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November 8, 2011

Summary:
Hawaii; Appropriations; General Obligation

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Table Of Contents

Rationale

Outlook

Related Criteria And Research

Summary:

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Credit Profile		
US$800.0 mil 2011 go bnds ser DZ due 06/30/2032		
Long Term Rating	AA/Stable	New
US$382.41 mil 2011 go rfdg bnds ser EA due 06/30/2024		
Long Term Rating	AA/Stable	New
US$56.0 mil 2011 go rfdg bnds ser EC due 06/30/2024		
Long Term Rating	AA/Stable	New
US$23.0 mil 2011 go rfdg bnds ser ED due 06/30/2024		
Long Term Rating	AA/Stable	New
US$2.8 mil 2011 go rfdg bnds ser EB due 06/30/2024		
Long Term Rating	AA/Stable	New
Hawaii GO		
Long Term Rating	AA/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AA' long-term rating to Hawaii's $800 million series 2011 DZ general obligation (GO) bonds. We also assigned a 'AA' rating to the state's estimated $467 million of GO refunding bonds issued in four series (2011 EA, EB, EC, and ED). At the same time we affirmed our 'AA' long-term rating and underlying rating (SPUR) on Hawaii's general obligation (GO) bonds and our 'AA-' long-term rating on the state's certificates of participation (COPs). The outlook on all ratings is stable.

The 'AA-' COP rating reflects our view of Hawaii's:

- Annual appropriation risk,
- Covenant to budget and appropriate lease payments for the life of the certificates, and
- General credit characteristics.

The 'AA' GO rating reflects our view of:

- Governor Neil Abercrombie's willingness to implement aggressive solutions, totaling $1.32 billion, to balance the fiscal 2011-2013 biennial budget in light of a projected budget shortfall that had reached $1.25 billion for the biennium;
- The state's plans to recapitalize its nearly depleted emergency budget reserve (EBR) and hurricane relief fund (HRF);
- Strong liquidity, particularly when including pooled cash balances available to the general fund for temporary borrowing;
- Management's well-established, proactive budget monitoring practices, including frequent revenue forecast updates from the Council on Revenues (COR), which facilitate prompt identification of potential budget adjustments for budget alignment;

- The governor's executive authority to restrict all executive branch expenditures, such as by cutting spending midyear without legislative approval or by cutting or delaying education disbursements during the course of a fiscal year;
- Other strong constitutional protections, which require budget balance, that allow for tax increases with legislative approval and give GO bonds first-lien priority before all other disbursements; and
- Stabilization of and modest growth across a number of key economic indicators in the state that should help buoy its tax revenues going forward.

Partly offsetting the above strengths is our view of:

- The state's reliance on tourism from both U.S. and international visitors, including Japan, and declines in tourism-related metrics and revenues, construction spending, and other related economic activity, which have reduced general fund tax revenue growth rates and employment levels;
- A relatively high level of federal funding in the state budget, exposing the state's fiscal performance to revenue loss should the federal government enact significant federal deficit reduction; and
- The low-funded status of the state's retirement system, lack of funding of the state's other postemployment benefits (OPEB) liability, and overall debt ratios considered among the highest of all U.S. states.

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 lengthening of the maturity dates relative to the existing debt to be refunded.

State revenue performance has begun to improve and for the first three months of fiscal 2012, tax collections are outpacing the same period during the past two fiscal years. Tourism, which in large part determines the fate of state tax revenue trends, is also showing signs of modest growth. Even after visitor arrivals increased 8.5% in 2010, however, total visitors continue to trail 2007 levels. After numerous downward revisions to the state revenue forecast going back to March 2008, in April 2011, and again in May 2011, Hawaii's COR projected that revenues would decline 1.6% in fiscal 2011 compared to fiscal 2010 (the prior forecast had been for 0.5% growth). The downward revision incorporated COR's view that the state's economy and revenues would see a drop in economic activity in response to the earthquake in Japan and some other macroeconomic concerns. Actual revenues for fiscal 2011 performed slightly better, down by 0.8% compared to fiscal 2010. This allowed the state to end with a slightly better ending balance of $126 million in its general fund than had been projected. The ending balance is equal to 2.5% of general fund expenditures, which we consider adequate.

As the end of fiscal 2011 approached, Governor Abercrombie proposed to the legislature closure of the fiscal 2011 gap mainly through the exhaustion of the state's reserves held outside of the general fund, including use of the entire balance of both the Hawaii Hurricane Relief Fund (HHRF; $121 million balance) and the EBR fund (or "rainy day" fund; $46 million balance). These alone would cover $167 million, or 78%, of the $215 million shortfall. With the somewhat better-than-expected revenue performance mentioned above, the EBR and HHRF balances, as of October 2011, are $9.7 million and $21.1 million, respectively.

When Hawaii's EBR and HHRF are added to its ending general fund balance, the total reserves at the end of fiscal 2011 are $156.8 million, equal to 3.1% of expenditures, which we still consider adequate.

Various measures to close the fiscal 2012 and 2013 budget gaps include the repeal of the state tax deduction, a pension tax, limitations on standardized deductions on tax returns, a suspension of general excise tax exemptions, and the imposition of a 4% general excise tax, a capping of county hotel tax revenues, an increase in rental car daily surcharges, labor savings, and a reduction in services. The COR projects a robust 14.5% increase in tax revenues in fiscal 2012 compared to fiscal 2011. However, 4.3% of this is attributable to the state's cash management measure at the end of fiscal 2010 whereby tax refunds were paid in early fiscal 2011, thereby artificially depressing net collections in July 2010. Another 5% of the revenue growth is due to the aforementioned tax increases. The remaining 5.3% of the projected growth is from the expected increase in economic activity.

At the end of fiscal 2011, the state-projected ending balance is forecast at $103.1 million, equal to 1.9% of expenditures, which we view as low. However, part of the state's general fund financial plan includes making $75 million in contributions to the state's EBR and HHRF which, when combined with existing balances in these funds, brings the projected total reserves to $208.9 million, which we view as adequate at 3.8% of expenditures.

Hawaii's debt burden of $5.2 billion of state GO and COP debt is high in our view, , as it translates to $ 3,967 per capita. Compared to other states, Hawaii's debt level stands out as high in part because, in Hawaii, the state assumes numerous functions that, in other states, are performed at the local level.

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

The stable outlook reflects our view that Hawaii's proactive budget management techniques will result in manageable out-year gaps that state officials will successfully resolve while rebuilding reserves to levels appropriate for the rating. The state's budget management over the 2011-2013 biennium, a period that we believe will be characterized by a challenging and uncertain revenue environment, will be critical to maintaining the rating, particularly in light of what we consider to be optimistic revenue growth assumptions. In our opinion, the state's strong constitutional protections and the governor's executive authority to restrict all executive branch expenditures, such as by cutting spending midyear without legislative approval, provides us with credit comfort at the current rating level. If actual revenue growth is significantly below the state's projections or if the state is unable to further reduce spending, the rating could come under pressure. Upside in the rating is substantially reliant on the state's ability to reduce its debt and retirement liability burden and its reliance on tourism.

Related Criteria And Research

- USPF Criteria: State Ratings Methodology, Jan. 3, 2011
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007

Ratings Detail (As Of November 8, 2011)		
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 1992BZ		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed

Ratings Detail (As Of November 8, 2011) **(cont.)**		
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 Taxable GO bnds ser 2008DM		
Long Term Rating	AA/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.

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