Moody's Investors Service

Global Credit Research
Rating Update
26 MAY 2009

Rating Update: Hawaii Housing Finance & Development Corp.

MOODY'S AFFIRMS THE A2 UNDERLYING RATING ON HAWAII HOUSING FINANCE AND DEVELOPMENT CORPORATION'S HAWAII RENTAL HOUSING SYSTEM REVENUE BONDS 2004 REFUNDING SERIES B

Outlook Remains Negative

Hawaii Housing Finance & Development Corp.
Housing
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Opinion

NEW YORK, May 26, 2009 -- Moody's Investors Service has affirmed the A2 underlying rating with a negative outlook on $20,875,000 outstanding Hawaii Rental Housing System Revenue Bonds, 2004 Refunding Series B (the Rental Housing Bonds), in connection with the proposed remarketing of the2004 Series B Bonds from bonds bearing interest in an auction rate mode to bonds bearing interest at fixed rates to maturity.

The A2 rating is based upon the solid performance of the multifamily housing developments from which revenues are pledged to bond repayment, the general obligation pledge of the Corporation and the Corporation's considerable financial resources, a debt service reserve that provides additional protection, and the legal provisions of the bond indenture. The negative outlook reflects some level of continued uncertainty arising from reallocation of funds from the Corporation to the state.

THE CORPORATION'S FINANCIAL POSITION PROVIDES SIGNIFICANT BACKING FOR REPAYMENT OF THE BONDS

The bonds are supported by the general obligation of the issuer, the Hawaii Housing and Development Corporation (the Corporation). Moody's views the Corporation's strong financial balances as a solid source of protection for repayment of the Bonds. The Corporation was organized in its present form in 2006 as a successor to a previous corporation that combined the State's housing finance agency and public housing authority. The 2006 reorganization separated the public housing and housing finance agency functions, so that the Corporation is now focused solely on affordable housing finance activities and not public housing.

The Corporation's June 30, 2008 audited financial statements show a combined fund balance (after Moody's adjustments) of $379 million, or 94.8% of bonds outstanding. The general fund balance was $318 million, or 79.58% of bonds outstanding. As reflected by these numbers, bond finance is a smaller proportion of the Corporation's activities than is the case with many other State housing finance agencies. The Corporation has three bond funds - the Rental Housing Bonds, the Single Family Mortgage Purchase Revenue Bonds, and the Multifamily Housing Revenue Bonds. The Single Family program is all-fixed rate bonds primarily backed by mortgage backed securities (MBS) and enjoys an asset to debt ratio of approximately 1.25. The Multifamily Housing Revenue Bonds are conduit issuances and not direct obligations of the Corporation. Apart from the bond funds, a significant part of the Corporation's assets comprise the Rental Housing Trust Fund and the Dwelling Unit Revolving Fund, which are based on funds derived from State appropriations over the years and the Corporation's own earnings and which operate a variety of affordable housing development and lending activities (including loans to support developments and repayable only from available cash flow and short-term construction loans). These funds (along with other smaller enterprise funds) have demonstrated significant cash balances over the past four fiscal years, and although these monies may be applied to fund loans, Moody's understands that the significant net assets of these funds provide additional support for the Corporation's obligations, including the Rental Housing Bonds. (Cash balances in those funds ranged from approximately $134 million in fiscal 2005 to approximately $200 million in 2008). The Corporation has demonstrated significant profitability, with net revenues of $65 million (after Moody's adjustments) in the year ending June 30, 2008.

In the past the State of Hawaii has added to the Corporation's assets with significant appropriations, but has also periodically directed withdrawals from the Corporation (including withdrawals in 1995, 1996, and 2002-2004). In addition, the Corporation's Rental Housing Trust Fund receives a share of the State conveyance tax, although the percentage directed to the Corporation is modified by legislation each year. Recently enacted legislation included withdrawals of approximately $20.6 million from the Corporation's funds, but also new appropriations totaling $50 million over the next two fiscal years for affordable housing development activities. The new legislation also directed that certain interest earnings from certain of the Corporation's funds -including a fund that provides subsidies to certain bond-funded projects - should be payable to the State rather than remitted to the Corporation. Continued uncertainty about the effects of these developments adds some level of uncertainty in Moody's assessment of the Corporation's finances.

MULTIFAMILY PROPERTIES FINANCED BY THE BONDS SUPPORT BOND REPAYMENT

The Rental Housing Bonds are supported by a pledge of the revenues from six real estate developments that were financed with bond proceeds and which are owned and operated directly by the Corporation. The projects include three high-rise, mixed use (commercial combined with affordable rental) properties in the Honolulu area (composed of between 226 and 268 units each) and three garden-style projects located in West Oahu and on the islands of Maui and Hawaii, respectively (80, 184, and 200 units respectively). One project is for elderly residents and the remaining five are family rentals. The projects have shown steady debt service coverage over the last three fiscal years (continued in the Corporation's projections for 2009). On a pro forma basis using estimated debt service costs after the remarketing of the 2009 Series B Bonds, coverage ranged from approximately 1.18 to 1.22x based on results of the past three years and the budget for the current year (this includes debt service on the 2004 Series B Bonds and the parity 2004 Series A Bonds). These coverage levels include interest earnings on funds held under the Indenture. They also include rental subsidies of approximately $950,000 per year received from the Corporation's Rental Assistance Revolving Fund. The Rental Assistance Revolving Fund is one of the funds as to which interest earnings are remitted to the State through 2015 under recent legislation; however, the Corporation estimates that there are sufficient resources in that Fund to continue the subsidy payments without the additional interest earnings, and even without the subsidy pro forma coverage remains at over 1.04x. Five of the projects have occupancy levels over 95%; the sixth has occupancy of only about 75%, reflecting units vacated due to ongoing capital repairs. Rental increases in 2008 were in the 6.75% to 7% range, with the exception of the elderly development, where increases were limited to 1.4%.

SATISFACTORY LEGAL STRUCTURE AND ADDITIONAL PROTECTION UNDER THE BOND INDENTURE

The 2004 Series B Rental Housing Bonds are on parity with approximately $78,125,000 outstanding 2004 Series A Rental Housing Bonds, which are fixed rate bonds and are not being remarketed. The Rental Housing Bonds are supported by a pledge of revenues from the projects financed through bond proceeds, as well a general obligation pledge of the Corporation. (the Bonds are not obligations of the State). The Bond Indenture includes a covenant to maintain overall available revenues sufficient to provide 1.25x debt service coverage from all available revenues and 1.10x from project revenues. Each Series of Bonds benefits from a Debt Reserve Fund funded with a surety provided by Financial Security Assurance Inc. (FSA -rated Aa3 on watch for downgrade), for the Series B bonds in the amount of $2.3 million.

Outlook

The outlook on the ratings remains negative due to continued uncertainty from the effects of possible State withdrawals of funds from the Corporation and changes in direction of interest earnings from the Corporation to state general funds, combined with general challenges related to operation of residential real estate properties in light of the economic downturn.

The last rating action with respect to the Rental Housing Program System Revenue Bonds was on September 22, 2004, when ratings were assigned to the 2004 Refunding Series A and B (negative outlook).

The principal methodology used in rating this issue was Moody's Methodology for Assigning Issuer Ratings to Housing Finance Agencies, which can be found at www.moodys.com in the Credit Policy & Methodologies directory, in the Ratings Methodologies subdirectory. Other methodologies and factors that may have been considered in the process of rating this issue can also be found in the Credit Policy & Methodologies directory.

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