. As of July 1, 2015, Hawaii reported an OPEB unfunded actuarial accrued liability (UAAL) of \$9.1 billion, which was down notably from the June 30, 2011 reported OPEB UAAL of over \$13 billion. The improvement largely reflects the actuarial recognition of the state's statutory prefunding plan and subsequent use of a higher discount rate assumption.

In 2013, the state Legislature adopted a bill requiring full funding of the OPEB ARC by fiscal 2019, including a mechanism to transfer state tax revenues if needed to ensure full contributions. The state has incorporated full ARC funding into its multiyear financial plan that extends through fiscal 2017. Fitch views Hawaii's statutory commitment to prefund its OPEB as a credit strength, despite the near-term budgetary impact.

Economic Trends

Nonfarm Employment
(000, Not Seasonally Adjusted)

	Hawaii	% Change	U.S.	% Change
2004	583	0.0	131,787	0.0
2005	602	3.1	134,051	1.7
2006	617	5.8	136,453	3.5
2007	625	1.3	137,999	1.1
2008	619	(0.9)	137,242	(0.5)
2009	591	(4.5)	131,313	(4.3)
2010	587	(0.8)	130,361	(0.7)
2011	593	1.1	131,932	1.2
2012	606	2.2	134,175	1.7
2013	619	2.0	136,381	1.6
2014	625	1.1	138,958	1.9
December 2014	635	—	141,327	—
December 2015	651	2.5	144,112	2.0

Note: Monthly unemployment rates are seasonally adjusted.

Unemployment Rates
(%, Not Seasonally Adjusted Annual Rates)

	Hawaii	U.S.	State as a % of U.S.
2004	3.4	5.5	61
2005	2.9	5.1	56
2006	2.6	4.6	56
2007	2.8	4.6	60
2008	4.3	5.8	75
2009	7.2	9.3	77
2010	6.9	9.6	72
2011	6.8	9.0	76
2012	6.0	8.1	74
2013	4.9	7.4	66
2014	4.4	6.2	71
December 2014	4.0	5.6	71
December 2015	3.2	5.0	64

Personal Income
(Change from Prior Year)

	% Change		State Growth as % of U.S.
	Hawaii	U.S.	
2004	8.1	5.9	137
2005	7.0	5.6	125
2006	7.6	7.3	105
2007	6.1	5.4	114
2008	5.4	4.1	129
2009	(0.2)	(3.3)	193
2010	2.5	3.1	80
2011	4.3	6.2	69
2012	4.7	5.1	93
2013	0.7	1.2	64
2014	4.7	4.4	106

Per Capita Personal Income
(Change from Prior Year)

	% Change		State Growth as % of U.S.
	Hawaii	U.S.	
2004	6.2	5.0	125
2005	5.4	4.6	117
2006	6.2	6.2	99
2007	5.7	4.4	129
2008	4.0	3.2	128
2009	(1.3)	(4.2)	168
2010	1.2	2.3	53
2011	3.2	5.4	60
2012	3.6	4.3	85
2013	(0.4)	0.4	(110)
2014	3.9	3.6	107

Per capita personal income: \$46,034 (2014); 100% of U.S. (ranked 22nd among states).

Real Gross Domestic Product Trends
(\$ Bil.)

	Hawaii		U.S.		State Growth as % of U.S.
	Real GDP	% Change	Real GDP	% Change	
2004	61.1	—	13,772.7	—	—
2005	64.3	5.3	14,211.3	3.2	166.3
2006	65.9	2.5	14,593.5	2.7	91.9
2007	67.2	1.9	14,807.0	1.5	129.9
2008	67.8	0.9	14,727.0	(0.5)	361.7
2009	65.3	(3.7)	14,329.6	(2.7)	64.4
2010	66.9	2.5	14,637.7	2.2	116.6
2011	68.0	1.6	14,844.1	1.4	110.8
2012	69.0	1.5	15,148.9	2.1	73.2
2013	70.0	1.4	15,432.0	1.9	76.9
2014	70.5	0.8	15,773.5	2.2	36.4

Economic Trends (continued)

Components of Real GDP
(%)

	Hawaii			U.S.		
	2004	2014	% Change	2004	2014	% Change
Natural Resources and Mining	1	1	(19.6)	2	3	27.8
Construction	7	5	(19.2)	6	4	(34.5)
Manufacturing	2	2	(15.6)	13	12	(3.3)
Trade, Transportation and Utilities	17	17	(1.6)	17	16	(5.8)
Information	2	2	2.3	4	5	20.0
Financial Activities	20	23	12.8	19	20	8.7
Professional and Business Services	9	9	2.7	11	13	12.0
Educational and Healthcare Services	7	7	6.1	8	8	8.4
Leisure and Hospitality	10	9	(7.6)	4	4	(5.7)
Other Services	3	2	(19.0)	3	2	(19.9)
Government and Government Enterprises	22	22	(0.7)	14	12	(9.9)
Total Real GDP	—	—	15.5	—	—	14.5

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