

Rating Action: Moody's assigns Aa2 rating to approximately \$800M State of Hawaii G.O. Bonds of 2012, Series EE, Refunding Series EF, and Taxable Series EG; outlook is stable

Global Credit Research - 07 Nov 2012

Approximately \$5.3 billion G.O. debt outstanding

New York, November 07, 2012 -- Moody's Ratings

Issue: General Obligation Bonds of 2012, Series EE; Rating: Aa2; Sale Amount: \$374,000,000; Expected Sale Date: 11/30/2012; Rating Description: General Obligation

Issue: General Obligation Refunding Bonds of 2012, Series EF; Rating: Aa2; Sale Amount: \$399,510,000; Expected Sale Date: 11/30/2012; Rating Description: General Obligation

Issue: Taxable General Obligation Bonds of 2012, Series EG; Rating: Aa2; Sale Amount: \$26,000,000; Expected Sale Date: 11/30/2012; Rating Description: General Obligation

Opinion

Moody's Investors Service has assigned Aa2 ratings to the State of Hawaii's \$374 million General Obligation Bonds of 2012, Series EE; \$399.51 million General Obligation Refunding Bonds of 2012, Series EF; and \$26 million Taxable General Obligation Bonds of 2012, Series EG

SUMMARY RATINGS RATIONALE

The Aa2 rating incorporates Hawaii's improving financial operations following the recession-driven revenue fall-off over the last several years; low pension funded ratios and growing expenses for other post employment benefits (OPEB); and high debt ratios that in part reflect debt issues for K-12 school capital projects. The state's vital tourism industry continues to show signs of improvement. The fiscal 2013 revenue forecast was recently reduced slightly, largely due to a reassessment of the cost of renewable energy tax credits. However, the annual growth projection remains relatively healthy at 4.9%. Hawaii has relatively strong governance practices such as multi-year financial planning and quarterly binding consensus revenue forecasting, and its fiscal 2011 audit was released in a timely manner, reversing four consecutive years of late audits from fiscal 2007 to fiscal 2010.

STRENGTHS

- Financial governance that includes well-established multi-year, quarterly consensus revenue forecasting, and strong executive power to reduce spending
- Historical fiscal conservatism; prompt action to address revenue shortfalls
- Continued military housing construction helps offset slow residential and commercial markets
- A good liquidity position that is sufficient for the state to avoid short-term cash flow borrowing
- Rapid amortization of debt; no exposure to variable rate debt or derivative products

CHALLENGES:

- Vulnerability to shifts in Hawaii's tourism-based economy, resulting in revenue falloff and budget shortfalls
- Modest reserve levels reduce the state's ability to address further revenue erosion
- Large state and local government employment sector contributes to spending pressure for salary and benefit settlements
- Debt ratios that are among the highest in the nation and likely to remain there given state-level capital funding,

especially for education, combined with relatively low pension funding levels despite recent reforms; high OPEB liability

Outlook

The rating outlook for Hawaii is stable reflecting expectations of continued revenue growth; signs of economic stabilization as tourism rebounds; a decreased reliance on one-time resources to balance the 2012-2013 biennial budget; and the state's proactive measures to improve the funded status of its retirement systems. The stable outlook also reflects our expectation that the state will manage its budget challenges and make appropriate adjustments as needed to restore budget balance in the event that the economic recovery is more prolonged and/or weaker than currently projected, resulting in revenue shortfalls.

WHAT COULD MAKE THE RATING GO UP

- Rebuilding and maintenance of strong reserve levels and restoration and maintenance of structural budget balance
- Reduced economic volatility and sustained job growth
- Sustained reduction in debt ratios and significant improvement in pension funded ratios, and sooner than currently projected

WHAT COULD MAKE THE RATING GO DOWN

- Economic weakening leading to sustained employment erosion or deterioration of revenue trends leading to budget imbalance, liquidity pressure, and narrowing of financial position
- Increased use of non-recurring solutions to balance budget
- Increased debt or debt service ratios relative to other states or deterioration of pension funded ratios below already low levels

RATING METHODOLOGY

The principal methodology used in this rating was Moody's State Rating Methodology published in November 2004. Please see the Credit Policy page on www.moody.com for a copy of this methodology.

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