

Rating Action: Moody's assigns Aa2 to State of Hawaii's \$16.4M DHHL COPs, Ser. 2017A; outlook stable

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New York, July 13, 2017 -- Issue: Department of Hawaiian Homelands, Certificates of Participation (Kapolei Office Facility), 2017 Series A; Rating: Aa2; Rating Type: Underlying LT; Sale Amount: \$16,390,000; Expected Sale Date: 07/25/2017; Rating Description: Lease: Appropriation;

Summary Rating Rationale

Moody's Investors Service has assigned a Aa2 rating to the State of Hawaii's current offering of Department of Hawaiian Homelands Certificates of Participation (Kapolei Office Facility), 2017 Series A, expected to be issued in the amount of approximately \$16.4 million. The COPs are secured by lease payments to be made by the state for the headquarters office of the department, an executive agency of the state. The outlook on this rating is stable.

The Aa2 rating on the COPs, one notch below the state's Aa1 general obligation, reflects the limited, subject to appropriation, nature of a lease security; the essentiality of the leased asset; and the state's obligation to fund administrative and operating costs of the department, including lease payments, from its general fund. The state's Aa1 general obligation rating reflects its positive economic and revenue trends, the restoration and maintenance of sizable reserves, and proactive measures to improve the funding of its pension and OPEB liabilities. State statutes require it to ramp up its OPEB contribution to 100% of the actuarially required contribution (ARC) by fiscal 2019; the state, notably, contributed more than the statutorily-required amount in fiscal years 2014 through 2017 which will result in savings in future years. The legislature also recently approved higher pension contributions in response to an increase in the estimated pension liability. Despite these measures, the state's fixed costs will remain among the highest in the country at least over the medium term.

The Aa2 rating on the Series 2017A COPs is one notch higher than the Aa3 rating on the department's Series 2006A COPs which will be refunded with the current issue. The lower rating on the 2006A COPs reflects the narrower revenue stream from which the lease payments securing these COPs were appropriated.

Rating Outlook

The stable outlook reflects the expectation that the state will maintain strong reserves while continuing to make planned progress in funding its pension and OPEB liabilities.

Factors that Could Lead to an Upgrade

Increased economic diversification and reduced economic volatility.

Sustained reduction in debt ratios and significant improvement in pension funded ratios, sooner than currently projected.

Factors that Could Lead to a Downgrade

Economic weakening leading to deteriorating revenue trends, budget imbalance, liquidity pressures, and narrowing of financial position.

Return to reliance on non-recurring solutions to balance the budget.

Increased debt ratios relative to other states, or deterioration of pension funded ratios.

Legal Security

The Series 2017A are secured by lease payments to be made by the state from its general fund for the use of the Department of Hawaiian Homeland's headquarters facility in the Kapolei area of Oahu. Lease payments are subject to appropriation by the state legislature.

Use of Proceeds

Proceeds of the Series 2017A COPs will be used to refund the department's 2006A COPs for debt service savings.

Obligor Profile

Hawaii is the 40th largest state by population, at 1.4 million. Its state gross domestic product is 38th largest. The population's income levels are above average, with per capita personal income equal to 100% of the US level and a median household income equal to 133%. Its poverty rate is in the bottom third among states.

The Department of Hawaiian Homelands, an executive agency of the state, is responsible, pursuant to the federal Hawaiian Homes Commission Act of 1920 and related state statutes, for the management of a land trust known as the "Hawaiian Homelands" for the benefit of native Hawaiians. The Hawaiian Homelands consist of more than 203,000 acres on the four main Hawaiian islands plus Molokai and Lanai. In general, the trust land may not be sold. Through its homestead lease program, the department leases much of the trust land to native Hawaiians for residential and agricultural purposes. The department also provides direct loans to lessees for construction, repair and replacement of residences, and makes infrastructure improvements needed for development of homestead land.

Methodology

The principal methodology used in this rating was Lease, Appropriation, Moral Obligation and Comparable Debt of US State and Local Governments published in July 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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