



Rating_Action: Moody's downgrades Honolulu City & County, HI's GOs to Aa2 and assigns Aa2 issuer rating; outlook revised to stable

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New York, February 14, 2023 -- Moody's Investors Service has downgraded the City & County of Honolulu, HI's general obligation unlimited tax (GOULT) rating to Aa2 from Aa1. Concurrently, Moody's has assigned a Aa2 issuer rating to the City & County of Honolulu. This action concludes a review that was initiated on November 3, 2022 in conjunction with the release of the US Cities and Counties Methodology. Honolulu has about \$4.2 billion in outstanding GOULT bonds. The outlook has been revised to stable from ratings under review.

RATINGS RATIONALE

The Aa2 issuer rating reflects Honolulu's very strong financial position and available cash, supported by an experienced management team and the unusual level of financial flexibility provided to counties in Hawaii (Aa2 stable). Only counties can collect property taxes, which equate to over 90% of Honolulu's general fund revenue and nearly 60% of governmental revenue. Additionally, Honolulu began collecting its own Oahu transient accommodations tax (OTAT) beginning in fiscal 2022. While the available governmental fund balances are well above the medians for the rating level, these balances include a receivable for an advance to the Honolulu Authority for Rail Transit (HART), which will be eliminated over eight years through reimbursement of debt service costs.

Since most of Honolulu's revenue is derived from property taxes, the pandemic had only a very modest effect on the city's revenue stream resulting from a decline in commercial property values. Honolulu has substantial flexibility to respond to economic declines, since tax rates are very low and can be adjusted by the city council without voter approval, and since property assessments lag market activity by 18 to 24 months.

Tourism is a key driver of the state's economy, which contracted during the pandemic, and international tourism has not recovered to pre-pandemic levels. Recovery of international tourism to Hawaii faces headwinds from the strong US dollar and inflation. However, Honolulu's economy is significantly more diverse than other Hawaii counties and benefits from the large military presence. Resident incomes and wealth measures are above average, with median household income adjusted for regional price parity equal to 114.7% of US and full value per capita equal to more than \$265,000 for fiscal 2023. These metrics are affected by the sizeable institutional military presence, with Pearl Harbor and other installations on Oahu serving a critical role in the nation's defense system. It is also notable that while reported economic growth has lagged the nation, the state's reported gross domestic product (GDP) was understated by about 1% starting in 2018 due to changes in the Department of Defense reporting to the Bureau of Labor Statistics of the categorization of its active personnel, rather than by actual changes in economic activity related to the military on the island.

A primary factor in the assignment of the Aa2 rating is Honolulu's high leverage, which is significantly higher than similarly rated peers. The debt burden has recently been rising due to GOULT bonds issued for construction of the rapid transit system, the leverage from which will

level off and begin to decline as the bonds rapidly amortize through fiscal 2031 and will be paid using state-authorized general excise tax (GET) and accommodations taxes specifically for the project. Regardless, we expect leverage to remain elevated in the near term, given the higher costs inherent in Honolulu's island location. Capital project costs are higher than other parts of the nation due to the need to import necessary materials and fuel, as well as due to higher costs for land and labor. Pension and OPEB liabilities have been a source of elevated leverage, though increased funding levels and strengthened policies have contributed to moderation of these reported liabilities. However, we note that Honolulu currently has a pension tread water gap, meaning that current pension contributions are not sufficient to prevent the liability from growing under reported actuarial assumptions. As such, pension liabilities will continue to be a pressure.

The absence of a distinction between the issuer and GOULT ratings reflects the county's general obligation unlimited property tax pledge that is dedicated to debt service.

RATING OUTLOOK

The stable outlook reflects the ongoing recovery from the effects of the pandemic. The economy and tax base will continue to grow, though GDP growth will likely lag the nation. Honolulu's revenue will grow through effective management of tax rate and assessment practices and strong fiscal management. The outlook further reflects materially improved fiscal flexibility provided by Honolulu's decision to implement a 3% Oahu transient accommodations tax in fiscal 2022, which will nearly double the amount of TAT that had been received from the state prior to the pandemic. Additionally, management has made significant progress in restructuring the administration of the rail project, scaling back the project and addressing technical and financial challenges, thereby reducing contingent liability risks associated with the cost and timeline for project completion. Future operating subsidies for the project will be manageable.

FACTORS THAT COULD LEAD TO AN UPGRADE OF THE RATINGS

- Strong economic rebound following the pandemic
- Material improvement in the funding of OPEB and pension liabilities
- Reduction in leverage and fixed cost burden

FACTORS THAT COULD LEAD TO A DOWNGRADE OF THE RATINGS

- Sustained economic weakness leading to declines in assessed values and property tax collections
- Material declines in the financial position
- Inability to manage fixed costs
- Substantial growth in Honolulu's contribution to the rail project beyond current commitment

LEGAL SECURITY

The bonds are secured by an unlimited property tax pledge; debt service payments represent a first charge on Honolulu's general fund.

PROFILE

Coterminous with the island of Oahu, the City & County of Honolulu is the capital city of the State of Hawaii and the economic and political center of the state. About one million people live on the island, constituting about 70% of the state's population.

METHODOLOGY

The principal methodology used in these ratings was US Cities and Counties Methodology published in November 2022 and available at <https://ratings.moodys.com/api/rmc-documents/386953>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

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