MOODY'S ASSIGNS Aa2 RATING AND STABLE OUTLOOK TO STATE OF HI $634.7 M G. O. BONDS OF 2008, SERIES DN, DP, AND REFUNDING SERIES DO

NEW YORK, September 15, 2008 -- Moody's Investors Service has assigned an Aa2 rating with a stable outlook to the State of Hawaii's General Obligation Bonds of 2008, $300 million Series DN, $26 million Series DP, and $308.7 million Refunding Series DO. The Aa2 rating incorporates the state's historical fiscal conservatism; its sound financial position despite lower revenue growth; a tourism-based economy with some diversification occurring in other employment sectors; and a high debt burden. Hawaii's economy shows signs of slowing, with lower employment growth in line with national trends. Currently strong reserve levels may decline over the near term but should remain satisfactory, although further economic weakness leading to revenue underperformance could lead to draws on balances to accommodate budgeted spending levels. Moody's expects that the state will continue to make the necessary budgetary adjustments to maintain fiscal stability.

Hawaii plans to sell its General Obligation Bonds of 2008, Series DN, DP, and Refunding Series DO on or about September 23. Proceeds of the new money series will be used to finance or to reimburse the state for certain expenditures for public purposes for which appropriations have been made. These include payments in connection with the Hawaiian Home Lands Settlement and various capital projects to improve elementary and secondary schools, public buildings and facilities, community colleges, universities, as well as public parks and libraries. Proceeds of the refunding series will be used to refinance outstanding bonds for net present value savings of approximately $7.1 million. The refunding schedule provides near term budget relief through fiscal year 2011 but increases the state's debt service costs by approximately $41 million annually in fiscal years 2012 through 2019.

Credit strengths are:

*Slower but still positive employment trends with gains in all major sectors; steady military housing construction helps offset a slowing residential market; healthy tourism industry.

*Even with planned draws over near term, available balances should provide financial flexibility in the event of greater than unexpected revenue falloff.

*Well-established multi-year and quarterly consensus forecasting by state's Council on Revenues.

*Historical fiscal conservatism.

Credit challenges are:

*Debt ratios likely to remain very high given state-level capital funding on behalf of local governments, especially for education.

*Vulnerability to sudden shifts in tourism-based economy, resulting in revenue falloff and budget shortfalls.

*Large government employment sector contributes to spending pressure for salary and benefit settlements.

*Low pension funding levels.

RECENTLY STRONG TAX REVENUE GROWTH SLOWS; OUTYEAR PROJECTIONS REFLECT MORE MODERATE REVENUE GROWTH

Hawaii's revenue performance was very strong as state finances rebounded from the 2001 recession and events of 9-11. Total tax revenues increased by 8.3%, 16%, and 10.9% in fiscal years 2004, 2005, and 2006, respectively. In fiscal year 2007, growth continued at a slower pace of 3.4%, reflecting strong general excise and use tax receipts (up 8.5%) offset by personal income tax receipts that increased by only 0.8% as previously high employment growth tapered off to the national average. General excise taxes, representing about half of General Fund revenues, jumped about 13% in fiscal year 2005, followed by 10% growth in fiscal year 2006. Increases in personal income taxes (approximately one-third of General Fund revenues) were also substantial in recent years: 12.6%, 18%, and 12% in fiscal years 2004, 2005, and 2006, respectively. These stellar revenue results were in part derived from the overall strength of the state's tourism sector, Hawaii's primary economic driver. In addition, the above-average revenue performance reflected growth in Hawaii's construction industry as both the commercial and residential construction markets were aided by the low interest rate environment.

For fiscal year 2008, as a result of the slowing economy, preliminary unaudited results showed that total tax revenues grew by 1.2%. Last month Hawaii lowered its forecasts for tax revenue growth to 1% for fiscal year 2009 to reflect slower employment and personal income growth. While still positive the expected pace of growth is considerably slower than the 4% annual increase that had been projected in March 2008. With economic improvement expected in fiscal year 2010, the state's council on revenues forecasts higher tax revenue growth rates of about 4% annually for fiscal years 2010 and 2011. Similar to most of the nation, Hawaii is experiencing a housing market slowdown that is moderating construction and building permit activity. However, continued demands for military housing should support the state's construction sector. Visitor arrivals were flat in 2006 and down slightly in 2007 although tourism-related expenditures continued to increase, reflected in higher average hotel room rates and revenue per room. For 2008 the state expects a 6.7% year-over-year drop in visitor arrivals followed by a modest decline (0.8%) in 2009.

STRONG RESERVE LEVELS MAY DECLINE IN NEAR TERM

After four consecutive years of operating surpluses, unaudited results for fiscal year 2008 show a $162.2 million decline in the state's ending general fund balance to $331 million. While a decrease of about $84 million was anticipated, the larger operating deficit was due to lower than expected tax revenue receipts. Hawaii's unreserved, undesignated general fund balance (UUFB) declined from $915 million at the end of fiscal year 2006 to $657 million in part due to specific appropriations for collective bargaining settlements and also for targeted spending in education, affordable housing initiatives, and medical care access. Collective bargaining agreements with state employees and teachers yielded increases of between 10% and 12% through fiscal year 2009, thereby adding spending pressures to the baseline at a time when revenue growth is slowing. Hawaii's Medicaid costs, growing at approximately 8% annually, remain a challenge as in other states.

Combined available reserves, consisting of the UUFB plus the emergency and budget reserve, remained very strong at almost 15% of general fund revenues at the end of fiscal year 2007. The state will likely draw on available balances in the near term as it adjusts to higher baseline spending and weathers the economic downturn. Given Hawaii's strong monitoring process, relatively conservative projections for revenue growth over the next few years, and current level of available reserves, the state's financial flexibility should be maintained even with planned draws on reserves. The state tapped its reserves to address budgetary shortfalls in fiscal years 2002 and 2003. With the strong revenue growth in recent years available reserves grew to 21% of general fund revenues at the end of fiscal year 2006, surpassing the state's previous peak of 15%, recorded at fiscal year-end 2001.

Hawaii's constitution provides for a tax refund or tax credit to state taxpayers whenever the General Fund balance at the close of two successive fiscal years exceeds 5% of General Fund revenues for each of those years. Reserves met that threshold in fiscal years 2006 and 2007. As a result, the legislature was required to provide a tax credit or refund in fiscal year 2008. However the constitution does not stipulate a specific dollar or percentage amount which gives the legislature broad flexibility in terms of satisfying this requirement. This situation has happened seventeen times in the past. The 2008 legislature agreed to a tax credit in the aggregate amount of $1 million.

CONSERVATIVE BUDGET CONTROLS POSITION STATE WELL TO MANAGE ECONOMIC DOWNTURNS; STATE CONSTITUTION REQUIRES REVENUE FORECASTS

Pursuant to the state constitution, the state legislature is required to establish a general Fund expenditure ceiling that limits the annual rate of expenditure growth to the rate of growth of Hawaii's economy. State appropriation levels from the general fund may not exceed the expenditure ceiling without a two-thirds vote of both houses of the legislature. The expenditure ceiling is determined by adjusting the prior year expenditure ceiling by the estimated growth in the state economy. This growth factor is determined by averaging the annual percentage change in total state personal income for the prior three years. Appropriations did not exceed the expenditure ceiling for eight fiscal years through the 2004-2005 biennium. Following strong revenue growth, the legislature voted to approve expenditures that exceeded the ceiling in the 2006-2007 biennium, and at the same time the state increased its available reserves. Appropriations for fiscal year 2008 did not exceed the ceiling and projected appropriations for fiscal year 2009 are not expected to exceed the ceiling. This expenditure limitation, combined with conservative forecasting and periodic updating by the state's council on revenues, mitigates fiscal stress during the business cycle.

The state constitution requires the council on revenues to prepare revenue estimates which serve as the basis for the governor's budget preparation and the legislature's appropriation of funds and enactment of revenue measures. The council reports its estimates and revisions each June 1, September 10, January 10, and March 15. The council also revises its estimates when it determines that such revisions are necessary or upon request of the governor or the legislature.

ECONOMY SLOWS IN LINE WITH NATION; JOB GROWTH DECLINES TO MORE MODERATE PACE

Hawaii posted a 1.1% gain in total non-farm employment in 2007, the same as the national rate of job growth, and the ninth consecutive year of positive job growth in the state as reported by the bureau of labor statistics. The state's employment growth significantly outpaced the nation in 2003 through 2006, peaking at a rate of 3.1% in 2005 when the U.S. pace was 1.7%. For July 2008, the state's job growth has moderated to a monthly average year-over-year increase of 0.6%, above the national pace of 0.3% over the same period.

Hawaii's unemployment rate was 3.9% in July 2008, when the national rate was 5.7%, and remains among the lowest in the nation. Since 2001 Hawaii's unemployment rate has remained below the national level, reversing a pattern in the 1990s when the state's unemployment level rose while the national rate declined. The national economic performance continues to be tempered by job losses in manufacturing, a sector that represents less than 3% of total employment in Hawaii. It should be noted that while government jobs represent the state's largest employment sector (19.6%) the state's primary source of jobs gains have been in several industry sectors, particularly services and construction. The construction sector gained jobs at an astonishing but likely unsustainable rate of 15.4% in 2006, more than three times the national pace of 4.8% that year, in part due to the continued favorable interest rate environment. Construction job growth dropped to a still healthy 5.8% in 2007 as the housing market softened. Nationally, construction jobs declined 1% in 2007. While the housing slowdown has affected construction jobs in Hawaii in 2008, significant military construction and defense-related spending in Hawaii should remain strong over the near term. Service sector growth reflects some diversity of the state's employment base beyond the tourism industry, with positive gains posted in educational and health services, and professional and business services.

After several very strong years, Hawaii's tourism industry softened somewhat in calendar year 2007. Visitor arrivals were flat year-over-year and hotel occupancy rates lower (75.3% versus almost 80% in 2006). Hotel occupancy rates for the first half of 2008 were slightly lower at 73.8%. However, these statistics were offset by continued increases in both average room rates and revenues per room. Visitor arrivals are forecast to decline by 6.7% in 2008 and 0.8% in 2009 before improving as the national economy recovers. Air travel has felt the negative effects of high energy prices as well as the bankruptcy of two carriers to the islands, although airline seat capacity has recently improved. According to state officials, hotels continue to make capital investments.

LARGE MILITARY PRESENCE PROVIDES STABLE EMPLOYMENT BASE

Federal defense spending in Hawaii, dictated by the island's strategic geographic importance, plays a large part in the state's economy. Total government employment in Hawaii is about 20% of non-farm employment versus 16% nationwide. Federal activity in Hawaii amounts to about 13% of the state's gross state product, with much of it defense related. The large federal defense presence provides a continuing and stable source of employment and income which helps to support the state's volatile tourist-based economy. This is augmented by federal transfer payments for Social Security and federal retirement benefits which also support the state's economy. The state economy should benefit over the near term from military expansion plans and the privatization of military housing.

"RAINY DAY" FUND BALANCE FUNDED WITH TOBACCO SETTLEMENT PAYMENTS

As part of the $206 billion tobacco settlement master agreement between the major tobacco companies and 46 states and five US territories, the state of Hawaii is expected to receive a total of $1.5 billion. The annual payments to the state will range from $42 million to $63 million through fiscal year 2027, and 24.5% of the money received is deposited into an emergency budget and reserve fund (EBR). Appropriations from the fund require a two-thirds majority vote of each house of the legislature and can only be made during times of emergency, economic downturn or unforeseen reductions in revenues.

The EBR Fund balance as of June 30, 2007 was $61.5 million, a relatively modest 1.3% of General Fund revenues. However the combined available balance, reflecting general fund UUFB plus emergency reserves, totaled about $719 million at fiscal year-end 2007, down from $969 million the prior year but still strong at approximately 15% of general fund revenues. The ERB balance increased to $74 million at the end of fiscal 2008 and is projected to grow to $110.8 million by the end of fiscal year 2011.

DEBT BURDEN REMAINS AMONG THE HIGHEST IN NATION

Hawaii has historically been one of the nation's most heavily-indebted states, both in terms of net tax-supported debt as a percentage of revenue, and debt per capita. The high debt ratios reflect, in part, the state's assumption of capital funding for many functions performed at the local level in other states such as capital financing for schools. Based on Moody's 2008 State Debt Medians Report, Hawaii ranked third highest in terms of debt per capita, Hawaii's debt per capita is $3,663 while the 50-state median is $889 for 2008.

For debt as a percentage of personal income, Hawaii's 9.9% ratio is almost 4 times the 50-state median of 2.6%. While still very high, Hawaii's debt to personal income ratio declined from 12.1% the prior year due to the state's recent gains in personal income at paces that exceeded those of both the U.S. and the far west region. Still, Hawaii's high debt burden places significant strain on the state's operating budget, as total general obligation bond debt service is about 10% of the general fund budget. Pension contributions are another area of expenditure concern given the state's below average retirement system funded ratio of 67.5% at the end of fiscal year 2007, up slightly from 65% the prior year. Funded ratios exceeded 90% through fiscal year 2001. Recently lower funded levels reflect the use of four-year smoothing that captured weak market returns earlier in the decade, and the increased life of plan participants. On a positive note, the state has been making its annually required contributions.

Hawaii's other post-employment (OPEB) obligations were evaluated to meet GASB 45 disclosure requirements. The OPEB obligation is quite sizeable at $8.8 billion or $5.6 billion on a pre-funded basis, reflecting full health benefits for both state employees and teachers paid by the state. Even at the lower level, the amount eclipses the size of Hawaii's general fund revenues which totaled about $4.9 billion in fiscal year 2007. For the present time, the state plans to continue funding these obligations on a pay-go basis.

OUTLOOK:

The stable outlook for Hawaii's credit rating reflects the state's strong management of its finances given the volatility of its tourism-based economy. The state's economic performance, with its heavy dependence on tourism, has slowed but appears to be sustainable for the near term. Recent indicators show some economic diversification, with increased employment in service sectors outside of leisure and hospitality, underscoring the state's resilience coming out of the last recession. Military investment in the state should continue to benefit from the nation's heightened state of alert. Hawaii's financial position is expected to remain sound incorporating more moderate near term revenue growth assumptions.

What would it take for rating to move up?

*Maintenance of strong reserve levels.

*Broader economic diversification, sustained job growth, and reduced vulnerability to the tourism industry.

*Maintenance of structural budget balance.

What would it take for rating to move down?

*Economic weakening leading to employment erosion.

*Slowing of revenue trends leading to budget imbalance, liquidity pressure, and narrowing of financial position.

*Use of non-recurring solutions to balance budget.

ANALYSTS:
Nicole Johnson, Analyst, Public Finance Group, Moody's Investors Service Nicholas Samuels, Backup Analyst, Public Finance Group, Moody's Investors Service

CONTACTS:
Journalists: (212) 553-0376
Research Clients: (212) 553-1653