STANDARD & POOR'S
RATINGS SERVICES
McGRAW HILL FINANCIAL

RatingsDirect®

Hawaii; Appropriations; General Obligation

Primary Credit Analyst:
Gabriel J Petek, CFA, San Francisco (1) 415-371-5042; gabriel.petek@standardandpoors.com

Secondary Contact:
Robert Tu, San Francisco (1) 415-371-5087; robert.tu@standardandpoors.com

Table Of Contents

Hawaii; Appropriations; General Obligation

Credit Profile		
US$575.0 mil GO bnds ser EO due 08/01/2034		
Long Term Rating	AA/Stable	New
US$503.325 mil GO rfdg bnds ser EP due 08/01/2028		
Long Term Rating	AA/Stable	New
US$25.0 mil Taxable GO bnds ser EQ due 08/01/2025		
Long Term Rating	AA/Stable	New
Hawaii GO		
Long Term Rating	AA/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services has revised the outlook on all of Hawaii's debt to stable. In addition, we assigned our 'AA' long-term rating to the state's following planned bond issues:

- $575 million series 2014 EO general obligation (GO) bonds;
- $503.3 million series 2014 EP GO refunding bonds; and
- $25 million series 2014 EQ taxable GO bonds.

At the same time, we affirmed our 'AA' long-term rating and underlying rating (SPUR) on Hawaii's GO bonds and our 'AA-' long-term rating on the state's certificates of participation (COPs), reflecting our view of appropriation risk.

The outlook revision reflects a change in circumstances that we believe reduce the likelihood we will raise our rating within a one-to-two year timeframe. One such change is the strengthening U.S. dollar, which makes Hawaii a more expensive destination for tourists with international origins. Other signs of potential softening are reflected in Hawaii's arrivals, which dipped during the final quarter of 2013 and the first quarter of this year (after 17 quarters of growth). The state's construction industry, which we anticipate will continue increasing in importance to the state economy, has shown some mixed signals in recent quarters. Reflecting these developments, state tax revenues underperformed what the state's Council on Revenues (COR) had forecast for fiscal 2014 (although, in our view, not by as much as officially reported). In addition, the state's fiscal outlook -- while still strong -- is less robust than last year at this time.

Finally, a change in administration that will take place when a new governor is inaugurated on Dec. 1, 2014 introduces some uncertainty with regard to the state's budget management. The current administration built its financial plan around a policy objective to maintain combined ending and rainy day fund balances of 10% or more of general fund revenues. We have viewed this as favorable for the state's credit outlook, but given that the policy was informal, we make no assumption about whether a new administration will adhere to this.

We note, however, that notwithstanding our view that economic and revenue trends could moderate relative to prior performance and forecasts, actual performance has remained strong. In fact, total visitor arrivals set records in 2012, 2013, and may do so again in 2014. Likewise, the state still anticipates a healthy ending and rainy day fund balance, albeit at somewhat lower levels than before.

The 'AA' GO rating reflects our view of:

- The state's strong financial position, which weathered several major economic stressors during the past 10 years -- including the Great Recession;
- Strong liquidity, particularly when including pooled cash balances available to the general fund for temporary interfund borrowing;
- The prioritizing of contributions to the retiree health care benefits system, resulting in lower actuarial estimates of the state's long-term liability;
- Management's well-established, proactive budget monitoring practices, including frequent revenue forecast updates from the independent Council on Revenues (COR), which facilitates prompt identification of potential budget adjustments for budget alignment;
- The governor's executive authority to restrict all executive branch expenditures through such actions as cutting spending midyear without legislative approval or cutting or delaying education disbursements during the course of a fiscal year; and
- Other strong constitutional protections, including requiring budget balance, that allow for tax increases with legislative approval and give GO bonds first-lien priority before all other disbursements.

Partly offsetting the above strengths is our view of:

- The low-funded status of the state's retirement system and generally higher-than-average debt ratios because of the state's centralized provision of public sector services and
- Large, nearly unfunded other postemployment benefit (OPEB) liability despite a new statutory requirement to increase annual contributions until fiscal 2019, when they would equal the actuarially recommended level.

All GO bonds are secured by Hawaii's full faith and credit, which the state considers the highest priority in payment according to its constitution. None of the refunding bonds include later maturity dates than the existing debt to be refunded.

Any assessment of the condition of Hawaii's current revenue situation depends on how several factors are interpreted. On one hand, the state's COR has revised down its estimate of revenue growth for fiscal 2015 when compared with its forecast published in 2013. In September 2013, the COR had estimated that general fund tax revenues would increase 4.1% in fiscal 2014 before accelerating to 7.4% growth in fiscal 2015. Actual revenue performance in fiscal 2014 fell short of the estimate, but not by as much as reported by the COR in our view. Under its methodology, which excludes certain revenues that are transferred out of the general fund, the COR estimates that fiscal 2014 collections declined 1.8% versus the prior year. The COR read the decline as a sign of softening conditions. In September 2014, therefore, the COR revised its estimate of fiscal 2015 tax revenue to 3.5%.

We interpret the state's recent revenue performance somewhat differently, however. In our view, it's appropriate when measuring revenue to adjust the state's performance in fiscal 2014 by including more than $80 million in tax revenues that were transferred out of the general fund ($55.5 million of which went to the state's hurricane relief fund). When these revenues are included, the state's revenue trend was much flatter in fiscal 2014, declining just 0.2%. To be sure, revenues still underperformed earlier forecasts, partially as a result of weaker-than-expected economic performance. Most notably, the outright decline in U.S. GDP during the first quarter of 2014 (calendar year basis) was felt in Hawaii's economy and weighed on its tax collections. Much of the dip -- as a percentage from the prior year -- also likely reflected a larger-than-expected effect from taxpayers accelerating some of their capital gains income to calendar year 2012. This inflated, on a one-time basis, tax receipts in fiscal 2013. The subsequent drop off in fiscal 2014 appears to have been larger than COR had expected, but most likely reflects the fact that tax revenues had somewhat surged in fiscal 2013 (when they increased 9.9%).

Insofar as the decline in tax revenue collections in fiscal 2014 reflected nonrecurring circumstances, thus suppressing the growth rate that year, the state could now be in line for something of an income tax rebound. And indeed, the state's actual tax collections during the first two months of fiscal 2014 have outpaced the COR's forecast at 6%. Furthermore, after growing at 2.4% (versus the national 2.0% rate) in 2013, total state personal income has increased 3.7% during the first two quarters of 2014. But as noted, we also acknowledge some risk to the state's visitor industry presented by the recent pronounced strengthening of the U.S. dollar. Given that visitors from international markets now make up one-third of all arrivals -- and an even higher share (42%) of tourist-related spending -- we believe a strong dollar could undercut to a degree these expenditures and tax revenues.

The state's general fund financial plan shows it ending fiscal 2015 with an ending balance of $428 million. When coupled with the $274 million in its two budget reserves, the state's ending and reserve fund balances total $701.4 million, or 10.9% of expenditures. We view the state's reserve levels as strong. Although expenditures outpace revenues in the fiscal 2015 plan, this is premised on the COR's forecast. If the pace of tax revenue collections maintains its current pace, revenues would exceed the fiscal 2015 budgeted expenditures.

Notwithstanding that we view the state's revenue outlook as more favorably than the COR, we view the state economy as in a transition mode, introducing a bit more uncertainty than normal. Although the leisure and hospitality sectors will likely continue to play a prominent role in its economy, Hawaii's construction sector is also ascendant. We expect the state economy to gradually migrate toward greater reliance on the construction sector, balancing out its traditional more heavy dependence on tourism.

Beyond the next business cycle, shifting demographics and a shortage of housing supply throughout the state are likely to fuel construction activity. To a certain degree, state officials had anticipated that construction activity and related tax revenues would already account for more of the state's economy. But there are conflicting signals on the real estate front. Although the value of newly completed construction and private residential construction authorizations has entered a declining trend (year-over-year comparison as of late 2013), estimated total private building authorizations are still increasing. This uncertainty appears to be one reason that the COR dialed back its revenue forecast for fiscals 2015 and 2016, reflecting that permit fee revenues have lagged its forecast. But even with this slower-than-expected performance in new housing construction, the number of housing permits issued has risen 18.5% through the first eight months of 2014 relative to 2013. Despite strength in the private sector, government contracts have softened, leading to an overall 1.3% decline in the construction sector during the first half of 2014. This contrasts with robust historical trends in the sector, which posted 8% average annual increases from 2002 through 2007.

Although Hawaii's debt burden of $5.6 billion of tax-supported state GO, COP, and highway (gas tax) debt is high in our view, translating to $4,289 per capita, it reflects the centralized nature of state and local government in Hawaii. Compared to other states, Hawaii's debt level stands out as high in part because the state assumes numerous functions that are performed at the local level in other states.

Based on the analytic factors we evaluate for states, we have assigned Hawaii a composite score of '1.9' on a four-point scale in which '1' is strongest.

Outlook

We have revised our rating outlook to stable from positive. Although in our view, the state's general fund tax revenues could outperform the COR's forecast for fiscal 2015, there is also potential for collections to level off through the remainder of the budget year. The strengthening U.S. dollar could deter international arrivals and undercut their propensity to spend for those that do visit the state. A slightly less robust economic and revenue outlook contributes to the state's multiple year financial forecast showing materially lower ending and rainy day fund balances. While the balances remain comfortably within levels we view as appropriate for the 'AA' rating, we believe the state's sensitivity to broader economic conditions makes somewhat higher reserves important. This would be especially true at a higher rating level. Adding a bit to our uncertainty is the upcoming change in administration. Higher reserves, even on an informal basis, have been part of the current governor's policy priorities. To the extent this changes under a new administration, it could further reduce the potential for a higher rating.

This being said, we believe the state is currently laying a foundation for a potentially stronger rating in the future due to its pension and OPEB reforms. The state's adherence to new legislation requiring escalating annual OPEB contributions and its plan to increase its reserves will be important indicators of the state's follow-through on both fronts. In addition, we expect that the state's credit quality will only strengthen if it can accomplish its objectives while maintaining a balanced budget structure. This has become somewhat more difficult, in our view, given our expectation that revenue growth could be slower than previously forecasted. As with other states, much of the above is likely to hinge on the economy -- both nationally and within the state -- and revenue performance.

Governmental Framework

Hawaii's constitution requires that the state operate on a balanced budget, including on an intra-year basis, as it monitors revenues and expenditures throughout the year and makes necessary adjustments to ensure that general fund expenditures do not exceed current general fund revenues and unencumbered cash balances. There are no constitutional restrictions on the state's ability to raise taxes or other revenues, but property tax authority rests with the counties. Approval of taxes is by simple majority vote of the legislature, and the legislature has broad legal latitude to adjust spending levels. The governor has authority to restrict all executive branch expenditures and to cut spending midyear without legislative approval via such methods as cutting or delaying spending on education, but in practice this is politically difficult.

Hawaii is not a voter-initiative state, and no vote is required to issue GO bonds or for tax increases. GO bonds in Hawaii have a first-lien status, prior to all other payments, and the issuance of GO bonds must be authorized by a majority vote of the legislature.

Hawaiian state government is highly centralized, and, as such, the level of assistance to local governments is high. The state directly runs the public school system, as well as the university and community college systems. It also administers the public welfare system and operates prisons, harbors, and airport systems. The county functions are primarily property related (police, fire, streets, water, sewer, and parks).

On a four-point scale in which '1' is the strongest, we have assigned a score of '1.7' to Hawaii's governmental framework.

Financial Management

Financial Management Assessment (FMA): Strong

We consider the state's management practices "strong" under our FMA methodology. An FMA of strong indicates our view that practices are strong, well embedded, and likely sustainable. Among the highlights of the state's management techniques are statutorily required six-year operating and capital budgets that are updated by the governor and finance staff annually for legislative approval. The COR provides quarterly revenue forecasts for inclusion in the biennial budget, budget updates, and the multiyear financial forecast. State finance staff identifies budget variances throughout the year, and the governor is empowered to curtail expenditures without legislative approval, if required. The finance staff and treasury adhere to an official investment policy, and investment performance is disclosed monthly. There are statutory debt caps, including a calculation to ensure that the total amount of debt service payments required will not cause the state to exceed its debt limit of 18.5% of general fund revenues. The State Constitution requires that all state debt begin to amortize principal within five years of issuance, mature within 25 years, and have either level debt service or level principal payments. State law disallows the use of swaps or other derivative products. The legislatively created emergency and budget reserve fund (EBRF) fund provides for a small, controlled emergency fund, but there is no formal or informal target or policy for the size of this reserve or for the state's generally accepted accounting principal unreserved fund balance.

Budget management framework

COR, a seven-member, independent revenue forecasting body, prepares revenue forecasts at least quarterly but also in special sessions when fiscal conditions warrant. The executive branch and legislature are required to consider the council's estimates in the budget process. Should they use a different forecast, this development and the rationale must be publicized.

Spending is controlled through an allotment system, and the Hawaii Department of Budget and Finance monitors expenditures throughout the year. Budget adjustments are implemented periodically throughout the fiscal year as the state deems necessary. Restrictions can be implemented at any time but are usually imposed at the beginning of the fiscal year. Adjustments requiring legislative action are handled during the legislative session, which begins shortly after the start of the third quarter; in extraordinary circumstances a special legislative session may be called. The governor has unilateral authority to restrict executive branch spending. Legislative approval is required to authorize spending, to impose new taxes, or to increase existing taxes.

Beginning with the 2012-2013 biennium, the state has demonstrated willingness to provide timely -- and structural -- budget solutions when confronting previously projected budget deficits. As described above, the enacted deficit-closing solutions have been mostly structural. Deficits are not carried forward, but soft revenue performance and an expiration of the previous solutions contribute to a projected shortfall of revenue compared with baseline spending trends, necessitating either adjusted service levels or enhanced revenues for the upcoming biennium.

On a four-point scale in which '1' is the strongest, we have assigned a score of '1' to Hawaii's financial management.

Economy

We anticipate Hawaii's economy to produce slow but relatively steady growth in the upcoming years. Since 2000, total personal income in the state has grown faster than the nation, at a 4.7% compound average growth rate versus 4.2%. On a projected basis, our forecast, based on IHS Global Insight modeling, looks for growth of 4.1% in 2014 and up to 5.6% through 2017. The forecast for U.S. personal income is similar, in the range of 4.2% to 5.7% through 2017. In real terms, the state's GDP contracted 3.5% in 2009 and rebounded to 2.1% and 1.8% growth in 2010 and 2011. Growth trudged along at 1.7% and 1.9% in 2012 and 2013. From 2001 through 2013, Hawaii's real economic output grew at an average annual rate of 1.02%, almost exactly equal to the national rate of growth during the same span of years.

As of 2013, per capita personal income is 103% of the nation. Therefore, even if GDP and total personal income growth increased at somewhat slower rates than the nation, but the gap is narrowing. It's been common for Hawaii's unemployment rate to be lower than the nation's. As of August 2014, the state's 4.3% jobless rate was well below that of the nation, which was 6.1% at the time.Tourism will likely always be an important part of Hawaii's economy -- but to a lesser degree than in the past. Whereas various elements of the tourism industry accounted for 31% of state GDP in 1988, now it's only 16.8%.

Although the state's COR now anticipates the visitor industry to proceed at a slightly reduced pace, it continues to expect the construction sector to pick up much of the slack. That's why the more tempered activity in the construction sector since late 2013 poses a risk to the state's rate of overall economic growth.

Home prices and the cost of living are high in Hawaii relative to the nation, but the state's real estate sector proved considerably more stable than it did in most of the rest of the nation during the recession. We attribute this to the fact that the five state-headquartered banks originate most of the home mortgages in Hawaii and, during the middle 2000s, refrained from heavy subprime lending. The state reports that Honolulu city and county rates of foreclosures are well below national averages and below those of comparable metropolitan areas around the country.

Robust construction activity has spurred job growth during the past several years, and after pausing a bit in 2011 and 2012 to levels seen in 2003 and 2004, has since rebounded. Unlike many markets, the Hawaii housing market experienced only a moderate housing decline during the recession: The median home price in Honolulu, 70% of the state's real estate market, fell a total of 10.9% from 2006 through August 2008 and has now fully recovered. By this measure, Honolulu is much stronger than numerous other metropolitan areas throughout the country.

Population growth during the past 10 years has been robust, with 12.3% overall growth to 1.4 million people, above the 9.1% rate recorded for the U.S. However, the population is growing older, which has pushed up the state's age-dependency ratio to 60.1% from 58.4%. This puts the state in a somewhat weaker demographic position, in our view, than the nation as a whole, which has a ratio of 59.8.

On a four-point scale in which '1' is strongest, we have assigned a score of '1.6' to Hawaii's economy.

Budgetary Performance

After having used a significant portion of its EBRF and HHRF ("rainy day reserves") during and in the aftermath of the Great Recession, Hawaii has commenced rebuilding these balances. After four consecutive annual increases in ending balances, fiscal 2014 marked the first year in which the balance declined, albeit modestly. Combined ending and rainy day fund balances as of June 30, 2014 were $875 million, down from $889 million in fiscal 2013. According to the general fund financial plan, which is built on COR forecasts, the state should see higher rainy day reserves and correspondingly lower ending balances. The outlook has softened somewhat, however. At this time, the state's fiscal year 2017 ending balance plus rainy day funds are projected to be $405.7 million, or 5.8% of expenditures. This is down from the estimate in 2013 in which the state's combined ending balance and rainy day reserves were projected to dip to below $728.1 million, or more than 10% of expenditures, through fiscal 2017.

We continue to monitor the federal government's fiscal policies as they relate to state governments, however. Hawaii's fiscal position is exposed to the potential for revenue loss related to stepped-up federal deficit reduction efforts although the environment in Washington, D.C., has, in our view, made this risk less imminent. Normally, federal grants account for 15% to 18% of state spending but rose to 23% in fiscal year 2010 under the federal American Recovery and Reinvestment Act. As the federal stimulus program wound down, federal funds as a share of the state's total budget has receded to about 18%.

Liquidity

At the end of fiscal 2013, cash and equivalents totaled $194.6 billion, or 4.2% of general fund expenditures, which is lower than the $1 billion in cash and cash equivalents at the end of fiscal 2012. However, the decline in cash was more than offset by increased investment holdings, which were $2.3 billion (total governmental funds) at June 30, 2013, up from $941 million in 2012. The state reports that at the end of September 2014, the state's pooled cash and investment balances, which the general fund may borrow from for cash management purposes, were $5.28 billion. Furthermore, the state's pooled cash and investment balances have had an average balance of $4.8 billion since at least July 2012. Cash and cash-equivalent holdings in the state treasury pool typically make up $200 million to $400 million of the daily balances. Cash is monitored on a daily basis, with daily reports reflecting the state's investment positions. The state forecasts its liquidity needs on a one-year-forward basis, including recurring and known expenditures (debt service payments and payroll), and makes investments to provide liquidity on those dates. Annual cash flow is generally predictable although the state has made several downward revisions of forecast revenue growth following the recession. The state monitors and manages its disbursements with greater-than-average scrutiny to provide for positive general fund balances at fiscal year end. But given the recent economic downturn, the state indicates it has found that keeping the general fund balance positive has been challenging. The state has the statutory ability to borrow internally with the approval of the director of finance. The state has not done any external borrowing for cash flow purposes; it is permitted to issue GO bonds to fund a deficit but never has.

Audited financial statements

Hawaii published its fiscal 2013 comprehensive annual financial report (CAFR) on Jan. 22, 2013, marking the second consecutive year in which the report was published earlier than before (by about three weeks compared with fiscal 2011). The current governor, who will be leaving office at the end of 2014, had committed to accelerating the publication date of the state's annual CAFR earlier as one of his administration's policy objectives. The audited fiscal results for 2013 showed that general fund tax revenues increased 8.22%, which was down somewhat from tax revenue growth in fiscal 2012 and 2011, which grew 12.2% and 9.1%, respectively. As with most states, Hawaii's tax revenues proved sensitive to the effects of the Great Recession, when the state had two years of consecutive revenue declines, of 9.7% in fiscal 2009 and 0.69% in fiscal 2010. Audited revenues for fiscal 2013 consisted primarily of the general excise and use taxes (54% of revenues) and the individual and corporate income tax (approximately 33%). Education expenditures (including kindergarten through grade 12 and higher education) accounted for 49% of expenditures, followed by human services and health-related expenditures, which totaled 35%. The audited combined ending assigned and unassigned fund balance in fiscal year 2013 was $1.43 billion, or 31% of expenditures. The balance represents a large increase from fiscal 2012, when it was $807 million, or 17.5% of expenditures. Both years were increases from fiscal 2011, when the fund balance was equal to 13% of expenditures. We believe the state's reserve position is strong although slightly less liquid than at the end of fiscal 2012 given the changes in the state's cash position.

The EBRF, created by the legislature in 1999, is normally funded from 15% of tobacco settlement funds. However, this revenue was diverted to the state general fund during fiscal years 2012 and 2013. Pursuant to state statutes, Hawaii's general fund plan has included $55.5 million of deposits into the HHRF in each of fiscal years 2014 and 2015. The deposit was made in fiscal 2014 and has already been deposited for fiscal 2015 as well. At the governor's request, the legislature agreed to additional supplemental EBRF and HHRF deposits of $50 million each in fiscal 2014. The state's renewed commitment to replenish these funds is a departure from earlier plans to allow the reserves to become -- and stay -- depleted. We believe replenishing these funds could contribute to a strengthening of the state's credit quality.

On a four-point scale in which '1' is strongest, we have assigned a score of '1.9' to Hawaii's budgetary performance.

Debt And Liability Profile

Issuance of GO bonds must be authorized by a majority vote of the legislature, and each year, the GO authorization bill authorizes the aggregate amount of GO bonds that may be issued to finance capital improvement projects. The bill also contains a calculation to ensure that the total amount of debt service payments required will not cause the state to exceed its debt limit of 18.5% of the average of the preceding three years' general fund revenues. The state constitution requires that all debt begin to amortize principal within five years of issuance, mature within 25 years, and have level debt service payments. State law disallows the use of swaps or other derivative products.

Hawaii's debt ratios, as of June 30, 2013 (the most recent Comprehensive Annual Financial Report), on a per capita and percentage basis were high in our view, with direct state debt approximately $6.02 billion, or $4,298 per capita, 9.46% of total state personal income, and 7.4% of state GDP, among the highest of all the U.S. states. Hawaii's high per capita debt is attributable to the state's assumption of many functions that, in other states, are generally financed by local governments, including education, health, and welfare. Debt levels, however, rose rapidly during the 1990s as the state shifted from pay-as-you-go capital spending to GO bonds. However, debt amortization is rapid with 67% of principal repaid in 10 years and 100% repaid in 20 years. Total annual tax-supported debt service (GO bonds, appropriation-backed debt, and the state highway fund) equaled $696 million in fiscal year 2013, or about 12.5% of the expenditures from the general and state highway funds, which we consider high.

Pension liabilities

Pension benefits are administered by the Employees' Retirement System (ERS) of the State of Hawaii, which began operation on Jan. 1, 1926. The system is a cost-sharing, multiple-employer, defined-benefit pension plan that covers all regular employees of the state and each of its counties, including judges and elected officials. The system covers 115,350 active and retired beneficiaries as of June 30, 2013, up from 113,282 in 2012 (beneficiaries totaled more than 118,000 by March 2014). The ERS, as of fiscal 2012, had an unfunded actuarial accrued liability (UAAL)of $8.49 billion and actuarial assets of $12.75 billion to an actuarial accrued liability of $21.24 billion, resulting in a funded ratio that is slightly, but importantly, higher at 60% than the 59.2 % in fiscal 2012.

The funding level decreased steadily from a high of more than 95% in fiscal 2000 through 2012. A lower funded ratio is partly due to the state adopting a lower rate of return assumption (7.75%) beginning for fiscal 2011 compared with years prior, which assumed an 8% rate of return on pension system assets. Among the state's pension reforms was the creation, in fiscal 2011, of a new benefits tier for employees hired after July 1, 2012. The new tier includes a defined-contribution component and generally offers a lower level of benefits and requires higher employee contributions. As the mix of active plan members transitions to the new tier, employee contributions to the tier one plan will gradually decline. Whereas in 2013, the state expected its overall pension funded ratio to decline for several years, even on a postreform basis, strong investment gains of 17.4% in fiscal 2014 erased that. The state has opted to leverage the strong investment gains by adopting a lower rate of return assumption -- now on a path to decline to 7.50% from 7.75%. Although such a change puts additional negative pressure on the system's funded ratio, it reflects a more conservative orientation with regard to managing long-term pension liabilities.

The state's pension reforms, including its closed UAAL amortization of 28 years, down from 40 years in 2010, are important given that the state's liability is currently high. As of fiscal 2013, the per capita UAAL is $6,050 and 13.3% of total personal income, which stand out as high in our criteria.

OPEB risk assessment

Hawaii enacted legislation we view as significant and favorable that begins a program of prefunding the state's retiree health care benefit liability. Under the legislation, prefunding the OPEB liability ramps up to 100% of the annual required contribution (ARC) by fiscal 2019 from 20% of the ARC in fiscal 2015. To put the contribution differential into perspective, the state's pay-as-you-go cost in fiscal 2014 was $284 million while the full ARC stood at $1.04 billion. For fiscal 2014, however, in addition to the pay-as-you-go outlay, the state advance-funded $100 million of the OPEB liability. Under the legislation, the advance funding toward the ARC will increase to $117.4 million in fiscal 2015. The increased funding contributions are also included in the state's multiple-year financial plan.

By adopting the higher funding trajectory, the state's actuary incorporated a higher discount rate to measure the state's liability. This had the effect of lowering the state's estimated unfunded OPEB liability to $8.5 billion from $13.6, or almost 40%, when applied actuarially to fiscal 2013.

In general, we view the state's willingness to begin confronting its OPEB liability as favorable. We have previously noted that, at $13.6 billion as of fiscal 2012 or $9,770 per capita (2012 population estimates), the state's OPEB liability poses a risk to the state's long-term credit quality. The new legislation, despite it not resulting in an immediate improvement to the state's rating, is beneficial to our view of its credit quality.

On a four-point scale in which '1' is the strongest, we have assigned a score of '3.3' to Hawaii's debt and liability profile.

Related Criteria And Research

Related Criteria

- USPF Criteria: State Ratings Methodology, Jan. 3, 2011
- USPF Criteria: Financial Management Assessment, June 27, 2006
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007

Related Research

U.S. State And Local Government Credit Conditions Forecast, Oct. 15, 2014

Ratings Detail (As Of October 22, 2014)		
Hawaii rfdg GO bnds ser 2008DL & ser 2009DS		
Long Term Rating	AA/Stable	Affirmed
Hawaii COPs ser 2009A		
Long Term Rating	AA-/Stable	Affirmed
Hawaii GO bnds ser 2012EE due 11/01/2032		
Long Term Rating	AA/Stable	Affirmed
Hawaii GO rfdg bnds ser 2012EF due 11/01/2024		
Long Term Rating	AA/Stable	Affirmed
Hawaii GO (wrap of insured) (AMBAC & AGM) (SEC MKT)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Hawaii GO (wrap of insured) (FGIC & AGM) (SEC MKT)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Hawaii GO (MBIA) (National)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Hawaii GO (MBIA) (National) & (AGM)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Hawaii Tax Exempt GO		
Long Term Rating	AA/Stable	Affirmed
Hawaii GO		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.