

In the opinion of Bond Counsel to be dated the date of delivery of the Series 2006 Bonds, under existing laws, regulations, rulings and judicial decisions, (i) interest on the Series 2006 Bonds (including original issue discount treated as interest, if any) is excluded from gross income for federal income tax purposes except for interest on any such Series 2006 Bond for any period during which such Series 2006 Bond is held by a person who is a substantial user of the facilities financed by the proceeds of the Series 2006 Bonds or a related person as defined in Section 147(a) of the Internal Revenue Code of 1986, as amended, and (ii) interest on the Series 2006 Bonds (including any such original issue discount) is a specific preference item for purposes of the federal alternative minimum tax imposed on individuals and corporations. Bond Counsel also is of the opinion that, under the existing laws of the State of Hawaii, the Series 2006 Bonds and income therefrom are exempt from all taxation in the State of Hawaii or any county or other political subdivision thereof, except inheritance, transfer and estate taxes and the franchise tax imposed on banks and other financial institutions. See "TAX MATTERS" herein.

\$96,570,000
STATE OF HAWAII
Harbor System Revenue Bonds
Series A of 2006

Dated: Date of Delivery**Due: as shown on inside cover**

The Series 2006 Bonds are being issued to provide funds for certain capital improvements to the Harbor System, to pay the costs of issuance of such Series 2006 Bonds, and to provide a debt service reserve insurance policy as a reserve for the payment thereof. The Series 2006 Bonds are special limited obligations of the State, payable solely from and secured by the Net Revenues derived by the State from the ownership or operation of the statewide system of commercial harbors on a parity with certain outstanding Harbor System revenue bonds after payment of the costs of operation and maintenance.

The Series 2006 Bonds are issuable in fully registered form and when initially issued will be registered in the name of Cede & Co., as nominee of The Depository Trust Company ("DTC"), New York, New York. Purchases of the Series 2006 Bonds will be made in book-entry form only, through brokers and dealers who are, or who act through, DTC participants. Purchases of the Series 2006 Bonds may be made in the denomination of \$5,000 or any integral multiple thereof. Beneficial owners of the Series 2006 Bonds will not receive physical delivery of the Series 2006 Bond certificates so long as DTC or a successor securities depository acts as the securities depository with respect to the Series 2006 Bonds. So long as DTC or its nominee is the registered owner of the Series 2006 Bonds, payment of the principal of and interest on the Series 2006 Bonds will be made directly by the Director of Finance of the State of Hawaii to DTC or its nominee. Disbursement of such payments to DTC participants is the responsibility of DTC and disbursement of such payments to the beneficial owners is the responsibility of DTC participants (See "THE SERIES 2006 BONDS-Book-Entry System" herein).

The Series 2006 Bonds will bear interest at the rates per annum shown on the inside cover hereof, payable on January 1 and July 1 of each year, commencing on January 1, 2007. The Series 2006 Bonds are subject to redemption prior to maturity as and to the extent described herein. See "THE SERIES 2006 BONDS-Redemption."

The scheduled payment of principal of and interest on the Series 2006 Bonds maturing on January 1 of the years 2012 through 2031, inclusive (the "Insured Series 2006 Bonds"), when due will be guaranteed under a municipal bond insurance policy to be issued concurrently with the delivery of the Series 2006 Bonds by FINANCIAL SECURITY ASSURANCE INC.



The Series 2006 Bonds do not constitute a general or moral obligation of the State nor a charge upon the general fund of the State. The full faith and credit of neither the State nor any political subdivision thereof is pledged to the payment of or as security for the Series 2006 Bonds. Neither the real property nor the improvements comprising the Harbor System have been pledged or mortgaged to secure payment of the Series 2006 Bonds.

This cover page contains information for quick reference only. It is not a summary of this issue. Investors must read the entire Official Statement, including the Appendices hereto, to obtain information essential to the making of an informed investment decision.

The Series 2006 Bonds are offered when, as and if issued, subject to the approval of legality by Kutak Rock LLP, Bond Counsel. Certain legal matters will be passed upon for the Underwriter by its Counsel, McCorriston Miller Mukai MacKinnon LLP. It is expected that the Series 2006 Bonds in definitive form will be available for delivery to DTC on or about July 12, 2006.

**Dated: June 27, 2006**

MATURITY SCHEDULE
State of Hawaii
Harbor System Revenue Bonds
Series A of 2006

Series A of 2006 Serial Bonds

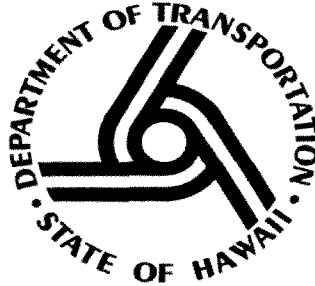
<u>Maturity Date (January 1)</u>	<u>Amount</u>	<u>Rate</u>	<u>Yield</u>	<u>Price</u>
2007*	\$1,960,000	4.00%	4.00%	100.000%
2008*	2,105,000	4.50	4.12	100.535
2009*	2,200,000	4.25	4.18	100.161
2010*	300,000	4.125	4.25	99.599
2010*	2,000,000	5.00	4.25	102.394
2011*	2,415,000	4.75	4.32	101.729
2012	2,525,000	4.25	4.29	99.805
2013	2,645,000	5.00	4.37	103.515
2014	50,000	4.75	4.40	101.951
2014	2,730,000	5.00	4.40	103.525
2015	40,000	4.75	4.50	101.743
2015	2,890,000	5.25	4.50	105.231
2016	140,000	4.50	4.56	99.541
2016	2,945,000	5.25	4.56	105.256
2017	745,000	4.50	4.62	99.011
2017	2,505,000	5.25	4.60	104.942**
2018	3,420,000	5.25	4.65	104.552**
2019	3,595,000	4.80	4.80	100.000
2020	3,780,000	5.25	4.72	104.008**
2021	1,475,000	4.75	4.86	98.864
2021	2,505,000	5.25	4.74	103.853**
2022	4,195,000	5.25	4.77	103.621**
2023	4,420,000	5.25	4.78	103.544**
2024	4,660,000	5.25	4.79	103.467**
2025	4,910,000	5.25	4.80	103.390**
2026	5,175,000	5.25	4.81	103.313**
2027	5,450,000	5.25	4.82	103.236**

Series A of 2006 Term Bonds

\$24,790,000 5.00% Term Bonds Due January 1, 2031, Yield 4.98%, Price 100.147%**

* Uninsured Bonds

** Priced to call on January 1, 2016 at par.



STATE OF HAWAII

Linda Lingle, Governor
James R. Aiona, Jr., Lieutenant Governor

DEPARTMENT OF TRANSPORTATION

Rodney K. Haraga, Director

Deputy Director
Deputy Director
Deputy Director
Deputy Director
Administrator, Airports Division
Administrator, Harbors Division
Administrator, Highways Division

Barry Fukunaga
Francis Paul Keeno
Brennon T. Morioka
Brian H. Sekiguchi
Davis K. Yogi
Glenn M. Okimoto
Glenn M. Yasui

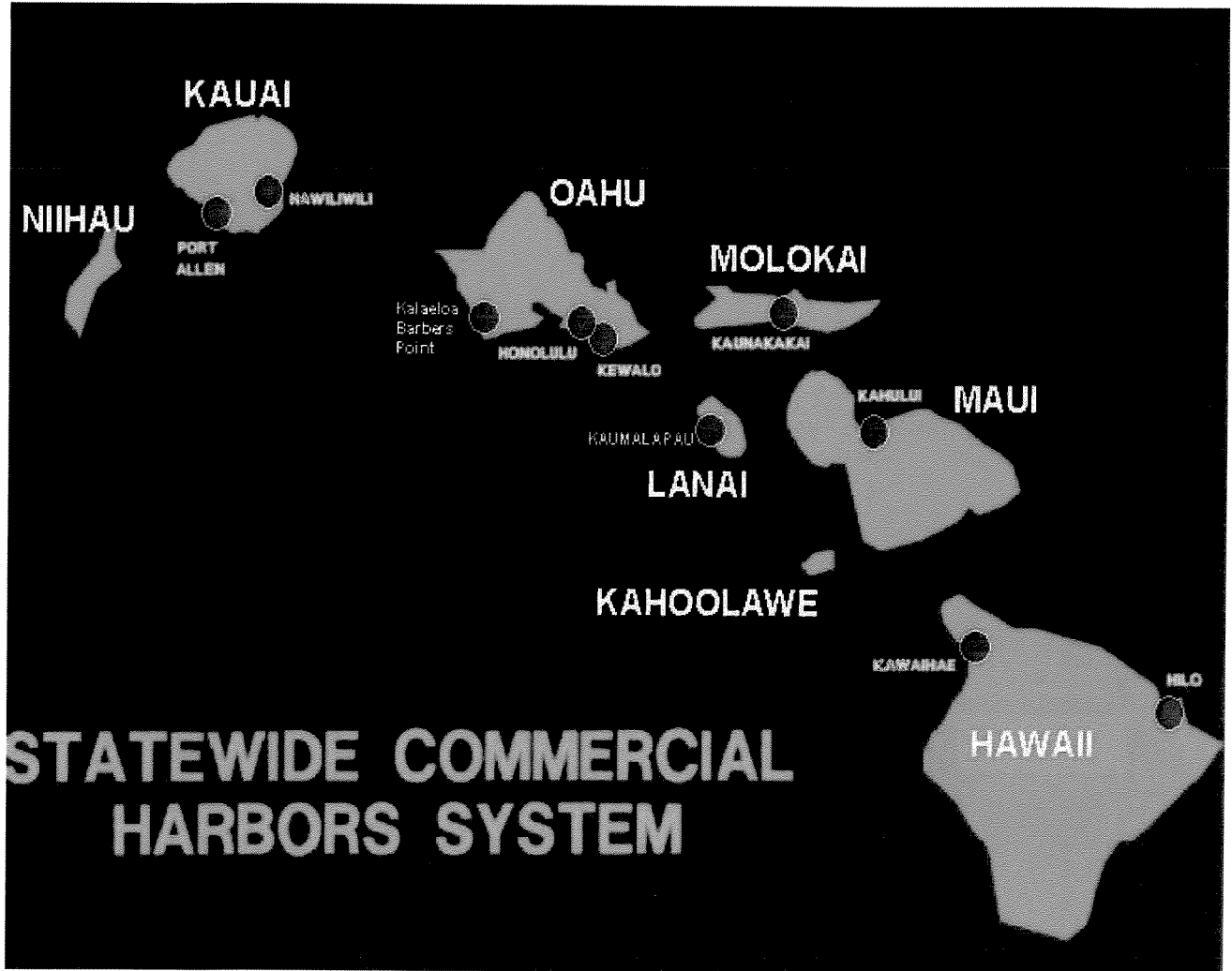
COMMISSION ON TRANSPORTATION

Kirk T. Tanaka, Chair
John Romanowski, Vice Chair
William Lindemann
David R. Marshall
Mel Miyamoto
Owen Miyamoto

James C. Pacopac
Ku'uhaku Park
Evans Rubenstein
David Sproat
Gail Yuh

SPECIAL SERVICES

Bond Counsel
Kutak Rock LLP



The information contained in this Official Statement has been obtained from the State of Hawaii and other sources deemed reliable. No guaranty is made, however, as to the accuracy or completeness of such information. The Underwriter has provided the following sentence for inclusion in this Official Statement. The Underwriter has reviewed the information in this Official Statement in accordance with, and as part of, its responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriter does not guarantee the accuracy or completeness of such information. Other than with respect to information concerning Financial Security Assurance Inc. (the "Bond Insurer") contained under the captions "INSURANCE FOR THE BONDS – Bond Insurance Policy" and "– Financial Security Assurance Inc." and Appendix F – "FORMS OF MUNICIPAL BOND INSURANCE POLICY AND MUNICIPAL BOND DEBT SERVICE RESERVE INSURANCE POLICY" herein, none of the information in this Official Statement has been supplied or verified by the Bond Insurer and the Bond Insurer makes no representation or warranty, express or implied, as to (i) the accuracy or completeness of such information; (ii) the validity of the Series 2006 Bonds; or (iii) the tax exempt status of the interest on the Series 2006 Bonds. This Official Statement, which includes the cover page and appendices, does not constitute an offer to sell the Series 2006 Bonds in any state to any person to whom it is unlawful to make such offer in such state. No dealer, salesman or other person has been authorized to give any information or to make any representations, other than those contained in this Official Statement, in connection with the offering of the Series 2006 Bonds, and, if given or made, such information or representations must not be relied upon. The information contained herein is subject to change without notice and neither the delivery of this Official Statement nor any sale hereunder at any time implies that the information contained herein is correct as of any time subsequent to its date.

THE SERIES 2006 BONDS HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, IN RELIANCE UPON AN EXEMPTION CONTAINED IN SUCH ACT. THE SERIES 2006 BONDS HAVE NOT BEEN REGISTERED OR QUALIFIED UNDER THE SECURITIES LAWS OF ANY STATE. IN CONNECTION WITH THIS OFFERING THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE SERIES 2006 BONDS OFFERED HEREBY AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

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OFFICIAL STATEMENT
\$96,570,000
STATE OF HAWAII
HARBOR SYSTEM REVENUE BONDS
Series A of 2006

INTRODUCTION

This Official Statement, which includes the cover and appendices (the "Official Statement"), provides information with respect to the issuance and sale of \$96,570,000 principal amount of State of Hawaii Harbor System Revenue Bonds, Series A of 2006 (the "Series 2006 Bonds"). Capitalized terms not otherwise defined in this Official Statement shall have the respective meanings given to such terms in Appendix C – "SUMMARY OF CERTAIN PROVISIONS OF THE CERTIFICATE - Definitions of Certain Terms."

The State of Hawaii (the "State") will issue the Series 2006 Bonds pursuant to the Constitution, the laws of the State and the Certificate of the Director of Transportation of the State, dated as of March 1, 1997, as heretofore supplemented and as further supplemented by the fifth supplemental certificate providing for the issuance of the Series 2006 Bonds. The foregoing Certificate, as so supplemented and as hereafter supplemented and amended, is referred to herein as the "Certificate" or the "1997 Certificate." See "THE SERIES 2006 BONDS" for a description of the Series 2006 Bonds. The Series 2006 Bonds, together with the \$180,865,000 aggregate principal amount of outstanding Harbor System Revenue Bonds, Series of 1997, Series A of 2000, Series A and B of 2002, and Series A and B of 2004, previously issued under the Certificate, and any additional parity bonds which may be issued in the future under the Certificate, are collectively referred to herein as the "Bonds."

The Series 2006 Bonds are being issued (1) to provide funds for certain capital improvements to the Harbor System operated by the Department of Transportation of the State (the "Department"), as described below under "PLAN OF FINANCING -- Capital Improvement Projects," and (2) to provide for the costs of issuance of such Bonds and the costs of a bond insurance policy and reserve fund insurance policy for the Series 2006 Bonds as herein described.

The Bonds, including the Series 2006 Bonds, are special limited obligations of the State, payable solely from and secured solely by the Net Revenues of the Harbor System. As defined in the Certificate, such Net Revenues consist of the Revenues of the Harbor System remaining after payment of the costs of operating and maintaining the Harbor System. The Series 2006 Bonds do not constitute a general or moral obligation of the State nor a charge upon the general fund of the State. The full faith and credit of neither the State nor any political subdivision of the State is pledged to the payment of or as security for the Series 2006 Bonds. All Bonds, including the Series 2006 Bonds, are and will be secured equally and ratably by the Net Revenues. See "SECURITY FOR THE BONDS" and "SOURCES OF REVENUES" for a description of the security for the Bonds and sources of Revenues.

Payment of the principal of and interest on the Series 2006 Bonds maturing on January 1 of the years 2012 through 2031, inclusive (the "Insured Series 2006 Bonds"), will be guaranteed by a municipal bond insurance policy (the "Policy") to be issued by Financial Security Assurance Inc. (the "Bond Insurer") concurrently with the delivery of the Series 2006 Bonds. Additionally, the Bond Insurer will issue a municipal bond debt service reserve insurance policy (the "Reserve Policy") simultaneously with the delivery of the Series 2006 Bonds in an amount equal to the Reserve Requirement for the Series 2006 Bonds pursuant to the Certificate. See "INSURANCE FOR THE BONDS" and Appendix F – "FORM OF MUNICIPAL BOND INSURANCE POLICY AND MUNICIPAL BOND DEBT SERVICE RESERVE INSURANCE POLICY" for additional information about the Bond Insurer, the Policy and the Reserve Policy.

The State is an archipelago located over 2,000 miles from the nearest continent. The State imports much of the food and nearly all of the building materials, manufactured goods, clothing and energy products used in the State by its 1.2 million residents and eight million annual visitors. Nearly all goods imported into, exported from and sent between the islands of the State are shipped through the ports comprising the Harbor System, other than crude oil that is shipped through privately-owned offshore mooring and fuel shipment facilities near the Kalaeloa Barbers Point Harbor. See "THE HARBOR SYSTEM - Summary of Harbor System Operations." There are no

economically viable alternatives to transport bulk goods to, from and among the islands. Therefore, the Harbor System is essential to the maintenance of the State's economy.

The Harbor System is the statewide system of commercial harbors comprised of ten harbors. See "THE HARBOR SYSTEM." The Harbor System is owned by the State and is operated as a single statewide system for management and financial purposes on behalf of the State by the Department through its Harbors Division (the "Harbors Division"). See "DEPARTMENT OF TRANSPORTATION." The Department is obligated to impose and collect rates and charges for the Harbor System services and properties to generate Revenues sufficient to pay debt service on the Bonds and certain other outstanding obligations of the Department, to pay the costs of operation, maintenance and repair of the Harbor System and to comply with the terms of the Certificate. See "SECURITY FOR THE BONDS – Rates and Charges."

The term "Harbor System" is used synonymously in this Official Statement with the term "Undertaking" under the Certificate. As defined in the Certificate and set forth under "Definitions of Certain Terms" in Appendix C hereto, the "Undertaking" includes all harbors, harbor and waterfront improvements, ports, docks, wharves, quays, bulkheads, landings and other related facilities and properties belonging to or controlled by the State and under the administration, jurisdiction, control and management of the Department, except facilities principally used for recreation or fishing. The Harbor System excludes any State ferry system, any properties disposed of or transferred pursuant to the Certificate, any properties subject to a Net Rent Lease executed in accordance with the Certificate, and properties in Kewalo Basin and Fort Armstrong transferred from the Department to the HCDA, although moneys received on account of the Kewalo Basin and Fort Armstrong properties continue to be included in Revenues under the Certificate while the transfers are in the process of being completed. See "SOURCES OF REVENUES - Other Matters Potentially Affecting Net Revenues; Makai Kakaako Development."

The information in this Introduction is intended for general reference only. Such information is not intended to be a summary of this Official Statement or the information presented elsewhere herein. Investors are advised to read this entire Official Statement to obtain information essential to the making of an informed investment decision. This Official Statement contains descriptions of the Department, the Harbor System, the Series 2006 Bonds, the security for the Series 2006 Bonds and certain provisions of the Certificate. All references to agreements and documents are qualified in their entirety by the definitive forms of such agreements and documents. All references to the Certificate and to the Series 2006 Bonds are qualified by the definitive forms of such Certificate and Series 2006 Bonds. Any statement or information involving matters of opinion or estimates are represented as opinions or estimates made in good faith, but no assurance can be given that facts will materialize as so opined or estimated.

PLAN OF FINANCING

Authority for Issuance

Article VII, Section 12 of the State Constitution and Part III, Chapter 39, Hawaii Revised Statutes ("HRS"), as amended (collectively, the "General Revenue Bond Law"), permit the issuance of revenue bonds of the State payable from and secured by the Revenues upon the approval of a majority of the members of each house of the Legislature and pursuant to a certificate of the Director of the Department (the "Director"), which becomes effective upon filing with the Director of Finance. The General Revenue Bond Law limits the maximum maturity of revenue bonds and also sets forth provisions for the sale, method of execution and other details of all revenue bonds. The Legislature from time to time enacts laws (including the general appropriations acts) authorizing the issuance of revenue bonds (without fixing any particular details), defining the purposes for which the bonds are to be issued and specifying the amount of the proceeds of such bonds which may be applied to such purposes; provided that the Department, with the approval of the Governor, may issue refunding bonds without further authorization of the Legislature. Pursuant to the General Revenue Bond Law, the Director has issued the Certificate, which, under State law, constitutes the security document pursuant to which all Bonds are issued and secured. The Certificate provides the terms of the Bonds including principal amounts, interest rates, maturities, redemption provisions and the covenants of the Department. The Series 2006 Bonds are being issued pursuant to the Certificate and the General Revenue Bond Law.

Capital Improvement Projects

Proceeds of the Series 2006 Bonds will be used for the purpose of financing or refinancing the cost of dredging and of design, implementation, land acquisition, renovation, purchase, construction, improvements, betterment, extension and replacements to harbor dock, wharf and storage facilities, including equipment and other property functionally related thereto, located at: Honolulu Harbor, Oahu; Nawiliwili Harbor, Kauai; Kahului Harbor, Maui; and Hilo Harbor, Hawaii. Proceeds of the Series 2006 Bonds may also be used for other projects now or hereafter authorized by the Legislature of the State with respect to the foregoing harbor facilities and facilities at Kalaeloa Barbers Point Harbor, Oahu; Kawaihae Harbor, Hawaii; Port Allen Harbor, Kauai; Kaunakakai Harbor, Molokai; and Kaunapali Harbor, Lanai.

Sources and Application of Funds

The following table shows the estimated sources and application of moneys realized by the State upon the sale of the Series 2006 Bonds:

Sources:	
Principal Amount of Series 2006 Bonds	\$96,570,000.00
Net Original Issue Premium	<u>2,118,691.30</u>
Total	<u>\$98,688,691.30</u>
Application:	
Deposit to Capital Improvements Fund	\$97,410,000.00
Costs of Issuance*	<u>1,278,691.30</u>
Total	<u>\$98,688,691.30</u>

* Includes underwriter's discount, bond insurance premium and debt service reserve policy premium.

THE SERIES 2006 BONDS

General

The Series 2006 Bonds will be issued in fully registered form without coupons, will be in the denomination of \$5,000 or any integral multiple of \$5,000, will bear interest from their respective dates at the rates per annum set forth on the cover of this Official Statement, and will mature on the dates and in the principal amounts set forth on the cover of this Official Statement. The Series 2006 Bonds will be dated as of the date of delivery thereof, and will bear interest payable on January 1 and July 1 of each year, commencing January 1, 2007. Interest on the Series 2006 Bonds will be computed on the basis of a 360-day year of twelve 30-day months.

The Series 2006 Bonds, when issued, will be registered in the name of Cede & Co., as nominee for The Depository Trust Company, New York, New York ("DTC"). DTC will act as securities depository for the Bonds. Individual purchases of the Series 2006 Bonds will be made in book-entry form only (the "Book-Entry System"), in the principal amount of \$5,000 or integral multiples thereof. Purchasers will not receive certificates representing their interest in the Bonds. Principal of and interest on the Series 2006 Bonds will be paid by the Director of Finance of the State (the "Director of Finance") to DTC, which will in turn remit such principal and interest to its participants (as hereinafter defined), for subsequent distribution to the Beneficial Owners (as hereinafter defined) of the Series 2006 Bonds, as described herein. The Series 2006 Bonds may be transferred or exchanged in the manner described in such Bonds and as referenced in related proceedings of the State. See "THE SERIES 2006 BONDS - Book-Entry System," below.

The books of registry will be kept and maintained by the Director of Finance. Interest on the Series 2006 Bonds will cease to accrue on the respective maturity dates thereof, and a holder will only be entitled to receive the principal amount and accrued interest on each Series 2006 Bond to such maturity dates. The State may deem and

treat the person in whose name a Series 2006 Bond is registered upon the books of registry as the absolute owner of such Bond for the purpose of receiving payment of the principal thereof, premium, if any, and interest thereon, and for all other purposes.

Redemption

Optional Redemption. The Series 2006 Bonds maturing on and after January 1, 2017 shall be subject to redemption at the option of the State prior to their stated maturity on and after January 1, 2016 as a whole or in part at any time, from such maturities as may be designated by the State, at a Redemption Price equal to 100% of the principal amount thereof plus accrued interest, if any, to the date fixed for redemption.

Mandatory Redemption. The Series 2006 Bonds maturing on January 1, 2031 are also subject to redemption, in part, on each of the dates and in the respective principal amounts set forth below, at a Redemption Price equal to 100% of the principal amount thereof plus accrued interest to the date of redemption, from mandatory Sinking Fund Installments which are required to be made in amounts sufficient to redeem the principal amount of Series 2006 Bonds specified for January of each of the years shown below:

Series 2006 Bonds
Maturing January 1, 2031

Year (January 1)	Principal Amount
2028	\$5,740,000
2029	6,035,000
2030	6,345,000
2031 [†]	6,670,000

[†] Final maturity

Notice of Redemption; Selection of Bonds. The Department shall cause notice of redemption to be mailed not less than 30 days prior to the redemption date, by registered or certified mail, to each registered holder of a Series 2006 Bond to be redeemed at its address appearing on the books of registry maintained by the Director of Finance. At the time notice of any optional redemption is given, the Department may also give notice to certain national information services selected by the Department and must also so notify certain bond information repositories. See “CONTINUING DISCLOSURE” and Appendix D.

If less than all of the Series 2006 Bonds of any maturity are to be redeemed, the Bonds to be redeemed shall be selected by lot within such maturity. See “THE SERIES 2006 BONDS - Book-Entry System” for a discussion of the notice of redemption to be given to Beneficial Owners (as therein defined for the purposes of such discussion) and the manner of selection of the Series 2006 Bonds to be redeemed when the Book-Entry System for such Bonds is in effect.

Effect of Redemption. If a Series 2006 Bond is subject by its terms to redemption and has been duly called for redemption in accordance with the Certificate, and if sufficient moneys available for the payment of the redemption price and interest to accrue to the redemption date on such Series 2006 Bond are held for such purpose by the Director of Finance, such Series 2006 Bond so called for redemption shall become due and payable, and interest on such Bond shall cease to accrue, on the redemption date designated in such notice.

Upon surrender of any Series 2006 Bond to be redeemed in part only, the Department will execute and deliver to the holder a new Bond (or Bonds) of the applicable series and maturity representing the unredeemed principal amount of the Bond surrendered.

Book-Entry System

Information on DTC and Book-Entry System. Information concerning DTC and the Book-Entry System contained in this Official Statement has been obtained from DTC and other sources the Department and the Underwriter believe to be reliable, and is not guaranteed as to accuracy or completeness by, and is not to be construed as a representation by, the Department or the Underwriter.

DTC will act as securities depository for the Series 2006 Bonds. The Series 2006 Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully registered Series 2006 Bond certificate will be issued for each maturity of the Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC and Its Participants. DTC, the world's largest depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 85 countries that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfer and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Government Securities Clearing Corporation, MBS Clearing Corporation, and Emerging Markets Clearing Corporation, (NSCC, GSCC, MBSCC, and EMCC, also subsidiaries of DTCC) as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others, such as securities brokers and dealers, banks, trust companies and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com.

Purchase of Ownership Interests. Purchases of the Series 2006 Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 2006 Bonds on DTC's records. The ownership interest of each actual purchaser of a Series 2006 Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which such Beneficial Owner entered into the transaction. Transfers of ownership interests in Series 2006 Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their beneficial ownership interests in the Series 2006 Bonds, except in the event that use of the Book-Entry System for such Series 2006 Bonds is discontinued.

To facilitate subsequent transfers, all Series 2006 Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co. or such other name as may be requested by an authorized representative of DTC. The deposit of Series 2006 Bonds with DTC and their registration in the name of Cede & Co. or such other nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Series 2006 Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Series 2006 Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Notices and Other Communications. Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulation requirements as may be in effect from time to time.

Redemption notices shall be sent to DTC. If less than all of the Series 2006 Bonds of a maturity are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Voting Rights. Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Series 2006 Bonds unless authorized by a Direct Participant in accordance with DTC's procedures. Under its usual procedures, DTC mails an Omnibus Proxy to an issuer as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Series 2006 Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and Interest Payments. Principal and interest payments on the Series 2006 Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts, upon DTC's receipt of funds and corresponding detail information from the issuer or paying agent, on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC nor its nominee, the State or the Department, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal, premium, if any, and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Director of Finance, and disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

Discontinuance of Book-Entry System. DTC may discontinue providing its services as depository with respect to the Series 2006 Bonds at any time by giving reasonable notice to the State or the Department. Under such circumstances, in the event that a successor securities depository is not obtained, Series 2006 Bond certificates are required to be printed and delivered.

The Department may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, Series 2006 Bond certificates will be printed and delivered.

The State, the Department and the Underwriter will have no responsibility for or obligation to Direct Participants, to Indirect Participants or to Beneficial Owners, nor can or do they give any assurances with respect to (i) the accuracy of any records maintained by DTC, any Direct Participants or Indirect Participants, or (ii) the payment by DTC, any Direct Participants or any Indirect Participants of any amount in respect of principal or redemption price of or interest on the Bonds, or (iii) any notice which is permitted or required to be given to owners (except such notice as is required to be given by the Department to DTC), or (iv) the selection by DTC of any Participant to receive payment in the event of a partial redemption of the Series 2006 Bonds, or (v) any consent given or other action taken by DTC as Owner of the Bond, or (vi) any other event or purpose. The State, the Department and the Underwriter are not responsible or liable for the failure of DTC or any Direct Participant or Indirect Participant to make any payments or to give any notice to a Beneficial Owner with respect to the Bonds or any error or delay relating thereto.

SECURITY FOR THE BONDS

General

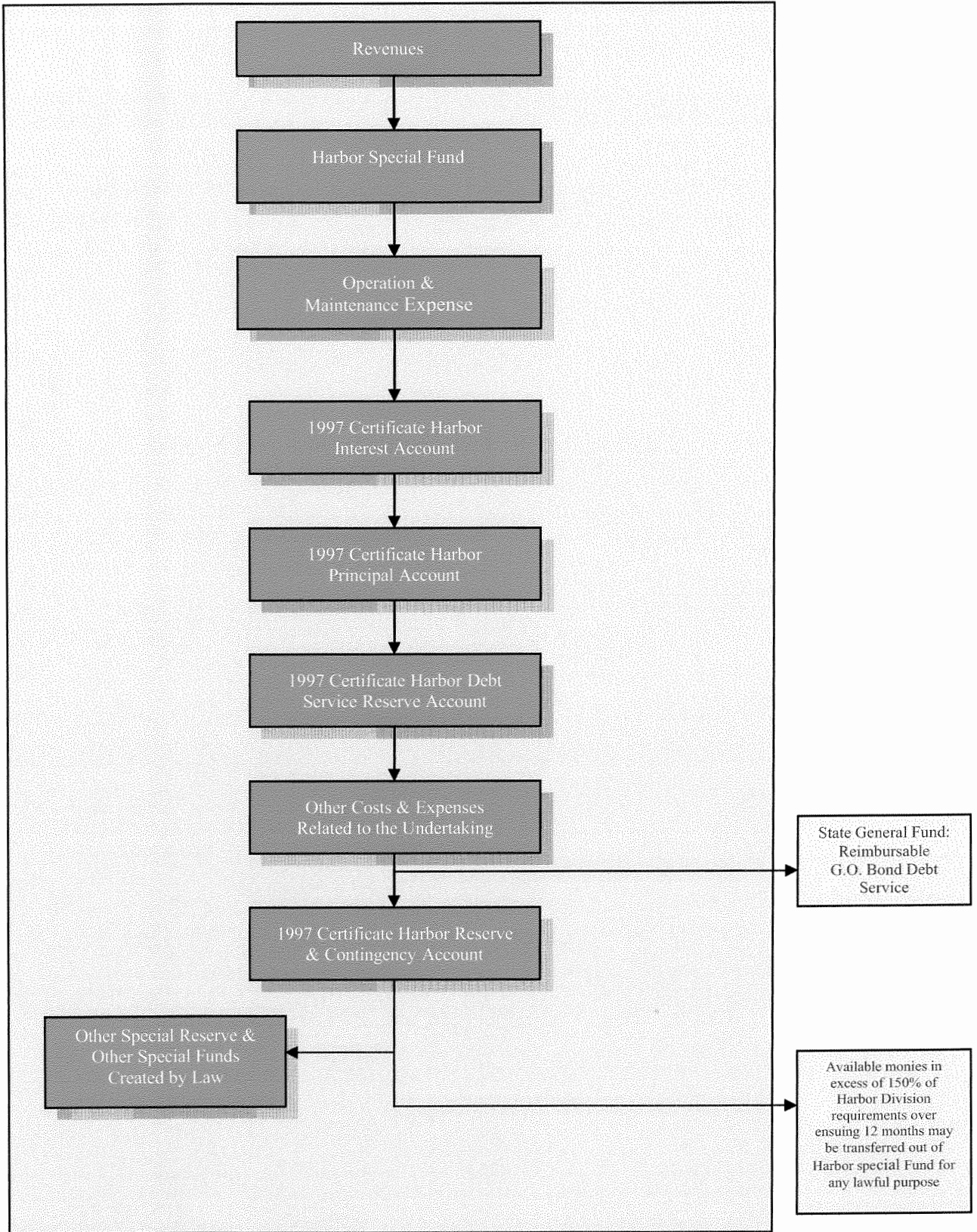
The Bonds, including the Series 2006 Bonds, are special limited obligations of the State, payable solely from and secured solely by the Harbor Special Fund, into which the State is obligated to deposit Revenues, as more fully set forth below and in the Certificate. Such deposits from Revenues shall be made after and subordinate to the

payment of the expenses of operation and maintenance of the properties constituting the Harbor System. See Appendix C – “SUMMARY OF CERTAIN PROVISIONS OF THE CERTIFICATE.”

The Bonds do not constitute a general or moral obligation of the State nor a charge upon the general fund of the State. The full faith and credit of neither the State nor any political subdivision thereof is pledged to the payment of or as security for the Bonds. Neither the real property nor the improvements comprising the Harbor System have been pledged or mortgaged to secure payment of the Bonds.

State law creates a special fund in the Treasury of the State, designated as the Harbor Special Fund. Pursuant to the Certificate, all Revenues are required to be deposited in the Harbor Special Fund. The Certificate provides that Revenues on deposit in the Harbor Special Fund shall be applied for the purposes and in the order of priority therein established. Table 1 provides a graphical representation of the flow of Revenues from one fund to another and the application of the Revenues. See Appendix C – “SUMMARY OF CERTAIN PROVISIONS OF THE CERTIFICATE - Allocation and Application of Revenues” for a further description of this flow of Revenues.

**TABLE 1
FLOW AND APPLICATION OF REVENUES**



The Department is obligated to impose rates and charges sufficient to pay the costs of operation and maintenance, including reserves therefor, of the Harbor System, to pay when due the debt service, and to maintain the debt service reserves for and to satisfy the requirements of the Certificate, including the requirement that the deposit into the Harbor Special Fund be sufficient to pay the debt service on the Bonds and for certain other purposes. See - "Rates and Charges" below.

Pursuant to Section 266-19, HRS, the Director may transfer from the Harbor Special Fund all or any portion of available moneys on deposit in such fund determined by the Director to be in excess of 150% of the requirements for the Harbor Special Fund for the ensuing 12 months. The Director may transfer such excess moneys to the general fund of the State or to any other fund under the control of the Department, as permitted by Section 37-53, HRS. The operation and maintenance costs of the Harbor System and debt service requirements on the Bonds are requirements to be considered by the Director before making any such transfer. See Appendix C – "SUMMARY OF CERTAIN PROVISIONS OF THE CERTIFICATE – Allocation and Application of Revenues."

Under the doctrine of sovereign immunity, a state of the Union (including the State) cannot be sued by its own citizens. Under the United States Constitution, a state (including the State) cannot be sued by citizens of another state of the Union or by citizens or subjects of any foreign state. A state (including the State) may waive its immunity and consent to a suit against itself. The State has waived by statute its immunity from contractual claims. However, such waiver and consent may subsequently be withdrawn by the State. Such immunity from and constitutional prohibition against suits against a state extend to officers of a state acting in their official capacity. Therefore, there can be no assurance that in the event the State fails to make timely payment of principal of or interest on the Bonds, a right of action would lie against the State or officials of the State to enforce such payment.

The State has never defaulted in the payment of either principal of or interest on any indebtedness.

Rates and Charges

In the Certificate, the Department has covenanted to prescribe and collect rates, rents, fees or charges for the services, facilities and commodities of the Undertaking, and to revise such rates, rents, fees and charges from time to time so that the Undertaking shall be and always remain self-supporting. Pursuant to this covenant (referred to herein as the "Rate Covenant"), the Department agrees that such rates, rents, fees or charges will:

(a) be such as will produce Revenues at least sufficient (i) to pay the costs of operation, maintenance and repair of the Harbor System (including reserves therefor) and the expenses of the Department in connection therewith; (ii) to pay into the Harbor Special Fund for credit to each account therein the amounts required by the Certificate; (iii) to reimburse the general fund of the State for all bond requirements for reimbursable general obligation bonds issued for the Harbor System; and (iv) to carry out the provisions of the Certificate; and

(b) at all times and in any and all events, yield Aggregate Net Revenues (as defined in the Certificate) for the next 12-month period which, (i) together with funds on deposit in the 1997 Harbor Reserve and Contingency Account, shall be at least equal to 1.25 times the Aggregate Certificate Bond Service on all Bonds for such 12 months, and (ii) without consideration of other funds, shall be at least equal to 1.00 times the Aggregate Certificate Bond Service for such 12 months.

Harbor Debt Service Reserve Account

In order to provide a reserve for the payment of the principal of, premium, if any, and interest on the Bonds, the Certificate creates a 1997 Certificate Harbor Debt Service Reserve Account in the Harbor Special Fund. Subject to provisions granting the Department the option to fund the 1997 Certificate Harbor Debt Service Reserve Account from Revenues upon the issuance of Bonds, the Certificate requires that moneys credited to the 1997 Certificate Harbor Debt Service Reserve Account be maintained in an amount equal (subject to the maximum amount permitted under the Internal Revenue Code of 1986, as amended) to the maximum Aggregate Bond Service for any Bond Year in which any Bonds are outstanding (the "Reserve Requirement"). In lieu of crediting moneys to the 1997 Certificate Harbor Debt Service Reserve Account, the Certificate permits the Department to obtain a surety bond or an insurance policy payable to the Department for the benefit of bondholders of a Series of Bonds or a letter

of credit, in each case in an amount equal to the difference between the Reserve Requirement and the amounts then credited to the 1997 Certificate Harbor Debt Service Reserve Account. The Department intends to use the Reserve Policy in lieu of depositing moneys into the 1997 Certificate Harbor Debt Service Reserve Account to satisfy the Reserve Requirement applicable under the Certificate to the Series 2006 Bonds. See Appendix C – “SUMMARY OF CERTAIN PROVISIONS OF THE CERTIFICATE – 1997 Certificate Harbor Interest Account,” “1997 Certificate Harbor Principal Account,” “1997 Certificate Harbor Debt Service Reserve Account” and “1997 Certificate Harbor Reserve and Contingency Account.”

Additional Indebtedness

The Certificate permits the issuance of Additional Bonds payable from and secured by the Harbor Special Fund on a parity with the Series 2006 Bonds for the purpose of paying or reimbursing the cost of acquiring or constructing properties that constitute part of the Undertaking or adding to, reconstructing, improving, replacing or expanding the Harbor System so long as:

(a) no default in the payment of any Bond exists, no deficiency exists in the Harbor Special Fund, and the Rate Covenant is satisfied; and

(b) (i) the Aggregate Net Revenues as derived from the most recent audited financial statements or for any consecutive twelve calendar month period during the preceding eighteen calendar month period, as certified by the Independent Public Accountant, are at least equal to 1.25 times the Aggregate Certificate Bond Service on all Bonds for any future fiscal year, or

(ii) (1) the Aggregate Net Revenues as derived from the most recent audited financial statements or for any consecutive twelve calendar month period during the preceding eighteen calendar month period, as certified by the Independent Public Accountant, are at least equal to 1.00 times the Aggregate Certificate Bond Service on all Bonds for any future fiscal year, and (2) the sum of such Aggregate Net Revenues and the Anticipated Net Revenue Increase, if any, is not less than 1.25 times such Aggregate Certificate Bond Service for any future fiscal year. See Appendix C – “SUMMARY OF CERTAIN PROVISIONS OF THE CERTIFICATE - Additional Bonds and Refunding Bonds.”

If, prior to the delivery of Additional Bonds, the Department has imposed increases in its schedule of rentals, rates, fees and charges, which increases are or shall be in effect upon the delivery of such Additional Bonds, the Harbor Consultant may adjust its estimates to reflect such increases for the purposes of making the determination required in clause (b) above.

The Department expects to issue Additional Bonds to finance a portion of future Capital Improvements Programs. See “THE HARBOR SYSTEM - Capital Improvements Program.”

The Certificate also permits the issuance of Refunding Bonds payable from and secured by the Harbor Special Fund on a parity with the Series 2006 Bonds to refund Bonds if (a) no default exists in the payment of any Bond, no deficiencies exist in the Harbor Special Fund, the Rate Covenant is satisfied, and there does not exist an “Event of Default” (as described in Appendix C – “SUMMARY OF CERTAIN PROVISIONS OF THE CERTIFICATE – Events of Default”) or a condition which upon the passage of time would constitute such an “Event of Default,” and (b) the aggregate Bond Service for the Refunding Bonds after such refunding shall be less than the aggregate Bond Service for the refunded bonds had such refunding not occurred. See Appendix C – “SUMMARY OF CERTAIN PROVISIONS OF THE CERTIFICATE – Additional Bonds and Refunding Bonds.”

Nothing in the Certificate prohibits the Department from incurring additional indebtedness with a lien on Net Revenues which is subordinate to that of the Bonds.

The Policy and the Reserve Policy

The Bond Insurer will issue, simultaneously with the delivery of the Series 2006 Bonds, a municipal bond insurance policy insuring the payment when due of the principal of and interest on the Insured Series 2006 Bonds.

Additionally, the Bond Insurer will issue, simultaneously with the delivery of the Series 2006 Bonds, a municipal bond debt service reserve insurance policy satisfying the Reserve Requirement for the Series 2006 Bonds pursuant to the Certificate, which will be used in lieu of the deposit of moneys in the 1997 Certificate Harbor Debt Service Reserve Account. See “INSURANCE FOR THE BONDS” and Appendix F – “FORM OF MUNICIPAL BOND INSURANCE POLICY AND MUNICIPAL BOND DEBT SERVICE RESERVE INSURANCE POLICY.”

The Department and the State have agreed, in connection with the issuance of the Policy and the Reserve Policy by the Bond Insurer, that any amendment or supplement to the Certificate, and any acceleration of debt service on the Series 2006 Bonds upon the occurrence and continuation of an event of default under the Certificate, which cannot become effective without the prior written consent of the holders of such Bonds, shall also require the prior written consent of the Bond Insurer.

There follows under the caption “INSURANCE FOR THE BONDS” below certain information concerning the Bond Insurer and the terms of the Policy and the Reserve Policy. Information with respect to the Bond Insurer and its Policy and Reserve Policy has been supplied by the Bond Insurer. No representation is made by the State or the Underwriter as to the accuracy or adequacy of such information subsequent to the date hereof. The Policy and Reserve Policy do not constitute a part of the contract between the State and the holders of the Bonds evidenced by the Certificate and the Bonds. Except for the payment of the premium on the Policy and Reserve Policy, the State has no responsibility with respect to such insurance in any way, including maintenance, enforcement or collection thereof.

INSURANCE FOR THE BONDS

The following information concerning the Policy has been provided by the Bond Insurer. No representation is made by the State or the Underwriter as to the accuracy, completeness or adequacy of such information, or as to the absence of material adverse changes in such information subsequent to the date hereof.

Bond Insurance Policy

Concurrently with the issuance of the Series 2006 Bonds, Financial Security Assurance Inc. (“Financial Security”) will issue its Municipal Bond Insurance Policy for the Insured Series 2006 Bonds (the “Policy”). The Policy guarantees the scheduled payment of principal of and interest on the Insured Series 2006 Bonds when due as set forth in the form of the Policy included as Appendix F to this Official Statement.

The Policy is not covered by any insurance security or guaranty fund established under New York, California, Connecticut or Florida insurance law.

Financial Security Assurance Inc.

Financial Security is a New York domiciled financial guaranty insurance company and a wholly-owned subsidiary of Financial Security Assurance Holdings Ltd. (“Holdings”). Holdings is an indirect subsidiary of Dexia, S.A., a publicly held Belgian corporation, and of Dexia Credit Local, a direct wholly-owned subsidiary of Dexia, S.A. Dexia, S.A., through its bank subsidiaries, is primarily engaged in the business of public finance, banking and asset management in France, Belgium and other European countries. No shareholder of Holdings or Financial Security is liable for the obligations of Financial Security.

At March 31, 2006, Financial Security’s combined policyholders’ surplus and contingency reserves were approximately \$2,459,829,000 and its total net unearned premium reserve was approximately \$1,858,167,000 in accordance with statutory accounting principles. At March 31, 2006, Financial Security’s consolidated shareholder’s equity was approximately \$2,856,995,000 and its total net unearned premium reserve was approximately \$1,504,103,000 in accordance with generally accepted accounting principles.

The consolidated financial statements of Financial Security included in, or as exhibits to, the annual and quarterly reports filed after December 31, 2005 by Holdings with the Securities and Exchange Commission are hereby incorporated by reference into this Official Statement. All financial statements of Financial Security

included in, or as exhibits to, documents filed by Holdings pursuant to Section 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934 after the date of this Official Statement and before the termination of the offering of the Series 2006 Bonds shall be deemed incorporated by reference into this Official Statement. Copies of materials incorporated by reference will be provided upon request to Financial Security Assurance Inc.: 31 West 52nd Street, New York, New York 10019, Attention: Communications Department (telephone (212) 826-0100).

The Policy does not protect investors against changes in market value of the Insured Series 2006 Bonds, which market value may be impaired as a result of changes in prevailing interest rates, changes in applicable ratings or other causes. Financial Security makes no representation regarding the Insured Series 2006 Bonds or the advisability of investing in the Insured Series 2006 Bonds. Financial Security makes no representation regarding the Official Statement, nor has it participated in the preparation thereof, except that Financial Security has provided to the State the information presented under this caption for inclusion in the Official Statement.

Reserve Policy

Concurrently with the issuance of the Series 2006 Bonds, Financial Security will also issue its Municipal Bond Debt Service Reserve Insurance Policy (the "Reserve Policy"). The Reserve Policy unconditionally guarantees the payment of that portion of the principal of and interest on the Series 2006 Bonds which has become due for payment, but shall be unpaid by reason of nonpayment by the Department, as set forth in the form of the Reserve Policy included in Appendix F to this Official Statement. The aggregate amount available for payment under the Reserve Policy shall not exceed the maximum amount of \$7,003,500, subject to reduction or reinstatement as provided in the Reserve Policy.

The Reserve Policy is not covered by any insurance security or guaranty fund established under New York, California, Connecticut or Florida insurance law.

SOURCES OF REVENUES

General

State law and the Certificate require the State to operate the Harbor System on a self-supporting basis. The Certificate requires the Department to prescribe and collect rates, rentals, fees and charges for the use of and services provided by the Harbor System to generate Revenues which will be sufficient to pay the principal of and interest on all Bonds and to pay the costs of operation, maintenance and repair of the Harbor System, to reimburse the general fund of the State for all reimbursable general obligation bonds issued by the State for the Harbor System and to satisfy other provisions of the Certificate. The Harbor System derives its Revenues from three major sources: services revenues, rental income and other operating revenues. See "SECURITY FOR THE BONDS – Rates and Charges." The services revenues, rental income and other operating revenues described below are obtained from the annual audited financial statements of the Harbor System. The most recent fiscal year for which such audited financial information is available is the year ending June 30, 2005. Also see "Other Matters Potentially Affecting Net Revenues," below.

Services Revenues

General. Services revenues represent the largest source of operating revenues for the Harbor System. Services revenues were \$47.6 million, \$48.7 million and \$52.9 million in the fiscal years ending June 30, 2003 (restated)*, June 30, 2004 and June 30, 2005, respectively, and accounted for 65%, 65% and 71% of operating revenues in such fiscal years. Services revenues are derived from tariffs assessed on the activities of ships and the handling of cargo and include wharfage charges, dockage fees, port entry fees, demurrage, mooring charges and fees for other services.

* The statement of net assets for the fiscal year ended June 30, 2003 and the statement of revenues, expenses and changes in net assets of the Undertaking for the fiscal year ended June 30, 2003 were restated to reflect the correction of certain assets, liabilities, revenues and expenses.

The Department establishes tariff schedules for wharfage charges, dockage fees, demurrage, port entry fees, mooring charges and other tariffs that comprise services revenues pursuant to the Department's rule-making authority. Tariffs relating to "overseas" voyages and cargoes generally are greater than those relating to "inter-island" voyages or cargoes. An overseas voyage is defined as a voyage between a Hawaii port and a foreign or United States mainland port. An inter-island voyage is defined as a voyage between the eight major islands within the State.

The current tariff rates have been in effect since April 1, 1997 and rates have generally been held unchanged except for certain wharfage charges at Kalaeloa Barbers Point Harbor. While potential amendments to certain tariff rates have been incorporated in the Harbors Division's financial planning, any changes to tariffs will be subject to the Governor's approval and compliance with the administrative rules procedures as set forth in Chapter 91, HRS. The Department intends to undertake a review of its tariff structure to better assess potential changes.

Wharfage Charges. Wharfage charges represent the largest component of services revenues. Wharfage charges accounted for \$39.7 million, \$40.2 million and \$43.6 million of operating revenues in the fiscal years ended June 30, 2003 (restated), June 30, 2004 and June 30, 2005, respectively, and comprised approximately 83%, 83% and 82% of total services revenues in such fiscal years.

Wharfage charges are assessed against all shipments of cargo conveyed over, on or under any pier, wharf or terminal facility or to or from any vessel at such a facility of the Harbor System. Wharfage rates are established by type of cargo with differing rate categories for incoming foreign overseas shipments (from a foreign port), incoming domestic overseas shipments (from the mainland United States), outgoing overseas shipments and inter-island shipments. Nearly all non-bulk cargo is shipped through the Harbor System in containers, with respect to which wharfage is determined by the length of the container. The following Table 2 presents current wharfage rates for selected types of cargo.

TABLE 2
WHARFAGE CHARGES FOR SELECTED CATEGORIES OF CARGO
(Rates Effective On and After April 1, 1997)

<u>Category</u>	<u>Rate</u>
CONTAINERS (per linear foot) ¹	
Incoming Foreign Overseas	\$ 2.50
Incoming Domestic Overseas	1.93
Outgoing Overseas	1.31
Inter-island	1.31
AUTOMOBILES (per vehicle)	
Incoming Foreign Overseas	\$23.37
Incoming Domestic Overseas	17.50
Outgoing Overseas	17.50
Inter-island	10.50
LUMBER (per thousand board feet) ²	
Incoming Domestic Overseas	\$ 3.31
GENERAL MERCHANDISE (per ton) ²	
Incoming Foreign Overseas	\$ 2.87
Incoming Domestic Overseas	2.12
Outgoing Overseas	2.12
Inter-island	1.37
FUEL OIL (per barrel)	
Incoming, State-owned pipeline	\$ 0.15
Incoming, privately-owned pipeline ³	0.075
PASSENGER FEES (per passenger)	
Embarking/Disembarking	\$ 2.50
In transit ⁴	1.85
WATER (per thousand gallons), State-owned pipeline	\$2.1875

¹ Effective January 1, 2006 to December 31, 2006, wharfage rates for containers at Kalaeloa Barbers Point Harbor are discounted 30% of the rates stated.

² Effective January 1, 2006 to December 31, 2006, wharfage rates for general merchandise and lumber at Kalaeloa Barbers Point Harbor are discounted 40% of the rates stated.

³ Located at facilities of the Harbor System.

⁴ Consists of passengers in transit on a vessel making a continuous trip whose point of origin and termination is a state port.

The Department collects wharfage on a self-reporting basis. Each of the shipping lines that uses the ports comprising the Harbor System is responsible for reporting to the Department the wharfage owed for each voyage and submitting payment of such wharfage within 45 days after the completion of handling cargo over state wharves. The Department conducts random audits to verify the wharfage paid by the shipping lines that use the Harbor System.

Dockage Fees. Dockage fees represent the second largest component of services revenues. Dockage fees accounted for \$4.5 million, \$4.6 million and \$4.9 million of operating revenues in the fiscal years ended June 30, 2003 (restated), June 30, 2004 and June 30, 2005, respectively, and comprised approximately 9.4%, 9.5% and 9.4% of services revenues in such fiscal years.

Dockage fees are assessed against all vessels using a dock or other State-owned structure in a port in the Harbor System at rates per 12 hours based on the length of the vessel. The dockage fee assessed in connection with an inter-island voyage is approximately 60% of the dockage fee assessed in connection with an overseas voyage. Current dockage fees assessed in connection with an inter-island voyage range from \$16.25 to \$1,725, depending on

vessel length, and the current dockage fees assessed in connection with an overseas voyage range from \$31.25 to \$2,875, depending on vessel length.

Dockage fees in connection with inter-island voyages are billed by the Department or assessed on a self-reporting basis. If assessed on a self-reporting basis, each shipping line that uses the ports comprising the Harbor System is responsible for reporting to the Department the dockage owed for each inter-island voyage, which is payable within 30 days. Dockage fees in connection with overseas voyages are assessed based upon vessel logs maintained by each district of the Harbor System and are payable 30 days from the date of invoice.

Demurrage. Demurrage is a charge assessed against cargo remaining on a pier or terminal area beyond the free time provided for loading or unloading. Demurrage accounted for approximately \$1.0 million, \$1.0 million and \$1.4 million of operating revenues in each of the fiscal years ended June 30, 2003 (restated), June 30, 2004 and June 30, 2005, and comprised approximately 2.2%, 2.1% and 2.6% of services revenues in such fiscal years, respectively. Current demurrage rates are typically \$.56 per linear foot per day for the first five days and \$1.12 per linear foot per day thereafter for containerized cargo and shipping devices.

Demurrage fees are self-reported and each shipping line that uses the ports comprising the Harbor System is responsible for reporting to the Department the demurrage owed for each voyage. No audits are performed for demurrage reports.

Rental Income

Rental income is the second major source of operating revenues for the Harbor System. Rental income accounted for \$25.1 million, \$25.1 million and \$20.3 million of operating revenues in the fiscal years ended June 30, 2003 (restated), June 30, 2004 and June 30, 2005, respectively, and comprised approximately 34%, 34% and 27% of total operating revenues in such fiscal years. Rental income includes charges for wharf space and land, storage, pipeline usage and automobile parking space. Rental income for all fiscal years represents net rental revenues after deducting the provision for doubtful accounts.

The Department derives rental income principally from leasing of land and improvements under revocable permits and leases. Such permits and leases accounted for \$19.0 million, \$18.1 million and \$13.7 million of net rental income in the fiscal years ended June 30, 2003 (restated), June 30, 2004 and June 30, 2005, respectively, and comprised approximately 76%, 72% and 68% of rental income in such fiscal years. The rental rates under revocable permits may be adjusted annually to reflect contemporaneous real estate values in the State. The rental rates under leases may be fixed for periods of five years or more. Currently, revenues derived from leases constitute approximately 40% and revenues from revocable permits constitute approximately 60% of the total revenues from leases and permits.

Rentals under leases are based upon the independently appraised value of the property leased and are issued by direct negotiation or by public auction. When rentals are determined by public auction, however, the price at which bidding is started may be less than the appraised value. In leases exceeding ten years, the rent generally is fixed for five-year periods, with increases of 15% at the end of each five-year period up to the 15th year of the lease term. Subsequently, the rentals are reopened by appraisal in the 15th and 25th years of the lease.

The Department has leased land or building space through revocable permits and leases to approximately 323 tenants. The rental income generated from leases by the top ten lessees of the Department represented approximately 30%, 30% and 36% of total annual lease and revocable permit rents in the fiscal years ended June 30, 2003 (restated), June 30, 2004 and June 30, 2005, respectively.

Other Operating Revenues

Other operating revenues, including reimbursement for the cost of utilities furnished to ships, sales of materials and supplies and other miscellaneous items, accounted for approximately \$0.9 million, \$1.0 million and \$1.3 million in the fiscal years ended June 30, 2003 (restated), June 30, 2004 and June 30, 2005, respectively, and comprised approximately 1.2%, 1.3% and 1.8% of total operating revenues in such fiscal years.

Interest Income

In addition to operating revenues, the Department receives interest income from investments such as certificates of deposit, direct finance leases and U.S. Treasury obligations. The interest income received by the Department in any fiscal year depends on the amount available for investment, prevailing interest rates and restrictions on the investment practices of the Department that affect the types of investments made. Interest income from investments other than direct finance leases is included in Net Revenues and totaled \$3.9 million, \$3.7 million and \$4.8 million in the fiscal years ended June 30, 2003 (restated), June 30, 2004 and June 30, 2005, respectively.

Other Matters Potentially Affecting Net Revenues

Honolulu Waterfront Master Plan. The Honolulu Waterfront Master Plan, completed in January 1990, covered the area from Ala Moana Park on the east to the Honolulu International Airport on the west and Kalaeloa Barbers Point Harbor on the southwest shore of Oahu, which area includes Kewalo Basin and Honolulu Harbor. The Plan represents a comprehensive long-range vision for the Honolulu Waterfront. It was designed to recognize the importance of Honolulu Harbor as the lifeline of Statewide commerce and, at the same time, provide for the recreational, cultural and economic needs of a growing population. The Plan addresses major planning issues concerning public access and use of the waterfront, long-term integrity of commercial maritime operations, plan implementation, relocation needs and financial feasibility. The Plan reflects many competing interests and the effect on the Revenues and operations of the Harbor System cannot be determined with certainty at this time.

Oahu Commercial Harbors 2020 Master Plan. Since the completion of the Honolulu Waterfront Master Plan, financial support for non-maritime development of the lands surrounding Honolulu Harbor has declined. The spatial, facility and support requirements of Hawaii's life-line ocean cargo carriers, on the other hand, have increased. This shift in trends necessitated a return to a focus on the needs and projected growth of the maritime community. The Oahu Commercial Harbors 2020 Master Plan, approved by the Governor on May 6, 1997, used then current economic indicators to plan the infrastructure required by Hawaii's essential commodity carriers. The Oahu Commercial Harbors 2020 Master Plan incorporates and updates the commercial harbor components of the Honolulu Waterfront Master Plan, as well as the 2010 Master Plans for Honolulu and Kalaeloa Barbers Point Harbors.

The Oahu Commercial Harbors 2020 Master Plan provides a general, long-range guide for commercial harbor development, based on the knowledge and experience of the users of the facilities and their anticipation of future trends. Implementation of the recommendations of this plan will enhance operational efficiency and encourage further development of Oahu harbors. Many aspects of this master plan have been completed, including the Honolulu Harbor Inter-Island Cargo Terminal at Piers 39-40, acquisition of land for cargo operations near Pier 40, the ferry terminal at Pier 19, the Pier 2 cruise passenger terminal, the dredging of the Kalaeloa Barbers Point Harbor expansion, and construction of the Kalaeloa Barbers Point Harbor Pier P-5 and Pier P-7 extensions. Many other aspects are underway, including private construction within the Domestic Commercial Fishing Complex and the design of the Pier 51A and Pier 51C to Pier 53 terminal yard reconstruction.

Hawaii Commercial Harbors 2020 Master Plan, Kahului Harbor 2025 Master Plan, Kauai Commercial Harbors 2025 Master Plan. Following completion of the Oahu Commercial Harbors 2020 Master Plan, the Harbors Division began to update the remaining 2010 Master Plans for commercial harbors statewide. To date the aforementioned plans were completed and approved by the Governor on August 7, 1998, September 14, 2000, and September 21, 2001, respectively. These master plans provide a general, long-range guide for commercial harbor development, based on the knowledge and experience of the users of the facilities and their anticipation of future trends. In the fourth quarter of 2006, the Harbors Division will begin to update the Hawaii Commercial Harbors 2020 Master Plan and the Kahului Harbor 2025 Master Plan to the planning horizon of 2030.

Cruise Ships. Hawaii continues to be an attractive market for the cruise ship industry. Since December 2001, Norwegian Cruise Lines has operated passenger cruises which have included a required stopover in the Republic of Kirabati to comply with federal restrictions on foreign flagged vessels. In 2003, Norwegian obtained an exemption from federal maritime law to operate three ships under the U.S. flag in Hawaii. Two of these ships, *Pride of Aloha* and *Pride of America*, initiated year-round, inter-island service in July 2004 and July 2005, respectively. The third ship, *Pride of Hawaii*, began operations in June 2006. The Department has several projects designed to

improve certain terminal facilities statewide to accommodate the increased activity. The construction of a new cruise passenger terminal at Pier 2, Honolulu Harbor, was substantially completed on February 16, 2006. The design of additional security and related improvements at Pier 2 is ongoing.

Revenues from debarked and embarked cruise ship passengers totaled \$3.6 million in the fiscal year ended June 30, 2005. Passenger counts increased 15.8% for such fiscal year compared to the previous fiscal year. Passenger counts for the fiscal years ended June 30, 2001 through June 30, 2005 were as follows:

<u>Fiscal Year</u>	<u>Passengers</u>
2001	661,236
2002	1,088,133
2003	1,565,669
2004	1,322,370
2005	1,531,553

While the passenger count increased by 15.8% in 2005 over 2004, revenues for the same period increased by 9.6% since approximately 20.6% of the 2005 passengers were in-transit. Passengers on the *Pride of Aloha* taking a continuous voyage whose point of origin and termination is a State port were charged a total in-transit fee of \$1.85 under the tariff for disembarking and embarking. Other passengers were assessed a fee of \$2.50 for embarking and \$2.50 for disembarking under the tariff. Passengers on Norwegian's two other U.S. flagged vessels, *Pride of America* and *Pride of Hawaii*, are also assessed at the in-transit rate.

Inter-island Ferry System. Hawaii Superferry, Inc. ("HSF"), a private ferry operator, has secured financing to construct two new inter-island ferry vessels and commence ferry service operations that will initiate a roll on/roll off, high speed daily service for the transport of passengers and vehicles, including cars, trucks and commercial vehicles, between the harbors of Honolulu, Kahului, Nawiliwili and Kawaihae. Service is estimated to begin in the third quarter of fiscal year 2007 with one vessel. A second vessel is expected to be placed into service approximately 18 months later.

Act 178, Session Laws of Hawaii 2005 ("Act 178"), appropriated reimbursable general obligation bonds in the principal amount of \$20 million in each of fiscal years 2006 and 2007 for harbor improvements needed to support the operations of HSF. The Department will be responsible for debt service payments on the bonds. The Harbors Division has executed a \$37.5 million contract for the construction of barges and ramps with a current authorized expenditure limitation of \$20 million, with an additional \$17.5 million to be encumbered in fiscal year 2007. Expenditure of the balance of the appropriation is planned to finance other harbor upgrades needed to support the operations of HSF.

The 2006 legislature included a proviso in its passage of legislation to provide for supplemental appropriations and other amendments to Act 178 effective during fiscal biennium 2005-2007. Section 88.1 of the bill provides that no moneys shall be expended from the general obligation bond fund appropriations for ferry terminal improvements that have not been expended or encumbered as of the effective date of the legislation until certain conditions have been met. The supplemental appropriations bill was enacted into law by the Governor on June 1, 2006, as Act 160, Session Laws of Hawaii 2006.

HSF has executed an operating agreement with the Department which sets forth the terms and conditions for operational access and use of the State's commercial harbors by HSF. The agreement, executed on September 7, 2005, is effective until the earlier of 22 years from the date the of the first voyage of the first ferry or 20 years from the date of the first voyage of the second ferry.

Pasha Hawaii. Pasha Hawaii Transport Lines LLC initiated service to Hawaii in March, 2005. Its vessel, the *Jean Anne*, is the first pure car/truck carrier constructed to meet the requirements of the Jones Act. The ship is designed to carry approximately 4,300 vehicles on 10 decks and provides Hawaii with new service to transport vehicles, rolling stock and other commodities from the west coast of the United States.

Aloha Tower Development. In 1981, the State created the Aloha Tower Development Corporation ("ATDC") to redevelop the Aloha Tower area of Honolulu Harbor (the "Aloha Tower Complex"), which

encompasses Piers 5 to 23 of Honolulu Harbor. In 1993, the Harbors Division leased a portion of the Aloha Tower Complex to ATDC. The lease required ATDC to reimburse the Harbors Division annually for any losses in revenues caused by ATDC or the developer of the complex and to provide replacement facilities for maritime activities at no cost to the Harbors Division.

In September 1993, ATDC subleased lands surrounded by Piers 8 and 9 and a portion of land surrounded by Pier 10 to a developer. The sublease required the developer to construct various facilities on the land including a retail marketplace. The developer entered into a capital improvements, maintenance, operations and securities agreement with the Harbors Division (the "Operations Agreement"), providing for the Harbors Division to operate the related harbor facilities. The developer was forced into bankruptcy shortly thereafter. In March 1998, a second entity assumed the developer's obligations under the sublease and the Operations Agreement. This entity filed for bankruptcy protection in 2002 and a third entity has since assumed the initial developer's obligations under the sublease and the Operations Agreement. Although construction of the marketplace has been substantially completed, several items on the Harbors Division's construction punchlist have yet to be completed and are being pursued with the current sublessee.

On January 18, 2006, an Agreement Amending the Aloha Tower Project Memorandum of Understanding and Aloha Tower Ground Lease was executed, effective as of June 30, 2005, and retroactive to July 1, 2004 (the "Amendment"). The Amendment requires ATDC to pay \$225,000 as a minimum annual base payment for losses in revenues owing in the fiscal year beginning July 1, 2004. From July 1, 2005, subject to the approval of the Deputy Director for the Harbors Division, the base payment of \$225,000 will be reduced by expenses incurred by ATDC for the Hawaii Harbors Project. The Amendment also requires an equity participation payment to be made in an amount of 50% of the difference between the total revenues and total operating expenses of ATDC for a fiscal year (the "equity payment"), provided that if the equity payment exceeds two and one-half times the actual operating expenses of ATDC for such fiscal year, ATDC must make a supplemental payment equal to 75% of the difference between the equity payment and the product of two and one-half times the actual operating expenditures of ATDC. These payments are to be applied towards the outstanding June 30, 2004, balance due to the Harbors Division.

Revenues for the fiscal years ended June 30, 2004 and June 30, 2005 totaled \$1,763,995 and \$1,848,086, respectively, and were included in the rental revenues for such years. As of June 30, 2004 and June 30, 2005, amounts due to the Harbors Division from ATDC were \$8,051,363 and \$9,899,449, respectively.

Makai Kakaako Development. Under Act 86, Session Laws of Hawaii 1990 ("Act 86"), the State legislature transferred approximately 73 acres of lands at Kewalo Basin and Fort Armstrong under the jurisdiction of the Harbor System to the Hawaii Community Development Authority ("HCDA"). HCDA is a State agency which is responsible for overseeing the development of the Kakaako Community Development District (the "District"). The Director of Transportation is one of 11 voting members of the HCDA board of directors.

Under Act 86, HCDA is required, as part of the transfer, to ensure that the State is able to satisfy any covenant between the State or any county or any department or board thereof and the holders of bonds issued by the State or such county, department or board, if any. As of the date of this Official Statement, all acts necessary to complete the transfer of the subject property to HCDA have been completed, including execution of the deed and cancellation of the relevant Governor's executive orders which had previously set aside the subject property to the Harbors Division.

As part of HCDA's development of the District, the western portion of the Kewalo Basin area is scheduled for redevelopment. HCDA has selected a master developer for the waterfront around Kewalo Basin. A key element of the redevelopment plan included the construction of residential high-rise condominium towers. The residential element has generated public controversy and the 2006 legislature passed legislation to prohibit residential use of the lands. The bill is awaiting action by the Governor. At this time the Department cannot predict the effect such legislation might have on HCDA's redevelopment plan. The Harbors Division has long been negotiating with HCDA to resolve issues relating to the Harbor Division's continued operation and management of Kewalo Basin until HCDA was ready to proceed with its redevelopment plans. By an informal understanding, the Harbors Division retained all revenues generated from its management of Kewalo Basin and continued to manage maritime operations and provide for maintenance and capital improvements during this interim period. While fee title to Kewalo Basin was transferred to HCDA under Act 86, the law was silent as to the transfer of the related

improvements. As of June 30, 2005, the Harbors Division recorded approximately \$4.5 million as the remaining depreciated value of its Kewalo improvements. Legal advice has been rendered that all improvements as well as the fee simple title transferred as a result of Act 86. The Harbors Division is discussing the orderly transfer of its management of Kewalo Basin to HCDA in light of HCDA's development schedule. Issues to be resolved include whether HCDA will provide compensation to the Harbors Division for the remaining depreciated value of the improvements. The outcome of these discussions may result in a loss on disposal of the Kewalo improvements in future financial statements and the elimination of the Harbors Division's management and operation of Kewalo Basin, and all revenues therefrom as well as all expenses related thereto, as of June 30, 2007.

The 2006 legislature passed a bill to remove Piers 1 and 2 from the District and grant jurisdiction and administrative authority over these piers to the Department and the Foreign Trade Zone Division of the State of Hawaii Department of Business, Economic Development & Tourism. The bill was enacted into law by the Governor on June 2, 2006, as Act 165, Session Laws of Hawaii 2006.

Kapalama Military Reservation. Between 1990 and 1993, the State acquired three parcels of land totaling approximately 61.8 acres within the Kapalama Military Reservation ("KMR"), comprised primarily of areas adjacent to or near Piers 39 through 41 at Honolulu Harbor (the "KMR site"). Governor's Executive Order No. 3497 set aside two parcels comprising 40.6 acres to the Department for harbor purposes on September 24, 2002. The set-aside of the remaining 21.2-acre parcel is pending. This parcel was purchased for approximately \$34.9 million and involved the use of approximately \$8.2 million of the Airports Division's funds. There have been ongoing efforts between the Harbors Division and the Airports Division to designate the portions of the parcel to be used for their respective purposes. The parties also discussed the possibility of the Airports Division selling its interest in the parcel to the Harbors Division. As a result, action on the issuance of a further Executive Order for the remaining parcel was deferred until the matter could be resolved.

Efforts to plan for the future development of the KMR site intensified with the Governor's action to establish a KMR Task Force to focus on the collaboration between the Harbors Division and ATDC to redevelop the KMR site and other expansion areas in Honolulu Harbor for maritime operations. The ATDC was tasked with primary collaboration and development assistance as its enabling statute, Chapter 206J, HRS, provides the legislative authority to develop, redevelop and improve the Honolulu waterfront. A Hawaii Harbors Project Office was established within the Harbors Division to lead and coordinate the development of a proposed cargo container yard and vessel berthing piers. The executive officer of the ATDC serves as the chief executive of the Hawaii Harbors Project Office, while the Deputy Director of the Harbors Division heads the KMR Task Force.

Legal advice has been rendered that efforts seeking an Executive Order for the remaining parcel should cease, and that in order to transfer the Airports Division's interest in the KMR site to the Harbors Division, the Airports Division must be repaid \$8.2 million, the amount it contributed to the purchase price of the KMR site. The Harbors Division is also seeking the transfer of approximately 11.344 acres of ceded lands that were previously promised to the Airports Division near the KMR site to consolidate the lands needed for the future development. The resolution of this matter is dependent upon compliance by the Airports Division with certain steps outlined in the aforementioned legal advice, based on a clarification from the FAA on the State's land ownership procedures and the FAA's requirement of receipt of fair market value on lands disposed.

Environmental Issues. The Harbors Division has been identified, among others, as a potentially responsible party by the State Department of Health with respect to subsurface contamination along the Honolulu waterfront. The contamination is due to past releases of petroleum-based materials, and the Department of Health is initially concentrating on the areas between Piers 18 and 38 of Honolulu Harbor. Remediation is underway at several harbor sites and the Harbors Division is sharing the costs of this remediation effort. Studies are continuing to determine the scope of contamination, and it is not possible to predict the outcome of such studies or to estimate the costs of remediation at this time. The Department of Health has stated that it will take a risk-based approach to any remediation efforts, that is, remediation consistent with the use of the property. Since the sites involved are expected to remain in industrial use, such remediation efforts may be limited.

Port Security. The Maritime Transportation Security Act of 2002, and its implementing regulations, have imposed substantial security requirements on the State. The State, through its Harbors Division, owns harbor property and facilities at its commercial harbors. Therefore, the Harbors Division has a significant responsibility to

provide port security. As part of its port security program, the Harbors Division submitted facility security plans to the United States Coast Guard in December 2003, and by mid- to late-2004 had 17 facility security plans approved, along with five public access facilities letters that require additional security requirements for higher levels of maritime security (MARSEC LEVELS 2 & 3). The Harbors Division continues to implement the requirements of these plans throughout the State. Costs attributed to the implementation include, but are not limited to, the use of contract security (totaling over \$1.5 million throughout the State), an access control and credentialing system, waterside security control, and budgeting for and creating facility security offices with personnel and equipment for all regulated ports throughout the State, which will require additional funding to accomplish and sustain.

Office of Hawaiian Affairs and Ceded Lands. The property comprising the Harbor System includes certain lands (“Ceded Lands”) transferred by the former Republic of Hawaii to the United States in 1898. Upon Hawaii’s admission to the Union in 1959, the United States reconveyed title to the Ceded Lands to the State to be held as a public trust for five purposes: (1) public education; (2) betterment of the conditions of native Hawaiians; (3) development of farm and home ownership; (4) making public improvements; and (5) provision of land for public use. In 1978, the State Constitution was amended expressly to provide that the Ceded Lands were to be held as a public trust for native Hawaiians and the general public, and to establish the Office of Hawaiian Affairs (“OHA”) to administer and manage the proceeds and income derived from a pro rata portion of the Ceded Lands to better the conditions of native Hawaiians. See “Office of Hawaiian Affairs and Ceded Lands” in Appendix B hereto for a discussion of pending litigation regarding the Ceded Lands.

During the 2006 session of the State legislature, the legislature passed Senate Bill 2948 which fixes the amount of proceeds and income from the Ceded Lands that OHA is to receive annually, beginning with the fiscal year ending June 30, 2006. The bill was enacted into law by the Governor on June 7, 2006, as Act 178, Session Laws of Hawaii 2006. The Act provides that all State departments or agencies collecting receipts from the use of Ceded Lands (specifically including the Departments of: Agriculture; Accounting and General Services; Business, Economic Development and Tourism; Education; Land and Natural Resources; and Transportation - Harbors Division) shall collectively pay the following amounts to OHA from such receipts: (a) within 30 days after the end of the 2005-2006 fiscal year, the sum of \$15.1 million; and (b) within 30 days after each fiscal quarter thereafter, such amounts as are necessary to ensure that a total of \$3.775 million of such receipts is transferred to OHA. The Act does not specify each affected department's or agency's share of such payments, but expressly authorizes the Governor to do so by executive order. No assurance can be given as to how the required payments to OHA will be allocated among the affected departments and agencies, including the Harbors Division.

Tariff Rate Increases; Rate Covenant. As indicated under the heading “SECURITY FOR THE BONDS – Rates and Charges,” the Department has covenanted to impose, prescribe and collect rates, rentals, fees and charges which will enable it to comply with the Rate Covenant. If any event, including any of the foregoing events, causes an extraordinary decrease in Revenues or increase in operating expenses, the Department will be obligated to adjust tariffs in order to comply with the Rate Covenant. See “SECURITY FOR THE BONDS – Rates and Charges” and “SOURCES OF REVENUES.”

DEPARTMENT OF TRANSPORTATION

Department Organization

The Department is one of 18 principal executive departments of the State. Chapter 26, HRS, empowers the Department to establish, maintain and operate the transportation facilities of the State, including highways, airports, harbors and other transportation facilities. The Department’s activities are carried out through three primary operating divisions: Airports, Harbors and Highways.

Through the Harbors Division, the Department exercises control and management of the harbors, harbor and waterfront improvements, docks, ports, wharves, quays, bulkheads and landings belonging to or controlled by the State and all vessels and shipping lines using the same. The Harbors Division operates the Harbor System as a single integrated system for management and financial purposes.

Department Management

The Department is headed by the Director of Transportation, a single executive appointed by the Governor and confirmed by the State Senate. The Governor is authorized to appoint, without State Senate confirmation, three Deputy Directors of Transportation. The Director and Deputy Directors of Transportation serve four-year terms conterminous with the Governor's term.

Chapter 26, HRS, establishes the Commission on Transportation which sits in an advisory capacity to the Director on matters within the jurisdiction of the Department, including the Harbor System. The Commission on Transportation consists of at least one member from each of the four counties of the State.

The Harbors Division is managed by a Harbors Administrator. Each district of harbors is managed by a district manager. The Staff Services Office, which is headed by an Administrative Services Officer, performs the following services for the Harbors Division: personnel; budget; property management; financial management; methods, standards and evaluation; data processing; and office services. The Engineering Branch, which is headed by an engineering program manager, performs all planning, design, construction and maintenance engineering functions for the Harbors Division.

In September 2005, the decision-making structure within the Department was decentralized to allow the Airports, Harbors and Highways Divisions to operate with a greater degree of autonomy and flexibility. Divisional deputies were granted greater decision-making authority to oversee their respective divisions.

Management Personnel

The following are the current senior executives of the Department responsible for the management of the Harbor System:

Rodney K. Haraga, Director, assumed his present position in January, 2003. Mr. Haraga retired from the City of Los Angeles, Department of Public Works, as a Deputy City Engineer in 1999 with over 32 years of design and construction management experience in the public sector. Prior to this position as the Deputy, he managed and directed many programs for that city including the establishment of an \$80 million program for sound insulation of residential properties and buildings at Los Angeles International Airport in 1992-1994. Upon his retirement, Mr. Haraga returned to Hawaii and worked as a Project Manager for KFC Engineering Management Inc. from 2000 to his appointment as Director. Mr. Haraga graduated from Purdue University in 1966 with a B.S. in Civil Engineering and holds a Masters in Public Administration from California State University and the Executive MBA Program, University of California, Los Angeles.

Barry Fukunaga, Deputy Director, Harbors Division, assumed his position in September 2004. Prior to his appointment as Deputy Director, Mr. Fukunaga served as the Director of the Department of Enterprise Services of the City and County of Honolulu where he administered and managed the Neal S. Blaisdell Center and Waikiki Shell, the Honolulu Zoo and various golf courses. Before that, Mr. Fukunaga served as Deputy Director of the Department of Environmental Services of the City and County of Honolulu where he was responsible for wastewater treatment facilities, solid refuse collection and disposal functions, and other programs. Mr. Fukunaga also previously served in various capacities for 25 years with the State Department of Transportation, Airports Division, including airports manager, airports operations manager and airports services supervisor. From 1968 to 1973, Mr. Fukunaga was a commissioned officer, command pilot and co-pilot in the United States Air Force. Mr. Fukunaga earned a Master of Public Administration degree and a Bachelor of Business Administration degree from the University of Hawaii.

Francis Paul Keeno, Deputy Director, Support Services, assumed his present position on June 6, 2006. Mr. Keeno, a licensed attorney, was appointed to the position of Deputy Attorney General in 1979 and has worked for the State Attorney General's Office for over 20 years. While there, he specialized in the area of employment law. In January 2003, Mr. Keeno was appointed Special Assistant to the Director of Human Resources Development. The State Department of Human Resources Development is the personnel department for the Executive Branch. From there, Mr. Keeno was appointed to his present position in the Department.

Brennon T. Morioka, Deputy Director, Highways Division, assumed his position in January 2005. He was formerly a senior geotechnical engineer and project manager for URS Corporation where he specialized in landfills and waste technologies, earthquake engineering, and trenchless technologies such as microtunneling and directional drilling. Dr. Morioka also previously worked as a civil engineer for M&E Pacific and Harding Lawson & Associates in Hawaii and San Francisco. Dr. Morioka received his Bachelor and Master of Science degrees in Civil Engineering from the University of California at Berkeley and completed his doctoral studies at the University of Hawaii. He was a previous recipient of the State of Hawaii Young Engineer Award and represented the United States as one of five delegates to the First International Young Geotechnical Engineering Conference in Southampton, Great Britain, in 2000 for his research work at the University of Hawaii.

Brian H. Sekiguchi, Deputy Director, Airports Division, assumed his present position in November 2003. Mr. Sekiguchi has an extensive background in construction and engineering, including a combined 26 years of work experience with the Department of the Navy, the Department of the Air Force and private industry. Mr. Sekiguchi most recently served as a division director of the Resident Officer in Charge of Construction for the Naval Facilities Engineering Command at Pearl Harbor, which oversees a \$320 million program annually for design, construction and maintenance of facilities throughout Hawaii. He earned a Master of Business Administration degree from Chaminade University, a Master's degree in Engineering Management from the Air Force Institute of Technology in Dayton, Ohio, and a Bachelor's degree in Civil Engineering from the University of California at Berkeley.

Glenn M. Okimoto, Administrator, Harbors Division, assumed his present position in August 2002. Prior to that time, Mr. Okimoto held various positions in State government as an economist and a program evaluation manager for the Department. He also served as Deputy Director of the Department from January 1994 to November 2001, and as State Comptroller from December 2001 to July 2002. Mr. Okimoto received his Doctorate in Agricultural and Resource Economics from the University of Hawaii in 1981.

Jean L. Oshita, Administrative Services Officer, Harbors Division, assumed her position in December, 2004. She oversees the Harbors Division's financial management, personnel and property management programs and provides budget, information systems and management analysis support services. Prior to assuming this position, Ms. Oshita was the Administrative Services Officer for the Airports Division from 1991 to 2004. She graduated from the University of Hawaii in 1974 with a B.Ed degree in Elementary Education.

Frederick S. Nunes, Engineering Program Manager, Harbors Division, has held this position since 1998. Prior to that date, Mr. Nunes worked in various engineering positions with the Department. Mr. Nunes received a Bachelor of Science degree in engineering from the University of Hawaii in 1971 and obtained his Hawaii professional engineer's license in 1975.

Employees

The Harbors Division has a workforce of approximately 250 employees. State law grants public employees, except those excluded from any appropriate bargaining unit, the right to organize for the purpose of collective bargaining. Each recognized bargaining unit designates an employee organization as the exclusive representative of all employees of such unit, which organization negotiates with the public employer. Under State law, if an impasse in any negotiation is declared, only the United Public Workers (UPW) blue collar workers have the right to strike.

The Harbors Division has employees in five different bargaining units, each of which is operating under contracts that are scheduled to expire on June 30, 2007. Blue collar non-supervisory employees (Unit 1) are represented by the UPW, Local 646. Blue collar supervisors (Unit 2), white collar supervisors (Unit 4), white collar workers (Unit 3) and professional employees (Unit 13) are represented by the Hawaii Government Employees' Association, Local 152. There are also managers and employees excluded from collective bargaining.

THE HARBOR SYSTEM

General

The Harbor System is comprised of ten harbors which are operated and maintained by the Department as a single integrated system for financial and management purposes. The harbors are: (1) Honolulu Harbor, Kalaeloa Barbers Point Harbor and Kewalo Basin on the Island of Oahu, comprising the Oahu District; (2) Hilo Harbor and Kawaihae Harbor on the Island of Hawaii, comprising the Hawaii District; (3) Nawiliwili Harbor and Port Allen Harbor on the Island of Kauai, comprising the Kauai District; (4) Kahului Harbor on the Island of Maui, Kaunakakai Harbor on the Island of Molokai, and Kaunapali Harbor on the Island of Lanai, comprising the Maui District. The locations of the harbors comprising the Harbor System are shown on the map of Principal Commercial Harbors of Hawaii on the page before the table of contents of this Official Statement.

Table 3 shows the percentage breakdown of operating revenues by district for the fiscal year ended June 30, 2005.

TABLE 3
BREAKDOWN OF OPERATING REVENUES BY DISTRICT
Fiscal Year Ended June 30, 2005

<u>District</u>	<u>Percentage</u>
Oahu (Honolulu, Kewalo Basin and Kalaeloa Barbers Point)	73%
Hawaii (Hilo and Kawaihae)	11
Maui (Kahului, Kaunakakai and Kaunapali)	10
Kauai (Nawiliwili and Port Allen)	<u>6</u>
TOTAL	100%

Source: State of Hawaii Harbors Division.

There are a number of State-owned, shallow-draft, small boat harbors and boat launching ramps throughout the State which are utilized primarily for recreational purposes. These harbors, which are under the administrative jurisdiction of the State Department of Land and Natural Resources, are not part of the Harbor System. These harbors do not involve the commercial harbor operations and were not financed with Bonds.

Summary of Harbor System Operations

General. The Department operates the Harbor System as a landlord port. The Department leases land and building space through revocable permits or leases to shipping companies, terminal operators and other maritime or related entities. The Department maintains all piers, wharves, cargo sheds, container yards and other back-up facilities as common areas, which are used by the shipping companies and terminal operators on a nonexclusive basis for their operations. The shipping companies and terminal operators are responsible for the maintenance of the leased premises and cargo handling equipment.

The Department estimates that approximately 19% of the land (excluding submerged land and easements) and improvements comprising the Harbor System on Oahu (Honolulu, Kewalo Basin and Kalaeloa Barbers Point) is leased or held for lease under revocable permits or leases. Revocable permits generally are granted where the use of the leased property is subject to change. Revocable permits have terms of up to a year and can be terminated upon one month's notice. Leases generally are of a long-term period where the tenant intends to make improvements to the premises. Leases have terms of five years or more. All leases and non-maritime related revocable permits must be approved by the State Board of Land and Natural Resources.

The Department derives Revenues from the rentals under revocable permits and leases. With respect to the land and improvements comprising the Harbor System that is not under a lease or revocable permit, the Department derives Revenues only from tariffs assessed on shipping and charges for other services. See "SOURCES OF REVENUES."

The terminal operators that use the ports comprising the Harbor System hire longshoremen and other employees to provide stevedoring, cargo handling and other services in connection with the operation of the leased property and the use of the common areas. In 2002, labor contracts between the terminal operators and the International Longshoremen's and Warehousemen's Union expired. A new six year agreement was ratified in January 2003.

The Harbors Division and the U.S. Army Corps of Engineers (the "Corps") monitor the depths of the harbors comprising the Harbor System on a periodic basis to ensure timely dredging. The Corps maintains the design depths of the entrance channels and turning basins and dredges at intervals of six to 11 years. The Harbors Division maintains the design depths of the berths and dredges at intervals of ten to 20 years. Kahului Harbor, Nawiliwili Harbor, Port Allen Harbor, Kalaheo Barbers Point Harbor and parts of Honolulu Harbor were dredged by the Corps in 1999.

Each harbor has facilities for the loading, unloading, handling and storage of bulk and other cargo, and some harbors provide passenger facilities. The major types of bulk cargo shipped through the Harbor System include cement, oil and petroleum products, sugar, molasses, grain, coal and other solid products. Nearly all non-bulk cargo is shipped through the Harbor System in containers.

There are approximately thirty principal shipping lines providing service to Hawaii. Table 4 lists the ten largest contributors of wharfage revenues to the Department. Matson Navigation Company, Inc. ("Matson"), Horizon Lines, LLC ("Horizon"), and Young Brothers, Ltd. ("Young Brothers") are the major cargo operators serving the Harbor System, accounting for almost 77% of the wharfage revenues of the system.

Matson operates seven large container ships between Honolulu Harbor and the west coast of the United States with ships arriving at Honolulu Harbor three to four times a week. Matson Terminals, Inc. ("Matson Terminals"), a wholly owned subsidiary of Matson, provides container stevedoring, container equipment maintenance and other terminal services for Matson and other ocean carriers. Matson Terminals continues to maintain seven gantry cranes on Sand Island at Piers 51-53 of Honolulu Harbor and maintains facilities for transshipment services at several of the other harbors. Matson implemented a new dedicated automobile and roll-on/roll-off service every 14 days between Oakland, California and Honolulu (Piers 24-29) and Kahului, Hawaii using a chartered ship. In addition, with the commencement of its new China trade in February 2006, Matson now schedules one vessel call per week in Honolulu, ultimately bound for Guam and Shanghai.

Horizon operates seven container ships between Honolulu Harbor and the west coast of the United States with ships arriving at Honolulu Harbor twice a week, one that proceeds on to the Far East. Horizon has three gantry cranes and a back-up area on Sand Island and maintains offices at several of the other harbors. Horizon will be changing its yard operations to include the use of rubber tired gantry equipment for stacking and storing containers. This switch in mode of operations will occur after the State's project to reconstruct portions of the Horizon yard in 2006-2007.

Young Brothers operates inter-island vessels at Piers 39 and 40 of Honolulu Harbor and at all other harbors with the exception of Kewalo Basin.

Table 4 shows the top 10 shipping agencies for the fiscal year ended June 30, 2005.

TABLE 4
TOP TEN SHIPPING AGENCIES
Fiscal Year Ending June 30, 2005

<u>SHIPPING AGENT</u>	<u>WHARFAGE REVENUES (x000's)</u>	<u>AS A PERCENTAGE OF TOTAL WHARFAGE REVENUES</u>
1 Matson Navigation Company, Inc.	\$19,460	43.0%
2 Young Brothers, Ltd.	8,291	18.3%
3 Horizon Lines, LLC	7,126	15.7%
4 NCL America	2,230	4.9%
5 Waldron Steamship Company	1,762	3.9%
6 Inchcape Shipping Services	1,505	3.3%
7 Transmarine Navigation Corporation	1,255	2.8%
8 Tesoro Hawaii Corporation	759	1.7%
9 Aloha Cargo Agency Services, Inc.	576	1.3%
10 Hawaiian Cement	<u>455</u>	<u>1.0%</u>
	<u>\$43,419</u>	<u>95.9%</u>

Above figures reflect Wharfage Revenues on accrual basis.

Wharfage Revenues include Wharfage, Passenger Fees, Pipeline and Bunkering.

Table 5 presents historical data for cargo traffic in the Harbor System (by type of cargo) for the fiscal years ended June 30, 2001 through June 30, 2005. Because different wharfage rates are imposed for different types of cargo, trends in certain types of cargo traffic may have more significant impacts on total revenues than trends in other types of cargo.

TABLE 5
ANNUAL TRENDS IN CARGO TRAFFIC FOR HAWAII HARBORS

Fiscal Year Ended June 30	CARGO VOLUME – UNITS (x000's)					REVENUES – DOLLARS (x000's)				
			Restated					Restated		
	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
WHARFAGE:										
Containers ¹	1,044	1,198	1,471	1,356	1,425	\$22,757	\$26,386	\$31,430	\$29,108	\$30,708
Autos and Trucks	840	116	155	190	220	5,387	1,384	1,837	2,519	3,066
General Merchandise and Bulk Items ²	2,904	4,058	4,894	4,650	5,309	3,623	4,497	5,419	5,208	5,605
Pipelines ³	29,977	30,263	31,924	31,550	33,060	1,903	1,731	1,873	1,794	1,923
Other ⁴	715	94	145	164	178	906	136	260	309	316
Passengers	661	1,088	1,672	1,323	1,532	1,510	2,657	4,181	3,308	3,625

¹ Containers are expressed in twenty-foot equivalent units (TEU's) and include empty containers, loaded containers and autos and trucks in containers.

² Items are expressed in tons and include cement, molasses, sugar, explosives, lumber, scrap metal, vehicles, trucks and trailers.

³ Petroleum and chemical products are expressed in barrels. Cement and molasses are measured in tons, and therefore are reported as "General merchandise and Bulk Items." Pipeline water is excluded from above data.

⁴ Individual units are used for livestock and crates. Lumber is measured by foot.

Note a: The above information is presented for illustrative purposes only.

Note b: Certain group classifications were changed in the fiscal year ending June 30, 2002. Specifically, explosives, lumber, scrap metal and sugar measured in tons were moved from "Other" to "General Merchandise and Bulk Items;" containerized autos and trucks were moved from "Autos and Trucks" to "Containers;" and vehicles, trucks and trailers measured in tons were moved from "Autos and Trucks" to "General Merchandise and Bulk Items."

Note c: The above data is reported on a cash basis for fiscal years 2001 and 2002 and does not reflect accrued cargo and related revenues for these years. The method of reporting changed from cash basis reporting to accrual basis reporting in fiscal year 2004. As a result, the fiscal year ending June 30, 2003 has been restated to reflect this change and includes accrued cargo and related revenues for the fiscal year ending June 30, 2002.

Source: State of Hawaii Harbors Division.

Table 6 presents historical data for cargo traffic (in tonnage) for the different Hawaii harbors for the fiscal years ended June 30, 2001 through June 30, 2005. Because charges imposed by the Harbors Division are based primarily on units as opposed to tonnage, historical trends in tonnage do not necessarily correlate with trends in total revenues.

TABLE 6
ANNUAL TRENDS IN CARGO VOLUME FOR HAWAII HARBORS
SHORT TONS (x000's)
Fiscal Year 2001 – Fiscal Year 2005

Fiscal Year Ended <u>June 30</u>	Oahu		Maui	Hawaii		Kauai		Molokai	<u>Total</u>
	<u>Honolulu</u>	<u>Kalaeloa Barbers Point</u>	<u>Kahului</u>	<u>Hilo</u>	<u>Kawaihae</u>	<u>Nawiliwili</u>	<u>Port Allen</u>	<u>Kaunakakai</u>	
	2001	8,292	3,229	2,580	1,425	649	685	192	
2002	8,236	3,268	2,475	1,385	626	624	209	85	16,908
2003 (restated)	9,262	3,565	2,938	1,665	805	799	218	113	19,365
2004	9,032	3,495	2,758	1,505	829	794	205	98	18,716
2005	9,593	3,889	3,038	1,545	1,011	807	196	103	20,182

Note a: The above information is presented for illustrative purposes only. The table presents selected cargo data.

Note b: For fiscal year 2002 and prior years, the above data is reported on a cash basis, and therefore does not reflect accrued cargo for such years. A change in the method of reporting occurred in fiscal year 2004 from cash basis to accrual basis. As a result, the fiscal year ending June 30, 2003 has been restated to reflect this transition to accrual basis reporting and also includes fiscal year ending June 30, 2002 accrued cargo.

Source: State of Hawaii Harbors Division.

Table 7 presents historical data for cargo traffic in the Harbor System (by destination) for the fiscal years ended June 30, 2001 through June 30, 2005.

**TABLE 7
CARGO STATISTICS BY DESTINATION
INBOUND/OUTBOUND CARGO TRENDS
SHORT TONS (x000's)
Fiscal Year 2001 – Fiscal Year 2005**

	<u>2001</u>		<u>2002</u>		<u>2003*</u>		<u>2004</u>		<u>2005</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
INBOUND										
Domestic	4,360	38.1	4,418	41.3	4,984	30.7	5,004	41.3	5,188	38.8
Foreign	2,479	21.7	1,714	16.0	2,880	17.7	2,089	17.2	2,646	19.8
Inter-island	4,599	40.2	<u>4,568</u>	42.7	<u>8,373</u>	51.6	<u>5,026</u>	41.5	<u>5,545</u>	41.4
Total Inbound	11,438		10,700		16,237		12,119		13,379	
OUTBOUND										
Domestic	1,168	20.5	1,538	24.8			1,122	17.0	1,155	17.0
Foreign	652	11.4	554	8.9			491	7.4	637	9.4
Inter-island	<u>3,888</u>	68.1	<u>4,115</u>	66.3			<u>4,979</u>	75.6	5,011	73.6
Total Outbound	5,708		6,207		N/A		6,592		6,803	

* Inbound/outbound details are unavailable for fiscal year ended June 30, 2003 due to limitations of newly implemented computer system. Short tons for inbound and outbound shipments are combined and reflected as inbound short tons.

Note a: Change in group classification in fiscal year ended June 30, 2004. Moved all bunkering to outbound inter-island.

Source: State of Hawaii Harbors Division.

Table 8 shows the number of overseas and inter-island ship calls recorded in the Harbor System for fiscal years ended June 30, 2001 through June 30, 2005. These figures include arrivals by container, bulk and other cargo ships, passenger ships and tugs and barges, but exclude calls to privately operated facilities.

**TABLE 8
ANNUAL TRENDS IN SHIP CALLS**

<u>FISCAL YEAR ENDED JUNE 30</u>	<u>COUNT</u>
2001	8,395
2002	9,063
2003	9,134
2004	8,993
2005	9,714

Source: State of Hawaii Harbors Division.

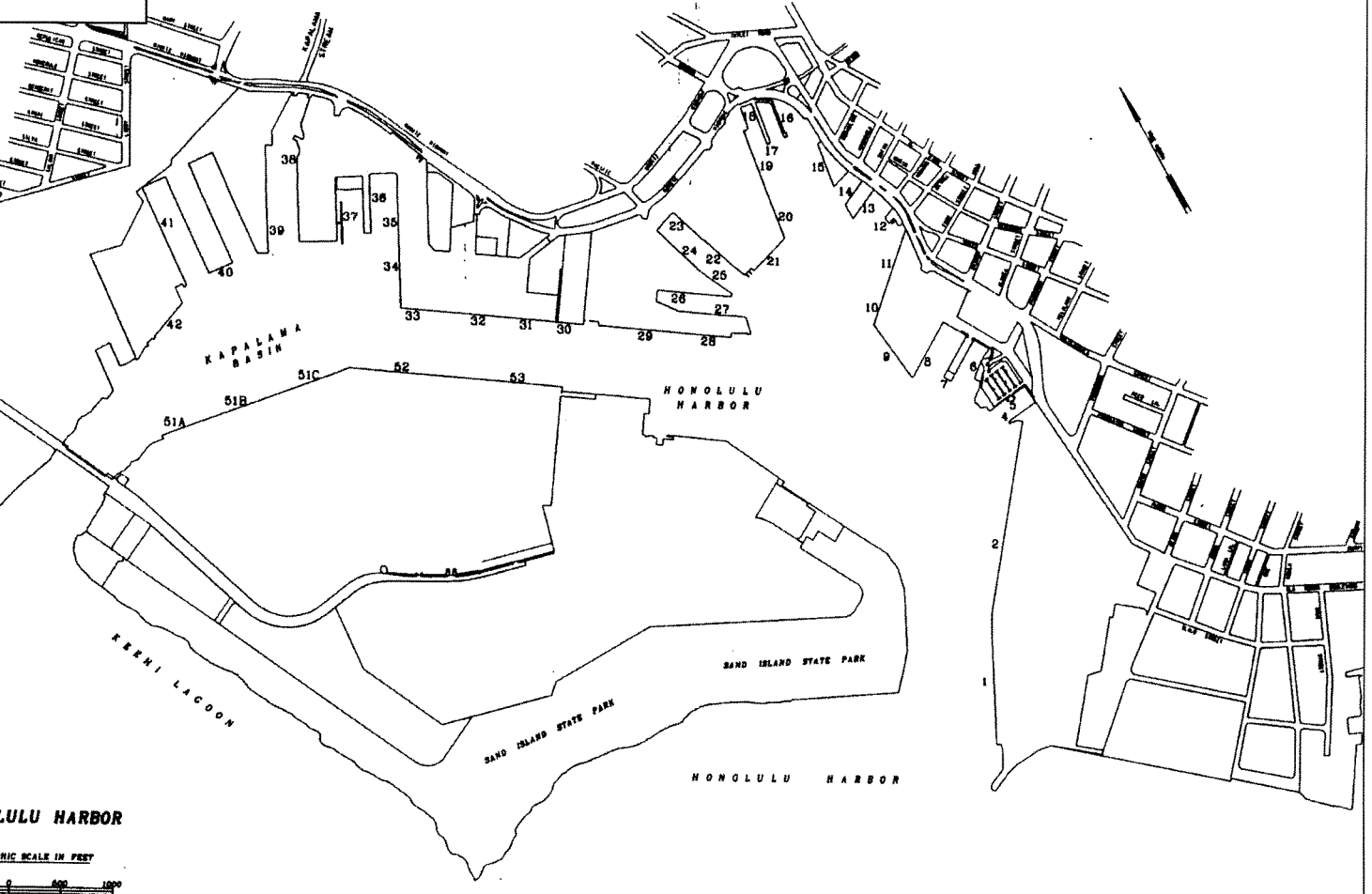
The facilities and operations of each commercial harbor comprising the Harbor System are described in greater detail below.

Honolulu Harbor. Honolulu Harbor, the principal harbor in the Harbor System, has over 30 berths, over 5 linear miles of cargo handling pier and over 230 acres of cargo handling area, a significant portion of which is yard area. Honolulu Harbor is located on the southern (leeward) coast of Oahu in Hawaii's capital city. The harbor is entered and exited through the Fort Armstrong Channel, which has a depth of 45 feet. The main harbor basin is dredged to a depth of 40 feet. Piers 1 through 42 have direct access to Nimitz Highway/Ala Moana Boulevard, the principal roadway bordering the harbor. Piers 51 through 53 on Sand Island comprise the State's principal container ship handling area. The area is connected to Nimitz Highway by a four-lane roadway, including two bridges over

the Kalihi Channel. Piers 1 and 2 at Fort Armstrong and the inter-island terminal at Piers 39 and 40 comprise the other major container handling facilities in Honolulu Harbor.

The State owns most of the land and waterfront facilities comprising Honolulu Harbor. Some facilities are owned by the U.S. government, however, including the U.S. Coast Guard Stations at Pier 4 and Sand Island. A few facilities are privately-owned, including Chevron Corporation's petroleum shipping, transfer and storage facilities and support equipment at Pier 30. A detailed map of Honolulu Harbor is provided on the following page. Table 9 indicates the principal characteristics of the cargo, shipping and other facilities of piers in Honolulu Harbor, as of May 2006.

HARBOR



HARBOR

GRAPHIC SCALE IN FEET
0 500 1000

PACIFIC OCEAN

TABLE 9
PRINCIPAL CHARACTERISTICS OF AVAILABLE PIERS
HONOLULU HARBOR

<u>PIER</u>	<u>BERTH LENGTH</u> <u>(feet)</u>	<u>YARD AREA</u> <u>(acres)</u>	<u>SHED AREA</u> <u>(sq. ft)</u>	<u>PRINCIPAL CARGO OR PIER USE</u> ¹
1	1,175	20.1	111,337	Foreign Containers
2	1,850	4.9	169,355	Cruise Ship Terminal, Foreign Trade Zone No. 9 and Neo-Bulk Cargo
4	---	---	---	Owned and Used by U.S. Coast Guard
5	200	---	---	Small Passenger Vessels
6	163	---	---	Small Passenger Vessels and Vehicle Parking
7	710	---	---	Falls of Clyde and Hawaii Maritime Center
8	602	---	---	Small Passenger Vessels and Retail Space
9	629	---	---	Lay Berths and Retail Space
10	502	---	---	Cruise Ship Terminal and Vehicle Parking
11	472	---	---	Cruise Ship Terminal and Harbors Division Administrative Office
12	---	---	---	Vehicle Parking
13	345	---	13,824	Tugboats, Office Space and Vehicle Parking
14 and 14 End	430	---	13,825	Tugboats, Office Space and Vehicle Parking
15	250	0.4	5,498	Harbor Fireboat
16	930	---	---	Commercial Fishing Boats
17	971	---	---	Commercial Fishing Boats
18	214	---	---	Pilot Boats, Loading Dock, Ferry Terminal
19	530	0.3	87,845	Tugboats, Barges, Cruise Ships, Ferry Terminal, General Cargo and Storage Shed
20	480	3.0	---	Ferry Vehicle Staging Area
21	494	0.4	---	Tugboats, Barges and General Cargo
22	446	0.8	---	Tugboats, Barges and Office Space
23	500	2.9	---	Grain Ship, Tugboats, Barges and Grain Storage and Processing Facility
24	558	3.4	---	RO/RO ² Cargo, Tugboats and Barges
25	365	0.5	---	RO/RO Cargo, Tugboats and Barges
26	685	3.9	---	RO/RO Cargo, Tugboats and Barges
27 and 27 End	875	2.4	---	Maintenance, Tugboats and Barges
28	722	0.9	---	Maintenance, Tugboats and Barges
29	801	7.8	---	RO/RO Cargo, Tugboats and Barges
30	270	---	---	Privately Owned Petroleum Facility
31	775	0.2	74,130	Tugboats, Barges and Storage
32	400	3.3	99,400	RO/RO and General Cargos, Bunker Fuel ³ and Pipelines
33	325	4.1	67,228	RO/RO and General Cargos, Bunker Fuel and Pipelines
34	545	2.0	---	RO/RO and General Cargos
35	705	1.9	---	Oil Spill Response Vessel and General Cargo
36	946	---	32,400	Commercial Fishing Boats
37	408	---	---	Commercial Fishing Boats
38 End	587	---	---	Commercial Fishing Boats and Fish Auction
38	---	---	---	Liquid-Bulk Cargo
39 and 39 End	2,722	16.1	98,239	Barges and Tugboats, Break-Bulk and Container Cargos and RO/RO
40 and 40 End	2,430	10.8	67,500	Barges and Tugboats, Break-Bulk and Container Cargos and RO/RO
41	900	---	---	Dry-Docks and Ship Repair Facility
42	510	---	---	Container Freight Station
44 and 45	670	---	---	Used by the Oceanographic Research Facility and Research Vessels
51A	680	26.3	---	Domestic Containers, Autos and Petroleum
51B	556	31.1	---	Domestic Containers
51C	677	11.9	---	Domestic Containers
52	800	31.5	50,300	Domestic Containers
53	1,160	37.4	51,481	Domestic Containers

¹ All cargo handling equipment for loading and moving cargo to, from and around the piers and ships is owned by the shipping and stevedoring companies.

² RO/RO = roll on/roll off.

³ "Bunker" is related to the fueling operation for ships.

Source: State of Hawaii Harbors Division.

Kewalo Basin. Kewalo Basin is located approximately one mile east of the Fort Armstrong Channel in Honolulu and is adjacent to Ala Moana Boulevard. Kewalo Basin's facilities are used primarily for the mooring of sightseeing, commercial, charter fishing, commercial fishing and small cruising vessels. One hundred sixty-eight commercial fishing boats, 34 charter boats and 24 cruise vessels currently use Kewalo Basin's facilities. The land underlying Kewalo Basin has been transferred to the HCDA, but the Department operates the harbor facilities located there and expects to continue to do so until June 2007. While the development of lands adjacent to Kewalo Basin has been proposed, the Department cannot predict the likelihood of HCDA proceeding in its plans to develop this area. See "SOURCES OF REVENUES - Other Matters Potentially Affecting Revenues; Makai Kakaako Development."

Kalaeloa Barbers Point Harbor. Kalaeloa Barbers Point Harbor is located at Kalaeloa, which is approximately 20 miles west of downtown Honolulu, adjacent to the privately-owned Campbell Industrial Park. The harbor was constructed to provide port facilities for Kapolei, the industrial and commercial development on the Ewa Plain west of Honolulu, which is presently being developed as Oahu's "New City."

The harbor's entrance channel is 42 feet deep, and the basin is 38 feet deep. The harbor facilities include a 2,700 foot concrete pier with a 37.8-acre paved back-up area, a 255-foot barge pier with a 4.4-acre back-up yard, a 36,000 square-foot transit shed, and a 150-foot service vessel pier. The harbor's primary operations include the transshipment of petroleum products, bulk cargo handling and ship repair. A bulk unloader, coal conveyor and cement storage facility, each of which is privately owned, are in operation. Construction of an additional 800-foot extension to Pier 7 was recently completed. See "THE HARBOR SYSTEM - Capital Improvements Program."

Ninety percent of the cargo that is shipped through the Kalaeloa area flows through the privately operated off-shore mooring and fuel shipment facilities near the Kalaeloa Barbers Point Harbor. This cargo consists primarily of crude oil products shipped into refineries and refined fuel being shipped to neighbor island ports and out of the State. The Department does not receive any tariffs in connection with cargo that is shipped through the privately-operated off-shore mooring and fuel shipment facilities.

Hilo Harbor. Hilo Harbor is located on the northeast coast of the Island of Hawaii, the largest island in the State, at the commercial center of the Island. Hilo Harbor's basin measures approximately 2,300 feet by 1,400 feet and is 35 feet deep. Hilo Harbor has three piers, which primarily handle container and general cargo, petroleum products, lumber, cement, livestock and liquefied petroleum gas. Pier 1 has 1,265 feet of berthing space, 81,635 square feet of shed space, and a back-up area for container storage. Matson loads and unloads containers from its inter-island barges at Pier 1. Pier 1 also accommodates cruise ships. Young Brothers uses Pier 2 for inter-island barge operations. Pier 3 is used for transshipment of petroleum products, general cargo and occasionally for small passenger ships. Design is underway to improve the inter-island barge terminal as well as construction to extend Pier 3 to accommodate large cruise ships.

Kawaihae Harbor. Kawaihae Harbor is located on the northwest coast of the Island of Hawaii. Kawaihae Harbor's basin measures approximately 1,450 feet by 1,500 feet. The depth of the harbor is 35 feet, with the exception of the barge berth which has a depth of 20 to 24 feet. The Harbor's facilities include a 412-foot barge pier with 8,300 square feet of cargo sheds and a 1,150-foot pier with 13,326 square feet of cargo shed space. The types of cargo that are primarily handled at Kawaihae Harbor are container and general cargo, bulk cement, lumber, steel, produce, petroleum products, bulk fertilizer, livestock, grain and lava cinders. Privately-owned petroleum products pipelines are available. Both Matson and Young Brothers provide regularly scheduled tug and barge service.

Nawiliwili Harbor. Nawiliwili Harbor is located near Lihue on the southeast coast of the Island of Kauai. The harbor has three piers. Matson uses Pier 1 for inter-island barge cargo traffic and uses the nine-acre container yard. Pier 2 is used for berthing cruise ships and for handling petroleum products, sugar and molasses. Pier 2 has a total of 39,950 square feet of cargo shed space available. Nawiliwili Harbor's support facilities include ten pipelines for molasses, liquid fertilizer, petroleum products and cement and a bulk sugar loading tower with conveyor belts. Young Brothers uses the facility at Pier 3, which includes a 625-foot pier, a 150-foot roll-on roll-off ("Ro-Ro") pier and a 16.6-acre container yard with covered cargo shed. Pier 3 is also used to berth smaller cruise ships. The facilities were designed both to accommodate existing demand and growth in such demand.

Port Allen Harbor. Port Allen Harbor is located on the south coast of Kauai. Port Allen Harbor's basin measures 1,200 feet by 1,500 feet and is 35 feet deep. This harbor has two piers, 1,200 feet of berthing space and a

cargo shed of 34,792 square feet. Petroleum products constitute the principal cargo handled at Port Allen Harbor, for which pipelines are available. The United States Navy is a principal tenant, using the facilities in connection with its Pacific Missile Testing Range Facility operations. The piers are also used by excursion vessels.

Kahului Harbor. Kahului Harbor is located along the northern shore of the Island of Maui, near the commercial center of the island. Kahului Harbor's basin measures approximately 2,050 feet by 2,400 feet and is 35 feet deep. Kahului Harbor has three piers and a total berthing space of 3,052 linear feet. Pier 1 has 43,925 square feet of cargo shed space and is served by a bulk sugar loading gantry with conveyor belts. Pier 1 is used for containerized cargo, petroleum products, bulk shipment of raw sugar, molasses and liquid fertilizer and by cruise ships. Pier 2, which has two cargo sheds totaling 38,100 square feet and 12.2 acres of open storage area, is used by Young Brothers for inter-island barge cargo traffic. Pier 3 is a Ro-Ro facility for inter-island cargo and also provides berths for commercial fishing vessels, sand barges and fuel barges. Kahului Harbor has seven pipelines, including privately-owned cement and petroleum product pipelines.

Kaunakakai Harbor. Kaunakakai Harbor is located on the south central coast of the Island of Molokai, near the population center of the island. Kaunakakai Harbor's basin has a depth of 23 feet. Kaunakakai Harbor has one 689-foot barge pier, 7,900 square feet of cargo shed space and 2.9 acres for open cargo storage. Kaunakakai Harbor has a privately-operated fuel transfer pipeline.

Kaunapali Harbor. Kaunapali Harbor is the only commercial harbor on the Island of Lanai. The Department of Transportation recently acquired the harbor from Lanai Company Inc., a subsidiary of Castle & Cooke, Inc. By acquiring this area, the State is able to cost-share federal improvements by the Corps of Engineers for the reconstruction of an existing breakwater which was damaged by Hurricanes Iwa and Iniki. Construction is anticipated to be completed in 2007.

Capital Improvements Program

The current Capital Improvements Program for the Harbor Division covers the six-year period from fiscal year 2006 through fiscal year 2011. The State Legislature must authorize capital improvement projects and funding as part of a biennium capital budget submitted for their review in every odd numbered year. In every even numbered year, the State Legislature considers additional requests for the second year of the biennium period as part of the supplemental budget appropriation process.

The Legislature can appropriate funds for Harbor System capital improvement projects from three sources: bonds, federal funds and the Harbor Revenue Fund. The appropriation of bond funds for a capital improvement project serves as the legislative authorization to issue bonds when required in the future. If bond funds are appropriated for a particular capital improvements project, the Department may, with the approval of the Governor, use funds in the Harbor Revenue Fund rather than bond funds to finance that project. Appropriations made for a fiscal biennium that is not encumbered lapses three years from the first year of that biennium period. However, appropriations that involve federal matching funds are not subject to lapsing.

Capital improvement projects included in the Capital Improvements Program for fiscal years 2006 through 2011 total \$366 million, of which \$190 million is programmed to be financed with revenue bonds. Of this amount, the Legislature has authorized the issuance of \$65 million for the 2006-2007 fiscal biennium.

Summary of Financial Information

General. The Harbors Division maintains its accounting records on a modified cash basis of accounting whereby revenues are recognized when billed and expenses are recognized when paid. In order to prepare its annual financial statements on an accrual basis of accounting, adjustments are made to convert the accounting records from a modified cash basis to an accrual basis. The annual financial statements of the Harbors Division, including those presented in Appendix A, are audited by independent auditors retained by the office of the auditor. The most recent fiscal year for which audited financial statements are available is the fiscal year ended June 30, 2005.

Historical Operations. Table 10 sets forth the sources of operating revenues and operating expenses of the Harbor System for fiscal years 2001 through 2005.

TABLE 10
STATEMENT OF HISTORICAL OPERATIONS
Fiscal Years Ended June 30, 2001 through 2005
(x000's)

	Fiscal Year Ended June 30				
	<u>2001</u>	<u>2002</u>	Restated <u>2003</u>	<u>2004</u>	<u>2005</u>
OPERATING REVENUES					
Services					
Wharfage	\$34,038	\$35,168	\$35,492	\$36,925	\$39,885
Passenger debark/embark	0	0	4,181	3,308	3,625
Dockage	4,131	4,233	4,490	4,641	4,972
Port Entry	1,026	998	955	1,102	1,388
Demurrage	1,781	1,525	1,029	998	1,103
Mooring charges	1,061	1,022	1,269	1,273	1,417
Cleaning wharves	79	95	122	138	152
Others	<u>16</u>	<u>8</u>	<u>38</u>	<u>273</u>	<u>381</u>
Total services	<u>\$42,132</u>	<u>\$43,049</u>	<u>\$47,576</u>	<u>\$48,658</u>	<u>\$52,923</u>
Rentals					
Wharf space and land	\$17,362	\$16,324	\$18,985	\$18,197	\$13,778
Storage	2,606	2,490	2,684	3,668	2,912
Pipelines	2,107	2,087	2,257	2,144	2,461
Auto parking	<u>1,205</u>	<u>1,094</u>	<u>1,197</u>	<u>1,117</u>	<u>1,105</u>
Total rentals	<u>\$23,280</u>	<u>\$21,995</u>	<u>\$25,123</u>	<u>\$25,126</u>	<u>\$20,256</u>
Other Revenues					
Sale of utilities	\$622	\$553	\$537	\$676	\$943
Permits to vendors	584	389	0	0	0
Miscellaneous	<u>120</u>	<u>180</u>	<u>369</u>	<u>309</u>	<u>404</u>
Total other revenues	<u>\$1,326</u>	<u>\$1,122</u>	<u>\$906</u>	<u>\$985</u>	<u>\$1,347</u>
Total Operating Revenues	<u>\$66,738</u>	<u>\$66,166</u>	<u>\$73,605</u>	<u>\$74,769</u>	<u>\$74,526</u>
OPERATING EXPENSES					
BEFORE DEPRECIATION					
Personal services	\$8,111	\$9,453	\$10,630	\$10,757	\$11,541
Harbor operations, maintenance and general administration	16,350	8,922	22,312	13,614	21,941
State of Hawaii surcharge for central service expenses	2,388	2,342	1,906	2,766	2,699
Fireboat operations	1,086	1,605	1,308	1,705	1,597
Department of Transportation, administrative expense	<u>978</u>	<u>1,011</u>	<u>963</u>	<u>734</u>	<u>973</u>
Total Operating Expenses Before Depreciation	<u>\$28,913</u>	<u>\$23,333</u>	<u>\$37,119</u>	<u>\$29,576</u>	<u>\$38,751</u>
INCOME FROM OPERATIONS					
BEFORE DEPRECIATION	<u>\$37,825</u>	<u>\$42,833</u>	<u>\$36,486</u>	<u>\$45,193</u>	<u>\$35,775</u>

Note: Effective in the fiscal year ended June 30, 2002, operating revenues are reported net of allowances for doubtful accounts in the financial statements for the Harbors Division. Prior to this change, operating revenues were reported without adjustment for allowances for doubtful accounts, and such allowances were reported separately as operating expenses.

Historical and Projected Debt Service Coverage. Table 11 presents a summary of historical Revenues and debt service coverage on outstanding Bonds for the fiscal years ended June 30, 2001 through 2005, and the projected Revenues and debt service coverage on the Bonds, including the Series 2006 Bonds, for the fiscal years ending June 30, 2006 through 2008. The historical information for the fiscal years ended June 30, 2001 through 2004 also includes the debt service and debt service coverage figures for Harbor Revenue Bonds issued by the Department prior to the effective date of the Certificate (such prior bonds being herein referred to as the "1990 Certificate Harbor Revenue Bonds"), all of which were refunded in the fiscal year ended June 30, 2004 and are no longer

outstanding. The figures for historical operating revenues and operating expenses before depreciation are taken from the audited financial statements for each fiscal year. The adjustments and calculations performed to determine debt service coverage are in accordance with the provisions of the certificates providing for the issuance of such bonds.

TABLE 11
HISTORICAL AND PROJECTED DEBT SERVICE COVERAGE
Fiscal Years Ended June 30, 2001 through 2008
(x000's)

	Historical			Fiscal Year Ended June 30		
	2001	2002	Restated 2003	2004	2005	2006
OPERATING REVENUES						
Services	\$42,132	\$43,049	\$47,576	\$48,658	\$52,923	\$54,986
Rentals	23,280	21,995	25,123	25,126	20,256	23,135
Other revenues	<u>1,326</u>	<u>1,122</u>	<u>906</u>	<u>985</u>	<u>1,347</u>	<u>1,465</u>
Total Operating Revenues	<u>\$66,738</u>	<u>\$66,166</u>	<u>\$73,605</u>	<u>\$74,769</u>	<u>\$74,526</u>	<u>\$79,586</u>
OPERATING EXPENSES BEFORE DEPRECIATION	\$28,913	\$23,333	\$37,119	\$29,576	\$38,751	\$45,177
INCOME FROM OPERATIONS BEFORE DEPRECIATION	\$37,825	\$42,833	\$36,486	\$45,193	\$35,775	\$34,409
ADD¹:						
Interest income ²	\$8,615	\$4,707	\$3,966	\$3,665	\$4,791	\$5,189
State of Hawaii surcharge for central services ³	2,388	2,342	1,906	2,766	2,699	3,404
Cash available in 1997 Certificate Harbor Reserve and Contingency Account ⁴					<u>10,898</u>	<u>10,898</u>
REVENUES AVAILABLE FOR DEBT SERVICE	<u>\$48,828</u>	<u>\$49,882</u>	<u>\$42,358</u>	<u>\$51,624</u>	<u>\$54,163</u>	<u>\$53,900</u>
DEBT SERVICE COVERAGE OF 1990 CERTIFICATE HARBOR REVENUE BONDS						
Harbor Revenue Bond Debt Service	\$10,369	\$9,963	\$7,127			
Harbor Revenue Bond Debt Service Coverage ⁵	4.71	5.01	5.94			
AGGREGATE DEBT SERVICE COVERAGE OF 1990 AND 1997 CERTIFICATE HARBOR REVENUE BONDS						
Aggregate Debt Service	\$20,221	\$20,093	\$19,652	\$19,578	\$19,121	\$19,134
Aggregate Debt Service Coverage ⁶	2.41	2.48	2.16	2.64	2.83	2.82
REIMBURSABLE GENERAL OBLIGATION BOND DEBT SERVICE⁷	\$543	\$520	\$474	\$25	\$25	\$100

¹ In accordance with the definition of Revenues set forth in the Certificate.

² Excludes direct financing leases.

³ The State assesses a surcharge of 5% for central services expenses on all receipts of the Harbors Division, after deducting any amounts pledged, charged or encumbered for the during the fiscal year.

⁴ Special reserve account created pursuant to the Certificate. See "Application and Allocation of Revenues - 1997 Certificate Harbor Reserve and Contingency Account" in Appendix.

⁵ Revenues available for debt service divided by annual debt service on 1990 Certificate Harbor Revenue Bonds. The 1990 Certificate Harbor Revenue Bonds were refunded in the year and are no longer outstanding.

⁶ Revenues available for debt service divided by aggregate annual debt service on all Bonds and, for fiscal years ended June 30, 2001 through 2004 only, all 1990 Certificate Harbor Revenue Bonds.

⁷ The Department is required to reimburse the State general fund for debt service on these bonds (which includes bonds appropriated under Act 178 relating to the operations of Hawaii).

Note a: Historical figures for fiscal years 2001-2005 are presented on an accrual basis; projections for fiscal years 2006-2008 are presented on a cash basis.

Note b: Effective in the fiscal year ended June 30, 2002, operating revenues are reported net of allowances for doubtful accounts in the financial statements for the Harbors Division.

Management Discussion and Analysis

Revenues. Revenues include operating revenues and interest income. Revenues for fiscal years 2005, 2004, 2003 (restated), and 2002 were \$79.3 million, \$78.4 million, \$77.6 million and \$70.9 million, respectively. Operating revenues (excluding interest income) decreased by 0.4% from \$74.8 million in fiscal year 2004 to \$74.5 million in fiscal year 2005.

Expenses. Operating expenses excluding depreciation increased by 31.1% from \$29.6 million in fiscal year 2004 to \$38.8 million in fiscal year 2005. This increase was due primarily to an approximately \$7.1 million increase in maintenance expenses resulting from a greater number of special maintenance and repair projects undertaken in the fiscal year. Operating expenses increased by \$1.5 million from 2004 to 2005 primarily due to approximately \$831,000 in additional security expenses, increases in utility costs and other expenses. Personnel services expenses increased by approximately \$786,000 primarily due to collective bargaining pay increases and increases in accrued vacation.

A summary of operations and changes in net assets for the fiscal years ended June 30, 2005 and 2004 follows:

TABLE 12
CONDENSED STATEMENTS OF REVENUES,
EXPENSES AND CHANGES IN NET ASSETS
(x000's)

	<u>2005</u>	<u>2004</u>	<u>Dollar</u> <u>Change</u>	<u>Percent</u> <u>Change</u>
Operating revenues	\$74,527	\$74,768	\$ (241)	0 %
Nonoperating revenues	<u>4,791</u>	<u>3,900</u>	<u>891</u>	23
Total Revenues	<u>\$79,318</u>	<u>\$78,668</u>	<u>\$ 650</u>	1
Depreciation	15,998	13,766	2,232	16
Other operating expenses	38,752	29,575	9,177	31
Nonoperating expenses	<u>9,989</u>	<u>11,102</u>	<u>(1,113)</u>	(10)
Total Expenses	<u>\$64,739</u>	<u>\$54,443</u>	<u>\$ 10,296</u>	19
Income before capital contributions	14,579	24,225	(9,646)	(40)
Capital contributions	<u>385</u>	<u>737</u>	<u>(352)</u>	(48)
Increase in net assets	\$14,964	\$24,962	\$(9,998)	(40) %

Forecast for Fiscal Year 2006. Revenues including operating revenues and interest income for fiscal year 2006 are forecast to be \$84.7 million. Revenues for fiscal year 2005 were \$79.3 million. Revenues are forecast to increase by \$5.4 million or 6.8% in 2006 from 2005 due to projected increases in various revenues and interest income.

Operating expenses for fiscal year 2006 are forecast on a cash basis to be \$45.1 million. Expenses for fiscal year 2005 on an accrual basis were \$38.8 million. Expenses are forecast to increase by \$6.3 million or 16% in 2006 from 2005 due to projected increases in security costs, special maintenance, personnel, ceded lands and other operational expenditures.

Employee Benefits. All full-time employees of the Department are required to participate in the employees retirement system of the State and are entitled to health care and life insurance benefits afforded to all State employees on a non-discriminatory basis. Department employees hired after June 30, 1984 participate in a non-

contributory retirement plan. Employees hired before that date were given the option of remaining in a contributory retirement plan or joining the non-contributory plan. Act 179, Session Laws of Hawaii 2004, established a new defined benefit contributory plan with a hybrid feature. This hybrid plan takes effect on July 1, 2006 and all employees hired after that date will participate in the new plan. Employees hired prior to July 1, 2006 could elect to transfer to the new plan if the election were made by March 31, 2006. Employee benefits for employees of the Harbors Division are an operating expense of the Harbors Division. The actuarially determined employer contribution requirements were met as of June 30, 2005.

INDEBTEDNESS

Bonds Issued Under the Certificate

As of March 31, 2006, \$180,865,000 in aggregate principal amount of Bonds are outstanding under the Certificate. Such outstanding Bonds, together with the Series 2006 Bonds to be issued, will be equally and ratably payable from Net Revenues as provided in the Certificate. See Appendix C – “SUMMARY OF CERTAIN PROVISIONS OF THE CERTIFICATE.” The Department expects to fund all its future capital improvement needs with proceeds of Bonds issued under the Certificate or with funds derived from sources other than indebtedness.

Reimbursable General Obligation Bonds

As of March 31, 2006, \$99,764 in principal amount of reimbursable general obligation bonds issued for the Harbor System are outstanding. These bonds are general obligation bonds of the State, but since the proceeds of these bonds were used to finance improvements to the Harbor System, the Department is required to reimburse the State general fund for the payment of the principal of and interest on such bonds from the Revenues. Reimbursement is made from the Revenues after the payment of the costs of operation, maintenance and repair of the Harbor System, the credits to the accounts in the Harbor Revenue Special Fund and payments for any other purpose within the jurisdiction, powers, duties and functions of the Department related to the Harbor System. See Appendix C – “SUMMARY OF CERTAIN PROVISIONS OF THE CERTIFICATE.”

The State has authorized, but not yet issued, reimbursable general obligation bonds in the aggregate principal amount of \$40 million for harbor improvements necessary to support the operations of Hawaii Superferry, Inc. See “SOURCES OF REVENUES - Other Matters Potentially Affecting Net Revenues; Inter-island Ferry System.” Except for these bonds, the State does not presently intend to issue additional reimbursable general obligation bonds for the Harbor System.

Special Facility Revenue Bonds

The Legislature authorized \$100,000,000 of special facility revenue bonds in Part II of Chapter 266, HRS. Pursuant to this authorization, three series of special facility revenue bond anticipation notes and special facility revenue bonds were issued between 1981 and 1993 to finance or refinance the construction of certain container terminal facilities on Sand Island. All three issues have been retired in full. The State is not currently contemplating the issuance of any other special facility revenue bonds for facilities in the Harbor System.

Summary of Debt Service

Table 13 sets forth the principal and interest requirements for the outstanding Bonds issued under the Certificate, including the Series 2006 Bonds, and the outstanding reimbursable general obligation bonds following issuance of the Series 2006 Bonds. Debt service requirements presented on the Table have been calculated, and are set forth, as if payments made on July 1 are paid in the prior fiscal year.

**TABLE 13
ESTIMATED DEBT SERVICE TABLE**

FY Ending <u>July 1</u>	Outstanding <u>Bonds</u>	Series 2006 <u>Bonds</u>	Total Debt Service Under <u>1997 Certificate</u>	Total Reimbursable G.O. Debt <u>Service</u>	<u>Grand Total</u>
2007	\$19,147,458.75	\$6,628,310.74	\$25,775,769.49	\$24,757.11	\$25,800,526.60
2008	19,171,646.25	6,835,122.50	26,006,768.75	24,418.51	26,031,187.26
2009	16,437,733.75	6,836,010.00	23,273,743.75	23,366.86	23,297,110.61
2010	16,469,351.25	6,833,072.50	23,302,423.75	11,998.33	23,314,422.08
2011	16,501,913.75	6,834,528.75	23,336,442.50	12,201.39	23,348,643.89
2012	16,499,495.00	6,833,516.25	23,333,011.25	1,191.98	23,334,203.23
2013	16,516,145.00	6,833,735.00	23,349,880.00	444.37	23,350,324.37
2014	13,639,563.75	6,833,172.50	20,472,736.25	457.32	20,473,193.57
2015	13,657,710.63	6,836,922.50	20,494,633.13	471.00	20,495,104.13
2016	13,648,462.50	6,834,653.75	20,483,116.25	248.38	20,483,364.63
2017	13,670,558.13	6,836,678.75	20,507,236.88	189.42	20,507,426.30
2018	13,687,111.25	6,834,385.00	20,521,496.25	192.94	20,521,689.19
2019	13,704,408.13	6,833,330.00	20,537,738.13		20,537,738.13
2020	12,620,527.50	6,832,825.00	19,453,352.50		19,453,352.50
2021	12,630,640.63	6,832,812.50	19,463,453.13		19,463,453.13
2022	12,634,756.25	6,836,906.25	19,471,662.50		19,471,662.50
2023	8,154,006.25	6,835,762.50	14,989,768.75		14,989,768.75
2024	8,156,221.88	6,837,412.50	14,993,634.38		14,993,634.38
2025	5,677,725.00	6,836,200.00	12,513,925.00		12,513,925.00
2026	5,682,462.50	6,836,468.75	12,518,931.25		12,518,931.25
2027	5,687,437.50	6,832,562.50	12,520,000.00		12,520,000.00
2028	1,671,812.50	6,836,000.00	8,507,812.50		8,507,812.50
2029	1,670,850.00	6,836,625.00	8,507,475.00		8,507,475.00
2030	--	6,837,125.00	6,837,125.00		6,837,125.00
2031	--	6,836,750.00	6,836,750.00		6,836,750.00
TOTAL	\$277,337,998.15	\$170,670,888.24	\$448,008,886.39	\$99,937.61	\$448,108,824.00

Note: For purposes of the above Table, debt service amounts are presented based on funding requirements. Generally, principal payments are required to be funded in 12 month periods and interest payments are required to be funded in six month periods, preceding the date on which payments are due. Accordingly, principal payments due on January 1, 2007 and interest payments due on January 1, 2007 and July 1, 2007, would require funding in fiscal year ending June 30, 2007.

LITIGATION

Certain litigation is described in Appendix B hereto under "Office of Hawaiian Affairs and Ceded Lands."

In addition, the State is subject to litigation in connection with the day-to-day operations of the Harbor System by the Department. There is no litigation now pending or threatened restraining or enjoining the issuance and delivery of the Series 2006 Bonds or the power and authority of the Department to impose, prescribe or collect rates, rentals, fees or charges for the use and services of, and the facilities or commodities furnished by, the Harbor System, or in any manner questioning the power and authority of the Department to impose, prescribe or collect such rates, rentals, fees or charges or to issue and deliver the Series 2006 Bonds or affecting the validity of the Series 2006 Bonds.

TAX MATTERS

The following opinions expressed by Kutak Rock LLP, Bond Counsel for the State, are based upon existing legislation as of the date of issuance and delivery of the Series 2006 Bonds, and Bond Counsel expresses no opinion as of any date subsequent thereto or with respect to any pending or future legislation.

General

In the opinion of Bond Counsel, under existing laws, regulations, rulings and judicial decisions, interest on the Series 2006 Bonds (including original issue discount treated as interest, if any) is excluded from gross income for federal income tax purposes, except that such exclusion does not apply with respect to interest on any Series 2006 Bond for any period during which such Series 2006 Bond is held by a person who is a "substantial user" of the facilities financed by the proceeds of the Series 2006 Bonds or a person "related" to such substantial user within the meaning of Section 147(a) of the Internal Revenue Code of 1986 (the "Code"). Interest on the Series 2006 Bonds (including original issue discount treated as interest, if any) is a specific preference item for purposes of the federal alternative minimum tax imposed on individuals and corporations.

In the opinion of Bond Counsel, under the existing laws of the State of Hawaii, the Series 2006 Bonds and income therefrom are exempt from all taxation in the State of Hawaii or county or other political subdivision thereof, except inheritance, transfer and estate taxes, and the franchise tax imposed on banks and other financial institutions.

The Code imposes various restrictions, conditions and requirements relating to the exclusion from gross income for federal tax purposes of interest on obligations such as the Series 2006 Bonds. The State has covenanted in the Certificate and the Tax Regulatory Certificate to comply with certain restrictions, conditions and requirements designed to assure that interest on the Series 2006 Bonds will not become includible in gross income. Failure to comply with these covenants may result in interest on such Series 2006 Bonds being included in gross income retroactively from the date of issue of such Series 2006 Bonds. The opinion of Bond Counsel assumes compliance with such covenants.

Although Bond Counsel has rendered an opinion that interest on the Series 2006 Bonds is excluded from gross income for federal income tax purposes, the accrual or receipt of interest on the Series 2006 Bonds may otherwise affect the federal income tax liability of the recipient. The extent of these other tax consequences will depend upon the recipient's particular tax status or other items of income or deduction. Bond Counsel expresses no opinion regarding any such consequences. Purchasers of the Series 2006 Bonds, particularly purchasers that are corporations (including S corporations and foreign corporations operating branches in the United States), property or casualty insurance companies, banks, thrifts or other financial institutions, certain recipients of Social Security or Railroad Retirement benefits, taxpayers otherwise entitled to claim the earned income credit and taxpayers who may be deemed to have incurred (or continued) indebtedness to purchase or carry tax-exempt obligations are advised to consult their tax advisors as to the tax consequences of purchasing or owning the Series 2006 Bonds.

From time to time, there are legislative proposals in the United States Congress that, if enacted, could alter or amend the federal income tax consequences referred to above or could adversely affect the market value of the Series 2006 Bonds. It cannot be predicted whether or in what form any such proposal might be enacted or whether, if enacted, any such proposal would apply to bonds issued prior to enactment. Each purchaser of the Series 2006 Bonds should consult his or her own tax advisor regarding any pending or proposed federal tax legislation. Bond Counsel expresses no opinion regarding any pending or proposed federal tax legislation.

A copy of the proposed form of opinion of Bond Counsel with respect to the Series 2006 Bonds is attached as Appendix E to this Official Statement.

Tax Treatment of Original Issue Discount

A portion of the Series 2006 Bonds maturing in the years 2010, 2012, 2016, 2017 and 2021 are being sold at a discount (collectively, the "Discounted Obligations"). The difference between the initial public offering prices, as set forth on the cover page hereof, of the Discounted Obligations and their stated amounts to be paid at maturity

or upon prior redemption, constitutes original issue discount treated as interest which is not includible in gross income for federal income tax purposes and is exempt from all taxation in the State of Hawaii or any county or other political subdivision thereof, except inheritance, transfer and estate taxes, and the franchise tax imposed on banks and other financial institutions, subject to the caveats and provisions described above.

In the case of an owner of a Discounted Obligation, the amount of original issue discount which is treated as having accrued with respect to such Discounted Obligation is added to the cost basis of the owner in determining, for federal income tax purposes, gain or loss upon disposition of a Discounted Obligation (including its sale, redemption or payment at maturity). Amounts received upon disposition of a Discounted Obligation which are attributable to accrued original issue discount will be treated as tax-exempt interest, rather than as taxable gain, for federal income tax purposes.

Original issue discount is treated as compounding semiannually, at a rate determined by reference to the yield to maturity of each individual Discounted Obligation, on days which are determined by reference to the maturity date of such Discounted Obligation. The amount treated as original issue discount on a Discounted Obligation for a particular semiannual accrual period is equal to (a) the product of (i) the yield to maturity for such Discounted Obligation (determined by compounding at the close of each accrual period) and (ii) the amount which would have been the tax basis of such Discounted Obligation at the beginning of the particular accrual period if held by the original purchaser, (b) less the amount of any interest payable for such Discounted Obligation during the accrual period. The tax basis is determined by adding to the initial public offering price of such Discounted Obligation the sum of the amounts which have been treated as original issue discount for such purposes during all prior periods. If a Discounted Obligation is sold between semiannual compounding dates, original issue discount which would have been accrued for that semiannual compounding period for federal income tax purposes is to be apportioned in equal amounts among the days in such compounding period.

The Code contains additional provisions relating to the accrual of original issue discount in the case of owners of a Discounted Obligation who purchase such Discounted Obligations after the initial offering. Owners of Discounted Obligations including purchasers of the Discounted Obligations in the secondary market should consult their own tax advisors with respect to the determination for federal income tax purposes of original issue discount accrued with respect to such obligations as of any date and with respect to the state and local tax consequences of owning a Discounted Obligation.

Tax Treatment of Original Issue Premium

All of the Series 2006 Bonds maturing in the years 2007, 2008, 2009, 2011, 2013, 2014, 2015, 2018, 2019, 2020, 2022 through 2027, and 2031, and a portion of the Series 2006 Bonds maturing in the years 2010, 2016, 2017 and 2021, are being sold at a premium (collectively, the "Premium Obligations"). An amount equal to the excess of the issue price of a Premium Obligation over its stated redemption price at maturity constitutes premium on such Premium Obligation. An initial purchaser of such Premium Obligation must amortize any premium over such Premium Obligation's term using constant yield principles, based on the purchaser's yield to maturity (or, in the case of Premium Obligations callable prior to their maturity, by amortizing the premium to the call date, based upon the purchaser's yield to the call date and giving effect to any call premium). As premium is amortized, it offsets the interest allocable to the corresponding payment period and the purchaser's basis in such Premium Obligation is reduced by a corresponding amount resulting in an increase in the gain (or decrease in the loss) to be recognized for federal income tax purposes upon a sale or disposition of such Premium Obligation prior to its maturity. Even though the purchaser's basis may be reduced, no federal income tax deduction is allowed. Purchasers of Premium Obligations should consult with their own tax advisors with respect to the determination and treatment of amortizable premium for federal income tax purposes and with respect to the state and local tax consequences of owning a Premium Obligation.

APPROVAL OF LEGAL PROCEEDINGS

All legal matters incident to the authorization, issuance and sale of the Series 2006 Bonds are subject to the approval of Kutak Rock LLP, Bond Counsel for the State. Copies of the approving opinion of Bond Counsel will be available at the time of delivery of the Series 2006 Bonds. The form of opinion Bond Counsel proposes to render is

set forth in Appendix E hereto. Certain legal matters will be passed upon for the State by the Attorney General of the State and for the Underwriter by its counsel, McCorriston Miller Mukai MacKinnon LLP, Honolulu, Hawaii.

RATINGS

Fitch Ratings, Moody's Investors Service and Standard & Poor's Ratings Services have assigned ratings of "AAA," "Aaa" and "AAA," respectively, to the Insured Series 2006 Bonds, with the understanding that upon delivery of such Bonds, the Policy and the Reserve Policy will be issued by the Bond Insurer. Fitch Ratings, Moody's Investors Service and Standard & Poor's Ratings Services have also assigned underlying ratings (without regard to bond insurance) of "A+," "A1," and "A+," respectively, to the Series 2006 Bonds. Such ratings reflect only the views of such organizations and any desired explanation of the significance of such ratings should be obtained from the rating agencies furnishing the same, at the following addresses: Fitch Ratings, One State Street Plaza, New York, New York 10004; Moody's Investors Service, 99 Church Street, New York, New York 10007; and Standard & Poor's Ratings Services, a division of the McGraw-Hill Companies, Inc., 55 Water Street, New York, New York 10004. Generally, a rating agency bases its rating on the information and materials furnished to it and on investigations, studies and assumptions of its own. There is no assurance that such ratings will continue for any given period of time or that such ratings will not be revised downward or withdrawn entirely by the rating agencies, if in the judgment of such rating agencies, circumstances so warrant. Any such downward revision or withdrawal of such ratings may have an adverse effect on the market price of the Bonds.

UNDERWRITING

The Series 2006 Bonds are being purchased by the Underwriter pursuant to a bond purchase contract between the Underwriter and the Department, pursuant to which the State has agreed to sell, and the Underwriter has agreed to purchase, such Series 2006 Bonds at an aggregate purchase price of \$98,112,554.68, plus accrued interest, reflecting an underwriting discount of \$576,136.62 and a net original issue premium of \$2,118,691.30. Such bond purchase contract provides that the Underwriter's obligation to purchase such Series 2006 Bonds is predicated on the satisfaction of certain terms and conditions set forth therein, including the approval of certain legal matters by counsel. The Underwriter will be obligated to purchase all of the Series 2006 Bonds if any are purchased.

The Underwriter reserves the right to join with dealers and other underwriters in offering the Series 2006 Bonds to the public. Such Bonds may be offered and sold to certain dealers (including dealers depositing Series 2006 Bonds into investment trusts) at prices lower than the public offering prices appearing on the cover hereof and the public offering prices may be changed from time to time.

LEGALITY FOR INVESTMENT

The Series 2006 Bonds are legal investments for the funds of all public officers and bodies and all political subdivisions of the State, and for the funds of all insurance companies and associations, banks, savings banks, savings institutions, including building or savings and loan associations, trust companies, personal representatives, guardians, trustees and all other persons and fiduciaries in the State who are regulated by law as to the character of their investment.

The Series 2006 Bonds may be deposited by banks with the Director of Finance as security for State moneys deposited in such banks.

CONTINUING DISCLOSURE

Not later than the date of issuance of the Series 2006 Bonds, the Department will enter into a supplement to its Continuing Disclosure Certificate for the benefit of the holders and beneficial owners of the Series 2006 Bonds to provide certain financial information and operating data relating to the Department to certain information repositories annually and to provide notice to the Municipal Securities Rulemaking Board of the occurrence of certain enumerated events, if material, pursuant to the requirements of Section (b)(5)(i) of Securities and Exchange

Commission Rule 15c2-12 (17 C.F.R. §240.15c2-12) (the "Rule"). A form of the Continuing Disclosure Certificate and a proposed form of the Fourth Supplement to such certificate are attached hereto as Appendix D.

A failure by the Department to comply with the Continuing Disclosure Certificate will not constitute an event of default of the Bonds, although any Bondholder or any beneficial owner may bring action to compel the Department to comply with its obligations under the Continuing Disclosure Certificate. Any such failure must be reported in accordance with the Rule and must be considered by any broker, dealer or municipal securities dealer before recommending the purchase or sale. The Department has never failed to comply with any previous undertaking under the Rule.

CAUTIONARY STATEMENTS REGARDING FORWARD-LOOKING STATEMENTS IN THIS OFFICIAL STATEMENT

Certain statements included or incorporated by reference in this Official Statement constitute "forward-looking statements." Such statements are generally identifiable by the terminology used such as "plan," "expect," "estimate," "budget" or similar words.

The achievement of certain results or other expectations contained in such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause actual results, performances or achievements described to be materially different from any future results, performances or achievements expressed or implied by such forward-looking statements. The Department does not plan to issue any updates or revisions to those forward-looking statements if and when changes to its expectations, or events, conditions or circumstances on which such statements are based, occur, unless such updates or revisions are made in the course of fulfilling its continuing disclosure obligation.

FINANCIAL STATEMENTS

The financial statements of the Harbors Division as of and for the years ended June 30, 2005 and June 30, 2004 are included in Appendix A hereto. The financial statements were audited by Grant Thornton LLP, independent auditors, as stated in their report appearing therein.

MISCELLANEOUS

The references herein to Acts of the Legislature or the Certificate (including the supplements thereto) do not purport to be complete and are subject to the detailed provisions thereof to which reference is hereby made. The Department has provided the information in this Official Statement relating to the Harbors Division, and other matters, as indicated.

As far as any statements made in this Official Statement involving matters of opinion or of estimates, whether or not so expressly stated, they are set forth as such and not as representations of fact, and no representation is made that any of the estimates will be realized. Neither this Official Statement nor any statement which may have been made orally or in writing is to be construed as a contract with the holders of any of the Series 2006 Bonds.

DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII

By /s/ Rodney K. Haraga
Director

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As far as any statements made in this Official Statement involving matters of opinion or of estimates, whether or not so expressly stated, they are set forth as such and not as representations of fact, and no representation is made that any of the estimates will be realized. Neither this Official Statement nor any statement which may have been made orally or in writing is to be construed as a contract with the holders of any of the Series 2006 Bonds.

DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII


By /s/ Rodney K. Haraga
Director

APPENDIX A

AUDITED FINANCIAL STATEMENTS

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION
HARBORS DIVISION

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Report of Independent Certified Public Accountants

The Auditor
State of Hawaii

We have audited the accompanying statements of net assets of the Harbors Division, Department of Transportation of the State of Hawaii, relating to the Public Undertaking (Harbors Division) as of June 30, 2005 and 2004, and the related statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the management of the Harbors Division. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America as established by the Auditing Standards Board of the American Institute of Certified Public Accountants and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Harbors Division's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note A, the financial statements of the Harbors Division, are intended to present the financial position, and the changes in financial position and cash flows, of only that portion of the business-type activities of the State of Hawaii that is attributable to the transactions of the Harbors Division. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2005 and 2004, and the changes in its financial position and its cash flows for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Harbors Division as of June 30, 2005 and 2004, and the changes in its net assets and its cash flows for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in note O to the financial statements, the State of Hawaii is a defendant in a lawsuit filed by the Office of Hawaiian Affairs (OHA) related to the inclusion of certain revenues received by the State of Hawaii through the Harbors Division in determination of ceded lands payments due to OHA.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 15, 2005, on our consideration of the Harbors Division's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that

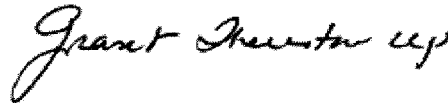
The Auditor
State of Hawaii

report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The Management's Discussion and Analysis on pages 5 through 12 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements. The supplementary information included in Schedules 1 through 6 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Honolulu, Hawaii
November 15, 2005

A handwritten signature in cursive script, appearing to read "Grant Stewart" followed by a flourish.

State of Hawaii
Department of Transportation
Harbors Division

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2005 and 2004

This section of the Harbors Division, Department of Transportation of the State of Hawaii, relating to the Public Undertaking (Harbors Division) financial report, presents the reader with an introduction and overview of the Harbors Division's financial performance for the fiscal years ended June 30, 2005 and 2004. This discussion has been prepared by management and should be read in conjunction with the financial statements, and the notes thereto, which follow this section.

The statewide system of commercial harbors consists of ten harbors on six islands. The system plays a vital role in Hawaii's economy as the ports serve as the primary means for goods to enter and exit the state. Hawaii imports approximately 80% of what it consumes, the majority of which enters the state through the commercial harbors system.

The Harbors Division is self-sustaining. The Department of Transportation (DOT) is authorized to impose and collect rates and charges for the harbors system services and properties to generate revenues to fund operating expenses. The Capital Improvements Program (CIP) is also funded by the Harbors Division's revenues and proceeds from the issuance of harbors system revenue bonds.

FINANCIAL HIGHLIGHTS

- The Harbors Division's net assets were \$574.1 million in 2005 compared to \$559.1 million in 2004, an increase of 2.7%.
- Wharfage revenues were \$39.9 million in 2005 compared to \$36.9 million in 2004, an increase of 8.1%.
- Total expenses were \$64.7 million in 2005 compared to \$54.4 million in 2004, an increase of 18.9%.

Total operating revenues, decreased by 0.4% from \$74.8 million in fiscal year 2004 to \$74.5 million in fiscal year 2005. Total operating revenues increased by 1.6% from \$73.6 million in fiscal year 2003 to \$74.8 million in fiscal year 2004.

The majority of operating revenues are directly related to cargo and ship operations. Service revenues, which include wharfage, dockage and passenger fees, generated \$52.9 million in fiscal year 2005, an increase of \$4.2 million or 8.6% over fiscal year 2004. The increase in revenues was primarily due to a \$3.0 million increase in wharfage revenue due to a 7% rise in container movements and a 3.5% increase in auto activities. During the fiscal year 2005, Matson Navigation Company, Inc. (Matson), our largest customer, replaced two older ships with larger capacity ships and Young Brothers, Ltd. chartered two additional barges. Pasha Hawaii Transport Lines introduced auto service to the State in March 2005, offering roll on/roll off service for vehicles between the U.S. Mainland and Hawaii. In addition, Matson continues to report growth after expanding its auto service in 2004. Service revenues increased \$1.1 million or 2.3% from fiscal year 2003 to 2004 mainly due to an increase in wharfage revenues. In 2004, Matson expanded its auto service by adding a roll-on/roll-off vessel enhancing its auto-carrying capability.

Approximately 1.5 million passengers (inbound and outbound) passed through these harbors in fiscal year 2005, an increase of 15.4% over fiscal year 2004's 1.3 million passengers. Fiscal year 2004's 1.3 million passengers was a decrease of 18.8% over fiscal year 2003's 1.6 million passengers. Passenger fee revenue for fiscal years 2005, 2004 and 2003 were \$3.6 million, \$3.3 million and \$4.2 million respectively. The 9.6% revenue increase from 2004 to 2005 is

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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2005 and 2004

due to growth in the number of cruise ship passengers. The drop in passengers and revenues from 2003 to 2004 were primarily the result of Norwegian Cruise Line's (NCL) reduction from two to one ship in 2004.

Since December, 2001, NCL has operated passenger cruises that included a required stopover in the Republic of Kirabati (Fanning Island) to comply with federal restrictions on foreign flagged vessels. In 2003, NCL obtained an exemption from federal maritime law to operate three foreign built ships under the U.S. flag in Hawaii. One of these ships, the Pride of Aloha, commenced service among the islands in July 2004. Passengers on the Pride of Aloha taking a continuous trip whose point of origin and termination is a state port were charged a total in-transit fee of \$1.85 under the tariff for disembarking and embarking. Other passengers are assessed a \$2.50 passenger fee for embarking and a \$2.50 for disembarking under the tariff. While passenger counts increased by 15.4% in 2005 over 2004, revenues increased by 9.6% as approximately 20.6% of the 2005 passengers were in-transit. NCL's second U.S. flagged vessel, the Pride of America, began service in Hawaii in July, 2005. NCL expects to commence service with its third U.S. flagged ship, the Pride of Hawaii, in June, 2006.

Gross rental revenues in fiscal years 2005, 2004 and 2003, were \$27.3 million, \$27.4 million and \$25.4 million respectively. The increase of \$2.0 million or 7.9% from fiscal years 2003 to 2004 was primarily due to Matson Terminal Inc.'s rental of exclusive use of space to support their roll-on/roll-off operations. Net rental revenues after deducting the provision for doubtful accounts were \$20.3 million for 2005 and \$25.1 million in 2004 and 2003. The provision for doubtful accounts for the fiscal year ending June 30, 2005, was approximately \$7.0 million. During 2005, allowances were made for various long-standing doubtful accounts, including the Aloha Tower Development Corporation. See note Q.

Operating expenses excluding depreciation increased by 31.1% from \$29.6 million in fiscal year 2004 to \$38.8 million in fiscal year 2005. Expenses decreased by \$7.5 million or 20.2% from 2003 to 2004. The increase from 2004 to 2005 of \$9.2 million is primarily due to an approximate \$7.1 million increase in maintenance expenses. The increase is primarily due to a greater number of special maintenance and repair projects undertaken in the fiscal year. Operational expenses increased by \$1.5 million from 2004 to 2005 primarily due to approximately \$831,000 in additional security expenses, increases in utilities costs and other expenses. Personnel services expenses increased by approximately \$785,000 primarily due to collective bargaining pay increases and increases in accrued vacation. The decrease from 2003 to 2004 is primarily due to the reduction in ceded land assessments of \$11.7 million (which included fiscal year 2003 and 2002 assessments) paid by the Harbors Division in fiscal year 2003 compared to \$6.5 million paid in fiscal year 2004, a decrease of \$5.2 million. The remaining \$2.3 million decrease in operating expenses were primarily due to delays in completing special maintenance projects. These delays were due to problems encountered in obtaining permits and the long construction cycle to complete major projects.

The Harbors Division issued \$52,030,000 Harbor System Revenue Bonds, Series A and B, 2004, in June 2004 to refund bonds issued in 1993 and 1994 at higher interest rates. The refunding will realize cash flow savings of approximately \$7.6 million over the next twenty years. There were no bonds issued in fiscal year 2005.

On September 18, 2003, outstanding \$16,500,000 Special Facility Revenue Bonds, Matson Terminals, Inc., Refunding Series 1993 were redeemed in full at a price of 102% of the principal together with interest accrued to the redemption

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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2005 and 2004

date. The remaining net investment in direct lease financing on the date of redemption was reclassified to buildings during 2004.

A summary of operations and changes in net assets for the fiscal years ended June 30, 2005, 2004 and 2003 follows:

Table 1
Condensed Statements of Revenues,
Expenses and Changes in Net Assets
(in thousands of dollars)

	As of June 30,			2005 – 2004		2004 – 2003	
	2005	2004	2003	Increase (decrease)	% Change	Increase (decrease)	% Change
Operating revenues	\$74,527	\$74,768	\$73,605	\$ (241)	0%	\$ 1,163	2%
Non-operating revenues	4,791	3,900	5,043	891	23%	(1,143)	(23%)
Total revenues	<u>79,318</u>	<u>78,668</u>	<u>78,648</u>	<u>650</u>	<u>1%</u>	<u>20</u>	<u>0%</u>
Depreciation	15,998	13,766	13,367	2,232	16%	399	3%
Other operating expenses	38,752	29,575	37,119	9,177	31%	(7,544)	(20%)
Non-operating expenses	9,989	11,102	11,698	(1,113)	(10%)	(596)	(5%)
Total expenses	<u>64,739</u>	<u>54,443</u>	<u>62,184</u>	<u>10,296</u>	<u>19%</u>	<u>(7,741)</u>	<u>(12%)</u>
Income before capital contributions	14,579	24,225	16,464	(9,646)	(40%)	7,761	47%
Capital contributions	<u>385</u>	<u>737</u>	<u>2,542</u>	<u>(352)</u>	<u>(48%)</u>	<u>(1,805)</u>	<u>(71%)</u>
INCREASE IN NET ASSETS	<u>\$14,964</u>	<u>\$24,962</u>	<u>\$19,006</u>	<u>\$(9,998)</u>	<u>(40%)</u>	<u>\$ 5,956</u>	<u>31%</u>

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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2005 and 2004

A condensed summary of the Harbors Division's net assets at June 30, 2005, 2004 and 2003 are shown below.

Table 2
Condensed Statements of Net Assets
(in thousands of dollars)

	Year ended June 30,			2005 – 2004		2004 – 2003	
	2005	2004	2003	Increase (decrease)	% Change	Increase (decrease)	% Change
Current and other assets	\$193,157	\$178,332	\$184,524	\$14,825	8%	\$ (6,192)	(3%)
Capital assets	584,730	587,445	584,206	(2,715)	0%	3,239	1%
Total assets	<u>777,887</u>	<u>765,777</u>	<u>768,730</u>	<u>12,110</u>	<u>2%</u>	<u>(2,953)</u>	<u>0%</u>
Long-term debt outstanding	184,434	192,509	219,406	(8,075)	(4%)	(26,897)	(12%)
Other liabilities	19,367	14,146	15,164	5,221	37%	(1,018)	(7%)
Total liabilities	<u>203,801</u>	<u>206,655</u>	<u>234,570</u>	<u>(2,854)</u>	<u>(1%)</u>	<u>(27,915)</u>	<u>(12%)</u>
Net assets							
Invested in capital assets, net of related debt	402,787	397,549	367,169	5,238	1%	30,380	8%
Restricted	10,898	10,898	10,898	–	0%	–	0%
Unrestricted	<u>160,401</u>	<u>150,675</u>	<u>156,093</u>	<u>9,726</u>	<u>6%</u>	<u>(5,418)</u>	<u>(3%)</u>
Total net assets	<u>\$574,086</u>	<u>\$559,122</u>	<u>\$534,160</u>	<u>\$14,964</u>	<u>3%</u>	<u>\$ 24,962</u>	<u>5%</u>

The largest portion of the Harbors Division's net assets (70% at June 30, 2005) represents its investment in capital assets (e.g., land, wharves, buildings, improvements, and equipment), less related indebtedness outstanding to acquire those capital assets. The Harbors Division uses these capital assets to provide services to its users of the harbors system; consequently, these assets are not available for future spending. Although the Harbors Division's investment in its capital assets is reported net of related debt, the resources required to repay this debt must be provided annually from operations, since it is unlikely the capital assets themselves will be liquidated to pay such liabilities.

The change in net assets is an indicator of whether the overall fiscal condition of the Harbors Division improved or worsened during the fiscal year. The change in net assets may serve over time as a useful indicator of the Harbor Division's financial position. The total assets exceeded liabilities by approximately \$574 million at June 30, 2005, and net assets increased by approximately \$15 million from June 30, 2004, and by \$25 million from June 30, 2003 to June 30, 2004.

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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2005 and 2004

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

As of June 30, 2005, the Harbors Division had \$585 million invested in capital assets as shown in Table 3. There was a net decrease (additions, deductions and depreciation) of \$2.7 million from the end of the prior fiscal year.

Table 3
Capital Assets
(in thousands of dollars)

	Year ended June 30,			2005 – 2004		2004 – 2003	
	2005	2004	2003	Increase (decrease)	% Change	Increase (decrease)	% Change
Land and land improvements	\$ 364,872	\$ 360,237	\$347,038	\$ 4,635	1%	\$ 13,199	4%
Wharves	222,065	221,285	190,499	780	0%	30,786	16%
Other improvements	74,908	74,908	74,636	–	0%	272	0%
Buildings and improvements	51,238	51,077	48,425	161	0%	2,652	5%
Equipment	9,997	10,769	10,876	(772)	(7%)	(107)	(1%)
Subtotal	723,080	718,276	671,474	4,804	1%	46,802	7%
Less accumulated depreciation	(173,081)	(157,697)	(144,101)	(15,384)	10%	(13,596)	9%
Subtotal	549,999	560,579	527,373	(10,580)	(2%)	33,206	6%
Construction in progress	34,731	26,866	56,833	7,865	29%	(29,967)	(53%)
Total	<u>\$ 584,730</u>	<u>\$ 587,445</u>	<u>\$ 584,206</u>	<u>\$(2,715)</u>	<u>0%</u>	<u>\$ 3,239</u>	<u>1%</u>

Major capital asset additions to the statewide harbors system for the fiscal year ended June 30, 2005, included the following:

- \$724,000 Methane Mitigation, Piers 36-38, Honolulu Harbor, Oahu
- \$304,000 Methane Mitigation, Parcels 2 and 38, Honolulu Harbor, Oahu
- \$378,000 Upgrade Perimeter Fencing at Nawiliwili Harbor, Kauai

In addition to these capital asset additions, the Harbors Division is currently constructing the following projects statewide:

- \$25.0 million Pier 2 Cruise Terminal, Honolulu Harbor, Oahu
- \$2.1 million Replacement of Pier 3 Fendering System at Nawiliwili Harbor, Kauai
- \$4.3 million Ferry Terminal at Pier 19, Honolulu Harbor, Oahu.
- \$2.2 million Pier 1 Comfort Station, waterline and sewer line improvements, Kahului Harbor, Maui

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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2005 and 2004

- \$4.0 million Pier 3 breasting dolphins and catwalks, Hilo Harbor, Hawaii
- \$3.6 million Reconstruction of Puunene Container Yard, Kahului Harbor, Maui
- 5.5 million Segmented Pier 3 improvements, Nawiliwili Harbor, Kauai

Finally, the Harbors Division is currently designing improvements, some of which include the following projects statewide:

- \$20.0 million Reconstruction of Pier 51B Container Yard, Honolulu Harbor, Oahu
- \$26.0 million Reconstruction of Pier 52 & 53 Container Yard, Sand Island, Oahu
- \$35.0 million Construction of Inter-Island Cargo Terminal Facility at Hilo Harbor, Hawaii
- \$6.0 million Construction of CBP Facilities and Other Improvements for Pier 2 Cruise Terminal, Honolulu Harbor, Oahu
- \$1.0 million Passenger Gangway at Pier 2 Cruise Terminal, Honolulu Harbor, Oahu
- \$600,000 Methane Mitigation, Pier 38, Lease Parcel 8, Honolulu Harbor, Oahu
- \$550,000 Security Surveillance System for Neighbor Island Passenger Terminals, Statewide
- \$750,000 Statewide Maritime Identification Credentialing System
- \$315,000 Crash Barrier Gates for Container Terminals, Honolulu Harbor
- \$37.4 million Design and Build Barges and Vehicle Ramp Systems for Inter-Island Ferry Service, Statewide

The Harbors Division is committed under contracts awarded for capital improvement projects totaling approximately \$39.3 million as of June 30, 2005.

Additional information regarding the Harbors Division's capital assets can be found in note D.

Indebtedness

Harbors System Revenue Bonds and Reimbursable General Obligation Bonds

As of June 30, 2005, \$189,890,000 of harbors system revenue bonds was outstanding compared to \$198,440,000 as of June 30, 2004. The last series of "new money" bonds to fund capital improvement projects, was issued in April 2000. The Harbors Division has managed its debt levels by issuing refunding bonds and defeasing bonds with unencumbered cash from the Harbors Revenue Fund. On June 10, 2004, Harbors issued Harbor System Revenue Bond Series 2004 A and B, in the amount of \$52,030,000, for the purpose of refunding outstanding Harbor Revenue Bond Series 1994 and Refunding Series 1993.

As of June 30, 2005, \$111,281 of reimbursable general obligation bonds issued for the harbors system was outstanding, compared to \$130,743 as of June 30, 2004. These bonds are general obligations of the State. Since the

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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2005 and 2004

proceeds were used to finance improvements to the harbors system, Harbors Division is required to reimburse the State General Fund for the payment of the principal and interest on such bonds.

Special Facility Lease and Revenue Bonds

As of June 30, 2005 and 2004, there were no outstanding bond obligations compared to the June 30, 2003 outstanding balance of \$16,500,000. On September 18, 2003, outstanding \$16,500,000 Special Facility Revenue Bonds, Matson Terminals, Inc. (MTI), Refunding Series 1993 were redeemed in full by MTI at a price of 102% of the principal with interest accrued to the redemption date.

Additional information regarding the Harbors Division's indebtedness can be found in notes E, F, G, H, and I.

Credit Rating and Bond Insurance

All harbor system revenue bonds issued since 1997 have been issued with bond insurance. As of June 30, 2005, the underlying ratings for harbor system revenue bonds were as follows:

- Standard and Poor's A+
- Moody's Investors Service A1
- Fitch IBCA, Inc. A+

Ratings made by Standard and Poor's, Moody's Investors Service, and Fitch IBCA, Inc. may be changed, suspended or withdrawn as a result of changes in, or unavailability of, information. Ratings provided by these rating companies are not "market ratings," as the ratings are not a recommendation to buy, hold, or sell any security.

Bond Covenants

Bond covenants allow the issuance of additional debt, on parity, as to a lien on the net revenues of the Harbors Division provided certain net revenue ratios are met. Net revenues of the Harbors Division must be at least 1.35 or 1.25 times the debt service requirements under the 1990 and 1997 Harbor Revenue Bond Certificates, respectively. As a result of the issuance of Harbor System Revenue Bonds, Series A and B, 2004, none of the 1990 Certificate Harbors Revenue Bonds remained outstanding upon the issuance of the Series 2004 Bonds. No further bonds will be issued under the 1990 Certificate.

The Harbors Division currently enjoys a coverage ratio of 2.82 under the 1997 Harbor Revenue Bond Certificate as compared to the prior fiscal year's ratio of 2.42.

Currently Known Facts, Decisions, or Conditions

Act 178, Session Laws of Hawaii 2005, appropriated reimbursable general obligation bonds of \$20 million each year, FY 2006 and FY 2007, for harbor improvements needed to support the operations of Hawaii Superferry, Inc. (HSF).

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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2005 and 2004

Details on the reimbursement schedule are still being determined by the Department of Budget and Finance. The Harbors Division expects interest only repayments to begin in FY 2006. See Note V.

REQUEST FOR INFORMATION

The financial report is designed to provide a general overview of the Harbors Division's finances for all interested parties. Questions concerning any of the information provided in this report or requests for additional information should be addressed in writing to the Harbors Administrator, State of Hawaii, Department of Transportation, Harbors Division, 79 S. Nimitz Highway, Honolulu, Hawaii 96813, or by e-mail to glenn.okimoto@hawaii.gov.

State of Hawaii
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STATEMENTS OF NET ASSETS OF THE PUBLIC UNDERTAKING

June 30,

ASSETS	2005	2004	LIABILITIES AND NET ASSETS
CURRENT ASSETS			CURRENT LIABILITIES (payable from current assets)
Cash and cash equivalents (notes B and C)	\$ 89,201,548	\$ 76,192,844	Accounts payable
Receivables			Accrued workers' compensation
Accounts receivable, less allowance for doubtful accounts of \$14,681,000 in 2005 and \$9,896,000 in 2004	7,228,293	10,757,205	Contracts payable, including retainages
Interest	1,174,219	802,679	Accrued vacation (notes B and E)
Grant	724,589	1,040,168	Due to Department of Budget and Finance
Other	177,327	299,631	
Materials and supplies, at cost	28,449	45,495	Total current liabilities (payable from current assets)
Prepaid insurance and others	23,800	23,800	
Total current assets	98,558,225	89,161,822	CURRENT LIABILITIES (payable from restricted assets)
RESTRICTED ASSETS			Contracts payable, including retainages
Current			Matured revenue bonds and interest payable
Cash and cash equivalents (notes B and C)	92,107,590	86,556,797	Revenue bonds payable, current maturities (note F)
Total current restricted assets	92,107,590	86,556,797	General obligation bonds payable, current maturities (note I)
			Accrued interest payable
			Security deposits
			Total current liabilities (payable from restricted assets)
CAPITAL ASSETS (notes B and D)			LONG-TERM LIABILITIES
Non-depreciable facilities			Accrued workers' compensation
Land	164,404,484	164,404,485	Long-term debt, less current maturities
Land improvements	76,086,739	74,223,157	Revenue bonds payable, net (note F)
Other improvements	66,908	66,908	General obligation bonds payable (note I)
Total non-depreciable facilities	240,558,131	238,694,550	Accrued vacation (notes B and E)
Depreciable facilities			Total non-current liabilities
Land improvements	124,313,276	121,542,847	
Wharves	222,064,599	221,284,577	Total liabilities
Other improvements	74,907,783	74,907,783	
Buildings	51,238,436	51,077,048	
Equipment	9,997,197	10,769,362	
Total depreciable facilities	482,521,291	479,581,617	
Less accumulated depreciation	173,080,604	157,697,125	
Total capital assets	309,440,687	321,884,492	NET ASSETS
Construction in progress	34,731,207	26,866,167	Invested in capital assets, net of related debt
Total capital assets	584,730,025	587,445,209	Restricted - reserved for revenue bond requirements
OTHER ASSET			Unrestricted net assets
Unamortized bond issue costs	2,490,975	2,613,075	Total net assets
	\$777,886,815	\$765,776,903	

The accompanying notes are an integral part of these statements.

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STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
OF THE PUBLIC UNDERTAKING

Fiscal year ended June 30,

	2005	2004
Operating revenues, net		
Services	\$ 52,922,707	\$ 48,657,768
Rentals	20,256,475	25,125,270
Others	1,347,501	985,135
	74,526,683	74,768,173
 Operating expenses before depreciation		
Personal services	11,541,230	10,756,552
Harbor operations	10,824,219	9,277,336
Maintenance	9,979,185	2,915,374
State of Hawaii, surcharge for central service expenses (note P)	2,698,964	2,766,405
Fireboat operations (note P)	1,596,781	1,704,790
General administration	1,138,582	1,420,991
Department of Transportation, general administration expenses (note P)	972,529	733,531
	38,751,490	29,574,979
Income from operations before depreciation	35,775,193	45,193,194
 Depreciation	15,998,257	13,766,433
Income from operations	19,776,936	31,426,761
 Nonoperating income (expense)		
Interest income		
Deposits in investment pool	4,791,636	3,664,514
Investment in direct financing lease	-	236,050
Interest expense (note J)		
Revenue bonds	(9,197,432)	(10,246,336)
Special facility revenue bonds	-	(207,945)
General obligation bonds	(4,888)	(5,647)
Amortization of bond discount, issue costs and loss on refunding	(616,414)	(630,998)
Loss on disposal of capital assets	(170,599)	(12,064)
	(5,197,697)	(7,202,426)
Income before contributions	14,579,239	24,224,335
 Capital contributions	384,902	737,366
INCREASE IN NET ASSETS	14,964,141	24,961,701
 Net assets at beginning of year	559,122,174	534,160,473
 Net assets at end of fiscal year	\$574,086,315	\$559,122,174

The accompanying notes are an integral part of these statements.

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STATEMENTS OF CASH FLOWS OF THE PUBLIC UNDERTAKING

Fiscal year ended June 30,

	2005	2004
Cash flows from operating activities:		
Cash received from customers	\$ 78,286,348	\$ 74,188,910
Cash paid to suppliers	(23,480,257)	(17,760,562)
Cash paid to employees	(11,031,720)	(10,893,276)
Net cash provided by operating activities	43,774,371	45,535,072
Cash flows from capital and related financing activities:		
Government grants received in aid of construction	700,485	1,442,076
Acquisition and construction of capital assets	(13,453,676)	(14,721,646)
Proceeds from sale of revenue bonds	-	53,315,009
Principal paid on bonds	(8,574,562)	(63,094,929)
Premium paid on bond refunding	-	(949,330)
Interest paid on bonds	(8,307,217)	(12,004,895)
Bond issuance costs paid	-	(843,407)
Net cash used in capital and related financing activities	(29,634,970)	(36,857,122)
Cash flows from investing activities		
Interest received on investments	4,420,096	3,659,510
Net cash provided by investing activities	4,420,096	3,659,510
NET INCREASE IN CASH AND CASH EQUIVALENTS	18,559,497	12,337,460
Cash and cash equivalents at beginning of fiscal year	162,749,641	150,412,181
Cash and cash equivalents at end of fiscal year	\$ 181,309,138	\$ 162,749,641
Reconciliation of operating income to net cash provided by operating activities:		
Income from operations	\$ 19,776,936	\$ 31,426,761
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation	15,998,257	13,766,433
Provision for doubtful accounts	6,998,851	2,253,832
Changes in assets and liabilities:		
(Increase) decrease in:		
Receivables, net	(3,347,635)	(2,939,225)
Materials and supplies	17,046	(7,899)
Increase (decrease) in:		
Payables	3,661,260	1,065,764
Accrued vacation	509,510	(136,724)
Accrued workers' compensation	74,987	-
Due to Department of Budget and Finance	(23,290)	-
Security deposits	108,449	106,130
Net cash provided by operating activities	\$ 43,774,371	\$ 45,535,072
Supplemental disclosure of noncash capital and related financing activities:		
Principal payments relating to special facility bonds	\$ -	\$ 16,500,000
Interest payments related to special facility revenue bonds	-	207,945
Amortization of bond discount, issue costs and loss on refunding	616,414	630,998
Transfer of net investment in lease financing to harbor facilities	-	2,296,279

The accompanying notes are an integral part of these statements.

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NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING

June 30, 2005 and 2004

NOTE A – FINANCIAL REPORTING ENTITY

In 1959, the Harbors Division was established within the Department of Transportation of the State of Hawaii (DOT) effective July 1, 1961. All functions and powers to administer, control and supervise all State of Hawaii (State) harbors and water navigational facilities were assigned to the Director of DOT on that date.

The Harbors Division is part of DOT which is part of the executive branch of the State. The Harbors Division's financial statements reflect only its portion of the proprietary fund type. The State Comptroller maintains the central accounts for all state funds and publishes financial statements for the State annually, which include the Harbors Division's financial activities.

The "Certificate of the Director of Transportation Providing for the Issuance of 1997 State of Hawaii Harbor Revenue Bonds," dated March 1, 1997 (1997 Certificate), define the "Undertaking" as all of the harbor and waterfront improvements and other properties under the jurisdiction, control and management of the Harbors Division, except those principally used for recreation and the landing of fish.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Measurement Focus and Basis of Accounting

The accounting policies of the Harbors Division conform to accounting principles generally accepted in the United States of America as applicable to enterprise activities of governmental units as promulgated by the Governmental Accounting Standards Board (GASB). In accordance with GASB standards, the Harbors Division has elected not to apply the Financial Accounting Standards Board pronouncements on accounting and financial reporting that were issued after November 30, 1989.

An enterprise fund is used to account for the acquisition, operation and maintenance of government facilities and services that are entirely or predominantly supported by user charges. The Harbors Division's operations are accounted for on the flow of economic resources measurement focus and the accrual basis of accounting is utilized. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

2. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

3. Cash and Cash Equivalents

Cash and cash equivalents, for the purpose of the statements of cash flows, include all cash and investments with original maturities of three months or less. Cash and cash equivalents also include investments of pooled cash balances. The Director of Finance invests state treasury cash surpluses where funds can be disbursed at any time without prior notice or penalty. As a result, the cash balances are not reduced for these investments.

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NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4. Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are reported at their gross value when earned, reduced by an allowance for doubtful accounts.

Accounts are written-off upon the approval of the Department of the Attorney General, when it believes, after considering economic conditions, business conditions, and collection efforts, that the accounts are uncollectible.

The allowance for doubtful accounts is increased by charges to operating income and decreased by charge-offs (net of recoveries). Management’s periodic evaluation of the adequacy of the allowance is based on the adverse situations that may affect the customer’s ability to repay, historical experience and current economic conditions. Past due status is determined based on contractual terms.

5. Risk Management

The Harbors Division is exposed to various risks for losses related to torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees. A liability for a claim for a risk of loss is established if information indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss is reasonably estimable.

6. Capital Assets and Depreciation

Capital assets are stated at cost. Depreciation of capital assets is computed using the straight-line method over the estimated useful lives of the assets. Depreciation is not provided for in the year of acquisition, but is provided for the entire year in the year of disposal. Disposals of assets are recorded by removing the cost and related accumulated depreciation from the accounts with the resulting gain or loss reflected in non-operating income or expense.

Capital assets and their related straight-line rates used to compute depreciation are as follows:

	Rates	Capitalization Threshold
Land improvements	1.0% – 4.0%	\$100,000
Wharves	1.0% – 10.0%	100,000
Buildings	1.5% – 20.0%	100,000
Other improvements	2.0% – 20.0%	100,000
Equipment	8.0%	5,000

Maintenance and repairs, as well as minor replacements, renewals and betterments, are charged to operations. Major renewals, replacements and betterments are capitalized in the year incurred. Interest cost is capitalized during the period of construction for all capital improvement projects except those projects funded by grants from the State or the federal government.

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NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

7. Bond Issue Costs

Costs relating to the issuance of bonds are recognized using the interest method over the term of the obligations.

8. Unamortized Debt Premium (Discount)

Debt premium (discount) is amortized ratably over the term of the related debt, and the unamortized balance is reflected as an offset against the related long-term liabilities in the statements of net assets.

9. Refunding of Debt

The difference between the reacquisition price and the net carrying amount of the old debt is deferred and amortized as a component of interest expense in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter. The deferred amount is reported as a deduction from or an addition to the new debt liability.

10. Accrued Vacation

The Harbors Division accrues all vacation and compensatory pay at current salary rates, including additional amounts for certain salary-related expenses associated with the payment of compensated absences, in accordance with GASB Statement No. 16, *Accounting for Compensated Absences*. Vacation is earned at the rate of 168 hours per calendar year, depending on employee's date of hire. Accumulation of such vacation credits is limited to 720 hours at calendar year end and is convertible to pay upon termination of employment.

11. Operating Revenues

Operating revenues are those that result from providing goods and services. It excludes revenues related to capital and related financing activities, noncapital financing activities, or investing activities. Operating revenues are reported net of the provision for doubtful accounts which were \$6,998,851 and \$2,253,832 for the years ended June 30, 2005 and 2004, respectively.

12. Capital Contributions

The Harbors Division receives federal grants for capital asset acquisition and facility development, which are reported in the statement of revenues, expenses and changes in net assets, after non-operating revenues and expenses as capital contributions.

13. Reclassifications

Reclassifications have been made to the 2004 financial statements to conform to the classifications used in 2005.

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NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE C – CASH AND INVESTMENTS

At June 30, 2005 and 2004, information relating to the insurance and collateral of cash deposits is not available since such information is determined on a statewide basis and not for individual departments or divisions. Cash deposits of the State are either federally insured or collateralized with obligations of the State or the United States. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State.

Statutes authorize the Harbors Division to invest, with certain restrictions, in obligations of the State or the United States, in federally insured savings accounts, time certificates of deposit and repurchase agreements with federally insured banks and savings and loan associations authorized to do business in the State. Money held as reserves may be invested in obligations of the United States, the State or any subdivision of the State. Investments are insured or collateralized with securities held by the State or by its agent in the State's name.

NOTE D – CAPITAL ASSETS

The changes in capital assets were as follows:

	Balance July 1, 2004	Additions	Deductions	Balance June 30, 2005
Nondepreciable assets				
Land and improvements	\$238,694,550	\$ 1,863,581	\$ –	\$240,558,131
Depreciable assets				
Land improvements	121,542,847	2,770,429	–	124,313,276
Wharves	221,284,577	780,022	–	222,064,599
Other improvements	74,907,783	–	–	74,907,783
Buildings	51,077,048	161,388	–	51,238,436
Equipment	10,769,362	89,437	861,602	9,997,197
Total at historical cost	718,276,167	5,664,857	861,602	723,079,422
Less accumulated depreciation for:				
Land improvements	27,934,288	5,000,701	–	32,934,989
Wharves	73,805,986	6,453,153	–	80,259,139
Other improvements	25,415,470	2,366,282	–	27,781,752
Buildings	21,772,282	1,431,711	–	23,203,993
Equipment	8,769,099	746,410	614,778	8,900,731
Total accumulated depreciation	157,697,125	15,998,257	614,778	173,080,604
Construction in progress	26,866,167	18,563,768	10,698,728	34,731,207
	<u>\$587,445,209</u>	<u>\$ 8,230,368</u>	<u>\$10,945,552</u>	<u>\$584,730,025</u>

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NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE D – CAPITAL ASSETS (continued)

	Balance July 1, 2003	Additions	Deductions	Balance June 30, 2004
Nondepreciable assets				
Land and improvements	\$238,694,550	\$ –	\$ –	\$238,694,550
Depreciable assets				
Land improvements	108,342,951	13,199,896	–	121,542,847
Wharves	190,499,253	30,785,324	–	221,284,577
Other improvements	74,636,071	271,712	–	74,907,783
Buildings	48,425,083	2,651,965	–	51,077,048
Equipment	10,875,730	75,888	182,256	10,769,362
Total at historical cost	671,473,638	46,984,785	182,256	718,276,167
Less accumulated depreciation for:				
Land improvements	23,803,713	4,130,575	–	27,934,288
Wharves	68,743,714	5,062,272	–	73,805,986
Other improvements	23,139,295	2,276,175	–	25,415,470
Buildings	20,229,924	1,542,358	–	21,772,282
Equipment	8,184,238	755,053	170,192	8,769,099
Total accumulated depreciation	144,100,884	13,766,433	170,192	157,697,125
Construction in progress	56,833,027	14,705,389	44,672,249	26,866,167
	<u>\$584,205,781</u>	<u>\$47,923,741</u>	<u>\$44,684,313</u>	<u>\$587,445,209</u>

Depreciation expense was \$15,998,257 and \$13,766,433 for the fiscal years ended June 30, 2005 and 2004, respectively.

NOTE E – LONG-TERM LIABILITIES

The changes in long-term liabilities were as follows:

	Balance July 1, 2004	Additions	Deductions	Balance June 30, 2005	Current	Noncurrent
Accrued vacation	\$ 1,870,468	\$ 1,708,762	\$ 1,199,252	\$ 2,379,978	\$ 595,178	\$ 1,784,800
Accrued workers' compensation	378,070	233,145	158,158	453,057	149,442	303,615
Revenue bonds	198,440,000	–	8,550,000	189,890,000	9,025,000	180,865,000
General obligation bonds	130,743	–	19,462	111,281	20,688	90,593
Subtotal carried forward	\$200,819,281	\$ 1,941,907	\$ 9,926,872	\$192,834,316	\$ 9,790,308	\$183,044,008

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NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE E – LONG-TERM LIABILITIES (continued)

	Balance July 1, 2004	Additions	Deductions	Balance June 30, 2005	Current	Noncurrent
Subtotal brought forward	\$200,819,281	\$ 1,941,907	\$ 9,926,872	\$192,834,316	\$9,790,308	\$183,044,008
Less						
Unamortized discount	(2,054,400)	–	(142,940)	(1,911,460)	(141,418)	(1,770,042)
Unamortized premium	1,384,600	–	189,102	1,195,498	231,816	963,682
Unamortized deferred loss on refunding	(5,392,020)	–	(540,476)	(4,851,544)	(640,141)	(4,211,403)
	<u>\$194,757,461</u>	<u>\$ 1,941,907</u>	<u>\$ 9,432,558</u>	<u>\$187,266,810</u>	<u>\$9,240,565</u>	<u>\$178,026,245</u>
	Balance July 1, 2003	Additions	Deductions	Balance June 30, 2004	Current	Noncurrent
Accrued vacation	\$ 2,007,192	\$ 697,732	\$ 834,456	\$ 1,870,468	\$ 525,105	\$ 1,345,363
Accrued workers' compensation	–	663,854	285,784	378,070	155,189	222,881
Revenue bonds	209,185,000	52,030,000	62,775,000	198,440,000	8,550,000	189,890,000
Special facility revenue bonds	16,500,000	–	16,500,000	–	–	–
General obligation bonds	149,772	–	19,029	130,743	19,462	111,281
	<u>227,841,964</u>	<u>53,391,586</u>	<u>80,414,269</u>	<u>200,819,281</u>	<u>9,249,756</u>	<u>191,569,525</u>
Less						
Unamortized discount	(2,854,894)	–	(800,494)	(2,054,400)	(142,940)	(1,911,460)
Unamortized premium	111,849	1,285,009	12,258	1,384,600	189,102	1,195,498
Unamortized deferred loss on refunding	(3,685,828)	(2,184,199)	(478,007)	(5,392,020)	(566,849)	(4,825,171)
	<u>\$221,413,091</u>	<u>\$52,492,396</u>	<u>\$79,148,026</u>	<u>\$194,757,461</u>	<u>\$8,729,069</u>	<u>\$186,028,392</u>

NOTE F – REVENUE BONDS PAYABLE

Pursuant to authorization from the State Legislature, the Director of DOT issued the 1997 Certificate, which provides for the issuance of bonds at any time and from time-to-time upon compliance with certain conditions of the respective Certificate.

The harbor revenue bonds (Bonds) are collateralized by a charge and lien on the revenues of the Public Undertaking as defined in the 1997 Certificate.

The Bonds are subject to redemption at the option of the Director of DOT and the State during specific years at prices ranging from 102-1/2% to 100% of face value.

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NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE F – REVENUE BONDS PAYABLE (continued)

The following is a summary of the Bonds issued and outstanding at June 30, 2005:

Year of issue	Final redemption date	Interest rates	Original amount of issue	Current		Total Current	Noncurrent
				Principal due July 1, 2005	Principal due January 1, 2006		
1997	July 1, 2027	3.95 – 5.75%	\$ 56,290,000	\$ 485,000	\$ –	\$ 485,000	\$ 52,915,000
2000	July 1, 2029	4.50 – 6.00%	79,405,000	2,140,000	–	2,140,000	66,145,000
2002	July 1, 2019	3.00 – 5.50%	24,420,000	2,010,000	–	2,010,000	18,290,000
2004	January 1, 2024	2.50 – 6.00%	52,030,000	–	4,390,000	4,390,000	43,515,000
			<u>\$212,145,000</u>	<u>\$4,635,000</u>	<u>\$4,390,000</u>	9,025,000	180,865,000
Less:							
Unamortized discount						(141,418)	(1,770,042)
Unamortized premium						231,816	963,682
Unamortized deferred loss on refunding						(640,141)	(4,211,403)
						<u>\$8,475,257</u>	<u>\$175,847,237</u>

The following is a summary of the Bonds issued and outstanding at June 30, 2004:

Year of issue	Final redemption date	Interest rates	Original amount of issue	Current		Total Current	Noncurrent
				Principal due July 1, 2004	Principal due January 1, 2005		
1997	July 1, 2027	3.95 – 5.75%	\$ 56,290,000	\$ 470,000	\$ –	\$ 470,000	\$ 53,400,000
2000	July 1, 2029	4.50 – 6.00%	79,405,000	2,035,000	–	2,035,000	68,285,000
2002	July 1, 2019	3.00 – 5.50%	24,420,000	1,920,000	–	1,920,000	20,300,000
2004	January 1, 2024	2.50 – 6.00%	52,030,000	–	4,125,000	4,125,000	47,905,000
			<u>\$212,145,000</u>	<u>\$4,425,000</u>	<u>\$4,125,000</u>	8,550,000	189,890,000
Less:							
Unamortized discount						(142,940)	(1,911,460)
Unamortized premium						189,102	1,195,498
Unamortized deferred loss on refunding						(566,849)	(4,825,171)
						<u>\$8,029,313</u>	<u>\$184,348,867</u>

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NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE F – REVENUE BONDS PAYABLE (continued)

Debt service requirements to maturity for the Bonds are as follows:

Fiscal year ending June 30,	Principal	Interest	Total
2006	\$ 9,345,000	\$ 9,879,000	\$ 19,224,000
2007	9,803,000	9,462,000	19,265,000
2008	9,500,000	8,982,000	18,482,000
2009	7,993,000	8,523,000	16,516,000
2010	8,425,000	8,139,000	16,564,000
2011 – 2015	41,885,000	33,835,000	75,720,000
2016 – 2020	45,683,000	21,891,000	67,574,000
2021 – 2025	37,193,000	9,028,000	46,221,000
2026 – 2029	13,235,000	1,478,000	14,713,000
	<u>\$183,062,000</u>	<u>\$111,217,000</u>	<u>\$294,279,000</u>

The above debt service requirements are set forth based upon funding requirements. Principal and interest payments are required to be funded in the 12-month and 6-month periods, respectively, preceding the date on which the payments are due. Accordingly, the above debt service requirements do not include debt service reserves as of June 30, 2005 which are held in anticipation of principal and interest payments due on July 1, 2005 and January 1, 2006.

On June 10, 2004, the Harbors Division issued \$5,730,000 in Bonds, Series A of 2004, and \$46,300,000 in Bonds, Series B of 2004. Series A of 2004 Bonds will mature through the year 2008 at an average interest rate of 4.20%, and Series B of 2004 Bonds will mature through the year 2024 at an average interest rate of 5.12%. The 2004 Series, totaling \$52,030,000 were issued at an average interest rate of 4.98% to refund \$5,760,000 of Bonds, 1993 Series (average interest rate of 6.09%) and \$45,765,000 of Bonds, 1994 Series (average interest rate of 6.20%). Total net proceeds of \$52,474,330 (including a premium of \$1,285,009 and after payment of \$840,679 in underwriting fees, insurance, and other issuance costs), along with an additional \$5,323,718 from the debt service reserve account, was deposited into an irrevocable trust with an escrow agent to provide for the redemption of the refunded portion of the Bonds, 1993 Series and 1994 Series, on July 1, 2004.

Although the refunding resulted in the recognition of a deferred loss of \$2,184,199, the Harbors Division in effect reduced its aggregate debt service payments by approximately \$7,573,128 over the next 20 years and obtained an economic gain (difference between present values of the old and new debt service payments) of approximately \$4,129,526.

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NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE G – HARBOR REVENUE BOND REQUIREMENTS

1. 1997 Certificate

a. Minimum Net Revenue Requirement

Pursuant to Section 6.03 of the 1997 Certificate, the Harbors Division covenants and agrees that so long as any of the Bonds remain outstanding, it will enforce and collect fees, rates, rents and charges for the Public Undertaking that will yield net revenue, as defined by the 1997 Certificate, for the immediately ensuing 12 months, in an amount at least sufficient to:

- (1) The amount computed in accordance with Section 6.03 of the 1997 Certificate:
 - (a) Together with funds legally available therefore including any amounts on deposit in the harbor reserve and contingency account; an aggregate sum equal to at least 1.25 times the total amount of: (i) the interest payments for such 12 months on all the Bonds outstanding under the 1997 Certificate, (ii) the principal amount of the Bonds maturing by their terms during such 12 months and (iii) the minimum sinking fund payments for all Bonds required to be made during such 12 months; and
 - (b) Without consideration of other funds, shall be at least equal to 1.00 times the bond service for such 12 months.

The harbor revenue bond debt service requirements, including minimum sinking fund payments during the current fiscal year, computed in accordance with Section 6.03 of the 1997 Certificate totaled \$19,224,013. Net revenues of the Public Undertaking amounted to \$54,163,450 or 2.82 times the minimum net revenue requirement for the fiscal year ended June 30, 2005.

b. Harbor Special Fund

All revenues are deposited into this fund and applied in the order of priority set forth under the 1997 Certificate. Section 5.01 of the 1997 Certificate requires that the following accounts be established:

(1) Harbor Interest Account

Equal monthly installments sufficient to pay for the interest next becoming due on the Bonds are required to be paid into this account. This requirement was met as of June 30, 2005.

(2) Harbor Principal Account

Commencing with the first business day of each fiscal year, equal monthly payments are required to be made to this account sufficient to redeem the Bonds scheduled for redemption on the following July 1 and January 1. This requirement was met as of June 30, 2005.

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NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE G – HARBOR REVENUE BOND REQUIREMENTS (continued)

1. 1997 Certificate (continued)

b. Harbor Special Fund (continued)

(3) Harbor Debt Service Reserve Account

In order to provide a reserve for the payment of the principal and interest on the Bonds, the Harbors Division is required to deposit in the harbor revenue special fund an amount equal to the lesser of: (a) the average annual bond service on such series and (b) the amount permitted by the Internal Revenue Code of 1986 in order that the interest on such series is excluded from gross income for federal income tax purposes.

Furthermore, the Harbors Division is required to satisfy the reserve requirement of maximum aggregate bond service by no later than the first date on which a principal installment is payable on July 1st or January 1st of each fiscal year.

In lieu of the credit of monies to the harbor debt service reserve account, the Harbors Division may cause to be so credited a surety bond or an insurance policy payable to the Harbors Division for the benefit of the holders of the Bonds of a series or a letter of credit in an amount equal to the difference between the reserve requirement and the amounts then on credit to the harbor debt service reserve account. In the event a surety bond, insurance policy, or letter of credit is secured to satisfy that portion of the reserve requirement allocable to a series of Bonds, so long as such surety bond, insurance policy, or letter of credit is in effect, the owners of such series of Bonds shall not be entitled to payment from or a lien on the funds on deposit in the harbor revenue special fund credited to the harbor debt service reserve account to satisfy that portion of the reserve requirement allocable to other series of Bonds, nor shall the owners of Bonds of such other series be entitled to any payment from such surety bond, insurance policy, or letter of credit. The surety bond, insurance policy, or letter of credit shall be payable (upon the giving of notice as required thereunder) on any date on which monies will be required to be applied from the harbor debt service reserve account to the payment of the principal or interest on any Bonds of such series and such withdrawals may not be made from amounts credited to the harbor debt service reserve account for such series of Bonds.

Prior to the use of a surety bond, insurance policy, or letter of credit pursuant to the provisions of this paragraph (other than any such use at the time of issuance of the 1997 Series bonds), DOT shall receive written confirmation from the rating agency that the rating on the Bonds outstanding as then in effect shall not be reduced as a result of such use. If a disbursement is made pursuant to a surety bond, an insurance policy, or a letter of credit provided pursuant to this paragraph, the Harbors Division shall be obligated either (a) to reinstate the maximum limits of such surety bond, insurance policy, or letter of credit or (b) to credit to the harbor debt service reserve account, funds in the amount of the disbursement made under such surety bond, insurance policy, or letter of credit, or a combination of such alternatives, as shall provide that the amount credited to the

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NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE G – HARBOR REVENUE BOND REQUIREMENTS (continued)

1. 1997 Certificate (continued)

b. Harbor Special Fund (continued)

(3) Harbor Debt Service Reserve Account (continued)

harbor debt service reserve account allocable to a series of Bonds equals that portion of the reserve requirement allocable to such series; provided, however, a failure to immediately restore such reserve requirement shall not constitute an event of default if the reserve requirement is restored within the time period permitted by Section 11.01(c) (90 days following the required notice). Notwithstanding the provisions of Section 11.01(c), the Harbors Division shall not permit any surety bond, insurance policy, or letter of credit which has been established in lieu of a deposit into the harbor revenue special fund for credit to the harbor debt service reserve account to terminate or expire prior to depositing to such fund for credit to such account the amount satisfied previously by the surety bond, insurance policy, or letter of credit.

(4) Harbor Reserve and Contingency Account

Monies on credit to the harbor reserve and contingency account may be used to make up any deficiency with respect to any series of Bonds in the harbor interest account, the harbor principal account and the harbor debt service reserve account. To the extent not used to make up any such deficiencies, monies on credit to the harbor reserve and contingency account may be used for any other purpose within the jurisdiction, powers, duties and functions of the Harbors Division.

NOTE H – SPECIAL FACILITY LEASE AND REVENUE BONDS

The State Legislature, in its 1980 session, authorized the issuance of special facility revenue bonds for the construction, acquisition, remodeling, furnishing and equipping of state-owned special facilities for lease to parties engaged in maritime operations.

Pursuant to this authorization, \$15,700,000 of 8-1/2% special facility revenue bond anticipation notes were issued in 1981 to finance the construction of container terminal facilities on Sand Island for the exclusive use of Matson Terminals, Inc. In 1983, special facility revenue bonds of \$16,750,000 were issued to refund the notes and to provide additional funds for construction. On April 15, 1993, special facility revenue bonds of \$16,500,000 were issued to refund the outstanding 1983 Series bonds. The special facility lease with Matson Terminals, Inc. was accounted for as a direct financing lease.

These bonds, which bear interest at 5.75% per annum, mature on March 1, 2013, subject to optional redemption on or after March 1, 2003 at prices ranging from 102% to 100% of face value. Matson Navigation Company, Inc., parent company of the lessee, has provided a guaranty agreement as to payment of principal and interest on the bonds.

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NOTE H – SPECIAL FACILITY LEASE AND REVENUE BONDS (continued)

On September 18, 2003, the bonds were redeemed in full at a price of 102% of the principal together with interest accrued to the redemption date. The remaining net investment in direct lease financing on the date of redemption was reclassified to buildings.

NOTE I – GENERAL OBLIGATION BONDS PAYABLE

The Harbors Division is required to reimburse the State General Fund for principal and interest on the following state general obligation bonds authorized and issued to finance certain capital improvement projects of the Public Undertaking:

The following is a summary of general obligation bonds issued and outstanding at June 30, 2005:

Year of issue	Last installment due date	Interest rates	Original amount of issue	Current	Noncurrent
1992	March 1, 2012	5.15 – 6.40%	\$ 12,870	\$ 715	\$ 4,289
1993	November 1, 2010	4.00 – 5.00%	160,901	10,725	53,627
1998	April 1, 2009	5.00 – 5.25%	64,631	9,196	30,511
2001	August 1, 2015	3.40 – 5.50%	737	52	685
2002	February 1, 2015	3.60 – 5.75%	1,481	–	1,481
			<u>\$240,620</u>	<u>\$20,688</u>	<u>\$90,593</u>

The following is a summary of general obligation bonds issued and outstanding at June 30, 2004:

Year of issue	Last installment due date	Interest rates	Original amount of issue	Current	Noncurrent
1992	March 1, 2012	5.15 – 6.40%	\$ 12,870	\$ –	\$ 5,004
1993	November 1, 2010	4.00 – 5.00%	160,901	10,725	64,352
1998	April 1, 2009	5.00 – 5.25%	64,631	8,737	39,707
2001	August 1, 2015	3.40 – 5.50%	737	–	737
2002	February 1, 2015	3.60 – 5.75%	1,481	–	1,481
			<u>\$240,620</u>	<u>\$19,462</u>	<u>\$111,281</u>

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NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

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NOTE I – GENERAL OBLIGATION BONDS PAYABLE (continued)

Debt service requirements to maturity for general obligation bonds are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Fiscal year ending June 30,			
2006	\$ 20,866	\$ 4,151	\$ 25,017
2007	21,432	3,330	24,762
2008	21,932	2,493	24,425
2009	19,655	1,634	21,289
2010	11,663	840	12,503
2011 – 2015	5,990	339	6,329
2016	7	–	7
	<u>\$101,545</u>	<u>\$12,787</u>	<u>\$114,332</u>

The above debt service requirements are set forth based upon funding requirements. Principal and interest payments are required to be funded in the 12-month and 6-month periods, respectively, preceding the date on which the payments are due. Accordingly, the above debt service requirements do not include debt service reserves as of June 30, 2005, which are held in anticipation of principal and interest payments due during the fiscal year ended June 30, 2006.

NOTE J – INTEREST COST

Total interest cost incurred for the fiscal years ended June 30, 2005 and 2004, amounted to \$10,847,813 and \$12,527,950, respectively. Of this amount, \$1,029,080 and \$1,437,024 were capitalized in the respective fiscal years as part of the construction cost of harbor facilities.

NOTE K – LEASING OPERATIONS

The Harbors Division's leasing operations consist principally of the leasing of land, wharf and building space under revocable permits and long-term leases. The revocable permits provide for tenancy on a month-to-month basis and are renewable annually at the option of the State. The long-term leases, which are classified as operating leases, expire in various years through 2058. These leases generally call for rental increases every five to ten years based on independent appraisals of the fair rental value of the leased property.

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NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

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NOTE K – LEASING OPERATIONS (continued)

The following is a schedule of approximate future minimum lease rentals on noncancelable operating leases as of June 30, 2005:

Fiscal year ending June 30,	Amount
2006	\$ 9,052,000
2007	8,473,000
2008	8,291,000
2009	8,356,000
2010	8,276,000
Thereafter	313,155,000
	\$355,603,000

The above schedule does not include estimated future rental revenue for certain leases beyond their first 15 years. An estimate could not be made due to rental re-openings after the fifteenth year in which rental rates will be based upon the prevailing fair value.

The Harbors Division estimates that approximately 10% of the land area (excluding submerged lands) and floor space of the harbor facilities is leased or held for lease. Information regarding the cost and related accumulated depreciation of these facilities, which is required by Statement of Financial Accounting Standards No. 13, *Accounting for Leases*, to be disclosed, is not provided because the accumulation of such data was not considered practical and because the information, when compared to the future minimum lease rentals to be received, would not be an accurate indication of the productivity of the property on lease or held for lease, due to the methods by which and the long period of time over which the properties were acquired.

NOTE L – RETIREMENT BENEFITS

1. Employees' Retirement System

Substantially all eligible employees of the Harbors Division are required by Chapter 88, Hawaii Revised Statutes (HRS), to become members of the Employees' Retirement System of the State of Hawaii (ERS), a cost-sharing multiple-employer public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. The ERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to the ERS at City Financial Tower, 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

Members of the ERS belong to either a contributory or noncontributory option. Only employees of the Harbors Division hired on or before June 30, 1984 are eligible to participate in the contributory option. Members are required by State statute to contribute 7.8% of their salary to the contributory option and the Harbors Division is required to contribute to both options at an actuarially determined rate. Contributions by

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NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE L – RETIREMENT BENEFITS (continued)

1. Employees' Retirement System (continued)

the Harbors Division for the fiscal years ended June 30, 2005, 2004 and 2003 were approximately \$766,000, \$734,000 and \$738,000, respectively. The contribution rate for the fiscal years ended June 30, 2005, 2004 and 2003 was 10.82%, 9.14% and 8.87%, respectively.

2. Post-Retirement Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State provides certain health care and life insurance benefits to retired State employees. Contributions are financed on a pay-as-you-go basis. The Harbors Division's share of the expense for post-retirement health care and life insurance benefits for the fiscal years ended June 30, 2005 and 2004, was approximately \$599,000 and \$595,000, respectively.

NOTE M – COMMITMENTS

1. Construction and Other Service Contracts

The Harbors Division is committed under contracts awarded for construction and other services. These commitments amounted to approximately \$49,496,000 at June 30, 2005.

2. Accumulated Sick Leave Pay

Employees earn sick leave credits at the rate of 14 hours for each month of service depending on the employee's hire date. Unused sick leave may be accumulated without limitation and is not convertible to pay upon termination of employment. Accordingly, no liability for sick pay is recorded. However, for public employees who retire or leave government service in good standing with sixty days or more of unused sick leave, the unused sick leave is converted to additional retirement service credit at the rate of one additional month of service for each 20 days of unused sick leave. Accumulated sick leave as of June 30, 2005 approximated \$5,726,000.

3. Deferred Compensation Plan

The State offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all state employees, permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

All plan assets are held in a trust fund to protect them from claims of general creditors. The State has no responsibility for loss due to the investment or failure of investment of funds and assets in the plan, but does have the duty of due care that would be required of an ordinary prudent investor. Accordingly, the assets and liabilities of the State's deferred compensation plan are not reported in the State's or Harbors Division's financial statements.

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NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE N – RISK MANAGEMENT

The Harbors Division is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; workers' compensation and acts of terrorism. The State generally retains the first \$250,000 per occurrence of property losses and the first \$3 million with respect to general liability claims. Losses in excess of those retention amounts are insured with commercial insurance carriers. The limit per occurrence for property losses is \$25 million (\$10 million for earthquake, named hurricane, and flood) and the annual aggregate for general liability losses per occurrence is \$7 million.

The State is generally self-insured for workers' compensation and automobile claims. The State's estimated reserve for losses and loss adjustment costs includes the accumulation of estimates for losses and claims reported prior to fiscal year end, estimates (based on projections of historical developments) or claims incurred but not reported, and estimates of costs for investigating and adjusting all incurred and unadjusted claims. Amounts reported are subject to the impact of future changes in economic and social conditions. The State believes that, given the inherent variability in any such estimates, the reserves are within a reasonable and acceptable range of adequacy. Reserves are continually monitored and reviewed, and as settlements are made and reserves adjusted, the differences are reported in current operations. A liability for a claim is established if information indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss is reasonably estimable.

NOTE O – CEDED LANDS

In 1898, the former Republic of Hawaii transferred certain lands to the United States. Upon Hawaii's admission to the Union 1959, the United States reconveyed title to those lands (collectively, the ceded lands) to the State to be held as a public trust for five purposes: (1) public education; (2) betterment of the conditions of native Hawaiians; (3) development of farm and home ownership; (4) making public improvements; and (5) provision of land for public use. In 1978, the State Constitution was amended expressly to provide that the ceded lands were to be held as a public trust for native Hawaiians and the general public, and to establish the Office of Hawaiian Affairs (OHA) to administer and manage the proceeds and income derived from a pro rata portion of the ceded lands to better the conditions of native Hawaiians.

In 1979, the State Legislature adopted HRS Chapter 10 (Chapter 10), which, as amended in 1980, specified, among other things, that OHA expend 20% of all funds derived by the State from the ceded lands for the betterment of native Hawaiians.

In 1987, in *Trustees of the Office of Hawaiian Affairs v. Yamasaki*, 69 Haw. 154 (1987), the Hawaii Supreme Court concluded that Chapter 10 was insufficiently clear regarding the amount of monies OHA was entitled to receive from the public trust lands.

In 1990, in response to *Yamasaki*, the State Legislature adopted Act 304, Session Laws of Hawaii 1990, which (1) defined "public land trust" and "revenue," (2) reiterated that 20% of the now defined "revenue" derived from the "public land trust" was to be expended by OHA for the betterment of native Hawaiians, and (3) established a

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NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE O – CEDED LANDS (continued)

process for OHA and the Director of Finance to jointly determine the amount of monies which the State would pay OHA to retroactively settle all of OHA's claims for the period June 16, 1980 through June 30, 1991. Since fiscal year 1992 and until the first quarter of fiscal year 2002, the State, through its departments and agencies, paid 20% of "revenues" to OHA on a quarterly basis.

In 1993, the State Legislature enacted Act 35, Session Laws of Hawaii 1993, appropriating \$136.5 million to pay the amount determined to be OHA's claims, with interest, for the period June 16, 1980 through June 30, 1991.

On January 14, 1994, OHA and its Board of Trustees (the Plaintiffs) filed suit against the State (*OHA, et al. v. State of Hawaii, et al.*, Civil No. 94-0205-01 (First Circuit)) (OHA I), claiming that the amount paid to OHA was inadequate and alleging that the State had failed to properly account for and fully pay the pro rata share of proceeds and income derived from the public land trust. Among other things, the Plaintiffs sought an accounting of all proceeds and income, funds and revenue derived from the public land trust since 1978, and restitution or damages amounting to 20% of the proceeds and income derived from the public land trust, as well as interest thereon. In its answer to OHA's complaint, the State denied all of the Plaintiff's substantive allegations, and asserted its sovereign immunity from suit and other jurisdictional and claim-barring defenses.

The Plaintiffs thereafter filed four motions for partial summary judgment as to the State's liability to pay OHA 20% of monies it receives from (1) the Department of Transportation Airports Division's in-bound duty free airport concession (including receipts from the concessionaire's off-airport sales operations), (2) the State-owned and operated Hilo Hospital, (3) the State's public rental housing projects and affordable housing developments, and (4) interest income, including investment earnings (collectively, the Sources). In response, the State filed a motion to dismiss on the basis of sovereign immunity and opposed Plaintiff's four motions on the merits and raised several affirmative defenses.

On October 24, 1996, the Circuit Court filed an order denying the State's motion to dismiss and rejecting its affirmative defenses. Also on October 24, 1996 the Circuit Court filed an order granting Plaintiff's four motions for partial summary judgment with respect to the State's liability to pay OHA 20% of the monies it receives from each of the Sources, and deferred establishing amounts owed from those Sources for further proceedings or trial. The State's motion for leave to file an interlocutory appeal from both the order denying its motion to dismiss and the order granting Plaintiff's four partial summary judgments was granted and all proceedings in the suit were stayed pending the Hawaii Supreme Court's disposition of the State's appeal.

On September 12, 2001, the Hawaii Supreme Court concluded OHA I by holding in *OHA v. State of Hawaii* 96 Haw. 388 (2001) that Act 304 was effectively repealed by its own terms, and that there was no judicially manageable standard by which to determine whether OHA was entitled to the revenues it sought from the Sources because the repeal of Act 304 revived the law which the Hawaii Supreme Court in *Yamasaki* had previously concluded was insufficiently clear to establish how much OHA was entitled to receive from the ceded lands. The Hawaii Supreme Court dismissed the case for lack of justiciability, that is, that the case was not appropriate for review by the Court, noting that it was up to the State Legislature to enact legislation to give effect to the right of native Hawaiians to benefit from the ceded lands under the State Constitution. Immediately thereafter, agencies ceased paying OHA the receipts from the ceded lands.

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NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE O – CEDED LANDS (continued)

The State Legislature took no action during the 2002, 2003 and 2004 legislative sessions to establish a new mechanism for establishing how much OHA was entitled to receive from the ceded lands. On January 10, 2003, and pending legislative action to establish such a mechanism, the Governor issued Executive Order No. 03-03 directing state agencies to resume transferring 20% of receipts from leases, licenses and permits indisputably paid for the use of improved or unimproved parcels of ceded lands to OHA, if federal or state law did not preclude all or any portion of the receipt from being used to better the conditions of native Hawaiians, and the transfer of all or any portion of the receipt to OHA would not cause the agency to renege on a preexisting pledge, rate covenant, or other preexisting obligation to holders of revenue bonds or other indebtedness of the State or the agency. During the 2003 legislative session, the State Legislature appropriated moneys from the various funds into which the ceded lands receipts had been deposited after the decision in *OHA I* was issued and agencies ceased making payments to OHA, and directed the agencies to pay them to OHA.

OHA continues to pursue its claims for a portion of the revenues from the Sources and other Ceded Lands that it made to *OHA I*. On July 21, 2003, OHA filed a new lawsuit, *OHA et al. V. State of Hawaii, et al.*, Civil No. 03-1-1505-07 (*OHA II*). There follows additional background information pertinent to *OHA II*. In September 1996, the Office of the Inspector General of the U.S. Department of Transportation (DOT) issued a report (the IG Report) concluding that from 1992 to 1995, the Hawaii Department of Transportation's payment to OHA of \$28.2 million was a diversion of airport revenues in violation of applicable federal law as OHA provided no airport services in return. The Attorney General of Hawaii disagreed with the IG Report's conclusion, stating in November 1996 that the payments to OHA were simply an operating cost of the airports, and thus not a diversion of airport revenues in violation of federal law. In April 1997, the Acting Administrator of the FAA concurred in writing (the FAA Memorandum) with the IG Report and opposed the Hawaii Attorney General's position. In support of its appeal of the circuit court's *OHA I* decision to the Hawaii Supreme Court, but differing with the original position of the Attorney General, the State noted in its May 1997 amended opening brief that "unless the federal government's position set forth in the IG Report changes, Act 304 prohibits the State from paying OHA airport-related revenues." In its June 1997 reply brief, the State stated that the "DOT Inspector General's determination shows that the federal government is on its way to finding such payments illegal and requiring the State to reimburse past payments of airport-related revenues to OHA." In October 1997, the Department of Transportation and Related Agencies Appropriation Act, 1998, PL 105-66, 1997 HR 2169 (the DOT Appropriation Act) was enacted into federal law. Section 340 of the DOT Appropriation Act (Section 340) essentially provides that in exchange for there being no further payments of airport revenues for claims related to Ceded Lands, any such payments received prior to April 1, 1996 need not be repaid. The Hawaii Attorney General submitted enactment of Section 340 to the Hawaii Supreme Court in December 1997, "for the Court's use" in conjunction with the *OHA I* appeal, whereupon the Court requested the parties to submit supplemental briefs to address whether Section 340 affected the Court's interpretation of Act 304. The State, in its March 1998 supplemental brief, stated, inter alia, that paying OHA a pro rata share of airport monies violated federal law, and that there was no live, ripe controversy regarding those payments because the DOT appropriation Act relieved the State and OHA of any obligation to return improper past payments.

Despite the adverse *OHA I* decision, the Plaintiffs in *OHA II* sued the State for alleged breaches of fiduciary duties as purported trustee of the Ceded Lands public trust, alleged violations of Act 304, Chapter 10, and Article

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NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE O – CEDED LANDS (continued)

XII, Sections 4, 5 and 6 of the Hawaii Constitution, violations of the Contract Clause of the U.S. Constitution, and misrepresentation and non-disclosure, by the following alleged acts (but not limited to these acts): (1) failing to oppose the positions set forth in the FAA Memorandum; (2) resolving its dispute with the FAA by obtaining a forgiveness of the prior \$28.2 million payment in exchange for a promise not to make future airport revenue payments to OHA and not to appeal the positions set forth in the FAA Memorandum; (3) breaching the trust duty of impartiality by not opposing the positions set forth in the FAA Memorandum in order to use them as a sword in *OHA I*; (4) failing to timely advise OHA that the State was not going to continue to oppose the positions set forth in the FAA Memorandum or IG Report, and that it was planning to settle with the federal government, in order to provide OHA with a fair opportunity to take measures to step into the State's position to oppose the FAA; and (5) failing to obtain instructions from the Court on how to proceed given the State's conflict between defending the State against OHA in *OHA I*, and having a duty to oppose the positions set forth in the FAA Memorandum.

OHA further alleges that these alleged "breaches, errors and omissions" were substantial factors that resulted in the passing of Section 340 and the issuance of the Hawaii Supreme Court's opinion in *OHA I*. Plaintiffs claim that, accordingly, the State is liable to OHA for damages including, but not limited to: (1) the damages alleged by OHA in *OHA I*, and (2) amounts payable under Act 304 that have not been paid, including but not limited to, airport landing fees. Plaintiffs also sought declaratory and injunctive relief ordering the State to reinstate Act 304, pay airport-related revenues to OHA from sources other than airport revenues (and enjoining the State and its agents, employees, and officials from opposing any of the above), and sought appointment of an independent trustee to temporarily replace the State as trustee of the native Hawaiian public trust with respect to matters relating to reinstatement of Act 304 and the payment of airport-related revenues to OHA from sources other than airport revenues. The State filed a motion to dismiss OHA's complaint in *OHA II* which the Court granted in an order filed on December 26, 2003. The Court entered a final judgment on May 19, 2004, encompassing the order dismissing the complaint and several procedural orders. On June 8, 2004, OHA filed a notice of appeal from the portions of the May 19, 2004 judgment dismissing its complaint in *OHA II*, denying leave to amend the complaint and denying a request for bifurcation of OHA's claims for liability and damages. The Hawaii Supreme Court affirmed the Circuit Court's order dismissing OHA's complaint in a decision issued September 9, 2005. OHA has asked the Court to reconsider its decision, and the Court has given itself until November 15, 2005 to respond to the request.

The State intends to vigorously defend against all of OHA's claims. It is currently unable to predict with reasonable certainty the magnitude of its potential liability for such claims, if any. Accordingly, no estimate of loss has been recorded in the accompanying financial statements of the Harbors Division. The State Attorney General is of the view that the claims asserted by OHA in *OHA II* are meritless. Resolution of all of the OHA's claims could have a material adverse effect on the Harbors Division's financial condition.

In a second lawsuit, OHA and four individuals filed complaints for declaratory and injunctive relief on November 4, 1994, and November 9, 1994 (*OHA v. Housing Finance and Development Corporation et al.*, Civil No. 94-4207-11 (1st Cir.)) to enjoin the State from alienating any Ceded Lands and extinguishing any rights Hawaiians may have in Ceded Lands that may be alienated. Alternatively, OHA sought a declaration that the amounts the

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NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

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NOTE O – CEDED LANDS (continued)

Housing Finance and Development Corporation (now, the Housing and Community Development Corporation of Hawaii or the Corporation) and the State paid to OHA for Ceded Lands the Corporation planned to use to develop and sell housing units pursuant to Act 318, 1992 Session Laws of Hawaii, were insufficient. Act 318 established a separate process for valuing the Ceded Lands the Corporation used for its two housing developments at Kealakehe and Lahaina, and quantifying the amounts of income and proceeds from the Ceded Lands that the Corporation and State were required to pay to OHA for conveying and using the parcels for the Corporation's two projects.

In December 2002, following a trial on the issues, the trial court confirmed the State's authority to sell ceded lands, denied the declaratory ruling that the sale of ceded lands did not directly or indirectly release or limit Hawaiians' claims to those lands which the plaintiffs requested, and ordered that judgment be entered in the State's and Corporation's favor as to Counts I, II, and III of the Amended Complaint. The plaintiffs moved for and were granted leave to file immediate appeals from the court's rulings to the Hawaii Supreme Court. Those appeals are now pending. Trial to determine the sufficiency of the proceeds paid to OHA from the sale of the particular parcels of ceded lands at issue has not been scheduled.

In a third lawsuit, OHA filed suit against the Hawaii Housing Authority (HHA and now the Corporation), the executive director of the HHA, the board members of the HHA and the Director of Finance on July 27, 1995 (OHA v. HHA, et al., Civil No. 95-2682-07 (1st Cir)) to secure additional compensation and an itemized accounting of the sums previously paid to OHA for five specifically identified parcels of Ceded Lands which were transferred to the HHA for its use to develop, construct, and manage additional affordable public rental housing units under HRS Chapter 201G. On January 11, 2000, all proceedings in this suit were stayed pending the Hawaii Supreme Court's decision in the State's appeal in *OHA I*. OHA disagrees that the repeal and revival of the pre-Yamasaki law by the Hawaii Supreme Court's September 12, 2001 decision in *OHA I* should also require dismissal of the claims OHA makes in *OHA v. HHA*, and the case remains pending.

Amounts payable to OHA are treated as operating expenses of DOT's commercial harbors system. Assessments of \$6,520,111 and \$6,517,123 for the fiscal years ended June 30, 2005 and 2004, respectively, are included as an operating expense in the statements of revenues, expenses and changes in net assets.

NOTE P – TRANSACTIONS WITH OTHER GOVERNMENT AGENCIES

The State assesses a surcharge of 5% for central service expenses on all receipts of the Harbors Division, after deducting any amounts pledged, charged or encumbered for the payment of bonds and interest during the fiscal year. The assessments amounted to \$2,698,964 and \$2,766,405 for the fiscal years ended June 30, 2005 and 2004, respectively.

The Harbors Division is assessed a percentage of DOT's general administration expenses. The assessments amounted to \$972,529 and \$733,531 for the fiscal years ended June 30, 2005 and 2004, respectively.

The Harbors Division incurred costs of \$1,596,781 and \$1,704,790 for fireboat operation services provided by the City and County of Honolulu during the fiscal years ended June 30, 2005 and 2004, respectively.

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NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

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NOTE P – TRANSACTIONS WITH OTHER GOVERNMENT AGENCIES (continued)

The Small Boat Harbors Boating Program (Program) was transferred from DOT to the Department of Land and Natural Resources (DLNR) in fiscal year 1992. Services performed by the Harbors Division for the Program are fully reimbursed by the Program. Services rendered to the Program during the fiscal years ended June 30, 2005 and 2004 amounted to \$96,140 and \$100,636, respectively.

NOTE Q – ALOHA TOWER COMPLEX DEVELOPMENT

The Aloha Tower Development Corporation (ATDC) is a state agency established under HRS Chapter 206J, primarily to redevelop the Aloha Tower complex. The complex encompasses Piers 5 to 23 of Honolulu Harbor. In September 1993, the Harbors Division entered into a lease with ATDC transferring to ATDC portions of the Aloha Tower complex. ATDC is required annually to reimburse the Harbors Division for any losses in revenues during the term of the lease caused by any action of ATDC or the developer and to provide replacement facilities for maritime activities at no cost to the Harbors Division.

In September 1993, the ATDC subleased lands surrounded by Piers 8 and 9 and a portion of land surrounded by Pier 10 to a developer. The sublease required the developer to construct, at the developer's cost, various facilities including a Marketplace. The developer and the Harbors Division entered into a capital improvements, maintenance, operations and securities agreement (Operations Agreement). The Operations Agreement allows the Harbors Division to operate the harbor facilities.

The developer later went into bankruptcy. The subsequent operator of the Marketplace assumed the obligations of the sublease and the Operations Agreement in March of 1998. This replacement operator has also gone through a bankruptcy proceeding and there is a new operator who has assumed the same obligations. Although the Marketplace construction was substantially completed, several items on a Harbors Division construction punchlist have yet to be completed and are being pursued with the new operator.

Discussions have been on-going between the Harbors Division and ATDC to revise the provisions in the lease requiring ATDC to annually reimburse the Harbors Division for any losses in revenues during the term of the lease. The outcome of these discussions may result in an amendment of the lease which will alter the obligations of ATDC to reimburse the Harbors Division on an annual basis from and after July 1, 2004.

Revenues for the fiscal years ended June 30, 2005 and 2004 amounted to \$1,848,086 and \$1,763,995, respectively, and have been included in rental revenues in the respective fiscal year. As of June 30, 2005 and 2004, amounts due to the Harbors Division were \$9,899,449 and \$8,051,363, respectively.

NOTE R – TRANSFER OF LAND TO OTHER STATE AGENCIES

In the 1990 legislative session, the State Legislature enacted Act 86, which transferred certain lands at Kewalo Basin and Fort Armstrong under the jurisdiction of the Harbors Division to the Hawaii Community Development Authority (HCDA), a state agency which oversees the development of the Kakaako Community Development District (District).

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NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

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NOTE R – TRANSFER OF LAND TO OTHER STATE AGENCIES (continued)

Approximately 73 acres of the Harbors Division's land was transferred to HCDA under Act 86. Act 86 provides for HCDA to ensure due and adequate satisfaction of provisions for any covenant between the State or any county or any department or board thereof and the holders of bonds issued by the State or such county, department or board, if any.

As part of HCDA's development of the District, the western portion of the Kewalo Basin area is scheduled for redevelopment. HCDA has selected a master developer for the waterfront around Kewalo Basin. The Harbors Division has long been negotiating with HCDA to resolve issues relating to the Harbors Division's continued operation and management of Kewalo Basin until HCDA was ready to proceed with its redevelopment plans. By an informal understanding, the Harbors Division retained all revenues generated from its management of Kewalo Basin and continued to manage maritime operations and provide for maintenance and capital improvements during this interim period. While fee title to Kewalo Basin was transferred to HCDA under Act 86, SLH 1990, the law was silent as to the transfer of the improvements. As of June 30, 2005, the Harbors Division recorded approximately \$4.5 million as the remaining depreciated value of its Kewalo improvements. Legal advice has been rendered that all improvements as well as the fee simple title transferred as a result of the law. The Harbors Division is discussing the orderly transfer of all responsibilities relating to Kewalo Basin to HCDA in light of HCDA's development schedule. Issues to be resolved include whether HCDA will provide compensation to the Harbor Division for the remaining depreciated value of the Kewalo improvements. The outcome of these discussions may result in a loss on disposal of the Kewalo improvements in future financial statements and the elimination of the Harbors Division's management and operation of Kewalo Basin, and all revenues therefrom, as of June 30, 2006.

Within the Fort Armstrong area, consisting of Piers 1 and 2 at Honolulu Harbor, HCDA has extended Ilalo Street and realigned Forrest Avenue, both of which are major circulatory roadways in the District. Because the realignment of Forrest Avenue affected certain facilities and improvements used by harbor users, HCDA has replaced such facilities and improvements at HCDA's cost. With respect to Fort Armstrong, the Harbors Division also expects to continue operating the harbor facilities, managing adjacent land areas, and enforcing its applicable administrative rules.

The legal advice rendered on the Kewalo improvements is also applicable to the Fort Armstrong area. The Harbors Division is preparing legislation to be considered by the 2006 Legislature to return Piers 1 and 2 to the jurisdiction of the Harbors Division.

NOTE S – KAPALAMA LAND DEVELOPMENT

Between 1990 and 1993, the State acquired three parcels of land totaling approximately 61.8 acres within the Kapalama Military Reservation area, comprised primarily of areas adjacent or near to Piers 39 through 41 at Honolulu Harbor (the "KMR site"). Governor's Executive Order No. 3497 set aside two parcels comprising 40.6 acres to the Harbors Division for harbor purposes on September 24, 2002. The set-aside of the remaining 21.2-acre parcel is pending. This parcel was purchased for approximately \$34.9 million and involved the use of approximately \$8.2 million of the Department of Transportation, Airports Division's (Airports Division) funds.

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NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE S – KAPALAMA LAND DEVELOPMENT (continued)

There have been ongoing efforts between the Harbors Division and Airports Division to designate the portion of the parcel to be used for their respective purposes. Discussions have also been explored regarding the possibility of the Airports Division selling its interest in the parcel to the Harbors Division. As a result, action on the issuance of a further Executive Order for the remaining parcel has been deferred until the matter could be resolved.

During the past year, the Harbors Division intensified its efforts to plan for the future development of the KMR site. The intended improvements will involve the creation of a new cargo container yard and vessel berthing piers. In support of this development effort, the Harbors Division established the Hawaii Harbors Project Office to lead and coordinate the development of the KMR site improvements. Legal advice has been rendered that current efforts seeking an Executive Order for the remaining parcel as noted above should cease and that in order to transfer Airports Division's interest in the KMR site to Harbors, Airports Division must be repaid \$8.2 million, the amount it contributed to the purchase price of the KMR site.

The Harbors Division is also seeking the transfer of approximately 11.344 acres of ceded lands that were previously promised to the Airports Division near the KMR site to consolidate the lands needed for the future development. The resolution of this matter is dependent upon Airports Division's compliance with certain steps outlined in the legal advice rendered, based on a clarification from the FAA on the State's land ownership procedures and the FAA's requirement of receipt of fair market value on land disposal.

NOTE T – ARBITRAGE

The Harbors Division is required to annually calculate rebates to the U.S. treasury on the harbor revenue bonds issued from 1986. In accordance with the requirements of Section 148 of the Internal Revenue Code of 1986, as amended, rebates are calculated by bond series based on the amount by which the cumulative amount of investment income exceeds the amount that would have been earned had funds been invested at the bond yield. In the opinion of management, rebates payable as of June 30, 2005, if any, are not material to the financial statements. Accordingly, no rebates payable have been recorded in the accompanying financial statements.

NOTE U – CONTINGENCIES

1. Environmental Issues

The Harbors Division is subject to laws and regulations relating to the protection of the environment. The Harbors Division has been identified by the State Department of Health as a potentially responsible party, for petroleum contamination in the Honolulu Harbor/Iwilei area. Pursuant thereto, the Harbors Division entered into a voluntary agreement with the Department of Health and other third parties to share in the responsibility for the investigation and potential remediation of petroleum contamination in the Iwilei District. This group of potentially responsible parties known as the Iwilei District Participating Parties ("IDPP"), has conducted various investigations to determine potential contamination in the Iwilei area from 1997 to present, which investigations have determined the existence of petroleum contamination at various

State of Hawaii
Department of Transportation
Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE U – CONTINGENCIES (continued)

1. Environmental Issues (continued)

locations. Potential remedial alternatives are still being studied. At this stage, the project has not yet advanced to the stage where total costs to the IDPP can reasonably be estimated, due to (1) the extent of environmental impact, (2) the undetermined allocation among the potentially responsible parties, (3) the ongoing review of reasonable remediation alternatives, and (4) continued discussion with the regulatory authorities. As a result, it is not possible to reasonably estimate the amount of the potential cost to the IDPP and of the share of the Harbor's Division; and if there would be a material impact to the Harbor's Division's financial statements. Accordingly, no estimate of loss has been recorded in the accompanying financial statements.

2. Litigation

The Harbors Division is subject to a number of lawsuits arising in the ordinary course of its operations. While the ultimate liabilities, if any, in the disposition of these matters are presently difficult to estimate, it is management's belief that the outcomes are not likely to have a material adverse effect on the Harbors Division's financial position. Accordingly, no provisions for any liabilities that might result have been made in the accompanying financial statements.

NOTE V – SUBSEQUENT EVENTS

Act 178, Session Laws of Hawaii 2005, appropriated reimbursable general obligation bonds of \$20.0 million each year, FY 2006 and FY 2007, for harbor improvements needed to support the operations of Hawaii Superferry, Inc. (HSF). HSF plans to begin inter-island ferry service with its first ferry to Maui and Kauai from Honolulu in April, 2007 and to the island of Hawaii approximately 18 months later. The Harbors Division will be responsible for debt service payments on the bonds. The Harbors Division has executed a \$37.5 million contract for the construction of barges and ramps with a current authorized expenditure limitation of \$20 million, with an additional \$17.5 million to be encumbered in FY 2007. Expenditure of the balance of this appropriation is planned to finance other harbor upgrades needed to support the operations of HSF.

SUPPLEMENTARY INFORMATION

State of Hawaii
Department of Transportation
Harbors Division

CASH AND CASH EQUIVALENTS OF THE PUBLIC UNDERTAKING

June 30, 2005

Unrestricted cash and cash equivalents	<u>\$ 89,201,548</u>
Restricted cash and cash equivalents	
For construction	66,613,879
For matured revenue bonds and interest coupons payable	5,100
For general obligation bond debt service payments	10,655
For revenue bond debt service payments	11,915,794
For security deposits	2,664,504
For revenue bond harbors reserve and contingency account	<u>10,897,658</u>
	<u>92,107,590</u>
	<u><u>\$ 181,309,138</u></u>
With Director of Finance, State of Hawaii	\$ 181,288,538
With fiscal agents	5,100
On hand	<u>15,500</u>
TOTAL	<u><u>\$ 181,309,138</u></u>

State of Hawaii
Department of Transportation
Harbors Division

CONSTRUCTION IN PROGRESS OF THE PUBLIC UNDERTAKING

Fiscal year ended June 30, 2005

Project	Balance at July 1, 2004	Additions by source of funds			
		Harbor Special Fund	Harbor Revenue Bonds	Capitalized interest	
Statewide:					
Removal of architectural barriers	\$ 445,916	\$ 24,312	\$ -	\$ -	\$
Site survey and installation of controls	969	-	-	-	
Various commercial harbor improvements	15,418	467,646	-	12,939	
Screening Equipment for Neighbor Island Passenger Terminals	-	4,255	-	110	
Maritime Workers Identification System, Statewide	-	8,789	-	228	
Security Surveillance System for Neighbor Island Passenger Terminals	-	18,161	-	472	
Installation of Septic System at Harbor Agent's Office, Kalaeloa BP & Inter-Island Ferry System, Statewide	-	45,713	-	1,189	
Inter-Island Ferry System, Statewide	-	100,827	-	2,621	
Barges & Vehicle Ramp Systems for Inter-Island Ferry Service, Statewide	-	2,564	-	67	
Honolulu Harbor:					
Repair and Repaint Exterior of CFS No. 2, Fort Armst	2,611	110,347	-	-	
Petroleum, oil and lubricant remediation study	858,667	88,629	-	-	
Lead paint and asbestos study	220,730	5,746	(4,200)	-	
Sand Island tunnel feasibility study	1,111,152	-	-	11,608	
Piers 24-29 shed demolition and site improvement	1,800,549	473	-	-	
Sand Island container yard reconstruction	2,137,421	-	-	91,594	
Harbor planning	253,447	-	-	-	
Demolition of storage tanks	112,454	414,520	8,260	15,496	
Pier 19 ferry and cruise passenger terminal	5,792,797	172,008	-	99,516	
Pier 2 cruise ship terminal	1,474,750	9,929,328	-	314,199	
Risk assessment for Piers 36-38	464,052	(18,039)	-	-	
Substructure Repairs at Piers 8 and 9	185	216,594	-	-	
Replace lift station at Pier 27	228,962	16,285	-	-	
Bulkhead improvements at Piers 25-28	1,013,077	6,239	-	-	
Bullrail installation	1,106,578	1,249	-	54,714	
Environmental investigation near Pier 32	6,971	1,392	-	359	
Revetment Repairs at Pier 39, Honolulu Harbor	-	12,268	-	-	
Dredge Ewa end of Pier 51A	596,896	9,634	-	29,357	
Environmental Remediations Piers 36-38	849,808	87,067	-	18,164	
Video monitoring system	81,735	293	-	3,736	
Relamp floodlights at Piers 51-53	86,975	-	-	-	
Pile improvements at Pier 40	133,936	125	-	-	
Subtotal carried forward	\$ 18,796,056	\$ 11,726,425	\$ 4,060	\$ 656,369	\$

State of Hawaii
Department of Transportation
Harbors Division

CONSTRUCTION IN PROGRESS OF THE PUBLIC UNDERTAKING (continued)

Fiscal year ended June 30, 2005

Project	Balance at July 1, 2004	Additions by source of funds		
		Harbor Special Fund	Harbor Revenue Bonds	Capitalized interest
Subtotal brought forward	\$ 18,796,056	\$ 11,726,425	\$ 4,060	\$ 656,369
Honolulu Harbor (continued):				
Reroof Pier 40 office building	3,597	5,543	-	-
Pavement improvements at Fort Armstrong	314,627	45,410	-	-
Risk assessment for Pier 29	55,550	2,692	-	2,816
Keehi Industrial Park drainage improvements	187,570	97,551	-	11,970
Methane Mitigation, Pier 38, Parcel 2	327,435	23,911	-	9,201
Piers 1-2 substructure barrier	32,188	325,319	-	2,904
Security surveillance system	528,218	23,992	-	4,519
Reconstruction of Pier 51B Container Yard	9,598	268,656	-	7,470
Replace Fire Alarm system at Piers 19-21	1,239	282,578	-	-
Replace Fire Alarm System at Pier 32 Shed	901	91,718	-	-
Repair Roll-up Doors at Piers 13-14 Shed	1,314	80,390	-	-
Construction of Mooring Bollards at Piers 19-21	8,377	51,358	-	1,759
Replace Fenders at Pier 39E	263	109,716	-	-
Repair Gutter System at Pier 39 Shed	225	113,388	-	-
Environmental Soil Testing and Soil Disposal	109,847	-	-	2
Installation of RPM system at Fort Armstrong	1,513	20,632	-	609
Replacement of Fireboat	-	-	(74,225)	-
Tank Farm Demolition & Pipeline Removal Near Pier 32	-	-	62,560	-
Repaint Shed at Piers 10 & 11	-	842	-	-
Fender Repairs at Pier 39	-	6,422	-	-
Crash Barriers Gates for Container Terminal	-	7,022	-	183
Channel Barrier	-	14,240	-	370
Ph I Environmental Site Assessment of the Former Kapalama Military Reserv	-	51,979	-	1,165
Substructure Repairs at Pier 2	-	9,678	-	-
Perimeter Fencing Improvement at Honolulu & Kalaheo BPT Harbors	-	5,818	-	151
Methane Mitigation, Pier 38, Lease Parcel 8	-	8,657	-	225
Construction of CBP Facilities and Misc Improvement for Pier 2 Cruise Termi	-	89,142	-	2,318
Methane Mitigation Pier 38 Lease Parcel 9	-	1,782	-	47
Passenger gangway at Pier 2 Cruise Terminal	-	1,029	-	27
Extension of Pier 38 Fender System	-	4,416	-	115
Keehi Industrial Park Dust Mitigation	-	2,569	-	67
Subtotal carried forward	\$ 20,378,518	\$ 13,472,875	\$ (7,605)	\$ 702,287

State of Hawaii
Department of Transportation
Harbors Division

CONSTRUCTION IN PROGRESS OF THE PUBLIC UNDERTAKING (continued)

Fiscal year ended June 30, 2005

Project	Balance at July 1, 2004	Additions by source of funds			Transfer out	Balance June 30, 2005
		Harbor Special Fund	Harbor Revenue Bonds	Capitalized interest		
	\$ 20,378,518	\$ 13,472,875	\$ (7,605)	\$ 702,287	\$ 7,610,144	\$ 26,935,931
Construction for Various Pier 2 Cruise Terminal In	-	1,598	-	42	-	1,640
	-	3,523	-	92	-	3,615
	-	448	-	12	-	460
Barriers at Pier 11	-	1,004	-	26	-	1,030
and Soil from Domestic Commercial Fishing	-	121	-	3	-	124
	103,928	42	-	-	103,970	-
	93,380	22,275	-	4,838	-	120,493
	3,723	274,144	-	-	277,867	-
	75	216,167	-	-	216,242	-
	-	9,563	-	-	9,563	-
	491,353	283,614	-	29,283	-	804,250
	15,714	130,566	-	3,985	-	150,265
Closures at piers P-1, P-5, and P-6	113	88,741	-	-	88,854	-
	606	158	-	30	-	794
	-	437	-	-	437	-
	322,777	-	-	-	322,777	-
	119,193	-	-	-	119,193	-
	109,249	39,000	-	6,318	-	154,567
Construction- Phase 2	191	217,809	-	-	218,000	-
District Office	41	41,287	-	-	41,328	-
sewerline improvements	254,067	25,904	-	13,843	-	293,814
	75,636	222,229	-	9,538	-	307,403
ber Yard	172,263	111,003	-	11,585	-	294,851
Pier 1c	3,551	6,493	-	324	-	10,368
Yard	41	111,063	-	-	111,104	-
	\$ 22,144,419	\$ 15,280,064	\$ (7,605)	\$ 782,206	\$ 9,119,479	\$ 29,079,605

State of Hawaii
Department of Transportation
Harbors Division

CONSTRUCTION IN PROGRESS OF THE PUBLIC UNDERTAKING (continued)

Fiscal year ended June 30, 2005

Project	Balance at July 1, 2004	Additions by source of funds			
		Harbor Special Fund	Harbor Revenue Bonds	Capitalized interest	
Subtotal brought forward	\$ 22,144,419	\$ 15,280,064	\$ (7,605)	\$ 782,206	\$
Kahului Harbor (continued):					
Pier 1-C Extension	-	(3,990)	(5,939)	-	-
Passenger Cruise Terminal at Pier 1A Shed	-	3,462	-	-	-
Reconstruction of Pier 3 Container Yard	-	8,438	-	-	-
Replace Fender System at Pier 2	-	30	-	-	-
Kaunapau Harbor					
Breakwater Repair	1,542,548	645,354	-	94,710	
Kaunakakai Harbor:					
Substructure improvement	27	-	-	-	-
Commuter Ferry System Improvements	-	276	-	7	
Hilo Harbor:					
Pier 1 shed modifications	716,277	6,043	-	33,303	
Pier 3 breasting dolphins and catwalks	405,328	53,437	-	20,346	
Interisland Barge Terminal Facility	73,954	11,320	-	3,591	
Bullrail installation	307,701	19,401	-	5,168	
Substructure repairs at Piers 2 & 3	1,863	2,568	-	-	
Pier 1 shed waterline improvements	2,469	129,782	-	-	
Upgrade perimeter fencing	26,883	222,074	-	5,720	
Construction of Inter-island cargo terminal	4,397	7,676	-	421	
Geotechnical Engineering Study, Hilo Harbor	-	272	-	7	
Kawaihae Harbor:					
Repair cut-off wall	1,000	-	-	-	
Modifications project	246,732	215,812	-	18,033	
Removal of architectural barriers at overseas terminal	53	52,284	-	-	
Nawiliwili Harbor:					
Environmental risk assessment	39,663	78,647	-	3,757	
	\$ 25,513,314	\$ 16,732,950	\$ (13,544)	\$ 967,269	\$

State of Hawaii
Department of Transportation
Harbors Division

CONSTRUCTION IN PROGRESS OF THE PUBLIC UNDERTAKING (continued)

Fiscal year ended June 30, 2005

	Balance at July 1, 2004	Additions by source of funds			Transfer out	Balance June 30, 2005
		Harbor Special Fund	Harbor Revenue Bonds	Capitalized interest		
	\$ 25,513,314	\$ 16,732,950	\$ (13,544)	\$ 967,269	\$ 9,898,473	\$ 33,301,516
	661,335	216,500	-	36,826	-	914,661
lan	63,533	119,488	-	6,320	-	189,341
	20,739	2,110	-	-	22,849	-
tem	92,214	(5,036)	-	4,497	-	91,675
	208,528	231,960	-	8,169	448,657	-
tions Feasibility Study	-	225,053	-	5,850	-	230,903
	166,443	16,673	-	-	183,116	-
	137,099	8,534	-	-	145,633	-
main	2,962	-	-	149	-	3,111
	<u>\$ 26,866,167</u>	<u>\$ 17,548,232</u>	<u>\$ (13,544)</u>	<u>\$ 1,029,080</u>	<u>\$ 10,698,728</u>	<u>\$ 34,731,207</u>

State of Hawaii
Department of Transportation
Harbors Division

GENERAL OBLIGATION BONDS OF THE PUBLIC UNDERTAKING

June 30, 2005

of Bonds	Last installment due date	Interest rate	Original amount of issue	Amount repaid	Balance at June 30, 2005		
					Current	Noncurrent	Total
1992	March 1, 2012	5.15 - 6.40%	\$ 12,870	\$ 7,866	\$ 715	\$ 4,289	\$ 5,004
er 1, 1993	November 1, 2010	4.00 - 5.00%	160,901	96,549	10,725	53,627	64,352
998	April 1, 2009	5.00 - 5.25%	64,631	24,924	9,196	30,511	39,707
, 2001	August 1, 2015	3.40 - 5.50%	737	-	52	685	737
1, 2002	February 1, 2015	3.60 - 5.75%	1,481	-	-	1,481	1,481
			<u>\$ 240,620</u>	<u>\$ 129,339</u>	<u>\$ 20,688</u>	<u>\$ 90,593</u>	<u>\$ 111,281</u>

State of Hawaii
Department of Transportation
Harbors Division

REVENUE BONDS OF THE PUBLIC UNDERTAKING

June 30, 2005

Final redemption date	Interest rate	Original amount of issue	Balance at June 30, 2005		
			Current	Noncurrent	Total
July 1, 2027	3.95 - 5.75%	\$ 56,290,000	\$ 485,000	\$ 52,915,000	\$ 53,400,000
July 1, 2029	4.50 - 6.00%	79,405,000	2,140,000	66,145,000	68,285,000
July 1, 2019	3.00 - 5.50%	24,420,000	2,010,000	18,290,000	20,300,000
January 1, 2024	2.50 - 6.00%	52,030,000	4,390,000	43,515,000	47,905,000
		<u>\$ 212,145,000</u>	<u>\$ 9,025,000</u>	<u>\$ 180,865,000</u>	<u>\$ 189,890,000</u>

State of Hawaii
Department of Transportation
Harbors Division

INCOME FROM OPERATIONS BEFORE DEPRECIATION

Fiscal year ended June 30, 2005

Statewide	District										Total
	Oahu			Hawaii			Maui		Kauai		
	Honolulu	Kalaheo	Kewalo	Hilo	Kawaihae	Kahului	Kaunakakai	Kaunapali	Nawiliwili	Port Allen	
\$ -	\$ 28,958,620	\$ 1,475,295	\$ -	\$ 1,640,005	\$ 2,184,955	\$ 3,979,468	\$ 147,076	\$ -	\$ 1,499,969	\$ -	\$ 39,885,388
-	1,259,848	-	-	1,002,672	-	407,500	-	-	954,626	-	3,624,646
-	3,273,612	556,311	-	315,533	51,251	401,870	42,358	-	318,924	11,855	4,971,714
-	630,184	-	-	432,454	161,903	124,623	-	-	38,837	-	1,388,001
-	649,046	124,850	500	96,816	38,725	105,619	12,781	-	71,800	3,162	1,103,299
-	302,348	-	753,663	44,050	-	275	10,320	-	50	305,873	1,416,579
-	133,185	5,435	-	-	-	1,334	-	-	8,934	3,139	152,027
-	215,434	33,303	113,984	853	10,505	756	466	-	2,638	3,114	381,053
-	35,422,277	2,195,194	868,147	3,532,383	2,447,339	5,021,445	213,001	-	2,895,778	327,143	52,922,707
-	11,283,001	981,969	470,649	104,767	158,540	233,834	13,664	300	364,180	167,224	13,778,128
-	2,119,055	20,015	1,350	96,012	102,279	236,066	2,113	-	323,175	12,382	2,912,447
-	800,602	-	58,150	76,607	5,566	64,736	-	-	84,551	14,364	1,104,576
-	628,163	681,533	-	417,063	37,273	485,042	19,030	-	104,174	89,046	2,461,324
-	14,830,821	1,683,517	530,149	694,449	303,658	1,019,678	34,807	300	876,080	283,016	20,256,475
-	581,071	120,786	28,803	65,171	3,278	93,168	-	-	47,174	3,815	943,266
-	307,486	11,543	58,354	5,371	2,329	(4,474)	11,518	-	11,571	537	404,235
-	888,557	132,329	87,157	70,542	5,607	88,694	11,518	-	58,745	4,352	1,347,501
-	51,141,655	4,011,040	1,485,453	4,297,374	2,756,604	6,129,817	259,326	300	3,830,603	614,511	74,526,683
4,121,763	5,067,750	87,281	109,468	700,609	48,073	600,877	56,618	-	692,440	56,351	11,541,230
19,532	7,951,256	435,801	655,892	356,617	697,840	220,729	71,861	-	399,546	15,145	10,824,219
477,159	5,808,148	156,177	873,492	525,171	677,123	621,437	83,512	837	276,057	480,072	9,979,185
2,698,964	-	-	-	-	-	-	-	-	-	-	2,698,964
-	1,596,781	-	-	-	-	-	-	-	-	-	1,596,781
914,600	150,481	309	5,924	21,130	3,536	20,619	21	-	20,472	1,490	1,138,582
972,529	-	-	-	-	-	-	-	-	-	-	972,529
9,204,547	20,574,416	679,568	1,644,776	1,603,527	1,426,572	1,463,662	212,012	837	1,388,515	553,058	38,751,490
(9,204,547)	6,316,339	495,390	183,463	530,755	340,459	757,074	32,029	37	473,105	75,896	-
-	26,890,755	1,174,958	1,828,239	2,134,282	1,767,031	2,220,736	244,041	874	1,861,620	628,954	38,751,490
\$ -	\$ 24,250,900	\$ 2,836,082	\$ (342,786)	\$ 2,163,092	\$ 989,573	\$ 3,909,081	\$ 15,285	\$ (574)	\$ 1,968,983	\$ (14,443)	\$ 35,775,193

harbors based upon their respective current-year operating revenues to total current-year operating revenues for all harbors.

State of Hawaii
 Department of Transportation
 Harbors Division

HARBOR REVENUE BONDS 1997 CERTIFICATE - MINIMUM NET
 REVENUE REQUIREMENT OF THE PUBLIC UNDERTAKING

Fiscal year ended June 30, 2005

Net revenues, as defined by the 1997 Certificate:		
Income from operations before depreciation		\$ 35,775,193
Add:		
Interest income	\$ 4,791,636	
State of Hawaii, surcharge for central service expenses	2,698,964	
Cash available in the harbor reserve and contingency account	<u>10,897,658</u>	<u>18,388,258</u>
		<u>\$ 54,163,451</u>
Harbor revenue bond debt service requirements under the 1997 Certificate, including minimum sinking fund payments for the immediately ensuing 12 months		<u>\$ 19,224,013</u>
Ratio of net revenues to harbor revenue bond debt service requirements		<u>2.82</u>

APPENDIX B
INFORMATION CONCERNING THE STATE OF HAWAII

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APPENDIX B

INFORMATION CONCERNING THE STATE OF HAWAII

The statistical information presented by this Appendix B is the most current information available to the State. Because such information becomes available at different times, the dates of such information, as presented herein, are not the same.

INTRODUCTION

General

The State was admitted into the Union on August 21, 1959, as the fiftieth state. It is an archipelago of eight major islands, seven of which are inhabited, plus 124 named islets, totaling 6,425 square miles in land area, located in the Pacific Ocean in the Northern Hemisphere, mostly below the Tropic of Cancer, about 2,400 statute miles from San Francisco. The State is slightly larger than the combined area of the States of Connecticut and Rhode Island and ranks forty-seventh of the fifty states in land area, being also larger in area than the State of Delaware. The Island of Hawaii is the largest Island, with 4,028 square miles in area. The other inhabited Islands in the order of size are Maui, Oahu, Kauai, Molokai, Lanai and Niihau. According to the U.S. Census, the total population of the State was 422,770 in 1940, 499,794 in 1950, 632,772 in 1960, 769,913 in 1970, 964,691 in 1980, 1,115,274 in 1990, and 1,211,537 in 2000, making the State the forty-second most populous state in the Union as of 2000. The City and County of Honolulu consists of the Island of Oahu (plus some minor islets) with a land area of 599.8 square miles. The capital of the State and the principal port are located on Oahu. According to the 2000 U.S. Census, about 72.3% of the population of the State lives on Oahu. Hawaii's population shows greater ethnic diversity than other states because it is descended from immigrants from the Far East as well as from Europe and the mainland United States. The 2000 U.S. Census indicated that about 41.6% of the State's population is of Asian descent and about 24.3% of the State's population is Caucasian. Native Hawaiians and other Pacific Islanders constitute 9.4% of the population. The balance consists of other races, such as African Americans and American Indians.

State Government

The Constitution of the State provides for three separate branches of government: the legislative, the executive and the judicial. The legislative power is vested in a bicameral Legislature consisting of a Senate of twenty-five members elected for four-year terms and a House of Representatives of fifty-one members elected for two-year terms. The Legislature convenes annually. The executive power is vested in a Governor elected for a four-year term. In the event of the absence of the Governor from the State, or his inability to exercise and discharge the powers and duties of his office, the Lieutenant Governor, also elected for a four-year term, serves as the chief executive. Under the Constitution, the judicial power is vested in a Supreme Court, one intermediate appellate court, circuit courts, district courts, and such other courts as the Legislature may from time to time establish. Pursuant to statute, the Legislature has established four circuit courts, four district courts and an intermediate appellate court. The executive and administrative offices are limited to not more than twenty principal departments under the supervision of the Governor. The executive functions have in fact been grouped into eighteen departments. The heads of the departments are appointed by the Governor with the advice and consent of the Senate and hold office for a term to expire with the term of the Governor. The Department of Budget and Finance is one of the principal departments permitted by the Constitution of the State, with the head of said department being designated as the Director of Finance. Under the general direction of the Governor, the Department of Budget and Finance administers the State's proposed six-year program and financial plan, the State budget, and financial management programs of the State.

The Counties and Their Relationship to the State

There are four counties in the State, being the City and County of Honolulu, the County of Maui, the County of Hawaii and the County of Kauai, and one quasi-county, Kalawao. Each of the counties has a separate charter for its government, each of which provides for an elected mayor and an elected council. The mayor is the chief executive and the council is the legislative body. *There are no independent or separate cities or other municipalities, school districts or townships.* The State government of Hawaii has total responsibility for many functions which in most other parts of the United States are performed by or shared by local governments. For example, the State pays all costs in connection

with the public school system, libraries, public welfare, and judiciary. The greatest expenditures by the State in past years have been in the areas of education and public welfare. The counties' major areas of responsibility and expenditure are in police and fire protection, waste disposal, water and sewer facilities, and secondary streets and highways.

GENERAL ECONOMIC INFORMATION

General

Certain of the following material pertaining to economic factors in the State under the captions "**State of the Economy**" through and including "**Table B-10**" has been excerpted from the Hawaii State Department of Business, Economic Development and Tourism ("DBEDT") Second Quarter 2006 Quarterly Statistical and Economic Report ("QSER") or otherwise prepared by DBEDT some of which may be found at http://www2.hawaii.gov/dbedt/info/economic/data_reports/qser. Unless otherwise stated, the following information is historical; estimated figures are used only when the definitive figures are unavailable. Unless otherwise specifically stated, all references to years and quarters in the following information are to calendar years and calendar quarters, respectively. The text refers to certain enumerated tables found under "**GENERAL ECONOMIC INFORMATION.**" Following descriptions of the various components of the State's economy and DBEDT's outlook for the economy, there is a brief description of the impact of these components on the State's fiscal position.

DBEDT's latest forecast for nominal Gross State Product ("GSP") (the value of all goods and services produced and consumed within the State) growth in 2006 is 6.0%. In real terms (adjusting for inflation), DBEDT estimates that 2006 GSP growth over 2005 will be 3.0%.

State of the Economy

Several indicators of Hawaii's economy in the first quarter provide support for solid growth in 2006. Strong employment and job growth in the quarter will lead to comparable growth in income and tax revenues. The unemployment rate is at its lowest since 1990. Although visitor arrivals were slightly down during the first quarter, the latest arrival data suggest healthy growth in the visitor industry for the year. Gains in construction jobs and continued growth in the value of building permits portend robust construction sector activity.

Hawaii's total civilian labor force reached 645,400 people in the first quarter of 2006, which is 3.2% or 20,100 people more compared to the first quarter of 2005. A total of 630,400 people were employed in Hawaii, an increase of 22,300 people or 3.7% higher than that in the first quarter of 2005. The number of civilian unemployed totaled 14,950, down 13.1% from the first quarter of 2005. The unemployment rate (not seasonally adjusted) averaged 2.3%, the lowest since the fourth quarter of 1990. In March 2006, at 2.5%, Hawaii had the lowest unemployment rate in the nation for the 23rd consecutive month.

Hawaii's total civilian wage and salary jobs grew 3.3% to 618,950 in the first quarter of 2006, a gain of 19,950 jobs over the first quarter of 2005. All private non-agricultural sectors contributed to job growth, most notably Natural Resources, Construction & Mining, Professional and Business Services, and Transportation and Utilities.

After 8% growth in 2004, nominal total personal income rose by 7% in 2005. For the last quarter, nominal personal income rose by \$2.4 billion or 5.6% compared to the fourth quarter of 2004. Among its components, the greatest growth was seen in Proprietors' Income (11.7%), followed by Supplements to Wages and Salaries (8.5%), Personal Current Transfer Receipts (5.9%), and Wage and Salary Disbursements (5.5%). Contributions for Government Social Insurance, subtracted from personal income, also increased 5.5%.

Total tax collections distributed to the State general fund totaled more than \$1.1 billion in the first quarter of 2006. This is a 4.9% increase over the first quarter of 2005. Among the different components of the State general fund, revenues from general excise and use tax (GET), transient accommodations tax (TAT), and net individual income tax were up 10.1%, 9.4%, and 5.1%, respectively.

After positive growth for 10 quarters in a row, the total visitor arrivals by air were slightly down in the first quarter of 2006 as compared to the first quarter of 2005. The drop in arrivals resulted from a 2.7% decrease in international arrivals and slower growth in domestic travel, largely due to the shift in Easter from March to April in 2006. The average daily visitor census was up 0.2%, while the statewide hotel occupancy rate was slightly down compared to the first quarter of 2005. Visitor arrivals jumped in April by 10.7%, bringing the first four month growth up to 2.1%.

Indicators of Hawaii's construction industry in the first quarter of 2006 suggest the continuation of upbeat building activity for 2006 and 2007. Natural Resources, Mining and Construction sector added 4,050 or 13.0% more wage and salary jobs as compared to the first quarter of 2005. Total value of private building authorizations increased 9.6% for the first quarter of 2006 over that of 2005. Honolulu's median sales price for single family home resales was \$625,000 and that of condominium resales was \$309,000, up 18.1% and 34.9%, respectively, compared to the first quarter of 2005. However, the number of single-family and condominium resales were down 3.4% and 4.8%, respectively.

Outlook for the Economy

As compared to the three consecutive years of higher growth than the national economy, the current DBEDT forecast for Hawaii's economy expects to see real GSP growth to be somewhat moderate at 3.0% in 2006. DBEDT forecasts are based on the latest trends of growth for Hawaii's economy, as well as those for the U.S and Japanese economies, the two economies influencing Hawaii the most.

Combined with the continuing boom in construction and related activities, a strong visitor sector and increased federal government spending, the economy is positioned for healthy employment and income growth in 2006.

The May 2006 *Blue Chip Economic Consensus Forecasts* expects economic growth for both U.S. and Japanese economies to remain strong, at least for this year and the next. Real GDP growth in 2006 is projected to be 3.4% for the U.S. and 3.0% for Japan. In 2007, GDP growth is expected to be 3.0% for the U.S. and 2.2% for Japan. The U.S. CPI is now expected to rise 3.1% in 2006 and 2.5% in 2007.

Based on current conditions, visitor days in 2006 are expected to increase 3.3%. Total nominal visitor expenditures are forecast to increase 4.7% and visitor arrivals 2.8% in 2006. In 2007, visitor days, visitor arrivals, and visitor expenditures are predicted to increase 2.6%, 2.7%, and 5.2%, respectively.

Several other indicators also provide support for healthy growth for Hawaii for the year. The most notable may be the level of private building permit authorizations. Private permit levels totaled \$774 million during the first quarter of 2006, following the nearly \$3.5 billion worth of permit levels seen in 2005. The large number of permits should mean a robust construction sector for 2006 and 2007. However, with rising interest rates and a decline in demand for housing in recent months, private construction activity is expected to slow in the next few years.

Nominal total personal income is expected to rise 6.8% in 2006. For 2007, income growth is projected to be slightly lower at 6.2%. Real personal income (adjusted for inflation) is expected to grow 2.9% in 2006 and 2.8% in 2007.

The torrid job growth in the first quarter contributed to an upward revision in the 2006 DBEDT forecast for total wage and salary job growth to 2.2% from 1.8% in the previous QSER forecast. Job growth is projected to gradually moderate to 1.5% in 2007.

Hawaii's projected inflation rate for 2006 is now revised up to 3.8% from 3.5% in the previous forecast. The upward revision reflects the recent rises in oil prices and their impacts on goods sold in Hawaii, as well as increases in housing costs. The rate of inflation is expected to be 3.3% in 2007.

Information On Employment, Wages And Salaries, Tax Revenues And Tax Base

**Table B-1
SELECTED ECONOMIC ACTIVITIES: STATE**

	UNIT	FIRST QUARTER 2006		YEAR ENDING DECEMBER 31, 2005	
		NUMBER	% CHANGE YEAR AGO	NUMBER	% CHANGE YEAR AGO
Civilian Labor Force ¹	Persons	645,400	3.2	634,600	2.5
Civilian Employment	Persons	630,400	3.7	616,850	3.0
Civilian Unemployment	Persons	14,950	-13.1	17,750	-12.3
Unemployment Rate ^{1,2}	%	2.3	-0.4	2.8	-0.5
Total Wage & Salary Jobs	Jobs	618,950	3.3	608,900	3.1
Total Non-Agriculture Wage & Salary Jobs	Jobs	612,600	3.5	602,050	3.2
Natural Resources, Mining, Construction	Jobs	35,250	13.0	33,450	13.6
Manufacturing	Jobs	15,250	0.3	15,200	-1.3
Wholesale Trade	Jobs	17,950	4.1	17,650	3.5
Retail Trade	Jobs	71,000	4.0	69,350	3.6
Transportation, Warehousing, Utilities	Jobs	32,550	10.3	31,000	9.7
Information	Jobs	11,050	5.2	10,750	-0.5
Financial Activities	Jobs	29,700	2.9	29,300	1.7
Professional & Business Services	Jobs	75,800	4.6	74,000	4.6
Educational Services	Jobs	13,900	3.0	13,650	5.0
Health Care & Social Assistance	Jobs	57,050	2.1	56,400	3.2
Arts, Entertainment & Recreation	Jobs	11,650	3.6	11,650	2.2
Accommodation	Jobs	39,350	2.3	38,800	2.6
Food Services and Drinking Places	Jobs	56,650	2.7	56,050	2.7
Other Services	Jobs	25,300	2.8	25,150	2.9
Government	Jobs	120,150	0.3	119,650	-0.3
Federal	Jobs	31,450	1.1	31,300	-0.5
State	Jobs	71,500	-0.4	71,150	-0.5
Local	Jobs	17,250	2.1	17,200	0.6
Agriculture Wages & Salary Jobs	Jobs	6,300	-11.3	6,850	-6.2
State General Fund Revenues	\$1,000	1,106,472	4.9	4,252,231	16.4
General Excise And Use Tax	\$1,000	638,194	10.1	2,263,393	13.7
Income-Individual	\$1,000	355,719	5.1	1,447,744	17.2
Transient Accommodations Tax	\$1,000	59,698	9.4	207,381	9.2

¹ Labor force and jobs are Hawaii State Department of Labor and Industrial Relations (DLIR) monthly and annual data. Quarterly averages computed by DBEDT.

² Change represents absolute change in rates rather than percentage change in rates.

Source: DLIR; Hawaii State Department of Taxation; DBEDT; and Hospitality Advisors, LLC.

Key Economic Indicators

Table B-2
ACTUAL AND FORECAST KEY ECONOMIC INDICATORS
FOR HAWAII: 2004 TO 2009

Economic Indicators	2004	2005	2006	2007	2008	2009
	Actual	Actual	Forecast	Forecast	Forecast	Forecast
Total population (in thousands).....	1,262	1,275	1,289	1,303	1,317	1,330
Visitor arrivals (in thousands).....	6,992	7,433 ¹	7,642	7,848	8,035	8,230
Visitor days (thousands)	63,343	67,549 ¹	69,775	71,583	73,246	74,991
Visitor expenditures (in million dollars).....	10,862	11,808 ¹	12,367	13,016	13,673	14,348
Honolulu CPI-U (1982-84=100).....	190.6	197.8	205.3	212.1	218.4	224.2
Personal income (in million dollars).....	41,177	44,044	47,039	49,955	52,703	55,496
Real Personal income (in millions of 2000\$)...	38,087	39,257	40,391	41,521	42,547	43,646
Total wage & salary jobs (in thousands).....	590.7	608.9	622.3	631.6	639.2	646.9
Gross state product (in million dollars).....	50,322	53,593 ²	56,809	59,819	62,870	66,014
Real gross state product (in millions of 2000\$)	44,976 ³	46,414 ²	47,812	49,070	50,266	51,492
Gross state product deflator (2000=100).....	111.9 ³	115.5 ²	118.8	121.9	125.1	128.2

ANNUAL PERCENTAGE CHANGE

Economic Indicators	Percent Change	Percent Change	Percent Change	Percent Change	Percent Change	Percent Change
Total population (in thousands).....	1.1	1.0	1.1	1.1	1.1	1.0
Visitor arrivals (in thousands).....	8.5	6.3 ¹	2.8	2.7	2.4	2.4
Visitor days (thousands)	6.9	6.6 ¹	3.3	2.6	2.3	2.4
Visitor expenditures (in million dollars).....	8.0	8.7 ¹	4.7	5.2	5.0	4.9
Honolulu CPI-U (1982-84=100).....	3.3	3.8	3.8	3.3	3.0	2.6
Personal income (in million dollars).....	8.0	7.0	6.8	6.2	5.5	5.3
Real Personal income (in millions of 2000\$) ...	4.6	3.1	2.9	2.8	2.5	2.6
Total wage & salary jobs (in thousands).....	2.8	3.1	2.2	1.5	1.2	1.2
Gross state product (in million dollars).....	7.8	6.5 ²	6.0	5.3	5.1	5.0
Real gross state product (in millions of 2000\$)	4.7 ³	3.2 ²	3.0	2.6	2.4	2.4
Gross state product deflator (2000=100).....	3.0 ³	3.2 ²	2.9	2.6	2.6	2.5

¹ Preliminary.

² Forecast.

³ DBEDT-adjusted U.S. Bureau of Economic Analysis accelerated estimate.

Source: DBEDT, May 17, 2006.

Labor Force and Jobs

Hawaii's civilian labor force, employment, and wage and salary jobs continued to show phenomenal gains in the first quarter of 2006, each increasing more than 3.0% from the first quarter of 2005. All private sector industries, except for agriculture, showed positive job growth. The Natural Resources Construction & Mining sector continued to lead growth in Hawaii.

In the first quarter of 2006, total civilian labor force increased by 3.2% from the first quarter of 2005 to 645,400. In 2005, labor force was up 2.5% from 2004. This was the first time since 1996 that the labor force grew by more than 1% for the year.

During the first quarter of 2006, 630,400 people were employed in Hawaii, an increase of 22,300 people or 3.7% higher than that in the first quarter of 2005. In 2005, employment increased 3.0% from 2004, the highest annual employment growth since 1990.

The number of civilian unemployed totaled 14,950 in the first quarter of 2006, which is a 13.1% decrease from the first quarter of 2005. In 2005, the number of people unemployed in Hawaii averaged 17,750 or 12.3% lower than that for 2004.

In the first quarter of 2006, Hawaii unemployment rate (not seasonally adjusted) averaged 2.3% compared to the 2.7% rate in the first quarter of 2005. This is the sixth straight quarter that Hawaii's unemployment rate has been at or below 3.0% and the lowest since the fourth quarter of 1990. In March 2006, at 2.5%, Hawaii had the lowest unemployment rate in the nation, according to the U.S. Bureau of Labor Statistics. In 2005, the Hawaii unemployment rate averaged 2.8%, as compared to 3.3% in 2004.

In the first quarter of 2006, Hawaii's civilian wage and salary jobs totaled 618,950, an increase of 3.3% or 19,950 jobs over the first quarter of 2005. In 2005, Hawaii economy had added 3.1% or 18,250 more wage and salary jobs than it had in 2004.

In first quarter of 2006, Natural Resources, Mining and Construction sector added 4,050 jobs or 13.0% more than the first quarter of 2005. Professional and Business Services had the next greatest increase of 3,300 jobs or 4.6%. Visitor-related industries also did well, with Transportation, Warehousing, and Utilities adding 3,050 jobs or 10.3%, Retail Trade 2,750 jobs or 4.0%, and Food Services and Drinking Places 1,500 jobs or 2.7%. With an increase of 1,150 jobs or 2.1%, Health Care and Social Assistance rounds out the list of the sectors with the highest job growth in the first quarter of 2006.

In the first quarter of 2006, Agriculture lost 11.3% or 800 wage and salary jobs compared with the first quarter of 2005. After registering decline for all four quarters of 2005, Manufacturing jobs seemed to have stabilized in the first quarter of 2006 - at 0.3% growth.

In the first quarter of 2006, Federal government and Local government jobs increased by 1.1% and 2.1%, respectively, while State government jobs decreased by 0.4%, with a net gain of 0.3% or 400 jobs in the government sector.

Table B-3

**CIVILIAN LABOR FORCE AND EMPLOYMENT
(Number of persons)**

<u>Year</u>	<u>Civilian Labor Force</u>	<u>% Change Civilian Labor Force</u>	<u>Civilian Employment</u>	<u>% Change Civilian Employment</u>	<u>Civilian Unemployment Rate</u>
1996	596,750	1.2	561,700	0.8	5.9
1997	601,650	0.8	566,750	0.9	5.8
1998	604,300	0.4	570,150	0.6	5.7
1999	606,650	0.4	576,300	1.1	5.0
2000 ¹	609,000	0.4	584,850	1.5	4.0
2001 ¹	615,250	1.0	589,200	0.7	4.2
2002 ¹	610,400	-0.8	585,700	-0.6	4.1
2003 ¹	614,700	0.7	590,750	0.9	3.9
2004 ¹	619,150	0.7	598,900	1.4	3.3
2005 ¹	634,600	2.5	616,850	3.0	2.8

¹ DLIR has benchmarked the statewide data.

Source: DLIR.

Income and Prices

Hawaii total personal income continued to rise during the fourth quarter of 2005 (the period for which the latest data are available from the U.S. Bureau of Economic Analysis), over the fourth quarter of 2004, albeit at a lower rate than in the previous three quarters. The greatest increase was seen in Proprietors' Income, followed by Supplements to Wages and Salaries, Personal Current Transfer Receipts, and Wage and Salary Disbursements. Contributions for Government Social Insurance, which is subtracted from personal income, also increased. The fourth quarter earnings increased for all sectors except for Management of Companies and Enterprises, Finance and Insurance, and Information.

Nominal total personal income rose \$2.4 billion or 5.6% in the fourth quarter of 2005 compared to the fourth quarter of 2004. For the year, personal income was up 7.0% from 2004.

Wage and Salary Disbursements grew by \$1.4 billion or 5.5% in the fourth quarter of 2005. For the year, Wage and Salary Disbursements rose 7.2%. Wages and salaries accounted for 58% of total personal income.

Supplements to Wages and Salaries, consisting of employer payments to retirement plans, private group health insurance plans, private workers compensation plans, and other such benefits, increased by \$573 million or 8.5% for the fourth quarter of 2005 compared to the fourth quarter of 2004. For the year, Supplements to Wages and Salaries were up 9.6% from 2004.

Proprietors' Income, the income most closely related to entrepreneurial activity, grew by \$335 million or 11.7% in the fourth quarter of 2005 compared to the fourth quarter of 2004. For the year, Proprietors' Income rose 10.9%.

Dividends, Interest, and Rent was essentially unchanged at \$6.6 billion in the fourth quarter of 2005, but it was up 1.8% for the year.

Personal Current Transfer Receipts, consisting largely of retirement and medical payments, grew by \$317 million or 5.9% in the fourth quarter of 2005 from the same quarter a year ago. For the year, Personal Current Transfer Receipts increased 5.9%.

Contributions to Government Social Insurance increased \$191 million or 5.5% for the fourth quarter of 2005 and 6.0% for the year.

Earnings increased across most private sector industries in the fourth quarter of 2005, as well as for the year as a whole. In dollar terms, the largest increases occurred in Natural Resources, Mining and Construction, followed by Health and Social Assistance, Accommodations and Food Services, Professional and Technical Services, and Transportation and Warehousing. Earnings also increased in all government sectors.

Honolulu's inflation rate increased to 4.5% in the second half of 2005. This was considerably higher than the 3.3% increase in the second half of 2004. The annual average inflation for 2005 was up 3.8%. Honolulu's inflation was 0.7 percentage points higher than the U.S. average of 3.8% in the second half of 2005. The Honolulu increase was primarily due to a jump in the Housing and Transportation (mostly fuels) components, which increased by 7.2% and 5.7%, respectively.

Table B-4

PERSONAL INCOME FOR HAWAII BY MAJOR SOURCES
(in millions of dollars at seasonally adjusted annual rates)

Series	Fourth Quarter 2005	% CHANGE FROM YEAR AGO	YEAR ENDING DECEMBER 31, 2005	% CHANGE FROM YEAR AGO
Personal Income	45,117	5.6	44,044	7.0
Derivation of Personal Income				
Earnings by place of work	36,540	6.6	35,669	8.0
Wage and salary disbursements.....	26,020	5.5	25,437	7.2
Supplements to wages and salaries	7,324	8.5	7,142	9.6
Proprietors' income	3,196	11.7	3,091	10.9
Dividends, interest, rent	6,570	0.1	6,393	1.8
Personal current transfer receipts	5,676	5.9	5,583	5.9
Less: Contributions for government social insurance	3,668	5.5	3,601	6.0
Earnings by Industry.....	36,540	6.6	35,669	8.0
Farm.....	276	17.4	258	15.7
Nonfarm.....	36,264	6.5	35,412	8.0
Private.....	25,339	7.4	24,575	9.2
Forestry, fishery, other.....	57	0.0	58	-0.9
Mining.....	41	0.0	40	11.2
Utilities.....	296	5.0	295	7.5
Construction, etc.....	3,011	24.0	2,763	23.5
Manufacturing.....	845	2.4	837	4.3
Wholesale trade.....	1,053	4.3	1,031	6.2
Retail trade.....	2,469	6.3	2,413	8.3
Transportation and Warehousing.....	1,564	13.7	1,491	13.5
Information	717	-0.8	703	1.6
Finance and Insurance	1,237	-2.5	1,227	2.2
Real Estate and Rental and Leasing.....	1,236	6.3	1,228	8.7
Professional and Technical Services.....	2,139	10.0	2,067	9.8
Management of Companies and Enterprises	568	-37.2	628	-9.3
Administrative and Waste Services.....	1,561	13.1	1,503	11.0
Educational Services	503	6.6	492	7.1
Health Care and Social Assistance	3,240	9.8	3,136	9.6
Arts, Entertainment, and Recreation.....	492	5.1	484	8.2
Accommodation and Food Services	3,142	8.6	3,034	8.1
Other Services, except Public Administration.....	1,169	7.2	1,147	8.2
Government and government enterprises	10,924	4.6	10,836	5.3
Federal, civilian.....	2,695	5.4	2,649	3.5
Federal, military	3,895	3.6	3,911	6.2
State and local.....	4,335	5.0	4,277	5.6

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *State Quarterly Personal Income*, March 28, 2006
<<http://www.bea.doc.gov/bea/regional/sqpi/>>.

Table B-5
PERSONAL INCOME
(in millions of dollars at seasonally adjusted annual rates)

YEAR	ANNUAL AVERAGE	% CHANGE
1996	30,122	0.7
1997	31,002	2.9
1998	31,757	2.4
1999	32,646	2.8
2000	34,451	5.5
2001	35,126	2.0
2002 ¹	36,370	3.5
2003 ¹	38,115	4.8
2004 ¹	41,177	8.0
2005 ¹	44,044	7.0

¹ Source data for 2002Q1 through 2005Q3 have been revised.

Source: U.S. Department of Commerce, Bureau of Economic Analysis.

Table B-6
CONSUMER PRICE INDEX, ALL URBAN CONSUMERS (CPI-U), AND
SELECTED ITEMS, FOR U.S. AND HONOLULU: 1996-2005
(1982-1984 = 100)

Year	HONOLULU									
	U.S.	All Items	Food & Beverages	Housing	Apparel	Transportation	Medical Care	Recreation¹	Education & Comm¹	Other Goods & Services
1996	156.9	170.7	156.6	176.8	118.5	167.0	215.0	NA	NA	226.5
1997	160.5	171.9	159.2	177.1	117.3	166.2	217.3	NA	NA	239.0
1998	163.0	171.5	159.1	176.0	112.2	162.5	226.1	100.8	99.1	256.1
1999	166.6	173.3	162.9	175.8	105.4	162.2	231.3	101.9	104.5	275.6
2000	172.2	176.3	164.8	177.9	103.5	169.6	239.8	102.8	106.5	279.7
2001	177.1	178.4	169.5	179.1	101.0	174.5	-- ²	101.6	104.6	289.3
2002	179.9	180.3	172.0	181.2	102.6	170.9	-- ²	99.5	107.8	302.2
2003	184.0	184.5	174.9	186.2	98.5	176.4	-- ²	100.4	112.5	307.6
2004	188.9	190.6	180.2	194.3	101.2	182.4	275.9	102.3	113.5	312.4
2005	195.3	197.8	185.9	205.2	102.5	191.6	-- ²	97.8	114.3	321.0

Data on U.S. CPI are released monthly and Honolulu CPI, twice a year in February and August for the half year previous.

¹ New Indexes as of January 1998. Base period is December 1997. The former "Entertainment" index has been discontinued.

² No data was available or data did not meet U.S. Bureau of Labor Statistics' publication criteria.

Source: U.S. Bureau of Labor Statistics, February 22, 2006..

Tourism

In 2005, the total arrivals by air reached nearly 7.4 million visitors, 6.4% or about 441,000 more visitors than in 2004.

After positive growth for 10 quarters in a row, the total number of visitors arriving by air was down in the first quarter of 2006 as compared to the first quarter of 2005. The total number of visitors arriving by air to Hawaii declined 0.5% in the first quarter of 2006 compared to the first quarter of 2005. This is a decrease of about 8,300 visitors compared with the first quarter of 2005. Longer average stays by visitors, however, caused the average total daily visitor census to increase, slightly. For the first quarter of 2006, hotel occupancy rates were also down compared to the same period last year.

After growing at impressive rates of 9.2% and 3.9% in 2004 and 2005, respectively, the number of travelers arriving on international flights decreased 2.7% in the first quarter of 2006 from that of 2005. Arrivals on domestic flights were up just 0.5% for the first quarter of 2006 as compared to the same quarter last year, much lower than the 8.0% and 7.4% annual growth for the previous two years. The slower growth in domestic travel is largely due to the shift in Easter from March to April in 2006.

Considering different major markets, between the first quarters of 2005 and 2006, arrivals from the U.S. West and U.S. East were up 0.2% and 0.9%, respectively, while arrivals from Japan declined 7.5%. Thus, the first quarter decline in international arrivals was largely a result from a decline in Japanese arrivals. In 2005, arrivals from U.S. West, U.S. East, and Japan increased 7.9%, 5.6%, and 2.7%, respectively.

The total average daily visitor census was up just 0.2% in the first quarter of 2006 over the first quarter of 2005. A 1.3% decline in international daily census combined with a much lower growth, of 0.6%, in domestic daily census resulted in that small growth in total daily census.

Airline capacity, as measured by the number of available seats flown to Hawaii, was down 0.6% in the first quarter of 2006. This decline in capacity was produced mainly by a 1.9% decline in international capacity. Domestic capacity showed little change from the same period last year.

In the first quarter of 2006, statewide hotel occupancy rate declined slightly to 83.2% from 83.6% in the first quarter of 2005. Nonetheless, the occupancy rate remained at the highest level since 1990.

Table B-7
VISITOR ARRIVALS¹
Average Length of Stay, Visitor Days, Average Daily Census
(Percentage Change from the Same Period in Previous Year)

	2003	2004	2005 ²	% Change 2003-2004	% Change 2004-2005
Total Arrivals					
Total	6,380,439	6,912,094	7,353,158	8.3	6.4
Domestic	4,531,289	4,892,960	5,255,098	8.0	7.4
International	1,849,150	2,019,134	2,098,060	9.2	3.9
Average Length of Stay					
Total	9.21	9.08	9.09	-1.4	0.1
Domestic	9.90	9.94	9.92	0.4	-0.2
International	7.43	7.09	7.00	-4.6	-1.2
Visitor Days					
Total	58,782,699	62,761,989	66,824,114	6.8	6.5
Domestic	45,036,982	48,441,764	52,134,002	7.6	7.6
International	13,745,717	14,320,225	14,690,112	4.2	2.6
Average Daily Census					
Total	161,048	171,481	183,080	6.5	6.8
Domestic	123,389	132,355	142,833	7.3	7.9
International	37,659	39,126	40,247	3.9	2.9

¹ Staying overnight or longer.

² Preliminary.

Source: DBEDT.

Table B-8
HOTEL OCCUPANCY RATE
(in percent)

<u>Year</u>	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>	<u>Annual</u>
1996	81.9	72.3	77.1	70.0	75.2
1997	79.5	70.8	75.5	69.9	73.9
1998	77.4	68.7	72.9	67.7	71.5
1999	77.0	67.7	75.0	68.7	72.1
2000	79.2	75.2	78.5	73.1	76.0
2001	80.7	70.7	70.3	57.2	69.2
2002	71.7	67.9	72.5	67.1	69.7
2003	74.4	67.1	77.4	71.3	72.6
2004	80.2	75.7	81.5	73.4	77.7
2005 ¹	83.6	78.5	84.4	77.3	81.2

¹ Source data revised.

Quarterly averages are computed by Hawaii State Department of Business, Economic Development & Tourism Hospitality Advisors LLC monthly averages.

Sources: Hawaii State Department of Business, Economic Development & Tourism and PKF — Hawaii and Hospitality Advisors LLC.

Construction

Hawaii's construction industry continued to perform well in the first quarter of 2006. In particular, construction jobs and housing prices continued to increase. Statewide private building authorizations were up, but the rate of expansion seemed to have decelerated compared to the last two quarters of 2005, perhaps signaling some slow down in the constructing activity ahead.

In first quarter of 2006, Natural Resources, Mining and Construction sector added the most jobs to the state economy, 13.0% or 4,050 more jobs compared to the first quarter of 2005.

Total value of private building authorizations increased 9.6% for the first quarter of 2006 over 2005. The value of residential permits was up 16.4% and that of commercial and industrial permits was up 25.5%, while the value of additions and alterations was down 5.7%. The first quarter increase in the value of residential permits was much smaller than that observed in the last two quarters of 2005.

Counties showed a mixed performance in terms of the permit activity in the first quarter of 2006. Construction activity continued to remain strong in Maui and Hawaii counties, with the total value of building authorizations increasing 66.7% and 54%, respectively, from the first quarter of 2005. After the strong third and fourth quarters of 2005, the value of total private authorizations for Honolulu was down 1.6% in the first quarter of 2006. Similarly, after the strong 2005, Kauai County saw a 71% decline in the value of private building permits.

For the first quarter of 2006, the total value of Government contracts awarded was up 39.1% from the first quarter of 2005. However, State Government Capital Improvement Project (CIP) expenditures were down 0.6% for the quarter. The largest share of CIP expenditure in the first quarter of 2006 was from General Obligation bond funds (44%), followed by Special funds (26%), and Federal funds (19%).

After a strong 26.1% increase in 2005, single-family unit authorizations were down 2.1% and multi-family unit authorizations were up 114.6% for the first quarter of 2006 from the same period a year ago.

The Honolulu Construction Cost Index for Single Family Residences rose 10.8% in the first quarter of 2006, over that of 2005, while the comparable index for High-Rise Buildings rose 8.4%.

Honolulu's median sales prices for both single family and condominium residential resales continued to increase in the first quarter of 2006. The single-family median price was up 18.1% to \$625,000 and the condominium median price was up 34.9% to \$309,000 from the first quarter of 2005. However, the number of single-family and condominium resales were down 3.4% and 4.8%, respectively.

Table B-9

ESTIMATED VALUE OF COMPLETED CONSTRUCTION, NEW PRIVATE BUILDING AUTHORIZATIONS, AND GOVERNMENT CONTRACTS AWARDED
(in millions of dollars and percentage change from the previous period)

Year	Contracting Tax Base ¹		Private Building Authorizations ⁴								Government Contracts Awarded	
		%	Private Authorizations	%	Residential ⁴	%	Commercial & Industrial ²	%	Additions/Alterations	%		%
1996	3,285.1	4.8	1,117.8	-27.0	487.0	-34.7	252.8	-31.4	378.0	-9.5	885.5	80.6
1997	2,944.4	-10.4	1,179.2	5.5	542.5	11.4	264.5	4.6	372.2	-1.5	615.6	-30.5
1998	3,016.0	2.4	1,054.3	-10.6	485.5	-10.5	205.6	-22.3	363.2	-2.4	685.5	11.4
1999	2,991.2	-0.8	1,320.2	25.2	628.8	29.5	306.2	48.9	385.3	6.1	584.8	-14.7
2000 ³	3,613.5	20.8	1,513.1	14.6	800.1	27.2	246.2	-19.6	466.7	21.1	810.9	38.7
2001	3,766.4	4.2	1,585.7	4.8	882.4	10.3	329.1	33.7	374.2	-19.8	715.7	-11.7
2002 ⁴	4,274.9	13.5	1,772.0	11.8	1,112.9	26.1	254.2	-22.8	404.9	8.2	768.3	7.3
2003 ⁴	4,536.3	6.1	2,352.7	32.8	1,336.0	20.0	507.9	99.8	508.8	25.7	633.4	-17.6
2004 ⁴	4,921.5	8.5	2,726.5	15.9	1,767.7	32.3	303.3	-40.3	655.6	28.9	1,384.6	118.6
2005 ⁴	5,618.4	14.2	3,491.9	28.1	2,259.3	27.8	433.5	42.9	799.2	21.9	725.1	-47.6

¹ Formerly, "Value of Construction Completed," subject to revision by Hawaii State Department of Taxation.

² Includes hotels.

³ Kauai County data for November consist of residential data only.

⁴ Beginning 2002, Kauai data available for residential only.

Source: Hawaii State Department of Taxation; county building departments; First Hawaiian Bank, Building Industry Magazine (various issues), and tabulations by DBEDT.

Table B-10

ESTIMATED VALUE OF PRIVATE BUILDING CONSTRUCTION AUTHORIZATIONS, BY COUNTY
(in thousands of dollars and percentage change from the previous period)

Year	State	%	City & County of Honolulu	%	Hawaii County	%	Kauai County	%	Maui County	%
1996	1,117,760	-27.0	698,697	-28.8	171,017	-36.0	101,981	29.2	146,065	-28.6
1997	1,179,182	5.5	772,825	10.6	155,776	-8.9	97,808	-4.1	152,773	4.6
1998	1,054,281	-10.6	624,227	-19.2	178,220	14.4	88,196	-9.8	163,640	7.1
1999	1,320,218	25.2	706,358	13.2	243,852	36.8	140,846	59.7	229,162	40.0
2000 ¹	1,512,601	14.6	694,223	-1.7	321,704	31.9	141,313	0.3	355,360	55.1
2001	1,585,739	4.8	682,660	-1.7	380,248	18.2	210,094	48.7	312,738	-12.0
2002 ²	1,772,028	11.7	876,051	28.3	449,600	18.2	172,661	-17.8	273,716	-12.5
2003 ²	2,352,720	32.8	1,109,568	26.7	620,634	38.0	153,242	-11.2	469,277	71.4
2004 ²	2,726,536	15.9	1,320,552	19.0	826,494	33.2	130,659	-14.7	448,831	-4.4
2005 ²	3,491,964	28.1	1,364,030	3.3	1,008,386	22.0	288,131	120.5	831,416	85.2

¹ Kauai County data for November consist of residential data only.

² Beginning with 2002, Kauai data available for residential only. Values shown for 2001 are all private authorizations however, percentage change 2001-2002 is based on residential only or 2001Q1 of 32,006; 2001Q2 of 22,290; 2001Q3 of 26,613; 2001Q4 of 53,344 and 2001 of 134,253.

Source: County Building Permits.

Federal Government Expenditures in Hawaii

Total federal expenditure reached \$12.2 billion in the federal fiscal year ending September 30, 2004, an increase of 8.1% over the previous year. Between federal fiscal years 1997 and 2004, the annual average growth rate for Federal expenditures was 5.9%. Overall, federal activity in Hawaii produces about 14% of GSP, much of which is defense-related. Hawaii's Federal government sector employed about 30,800 civilian and 53,750 armed forces personnel in calendar year 2004.

According to the U.S. Department of Defense, expenditures on payroll and procurement contracts in Hawaii increased from \$3.2 billion in fiscal year 1994 to \$5.1 billion in the federal fiscal year ending 2004. Military spending in Hawaii remains a relatively stable and important source of outside income. Over that period, payroll outlays grew

from \$2.4 billion in federal fiscal year 1994 to \$3.4 billion in federal fiscal year 2004. Payroll, however, slipped from 75% of total Hawaii Federal defense spending in federal fiscal year 1994 to 66% in federal fiscal year 2004. Procurement contracts accounted for \$0.8 billion or 25% of total defense spending in federal fiscal year 1994, rising to \$1.7 billion, or 34% of the total defense spending in federal fiscal year 2004. Between federal fiscal year 2003 and 2004, the total military spending rose 5.1% while payroll alone rose 11%.

The latest data from the U.S. Department of Commerce indicate that the total earnings of Federal government personnel in the federal fiscal year 2005 were 6.5% higher than a year earlier. Total federal government jobs increased 1.0% in federal fiscal year 2004 compared to 2003.

In 2005, the U.S. Senate approved more than \$354 million in Federal funds for 16 military construction projects in Hawaii during the federal fiscal year beginning October 1, 2005. Hawaii is also expected to receive about \$413 million under the Defense Appropriation Bill. These amounts are in addition to day-to-day defense operations and payroll outlays.

Banks and Other Financial Institutions

As of June 30, 2003, total assets of all State-chartered financial institutions, including banks, savings and loan associations and industrial loan companies were reported at \$23.2 billion, a .35% increase from 2002. The four State-chartered banks accounted for \$22.7 billion of such assets.

Transportation

Because the State's population resides on seven islands, the State is dependent on fast, efficient, low-cost transportation, both interstate and intrastate.

Sea Transportation. The State is dependent on regular shipping service for overseas lifeline support. While nearly all visitors to the State arrive by air, surface transportation provides the State with the bulk of both its imported goods and delivery of exported local products. Overseas and inter-island cargo shipments for the fiscal years 2003, 2004, and 2005 amounted to 19.4 million short tons, 18.7 million short tons, and 20.2 million short tons, respectively.

Hawaii continues to be an attractive market for the cruise ship industry. The number of cruise visitor arrivals has increased from 92,250 in 1996 to 229,400 in 2003 to 239,668 in 2004, according to DBEDT. In 2003, Norwegian Cruise Lines obtained an exemption from federal maritime law to operate three ships under the U.S. flag in Hawaii. Two of these ships, *Pride of Aloha* and *Pride of America*, initiated year-round, inter-island service in July 2004 and July 2005, respectively. The third ship, *Pride of Hawaii*, began operations in June 2006. The Harbors Division has several projects designed to improve certain terminal facilities statewide to accommodate the increased activity. The construction of a new cruise passenger terminal at Pier 2, Honolulu Harbor, was substantially completed in February, 2006. The design of additional security and related improvements is ongoing.

Hawaii Superferry, Inc., a private ferry operator, has secured financing to complete construction of two new inter-island ferry vessels and commence ferry service operations that will initiate a roll on/roll off high-speed daily service for the transport of passengers and vehicles, including cars, trucks and buses. Operations are planned between the harbors of Honolulu, Kahului, Nawiliwili and Kawaihae. Service is anticipated to begin in the second quarter 2007, starting with one vessel during the first year and a second vessel in the following 18 to 24 months.

The Harbor System is comprised of ten harbors, which are operated and maintained by the Department of Transportation as a single integrated system for financial and management purposes. The harbors are: (1) Honolulu Harbor, Kalaheo Barbers Point Harbor and Kewalo Basin on the island of Oahu, comprising the Oahu District; (2) Hilo Harbor and Kawaihae Harbor on the island of Hawaii, comprising the Hawaii District; (3) Nawiliwili Harbor and Port Allen Harbor on the island of Kauai, comprising the Kauai District; (4) Kahului Harbor on the island of Maui, Kaunakakai Harbor on the island of Molokai, and Kaunapali Harbor on the island of Lanai, comprising the Maui District.

The State uses nine harbors, with the exception of Kewalo Basin, to facilitate the movement of goods from the mainland, foreign and inter-island ports. The number of commercial vessels entering all ports was 9,134 in fiscal year 2003, and 8,993 in fiscal year 2004, and 9,714 in fiscal year 2005.

Honolulu Harbor is the hub of the State's statewide system of harbors, where it serves as a major distribution point of overseas cargo to the neighbor islands and a primary consolidation center for export of overseas cargo. Overseas and inter-island cargo tonnage handled through the Honolulu Harbor was 9.2 million short tons in fiscal year 2003, 9.0 million short tons in fiscal year 2004, and 9.6 million short tons in fiscal year 2005. The State manages, maintains and operates the statewide harbors system to provide for the efficient movement of cargo and passengers.

Air Transportation. The State operates and maintains fifteen airports on six islands within the State. The principal airport, which provides facilities for overseas flights (*i.e.*, other than inter-island flights within the State) is Honolulu International Airport (HNL) on the island of Oahu. HNL is located approximately five miles by highway from the center of the downtown area of Honolulu. It has four runways, two of which (12,000 feet and 12,300 feet) are among the nation's longest. Approximately 60 aircraft can be handled at one time at the terminal complex, including 36 wide-bodied aircraft. With 29 overseas gate positions, 18 inter-island and commuter positions and public parking stalls for 4,579 vehicles, HNL is the most important in the State airports system. The airfield at Barber's Point Naval Air Station became Kalaeloa Airport, a general aviation reliever airport for HNL, in July 1999.

Kahului Airport on the island of Maui, Hilo International Airport (renamed from General Lyman Field) at Hilo, and Kona International Airport at Keahole both on the island of Hawaii and Lihue Airport on the island of Kauai, also service direct flights to and from the continental United States.

According to data from the Airports Council International, HNL is the 56th busiest air terminal in the world, ranking 27th in the United States in total passengers serviced in 2004. In 2004, HNL recorded 320,520 aircraft operations. For the year 2004, there was a 3.6% increase in passengers at HNL to 19,370,796. In fiscal year 2005, overseas domestic, international, and inter-island passengers to Hawaii increased.

Inter-island air travel in Hawaii is primarily served by Aloha Airlines and Hawaiian Airlines. Inter-island traffic flights were reduced based on a federal exemption to collaborate on schedules to increase yields of passenger loads. Aloha Airlines and Hawaiian Airlines filed for Chapter 11 bankruptcy on December 30, 2004 and March 21, 2003, respectively. Aloha and Hawaiian Airlines have exited from bankruptcy.

Since January 2003, a number of major airlines have announced the addition of new routes to Hawaii. American Airlines added a daily flight from Chicago to Kahului, a second daily flight from Chicago to Honolulu, a second flight from Los Angeles to Kona and a second flight from Los Angeles to Lihue. Continental Airlines added daily service from Houston to Kahului and Delta Airlines added daily flights from Cincinnati and Atlanta respectively to Honolulu. Hawaiian Airlines increased frequency to Kahului from Portland and San Diego. Hawaiian also added a daily flight from Las Vegas to Honolulu.

In November 2004, HMY Airways launched new service from Victoria to Honolulu and added capacity in its Vancouver routes to Honolulu and Kahului in December 2005 for the service peak Canadian winter travel season. Also in December 2004, Northwest Airlines started daily Portland-Honolulu; United Airlines launched a daily Chicago-Kahului-Kona service; Continental Airlines started daily Nagoya-Honolulu service; and Delta Airlines added a second daily Atlanta-Honolulu flight.

In April 2005, ATA Airlines launched Phoenix-Honolulu daily service, increased Los Angeles-Kahului service and launched service from Las Vegas to Honolulu and Kona. Aloha Airlines increased service from Orange County to Hawaii to five daily flights and launched San Diego-Honolulu, Las Vegas-Honolulu, San Diego-Kahului, Sacramento-Kahului and Oakland-Kona, and suspended service from Burbank and Vancouver. Delta Airlines launched service from Salt Lake City to Kahului from Atlanta to Kahului, and from Atlanta to Kona via Salt Lake City. Northwest Airlines will offer services from Oakland to Honolulu, Kahului, Kona and Lihue; and Los Angeles, Portland and San Francisco to Honolulu. In addition, Northwest Airlines operates seasonal Anchorage-Kahului-Honolulu service from June 10 to August 22. Hawaiian launched service from San Jose to Honolulu. America West resumed service to Hawaii with nonstop flights from Phoenix to Honolulu and from Phoenix to Kahului. A new airline, WestJet, began twice a week service from Vancouver to Honolulu and to Kahului.

In July 2005, Northwest Airlines began service from Seattle to Kahului and Kona.

In 2006, United Airlines plans to begin service from the West Coast to Hilo. In February, 2006, Continental added a Los Angeles stop so it now has daily Houston-Los Angeles-Kahului flights. In March 2006, American West will begin service from Las Vegas to Kahului from Phoenix to Lihue, and from Phoenix to Kona. In June 2006, Mesa Air plans to begin inter-island service. Hawaiian Airlines will begin service from San Diego to Kahului. Air Japan Airlines will launch charter services from Tokyo to Honolulu. China Airlines Taipei-Honolulu flights will increase from 2 to 3 times daily. EVA Airways resumed Taipei-Honolulu service. Charter carrier, Harmony Airways, increased service from Vancouver to Honolulu and Kahului and added flights from Abbotsford, Kelowna and Victoria, Canada to Hawaii.

Charter carriers also added service to Hawaii in 2003. Hawaiian Vacations added two new routes to Kahului from Boise and Spokane, once a week. Pleasant/ATA added two weekly flights to Lihue from Los Angeles and San Francisco. Suntrips added a weekly flight from Oakland to Lihue. The total net domestic air seats added to Hawaii in 2003 is estimated at over 332,000.

Land Transportation. In the State, three levels of government have authority to construct and maintain public highways, streets and roads. These levels of government are the State, the counties and various federal agencies. The State is served by approximately 4,158 linear miles of public highways, streets and roads administered by the Department of Transportation and the counties. An additional 177 miles of public highways, streets and roads open to the public in national parks and military reservations are the responsibility of various federal agencies, including the United States National Park Service and the military services.

The State Highway System, which is administered by the Department of Transportation, consists of 932 linear miles of roadways. The most important component of the State Highway System is the 55 miles of interstate system on Oahu, which includes Interstates H-1, H-2, H-3 and H-201.

The following table shows the motor vehicle registrations in the State for the years 2000 to 2005, inclusive.

Table B-11
MOTOR VEHICLE REGISTRATION

<u>YEAR</u>	<u>VEHICLES</u>
2000	941,242
2001	967,151
2002	987,598
2003	1,030,843
2004	1,070,012
2005	1,119,838

Education

The State operates a statewide public school system for elementary, intermediate, and high schools and colleges and universities. In the 2005-2006 school year, system enrollment decreased from the 2004-2005 school year to a total of 181,355 in 285 public schools. The public education system at all levels (elementary, intermediate, high school, colleges and universities) is financed at the State level rather than the local level. This includes both capital outlays and costs of operation. Within the total student count, the number of students in regular education has decreased, while the number of charter school students has increased.

In the fall of 2005, 50,157 students attended State colleges and universities, 20,644 of them on the UH Manoa Campus. The UH offers bachelors, masters, and doctorate degrees, as well as a certificate in teaching. The system of community colleges, within the UH system, offers associate in arts and associate in science degrees and certificates, including certificates of achievement.

The University of Hawaii is developing a new medical and bioscience education and research complex for its John A. Bums School of Medicine on the Kakaako waterfront in Honolulu. The complex is being developed in two phases. The \$150 million Phase I includes an education/administration building and a biomedical research building to provide 500,000 square feet of education and research space. The education/administration building was completed in April 2005, and the research building was completed in August 2005. The State supports the project directly through the dedication of a share of its annual tobacco settlement receipts.

Phase II of the biomedical complex will include a research center and parking structure and provide the University with the opportunity to increase the positive critical mass of scientists, educators, students, and faculty that could both stimulate the growth of the University's research enterprise and Hawaii biomedical and biotechnical industries and contribute to the diversification of the State's economy.

The University is also planning the development of a new building for the Cancer Research Center of Hawaii (CRCH) adjacent to the biomedical complex. The new building will replace the existing CRCH facilities with expanded research facilities and the addition of a state-of-the-art out-patient cancer care facility.

State Housing Programs

Since 1970, the State has undertaken a program to alleviate the shortage of housing in the State under a comprehensive housing law. The law recognizes that all phases of housing are related to one another and consequently attempts to cover all such phases, from construction through permanent financing, and also attempts to solve or mitigate the housing problem by using both the public and private sectors. To this end the State has undertaken, among other things, facilitating the development of real property and the construction of dwelling units thereon in partnerships with qualified developers and contractors. The State's participation in such partnerships has consisted of construction financing (interim financing), including land acquisition. Other state efforts include construction and permanent financing for developers of residential housing; development by the State itself of single and multifamily residential housing units on land owned by the State or on land purchased or to be purchased for such purpose or on land to be leased from others; and loans to qualified residents of the State who are qualified purchasers of affordable dwelling units.

The State also administers federal and state housing assistance programs for low-income families. Included are the management of low-rent public housing units, the administration of the Section 8 tenant-based housing assistance program and other federal and State programs intended to provide very low to low-income residents with safe, decent and sanitary housing.

The State housing programs are carried out by the Housing and Community Development Corporation of Hawaii (the "HCDCH"). The HCDCH is empowered to raise funds through the issuance of revenue bonds and to use such funds for housing purposes. The bonds are special obligations of the HCDCH and do not impact the debt limit of the State, nor do the bonds constitute general obligations of the State.

On July 1, 2006, pursuant to Act 196, SLH 2005, the HCDCH will be bifurcated into the Hawaii Public Housing Administration and the Hawaii Housing Finance and Development Administration. The Hawaii Public Housing Administration will perform the function of developing and maintaining public housing. The Hawaii Housing Finance and Development Administration will perform the function of housing finance and development. The assets, obligations and functions of the HCDCH will be transferred to the Hawaii Public Housing Administration or the Hawaii Finance and Development Administration.

Office of Hawaiian Affairs and Ceded Lands

In 1898 the former Republic of Hawaii transferred certain lands to the United States. Upon Hawaii's admission to the Union in 1959, the United States reconveyed title to those lands (collectively, the "Ceded Lands") to the State of Hawaii (the "State") to be held as a public trust for five purposes: (1) public education; (2) betterment of the conditions of native Hawaiians; (3) development of farm and home ownership; (4) making public improvements; and (5) provision of land for public use. In 1978, the State Constitution was amended expressly to provide that the Ceded Lands were to be held as a public trust for native Hawaiians and the general public, and to establish the Office of

Hawaiian Affairs (“OHA”) to administer and manage the proceeds and income derived from a pro rata portion of the Ceded Lands to better the conditions of native Hawaiians.

In 1979, the State legislature (the “Legislature”) adopted HRS Chapter 10 (“Chapter 10”), which, as amended in 1980, specified, among other things, that OHA expend 20% of all funds derived by the State from the Ceded Lands for the betterment of native Hawaiians.

In 1987, in *Trustees of the Office of Hawaiian Affairs v. Yamasaki*, 69 Haw. 154 (1987) (“*Yamasaki*”), the Hawaii Supreme Court concluded that Chapter 10 was insufficiently clear regarding the amount of monies OHA was entitled to receive from the public trust lands.

In 1990, in response to *Yamasaki*, the Legislature adopted Act 304, Session Laws of Hawaii 1990, which (i) defined “public land trust” and “revenue,” (ii) reiterated that 20% of the now defined “revenue” derived from the “public land trust” was to be expended by OHA for the betterment of native Hawaiians, and (iii) established a process for OHA and the Director of Finance of the State jointly to determine the amount of monies which the State would pay OHA to retroactively settle all of OHA’s claims for the period June 16, 1980 through June 30, 1991. Since fiscal year 1992 and until the first quarter of fiscal year 2002, the State, through its departments and agencies, paid 20% of “revenues” to OHA on a quarterly basis.

In 1993, the Legislature enacted Act 35, Session Laws of Hawaii 1993, appropriating \$136.5 million to pay the amount determined to be OHA’s claims, with interest, for the period June 16, 1980 through June 30, 1991.

On January 14, 1994, OHA and its Board of Trustees (the “Plaintiffs”) filed suit against the State (*OHA, et al. v. State of Hawaii, et al.*, Civil No. 94-0205-01 (1st Cir.)(“*OHA I*”), claiming that the amount paid to OHA was inadequate and alleging that the State had failed to properly account for and fully pay the pro rata share of proceeds and income derived from the public land trust. Among other things, the Plaintiffs sought an accounting of all proceeds and income, funds and revenue derived from the public land trust since 1978, and restitution or damages amounting to 20% of the proceeds and income derived from the public land trust, as well as interest thereon. In its answer to OHA’s complaint, the State denied all of the Plaintiffs’ substantive allegations, and asserted its sovereign immunity from suit and other jurisdictional and claim-barring defenses.

The Plaintiffs thereafter filed four motions for partial summary judgment as to the State’s liability to pay OHA 20% of monies it receives from (i) the Department of Transportation Airports Division’s in-bound duty free airport concession (including receipts from the concessionaire’s off-airport sales operations), (ii) the State-owned and operated Hilo Hospital, (iii) the State’s public rental housing projects and affordable housing developments, and (iv) interest income, including investment earnings (collectively, the “Sources”). In response, the State filed a motion to dismiss on the basis of sovereign immunity and opposed Plaintiffs’ four motions on the merits and raised several affirmative defenses.

On October 24, 1996, the circuit court filed an order denying the State’s motion to dismiss and rejecting its affirmative defenses. Also on October 24, 1996, the circuit court filed an order granting Plaintiffs’ four motions for partial summary judgment with respect to the State’s liability to pay OHA 20% of the monies it receives from each of the Sources, and deferred establishing amounts owed from those Sources for further proceedings or trial. The State’s motion for leave to file an interlocutory appeal from both the order denying its motion to dismiss and the order granting Plaintiffs’ four partial summary judgments was granted and all proceedings in the suit were stayed pending the Hawaii Supreme Court’s disposition of the State’s appeal.

On September 12, 2001, the Hawaii Supreme Court concluded *OHA I* by holding in *OHA v. State of Hawaii*, 96 Haw. 388 (2001) that Act 304 was effectively repealed by its own terms, and that there was no judicially manageable standard, i.e., a legal standard, by which to determine whether OHA was entitled to the revenues it sought from the Sources because the repeal of Act 304 revived the law which the court in *Yamasaki* had previously concluded was insufficiently clear to establish how much OHA was entitled to receive from the Ceded Lands. The Supreme Court dismissed *OHA I* for lack of justiciability, that is, that the case was not appropriate for review by the Court, noting that it was up to the Legislature to enact legislation to give effect to the right of native Hawaiians to benefit from the Ceded Lands under the State Constitution. Immediately thereafter, agencies ceased paying OHA any receipts from the Ceded Lands.

The Legislature took no action during the 2002 and 2003 legislative sessions to establish a new mechanism for establishing how much OHA was entitled to receive from the Ceded Lands. On January 10, 2003, and pending legislative action to establish such a mechanism, the Governor issued Executive Order No. 03-03 directing state agencies to resume transferring 20% of receipts from leases, licenses and permits indisputably paid for the use of improved or unimproved parcels of Ceded Lands to OHA, if federal or state law did not preclude all or any portion of the receipt from being used to better the conditions of native Hawaiians, and the transfer of all or any portion of the receipt to OHA would not cause the agency to renege on a preexisting pledge, rate covenant, or other preexisting obligation to holders of revenue bonds or other indebtedness of the State or the agency. During the 2003 legislative session, the Legislature appropriated moneys from the various funds into which the Ceded Lands receipts had been deposited after the decision in *OHA I* was issued and agencies ceased making payments to OHA, and directed the agencies to pay them to OHA.

OHA continues to pursue its claims for a portion of the revenues from the Sources and other Ceded Lands that it made in *OHA I*. On July 21, 2003, OHA filed a new lawsuit, *OHA et al. v. State of Hawaii, et al.*, Civil No. 03-1-1505-07 ("*OHA II*"). In September 1996, the Office of the Inspector General of the U.S. Department of Transportation ("DOT") issued a report (the "IG Report") concluding that from 1992 to 1995, the Hawaii Department of Transportation's payment to OHA of \$28.2 million was a "diversion of airport revenues in violation of [applicable federal law] as OHA provided no airport services in return. The Attorney General of Hawaii disagreed with the IG Report's conclusion, stating in November 1996 that the payments to OHA were simply an operating cost of the airports, and thus not a diversion of airport revenues in violation of federal law. In April 1997, the Acting Administrator of the FAA concurred in writing (the "FAA Memorandum") with the IG Report and opposed the Hawaii Attorney General's position. In support of its appeal of the circuit court's *OHA I* decision to the Hawaii Supreme Court, but differing with the original position of the Attorney General, the State noted in its May 1997 amended opening brief that "unless the federal government's position [set forth in the IG Report] changes, Act 304 prohibits the State from paying OHA airport-related revenues." In its June 1997 reply brief, the State stated that the "DOT Inspector General's determination shows that the federal government is on its way to finding such payments illegal and requiring the State to reimburse past payments of airport-related revenues to OHA." In October 1997, the Department of Transportation and Related Agencies Appropriation Act, 1998, PL 105-66, 1997 HR 2169 (the "DOT Appropriation Act") was enacted into federal law. Section 340 of the DOT Appropriation Act ("Section 340") essentially provides that in exchange for there being no further payments of airport revenues for claims related to Ceded Lands, any such payments received prior to April 1, 1996 need not be repaid. The Hawaii Attorney General submitted enactment of Section 340 to the Hawaii Supreme Court in December 1997, "for the Court's use" in conjunction with the *OHA I* appeal, whereupon the Court requested the parties to submit supplemental briefs to address whether the Forgiveness Act affected the Court's interpretation of Act 304. The State, in its March 1998 supplemental brief, stated, inter alia, that paying OHA a pro rata share of airport monies violated federal law, and that there was no live, ripe controversy regarding those payments because the DOT Appropriation Act relieved the State and OHA of any obligation to return improper past payments.

Despite the adverse *OHA I* decision, the Plaintiffs in *OHA II* have now sued the State of Hawaii for alleged breaches of fiduciary duties as purported trustee of the Ceded Lands public trust, alleged violations of Act 304, Chapter 10, and Article XII, Sections 4, 5 and 6 of the Hawaii Constitution, violations of the Contract Clause of the U.S. Constitution, and misrepresentation and non-disclosure, by the following alleged acts (but not limited to these acts): (1) failing to oppose the positions set forth in the FAA Memorandum; (2) resolving its dispute with the FAA by obtaining a forgiveness of the prior \$28.2 million payment in exchange for a promise not to make future airport revenue payments to OHA and not to appeal the positions set forth in the FAA Memorandum; (3) breaching the trust duty of impartiality by not opposing the positions set forth in the FAA Memorandum in order to use them as a sword in *OHA I*, (4) failing to timely advise OHA that the State was not going to continue to oppose the positions set forth in the FAA Memorandum or IG Report, and that it was planning to settle with the federal government, in order to provide OHA with a fair opportunity to take measures to step into the State's position to oppose the FAA; and (5) failing to obtain instructions from the Court on how to proceed given the State's conflict between defending the State against OHA in *OHA I*, and having a duty to oppose the positions set forth in the FAA Memorandum.

OHA further alleges that these alleged "breaches, errors and omissions" were substantial factors that resulted in the passing of Section 340 and the issuance of the Hawaii Supreme Court's opinion in *OHA I*. Plaintiffs claim that, accordingly, the State is liable to OHA for damages including, but not limited to: (1) the damages alleged by OHA in *OHA I*, and (2) amounts payable under Act 304 that have not been paid, including but not limited to, airport landing

fees. Plaintiffs also sought declaratory and injunctive relief ordering the State to reinstate Act 304, pay airport-related revenues to OHA from sources other than airport revenues (and enjoining the State and its agents, employees, and officials from opposing any of the above), and sought appointment of an independent trustee to replace the State as trustee of the native Hawaiian public trust with respect to matters relating to reinstatement of Act 304 and the payment of airport-related revenues to OHA from sources other than airport revenues. On December 26, 2003, the court granted the State's motion to dismiss OHA's complaint in *OHA II*. The court entered a final judgment on May 19, 2004, encompassing the order dismissing the complaint and several procedural orders. On June 8, 2004, OHA filed a notice of appeal from the portions of the May 19, 2004 judgment dismissing its complaint in *OHA II*, denying leave to amend the complaint and denying a request for bifurcation of OHA's claims for liability and damages. The Hawaii Supreme Court affirmed the circuit court's final judgment dismissing OHA's complaint in a decision issued September 9, 2005; granted OHA's motion for reconsideration in an order filed on December 23, 2005; and affirmed the circuit court's final judgment again in an opinion entered on April 28, 2006.

The State intends to vigorously defend against all of OHA's claims. It is currently unable to predict with reasonable certainty the magnitude of its potential liability, if any, for such claims. The Attorney General is of the view that the claims asserted by OHA in *OHA II* are without merit. Resolution of all of OHA's claims in OHA's favor could have a material adverse effect on the State's financial condition.

In a second lawsuit, OHA and four individuals filed complaints for declaratory and injunctive relief on November 4, 1994, and November 9, 1994 (*OHA v. Housing Finance and Development Corporation et al.*, Civil No. 94-4207-11 (1st Cir.)) to enjoin the State from alienating any Ceded Lands and extinguishing any rights Hawaiians may have in Ceded Lands that may be alienated. Alternatively, OHA sought a declaration that the amounts the Housing Finance and Development Corporation (the "Corporation") and the State paid to OHA for Ceded Lands the Corporation planned to use to develop and sell housing units pursuant to Act 318, 1992 Session Laws of Hawaii, were insufficient. Act 318 established a separate process for valuing the Ceded Lands the Corporation used for its two housing developments at Kealakehe and Lahaina, and quantifying the amounts of income and proceeds from the Ceded Lands that the Corporation and State were required to pay to OHA for conveying and using the parcels for the Corporation's two projects.

In December, 2002, following a trial on the issues, the trial court confirmed the State's authority to sell Ceded Lands, denied the declaratory ruling that the sale of Ceded Lands did not directly or indirectly release or limit Hawaiians' claims to those lands which the plaintiffs requested, and ordered that judgment be entered in the State's and Corporation's favor as to Counts I, II, and III of the Amended Complaint. The plaintiffs moved for and were granted leave to file immediate appeals from the court's rulings to the Hawaii Supreme Court. Those appeals are now pending. Trial to determine the sufficiency of the proceeds paid to OHA by the Corporation and the State from the sale of the particular parcels of Ceded Lands at issue has not been scheduled.

In a third lawsuit, OHA filed suit against the Hawaii Housing Authority (the "HHA"), the executive director of the HHA, the board members of the HHA and the Director of Finance on July 27, 1995 (*OHA v. HHA, et al.*, Civil No. 95-2682-07 (1st Cir.)) to secure additional compensation and an itemized accounting of the sums previously paid to OHA for five specifically identified parcels of Ceded Lands which were transferred to the HHA for its use to develop, construct and manage additional affordable public rental housing units under HRS Chapter 201G. On January 11, 2000, all proceedings in this suit were stayed pending the Hawaii Supreme Court's decision in the State's appeal in *OHA I*. OHA disagrees that the repeal and revival of the pre-*Yamasaki* law by the Hawaii Supreme Court's September 12, 2001 decision in *OHA I* should also require dismissal of the claims OHA makes in *OHA v. HHA*, and the case remains pending.

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APPENDIX C

SUMMARY OF CERTAIN PROVISIONS OF THE CERTIFICATE

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APPENDIX C

SUMMARY OF CERTAIN PROVISIONS OF THE CERTIFICATE

The following is a summary of certain of the provisions of the Certificate. The summary does not purport to be complete or to follow the exact language of the Certificate and, accordingly, is qualified by reference thereto and is subject to the full text thereof. Capitalized terms not otherwise previously defined in this Official Statement or defined below have the meanings set forth in the Certificate. For the complete provisions of the Certificate and the precise wording thereof, reference should be made to the Certificate, copies of which are available upon request at the office of Bond Counsel or the Department. Unless clearly indicated otherwise, all section references are to the Certificate only.

The Capital Improvement Bonds and the 1990 Certificate Harbor Revenue Bonds referred to in the summary of the Certificate presented by this Appendix C no longer are Outstanding, and no additional Capital Improvement Bonds or 1990 Certificate Harbor Revenue Bonds will be issued. Accordingly, the references in this Appendix C to the Capital Improvement Certificate, the Capital Improvement Bonds, the Capital Improvement Special Fund, the Capital Improvement Debt Service Reserve Account, the 1990 Certificate and the 1990 Certificate Harbor Revenue Bonds no longer apply. In addition, the Certificate provides for the consolidation of the 1997 Certificate Harbor Revenue Special Fund into the Harbor Special Fund once the Capital Improvement Bonds and 1990 Certificate Harbor Revenue Bonds are no longer Outstanding. Accordingly, all references to the 1997 Certificate Harbor Revenue Special Fund shall be deemed to refer to the Harbor Special Fund.

Definitions of Certain Terms (Certificate – Section 1.01)

The following are definitions in summary form of certain terms contained in the Certificate and used in this Official Statement.

“*Additional Bonds*” means, collectively, any Additional Bonds issued under and pursuant to the provisions of the Certificate and, unless the context otherwise requires, any Refunding Bonds issued under and pursuant to the provisions of the Certificate.

“*Aggregate Net Revenues*” means (A) for any period prior to the date of calculation: (i) Revenues accrued during such period (after allowance for doubtful accounts deemed appropriate by the Department), minus (ii) Operation and Maintenance Expenses accrued during such period; and (B) for any period subsequent to the date of calculation, with respect to Section 6.03 of the Certificate: (i) estimated Revenues for such period, minus (ii) estimated Operation and Maintenance Expenses for such period.

“*Aggregate Certificate Bond Service*” means, as of any date of calculation and with respect to any period, the sum of the amounts of Bond Service for all Series of Bonds, Capital Improvement Bonds and 1990 Certificate Harbor Revenue Bonds for such period.

“*Bond Service*” means, as of any date of calculation and with respect to any period for any Series of Bonds, an amount equal to the sum of (i) the interest accruing during such period on the Bonds of such Series, except to the extent that such interest is to be paid from amounts credited to the 1997 Certificate Harbor Interest Account, and (ii) that portion of the next succeeding Principal Installment for the Bonds of such Series that would have accrued during such period if each such Principal Installment were deemed to accrue daily (based on a year of 12 months each of 30 days’ duration) in equal amount from the next preceding Principal Installment due date (or, in the event there shall have been no such preceding Principal Installment due date for such Series, then from a date one year preceding the due date of such Principal Installment or from the date of delivery of the Bonds of such Series, whichever is later). Such interest and Principal Installments shall be calculated on the assumption that no Bonds of such Series Outstanding at the date of calculation will cease to be Outstanding except by reason of the payment of each Principal Installment for the Bonds of such Series on the due date thereof.

(A) The assumed interest rate on Variable Rate Bonds for purposes of this definition shall be determined as follows: (a) with respect to a Series of Variable Rate Bonds against which an Interest Rate Swap Agreement has been executed pursuant to which the Department agrees to pay a fixed rate, the assumed interest rate will equal the

fixed rate to be paid by the Department under the Interest Rate Swap Agreement and (b) with respect to any other Series of Variable Rate Bonds then outstanding or proposed to be issued the interest rate shall be assumed to be a rate equal to the long-term revenue bond index rate as published by the Bond Buyer, or other similar publication within 10 days of calculation;

(B) In determining the principal amount due in each fiscal year for any Capital Appreciation Bonds, payment shall (unless a different subsection of this definition applies for purposes of determining principal maturities or amortization) be assumed to be made in accordance with any amortization schedule established for such debt, including any mandatory sinking account payments or any scheduled redemption or payment of Bonds on the basis of Accreted Value, and for such purpose, the redemption payment or payment of Accreted Value shall be deemed a principal payment and interest that is compounded and paid as part of Accreted Value shall be deemed due on the scheduled redemption or payment date of such Capital Appreciation Bond;

(C) If the Bonds are Paired Obligations, the interest rate on such Bonds shall be the resulting linked rate or effective fixed interest rate to be paid by the Department with respect to such Paired Obligations;

(D) If any Interest Rate Swap Agreement is in effect pursuant to which the Department pays a variable rate, and such swap is payable on a parity with the Bonds to which it relates (provided, however, that any termination or other cancellation payment due under the Interest Rate Swap Agreement shall be subordinate to the Bonds) no amounts payable under such interest rate swap agreement shall be included in the calculation of Bond Service unless the sum of (i) interest payable on such Bonds, plus (ii) amounts payable by the Department under such interest rate swap agreement, less (iii) amounts receivable by the Department under such interest rate swap agreement are greater than the interest payable on the Bonds to which it relates, then, in such instance, the amount of such payments to be made that exceed the interest to be paid on the Bonds shall be included in each calculation. For such purposes the variable amount under any such interest rate swap agreement shall be assumed to be equal to a rate equal to the assumed Revenue Bond Index-based rate, as published by *The Bond Buyer*, or other similar publication, within 10 days of calculation;

(E) If any Bonds feature an option, on the part of the Bondowners or an obligation under the terms of such Bonds, to tender all or a portion of such Bonds to the Department, or other fiduciary or agent and require that such Bonds or portion thereof be purchased if properly presented, then for purposes of determining the amounts of principal and interest due in any fiscal year on such Bonds, the options or obligations of the Owners of such Bonds to tender the same for purchase or payment prior to their stated maturity or maturities shall be treated as a principal maturity occurring on the first date on which Owners of such Bonds may or are required to tender such Bonds except that any such option or obligation to tender Bonds shall be ignored and not treated as a principal maturity, if (1) such Bonds are rated in one of the two highest long-term Rating Categories by Moody's and by Standard & Poor's or such Bonds are rated in the highest short-term note or commercial paper Rating Categories by Moody's and Standard & Poor's and (2) funds for the purchase price of such Bonds are to be provided by a Support Facility and the obligation of the Department with respect to the provider of such Support Facility, other than its obligations on such Bonds (including any increased interest rate thereon), shall be subordinated to the obligations of the Department on the Bonds;

(F) For purposes of calculating annual debt service on any Balloon Bonds, it shall be assumed that the principal of those Balloon Bonds, together with interest thereon at a rate equal to the assumed Revenue Bond Index-based rate, as published in *The Bond Buyer* or other similar publication, will be amortized in equal annual installments over a term of 30 years.

When used with reference to Capital Improvement Bonds or 1990 Certificate Harbor Revenue Bonds, "Bond Service" shall have the meaning set forth in the Capital Improvement Certificate and the 1990 Certificate, respectively.

"*Capital Appreciation Bonds*" means Bonds of any Series designated as Capital Appreciation Bonds in the Supplemental Certificate providing for the issuance of such Series and on which interest is compounded and paid at maturity or on prior redemption.

"*Capital Improvement Bonds*" means all Harbor Capital Improvement Revenue Bonds issued and Outstanding under the Capital Improvement Certificate.

“*Capital Improvement Certificate*” means the Certificate of the Director of Transportation Providing for the Issuance of State of Hawaii Harbor Capital Improvement Revenue Bonds dated September 1, 1967, as amended and supplemented.

“*Capital Improvement Special Fund*” means the second separate harbor special fund created in the treasury of the State by that paragraph which begins with the word “Fifth” of Section 266-19, Hawaii Revised Statutes, prior to amendment by Act 309, Session Laws of Hawaii, Regular Session 1989 and continued pursuant to paragraph (a) of Section 266-19, Hawaii Revised Statutes, as amended.

“*Code*” means the Internal Revenue Code of 1986, as from time to time amended, and any successor statute thereto, and any Treasury regulations or proposed regulations thereunder. Any reference herein to any Section of the Code shall be deemed to refer to any amended or successor provision enacted or promulgated after the date of this Certificate, but only with respect to each particular Series of Bonds to the extent effective as to such Series.

“*Event of Default*” means any occurrence or event specified under “*Events of Default; Remedies*” below.

“*Federal Securities*” means any of the following:

(i) any direct and general obligations of, or any obligations fully and unconditionally guaranteed as to the full and timely payment of principal and interest by, the United States of America;

(ii) any obligations issued or guaranteed by any of the following federal agencies, provided that such obligations are backed by the full faith and credit of the United States of America: United States Export-Import Bank (direct obligations or fully guaranteed certificates of beneficial ownership); Farmers Home Administration (certificates of beneficial ownership); Federal Financing Bank; Federal Housing Administration (debentures); General Services Administration (participation certificates); Government National Mortgage Association (“GNMA”) (GNMA-guaranteed mortgage-backed bonds; GNMA-guaranteed pass-through obligations); United States Maritime Administration (guaranteed Title XI financing); New Communities Debentures (United States Government guaranteed debentures); United States Public Housing Notes and Bonds (United States Government guaranteed public housing notes and bonds); and United States Department of Housing and Urban Development (project notes; local authority bonds);

(iii) any obligations of any state or political subdivision of a state (collectively, “Municipal Bonds”) which Municipal Bonds are either (A) rated “Aaa” by Moody’s and “AAA” by S&P (whether such rating is based upon the credit of the issuer, an insurance policy, a letter of credit or otherwise) or (B) fully secured as to principal and interest by an irrevocable pledge of moneys or direct and general obligations of, or obligations guaranteed by, the United States of America, which moneys or obligations are segregated in trust and pledged for the benefit of the holder of the Municipal Bonds, and which Municipal Bonds are rated “Aaa” by Moody’s and “AAA” by S&P and provided, however, that such Municipal Bonds are accompanied by (a) an opinion of Bond Counsel to the effect that such Municipal Bonds are not subject to redemption prior to the date the proceeds of such Municipal Bonds will be required for the purposes of the investment being made therein and (b) a report of an Independent Public Accountant verifying that the moneys and obligations so segregated are sufficient to pay the principal of, premium, if any, and interest on the Municipal Bonds; and

(iv) securities commonly referred to as CATs, TIGRs, STRIPs, other certificates of direct ownership of the principal of, or interest on, direct and general obligations of the United States of America or certificates of direct ownership of the interest on obligations of the Resolution Funding Corporation, which obligations are held by a commercial bank which is a member of the Federal Reserve System in trust on behalf of the holders of the derivative product:

provided, however, that the term “Federal Securities” shall exclude unit investment trusts or mutual funds which otherwise meet the criteria set forth above in clauses (i) through (iv) unless the trust or fund is in the highest rating category of the Rating Agency.

“*Fiscal Year*” means the fiscal year for the State as established from time to time by the State, being on the date of effectiveness of this Certificate the period from July 1 in any year to and including the following June 30.

“*Harbor Consultant*” means an independent person or firm or corporation who shall have a widely known and favorable reputation for special skill, knowledge and experience in methods of the development, operation and management of harbors of the approximate size and character as the properties constituting the Undertaking. The Independent Public Accountant or Consulting Engineer may be appointed as a Harbor Consultant, but the Department is not limited in its selection to such persons or entities.

“*Interest Payment Date*” means, with respect to any particular Series of Bonds, any date on which interest is payable on such Series of Bonds as such date shall be established in the Supplemental Certificate providing for the issuance of such Series of Bonds.

“*Net Revenues*” means (A) for any period prior to the date of calculation, and so long as there are 1990 Certificate Harbor Revenue Bonds Outstanding or Capital Improvement Bonds Outstanding:

(i) Revenues accrued during such period (after allowance for doubtful accounts deemed appropriate by the Department), minus

(ii) deposits made from Revenues during such period to (so long as there are Capital Improvement Bonds Outstanding) the Capital Improvement Special Fund to pay debt service on the Capital Improvement Bonds (including any such deposits made during such period to restore the Capital Improvement Debt Service Reserve Account to the amount required to be credited thereto), minus

(iii) Operation and Maintenance Expenses accrued during such period, minus

(iv) deposits made during such period to the Harbor Revenue Special Fund to pay debt service on the 1990 Certificate Harbor Revenue Bonds (including any such deposits made during such period to restore the Harbor Debt Service Reserve Account to the amount required to be credited thereto);

(B) for any period prior to the date of calculation, after there are no Capital Improvement Bonds Outstanding and no 1990 Certificate Harbor Revenue Bonds Outstanding, (A)(i) minus (A)(iii);

(C) for any period subsequent to the date of calculation, and so long as there are Capital Improvement Bonds Outstanding or 1990 Certificate Harbor Revenue Bonds Outstanding:

(i) estimated Revenues for such period, minus

(ii) deposits due from Revenues for such period to (so long as there are Capital Improvement Bonds Outstanding) the Capital Improvement Special Fund to pay debt service on the Capital Improvement Bonds (including any such deposits made during such period to restore the Capital Improvement Debt Service Reserve Account to the amount required to be credited thereto), minus

(iii) estimated Operation and Maintenance Expenses for such period, minus

(iv) deposits due for such period to the Harbor Revenue Special Fund to pay debt service on the 1990 Certificate Harbor Revenue Bonds (including any such deposits estimated to be made to restore the Harbor Debt Service Reserve Account to the amount required to be credited thereto);

(D) for any period subsequent to the date of calculation, after there are no Capital Improvement Bonds Outstanding and no 1990 Certificate Harbor Revenue Bonds Outstanding, (C)(i) minus (C)(iii).

“*1990 Certificate*” means the Certificate of the Director of Transportation Providing for the Issuance of State of Hawaii Harbor Revenue Bonds dated as of November 15, 1990, as amended and supplemented.

“1990 Certificate Harbor Revenue Bonds” means all State of Hawaii Harbor Revenue Bonds issued and Outstanding under the 1990 Certificate.

“1997 Certificate Harbor Debt Service Reserve Account” means the separate special account of the Department created pursuant to the Certificate in the 1997 Certificate Harbor Revenue Special Fund and designated in that Section as the “1997 Certificate Harbor Debt Service Reserve Account.”

“1997 Certificate Harbor Interest Account” means the separate special account of the Department created pursuant to the Certificate in the 1997 Certificate Harbor Revenue Special Fund and designated in that Section as the “1997 Certificate Harbor Interest Account.”

“1997 Certificate Harbor Principal Account” means the separate special account of the Department created pursuant to the Certificate in the 1997 Certificate Harbor Revenue Special Fund and designated in that Section as the “1997 Certificate Harbor Principal Account.”

“1997 Certificate Harbor Reserve and Contingency Account” means the separate special account of the Department created pursuant to the Certificate in the 1997 Certificate Harbor Revenue Special Fund and designated in that Section as the “1997 Certificate Harbor Reserve and Contingency Account.”

“1997 Certificate Harbor Revenue Special Fund” means the special fund of that name created in the Certificate.

“Operation and Maintenance Expenses” means the expenses of operation and maintenance of the properties constituting the Undertaking and the expenses of operation of the Department, including general administrative overhead, in connection with those properties, but excluding any (i) arbitrage earnings which are required to be paid to the United States Government pursuant to Section 148 of the Code, (ii) depreciation expense, (iii) surcharges imposed by the State for central services expenses and (iv) Qualified Litigation Costs (defined under “Undertaking” below).

“Outstanding,” when used with respect to any Bond, shall have the construction given to such word under “Discharge of Liens and Pledges; Bonds No Longer Deemed Outstanding Under the Certificate” below, i.e., a Bond shall not be Outstanding hereunder if such Bond is at the time not deemed to be Outstanding by reason of the operation and effect of said Section.

For purposes of the Certificate, in the event any Bonds of a Series are issued and sold at a price such that a portion or all of the interest thereon is intended to be earned by accrual of original issue discount or the compounding of interest, the amount of such Bonds deemed to be Outstanding for the purpose of calculating the principal amount of any such Bonds and the principal amount of Bonds Outstanding in connection with the exercise of any voting right or privilege, the giving of any consent or direction or the taking of any other action that the holders of the Bonds are entitled to take pursuant to Articles X and XI of the Certificate or otherwise, shall be the Accreted Value thereof. Prior to the issuance and delivery of any Series of Bonds of the character described in this paragraph, a certificate of the Department shall be executed setting forth the Accreted Value thereof as of each Interest Payment Date for such Series of Bonds to the stated maturity date thereof, which certificate shall be conclusive in the absence of manifest error. Unless otherwise provided in the Supplemental Certificate providing for the issuance of a Series of Bonds, this paragraph shall apply only to issues with an original issue discount in excess of 5% from the par amount thereof.

When used with reference to the 1990 Certificate Harbor Revenue Bonds and the Capital Improvement Bonds, “Outstanding” shall have the meaning set forth in the 1990 Certificate and the Capital Improvement Certificate, respectively.

“Paired Obligations” means any Series (or portion thereof) of Bonds designated as Paired Obligations in the Supplemental Certificate or other document authorizing the issuance or incurrence thereof, which are simultaneously issued or incurred (i) the principal of which is of equal amount maturing and to be redeemed (or canceled after acquisition thereof) on the same dates and in the same amounts, and (ii) the interest rates which, taken together, result in an irrevocably fixed interest rate obligation of the Certificate for the terms of such Bonds.

“*Rate Covenant*” means the covenant by the State in the Certificate relating to rates and charges, which is summarized in the Official Statement under the heading “SECURITY FOR THE BONDS – Rates and Charges.”

“*Reserve Requirement*” means an amount, as of any date of determination, equal to the maximum Aggregate Bond Service for any Bond Year, beginning with the Bond Year in which the date of determination occurs and ending with the Bond Year after which no Bonds are Outstanding; provided, however, the deposit to the 1997 Certificate Harbor Revenue Special Fund for credit to the 1997 Certificate Harbor Debt Service Reserve Account from the Proceeds of any Series of Bonds shall be deemed to satisfy the Reserve Requirement if such deposit is equal to the lesser of (1) Average Annual Bond Service on such Series and (2) the amount permitted by the Code in order that the interest on such Series is excluded from gross income for federal income tax purposes.

“*Revenues*” means and includes (A) all income, revenues and moneys derived by the State from the ownership or operation of the Undertaking or the supplying and furnishing of the services, facilities and commodities thereof, and without limiting the generality of the foregoing, shall include all income, revenues and moneys derived from rates, rentals, fees, tolls and charges assessable and chargeable by the Department in respect to dockage, wharfage, demurrage and rates appertaining to the Undertaking or derived from the rental of all or part of the Undertaking or from the sale or rental of any commodities or goods in connection with the Undertaking; earnings on the investment of moneys held under the Capital Improvement Certificate, the 1990 Certificate or the Certificate and the proceeds of the sale of any such investments; earnings on the investment of the proceeds of Bonds; and to the extent provided in Article VI of the Certificate, income derived by the Department or otherwise derived by the State from a Net Rent Lease (defined under “*Certain Covenants by the State – Net Rent Leases*” below); (B) income, revenues and moneys paid to the State or the Department with respect to properties that constitute part of the Undertaking on the effective date of the Certificate but are sold, leased or otherwise disposed of or transferred pursuant to the provisions of the Certificate so as to no longer constitute part of the Undertaking; and (C) any other moneys or funds deposited by the State or the Department into the Harbor Special Fund, the Harbor Revenue Special Fund or the 1997 Certificate Harbor Revenue Special Fund; provided, however, that the term “Revenues” shall not include:

- (i) moneys received as proceeds from the sale of Bonds or Special Obligation Bonds;
- (ii) condemnation proceeds or insurance proceeds except insurance proceeds received from rental or business interruption insurance;
- (iii) grants-in-aid or similar payments received from public agencies, provided that (1) the application of such moneys is restricted to a specific purpose or (2) such grants or payments constitute a reimbursement to the State for expenditures previously made from the Harbor Special Fund, the Capital Improvement Special Fund or the 1997 Certificate Harbor Revenue Special Fund;
- (iv) moneys or securities received by the State or the Department as gifts or grants, the use of which is restricted by the donor or grantor;
- (v) investment income derived from any moneys or securities which may be placed in escrow or trust to defease bonds of the State, including Capital Improvement Bonds, 1990 Certificate Harbor Revenue Bonds and the Bonds;
- (vi) any arbitrage earnings which are required to be paid to the United States Government pursuant to Section 148 of the Code; and
- (vii) the proceeds of any Support Facility.

“*Series 1997 Bonds*” means the State of Hawaii Harbor System Revenue Bonds, Series of 1997, being the initial Series of Bonds issued pursuant to the Certificate.

“*Sinking Fund Installment*” means, with respect to each Series of Bonds, the amount designated as such in the Supplemental Certificate authorizing such Series of Bonds. The portion of any such Sinking Fund Installment remaining after the deduction of any such amounts credited pursuant to the Certificate toward the same (or the original

amount of any such Sinking Fund Installment if no such amounts shall have been credited toward the same) shall constitute the unsatisfied balance of such Sinking Fund Installment for the purpose of calculation of Sinking Fund Installments due on a future date.

“*Support Agreement*” means the agreement or agreements, if any, entered into by the Department which provide for a Support Facility, and any and all modifications, alterations, amendments and supplements thereto.

“*Support Facility*” means any instrument entered into or obtained in connection with a Series of Bonds such as a letter of credit, a committed line of credit, insurance policy, surety bond or standby bond purchase agreement, or any combination of the foregoing, and issued by a bank or banks, other financial institution or institutions, or any combination of the foregoing, which Support Facility provides for the payment of (i) the purchase price equal to the principal of and accrued interest on Bonds delivered to the Remarketing Agent or any depository, tender agent or other party pursuant to a Remarketing Agreement or Supplemental Certificate and discount, if any, incurred in remarketing such Bonds and/or (ii) principal of and interest on all Bonds becoming due and payable during the term thereof.

“*Undertaking*” means and includes all harbors, harbor and waterfront improvements, ports, docks, wharves, quays, bulkheads and landings and other related facilities and properties (real, personal or mixed) now belonging to or controlled by the State and under the administration, jurisdiction, control and management of the Department, and all improvements, betterments or extensions thereto hereafter constructed or acquired, except in all cases such facilities and properties as are principally used for recreation or the landing of fish (except properties located at Kewalo Basin, Ewa of Ala Moana Park, Honolulu, and its annex), and without limiting the generality of the foregoing, the term “*Undertaking*” shall include each and every, all and singular, the properties and facilities constructed or acquired from the proceeds of the obligations issued under the Resolution of the Board of Harbor Commissioners adopted September 18, 1950 or constructed or acquired from the proceeds of Capital Improvement Bonds, 1990 Certificate Harbor Revenue Bonds or Bonds issued under the Certificate or constructed or acquired from the proceeds of any other bonds, notes or other evidences of indebtedness payable, or the principal and interest of which is reimbursable, from the Harbor Special Fund or from a fund maintained therefrom, or constructed or acquired from moneys in the Harbor Special Fund or in any other fund maintained therefrom and any settlement (negotiated, court-ordered or otherwise), judgment or order and related costs, arising from any litigation or relating to any of the foregoing properties and facilities to which the State or the Department is a party related to such properties or facilities or to which any of such properties and facilities are bound (any such settlement, judgment or order and related costs are hereinafter referred to as “*Qualified Litigation Costs*”); provided, however, that the term “*Undertaking*” shall not include:

- (1) any State ferry system established, financed and maintained pursuant to Chapter 268, Hawaii Revised Statutes, or established, financed and maintained pursuant to any other law;
- (2) properties sold, leased or otherwise disposed of or transferred pursuant to the provisions of the Certificate;
- (3) properties subject to a Net Rent Lease except to the extent provided in Article VII of the Certificate; and
- (4) properties in Kewalo Basin and Fort Armstrong to be transferred from the jurisdiction of the Department to the Hawaii Community Development Authority pursuant to Act 86, Session Laws of Hawaii, 1990.

“*Value of Investment Securities*” and words of like import means the amortized value thereof; provided, however, that all United States Treasury Obligations—State and Local Government Series shall be valued at par and those obligations which are redeemable or otherwise subject to payment (including purchase) at the option of the owner thereof shall be valued at the price at which such obligations are then redeemable, or otherwise subject to payment. The computations made under this definition shall include accrued interest on the Investment Securities paid as a part of the purchase price thereof and not collected. For the purposes of this definition, “*amortized value*,” when used with respect to a security purchased at par, means the purchase price of such security and when used with respect to a security purchased at a premium above or discount below par means, as of any subsequent date of valuation, the value obtained by dividing the total premium or discount by the number of interest payment dates remaining to maturity on any such security after such purchase and by multiplying the amount so calculated by the number of interest payment

dates having passed since the date of purchase and (i) in the case of a security purchased at a premium, by deducting the product thus obtained from the purchase price, and (ii) in the case of a security purchased at a discount, by adding the product thus obtained to the purchase price.

“*Variable Rate Bonds*” means any Bonds issued bearing interest at a rate per annum subject to adjustment from time to time pursuant to the terms thereof, based upon an index or otherwise calculated in a manner which precludes the actual rate for the entire term of such debt from being ascertainable in advance. For the purposes of this definition, Bonds shall not be considered to be Variable Rate Bonds upon the establishment of or conversion of the rate of interest thereon to a fixed interest rate.

Additional Bonds and Refunding Bonds (Certificate – Sections 4.02, 4.03 and 4.04)

Conditions Precedent to Issuance of Additional Bonds and Refunding Bonds. The Department at any time and from time to time may authorize the issuance of one or more Series of additional Bonds (“Additional Bonds”) or refunding Bonds (“Refunding Bonds”) payable from the 1997 Certificate Harbor Revenue Special Fund on a parity with the Series 1997 Bonds and any Additional Bonds or Refunding Bonds then Outstanding and equally and ratably secured therewith, upon compliance with the following conditions:

1. The issuance of the Additional Bonds or Refunding Bonds shall have been authorized by law and are issued under and pursuant to a Supplemental Certificate.
2. In the case of the issuance of Additional Bonds, upon compliance with the additional conditions summarized below.
3. In the case of the issuance of Refunding Bonds, upon compliance with the additional conditions summarized below.

Nothing in the Certificate shall prohibit or prevent, or be deemed or construed to prohibit or prevent, the Department from issuing Variable Rate Bonds, Capital Appreciation Bonds, Paired Obligations or entering into an Interest Rate Swap Agreement. The Supplemental Certificate providing for the issuance of Variable Rate Bonds, Balloon Bonds (as defined in the Certificate), Capital Appreciation Bonds or Paired Obligations may provide for, without limitation, the following: Support Facilities or alternative Support Facilities and Support Agreements in connection therewith; Remarketing Agreements and the appointment of Remarketing Agents; the appointment of tender agents to accept mandatory or optional tenders of Variable Rate Bonds; the payment, redetermination and accrual over specified periods of interest or Accreted Value; the establishment, use, composition, adjustment and change-of-interest indices or modes or the establishment and use of alternative interest indices or modes or the establishment of a fixed interest rate or rates; the establishment of special funds and accounts in connection with the issuance of Variable Rate Bonds, Capital Appreciation Bonds or Paired Obligations; special redemption or purchase provisions for such Variable Rate Bonds and notice provisions in connection with the purchase, redemption, delivery or tender of such Variable Rate Bonds; and any other terms and provisions not in conflict with the Certificate.

Additional Conditions for the Issuance of Additional Bonds. Each of the following conditions, in addition to those set forth above, shall be met upon the issuance of Additional Bonds:

- a. Such Bonds shall be issued only for the purpose of the payment or reimbursement of the cost of the acquisition or construction of properties to constitute part of the Undertaking or the making of additions to, expansions of, improvements of, renewals of, replacements of, or reconstructions of, the Undertaking or of properties which shall constitute part of the Undertaking (including, without limitation, any Qualified Litigation Costs, as defined in the Certificate);
- b. The Supplemental Certificate providing for the issuance of such Bonds shall provide that any accrued interest received upon the sale of said Bonds or any interest capitalized from the proceeds of said Bonds shall be paid into the 1997 Certificate Harbor Revenue Special Fund for credit to the 1997 Certificate Harbor Interest Account;

c. At the time of the issuance of such Additional Bonds, no default exists in the payment of the principal of and premium, if any, and interest on any Bond, any 1990 Certificate Harbor Revenue Bond or any Capital Improvement Bond; no deficiencies exist in the Harbor Special Fund, the Capital Improvement Special Fund, the Harbor Revenue Special Fund or the 1997 Certificate Harbor Revenue Special Fund; the Rate Covenant is satisfied currently without regard to provisions concerning curative action; and there does not exist an Event of Default or a condition which upon the passage of time would constitute an Event of Default;

d. The Aggregate Net Revenues as derived from the most recent audited financial statements or for any consecutive twelve calendar month period during the eighteen calendar month period preceding the date of adoption by the Department of the Supplemental Certificate authorizing the issuance of such Additional Bonds (the "Designated Period"), as certified by the Independent Public Accountant, are at least equal to (i) one and twenty-five hundredths (1.25) times the Aggregate Certificate Bond Service for any future Fiscal Year on all Bonds, 1990 Certificate Harbor Revenue Bonds and Capital Improvement Revenue Bonds to be Outstanding after the issuance of such Additional Bonds, or (ii) one (1.00) times the Aggregate Certificate Bond Service for any future Fiscal Year on all Bonds, 1990 Certificate Harbor Revenue Bonds and Capital Improvement Revenue Bonds to be Outstanding after the issuance of such Additional Bonds and the sum of (1) the Aggregate Net Revenues for the Designated Period, as certified by the Independent Public Accountant and as adjusted as hereinafter required, and (2) the Anticipated Net Revenue Increase (hereinafter defined), if any, is at least equal to one and twenty-five hundredths (1.25) times the Aggregate Certificate Bond Service for any future Fiscal Year on all Bonds, 1990 Certificate Harbor Revenue Bonds and Capital Improvement Revenue Bonds to be Outstanding after the issuance of such Additional Bonds; and

e. Upon the delivery of any Series of Additional Bonds there shall be on deposit in the 1997 Certificate Harbor Revenue Special Fund for credit to the 1997 Certificate Harbor Debt Service Reserve Account an amount equal to the Reserve Requirement, provided that the Supplemental Certificate providing for the issuance of such Series of Additional Bonds may provide that part of the proceeds thereof shall be paid into the 1997 Certificate Harbor Revenue Special Fund for credit to the 1997 Certificate Harbor Debt Service Reserve Account.

For the purposes of making the determinations required by clause (ii) of paragraph d. above:

A. In the event that at any time during the Designated Period the State acquired existing properties which at the time of such acquisition were used for harbor purposes and if the State shall have title to and possession of such properties on the day of such delivery and such properties shall constitute part of the Undertaking on such day, or in the event that any existing properties are to be acquired by the State from the proceeds of the Additional Bonds proposed to be issued, which properties at the time of such acquisition are used for harbor purposes, then in either event (or in both events) the Aggregate Net Revenues as determined by the Independent Public Accountant for the Designated Period shall be increased or decreased by the Harbor Consultant to reflect the revenues (if any) which would have been derived by the Department from, and the costs of operation and maintenance which would have been incurred by the Department with respect to, such properties during the said period and otherwise adjusted if necessary, so as to reflect the result had such properties been operated by the Department as part of the Undertaking throughout the Designated Period;

B. In the event that at any time prior to the day of the delivery of the proposed Additional Bonds, or in the event that during the month in which such Additional Bonds are to be delivered (but prior to such delivery), the Department has imposed increases in its schedule of rentals, rates, fees, tolls and charges, which increases are or shall be in effect upon the delivery of such Additional Bonds, the Aggregate Net Revenues for the aforesaid period may be adjusted by the Harbor Consultant to reflect the results had such increased rates been in effect throughout such entire period; and

C. "Anticipated Net Revenue Increase" means such increase in Aggregate Net Revenues as estimated by the Harbor Consultant for such period the Harbor Consultant deems reasonable and taking into account such factors as such consultant deems pertinent, including, without limitation, (1) of construction of additional facilities to constitute part of the Undertaking (including in the word "construction" the making of additions and expansions to or renovations or reconstructions of existing facilities constituting part of the

Undertaking, or the acquisition of properties not theretofore used for harbor purposes which are to constitute part of the Undertaking) and (2) the Rate Covenant.

Additional Conditions for the Issuance of Refunding Bonds. The following conditions, in addition to those set forth above, shall be met upon the issuance of Refunding Bonds: Refunding Bonds may be issued to refund prior to maturity all or part of the Capital Improvement Bonds, the 1990 Certificate Harbor Revenue Bonds or the Outstanding Bonds, including therein amounts to pay principal, redemption premium and interest to the redemption date on the Bonds, the 1990 Certificate Harbor Revenue Bonds or Capital Improvement Bonds to be refunded, which Bonds, 1990 Certificate Harbor Revenue Bonds or Capital Improvement Bonds to be refunded shall be specified in the Supplemental Certificate providing for the issuance of the Refunding Bonds, provided (1) at the time of the issuance of such Refunding Bonds, no default exists in the payment of the principal of and premium, if any, and interest on any Bonds, 1990 Certificate Harbor Revenue Bonds or Capital Improvement Bonds; no deficiencies exist in the Harbor Special Fund, the Capital Improvement Special Fund, the Harbor Revenue Special Fund or the 1997 Certificate Harbor Revenue Special Fund; the Rate Covenant is satisfied currently without regard to provisions concerning curative action, and there does not exist an Event of Default or a condition which upon the passage of time would constitute such an Event of Default; (2) the aggregate of the Bond Service on such Refunding Bonds shall be less than the aggregate of the Bond Service on the Capital Improvement Bonds, 1990 Certificate Harbor Revenue Bonds or Bonds to be refunded were such refunding not to occur; and (3) upon the delivery of such Refunding Bonds there shall be on credit to the 1997 Certificate Harbor Debt Service Reserve Account an amount equal to the Reserve Requirement.

Nothing in the Certificate shall be deemed to apply to or construed to prevent a refunding at one time of all Bonds then Outstanding.

Nothing in the Certificate shall prevent the Department from issuing Additional Bonds without compliance with the provisions for issuance of Refunding Bonds, for the purpose of refunding all or any portion of Outstanding Bonds, 1990 Certificate Harbor Revenue Bonds or Capital Improvement Bonds.

Allocation and Application of Revenues (Certificate – Section 5.01.)

There is created the 1997 Certificate Harbor Revenue Special Fund, which shall be comprised of the following accounts: 1997 Certificate Harbor Interest Account, 1997 Certificate Harbor Principal Account, 1997 Certificate Harbor Debt Service Reserve Account and Harbor Reserve and Contingency Account.

The Revenues deposited or to be deposited into the 1997 Certificate Harbor Revenue Special Fund shall be applied, used and disposed of as follows, and in the following order of priority:

FIRST: for Operation and Maintenance Expenses;

SECOND: for credit to the following accounts in the following order of priority in the amounts required pursuant to the provisions of the Certificate:

- a. 1997 Certificate Harbor Interest Account;
- b. 1997 Certificate Harbor Principal Account; and
- c. 1997 Certificate Harbor Debt Service Reserve Account;

THIRD: for any other purpose within the jurisdiction, powers, duties and functions of the Department related to the Undertaking, including, without limitation, Operation and Maintenance Expenses, acquisitions (including real property and interests therein), constructions, additions, expansions, improvements, renewals, replacements, reconstruction, engineering, investigation, and planning for the Undertaking, and Qualified Litigation Costs, all or any of which in the judgment of the Department are necessary to the performance of its duties or functions;

FOURTH: to reimburse the general fund of the State for Reimbursable General Obligation Bonds;

FIFTH: for deposit into the 1997 Certificate Harbor Reserve and Contingency Account;

SIXTH: to provide funds for other special reserve funds and other special funds as may be created by law; and

SEVENTH: all or any portion of available moneys on deposit in the 1997 Certificate Harbor Revenue Special Fund, after satisfying the requirements of priority items FIRST through FIFTH above, determined by the Director of Transportation to be in excess of 150% of the requirements for the ensuing 12 months for the 1997 Certificate Harbor Revenue Special Fund may be transferred from the 1997 Certificate Harbor Revenue Special Fund as permitted by and in accordance with Sections 37-53 and 266-19, Hawaii Revised Statutes, as amended, or any successor statute thereto.

At such time as there are no longer any Capital Improvement Bonds Outstanding, the Capital Improvement Special Fund and the Harbor Revenue Special Fund shall be consolidated into the Harbor Special Fund, all references therein to the Harbor Revenue Special Fund shall be deemed to refer to the Harbor Special Fund, and the Revenues shall continue to be deposited into the Harbor Special Fund.

At such time as there are no longer any 1990 Certificate Harbor Revenue Bonds Outstanding, the 1997 Certificate Harbor Revenue Special Fund shall be consolidated into the Harbor Special Fund, all references therein to the 1997 Certificate Harbor Revenue Special Fund shall be deemed to refer to the Harbor Special Fund, and the Revenues shall continue to be deposited in the Harbor Special Fund.

1997 Certificate Harbor Interest Account. (Certificate – Section 5.02.) The moneys credited to the 1997 Certificate Harbor Interest Account shall be disbursed solely for the purpose of paying interest on the Bonds as the same becomes due. In each month, commencing with the first Business Day of the month which follows the last month for which interest on a Series of Bonds, if any, is provided for from the proceeds of a Series of Bonds, (a) with respect to each Series of Bonds (other than Variable Rate Bonds which have Interest Payment Dates occurring at intervals of one month or less), commencing on such first Business Day and continuing on the first Business Day of each month thereafter so long as any of the Bonds of such Series are Outstanding, the Department shall credit to the 1997 Certificate Harbor Interest Account from amounts on deposit in the 1997 Certificate Harbor Revenue Special Fund an amount such that, if the same amount were so credited on the first Business Day of each succeeding month thereafter, the aggregate of such amounts credited on the first Business Day of the month preceding an Interest Payment Date will be equal to the installment of interest falling due on the Bonds on such Interest Payment Date or the amount required to reimburse the Support Provider for a draw on the Support Facility made to provide funds for the payment thereof; and (b) with respect to Variable Rate Bonds which have Interest Payment Dates occurring at intervals of one month or less, on the first Business Day of the month prior to each Interest Payment Date the Department shall credit to the 1997 Certificate Harbor Interest Account from amounts on deposit in the 1997 Certificate Harbor Revenue Special Fund the amount required, together with other funds available therefor credited to such account, to pay, or to reimburse the Support Provider for a draw on the Support Facility made to provide funds for the payment of, the interest payable on such Interest Payment Date or Dates on the Outstanding Variable Rate Bonds. In making the credits to the 1997 Certificate Harbor Interest Account required by this paragraph, consideration shall be given to and allowance made for accrued interest received upon the sale of a Series of Bonds, and for interest capitalized from the proceeds of a Series of Bonds (which accrued or capitalized interest shall in each case be deposited in the 1997 Certificate Harbor Revenue Special Fund for credit to the 1997 Certificate Harbor Interest Account), and for any other credits otherwise made to said account, Variable Rate Bonds shall be assumed to bear interest at the assumed interest rate as determined pursuant to subparagraph (A) of the definition of “Bond Service,” and monthly credits made with respect to Variable Rate Bonds shall be adjusted to the extent possible to reflect the actual interest rate on Variable Rate Bonds in the preceding month so that, as of any Interest Payment Date, the amount available is sufficient to pay the interest then due; provided, however, that any payments to a Support Provider pursuant to a Support Agreement as Holder of a Bond which are in excess of the stated rate of interest on such Bond, whether denominated additional interest, penalty rate or otherwise, shall not constitute interest for purposes of this paragraph.

1997 Certificate Harbor Principal Account. (Certificate – Section 5.03.) In the event of the issuance of any Series of Bonds under the Certificate maturing at times customarily known as maturing serially, in order to provide for the payment of principal of such Bonds of such Series, or to reimburse the Support Provider for a draw on the Support Facility made to provide funds for the payment of such Bonds maturing serially, commencing with the month which is

12 months prior to the first principal payment date of any of such Bonds maturing serially and in each month thereafter so long as any of such Bonds so maturing are Outstanding, there shall be credited to the 1997 Certificate Harbor Principal Account an amount such that, if the same amount were so credited to this account on the first Business Day of such first month and each succeeding month thereafter prior to the next date upon which the principal of any of said Bonds maturing serially becomes due and payable, the aggregate of the amounts on credit will on the first Business Day of the month preceding each such next principal payment date be equal to the principal amount of said Bonds becoming due on such principal payment date.

In the event of the issuance of any Series of Bonds under the Certificate in the form customarily known as "term bonds," for the purpose of retiring such Bonds, or to reimburse the Support Provider for a draw on the Support Facility made to provide funds for the payment of such term Bonds, commencing with the month which is 12 months immediately prior to the date upon which the first Sinking Fund Installment to provide for the retirement of such term Bonds is due, and in each month thereafter so long as any of such Bonds are Outstanding, there shall be credited to the 1997 Certificate Harbor Principal Account from amounts on deposit in the 1997 Certificate Harbor Revenue Special Fund an amount such that, if the same amount were so credited on the first Business Day of such first month and each succeeding month thereafter prior to the next date upon which a Sinking Fund Installment falls due, the aggregate of the amounts so credited will on the first Business Day of the month preceding each such next date upon which a Sinking Fund Installment falls due be sufficient to redeem the term Bonds of each Series in the principal amounts and at the times specified in the Supplemental Certificate authorizing the issuance thereof.

The amounts of moneys credited to the 1997 Certificate Harbor Principal Account for the purpose of providing for the retirement of Bonds issued in the form of term bonds shall be applied by the Director of Finance, without further authorization or direction, to the redemption of the Bonds of a Series on each date on which a Sinking Fund Installment for said Series of Bonds is due in the respective principal amounts required to be credited on such dates, or, if so directed by the Department, commencing with respect to each Series of Bonds with the second Sinking Fund Installment for each such Series, semiannually on both such due date and the day six months prior to such due date so that the aggregate amount so applied in each calendar year will equal the respective principal amount required to be credited on such Sinking Fund Installment dates. The Director of Finance shall give notice of all such redemptions, in the name and on behalf of the State, in accordance with the provisions of Article III of the Certificate. The Director of Finance may also, without further authorization or direction, apply the moneys credited to the 1997 Certificate Harbor Principal Account for the retirement of term Bonds of a Series to the purchase of said Bonds; provided, however, that no Bonds shall be purchased during the interval between the date on which notice of redemption of said Bonds from Sinking Fund Installments for such Series is given and the date of redemption set forth in such notice, unless the Bonds so purchased are Bonds called for redemption in such notice or are purchased from moneys other than those credited to the 1997 Certificate Harbor Principal Account for such Series, and provided, further, that no purchases of Bonds shall be made if such purchase would require the sale at a loss of securities credited to the 1997 Certificate Harbor Principal Account unless the difference between the actual purchase price (including accrued interest and any brokerage or other charge) paid for such Bonds and the then maximum purchase price (plus accrued interest) permitted to be paid therefor is greater than the loss upon the sale of any such securities. Any purchase of Bonds pursuant to this paragraph may be made with or without tenders of Bonds and at either public or private sale, but in any event at a purchase price (including accrued interest and any brokerage or other charge) not to exceed the then applicable Redemption Price, plus accrued interest. All Bonds purchased or redeemed pursuant to this paragraph shall be canceled and not reissued.

If the principal amount of Bonds purchased and retired through application of any Sinking Fund Installment shall exceed the amount of such Sinking Fund Installment, or in the event of the purchase or redemption of Bonds of any Series and maturity for which Sinking Fund Installments have been established from moneys other than Sinking Fund Installments, such excess or the principal amount of Bonds so purchased or redeemed, as the case may be, shall be credited toward future Sinking Fund Installments either (i) in order of their due dates or (ii) in such order as the Department establishes in a Certificate of the Director of Transportation and delivered to the Registrar on or prior to the forty-fifth day preceding the next Sinking Fund Installment due date established for such Bonds.

1997 Certificate Harbor Debt Service Reserve Account. (Certificate – Section 5.05.) The 1997 Certificate Harbor Debt Service Reserve Account shall be maintained in an amount equal to the Reserve Requirement and shall be disbursed solely for the purpose of paying principal of and interest on Bonds for the payment of which there shall be insufficient money in the 1997 Certificate Harbor Interest Account or 1997 Certificate Harbor Principal Account. The

Reserve Requirement shall be determined at the time of issuance of a Series of Bonds, July 1 of each year, at the time any Variable Rate Bonds of a Series cease to be Variable Rate Bonds, and such other time or times as the Department shall determine and shall be funded upon the issuance of each Series of Bonds.

Subject to the remaining provisions of this paragraph, (a) if at any time during a Fiscal Year the moneys on credit to the 1997 Certificate Harbor Debt Service Reserve Account are less than the Reserve Requirement (including any deficiency in a Support Facility used to fund all or a portion of the Reserve Requirement), the amount of the deficiency shall be restored from the first available Net Revenues; (b) if at the end of any Fiscal Year, the moneys credited to the 1997 Certificate Harbor Debt Service Reserve Account are less than the Reserve Requirement, the Department shall (after making the deposits and credits required by the Certificate) credit an amount to the 1997 Certificate Harbor Debt Service Reserve Account from Net Revenues on deposit in the 1997 Certificate Harbor Revenue Special Fund so that there shall then be credited to the 1997 Certificate Harbor Debt Service Reserve Account an amount equal to the Reserve Requirement; (c) if the deficiency in the 1997 Certificate Harbor Debt Service Reserve Account is due to the application of moneys credited thereto to pay principal of or interest on a Series of Bonds, then in each month, commencing with the month which follows the month in which such application is made from the 1997 Certificate Harbor Debt Service Reserve Account, the Department shall (after making the required deposits and credit) credit from the Net Revenues on deposit in the 1997 Certificate Harbor Revenue Special Fund to the 1997 Certificate Harbor Debt Service Reserve Account an amount which, if the same amount were so credited in each month thereafter until the day which is 60 months from the making of the first of such credits, there shall be credited to such account on such day an amount not less than the Reserve Requirement; and (d) if at any time and for so long as the moneys credited to the 1997 Certificate Harbor Debt Service Reserve Account are at least equal to the Reserve Requirement, no further credits shall be made to the account, and any amounts in excess of the Reserve Requirement may be retained in the 1997 Certificate Harbor Revenue Special Fund for use and application as are all other moneys on deposit therein.

When a Series of Bonds is refunded in whole or in part or is otherwise paid so that all of the Bonds of such Series are no longer Outstanding, moneys credited to the 1997 Certificate Harbor Debt Service Reserve Account may be withdrawn from the 1997 Certificate Harbor Revenue Special Fund to pay or provide for the payment of such Bonds or refunded Bonds, as the case may be, or may be transferred and applied to any reserve fund or account established for the Refunding Bonds issued to refund such refunded Bonds, provided that immediately after such withdrawal or transfer there shall be on credit to the 1997 Certificate Harbor Debt Service Reserve Account an amount equal to the Reserve Requirement.

In lieu of the credit of moneys to the 1997 Certificate Harbor Debt Service Reserve Account, the Department may cause to be so credited a surety bond or an insurance policy payable to the Department for the benefit of the Holders of the Bonds of a Series or a letter of credit in an amount equal to the difference between the Reserve Requirement and the amounts then credited to the 1997 Certificate Harbor Debt Service Reserve Account. In the event a surety bond, insurance policy or letter of credit is secured to satisfy a portion of the Reserve Requirement allocable to a Series of Bonds, so long as such surety bond, insurance policy or letter of credit is in effect, the Owners of such Series of Bonds shall not be entitled to payment from or a lien on the funds on deposit in the 1997 Certificate Harbor Revenue Special Fund credited to the 1997 Certificate Harbor Debt Service Reserve Account to satisfy that portion of the Reserve Requirement allocable to other Series of Bonds, nor shall the Owners of Bonds of such other Series be entitled to any payment from such surety bond, insurance policy or letter of credit. The surety bond, insurance policy or letter of credit shall be payable (upon the giving of notice as required thereunder) on any date on which moneys will be required to be applied from the 1997 Certificate Harbor Debt Service Reserve Account to the payment of the principal of or interest on any Bonds of such Series and such withdrawals may not be made from amounts credited to the 1997 Certificate Harbor Debt Service Reserve Account for such other Series of Bonds. Prior to the use of a surety bond, insurance policy or letter of credit pursuant to the provisions of this paragraph (other than any such use at the time of issuance of the Series 1997 Bonds), the Department shall receive written confirmation from the Rating Agency that the rating on the Bonds Outstanding as then in effect shall not be reduced as a result of such use. If a disbursement is made pursuant to a surety bond, insurance policy or letter of credit provided pursuant to this paragraph, the Department shall be obligated either (i) to reinstate the maximum limits of such surety bond, insurance policy or letter of credit or (ii) to credit to the 1997 Certificate Harbor Debt Service Reserve Account, funds in the amount of the disbursement made under such surety bond, insurance policy or letter of credit, or a combination of such alternatives, as shall provide that the amount credited to the 1997 Certificate Harbor Debt Service Reserve Account allocable to a Series of Bonds equals that portion of the Reserve Requirement allocable to such Series; provided, however, a failure to immediately restore such Reserve Requirement shall not constitute an Event of Default if the Reserve Requirement is

restored within the time period permitted by clause c. under “*Events of Default; Remedies – Events of Default*” below. Notwithstanding the provisions of said clause c., the Department shall not permit any surety bond, insurance policy or letter of credit which has been established in lieu of a deposit into the 1997 Certificate Harbor Revenue Special Fund for credit to the 1997 Certificate Harbor Debt Service Reserve Account to terminate or expire prior to depositing to such fund for credit to such account the amount satisfied previously by the surety bond, insurance policy or letter of credit.

1997 Certificate Harbor Reserve and Contingency Account. (Certificate – Section 5.06.) Moneys on credit to the 1997 Certificate Harbor Reserve and Contingency Account may be used (i) to make up any deficiency with respect to any Series of Bonds, Capital Improvement Bonds or 1990 Certificate Harbor Revenue Bonds in the 1997 Certificate Harbor Interest Account, the 1997 Certificate Harbor Principal Account and the 1997 Certificate Harbor Debt Service Reserve Account, (ii) to the extent not used to make up any such deficiencies and to the extent all other legally available moneys have been applied, moneys on credit to the 1997 Certificate Harbor Reserve and Contingency Account may be used for any other purpose within the jurisdiction, powers, duties and functions of the Department related to the Undertaking and (iii) to the extent not required pursuant to clauses (i) and (ii) above, moneys on credit to the 1997 Certificate Harbor Reserve and Contingency Account in excess of 25% of the maximum Aggregate Certificate Bond Service due in any future fiscal year may be transferred out of the 1997 Certificate Harbor Reserve and Contingency Account and applied in any legally permissible manner.

Investment of Moneys in Funds and Accounts. (Certificate – Section 5.07.) Moneys in the 1997 Certificate Harbor Revenue Special Fund credited to the 1997 Certificate Harbor Interest Account and the 1997 Certificate Harbor Principal Account therein shall be invested by the Director of Finance in Investment Securities so as to mature in such amounts and at such times so that the principal of and interest and premium, if any, on the Bonds can be paid when due, whether at maturity or upon the redemption thereof. Moneys in the 1997 Certificate Harbor Revenue Special Fund on credit to the 1997 Certificate Harbor Debt Service Reserve Account therein shall be invested by the Director of Finance in Federal Securities so as to mature within five years from the date of investment, but in any event by no later than the last or final maturity date of the Bonds then Outstanding. The Department thereby grants its approval for all investments made by the Director of Finance pursuant to this paragraph, and no further approvals of the Department shall be necessary therefor.

Income derived from investments made pursuant to Section 5.07 of the Certificate shall be treated as Revenues; expenses of purchase, safekeeping, sale and redemption, and all other expenses attributable to such investments shall be proper expenses of the Undertaking. Securities so purchased shall be considered as being deposited in the custody or control of the Director of Finance by the Department.

All moneys in the 1997 Certificate Harbor Revenue Special Fund, the investment of which is not provided for in Section 5.07 of the Certificate, may be invested, and the income from such investments disbursed or applied, as may be provided by applicable law.

All securities shall constitute a part of the respective fund or account from which the investment therein was made. For the purposes of making any calculations or computations at any time and from time to time of the amounts in the 1997 Certificate Harbor Special Fund, or any fund or account therein, which may be required for the purposes of the Certificate, the Value of Investment Securities shall be determined at the time of any withdrawal therefrom and as of July 1 of each year.

The Department will maintain records to enable it to cause to be made the computations necessary to determine whether a Series of Bonds the interest on which is excludable from gross income for federal income tax purposes meets the requirements of Section 148 of the Code, including, but not limited to, records showing the dates and amounts of all investments of funds credited to the 1997 Certificate Harbor Interest Account, the 1997 Certificate Harbor Principal Account and the 1997 Certificate Harbor Debt Service Reserve Account and the dates and amounts of the receipts of the earnings, sales proceeds and maturities of such investments.

Certain Covenants by the State

The Rate Covenant is summarized in this Official Statement under the heading “SECURITY FOR THE BONDS – Rates and Charges.” As to certain other subjects, summaries of the State’s covenants follow:

Accounts – Independent Public Accountant. (Certificate – Section 6.06.) The Department shall maintain and keep, or cause to be maintained and kept, proper books, records and accounts in which complete and correct entries shall be made of all dealings and transactions relating to the Undertaking. Such accounts shall show the amount of the Revenues and the application of such Revenues to the purposes specified in the Certificate and in the Capital Improvement Certificate and the 1990 Certificate and all financial transactions in connection therewith, including all deposits into and disbursements from the Harbor Special Fund, the Harbor Capital Improvement Special Fund, the Harbor Revenue Special Fund and the 1997 Certificate Harbor Revenue Special Fund.

The Department shall cause its accounts to be audited by an accountant (the “Independent Public Accountant”) employed by it, such period of appointment or employment to be from year to year. Such Independent Public Accountant shall be selected with special reference to his general knowledge, skill and experience in auditing books and accounts and shall be a certified or licensed accountant or firm of certified or licensed accountants who, or each of whom, is in fact independent and not under the domination of the State (including the Department) and who, or each of whom, is not connected with the State (including the Department) as an officer or employee thereof, but who may be regularly retained to make annual or similar audits of any of the books of the State (including the Department). Such audit shall be made annually and shall be completed within 270 days after the close of each Fiscal Year, shall set forth the items required to determine compliance with the Rate Covenant and shall include a detailed statement of the Revenues and the expenditure and application thereof for such year and a detailed balance sheet of the Undertaking as of the close of such year, including therein a statement of the Harbor Special Fund, the Capital Improvement Special Fund and accounts therein, the Harbor Revenue Special Fund and accounts therein and the 1997 Certificate Harbor Revenue Special Fund and accounts therein, and be accompanied in writing by a certificate of the Independent Public Accountant. Each such audit shall certify as to the correctness of the schedules contained in the audit report. A copy of each such annual audit shall be filed with the Director of Finance and shall be open for public inspection and shall be mailed to any Holder of the Bonds filing with the Department a request for same. The cost of any such audit shall be an Operation and Maintenance Expense.

Consulting Engineer. (Certificate – Section 6.07.) The Department shall appoint and retain from time to time a Consulting Engineer who shall be an independent engineer or engineers, engineering firm or corporation having a national and favorable reputation for skill and experience in respect to development, operation and management of harbor facilities and who, or each of whom, shall be paid by the Department but shall in fact be independent and not under the domination of the State (including the Department) and who, or each of whom, shall not be connected with the State (including the Department) as an officer or employee thereof, but who may be regularly retained to make triennial or other periodic reports to the State (including the Department) as to other properties thereof. The Consulting Engineer shall be available to advise the Department upon request and to make such investigations and determinations as may be necessary from time to time under the provisions of the Certificate. The Consulting Engineer shall once in every third Fiscal Year make an examination of and report on the operations of the Undertaking, such report to include recommendations as to amounts to be accumulated in the 1997 Certificate Harbor Reserve and Contingency Account created in the 1997 Certificate Harbor Revenue Special Fund and as to any changes in the operation and maintenance of the properties constituting the Undertaking, including changes required in the schedule of rates, rents, fees or other charges for the use of the Undertaking in order to produce the amount of Revenues required to be produced by the Rate Covenant. A copy of each such report shall be filed in the office of the Director of Finance, and a copy shall be forwarded to any Holder of Bonds filing a request therefor with the Department. The cost to the Department of the Consulting Engineer shall be an Operation and Maintenance Expense.

For purposes of determining compliance with the Rate Covenant, satisfaction of the requirements for the issuance of Additional Bonds, and certain other matters, the Department is authorized to use a Harbor Consultant, which may be the Independent Public Accountant or Consulting Engineer.

Insurance. (Certificate – Section 6.09.) The Department will carry, or cause to be carried, insurance with generally recognized responsible insurers with policies payable to the Department against such risks, accidents or casualties and in such amounts as the Department determines to be prudent. Any insurance carried by the Department may be procured and maintained as part of or in conjunction with any other policy or policies carried by it or by the State. The Department and the State may be self-insured and establish special funds for self-insurance. The Department shall seek advice and counsel from time to time from the State Risk Management staff or their consultants to advise and assist the Department with respect to the insurance program of the Undertaking, and the Department shall

take into consideration the advice of such persons in the placement of insurance and the establishment of any self-insurance fund or funds.

The proceeds of all insurance, to the extent the same shall be paid directly to the Department, shall be held by the Department under and subject to the Capital Improvement Certificate, the 1990 Certificate and the Certificate and applied as follows: (i) the proceeds of property insurance shall be deposited in the treasury of the State and held as a special trust fund, separate and apart from all other funds and moneys, to the end that such proceeds of insurance shall be applied to the reconstruction, restoration or replacement of the properties of the Undertaking damaged or destroyed; (ii) the proceeds of rental or business interruption insurance shall be deposited in the 1997 Certificate Harbor Revenue Special Fund for use and application as are all other moneys deposited in that fund; and (iii) the proceeds of personal injury insurance and any worker's compensation insurance shall be held separate and apart in the 1997 Certificate Harbor Revenue Special Fund and applied toward extinguishing or satisfying or remedying the liability or loss with respect to which such proceeds may be paid.

The Department will, with respect to each such loss, promptly and with all reasonable dispatch, repair, restore, reconstruct or replace the property damaged or destroyed or replace the same with other revenue-producing property or facilities to constitute part of the Undertaking, insofar as the same may be accomplished from proceeds of insurance carried pursuant to clause (i) above, to the extent necessary to the proper conduct of the operation of the business of the Undertaking and in any event so that the Undertaking shall possess at least the same revenue-producing capability as existed prior to the damage and shall apply the proceeds of any insurance policy or policies or self-insurance fund or funds covering such damage or loss for that purpose to the extent required therefor. Notwithstanding the foregoing provisions of this paragraph, no repair, restoration, reconstruction or replacement shall be required if the Department finds that repair, restoration, reconstruction or replacement of the damaged or destroyed property is not in the best interest of the Department and, based on a certificate of the Harbor Consultant, that the failure to repair, restore, reconstruct or replace the damaged or destroyed property will not cause the Revenues in any future Fiscal Year to be less than an amount sufficient to enable the Department to comply with all covenants and conditions of the Capital Improvement Certificate, the 1990 Certificate and the Certificate or impair the security or the payment of the Capital Improvement Bonds, the 1990 Certificate Harbor Revenue Bonds and the Bonds. Any proceeds of any insurance policy or policies or self-insurance fund or funds not required for the purpose of repair, reconstruction, restoration or replacement as aforesaid shall be paid into the Harbor Special Fund, to be used and applied as are other moneys deposited in that fund.

The cost to the Department of all insurance so required by the Certificate shall constitute an Operation and Maintenance Expense.

Annual Budget. (Certificate – Section 6.10.) The Department shall prepare and file with the proper officers of the State, at the time and in the manner prescribed by law, an estimated budget of Revenues and Operation and Maintenance Expenses, Bond Service, capital improvements and any other proposed expenditures for the Undertaking for each Fiscal Year, which budgets shall be open to inspection by any Holder of Bonds or other interested party.

Not To Alienate Ownership, Operation, Management and Control of Undertaking; Disposition of Worn-Out or Useless Property; Right To Alienate Certain Properties for Noncompetitive Uses. (Certificate – Section 6.11.) The State, whether acting by and through the Department or otherwise, will not sell, lease or otherwise dispose of any properties constituting part of the Undertaking, nor take any action or cause any action to be taken, to alienate from the State the ownership, management and control of the Undertaking and any and all properties constituting a part thereof, including any land or rights in land comprising the site thereof or necessary to the use or operation thereof, unless simultaneously with any such sale, lease, disposition or alienation due and adequate provision is made for the payment of the Bonds, including interest and premium (if any) thereon, or there is paid into, or due and adequate provision is made for the paying into, the treasury of the State for deposit in a separate fund therein, of an amount of cash sufficient to retire, and to pay the interest to accrue prior to such retirement on, all Bonds then Outstanding, together with any premium upon the redemption thereof; provided, however, that (i) the provisions of this Section shall not be deemed to prohibit, or construed as prohibiting, the leasing in the normal and customary course of business according to the schedule of rates, rentals and charges of the Department, of properties constituting the Undertaking, which rates, rentals and charges shall be part of the Revenues and which properties shall remain part of the Undertaking, but any such leasing shall be subject to the rights of the Holders of the Bonds and all the provisions of the Certificate; (ii) the State, whether acting through the Department or otherwise, may from time to time sell, lease or

otherwise dispose of any portion of the Undertaking (including any real and personal property comprising a part thereof) which the Department has determined has become unserviceable, inadequate, obsolete, worn-out or unfit to be used, or no longer required for use, in connection with the operation of the Undertaking or the maintenance of the Revenues therefrom; (iii) the State, whether acting through the Department or otherwise, may transfer to any other department, board, bureau, agency or other subdivision of the State or to any city, county or other municipal corporation in the State or any department, board, bureau, agency or other subdivision thereof, or to any nonprofit corporation or association, any property constituting part of the Undertaking and such property shall thereafter no longer constitute part of the Undertaking and any moneys derived therefrom shall no longer constitute part of the Revenues under clause (A) of the definition thereof, and such property may be sold, leased or otherwise disposed of as the transferee thereof may determine, if (a) the use thereafter to be made of such property after such transfer is noncompetitive with the Undertaking and (b) in the opinion of the Harbor Consultant such transfer will not reduce the Revenues below the amount required to be produced the Rate Covenant without any increase in the schedule of rates, rents, fees and charges then in effect for the Undertaking or if in the opinion of the Harbor Consultant such transfer would reduce the Revenues below the amount required to be produced in accordance with the Rate Covenant, due and adequate provision is made for the payment of the Bonds, including interest and premium (if any) thereon, or due and adequate provision is made for the payment into the 1997 Certificate Harbor Revenue Special Fund in each year in which any of the Bonds remain Outstanding of an amount equal to the difference between the Revenues produced in each such year and the amount of Revenues required to be produced in such year in accordance with the Rate Covenant; and (iv) the State, whether acting through the Department or otherwise, may from time to time sell, transfer or otherwise dispose of any property constituting part of the Undertaking and such property shall thereafter no longer constitute part of the Undertaking and any moneys derived therefrom shall no longer constitute part of the Revenues under clause (A) of the definition thereof, and such property may be sold, leased or otherwise disposed of as the transferee may determine, if (a) the proceeds of any such sale or transfer are deposited in the 1997 Certificate Harbor Revenue Special Fund as security for the payment of all Bonds then Outstanding, (b) in the opinion of the Harbor Consultant such sale, transfer or other disposition will not reduce Aggregate Net Revenues below the amount equal to one and twenty-five hundredths (1.25) times the amount required to be produced by the Rate Covenant without any increase in the schedule of rates, rents, fees and charges then in effect for the Undertaking and (c) the Department shall receive written confirmation from the Rating Agency that the rating on the Bonds Outstanding as then in effect shall not be reduced as a result of such sale, transfer or disposition. For the purposes of the provisos numbered (iii) and (iv) to the preceding sentence, the Harbor Consultant may assume that all parties to contractual or other agreements will comply with the terms and provisions of such contracts or agreements, including any commitment to pay amounts into the 1997 Certificate Harbor Revenue Special Fund, and any transfer of property to the University of Hawaii or other educational institution for use by it for oceanographic research and study (including therein any such research or study for which such institution may receive income or compensation) shall be considered to be noncompetitive.

Not To Dilute Security for the Bonds. (Certificate – Section 6.12.) Unless, and only while and so long as, due and adequate provision is made for the payment of the Bonds, including interest and premium (if any) thereon, or due and adequate provision is made for the payment into the 1997 Certificate Harbor Revenue Special Fund for use and application in accordance with the provisions of the Certificate the same as all other moneys deposited in that fund, in each year while any of the Bonds remain Outstanding, from moneys lawfully available therefor other than the Revenues, of amounts which when added to the Revenues paid into the 1997 Certificate Harbor Revenue Special Fund in such year, will at least equal the amount of Revenues required to be produced in such year in accordance with the provisions of the Rate Covenant, the State, whether acting by and through the Department or by and through any other department, bureau, board or other agency thereof, shall not own, engage in, erect, construct, maintain or operate any harbors, ports, docks, wharves, piers, warehouses or other waterfront or harbor facilities and improvements of a commercial nature (excluding properties principally used for recreation or the landing of fish, except properties located at Kewalo Basin, Ewa of Ala Moana Park, Honolulu, and its annex) which are competitive with the Undertaking unless the income derived therefrom constitutes part of the Revenues, to be deposited, used and applied as are all other Revenues, in which event such properties and facilities may constitute part of the Undertaking; provided, however, that nothing in this Section shall be construed as prohibiting the State from retaining or placing under the management and control of some department board, bureau or agency other than the Department, harbor properties and facilities constituting or to constitute a Foreign Trade Zone within the meaning of Chapter 212, Hawaii Revised Statutes, so long as in the opinion of the Harbor Consultant the operations of such Foreign Trade Zone are noncompetitive with the Undertaking, or if in the opinion of the Harbor Consultant the operations of the same are at any time competitive with the Undertaking, either (i) all income derived with respect to such properties through the loading or unloading of cargo from vessels or from wharfage or from harbor fees or demurrage or other fees and charges normally and customarily

paid as part of the loading and unloading of cargo and which would normally accrue to or be under the administration and control of the Department constitutes by law part of the Revenues and is paid into the Harbor Special Fund, in which event the costs of operation and maintenance of those properties from which such income is derived may be paid as costs of operation and maintenance of the Undertaking to the same extent as would be the case if such properties were in fact part of the Undertaking, or (ii) due and adequate provision is made for the payment of the Bonds, including interest and premium (if any) thereon, or due and adequate provision is made for the payment, in each year while any of the Bonds remain Outstanding, from moneys lawfully available therefor other than the Revenues, into the 1997 Certificate Harbor Revenue Special Fund for use and application in accordance therewith the same as all other moneys paid into that fund, of amounts which, when added to the Revenues paid into that fund in each such year, will produce the total amount required to be produced in such year in accordance with the Rate Covenant, and provided, further, that the operations of any such Foreign Trade Zone which is in existence at the time of effectiveness of the Certificate shall be deemed to be noncompetitive with the Undertaking.

Net Rent Leases. (Certificate – Section 7.01.) The State, either in its own name or acting by and through the Department, may enter into contracts, leases or other agreements pursuant to which the Department will agree to construct a pier, dock, wharf, warehouse or other harbor or waterfront facility on land constituting part of the Undertaking or will agree to acquire or construct a pier, dock, wharf, warehouse or other harbor or waterfront facility on land not then constituting part of the Undertaking (which land if not then owned by the State may be acquired for such purpose), or to acquire and remodel, renovate or rehabilitate a building, structure or other facility (including the site thereof) for harbor purposes (all said piers, docks, wharfs, warehouses, buildings, structures and facilities herein referred to as the “Improvement”), and lease such Improvement under the following conditions:

1. No Improvement will be constructed or acquired and leased for use or occupation (a) if the Improvement would provide services, facilities or supplies which then may be adequately made available through the Undertaking as then existing and (b) if the result of the use or occupation of such Improvement under the contract, lease or agreement therefor would result in a reduction of Net Revenues below the minimum Net Revenues required to be produced and maintained in accordance with the Rate Covenant.

2. A Net Rent Lease (hereinafter defined) shall be entered into between the State (either in the name of the State or by and through the Department), as lessor and the user or occupier of such Improvement, as lessee, pursuant to which the lessee shall agree to pay the Department in each year during the term thereof, which term shall not extend beyond the useful life of the Improvement as estimated by the Harbor Consultant, (i) fixed rentals in periodic installments which will be sufficient to pay during such term the principal of and interest on all Special Obligation Bonds to be issued to pay the cost of construction or acquisition of the Improvement as the same respectively mature, and (ii) such further rentals as shall be necessary or required to provide or maintain all reserves required for such obligations and to pay all trustee’s, fiscal agents’ and paying agents’ fees and expenses in connection therewith.

3. The Net Rent Lease shall provide for payments in periodic installments and as additional rental thereunder to the Department, free and clear of all charges under said lease, (i) of a properly allocable share of the (a) payments to the State to reimburse the general fund of the State for Reimbursable General Obligation Bonds, (b) payments to the State to reimburse administrative costs incurred by the State treasury in maintaining funds and accounts relating to the Undertaking and (c) administrative costs of the Department, and (ii) if the land on which the Improvement is to be constructed constitutes a part of the Undertaking, of a ground rental for the ground upon which such Improvement is located, in amounts not less than shall be required pursuant to the schedule for rental of ground space in the Undertaking as fixed from time to time by the Department. All such additional rentals shall constitute Revenues and be paid into the Harbor Special Fund, to be used and applied as are other moneys deposited therein.

4. The Net Rent Lease shall provide that all rentals payable thereunder pursuant to paragraph 2. above which are not required to pay Special Obligation Bonds issued for the Improvement leased thereby, including reserves for such obligations, or required to pay trustee’s, fiscal agents’ and paying agents’ fees and expenses in connection therewith, shall be paid to the Department for its own use and purposes, and, to the extent permitted by law, such excess amounts shall constitute Revenues and be paid into the Harbor Special Fund, to be used and applied as are other moneys deposited therein.

The term "Net Rent Lease" shall mean a lease of property encompassed within the introductory sentence of this Section, under and pursuant to which the lessee agrees to pay to the Department the rentals required by paragraphs 2. and 3. above, and to pay in addition all costs connected with the ownership, operation, maintenance, repair, renewal and rehabilitation of the leased property (including, without limitation, insurance, utilities, taxes or payments in lieu of taxes), under such conditions so that the amounts payable to the Department pursuant to said lease (exclusive of the ground rental, if any, payable pursuant to said paragraph 3.) shall be certainly paid whether or not the leased property is capable of being occupied and used by the lessee.

Special Obligation Bonds. (Certificate – Section 7.02.) The State, acting by and through the Department or otherwise, may issue Special Obligation Bonds for the purpose of constructing Improvements on ground then constituting part of the Undertaking or on ground not then constituting part of the Undertaking (which ground may then be owned by the State or acquired for that purpose), or to acquire and renovate and rehabilitate an Improvement (including the acquisition of necessary land), for lease pursuant to the provisions of the Certificate. (See "*Certain Covenants by the State - Net Rent Leases*" above.) Such Special Obligation Bonds (i) shall be payable solely from the rentals payable by the lessee under the Net Rent Lease entered into with respect to the Improvement to be financed from such Special Obligation Bonds; (ii) shall not be a charge or claim against or payable from the Revenues or any other moneys in the Harbor Special Fund, Capital Improvement Special Fund, Harbor Revenue Special Fund or 1997 Certificate Harbor Revenue Special Fund; (iii) shall mature within both the useful life of the Improvement (as estimated by the Harbor Consultant) to be financed from such Special Obligation Bonds and the term of the Net Rent Lease entered into with respect to such Improvement; and (iv) shall not be issued unless and until the following conditions have been met:

A. a certificate of the Harbor Consultant has been filed with the Department setting forth the opinion of such consultant as to the estimated useful life of the Improvement, the costs of acquisition or construction of which are to be financed from such Special Obligation Bonds, and certifying (i) that the construction or acquisition and leasing for use or occupation of such Improvement would not violate the conditions of paragraph 1 under "*Net Rent Leases*" above; (ii) that the lease referred to in paragraphs 2, 3 and 4 under "*Certain Covenants by the State – Net Rent Leases*" above has been entered into; (iii) that the payments to be made by the lessee pursuant to the provisions of such paragraph 2 will be sufficient to pay the principal of and interest and premium (if any) on the Special Obligation Bonds as the same mature and to pay all trustee's, fiscal agents' and paying agents' fees and expenses in connection therewith; and (iv) that the additional rentals to be paid by the lessee pursuant to such paragraph 3 are fair and reasonable and as to the ground rental required by that paragraph (if any such ground rent be required) is in compliance with the schedule established by the Department for the rental of lands of the Undertaking; and

B. there shall have been filed with the Department an Opinion of Counsel that the lease for the Improvement to be financed from such Special Obligation Bonds entered into pursuant to the Certificate is valid according to its terms and complies with the provisions of such paragraphs 2, 3 and 4.

Refunding of Special Obligation Bonds. (Certificate – Section 7.03.) Outstanding bonds of an issue of Special Obligation Bonds may be refunded by an issue of refunding Special Obligation Bonds, provided that: (1) the refunding Special Obligation Bonds shall be secured by and payable solely from the rentals from that Improvement, from the rentals of which the Special Obligation Bonds to be refunded were payable; (2) the aggregate amount of principal, interest and premium (if any) upon the redemption thereof from any sinking fund which shall be payable on the refunding Special Obligation Bonds shall not be greater than the aggregate amount of principal, interest and premium (if any) upon the redemption thereof from any sinking fund which would be payable on the Special Obligation Bonds to be refunded were such refunding not to occur; (3) the refunding will not decrease the rentals payable for the Improvement payable pursuant to paragraph 3 under "*Certain Covenants by the State – Net Rent Leases*" above; (4) the Net Rent Lease for the Improvement during the life of such refunding bonds shall comply with paragraphs 2, 3 and 4 under "*Certain Covenants by the State – Net Rent Leases*" above; (5) the refunding Special Obligation Bonds shall mature within the useful life of the Improvement (as estimated by the Harbor Consultant) and within the term of the new or amended lease entered into with respect to such refunding; (6) the termination date of the term of any new or amended lease entered into with respect to such Improvement shall not be later than the termination date of the term of the lease entered into upon the issuance of the Special Obligation Bonds to be refunded; and (7) the Certificate of the Harbor Consultant and the Opinion of Counsel required under "*Certain Covenants by the State – Special Obligation Bonds*" above shall be filed with respect to such refunding Special Obligation Bonds. Special

Obligation Bonds may also be refunded by Additional Bonds if (i) all such Special Obligation Bonds pertaining to a particular Improvement are refunded at one time from such Additional Bonds; (ii) the conditions contained in the Certificate for the issuance of Additional Bonds are complied with upon such refunding, and, for the purposes of any such refunding, such refunding shall be considered as though the Department were acquiring such Improvement by the issuance of such Additional Bonds; and (iii) upon any such refunding all leases pertaining to the Improvement shall be amended to include a provision to the effect that such lease is subject to the rights of the Holders of the Bonds.

When Improvement Shall Constitute Part of the Undertaking; Priority of Payments and Credits for Bonds Issued Under the Certificate. (Certificate – Section 7.04.) So long as any Special Obligation Bonds issued for an Improvement are outstanding and unpaid, or until the payment thereof shall have been duly and adequately provided for, such Improvement shall not be considered to be part of the Undertaking. Upon the retirement of the indebtedness evidenced by such Special Obligation Bonds or evidenced by refunding Special Obligation Bonds, unless such Improvement is subject to an option to purchase by the lessee and such option shall have been exercised, all rentals and other income thereafter received by the State (including by the Department) from the Improvement for which such Special Obligation Bonds were issued shall, to the extent permitted by law, constitute Revenues and be paid into the Harbor Special Fund, to be used and applied as are other moneys deposited therein, and if such rentals and other income shall constitute Revenues, such Improvement shall, unless contrary to law, constitute part of the Undertaking; provided, however, that if any such Special Obligation Bonds are retired through the refunding thereof from the proceeds of Additional Bonds, such Improvement may not be subject to any purchase option and in all events (subject to the provisions of the Certificate permitting alienation or disposition of Property) shall thereafter constitute part of the Undertaking and the rentals and other income therefrom shall constitute part of the Revenues; and provided, further, that, except with respect to properties which have become part of the Undertaking by reason of the issuance of Additional Bonds to refund the Special Obligation Bonds issued therefor (the costs of operation and maintenance of which properties shall be paid or provided for in the same manner as are such costs incurred with respect to all other properties constituting part of the Undertaking), any expenditure of moneys from the Revenues or the Harbor Special Fund for operation and maintenance of any property constituting or which constituted an Improvement shall be made only after the payments and credits required by priority items “FIRST” and “SECOND” described above under the caption “*Allocation and Application of Revenues*” have been duly made or provided for.

Right of State To Execute Supplemental Certificates Without Consent of Holders of Bonds. (Certificate – Section 10.01.) The State, acting by and through the Department or as may otherwise then be provided by law, from time to time and at any time and without the consent or concurrence of the Holder of any Bond, may make and execute a Supplemental Certificate (i) for the purpose of providing for the issuance of Additional Bonds or the issuance of Refunding Bonds, (ii) to make any changes or modifications of the Certificate or amendments, additions or deletions to the Certificate which may be required to permit the Certificate to be qualified under the Trust Indenture Act of 1939 of the United States of America and (iii) if the provisions of such Supplemental Certificate shall not materially adversely affect the rights of the Holders of the Bonds then Outstanding, for any one or more of the following purposes:

1. To make any changes or corrections in the Certificate or any supplement as to which it shall have been advised by its counsel that the same are minor clerical or typographical corrections or changes or are required for the purpose of curing or correcting any ambiguity or defective or inconsistent provision or omission or mistake or manifest error contained in the Certificate or in any such supplement thereto, or to insert in the Certificate such provisions clarifying matters or questions arising under the Certificate as are necessary or desirable;
2. To add additional covenants and agreements of the State for the purpose of further securing the payment of the Bonds, provided that such additional covenants and agreements are not contrary to or inconsistent with the covenants and agreements contained in the Certificate as originally issued or as amended with the consent of Bondholders;
3. To surrender any right, power or privilege reserved to or conferred upon the State by the terms of the Certificate or any supplement thereto;
4. To confirm as further assurance any lien, pledge or charge, or the subjection of any additional revenue, property or collateral to any lien, pledge or charge, created or to be created by the provisions of the Certificate or any supplement thereto;

5. To grant to or confer upon the Holders of the Bonds or any Support Provider any additional rights, remedies, powers, authority or security that lawfully may be granted to or conferred upon them;

6. To prescribe further limitations and restrictions upon the issuance of Bonds and the incurring of indebtedness by the State payable from the Revenues;

7. To include any modifications, amendments or supplements as may be required with respect to any Series of Bonds in order to obtain a favorable rating or ratings from any Rating Agency;

8. To add or modify any provision of the Certificate as a result of enactment of any State or federal law which changes the treatment of the Bonds or interest thereon for tax purposes;

9. To include any modifications, amendments or supplements as may be required with respect to any Series of Bonds in order to permit such Series to be available through a book-entry system maintained by, or to be cleared through, The Depository Trust Company, New York, New York, or other securities depository, clearing corporation, or clearing agency;

10. To make any changes or corrections to the Certificate as are necessary to provide for the issuance of Bonds in a form not contemplated by the express provisions of the Certificate, including, without limitation, in the form of commercial paper, indebtedness which converts from a variable rate to a fixed rate, indebtedness which initially compounds or accrues interest and then converts to a current-interest-bearing instrument, and a Series of Bonds whereby the State pays a particular rate of interest and such interest payment is divided in a manner such that certain Bondholders receive a variable interest rate determined by the market and other Bondholders receive a residual interest rate approximating the difference between the interest payment paid by the State and such variable rate of interest; or

11. To modify, amend or supplement in any other respect any of the provisions of the Certificate, provided that such modifications shall have no adverse affect as to any Bond or Bonds which are then Outstanding.

Except for Supplemental Certificates providing for the issuance of Additional Bonds or Refunding Bonds, the State shall not make and execute any instrument or Supplemental Certificate, unless in the Opinion of Counsel the making and entering into of such instrument or such Supplemental Certificate is permitted by the provisions of the Certificate and the provisions of such instrument or of such Supplemental Certificate are not contrary to or inconsistent with the covenants or agreements of the State contained in the Certificate as originally issued or as amended with the consent of the Bondholders.

Execution of Supplemental Certificates With Consent of Bondholders. (Certificate – Section 10.02.) With the consent of the Holders of not less than a majority of the principal amount of the Bonds then Outstanding, the State, acting by and through the Department or as may otherwise then be provided by law, from time to time and at any time, may make and execute an instrument or certificate amending or supplementing the provisions of the Certificate for the purpose of adding any provisions to, or changing in any manner or eliminating any of the provisions of, the Certificate or of any supplement thereto, or modifying or amending the rights and obligations of the Department thereunder, or modifying in any manner the rights of the Holders of the Bonds; provided, however, that, without the specific consent of the Holder of each Bond which would be affected thereby, whether or not such Bond shall then be deemed to be Outstanding under the Certificate, no such instrument or certificate amending or supplementing the provisions of the Certificate shall: (1) extend the fixed maturity date for the payment of the principal of any Bond, or reduce the principal amount of any Bond, or reduce the rate or extend the time of payment of interest thereon, or reduce any premium payable upon the redemption or prepayment thereof, or advance the date upon which any Bond may first be called for redemption prior to its fixed maturity date; (2) reduce the aforesaid percentage of Bonds, the Holders of which are required to consent to any such instrument or certificate amending or supplementing the provisions of the Certificate; (3) give to any Bond or Bonds, whether Series 1997 Bonds, Additional Bonds or Refunding Bonds, any preference over any other Bond or Bonds secured by the Certificate; (4) authorize the creation of any pledge of the Revenues or any lien or charge thereon prior or superior to or on a parity with the pledge of and lien and charge thereon created in the Certificate for the payment of the Bonds except to the extent provided in Article II of the Certificate; or (5) deprive any Holder of the Bonds of the pledge and lien created by the Certificate, and provided, further, that if moneys or Federal

Securities shall have been deposited in accordance with the provisions of the Certificate relating to the defeasance for the payment of particular Bonds and such Bonds shall not in fact have been paid, no amendments or supplements to the provisions of Article XII of the Certificate shall be made without the specific consent of the Holder of each Bond which would be affected thereby. A modification or amendment of the provisions of Article V of the Certificate with respect to the 1997 Certificate Harbor Revenue Special Fund or the 1997 Certificate Harbor Interest Account, 1997 Certificate Harbor Principal Account, 1997 Certificate Harbor Debt Service Reserve Account or 1997 Certificate Harbor Reserve and Contingency Account shall not be deemed a change in the terms of payment of the Bonds; provided, however, that no such modification or amendment shall, except upon the consent of the Holders of all Bonds then Outstanding affected thereby, reduce the amount or amounts required to be deposited in the 1997 Certificate Harbor Revenue Special Fund for credit to the 1997 Certificate Harbor Interest Account, 1997 Certificate Harbor Principal Account or 1997 Certificate Harbor Debt Service Reserve Account therein. (Nothing contained in the Certificate, however, shall be construed as making necessary the approval by the Holders of the Bonds of the adoption of any amending or supplementing certificate authorized by the Certificate.)

The proof of the giving of any consent required and of the holding of Bonds for the purposes of giving consent shall be made in accordance with the provisions of Section 9.01 of the Certificate, and it shall not be necessary that the consents of the Holders of the Bonds approve the particular form of wording of the proposed amendment or supplement, but it shall be sufficient if such consent approve the substance thereof. After the Holders of the required percentage of Bonds shall have filed their consents to the amendment or supplement of the Certificate, the Department shall mail, or shall cause the Registrar to mail, a copy of such notice, postage prepaid, to each Holder of Bonds then Outstanding, at his address appearing upon the Bond Register, but failure to mail copies of said notice to any Holder shall not affect the validity of such instrument or Supplemental Certificate or the consents thereto. A record, consisting of the required papers, shall be proof of the matters therein stated until the contrary is proved, and no action or proceeding to set aside or invalidate such instrument or Supplemental Certificate or any proceedings for its adoption shall be instituted or maintained unless such action or proceeding for such purpose is commenced within 60 days after the mailing of the required notice.

Bonds delivered after the effective date of any action taken as provided above may bear a notation, by endorsement or otherwise, in form approved by the Department, as to such action, and in that case upon demand of the Holder of any Bond Outstanding at such effective date and presentation of his Bond for the purpose at the office of the Director of Finance or other Paying Agent, transfer agent or Registrar for such Bond under the Certificate and at such additional offices as the Director of Finance may select and designate for that purpose, a suitable notation shall be made on such Bond. If the Department shall so determine, new Bonds so modified as in the opinion of the Department to conform to the amendments or supplements so consented to by the Bondholders shall be prepared, executed and delivered, and upon demand of the Holder of any Bond then Outstanding, his Bond shall be exchanged without cost to such Bondholder, for a new Bond, upon surrender of such Outstanding Bonds.

Events of Default; Remedies. (Certificate – Sections 11.01 to 11.06.)

Events of Defaults. The following shall constitute “Events of Default”:

- a. if payment of the interest on, or principal (including any Sinking Fund Installment) or premium (if any) of any Bond, whether at maturity or by proceedings for redemption, by declaration or otherwise, shall not be made after the same shall become due and payable; or
- b. unless all the Bonds then Outstanding shall have been called for retirement or for redemption, if the Undertaking or any building or facility constituting a part thereof shall be destroyed or damaged so as to reduce the revenues, fees and earnings derived from the Undertaking below the amount required by the Rate Covenant to be produced and maintained and the Department does not, to the extent of the proceeds of insurance or self-insurance and the moneys on deposit in the 1997 Certificate Harbor Revenue Special Fund on credit to the 1997 Certificate Harbor Reserve and Contingency Account available therefor, promptly repair or reconstruct such destroyed or damaged building or facility, or promptly erect or substitute in place of the building or facility destroyed or damaged other buildings and facilities which produce revenues and fees comparable to those produced by the building or facility destroyed or damaged and subject to the lien of the Certificate and deposit in the 1997 Certificate Harbor Revenue Special Fund an amount of the revenues and fees to be derived therefrom comparable to those theretofore derived from the building or facility

destroyed or damaged, which amounts so deposited shall constitute Revenues, to be used and applied as are all other Revenues, provided that nothing in this clause shall be deemed to require the repairing, reconstruction or replacement of any building or facility which at the time of such destruction or damage was unserviceable, inadequate, obsolete, worn-out or unfit to be used or no longer required for use in connection with the security and payment of the Bonds; or

c. if the Department shall default in the due and punctual performance of any of the covenants, conditions, agreements and provisions contained in the Bonds or in the Certificate or in any Supplemental Certificate on the part of the Department to be performed, and such default shall continue for 90 days after written notice specifying such default and requiring the same to be remedied shall have been given to the Department by the Holders of not less than 50% in principal amount of the Bonds then Outstanding, or any trustee or committee therefor; provided, however, that if such failure shall be such that it cannot be corrected within such 90-day period, it shall not constitute an Event of Default if corrective action is instituted within such period and diligently pursued until the failure is corrected; or

d. if the Capital Improvement Bonds or the 1990 Certificate Harbor Revenue Bonds shall have been declared due and payable pursuant to an acceleration resulting from an event of default under the Capital Improvement Certificate or the 1990 Certificate, respectively, as in force on the date of effectiveness of the Certificate; or

e. if any proceedings shall be instituted, with the consent or acquiescence of the State, for the purpose of effecting a composition between the State and its creditors and if the claim of such creditors is in any circumstance payable from any of the Revenues or any other moneys pledged and charged in the Certificate or in any Supplemental Certificate, or for the purpose of adjusting the claims of such creditors, pursuant to any federal or State statute as of date of the Certificate or thereafter enacted; or

f. if an order or decree shall be entered (1) with the consent or acquiescence of the State, appointing a receiver or receivers of the Undertaking or any of the buildings and facilities thereof, (2) with or without the consent or acquiescence of the State, appointing a receiver or receivers of the Undertaking or any of the buildings or facilities thereof if such receiver or receivers are appointed pursuant to the provisions of the Capital Improvement Certificate or the 1990 Certificate, or (3) without the consent or acquiescence of the State, appointing a receiver or receivers of the Undertaking or any of the buildings and facilities thereof and such order or decree having been entered, shall not be vacated or discharged or stayed on appeal within 60 days after the entry thereof; or

g. if, under the provision of any other law for the relief or aid of debtors, any court of competent jurisdiction shall assume custody or control of the Undertaking or any of the buildings and facilities thereof, and such custody or control shall not be terminated within 90 days from the date of assumption of such custody or control; or

h. if the Department or the State shall for any reason be rendered incapable of fulfilling its obligations under the Certificate.

Declaration of Principal and Interest as Due. Upon the occurrence and continuation of an Event of Default, then and in each and every case the Holders of not less than 50% in principal amount of the Bonds then Outstanding may, by written notice to the Department filed in the office of the Department and with the Director of Finance, proceed to declare the principal of all Bonds then Outstanding, together with all accrued and unpaid interest thereon and together with all other moneys secured by the Certificate, if not already due, to be due and payable immediately, and upon any such declaration the same shall become and be due and payable immediately, anything in the Certificate, any Supplemental Certificate or in any of the Bonds contained to the contrary notwithstanding, except to the extent otherwise provided in connection with a Support Facility. This provision is subject, however, to the condition that, if at any time after the principal of the Bonds, together with accrued and unpaid interest thereon shall have been so declared due and payable and before any further action has been taken (other than the making of the above declaration), the principal amount of all Bonds which have matured either according to the maturity date or dates specified therein or otherwise (except as a result of such declaration) and all arrears of interest upon all Bonds, except interest accrued but not yet due on said Bonds, shall be paid or caused to be paid, and all other Events of Default, if any, which shall have

occurred shall have been remedied, cured or secured, then and in every such case the Holders of a majority in principal amount of the Bonds then Outstanding, by notice in writing delivered to the Department and the Director of Finance, may waive such default and its consequences and rescind such declaration. No such waiver or rescission or annulment shall extend to or affect any subsequent default or impair or exhaust any right or power consequent thereon.

Possession of Undertaking by Bondholders' Committee; Appointment of a Receiver. Upon the occurrence of an Event of Default and the continuation thereof, if no Capital Improvement Bonds and 1990 Certificate Harbor Revenue Bonds are at the time Outstanding or any of such Capital Improvement Bonds and 1990 Certificate Harbor Revenue Bonds being then outstanding, if due and adequate provisions for the payment thereof has theretofore been made, then in each and every case a Bondholders' Committee representing the Holders of not less than a majority of the Bonds at the time Outstanding, as a matter of right against the State, without notice or demand, and without regard to the adequacy of the security for the Bonds, shall, but only if and to the extent then permitted by law, be entitled to take possession and control of the business and properties of the Undertaking. Upon taking such possession, the Bondholders' Committee shall operate and maintain the Undertaking, make any necessary repairs, renewals and replacements in respect thereof, impose and prescribe rates, fees and charges for use of the Undertaking and collect, receive and apply the Revenues.

Upon the occurrence of an Event of Default and the continuation thereof, if no Capital Improvement Bonds and 1990 Certificate Harbor Revenue Bonds are at the time Outstanding or any of such Capital Improvement Bonds and 1990 Certificate Harbor Revenue Bonds being then Outstanding, if due and adequate provision for the payment thereof has theretofore been made, then in each and every case the Holders of not less than 50% in the principal amount of the Bonds then Outstanding or any trustee therefor shall be entitled to the appointment of a receiver by any court of competent jurisdiction. Any such receiver may be appointed upon the application of Holders of Bonds of said aggregate principal amount, or any trustee therefor, to the Circuit Court of the First Judicial Circuit, which is vested with jurisdiction in such proceedings, or to any other court of competent jurisdiction in the State. Any receiver so appointed may enter and take possession and control of the Undertaking, operate and maintain the same, make any necessary repairs, renewals and replacements, impose and prescribe rates, fees and charges and collect, receive and apply all Revenues thereafter arising therefrom in the same manner as the Department itself might do. No bond shall be required of such receiver.

Bondholders' Committee. Upon the occurrence of an Event of Default and at any time such Event of Default shall be continuing, the Holders of not less than 50% in principal amount of the Bonds then Outstanding may call a meeting of the Holders of Bonds for the purpose of electing a Bondholders' Committee. Such meeting shall be called and proceedings thereat shall be conducted as provided for other meetings of Bondholders pursuant to the Certificate. At such meeting the Holders of not less than a majority of the principal amount of the Bonds then Outstanding must be present in person or by proxy in order to constitute a quorum for the transaction of business, less than a quorum, however, having power to adjourn from time to time without any notice, other than as required by the Certificate. A quorum being present at such meeting, the Bondholders present in person or by proxy may, by the votes cast by the Holders of a majority in principal amount of the Bonds so present in person or by proxy, elect one or more persons who may or may not be Bondholders to the Bondholders' Committee which shall act as trustee for all Bondholders. The Bondholders present in person or by proxy at said meeting, or at any adjourned meeting thereof, shall prescribe the manner in which the successors of the persons elected to the Bondholders' Committee at such Bondholders' meeting shall be elected or appointed, may prescribe rules and regulations governing the exercise by the Bondholders' Committee of the power conferred upon it in the Certificate and may provide for the termination of the existence of the Bondholders' Committee.

Suits at Law or Equity and Mandamus. In case any one or more of the Events of Default shall happen and be continuing, then and in every such case, but subject to the provisions, limitations and conditions contained in the Certificate relating to the amendment thereof, the Holder of any Bond at the time Outstanding shall be entitled, for the equal benefit and protection of all Holders of the Bonds similarly situated, to proceed and protect and enforce the rights vested in such Holder by the Certificate by such appropriate judicial proceeding as such Holder shall deem most effectual to protect and enforce any such right, either by suit in equity or by action of law, whether for the specific performance of any covenant or agreement contained in the Certificate, or in aid of the exercise of any power granted in the Certificate, or to enforce any other legal or equitable right vested in the Holders of Bonds by the Certificate or by law.

Remedies Not Exclusive; Effect of Waiver of Defaults; Effect of Abandonment of Proceedings or Adverse Determination. The Holders from time to time of the Bonds shall be entitled to all the remedies and benefits of the Certificate as is and as shall be provided by law, and nothing therein shall be construed to limit the rights or remedies of any such Holders under any applicable statute that may exist as of date of the Certificate or be enacted thereafter. The remedies shall not be exclusive of any other remedy or remedies, and each and every such remedy shall be cumulative and shall be in addition to every other remedy given under the Certificate, or as of the date of the Certificate or thereafter existing at law or in equity or by statute and may be exercised without exhausting and without regard to any other remedy.

No waiver of any default or breach of duty or contract by any Holder or any Bond shall extend to or affect any subsequent default or breach of duty or contract or shall impair any rights or remedies thereon. No delay or omission of any Holder of a Bond to exercise any right or power accruing upon any default shall impair any such right or power or shall be construed to be a waiver of any such default or acquiescence therein. Every substantive right and remedy conferred upon the Holders of the Bonds may be enforced from time to time and as often as may be deemed expedient. In case any suit, action or proceeding to enforce any right or exercise any remedy shall be brought or taken and then discontinued or abandoned, or shall be determined adversely to the Holders of the Bonds, then and in every such case the State and such Holders shall be restored to their former positions and rights and remedies as if no suit, action or proceeding had been brought or taken.

Discharge of Liens and Pledges; Bonds No Longer Deemed Outstanding Under the Certificate. (Certificate – Section 12.01.) The obligations of the State, including, without limiting the generality of the foregoing, of the Department, under the Certificate and the liens, pledges, charges, trusts, assignments, covenants and agreements of the State, including the Department, therein made or provided for, shall be fully discharged and satisfied as to any Bond and such Bond shall no longer be deemed to be Outstanding under the Certificate:

(A) if such Bond shall have been purchased and canceled by the State or surrendered to the Director of Finance or other Paying Agent, transfer agent or Registrar for cancellation or be subject to cancellation by him or it; or

(B) as to any Bond not theretofore purchased and canceled, surrendered for cancellation or subject to cancellation, when payment of the principal of and the applicable redemption premium, if any, on such Bond, plus interest on such principal (calculated, in the case of Variable Rate Bonds, at the maximum numerical rate permitted by the terms thereof) to the due date thereof (whether such due date be by reason of maturity or upon redemption or prepayment or by declaration as provided in the Certificate, or otherwise) either:

(1) shall have been made or caused to be made when due and payable in accordance with the terms thereof; or

(2) shall have been provided by irrevocably depositing with the Director of Finance or other Paying Agent therefor, in trust solely for such payment, either (i) moneys sufficient to make such payment, (ii) Federal Securities maturing as to principal and interest in such amounts and at such times as will insure the availability of sufficient moneys to make such payment, or (iii) a combination of both moneys and Federal Securities and all necessary and proper fees, compensation and expenses of any Paying Agent, transfer agent or Registrar appointed by the State pertaining to the Bond with respect to which such deposit is made shall have been paid or the payment thereof provided for to the satisfaction of such Paying Agent, transfer agent or Registrar. At such time as a Bond shall be deemed to be no longer Outstanding under the Certificate, as aforesaid, except for the purpose of any such payment from such moneys or Federal Securities, such Bond shall no longer be secured by or entitled to the benefits of the Certificate and shall cease to accrue interest from the due date thereof (whether such due date be by reason of maturity or upon redemption or prepayment or by declaration, or otherwise).

Notwithstanding the foregoing, with respect to Bonds which by their terms may be redeemed or otherwise prepaid prior to the stated maturities thereof and which the State elects to so redeem or prepay, no deposit under clause (2) of subparagraph (B) above shall constitute such discharge and satisfaction as aforesaid until such Bonds shall

have matured or shall have been irrevocably called or designated for redemption or prepayment and proper notice of such redemption or prepayment shall have been given or irrevocable provision shall have been made for the giving of such notice, provided that nothing in Article XII of the Certificate shall require or be deemed to require the State to elect to redeem or prepay such Bonds or, in the event the State shall elect to redeem or prepay such Bonds, shall require or be deemed to require the redemption or prepayment as of any particular date or dates.

Any such moneys so deposited with the Director of Finance or other Paying Agents as described above may at the direction of the Department be invested and reinvested in Federal Securities, maturing in the amounts and times as set forth in the Certificate, and all income from all such Federal Securities in the hands of the Director of Finance and other Paying Agents which is not required for the payment of the Bonds and interest and premium, if any, thereon with respect to which such moneys shall have been so deposited, shall, to the extent permitted by law, be deposited in the 1997 Certificate Harbor Revenue Special Fund as and when realized and collected for use and application as are other moneys deposited in such Fund.

Notwithstanding the foregoing, the payment of (i) the purchase price of and interest on Variable Rate Bonds tendered for purchase pursuant to the terms of the Certificate and of a Remarketing Agreement, or similar agreement, or (ii) principal of or interest on any Variable Rate Bonds with a draw, borrowing or payment under a Support Facility shall not be deemed payment of such Variable Rate Bonds pursuant to the defeasance provisions of the Certificate; provided, however, that with respect to (ii) above, a reimbursement or other payment by the State with respect to a draw, borrowing or payment under a Support Facility for the payment of principal, premium, if any, or interest on Variable Rate Bonds when due shall be deemed to the payment of such Variable Rate Bonds for the purpose of such defeasance provisions.

All moneys or Federal Securities set aside and held in trust pursuant to the provisions of Article XII of the Certificate for the payment of Bonds (including interest and premium thereon, if any) shall be applied to and used solely for the payment of the particular Bonds (including interest and premium thereon, if any) with respect to which such moneys and Federal Securities have been so set aside in trust.

If moneys or Federal Securities have been deposited or set aside with the Director of Finance or other Paying Agent for the payment of Bonds and such Bonds shall be deemed to have been paid and be no longer Outstanding under the Certificate, but such Bonds shall not have in fact been actually paid in full, no amendment to the defeasance provisions shall be made without the consent of the Holder of each Bond affected thereby and such Bonds shall be considered to be Outstanding for purposes of the provisions of the Certificate relating to amendments upon consent of Bondholders.

The State may at any time surrender to the Director of Finance for cancellation by him any Bonds previously executed and delivered, which the State may have acquired in any manner whatsoever, and such Bonds upon such surrender for cancellation shall be deemed to be paid and no longer Outstanding under the Certificate.

APPENDIX D

FORM OF CONTINUING DISCLOSURE CERTIFICATE

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APPENDIX D

FORM OF CONTINUING DISCLOSURE CERTIFICATE

[Excluding exhibits to original certificate.]

CONTINUING DISCLOSURE CERTIFICATE

This Continuing Disclosure Certificate (the "Disclosure Certificate") is executed and delivered by the State of Hawaii (the "State"), acting by and through the State Director of Transportation, in connection with the issuance of \$56,290,000 State of Hawaii Harbor System Revenue Bonds, Series of 1997 (the "1997 Bonds"). The 1997 Bonds are being issued pursuant to the authority of the Constitution and laws of the State, including, in particular, certain acts of the Legislature of the State and that certain Certificate of the Director of Transportation Providing for the Issuance of the State of Hawaii, Harbor System Revenue Bonds dated as of March 1, 1997, as supplemented by the First Supplemental Certificate of the Director of Transportation providing for the Issuance of the State of Hawaii, Harbor System Revenue Bonds, Series of 1997, dated as of March 20, 1997 (collectively, the "Bond Certificate").

Pursuant to the First Supplemental Certificate, the State, acting by and through its Director of Transportation, agrees as follows:

Section 1. Purpose of Disclosure Certificate. This Disclosure Certificate is being executed and delivered by the State for the benefit of the Bondholders and Beneficial Owners of the 1997 Bonds and in order to assist the Participating Underwriters in complying with Securities Exchange Commission Rule 15c2-12(b)(5).

Section 2. Definitions. In addition to the definitions set forth in the Bond Certificate, which apply to any capitalized term used in this Disclosure Certificate unless otherwise defined in this Section, the following capitalized terms shall have the following meanings:

"Annual Information" means the type of financial information and operating data set forth under the subheadings "SOURCES OF REVENUES – Service Revenues, Rentals Income, Other Operating Revenues and Interest Income," "THE HARBOR SYSTEM – Annual Trends in Cargo Traffic for Hawaii Harbors, Annual Trends in Cargo Volume for Hawaii Harbors, Statement of Historical Operations and Debt Service Coverage" in the final Official Statement, dated March 20, 1997, for the 1997 Bonds.

"Audited Financial Statements" means the audited financial statements of the Harbor Special Fund and any other fund of the State into which Revenues are deposited, prepared in accordance with generally acceptable accounting principles as promulgated from time to time by the Government Accounting Standards Board and the Financial Accounting Standards Board of the Financial Accounting Foundation.

"Beneficial Owner" shall mean any person which (a) has the power, directly or indirectly, to vote or consent with respect to, or to dispose of ownership of, any 1997 Bonds (including persons holding 1997 Bonds through a Clearing Agency, nominees, depositories or other intermediaries) or (b) is treated as the owner of any 1997 Bonds for federal income tax purposes.

"Dissemination Agent" shall mean the Director of Finance or any successor Dissemination Agent designated in writing by the Director of Finance and which has filed with the Director of Finance a written acceptance of such designation.

"Filing Date" means the first day of the tenth month following the end of each Fiscal Year (or the next succeeding business day if that day is not a business day), beginning April 1, 1998.

"Fiscal Year" means each fiscal year of the Department of Transportation, commencing with the fiscal year that begins July 1, 1996 and ends June 30, 1997.

"Listed Events" shall mean any of the events listed in subsection 4(a) of this Disclosure Certificate.

“National Repository” shall mean any Nationally Recognized Municipal Securities Information Repository for purposes of the Rule. The National Repositories currently approved by the Securities and Exchange Commission are set forth in Exhibit B.

“Participating Underwriters” shall mean any or the original underwriters of the 1997 Bonds required to comply with the Rule in connection with offering of the 1997 Bonds.

“Repositories” shall mean each National Repository and each State Repository.

“Rule” shall mean Rule 15c2-12(b)(5) adopted by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as the same may be amended from time to time.

“State” shall mean the State of Hawaii.

“State Repository” shall mean any public or private repository or entity designated by the State as a state repository for the purpose of the Rule and recognized as such by the Securities and Exchange Commission. As of the date of this Disclosure Certificate, there is no State Repository.

Section 3. Filing of Annual Information and Audited Financial Statements.

(a) The State is the only “obligated person” (as defined in the Rule) for the 1997 Bonds.

(b) The State shall provide, or shall cause the Dissemination Agent to provide, to each Repository:

 (i) Annual Information for the preceding Fiscal Year, and unaudited financial statements of the Pledged Funds if Audited Financial Statements are not provided at the same time, not later than the Filing Date for each Fiscal Year; and

 (ii) Audited Financial Statements for the preceding Fiscal Year, not later than the later of (A) the Filing Date of each Fiscal Year or (B) 30 days after receipt thereof by the Department of Transportation.

Audited Financial Statements are expected to be available together with the Annual Information. The State is required to deliver, or cause to be delivered, such information in such manner and by such time so that the Repositories receive the information on or before the date specified.

The Annual Information may be submitted as a single document or as separate documents comprising a package and may cross-reference other information including official statements of debt issues of the State or related public entities, which have been submitted to each of the Repositories or the Securities and Exchange Commission. If the document included by reference is a final official statement, it must be available from the Municipal Securities Rulemaking Board. The State shall clearly identify each such other document so included by reference. The Audited Financial Statements may be submitted separately from the Annual Information.

If the Department’s Fiscal Year changes, it shall give notice of such change in the same manner as for a Listed Event under subsection 4(b).

(c) If the State is unable to provide to the Repositories the information described in subsection (b) by the Filing Date, the Director of Finance shall send a notice to each Repository and the Municipal Securities Rulemaking Board in substantially the form attached as Exhibit A.

(d) If the Director of Finance has appointed a Dissemination Agent, then not later than 15 Business Days prior to Filing Date, the Director of Transportation shall provide the Annual Information and Audited Financial Statements (or unaudited financial statements if the Audited Financial Statements are not available) to the Dissemination Agent.

(e) The Dissemination Agent shall:

(i) determine each year prior to the Filing Date the name and address of each National Repository and the State Repository, if any; and

(ii) if the Dissemination Agent is other than the Director of Finance, file a report with the Director of Finance certifying that the information described in subsection (b) has been provided pursuant to this Disclosure Certificate, stating the date it was provided and listing all the Repositories to which it was provided.

Section 4. Reporting of Significant Events.

(a) Pursuant to the provisions of this Section 4, the State shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the 1997 Bonds, if material:

1. principal and interest payment delinquencies;
2. non-payment related defaults;
3. modifications to rights of Bondholders;
4. bond calls other than scheduled mandatory sinking fund redemptions;
5. defeasances;
6. rating changes;
7. adverse tax opinions or events affecting the tax-exempt status of the 1997 Bonds;
8. unscheduled draws on the debt service reserves reflecting financial difficulties;
9. unscheduled draws on the credit enhancements reflected financial difficulties;
10. substitution of the credit or liquidity providers or their failure to perform; or
11. release, substitution or sale of property securing repayment of the 1997 Bonds.

(b) Whenever the Director of Transportation or other responsible officials of the State become aware of the occurrence of a Listed Event, the State shall as soon as possible determine if such event would be material under applicable federal securities laws and, if so, the State shall prepare and provide or cause to be provided notice of such occurrence to each Repository.

Notwithstanding the foregoing, notice of Listed Events described in subsections (a)(4) and (5) above need not be given under this subsection (b) any earlier than the notice (if any) of the underlying event is given to Bondholders of affected 1997 Bonds pursuant to the Bond Certificate.

Section 5. Termination of Reporting Obligation. The State's obligations under this Disclosure Certificate shall terminate (a) upon the legal defeasance, prior redemption or repayment in full of all of the 1997 Bonds or (b) when the Rule no longer applies to the 1997 Bonds. If such termination occurs prior to the final maturity of the 1997 Bonds, the State shall give notice of such termination in the same manner as for a Listed Event under subsection 4(b).

Section 6. Dissemination Agent. The Director of Finance may, from time to time, appoint or engage a Dissemination Agent to assist the State in carrying out its obligations under this Disclosure Certificate, and may discharge any such Agent, with or without appointing a successor Dissemination Agent. The Dissemination Agent

shall not be responsible in any manner for the content of any notice or report prepared by the State pursuant to this Disclosure Certificate.

Section 7. Amendment; Waiver; Amendment to Accounting Principles to be Followed.

(a) Notwithstanding any other provision of this Disclosure Certificate, the State may amend this Disclosure Certificate, and any provision of this Disclosure Certificate may be waived, provided that the following conditions are satisfied:

(i) If the amendment or waiver relates to the definition of "Annual Information" or the provisions of subsection 3(a) or (b), or Sections 4, 5 or 7, it may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature or status of the Obligated Person with respect to the 1997 Bonds, or the type of business conducted by the Obligated Person;

(ii) The undertaking, as amended or taking into account such waiver, would, in the opinion of nationally recognized bond counsel selected by the State, have complied with the requirements of the Rule at the time of the original issuance of the 1997 Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(iii) The amendment or waiver either (i) is approved by the Holders of the 1997 Bonds in the same manner as provided in the Bond Certificate for amendments to the Bond Certificate with the consent of Holders of 1997 Bonds, or (ii) does not, in the opinion of nationally recognized bond counsel selected by the State, materially impair the interests of the Holders or Beneficial Owners of the 1997 Bonds.

(b) In the event of any amendment or waiver of a provision of this Disclosure Certificate, the State shall describe such amendment in the next Annual Information, and shall include, as applicable, a narrative explanation of the reason for the amendment or waiver and its impact on the type (or in the case of a change of accounting principles, on the presentation) of the information being presented by the State.

(c) If the amendment changes the accounting principles to be followed in preparing financial statements from that specified in the definition of Audited Financial Statements, then (i) the State shall give notice of such amendment in the same manner as for a Listed Event under subsection 4(b), and (ii) the Annual Information for the year in which the change is made should present a comparison (in narrative form and also, if feasible, in quantitative form) between the financial statements as prepared on the basis of the amended definition of accounting principles and those prepared on the basis of the former definition of accounting principles.

Section 8. Additional Information; Supplements.

(a) Nothing in this Disclosure Certificate shall be deemed to prevent the State from disseminating any other information, using the means of dissemination set forth in this Disclosure Certificate or any other means of communication, or including any other information in any Annual Information or notice of occurrence of a Listed Event, in addition to that which is required by this Disclosure Certificate.

If the State chooses to include any information in any Annual Information or notice of occurrence of a Listed Event in addition to that which is specifically required by this Disclosure Certificate, the State shall have no obligation under this Disclosure Certificate to update such information or include it in any future Annual Information or notice of occurrence of a Listed Event.

(b) Nothing in this Disclosure Certificate shall be deemed to prevent the State from supplementing this Disclosure Certificate to provide that it shall also govern continuing disclosure for one or more issues of Additional Bonds (as defined in the Bond Certificate).

Section 9. Failure to Perform.

(a) The agreements of the State set forth in Section 3 and 4 of this Disclosure Certificate are intended to be for the benefit solely of the Bondholders and Beneficial Owners from time to time of the 1997 Bonds.

The sole remedy for any breach of this Disclosure Certificate by the State shall be limited, as hereinafter described, to a right of Bondholders and Beneficial Owners to cause proceedings at law or in equity to be instituted and maintained to obtain mandate or specific performance by the State of its obligations hereunder. Any individual Bondholder or Beneficial Owner may institute and maintain, or cause to be instituted and maintained, such proceedings to require the State to provide or cause to be provided a pertinent filing if such filing is due and has not been made. Any such proceedings challenging the adequacy of the information provided in accordance with this Disclosure Certificate may be instituted and maintained only by the Bondholders and the Beneficial Owners of not less than 50% in principal amounts of the 1997 Bonds then outstanding or their agent.

(b) Any failure of the State to comply with any provisions of this Disclosure Certificate shall not be a default or an event of default with respect to the 1997 Bonds under the Bond Certificate.

Section 10. Beneficiaries. This Disclosure Certificate shall inure solely to the benefit of the State, the Dissemination Agent, the Participating Underwriters and Bondholders and Beneficial Owners from time to time of the 1997 Bonds and shall create no rights in any other person or entity.

Section 11. Recordkeeping. The Director of Finance shall maintain records of all Annual Information and notice of material Listed Events including the content of such disclosure, the names of the entities with whom such disclosures were filed and the date of filing such disclosure.

Section 12. Governing Law. This Disclosure Certificate shall be governed by the laws of the State.

Dated: April 3, 1997.

/s/ Kazu Hayashida
KAZU HAYASHIDA
Director of Transportation
Department of Transportation
State of Hawaii

FORM OF FOURTH SUPPLEMENT TO CONTINUING DISCLOSURE CERTIFICATE

This Fourth Supplement to Continuing Disclosure Certificate (this “Supplemental Disclosure Certificate”) is executed and delivered by the State of Hawaii (the “State”), acting by and through the State Director of Transportation, in connection with the issuance of \$96,570,000 State of Hawaii Harbor System Revenue Bonds, Series A of 2006 (the “Series 2006 Bonds”) and supplements the Continuing Disclosure Certificate (the “Disclosure Certificate”) dated April 3, 1997 (incorporated by reference herein) pursuant to Section 8(b) thereof. The Series 2006 Bonds are being issued pursuant to the authority of the Constitution and laws of the State, including, in particular, certain acts of the Legislature of the State and that certain Certificate of the Director of Transportation Providing for the Issuance of the State of Hawaii, Harbor System Revenue Bonds dated as of March 1, 1997, as heretofore supplemented and as supplemented by the Fifth Supplemental Certificate of the Director of Transportation Providing for the Issuance of the State of Hawaii Harbor System Revenue Bonds, Series A of 2006, dated as of June 27, 2006 (the “Bond Certificate”).

Pursuant to the Bond Certificate, the State, acting by and through its Director of Transportation, agrees as follows:

Section 1. Purpose of Supplemental Disclosure Certificate. This Supplemental Disclosure Certificate is being executed and delivered by the State for the benefit of the Bondholders and Beneficial Owners of the Series 2006 Bonds and in order to assist the Participating Underwriters in complying with Securities and Exchange Commission Rule 15c2-12(b)(5).

Section 2. Applicability of Disclosure Certificate. Section 8(b) of the Disclosure Certificate permits the State to supplement the Disclosure Certificate to provide that it also shall govern continuing disclosure for one or more issues of Additional Bonds (as defined in the Bond Certificate). The Series 2006 Bonds are Additional Bonds. Accordingly, and pursuant to Section 8(b) of the Disclosure Certificate, the Disclosure Certificate is hereby supplemented and shall govern the continuing disclosure for the Series 2006 Bonds. For the purposes of this Supplemental Disclosure Certificate, all references in the Disclosure Certificate to the “1997 Bonds” shall be deemed to be to the Series 2006 Bonds.

Section 3. Definitions. In addition to the definitions set forth elsewhere in this Supplemental Disclosure Certificate, in Section 2 of the Disclosure Certificate and in the Bond Certificate, the following capitalized terms shall have the following meanings for the purposes of this Supplemental Disclosure Certificate and the Series 2006 Bonds:

“*Annual Information*” means the type of financial information and operating data set forth under the subheadings “SOURCES OF REVENUES—Services Revenues - Rentals Income - Other Operating Revenues and - Interest Income,” and “THE HARBOR SYSTEM - Table 5 - Annual Trends in Cargo Traffic for Hawaii Harbors,” “Table 6- Annual Trends in Cargo Volume for Hawaii Harbors,” “Table 10 - Statement of Historical Operations” and “Table 11 – Historical Debt Service Coverage” in the final Official Statement, dated June 27, 2006, for the Series 2006 Bonds.

“*Filing Date*” means the first day of the tenth month following the end of each Fiscal Year (or the next succeeding business day if that day is not a business day), beginning April 1, 2007.

“*Fiscal Year*” means each fiscal year of the Department of Transportation, commencing with the fiscal year that begins July 1, 2006 and ends June 30, 2007.

Section 4. National Repository. The National Repositories currently approved by the Securities and Exchange Commission are set forth at www.sec.gov/info/municipal/nrmsir.htm.

Section 5. Governing Law. This Fourth Supplement to Continuing Disclosure Certificate shall be governed by the laws of the State.

Dated: June 27, 2006

STATE OF HAWAII

By _____
Name _____
Title _____

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APPENDIX E

FORM OF OPINION OF BOND COUNSEL

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APPENDIX E

FORM OF OPINION OF BOND COUNSEL

July 12, 2006

Mr. Rodney K. Haraga
Director of Transportation
Department of Transportation
State of Hawaii
869 Punchbowl Street
Honolulu, HI 96813

\$96,570,000
State of Hawaii
Harbor System Revenue Bonds
Series A of 2006

Dear Mr. Haraga:

At the request of the State of Hawaii (the "State"), we have acted as Bond Counsel in connection with the issuance and sale by the State of its \$96,570,000 State of Hawaii Harbor System Revenue Bonds, Series A of 2006 (the "Bonds"). The Bonds are dated July 12, 2006, are in the denomination of \$5,000 of any integral multiple thereof, and mature serially on January 1 in each of the years and in the respective principal amounts set forth below, with the Bonds maturing in a particular year bearing interest payable semiannually each January 1 and July 1, commencing January 1, 2007 at the rate per annum set opposite such year, as follows:

Year	Principal Amount	Interest Rate	Year	Principal Amount	Interest Rate
2007	\$1,960,000	4.000%	2017	\$745,000	4.500%
2008	2,105,000	4.500	2017	2,505,000	5.250
2009	2,200,000	4.250	2018	3,420,000	5.250
2010	300,000	4.125	2019	3,595,000	4.800
2010	2,000,000	5.000	2020	3,780,000	5.250
2011	2,415,000	4.750	2021	1,475,000	4.750
2012	2,525,000	4.250	2021	2,505,000	5.250
2013	2,645,000	5.000	2022	4,195,000	5.250
2014	50,000	4.750	2023	4,420,000	5.250
2014	2,730,000	5.000	2024	4,660,000	5.250
2015	40,000	4.750	2025	4,910,000	5.250
2015	2,890,000	5.250	2026	5,175,000	5.250
2016	140,000	4.500	2027	5,450,000	5.250
2016	2,945,000	5.250	2031	24,790,000	5.000

The Bonds are subject to optional redemption and mandatory sinking fund redemption by the State prior to the respective stated maturities thereof. The Bonds are transferable and exchangeable upon the terms and conditions set forth therein and recite that they have been authorized and issued pursuant to the laws of the State of Hawaii. The Bonds are being issued to provide for the construction of facilities that are part of the State's system of commercial harbors. The Bonds recite that they are authorized to be issued and are issued under, pursuant to, and in full compliance with the Constitution and statutes of the State of Hawaii, including particularly, Part III of Chapter 39, Hawaii Revised Statutes, as amended, and under and pursuant to that certain Certificate of the Director of

Transportation Providing for the Issuance of State of Hawaii Harbor System Revenue Bonds dated as of March 1, 1997 (the "Certificate"), duly authorized and delivered under the aforesaid Part III, and pursuant to that certain Fifth Supplemental Certificate of the Director of the Department of Transportation Providing for the Issuance of State of Hawaii Harbor System Revenue Bonds, Series A of 2006, dated as of June 27, 2006 (the "Fifth Supplemental Certificate"), duly authorized and delivered under the aforesaid Part III and the Certificate. All capitalized terms used herein that are not herein otherwise defined shall have the meanings ascribed thereto in the Certificate.

The Bonds and any bonds heretofore or hereafter issued on a parity therewith under the Certificate are payable from the Revenues of the Undertaking net of the payment of the operation and maintenance expenses of the Undertaking.

The State has covenanted in its proceedings authorizing the Bonds to comply with all necessary provisions of the Internal Revenue Code of 1986, as amended (the "Code"), to preserve the exclusion of interest on the Bonds from gross income for federal income tax purposes. Noncompliance by the State with such restrictions may cause the interest on the Bonds to be subject to federal income taxation retroactive to their date of issuance.

In connection with the issuance of the Bonds, we have examined the Constitution and laws of the State of Hawaii, certificates and documents of the Governor and of the Director of Transportation of the State authorizing the issuance of the Bonds, including the Certificate and Fifth Supplemental Certificate, such other proceedings as we have considered necessary or advisable and a copy of an executed Bond of said issue.

From such examination, we are of the opinion that:

(1) The Bonds have been duly authorized and issued in accordance with the Constitution and laws of the State of Hawaii and constitute valid special obligations of the State of Hawaii payable solely from and secured solely by a lien upon and pledge of Net Revenues, on a parity with all bonds which heretofore have been or hereafter may be issued under the Certificate, as set forth in the Certificate;

(2) The provisions of the Certificate and the Fifth Supplemental Certificate are valid in accordance with their terms;

(3) The rights of the owners of the Bonds and the enforceability thereof may be subject to valid bankruptcy, insolvency, reorganization, moratorium and other laws for the relief of debtors;

(4) Assuming compliance by the State with the covenant referred to in the fourth paragraph of this letter, under laws, regulations, rulings and judicial decisions existing as of the date hereof, (i) the interest on the Bonds, including any original issue discount properly allocable to an owner thereof, is excluded from gross income for federal income tax purposes, except that such exclusion does not apply with respect to interest on any Bond for any period during which such Bond is held by a person who is a "substantial user" of the facilities financed from the proceeds of the Bonds or by a "related person" within the meaning of Section 147(a) of the Code, and (ii) interest on the Bonds, including any original issue discount, is a specific item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations; and

(5) Under the existing laws of the State of Hawaii, the Bonds and the income therefrom are exempt from all taxation by the State or any county or other political subdivision thereof, except inheritance, transfer and estate taxes and the franchise tax imposed on banks and other financial institutions.

Although the interest on the Bonds is excluded from gross income for federal income tax purposes, the accrual or receipt of interest on the Bonds may otherwise affect the federal income tax liability of the recipient. The extent of these other tax consequences will depend upon the recipient's particular tax status or other items of income or deduction. We express no opinion regarding any such consequences. Purchasers of the Bonds, particularly purchasers that are corporations (including S corporations and foreign corporations operating branches in the United States), property or casualty insurance companies, banks, thrifts or other financial institutions, certain recipients of Social Security or Railroad Retirement benefits, taxpayers otherwise entitled to claim the earned income credit or taxpayers

who may be deemed to have incurred or continued indebtedness to purchase or carry tax-exempt obligations are advised to consult their tax advisors as to the tax consequences of purchasing or holding the Bonds. We express no opinion regarding any pending or proposed federal tax legislation.

Very truly yours,

[To be signed and delivered at
Closing by Kutak Rock LLP]

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APPENDIX F

**FORM OF MUNICIPAL BOND INSURANCE POLICY AND
MUNICIPAL BOND DEBT SERVICE RESERVE INSURANCE POLICY**

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APPENDIX F

FORM OF MUNICIPAL BOND INSURANCE POLICY AND
MUNICIPAL BOND DEBT SERVICE RESERVE INSURANCE POLICY



MUNICIPAL BOND
INSURANCE POLICY

ISSUER:

Policy No.: -N

BONDS:

Effective Date:

Premium: \$

FINANCIAL SECURITY ASSURANCE INC. ("Financial Security"), for consideration received, hereby UNCONDITIONALLY AND IRREVOCABLY agrees to pay to the trustee (the "Trustee") or paying agent (the "Paying Agent") (as set forth in the documentation providing for the issuance of and securing the Bonds) for the Bonds, for the benefit of the Owners or, at the election of Financial Security, directly to each Owner, subject only to the terms of this Policy (which includes each endorsement hereto), that portion of the principal of and interest on the Bonds that shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer.

On the later of the day on which such principal and interest becomes Due for Payment or the Business Day next following the Business Day on which Financial Security shall have received Notice of Nonpayment, Financial Security will disburse to or for the benefit of each Owner of a Bond the face amount of principal of and interest on the Bond that is then Due for Payment but is then unpaid by reason of Nonpayment by the Issuer, but only upon receipt by Financial Security, in a form reasonably satisfactory to it, of (a) evidence of the Owner's right to receive payment of the principal or interest then Due for Payment and (b) evidence, including any appropriate instruments of assignment, that all of the Owner's rights with respect to payment of such principal or interest that is Due for Payment shall thereupon vest in Financial Security. A Notice of Nonpayment will be deemed received on a given Business Day if it is received prior to 1:00 p.m. (New York time) on such Business Day; otherwise, it will be deemed received on the next Business Day. If any Notice of Nonpayment received by Financial Security is incomplete, it shall be deemed not to have been received by Financial Security for purposes of the preceding sentence and Financial Security shall promptly so advise the Trustee, Paying Agent or Owner, as appropriate, who may submit an amended Notice of Nonpayment. Upon disbursement in respect of a Bond, Financial Security shall become the owner of the Bond, any appurtenant coupon to the Bond or right to receipt of payment of principal or or interest on the Bond and shall be fully subrogated to the rights of the Owner, including the Owner's right to receive payments under the Bond, to the extent of any payment by Financial Security hereunder. Payment by Financial Security to the Trustee or Paying Agent for the benefit of the Owners shall, to the extent thereof, discharge the obligation of Financial Security under this Policy.

Except to the extent expressly modified by an endorsement hereto, the following terms shall have the meanings specified for all purposes of this Policy. "Business Day" means any day other than (a) a Saturday or Sunday or (b) a day on which banking institutions in the State of New York or the Insurer's Fiscal Agent are authorized or required by law or executive order to remain closed. "Due for Payment" means (a) when referring to the principal of a Bond, payable on the stated maturity date thereof or the date on which the same shall have been duly called for mandatory sinking fund redemption and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by mandatory sinking fund redemption), acceleration or other advancement of maturity unless Financial Security shall elect, in its sole discretion, to pay such principal due upon such acceleration together with any accrued interest to the date of acceleration and (b) when referring to interest on a Bond, payable on the stated date for payment of interest. "Nonpayment" means, in respect of a Bond, the failure of the Issuer to have provided sufficient funds to the Trustee or, if there is no Trustee, to the Paying Agent for payment in full of all principal and interest that is Due for Payment on such Bond. "Nonpayment" shall also include, in respect of a Bond, any payment of principal or interest that is Due for Payment

made to an Owner by or on behalf of the Issuer which has been recovered from such Owner pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final, nonappealable order of a court having competent jurisdiction. "Notice" means telephonic or telecopied notice, subsequently confirmed in a signed writing, or written notice by registered or certified mail, from an Owner, the Trustee or the Paying Agent to Financial Security which notice shall specify (a) the person or entity making the claim, (b) the Policy Number, (c) the claimed amount and (d) the date such claimed amount became Due for Payment. "Owner" means, in respect of a Bond, the person or entity who, at the time of Nonpayment, is entitled under the terms of such Bond to payment thereof, except that "Owner" shall not include the Issuer or any person or entity whose direct or indirect obligation constitutes the underlying security for the Bonds.

Financial Security may appoint a fiscal agent (the "Insurer's Fiscal Agent") for purposes of this Policy by giving written notice to the Trustee and the Paying Agent specifying the name and notice address of the Insurer's Fiscal Agent. From and after the date of receipt of such notice by the Trustee and the Paying Agent, (a) copies of all notices required to be delivered to Financial Security pursuant to this Policy shall be simultaneously delivered to the Insurer's Fiscal Agent and to Financial Security and shall not be deemed received until received by both and (b) all payments required to be made by Financial Security under this Policy may be made directly by Financial Security or by the Insurer's Fiscal Agent on behalf of Financial Security. The Insurer's Fiscal Agent is the agent of Financial Security only and the Insurer's Fiscal Agent shall in no event be liable to any Owner for any act of the Insurer's Fiscal Agent or any failure of Financial Security to deposit or cause to be deposited sufficient funds to make payments due under this Policy.

To the fullest extent permitted by applicable law, Financial Security agrees not to assert, and hereby waives, only for the benefit of each Owner, all rights (whether by counterclaim, setoff or otherwise) and defenses (including, without limitation, the defense of fraud), whether acquired by subrogation, assignment or otherwise, to the extent that such rights and defenses may be available to Financial Security to avoid payment of its obligations under this Policy in accordance with the express provisions of this Policy.

This Policy sets forth in full the undertaking of Financial Security, and shall not be modified, altered or affected by any other agreement or instrument, including any modification or amendment thereto. Except to the extent expressly modified by an endorsement hereto, (a) any premium paid in respect of this Policy is nonrefundable for any reason whatsoever, including payment or provision being made for payment, of the Bonds prior to maturity and (b) this Policy may not be canceled or revoked. THIS POLICY IS NOT COVERED BY THE PROPERTY/CASUALTY INSURANCE SECURITY FUND SPECIFIED IN ARTICLE 76 OF THE NEW YORK INSURANCE LAW.

In witness whereof, FINANCIAL SECURITY ASSURANCE INC. has caused this Policy to be executed on its behalf by its Authorized Officer.

[Countersignature]

FINANCIAL SECURITY ASSURANCE INC.

By _____

By _____
Authorized Officer

A subsidiary of Financial Security Assurance Holdings Ltd.
31 West 52nd Street, New York, N.Y. 10019

(212) 826-0100

Form 500NY (5/90)



**FINANCIAL
SECURITY
ASSURANCE®**

**MUNICIPAL BOND DEBT SERVICE
RESERVE INSURANCE POLICY**

ISSUER:

BONDS:

Policy No.: -R
Effective Date:
Premium: \$
Termination Date:

FINANCIAL SECURITY ASSURANCE INC. ("Financial Security"), for consideration received, hereby UNCONDITIONALLY AND IRREVOCABLY agrees to pay to the trustee (the "Trustee") or paying agent (the "Paying Agent") as set forth in the documentation (the "Bond Document") providing for the issuance of and securing the Bonds, for the benefit of the Owners, subject only to the terms of this Policy (which includes each endorsement hereto), that portion of the principal of and interest on the Bonds that shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer.

Financial Security will make payment as provided in this Policy to the Trustee or Paying Agent on the later of the Business Day on which such principal and interest becomes Due for Payment or the Business Day next following the Business Day on which Financial Security shall have received Notice of Nonpayment, in a form reasonably satisfactory to it. A Notice of Nonpayment will be deemed received on a given Business Day if it is received prior to 1:00 p.m. (New York time) on such Business Day; otherwise, it will be deemed received on the next Business Day. If any Notice of Nonpayment received by Financial Security is incomplete, it shall be deemed not to have been received by Financial Security for purposes of the preceding sentence and Financial Security shall promptly so advise the Trustee, Paying Agent or Issuer, as appropriate, who may submit an amended Notice of Nonpayment. Payment by Financial Security to the Trustee or Paying Agent for the benefit of the Owners shall, to the extent thereof, discharge the obligation of Financial Security under this Policy. Upon such payment, Financial Security shall become entitled to reimbursement of the amount so paid (together with interest and expenses) pursuant to the **[Bond Document] [Insurance Agreement]**.

The amount available under this Policy for payment shall not exceed the Policy Limit. The amount available at any particular time to be paid to the Trustee or Paying Agent under the terms of this Policy shall automatically be reduced by any payment under this Policy. However, after such payment, the amount available under this Policy shall be reinstated in full or in part, but only up to the Policy Limit, to the extent of the reimbursement of such payment (exclusive of interest and expenses) to Financial Security by or on behalf of the Issuer. Within three Business Days of such reimbursement, Financial Security shall provide the Trustee, the Paying Agent and the Issuer with notice of the reimbursement and reinstatement.

Payment under this Policy shall not be available with respect to (a) any Nonpayment that occurs prior to the Effective Date or after the Termination Date of this Policy or (b) Bonds that are not outstanding under the Bond Document. If the amount payable under this Policy is also payable under another insurance policy or surety bond insuring the Bonds, payment first shall be made under this Policy to the extent of the amount available under this Policy up to the Policy Limit. In no event shall Financial Security incur duplicate liability for the same amounts owing with respect to the Bonds that are covered under this Policy and any other insurance policy or surety bond that Financial Security has issued.

Except to the extent expressly modified by an endorsement hereto, the following terms shall have the meanings specified for all purposes of this Policy. "Business Day" means any day other than (a) a Saturday or Sunday or (b) a day on which banking institutions in the State of New York are, or the Insurer's Fiscal Agent is, authorized or required by law or executive order to remain closed. "Due for Payment" means (a) when referring to the principal of a Bond, payable on the stated maturity date thereof or the date on which the same shall have been duly called for mandatory sinking fund redemption and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by mandatory sinking fund redemption), acceleration or other advancement of maturity unless Financial Security shall elect, in its sole discretion, to pay such principal due upon such acceleration together with any accrued interest to the date of acceleration and (b) when referring to

interest on a Bond, payable on the stated date for payment of interest. "Insurance Agreement" means the Insurance Agreement dated as of the effective date hereof in respect of this Policy, as the same may be amended or supplemented from time to time. "Nonpayment" means, in respect of a Bond, the failure of the Issuer to have provided sufficient funds to the Paying Agent for payment in full of all principal and interest that is Due for Payment on such Bond. "Nonpayment" shall also include, in respect of a Bond, any payment of principal or interest that is Due for Payment made to an Owner by or on behalf of the Issuer that has been recovered from such Owner pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final, nonappealable order of a court having competent jurisdiction. "Notice" means telephonic or telecopied notice, subsequently confirmed in a signed writing, or written notice by registered or certified mail, from the Issuer, the Trustee or the Paying Agent to Financial Security which notice shall specify (a) the person or entity making the claim, (b) the Policy Number, (c) the claimed amount and (d) the date such claimed amount became Due for Payment. "Owner" means, in respect of a Bond, the person or entity who, at the time of Nonpayment, is entitled under the terms of such Bond to payment of principal or interest thereunder, except that "Owner" shall not include the Issuer or any person or entity whose direct or indirect obligation constitutes the underlying security for the Bonds. "Policy Limit" shall be the dollar amount of the debt service reserve fund required to be maintained for the Bonds by the Bond Document from time to time (the "Debt Service Reserve Requirement"), but in no event shall the Policy Limit exceed \$. The Policy Limit shall automatically and irrevocably be reduced from time to time by the amount of each reduction in the Debt Service Reserve Requirement, as provided in the Bond Document.

Financial Security may appoint a fiscal agent (the "Insurer's Fiscal Agent") for purposes of this Policy by giving written notice to the Trustee and the Paying Agent specifying the name and notice address of the Insurer's Fiscal Agent. From and after the date of receipt of such notice by the Trustee and the Paying Agent, (a) copies of all notices required to be delivered to Financial Security pursuant to this Policy shall be simultaneously delivered to the Insurer's Fiscal Agent and to Financial Security and shall not be deemed received until received by both and (b) all payments required to be made by Financial Security under this Policy may be made directly by Financial Security or by the Insurer's Fiscal Agent on behalf of Financial Security. The Insurer's Fiscal Agent is the agent of Financial Security only and the Insurer's Fiscal Agent shall in no event be liable to any Owner for any act of the Insurer's Fiscal Agent or any failure of Financial Security to deposit or cause to be deposited sufficient funds to make payments due under this Policy.

To the fullest extent permitted by applicable law, Financial Security agrees not to assert, and hereby waives, only for the benefit of each Owner, all rights (whether by counterclaim, setoff or otherwise) and defenses (including, without limitation, the defense of fraud) whether acquired by subrogation, assignment or otherwise, to the extent that such rights and defenses may be available to Financial Security to avoid payment of its obligations under this Policy in accordance with the express provisions of this Policy.

This Policy sets forth in full the undertaking of Financial Security, and shall not be modified, altered or affected by any other agreement or instrument, including any modification or amendment thereto. Except to the extent expressly modified by an endorsement hereto, (a) any premium paid in respect of this Policy is nonrefundable for any reason whatsoever, including payment, or provision being made for payment, of the Bonds prior to maturity and (b) this Policy may not be cancelled or revoked. THIS POLICY IS NOT COVERED BY THE PROPERTY/CASUALTY INSURANCE SECURITY FUND SPECIFIED IN ARTICLE 76 OF THE NEW YORK INSURANCE LAW.

In witness whereof, FINANCIAL SECURITY ASSURANCE INC. has caused this Policy to be executed on its behalf by its Authorized Officer:

[Countersignature]

FINANCIAL SECURITY ASSURANCE INC.

By _____

By _____
Authorized Officer

A subsidiary of Financial Security Assurance Holdings Ltd.
31 West 52nd Street, New York, N.Y. 10019

(212) 826-0100

Form 501 NY (6/90)