STANDARD & POOR'S
RATINGS SERVICES

RatingsDirect®

Hawaii; Appropriations; General Obligation

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

Secondary Contact:
John A Sugden, New York (1) 212-438-1678; john_sugden@standardandpoors.com

Table Of Contents

Rationale

Outlook

Governmental Framework

Financial Management

Economy

Budgetary Performance

Debt And Liability Profile

Related Criteria And Research

Hawaii; Appropriations; General Obligation

Credit Profile		
US$400.0 mil GO bnds ser 2012EF due 11/01/2024		
Long Term Rating	AA/Stable	New
US$374.0 mil GO bnds ser 2012EE due 11/01/2032		
Long Term Rating	AA/Stable	New
US$26.0 mil taxable GO bnds ser 2012EG due 11/01/2032		
Long Term Rating	AA/Stable	New
Hawaii GO		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AA' long-term rating to Hawaii's $374 million series 2012 EE general obligation (GO) bonds and its $26 million in taxable GO bonds. We also assigned a 'AA' rating to the state's estimated $400 million of series 2012 EF GO refunding 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). The outlook on all ratings is stable.

The 'AA' GO rating reflects our view of:

- The state's strong financial position, which has weathered several major economic stressors during the past 10 years -- the SARS epidemic, the Great Recession, and the more recent earthquake and tsunami in Japan;
- The state's plans to recapitalize its nearly depleted emergency budget reserve fund (EBRF) and Hawaii hurricane relief fund (HHRF);
- Strong liquidity, particularly when including pooled cash balances available to the general fund for temporary interfund borrowing;
- Management's well-established, proactive budget monitoring practices, including frequent revenue forecast updates from the independent 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 through such actions as cutting spending midyear without legislative approval or cutting or delaying education disbursements during the course of a fiscal year;
- 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; 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 low-funded status of the state's retirement system, lack of actuarial funding of the state's other postemployment benefits (OPEB) liability, and generally higher-than-average debt ratios because of the state's centralized provision of public sector services; and

- A relatively high level of federal funding in the state budget, which has historically been a stable source revenue, but, in the face of significant federal deficit-reduction efforts, presents a source of fiscal risk

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 lengthier maturity dates relative to the existing debt to be refunded.

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 of the state.

Hawaii ended fiscal year 2012 in a relatively strong position, with general fund revenues outpacing expenditures by $149 million, resulting in an ending balance of $275 million, which equals 5.0% of expenditures. The state's September 2012 Council on Revenue (COR) forecast projected revised general fund revenue growth in fiscal year 2013 to 4.9% from 5.3%, which had been the projection in the May forecast. Although the state's longer term forecast anticipates that macroeconomic factors will contribute to slower revenue growth, the downward growth revision for fiscal year 2013 is related to more specific causes. For one, the state's revenue growth in fiscal year 2012 surged to 15%, well above the 12% that had been previously forecast. The additional 3% growth in revenue translates to about $100 million in extra revenue. Slightly slower revenue growth in fiscal year 2013 is, therefore, partly a function of the updated forecast starting from a larger revenue base. In addition, the state's clean energy tax credit program is costing the state more in tax revenue than had originally been forecast. Nevertheless, despite a reduced revenue growth forecast for fiscal year 2013, the strong revenue performance late in fiscal year 2012 provides for a projected operating surplus in fiscal year 2013 of $73 million, a favorable reversal from the May 2012 revenue forecast, which anticipated that fiscal year 2013 would end with an operating deficit of $81.8 million. As a result, instead of eroding its ending balance to $220.9 million, or 3.8% of expenditures in fiscal year 2013, the state now forecasts a $348 million ending balance, or 6.1% of expenditures. In addition to its general fund, the state has an emergency and budget reserve fund with a balance of $24.2 million as of June 30, 2012. The state's hurricane relief fund is $21.7 million, also as of the end of June.

Fiscal year 2013 is the second year of the state's two-year biennium. At the outset of the biennium, Hawaii pursued various measures to close the fiscal 2012 and 2013 budget gaps (which at one point equaled an estimated $1.25 billion on an $11 billion total general fund budget), including the repeal of the state income 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 the county's share of the hotel tax revenues, an increase in rental car daily surcharges, labor savings, and a reduction in services. In January, COR lowered to 11.5% from 14.5% the expected increase in tax revenues in fiscal 2012 compared with fiscal 2011. At that time, the council retained its 6.5% revenue growth forecast for fiscal 2013. The downward revision to fiscal 2012 revenues reflects that through the first five months of the fiscal year, tax revenue collections had fallen short of the original forecast. In addition, there continued to be some uncertainty about the effect on revenues of Act 105, passed by the legislature in 2011, which eliminated certain general excise tax exemptions. Nevertheless, revenue growth in fiscal 2012 was strong, partly owing 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 difference of the projected growth is from the expected increase in economic activity.

Although Hawaii's debt burden of $5.1 billion of state GO and COP debt is high in our view, as it translates to $3,734 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, 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 -- and now lower than previously projected -- out-year gaps such that state officials will be well positioned to successfully resolve while rebuilding reserves to levels appropriate for the rating. The state's ability to follow through on its tentative plans to replenish its budgetary reserves in the upcoming biennial budget will serve as an important indicator of the state's commitment to prudent fiscal management. In our opinion, the state's strong constitutional protections and the governor's executive authority to restrict all executive branch expenditures, through such methods as cutting spending midyear without legislative approval, supports the rating. 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 potential for the rating is substantially reliant on the state's ability to reduce its debt and retirement liability burden and its reliance on tourism. In light of the state's above-average exposure to federal spending, Standard & Poor's will also continue to monitor the federal consolidation efforts stemming from the Budget Control Act of 2011 and, once these are identified, will evaluate their effect on the state's finances and officials' response to these revenue reductions.

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: "Strong"

We consider the state's management practices "strong" under our financial management assessment (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, an independent body, provides quarterly revenue and expenditure measures and forecasts for inclusion in the biennial budget, budget updates, and the multiyear financial forecast. State finance staff identifies budget variances monthly, 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 a level principal pay. . State law disallows the use of swaps or other derivative products. The legislatively created the Emergency 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 a different forecast be used, 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 were 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

As with other indicators, Hawaii's employment picture is strengthening with total payrolls up 2.1% in the 12 months ended Sept. 30, 2012. This rate of job growth compares favorably to the nation, which was up 1.37% in the same time period. After three consecutive years of declining unemployment rates (after peaking at 6.8% in 2009), the state's unemployment rate as of September 2012 is 5.7%, well below the nation, which is currently at 7.8% unemployment. All job creation is in the private sector as federal, state, and local government employment trends are negative, down 0.16% in September 2012 compared with September 2011. From their peak, total government jobs are down 3,500 from July 2008 while total public and private sector jobs in the state are down 22,200, or 3.54% since reaching a high point in December 2007.

Since 2003, Hawaii's unemployment rate has generally been 2% to 3% below the national rate. Personal income historically has shown steady growth, increasing 6.5% in 2008, reflecting the peak of the economic cycle, before falling 3.1% in 2009. Personal income in the state stabilized with 1.76% growth in 2010 and then began to accelerate, increasing 4.82% in 2011. The state's per capita personal income is strong in our view at 103% of the national average.

Federal spending plays an important role in Hawaii's economy. Total federal spending equaled 37% of the state's gross domestic product in 2010, the highest in the nation. Historically viewed as a stabilizing source of spending in the economy, the intensifying focus on deficit reduction at the federal level raises the specter that federal spending could be curtailed in the state. However, to the extent U.S. military installations are consolidated globally, Hawaii's location is strategically advantageous.

Similar to the nation, Hawaii's economic growth decelerated and turned negative in 2009. In real terms, the state's gross domestic product (GDP) contracted 4.6% in 2009, stabilized in 2010, and was down slightly, by 0.22%, again in 2011. However, with five state-headquartered banks that originate most of the home mortgages in the state and refrained from heavy subprime lending, Hawaii proved to be considerably less exposed to the subprime lending boom-and-bust cycle that hurt the national economy. 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 had spurred job growth during the past several years, but activity has slowed to levels seen in 2003 and 2004. However, unlike many markets, the Hawaii housing market experienced a moderate housing decline: The median home price in Oahu, 70% of the state's real estate market, fell a total of 9.5% from 2006 through August 2008 but has since rebounded by 10.5%. Overall, as of August 2012, the median home price on Oahu is just 0.48% below the 2006 level. By comparison, the median home prices in San Diego, Miami, Las Vegas, and Phoenix are still 37%, 44%, 44.7%, and 58.8% below their 2006 levels, according to the state's data.

Hawaii's economy remains dependent on tourism, which makes it vulnerable to dips in discretionary spending. However, measured in visitor arrivals, the tourism industry is on track to post a fourth consecutive year of growth. Swings in tourism trends affect excise and income tax collections given that leisure and hospitality is one of the state's leading employment sectors at 16.5%, versus the U.S. average of 9.1%. Visitor arrivals increased 4% in 2011 with growth accelerating thus far in 2012 and heading toward a 9% growth rate for the year. Showing signs of having fully rebounded from the effects of the tsunami in Japan, visitors originating from there are up 13.6% for the 12 month period ending in June, 2012. Other originations are also showing signs of strong growth, including the U.S. mainland (up 6.8%), Australia (55.7%), China (78%), and Latin America (26%). Visitor spending rose 16% in 2010 and 11% in 2011 after a 12.3% decline in 2009. So far in 2012, visitor spending is on course to increase 15%.

Population growth during the past 10 years has been robust, with 12.3% overall growth to 1.36 million people, above the 9.7% rate recorded for the U.S. Since 1997 and through 2010, annual Hawaii GDP growth has averaged 1.63%, somewhat lower than the national 2.21% rate during the same period. Real GDP per capita was 2.74%, above the U.S. per capita GDP in 2010.

On a four-point scale in which '1' is strongest, we have assigned a score of '1.5' to Hawaii's economy.

Budgetary Performance

Persistent revenue softness coupled with ascending demands for various social services first eroded, and have now nearly depleted the state's reserves. Heavy economic reliance on the service sector -- specifically in the leisure and hospitality areas -- subject a considerable portion of the state's revenues to dependence on discretionary consumer spending and tourism. Although revenues have followed a declining trajectory, ascending social service needs and increasing caseloads have placed upward pressure on spending.

Hawaii's fiscal position is exposed to the potential for revenue loss related to federal deficit reduction, should it be enacted. Federal grants are expected to finance about 18.4% of the state's approximately $11 billion total biennial budget spanning fiscal years 2012 and 2013. Normally, federal grants account for 15% to 16% of state spending, but rose to 23% in fiscal year 2010 under the federal American Recovery and Reinvestment Act. Federal funds remain elevated compared to the historically normal level but have been winding down since fiscal year 2010.

Part of the state's strategy is to improve employment and construction spending through the maintenance of high levels of capital improvement program (CIP) spending. State capital spending has averaged more than $1 billion annually since 2008, significantly above spending levels in 2000 through 2006, and management expects this level of expenditure to continue. Among the governor's priorities are $1.3 billion for the state's airport facilities, $618 million of upgrades to the state's ports and harbors, and a myriad of road and bridge projects.

Liquidity

General fund cash and cash-equivalent investments totaled $588 million in fiscal 2011, or 14.2% of expenditures. The state reports that as of October 2012, the state's pooled cash balances, which the general fund may borrow from for cash management purposes, was $4 billion. Furthermore, the state's pooled cash balances have had an average balance of $3.7 billion since at least July 2011. 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, but in the last three years, the state has made several downward revisions of forecast revenue growth. The state's disbursements are monitored and managed with greater-than-average scrutiny to provide for positive general fund balances at fiscal year end. But given the recent economic downturn, 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, but transfers of money between funds require legislative approval. 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

The state completed and published its fiscal year 2011 comprehensive annual financial statement (CAFR) in early 2012, representing a more timely release of its audited finances than for fiscal year 2010. The audited fiscal results for 2011 showed that general fund tax revenues increased 9.1%, marking a reversal from fiscal years 2009 and 2010, which saw consecutive declines in total general fund tax revenues of 9.7% and 0.69%, respectively. Audited revenues for fiscal 2011 consisted primarily of the general excise and use taxes (51% of revenues) and the individual and corporate income tax (30%). Education expenditures (including kindergarten through grade 12 and higher education) accounted for roughly 53% of expenditures, followed by human services and health-related expenditures, which totaled 29%. The audited ending assigned and unassigned fund balance in fiscal year 2011 was $557 million, or 13% of expenditures. We believe the state's reserve position is strong and, given its cash levels, highly liquid.

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. The state's fiscal plan calls for general fund deposits of $56 million in each of fiscal years 2014 and 2015 to its HHRF. 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 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. iState law disallows the use of swaps or other derivative products.

Hawaii's debt ratios, as of July 1, 2012, on a per capita and percentage basis were high in our view, with direct state debt exceeding $5.1 billion, or $3,734 per capita, 8.7% of total state personal income and 7.7% of real 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 from state debt we consider as supported by the state's tax base (GO bonds, appropriation-backed debt, and the state highway fund) equaled $619 million in fiscal year 2012, or about 10.8% of the expenditures from the general and state highway funds, which we consider high.

Other long-term obligations include the state's pension and other postemployment benefits (OPEBs). 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, multi-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 111,648 active and retired beneficiaries. The ERS, as of fiscal 2011, had an unfunded actuarial accrued liability (UAAL) of $8.15 billion and actuarial assets of $11.9 billion to an actuarial accrued liability of $20.1 billion, for a funded ratio of 59.4% -- down from 68.8% in fiscal 2008. The funding level has steadily decreased from a high of more than 95% in fiscal 2000. 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. Although the overall market experienced some recovery, with an 11.5% return in fiscal 2010, the market return from 2009 was negative 18%. The rate of return for the actuarial value was negative 0.42% in 2010, much less than the market return because of the four-year smoothing technique.

The funding level is low and represents a source of negative pressure on the state's rating. State contributions to the pension system are a function of statute that does not always align with the actuarially based annual required contribution (ARC). However, while the $534.9 million contribution in fiscal year 2011 was only 92% of the ARC, in 2009 and 2010 actual contributions exceeded the ARC. A new statute in 2011 raised the employer contribution rates and causes the projected amortization period for the state to extinguish its UAAL to decline to 25 years from 41 years, where it was as of 2010.

The state completed its valuation of its OPEBs in 2007 for all participants, including counties, which resulted in an $8.8 billion combined UAAL, which we consider significant. The UAAL has risen to an estimated $13.57 billion as of 2011. To fund the liability on an actuarial basis would have cost the state $952.6 million for fiscal year 2012. However, the state funds the annual benefit on a pay-as-you-go basis, which equaled $268.7 million in 2011. The total OPEB liability includes benefits provided to state employees, teachers, and the voluntary employee beneficiary trust. The state has no plans to fund the unfunded portion of the OPEB liability.

If OPEB benefits were funded at the ARC, fixed costs, including debt service, would represent 29% of fiscal 2011 general fund expenditures, which we consider high.

The state's GO bonding plans include the issuance of $2.08 billion in bonds from fiscal 2013 to fiscal 2015. Hawaii's capital plan anticipates $700 million of GO debt issuance in fiscal 2013.

On a four-point scale in which '1' is the strongest, we have assigned a score of '3.6 ' to Hawaii's debt and liability profile.

Related Criteria And Research

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

Alternate contact number for John Sugden: (1) 646-662-3437

Ratings Detail (As Of November 9, 2012)		
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
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 (AGM)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Hawaii GO (FGIC) (National)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Hawaii GO (MBIA) (National)		
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

Many issues are enhanced by bond insurance.