

FINANCIAL STATEMENTS

State of Hawaii
Department of Transportation
Harbors Division
Years Ended June 30, 2008 and 2007
With Report of Independent Auditors

Submitted by
The Auditor
State of Hawaii

State of Hawaii
Department of Transportation
Harbors Division

Financial Statements

Years Ended June 30, 2008 and 2007

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Report of Independent Auditors

The Auditor
State of Hawaii

We have audited the accompanying financial statements of the business-type activities of the Harbors Division, Department of Transportation of the State of Hawaii (Harbors Division), as of and for the years ended June 30, 2008 and 2007, as shown on pages 13 through 16, which collectively comprise the Harbors Division's basic financial statements as listed in the table of contents. 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 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. We were not engaged to perform an audit of the Harbors Division's internal control over financial reporting. Our audits included 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 and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, 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, 2008 and 2007, and the changes in its financial position or, where applicable, its cash flows for the fiscal years then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of the Harbors Division as of June 30, 2008 and 2007, and the respective changes in financial position and cash flows thereof for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 5, 2009, 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, and grant agreements and other matters. The purpose of that 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.

Management's Discussion and Analysis on pages 3 through 12 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required 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 financial statements that collectively comprise the Harbors Division's basic financial statements. The supplementary information included in Schedules 1 through 6 are presented for purposes of additional analysis and are not a required part of the basic financial statements. The supplementary 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.

Ernst + Young LLP

May 5, 2009

State of Hawaii
Department of Transportation
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Management's Discussion and Analysis

June 30, 2008

This section of the Harbors Division, Department of Transportation of the State of Hawaii (Harbors Division), relating to the Public Undertaking financial report, presents the reader with an introduction and overview of the Harbors Division's financial performance for the fiscal year ended June 30, 2008. 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 eleven 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 use of the harbors system and its 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 \$634.7 million in 2008 compared to \$623.3 million in 2007, an increase of 1.8%.
- Wharfage revenues were \$43.0 million in 2008 compared to \$41.8 million in 2007, an increase of 2.9%.
- Total expenses were \$83.4 million in 2008 compared to \$76.6 million in 2007, an increase of 8.9%.

Total operating revenues for fiscal year 2008 were \$85.4 million compared to \$85.7 million in fiscal year 2007. The major portion of operating revenues are directly related to cargo and ship operations. Service revenues include wharfage, dockage and passenger fees. Service revenues in fiscal years 2008, 2007 and 2006 were \$57.8 million, \$58.1 million and \$56.3 million, respectively. Service revenues for fiscal year 2008 were flat, as an increase in wharfage revenues of \$1.2 million was offset by decreases of \$1.0 million in passenger fees and decreases in dockage fees of \$333,000. During February and May 2008, NCL America removed two cruise ships, the Pride of Hawaii and the Pride of Aloha, respectively, from its Hawaii-based U.S. flagged service. The increase in 2007 revenues was primarily due to a \$1.0 million increase in passenger fees and a \$920,000 increase in dockage fees.

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Management's Discussion and Analysis (continued)

Financial Highlights (continued)

During fiscal 2008, approximately 2.0 million passengers (inbound and outbound) passed through the harbors compared to 2.4 million passengers in fiscal year 2007 and 1.9 million passengers in fiscal year 2006.

Passenger fee revenue for fiscal years 2008, 2007 and 2006 were \$4.5 million, \$5.5 million and \$4.5 million, respectively. The 18.2% revenue decrease from 2007 to 2008 is primarily due to NCL America's decision, effective in the second half of fiscal year 2008, to remove two cruise ships from Hawaii-based U.S. flag voyages, resulting in approximately 400,000 fewer NCL America cruise ship passengers in 2008. The 22.5% revenue increase from 2006 to 2007 is due to growth in the number of cruise ship passengers.

Passengers on U.S. flagged vessels taking a continuous trip whose point of origin and termination is a State of Hawaii (the State) port are charged a fee of \$2.50 at the point of origin and termination and an in-transit fee of \$1.85 at each of the other ports under the tariff for disembarking and embarking. Other passengers are assessed a \$2.50 passenger fee for embarking and a \$2.50 passenger fee for disembarking. Passenger counts decreased in 2008 by 16.7% and revenues decreased by 18.2%, as approximately 65.0% of the 2008 passengers were in-transit. While passenger counts increased by 26.3% in 2007 over 2006, revenues increased by 22.5% as approximately 71.5% of the 2007 passengers were in-transit.

Wharfage revenue in fiscal years 2008, 2007 and 2006 were \$43.0 million, \$41.8 million and \$41.4 million, respectively. The 2008 net increase in wharfage revenues of \$1.2 million was due primarily to \$1.3 million earned from the commencement of the operations of Hawaii Superferry, Inc. during the second quarter of fiscal year 2008, reduced by a decrease of \$100,000 in wharfage revenue earned from cargo handling at the State's ports. The 2007 increase of \$380,000 or 0.9% was primarily due to a 1.6% rise in containers expressed in twenty-foot equivalent units. Gross rental revenues in fiscal years 2008, 2007 and 2006, were \$25.4 million, \$26.0 million and \$25.4 million, respectively. The decrease of \$600,000 or 2.3% from fiscal year 2007 to 2008 was due primarily to rental renegotiations resulting in higher rental rates offset by lower Honolulu Harbor storage revenues. The increase of \$600,000 or 2.4% from fiscal year 2006 to 2007 was primarily due to rental renegotiations at higher rates. Net rental revenues after deducting the provision for doubtful accounts were \$25.3 million for 2008, \$25.5 million for 2007 and \$24.9 million for 2006. The provision for doubtful accounts for the fiscal years ending June 30, 2008 and 2007, affecting rental revenues, was approximately \$145,000 and \$500,000,

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Management's Discussion and Analysis (continued)

Financial Highlights (continued)

respectively. The remainder of the provision for doubtful accounts for the fiscal year ending June 30, 2008 affected service revenues by approximately \$591,000.

Operating expenses excluding depreciation increased by 20.3% from \$38.2 million in fiscal year 2006, to \$46.0 million in fiscal year 2007 and by 14.5% to \$52.6 million in fiscal year 2008. The increase from 2007 to 2008 of \$6.6 million was due primarily to increases in personnel services costs of approximately \$2.2 million, harbor maintenance costs of \$3.0 million and general administration expenses of \$1.5 million.

Personnel services costs increased in 2008 by approximately \$2.2 million, due primarily to the adoption of GASB Statement No. 45, *Post Employment Benefits Other Than Pensions Expense* (see Note 11) and collective bargaining pay increases. Personnel services costs increased in fiscal year 2007 by \$1.1 million, primarily due to collective bargaining pay increases.

Harbor maintenance expenses increased by approximately \$3.0 million and \$1.7 million in 2008 and 2007, respectively, due to a higher number of and cost increases in special maintenance projects undertaken during the respective years in comparison to the projects undertaken in the prior year.

General administration expenses increased in 2008 by approximately \$1.5 million, due primarily to \$600,000 contributed to fund a joint study with the Hawaii Tourism Authority regarding the impact of the cruise ship industry in Hawaii and \$500,000 provided to the Department of Agriculture to fund improvements to its Invicta system.

The increase in operating expenses of \$7.8 million from 2006 to 2007 is due to an approximate \$4.9 million increase in harbor operations expenses due to increases in security expenses, utilities and other expenses of \$2.5 million and write-offs of project costs totaling approximately \$2.4 million for costs of cancelled projects totaling \$1.3 million and costs of other completed projects totaling \$1.1 million which could not be capitalized.

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Management's Discussion and Analysis (continued)

Financial Highlights (continued)

A summary of operations and changes in net assets for the fiscal years ended June 30, 2008, 2007 and 2006 follows:

Table 1
Condensed Statements of Revenues,
Expenses and Changes in Net Assets
(In Thousands)

| | Year Ended June 30 | | | 2008 – 2007 | | 2007 – 2006 | |
|--|--------------------|-----------|-----------|------------------------|-------------|------------------------|-------------|
| | 2008 | 2007 | 2006 | Increase (decrease) | % Change | Increase (decrease) | % Change |
| Operating revenues | \$ 85,447 | \$ 85,663 | \$ 83,217 | \$ (216) | 0.1% | \$ 2,446 | 3% |
| Nonoperating revenues | 13,812 | 11,751 | 6,184 | 2,061 | 17% | 5,567 | 90% |
| Total revenues | 99,259 | 97,414 | 89,401 | 1,845 | 2% | 8,013 | 9% |
| Depreciation | 17,227 | 14,817 | 13,987 | 2,410 | 16% | 830 | 6% |
| Other operating expenses | 52,551 | 45,991 | 38,223 | 6,560 | 14% | 7,768 | 20% |
| Nonoperating expenses | 13,564 | 15,833 | 9,387 | (2,269) | (14)% | 6,446 | 69% |
| Total expenses | 83,342 | 76,641 | 61,597 | 6,701 | 9% | 15,044 | 24% |
| Net decrease in fair value of pooled cash balances invested by the State of Hawaii | (8,130) | — | — | (8,130) | (100%) | — | — |
| Income before capital contributions | 7,787 | 20,773 | 27,804 | (12,986) | (63)% | (7,031) | (25)% |
| Capital contributions | 3,616 | 4,371 | 122 | (755) | (17)% | 4,249 | 3,483% |
| Increase in net assets | \$ 11,403 | \$ 25,144 | \$ 27,926 | \$ (13,741) | (55)% | \$ (2,782) | (10)% |

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Management's Discussion and Analysis (continued)

Financial Highlights (continued)

A summary of the Harbors Division's net assets at June 30, 2008, 2007 and 2006 are shown below:

Table 2
Condensed Statements of Net Assets
(In Thousands)

| | As of June 30 | | | 2008 – 2007 | | 2007 – 2006 | |
|---|-------------------|-------------------|-------------------|------------------------|-------------|------------------------|-------------|
| | 2008 | 2007 | 2006 | Increase (decrease) | % Change | Increase (decrease) | % Change |
| Current and other assets | \$ 254,968 | \$ 291,812 | \$ 191,427 | \$ (36,844) | (13)% | \$ 100,385 | 52% |
| Capital assets | 694,905 | 659,042 | 611,054 | 35,863 | 5% | 47,988 | 8% |
| Total assets | <u>949,873</u> | <u>950,854</u> | <u>802,481</u> | <u>(981)</u> | <u>(1)%</u> | <u>148,373</u> | <u>18%</u> |
| Long-term debt outstanding | 288,780 | 298,209 | 182,948 | (9,429) | (3)% | 115,261 | 63% |
| Other liabilities | 26,428 | 29,383 | 21,415 | (2,955) | (10)% | 7,968 | 37% |
| Total liabilities | <u>315,208</u> | <u>327,592</u> | <u>204,363</u> | <u>(12,384)</u> | <u>(4)%</u> | <u>123,229</u> | <u>60%</u> |
| Net assets: | | | | | | | |
| Invested in capital assets, net of related debt | 499,914 | 484,199 | 426,195 | 15,715 | 3% | 58,004 | 14% |
| Restricted – revenue bond requirements | 10,898 | 10,898 | 10,898 | – | 0% | – | (0)% |
| Restricted – for capital projects | 55,461 | 87,735 | 11,380 | (32,274) | (37)% | 76,355 | 671% |
| Unrestricted | 68,392 | 40,430 | 149,645 | 27,962 | 69% | (109,215) | (73)% |
| | <u>\$ 634,665</u> | <u>\$ 623,262</u> | <u>\$ 598,118</u> | <u>\$ 11,403</u> | <u>2%</u> | <u>\$ 25,144</u> | <u>4%</u> |

The largest portion of the Harbors Division's net assets (78% at June 30, 2008 and 2007) 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 for such liabilities.

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Management's Discussion and Analysis (continued)

Financial Highlights (continued)

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. Net assets or the amount of total assets that exceeds liabilities at June 30, 2008, 2007 and 2006 are approximately \$634.7 million, \$623.3 million and \$598.1 million, respectively.

Capital Asset and Debt Administration

Capital Assets

As of June 30, 2008 and 2007, the Harbors Division had \$694.9 million and \$659.0 million invested in capital assets as shown in Table 3. There were net increases (additions, deductions and depreciation) of \$35.9 million and \$48.0 million from the end of the prior fiscal year.

Table 3
Capital Assets
(In Thousands)

| | As of June 30 | | | 2008 – 2007 | | 2007 – 2006 | |
|-------------------------------|---------------|------------|------------|------------------------|-------------|------------------------|-------------|
| | 2008 | 2007 | 2006 | Increase (decrease) | % Change | Increase (decrease) | % Change |
| Land and land improvements | \$ 388,729 | \$ 377,337 | \$ 362,054 | \$ 11,392 | 3% | \$ 15,283 | 4% |
| Wharves | 231,161 | 224,712 | 215,361 | 6,449 | 3% | 9,351 | 4% |
| Other improvements | 68,054 | 68,053 | 69,647 | 1 | 0% | (1,594) | (2)% |
| Buildings and improvements | 83,361 | 83,053 | 53,775 | 308 | 0.4% | 29,278 | 54% |
| Equipment | 47,509 | 47,061 | 9,427 | 448 | 1% | 37,634 | 399% |
| Subtotal | 818,814 | 800,216 | 710,264 | 18,598 | 2% | 89,952 | 13% |
| Less accumulated depreciation | (194,580) | (177,474) | (164,831) | (17,106) | 10% | (12,643) | 8% |
| Subtotal | 624,234 | 622,742 | 545,433 | 1,492 | 0.2% | 77,309 | 14% |
| Construction in progress | 70,671 | 36,300 | 65,621 | 34,371 | 95% | (29,321) | (45)% |
| Total | \$ 694,905 | \$ 659,042 | \$ 611,054 | \$ 35,863 | 5% | \$ 47,988 | 8% |

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Management's Discussion and Analysis (continued)

Capital Asset and Debt Administration (continued)

Major capital asset additions to the statewide harbors system for the fiscal year ended June 30, 2008, included the following:

- \$9.8 million Land Acquisition, Kahului Harbor, Maui
- \$4.8 million Substructure Repairs at Pier 2, Honolulu Harbor, Oahu
- \$1.2 million Bulkhead Repairs at Pier 29, Honolulu Harbor, Oahu
- \$538,000 Crash Barrier Gates for Container Terminals, Honolulu Harbor, Oahu
- \$310,000 Demolition of Pier 2 Shed and Misc. Site Work at Inter-Island Barge Terminal, Kahului Harbor, Maui

In addition to those capital asset additions, the Harbors Division is currently in the process of constructing the following projects statewide:

- \$24.0 million Reconstruction of Piers 52 & 53 Sand Island Container Yard, Honolulu Harbor, Oahu
- \$23.0 million Reconstruction of Pier 51B Container Yard, Honolulu Harbor, Oahu
- \$6.9 million Segmented Pier 3 Improvements, Nawiliwili Harbor, Kauai
- \$3.2 million Construction of Miscellaneous Improvements for Pier 2 Cruise Terminal, Honolulu Harbor, Oahu
- \$3.4 million Breakwater Repair at Kaunapali Harbor, Lanai
- \$750,000 Statewide Maritime Identification Credentialing System
- \$585,000 Security Surveillance System for Neighbor Island Passenger Terminals

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Management's Discussion and Analysis (continued)

Capital Asset and Debt Administration (continued)

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

- \$35.0 million Construction of Inter-Island Cargo Terminal Facility at Hilo Harbor, Hawaii
- \$28.5 million Construction of Pier 29 Container Yard, Honolulu Harbor
- \$3.5 million Commuter Ferry System at Kaunakakai Harbor, Molokai
- \$1.8 million Access and Electrical Improvements, Kalaeloa Barbers Point Harbor, Oahu
- \$1.8 million Pier 1 Makai Comfort Station and Waterline Improvements, Kahului Harbor
- \$2.0 million Pavement Improvements Along Pier 3 Bulkhead, Nawiliwili Harbor, Kauai
- \$1.5 million Perimeter Fencing Improvements at Honolulu and Kalaeloa Barbers Point Harbors, Oahu
- \$500,000 Disposal of Dredged Spoils Stockpiled at Pier 7, Kalaeloa Barbers Point Harbors, Oahu
- \$3,000,000 Pier 2A Shed Demolition and Container Yard Improvements at Kawaihae Harbor, Hawaii
- The Harbors Division is committed under contracts awarded for capital improvements projects totaling approximately \$29.0 million and \$68.0 million as of June 30, 2008 and 2007, respectively. Additional information regarding the Harbors Division's capital assets can be found in Note 4.

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Management's Discussion and Analysis (continued)

Indebtedness

Harbors System Revenue Bonds and Reimbursable General Obligation Bonds

As of June 30, 2008, \$253,795,000 of harbors system revenue bonds was outstanding compared to \$266,040,000 and \$180,865,000 as of June 30, 2007 and 2006, respectively. The Harbors Division issued \$96.5 million in Series A of 2006 Revenue Bonds in July 2006, and in August 2007, the Harbors Division issued \$51,645,000 Series A of 2007 Revenue Bonds to refund all outstanding Series of 1997 Bonds. The Harbors Division has managed its debt levels by issuing refunding bonds and defeasing bonds with unencumbered cash from the Harbors Revenue Fund.

Additional information regarding the Harbors Division's indebtedness can be found in Notes 5, 6 and 7.

Act 178, Session Laws of Hawaii 2005, appropriated reimbursable General Obligation bonds of \$20 million each in fiscal year 2006 and fiscal year 2007, for harbor improvements needed to support the operations of Hawaii Superferry, Inc. See Note 8.

Credit Rating and Bond Insurance

All harbor system revenue bonds issued since 1997 have been issued with bond insurance. As of June 30, 2008, 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 (S&P), Moody's Investors Service (Moody's) and Fitch IBCA, Inc. (Fitch) 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.

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Management's Discussion and Analysis (continued)

Indebtedness (continued)

Harbor System Revenue Bonds Series A and B of 2002 are insured by Ambac Assurance Corporation (Ambac). During calendar year 2008, S&P, Moody's and Fitch, downgraded the financial strength rating of Ambac resulting in a downgrade of the insured rating of the bonds insured by Ambac. On June 24, 2008, for a specified event occurring on June 19, 2008, Moody's downgraded the insured ratings of the bonds insured by Ambac from Aaa to Aa3 due to a rating downgrade of the financial strength rating of Ambac. On July 8, 2008, Fitch withdrew the insured rating of bonds insured by Ambac due to Ambac's request to withdraw the ratings. On November 17, 2008, for a specified event occurring on November 5, 2008, Moody's downgraded the insured ratings of the bonds insured by Ambac from Aa3 to Baa1.

These downgrades of the bond insurer, Ambac, have resulted in no negative impacts to the harbor system revenue bonds. There have been no increases in the stated interest rates, no requirements to accelerate or to prepay any principal amounts borrowed, nor have there been any requirements to pay additional premiums to Ambac. There have been no downgrades to the ratings of the harbor system revenue bonds.

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 1.25 times the debt service requirements under the 1997 Harbor Revenue Bond Certificate.

The Harbors Division currently has a coverage ratio of 2.29 under the 1997 Harbor Revenue Bond Certificate as compared to the prior fiscal year's ratio of 2.58.

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 davis.k.yogi@hawaii.gov.

State of Hawaii
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Statements of Net Assets

| | June 30 | | June 30 | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| | 2008 | 2007 | 2008 | 2007 |
| Assets | | | | |
| Current assets | | | | |
| Cash and cash equivalents (Note 3) | \$ 118,874,881 | \$ 134,227,965 | \$ 4,461,163 | \$ 5,905,180 |
| Receivables, less allowance for doubtful accounts of \$2,745,000 in 2008 and \$3,140,000 in 2007 | 6,342,446 | 7,776,981 | 95,772 | 102,026 |
| Notes receivable, less allowance for doubtful accounts of \$7,808,000 in 2008 and 2007 (Note 15) | 43,471 | 9,283 | 1,792,034 | 1,699,620 |
| Interest | 1,443,480 | 3,845,445 | 574,986 | 562,475 |
| Federal Government | 579,019 | — | 1,638,863 | 3,414,836 |
| Other | 567,971 | 160,240 | 8,562,818 | 11,684,137 |
| Materials and supplies, at cost | 241,236 | 236,495 | | |
| Prepaid insurance and others | 24,083 | 24,083 | | |
| | <u>128,116,587</u> | <u>146,280,492</u> | | |
| Restricted assets | | | | |
| Current | 17,746,358 | 15,634,909 | 4,887,847 | 5,956,182 |
| Cash and cash equivalents (Note 3) | 17,746,358 | 15,634,909 | 10,917,626 | 11,687,707 |
| Total current assets | <u>145,862,945</u> | <u>161,915,401</u> | 6,676,358 | 7,064,909 |
| | | | 2,816,628 | 2,736,273 |
| | | | <u>25,298,459</u> | <u>27,445,071</u> |
| Noncurrent | | | | |
| Cash and cash equivalents—restricted (Note 3) | 106,072,028 | 126,992,559 | 33,861,277 | 39,129,208 |
| Capital assets (Notes 4, 9 and 16) | | | | |
| Nondepreciable facilities: | | | | |
| Land | 173,940,070 | 164,116,866 | 369,510 | 356,254 |
| Land improvements | 76,086,739 | 76,086,739 | 1,450,866 | — |
| Other improvements | 66,908 | 66,908 | | |
| | <u>250,093,717</u> | <u>240,270,513</u> | 38,328,584 | 35,630,811 |
| Depreciable facilities: | | | 239,534,021 | 250,890,110 |
| Land improvements | 568,720,178 | 559,945,706 | 1,663,491 | 1,585,977 |
| Wharves | (194,579,633) | (177,474,093) | 281,346,472 | 288,463,152 |
| Other improvements | 374,140,545 | 382,471,613 | | |
| Buildings | 70,670,415 | 36,299,570 | | |
| Equipment | 694,904,677 | 659,041,696 | | |
| Less accumulated depreciation | | | | |
| Construction in progress | | | | |
| Total capital assets | <u>3,033,423</u> | <u>2,904,839</u> | 499,914,529 | 484,199,078 |
| | 804,010,128 | 788,939,094 | 10,897,658 | 10,897,658 |
| | <u>\$ 949,873,073</u> | <u>\$ 950,854,495</u> | 55,461,498 | 87,735,200 |
| Other asset | | | 68,391,639 | 40,430,199 |
| Unamortized bond issue costs | | | | |
| Total noncurrent assets | | | 634,665,324 | 623,262,135 |
| Total assets | | | <u>\$ 949,873,073</u> | <u>\$ 950,854,495</u> |
| | | | | |
| Liabilities and net assets | | | | |
| Current liabilities (payable from current assets) | | | | |
| Accounts payable | | | | |
| Accrued workers' compensation (Notes 5 and 12) | | | | |
| Contracts payable, including retainages | | | | |
| Accrued vacation (Note 5) | | | | |
| Due to Department of Budget and Finance (Note 8) | | | | |
| | | | | |
| Current liabilities (payable from restricted assets) | | | | |
| Contracts payable, including retainages | | | | |
| Revenue bonds payable, current maturities (Notes 5 and 6) | | | | |
| Accrued interest payable | | | | |
| Security deposits | | | | |
| | | | | |
| Total current liabilities | | | | |
| | | | | |
| Long-term liabilities | | | | |
| Accrued workers' compensation (Notes 5 and 12) | | | | |
| Other postretirement benefits payable (Note 11) | | | | |
| Long-term debt, less current maturities: | | | | |
| General obligation bonds payable (Note 8) | | | | |
| Revenue bonds payable, net (Notes 5 and 6) | | | | |
| Accrued vacation (Note 5) | | | | |
| Total long-term liabilities | | | | |
| | | | | |
| Total liabilities | | | | |
| | | | | |
| Net assets | | | | |
| Invested in capital assets, net of related debt | | | | |
| Restricted—revenue bond requirements | | | | |
| Restricted—for capital projects | | | | |
| Unrestricted | | | | |
| | | | | |
| Total net assets | | | | |
| | | | | |

See accompanying notes

State of Hawaii
Department of Transportation
Harbors Division

Statements of Revenues, Expenses and Changes in Net Assets

| | Year Ended June 30 | |
|---|-----------------------|-----------------------|
| | 2008 | 2007 |
| Operating revenues, net: | | |
| Services | \$ 57,782,028 | \$ 58,075,787 |
| Rentals | 25,263,428 | 25,529,333 |
| Others | 2,401,801 | 2,057,430 |
| | <u>85,447,257</u> | <u>85,662,550</u> |
| Operating expenses: | | |
| Personnel services | 15,187,852 | 13,002,627 |
| Harbor operations (Notes 4 and 13) | 15,647,708 | 16,442,169 |
| Maintenance | 11,470,476 | 8,470,658 |
| State of Hawaii, surcharge for central service expenses (Note 14) | 3,322,223 | 3,024,439 |
| Fireboat operations (Note 14) | 1,940,911 | 1,709,572 |
| General administration | 3,354,778 | 1,848,051 |
| Department of Transportation, general administration expenses (Note 14) | 1,627,530 | 1,493,490 |
| Depreciation | 17,226,748 | 14,816,871 |
| | <u>69,778,226</u> | <u>60,807,877</u> |
| Operating income | <u>15,669,031</u> | <u>24,854,673</u> |
| Nonoperating revenue (expense): | | |
| Proceeds from insurance on capital assets | 3,003,170 | — |
| Interest revenue: | | |
| Deposits in investment pool | 10,808,810 | 11,751,112 |
| Net decrease in the fair value of pooled cash balances invested by the State of Hawaii (Note 2) | (8,129,236) | — |
| Interest expense: | | |
| Bonds (Note 9) | (13,796,247) | (12,839,231) |
| Amortization of bond discount, issue costs and loss on refunding | 277,567 | (162,545) |
| Loss on disposal of capital assets | (45,668) | (2,831,614) |
| | <u>(7,881,604)</u> | <u>(4,082,278)</u> |
| Income before capital contributions | 7,787,427 | 20,772,395 |
| Capital contributions (Note 16) | 3,615,762 | 4,371,676 |
| Increase in net assets | 11,403,189 | 25,144,071 |
| Net assets as of beginning of year | 623,262,135 | 598,118,064 |
| Net assets as of end of year | <u>\$ 634,665,324</u> | <u>\$ 623,262,135</u> |

See accompanying notes.

State of Hawaii
Department of Transportation
Harbors Division

Statements of Cash Flows

| | Year Ended June 30 | |
|---|-----------------------|-----------------------|
| | 2008 | 2007 |
| Operating activities | | |
| Cash received from customers | \$ 86,521,182 | \$ 85,287,368 |
| Cash paid to suppliers | (39,781,303) | (28,725,783) |
| Cash paid to employees | (13,646,961) | (12,939,537) |
| Net cash provided by operating activities | 33,092,918 | 43,622,048 |
| Capital and related financing activities | | |
| Proceeds received from issuance of refunding revenue bonds | 52,960,423 | 97,427,072 |
| Repayment for refunded revenue bonds | (52,902,611) | — |
| Government grants received in aid of construction | 185,233 | 305,953 |
| Acquisition and construction of capital assets | (50,539,172) | (57,992,463) |
| Proceeds from insurance on capital assets | 3,003,170 | — |
| Principal paid on bonds | (12,254,754) | (11,395,000) |
| Interest paid on bonds | (15,488,685) | (11,972,441) |
| Borrowings from general obligation bonds <i>(Note 8)</i> | 2,699,773 | 28,530,090 |
| Net cash (used in) provided by capital and related financing activities | (72,336,623) | 44,903,211 |
| Investing activities | | |
| Interest received | 13,210,775 | 9,303,180 |
| Change in fair value of investments of pooled cash balances | (8,129,236) | — |
| Net cash provided by investing activities | 5,081,539 | 9,303,180 |
| Net (decrease) increase in cash and cash equivalents | (34,162,166) | 97,828,439 |
| Cash and cash equivalents at beginning of fiscal year | 276,855,433 | 179,026,994 |
| Cash and cash equivalents at end of fiscal year | <u>\$ 242,693,267</u> | <u>\$ 276,855,433</u> |
| Reconciliation of operating income to net cash provided by operating activities: | | |
| Operating income | \$ 15,669,031 | \$ 24,854,673 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | |
| Depreciation | 17,226,748 | 14,816,871 |
| Provision for doubtful accounts | 736,347 | 675,792 |

(Continued on following page)

State of Hawaii
Department of Transportation
Harbors Division

Statements of Cash Flows *(continued)*

| | Year Ended June 30 | |
|--|----------------------|----------------------|
| | 2008 | 2007 |
| Changes in assets and liabilities | | |
| Receivables | \$ 257,223 | \$ (549,166) |
| Materials and supplies | (4,741) | (5,253) |
| Payables | (2,419,938) | 3,595,137 |
| Accrued vacation | 90,025 | 63,090 |
| Prepays | — | (283) |
| Accrued workers' compensation | 7,002 | (2,797) |
| Other postretirement benefits payable | 1,450,866 | — |
| Security deposits | 80,355 | 173,984 |
| Net cash provided by operating activities | <u>\$ 33,092,918</u> | <u>\$ 43,622,048</u> |
| Supplemental disclosure of noncash capital and related financial activities | | |
| Amortization of bond discount, issue costs and loss on refunding | <u>\$ (277,567)</u> | <u>\$ 162,545</u> |
| Acquisition of capital assets from the Hawaii Community Development Authority | <u>\$ —</u> | <u>\$ 4,437,379</u> |
| Development of capital assets from other sources | <u>\$ 3,615,762</u> | <u>\$ —</u> |

See accompanying notes.

State of Hawaii
Department of Transportation
Harbors Division

Notes to Financial Statements

June 30, 2008

1. 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 the 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.

2. Summary of Significant Accounting Policies

Measurement Focus and Basis of Accounting

The accounting policies of the Harbors Division conform to U.S. generally accepted accounting principles, 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.

State of Hawaii
Department of Transportation
Harbors Division

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

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 State Director of Finance invests state treasury cash surpluses where funds can be disbursed at any time without prior notice or penalty. Pooled cash balances invested included auction rate securities, which were determined to be impaired at June 30, 2008. As such, the Harbors Division's allocated share of the investments were written down by \$8,129,000 which served to reduce cash and cash equivalents at June 30, 2008.

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 State 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.

Risk Management

The Harbors Division is exposed to various risks for losses related to, among other risks, 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.

State of Hawaii
Department of Transportation
Harbors Division

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

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 nonoperating revenue or expense.

Capital assets and their related estimated useful lives used to compute depreciation are as follows:

| | Useful Lives | Capitalization Threshold |
|--------------------|-------------------------|-------------------------------------|
| Land improvements | 10 – 100 years | \$ 100,000 |
| Wharves | 10 – 100 years | 100,000 |
| Buildings | 5 – 50 years | 100,000 |
| Other improvements | 5 – 50 years | 100,000 |
| Equipment | 5 – 20 years | 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 capital improvement projects except those projects funded by grants from the State or the federal government.

Bond Issue Costs

Costs relating to the issuance of bonds are amortized using the straight-line method over the term of the obligations.

Unamortized Debt Premium (Discount)

Debt premium (discount) is amortized using the effective interest rate method 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.

State of Hawaii
Department of Transportation
Harbors Division

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

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.

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 an 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.

Operating Revenues

Operating revenues are those that result from providing goods and services. The provision for bad debts for the years ended June 30, 2008 and 2007 was approximately \$736,000 and \$676,000, respectively. It excludes revenues related to capital and related financing activities, noncapital financing activities, or investing activities.

The Harbors Division has pledged its future operating revenues, net of certain operating expenses, to repay \$253,795,000 in Harbor Revenue Bonds. Proceeds from the bonds provided financing for the construction of new facilities and the improvement of existing facilities related to the State's commercial harbors. The bonds are payable solely from operating revenues and are payable through January 2031. The total principal and interest remaining to be paid on the bonds is \$405,937,000. Principal and interest paid for the current year and total operating revenues, net of certain operating expenses, were \$27,743,000 and \$43,141,000, respectively.

Operating Expenses

When an expense is incurred for which unrestricted and restricted resources are available to pay the expense, it is the Harbors Division's policy to apply the expense to unrestricted resources first, then to restricted resources.

State of Hawaii
Department of Transportation
Harbors Division

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Capital Contributions

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

Reclassifications

Certain reclassifications have been made to the prior-year balances to conform to the current-year presentation.

3. Cash

At June 30, 2008 and 2007, 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 of the State. Substantially all of Harbors Division's cash is under the custody of the State Director of Finance. Cash deposits of the State are either federally insured or collateralized with obligations of the State or the U.S. government. 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 State Department of Finance to invest, with certain restrictions, in obligations of the State or the U.S. government, 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 U.S. government, 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.

State of Hawaii
Department of Transportation
Harbors Division

Notes to Financial Statements (continued)

4. Capital Assets

The changes in capital assets were as follows:

| | Balance July 1 2007 | Additions | Deductions | Balance June 30 2008 |
|---------------------------------------|---------------------------|----------------------|------------------------|----------------------------|
| Nondepreciable assets: | | | | |
| Land and improvements | \$ 240,270,513 | \$ 9,823,204 | \$ — | \$ 250,093,717 |
| Depreciable assets: | | | | |
| Land improvements | 137,066,198 | 1,569,094 | — | 138,635,292 |
| Wharves | 224,711,606 | 6,449,429 | — | 231,161,035 |
| Other improvements | 68,053,566 | — | — | 68,053,566 |
| Buildings | 83,053,555 | 307,715 | — | 83,361,270 |
| Equipment | 47,060,781 | 615,112 | (166,878) | 47,509,015 |
| Total at cost | 800,216,219 | 18,764,554 | (166,878) | 818,813,895 |
| Less accumulated depreciation for: | | | | |
| Land improvements | 36,546,165 | 4,244,200 | — | 40,790,365 |
| Wharves | 84,249,299 | 6,614,952 | — | 90,864,251 |
| Other improvements | 26,960,266 | 2,077,683 | — | 29,037,949 |
| Buildings | 22,518,048 | 2,077,730 | — | 24,595,778 |
| Equipment | 7,200,315 | 2,212,183 | (121,208) | 9,291,290 |
| Total accumulated depreciation | 177,474,093 | 17,226,748 | (121,208) | 194,579,633 |
| Construction in progress | 36,299,570 | 44,880,314 | (10,509,469) | 70,670,415 |
| | <u>\$ 659,041,696</u> | <u>\$ 46,418,120</u> | <u>\$ (10,555,139)</u> | <u>\$ 694,904,677</u> |

State of Hawaii
Department of Transportation
Harbors Division

Notes to Financial Statements (continued)

4. Capital Assets (continued)

| | Balance July 1 2006 | Additions | Deductions | Balance June 30 2007 |
|---------------------------------------|---------------------------|-----------------------|------------------------|----------------------------|
| Nondepreciable assets: | | | | |
| Land and improvements | \$ 236,356,084 | \$ 3,914,429 | \$ — | \$ 240,270,513 |
| Depreciable assets: | | | | |
| Land improvements | 125,698,206 | 11,908,380 | (540,388) | 137,066,198 |
| Wharves | 215,361,524 | 9,377,671 | (27,589) | 224,711,606 |
| Other improvements | 69,646,543 | — | (1,592,977) | 68,053,566 |
| Buildings | 53,774,996 | 31,897,308 | (2,618,749) | 83,053,555 |
| Equipment | 9,426,703 | 37,859,901 | (225,823) | 47,060,781 |
| Total at cost | 710,264,056 | 94,957,689 | (5,005,526) | 800,216,219 |
| Less accumulated depreciation for: | | | | |
| Land improvements | 33,056,822 | 3,956,729 | (467,386) | 36,546,165 |
| Wharves | 78,237,853 | 6,125,018 | (113,572) | 84,249,299 |
| Other improvements | 25,225,564 | 2,167,756 | (433,054) | 26,960,266 |
| Buildings | 21,496,385 | 2,036,033 | (1,014,370) | 22,518,048 |
| Equipment | 6,814,511 | 531,335 | (145,531) | 7,200,315 |
| Total accumulated depreciation | 164,831,135 | 14,816,871 | (2,173,913) | 177,474,093 |
| Construction in progress | 65,620,635 | 62,279,831 | (91,600,896) | 36,299,570 |
| | <u>\$ 611,053,556</u> | <u>\$ 142,420,649</u> | <u>\$ (94,432,509)</u> | <u>\$ 659,041,696</u> |

The Harbors Division decreased construction in progress by approximately \$694,000 during fiscal year 2008 and approximately \$2,371,000 during fiscal year 2007 for costs associated with terminated projects and completed projects for which costs could not be capitalized. The decrease in construction in progress for both years is included in operating expenses in the accompanying statements of revenues, expenses and changes in net assets.

State of Hawaii
Department of Transportation
Harbors Division

Notes to Financial Statements (continued)

5. Long-Term Liabilities

The changes in long-term liabilities were as follows:

| | Balance July 1 2007 | Additions | Deductions | Balance June 30 2008 | Current | Noncurrent |
|--|---------------------------|----------------------|----------------------|----------------------------|----------------------|----------------------|
| Accrued workers' compensation | \$ 458,280 | \$ 134,154 | \$ 127,152 | \$ 465,282 | \$ 95,772 | \$ 369,510 |
| Accrued vacation | 2,148,452 | 1,085,766 | 995,741 | 2,238,477 | 574,986 | 1,663,491 |
| Other postretirement benefits payable | — | 2,316,683 | 865,817 | 1,450,866 | — | 1,450,866 |
| General Obligation bonds | 35,630,811 | 2,697,773 | — | 38,328,584 | — | 38,328,584 |
| Revenue bonds | 266,040,000 | 51,645,000 | 63,890,000 | 253,795,000 | 11,070,000 | 242,725,000 |
| | <u>304,277,543</u> | <u>57,879,376</u> | <u>65,878,710</u> | <u>296,278,209</u> | <u>11,740,758</u> | <u>284,537,451</u> |
| Less: | | | | | | |
| Unamortized discount | (2,001,511) | — | (1,909,317) | (92,194) | (8,131) | (84,063) |
| Unamortized premium | 2,231,776 | 928,865 | 304,666 | 2,855,975 | 348,662 | 2,507,313 |
| Unamortized deferred loss on refunding | (3,692,448) | (2,477,971) | (63,285) | (6,107,134) | (492,905) | (5,614,229) |
| | <u>\$300,815,360</u> | <u>\$ 56,330,270</u> | <u>\$ 64,210,774</u> | <u>\$292,934,856</u> | <u>\$ 11,588,384</u> | <u>\$281,346,472</u> |

| | Balance July 1 2006 | Additions | Deductions | Balance June 30 2007 | Current | Noncurrent |
|--|---------------------------|----------------------|----------------------|----------------------------|----------------------|----------------------|
| Accrued workers' compensation | \$ 461,077 | \$ 140,469 | \$ 143,266 | \$ 458,280 | \$ 102,026 | \$ 356,254 |
| Accrued vacation | 2,085,363 | 968,477 | 905,388 | 2,148,452 | 562,475 | 1,585,977 |
| General Obligation bonds | 7,100,721 | 28,530,090 | — | 35,630,811 | — | 35,630,811 |
| Revenue bonds | 180,865,000 | 96,570,000 | 11,395,000 | 266,040,000 | 12,025,000 | 254,015,000 |
| | <u>190,512,161</u> | <u>126,209,036</u> | <u>12,443,654</u> | <u>304,277,543</u> | <u>12,689,501</u> | <u>291,588,042</u> |
| Less: | | | | | | |
| Unamortized discount | (1,770,043) | — | 231,468 | (2,001,511) | (124,544) | (1,876,967) |
| Unamortized premium | 963,683 | 1,542,554 | 274,461 | 2,231,776 | 276,666 | 1,955,110 |
| Unamortized deferred loss on refunding | (4,211,403) | — | (518,955) | (3,692,448) | (489,415) | (3,203,033) |
| | <u>\$185,494,398</u> | <u>\$127,751,590</u> | <u>\$ 12,430,628</u> | <u>\$300,815,360</u> | <u>\$ 12,352,208</u> | <u>\$288,463,152</u> |

State of Hawaii
Department of Transportation
Harbors Division

Notes to Financial Statements (continued)

6. 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 1997 Certificate.

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

The Revenue 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.

In July 2006, the Harbors Division issued \$96,570,000 Series A of 2006 Revenue Bonds and received proceeds of approximately \$97,400,000. These Revenue Bonds will mature through the year 2031 with interest rates ranging from 4.00% to 5.25%.

In August 2007, the Harbors Division issued \$51,645,000 Series A of 2007 Revenue Bonds and received proceeds of approximately \$53,360,000. These Revenue Bonds refunded all outstanding series of 1997 Bonds and will mature through the year 2027 with interest rates ranging from 4.50% to 5.50%. The net cash savings on the refunding was approximately \$2,517,000 and the economic gain recognized on the refunding was approximately \$1,600,000. The unamortized deferred loss on the refunding was approximately \$2,478,000.

State of Hawaii
Department of Transportation
Harbors Division

Notes to Financial Statements (continued)

6. Revenue Bonds Payable (continued)

The following is a summary of the Revenue Bonds issued and outstanding at June 30, 2008:

| Year of Issue | Final Redemption Date | Interest Rates | Original Amount of Issue | Current | | Total Current | Noncurrent |
|---------------------|--|-------------------|--------------------------------|------------------------------------|---------------------------------------|----------------------|-----------------------|
| | | | | Principal Due July 1 2008 | Principal Due January 1 2009 | | |
| 2000 | July 1, 2029 | 4.50–6.00% | \$ 79,405,000 | \$ 2,500,000 | \$ – | \$ 2,500,000 | \$ 59,020,000 |
| 2002 | July 1, 2019 | 3.00–5.50% | 24,420,000 | 2,320,000 | – | 2,320,000 | 11,665,000 |
| 2004 | January 1, 2024 | 2.50–6.00% | 52,030,000 | – | 3,425,000 | 3,425,000 | 30,715,000 |
| 2006 | January 1, 2031 | 4.00–5.25% | 96,570,000 | – | 2,200,000 | 2,200,000 | 90,305,000 |
| 2007 | July 1, 2027 | 4.25–5.50% | 51,645,000 | 625,000 | – | 625,000 | 51,020,000 |
| | | | <u>\$ 304,070,000</u> | <u>\$ 5,445,000</u> | <u>\$ 5,625,000</u> | 11,070,000 | 242,725,000 |
| Less: | | | | | | | |
| | Unamortized discount | | | | | (8,131) | (84,063) |
| | Unamortized premium | | | | | 348,662 | 2,507,313 |
| | Unamortized deferred loss on refunding | | | | | (492,905) | (5,614,229) |
| | | | | | | <u>\$ 10,917,626</u> | <u>\$ 239,534,021</u> |

State of Hawaii
Department of Transportation
Harbors Division

Notes to Financial Statements (continued)

6. Revenue Bonds Payable (continued)

The following is a summary of the Revenue Bonds issued and outstanding at June 30, 2007

| Year of Issue | Final Redemption Date | Interest Rates | Original Amount of Issue | Current | | Total Current | Noncurrent |
|--|-----------------------------|-------------------|--------------------------------|------------------------------------|---------------------------------------|----------------------|-----------------------|
| | | | | Principal Due July 1 2007 | Principal Due January 1 2008 | | |
| 1997 | July 1, 2027 | 3.95–5.75% | \$ 56,290,000 | \$ 540,000 | \$ – | \$ 540,000 | \$ 51,865,000 |
| 2000 | July 1, 2029 | 4.50–6.00% | 79,405,000 | 2,370,000 | – | 2,370,000 | 61,520,000 |
| 2002 | July 1, 2019 | 3.00–5.50% | 24,420,000 | 2,205,000 | – | 2,205,000 | 13,985,000 |
| 2004 | January 1, 2024 | 2.50–6.00% | 52,030,000 | – | 4,805,000 | 4,805,000 | 34,140,000 |
| 2006 | January 1, 2031 | 4.00–5.25% | 96,570,000 | – | 2,105,000 | 2,105,000 | 92,505,000 |
| <u>\$308,715,000</u> | | | | <u>\$ 5,115,000</u> | <u>\$ 6,910,000</u> | <u>\$ 12,025,000</u> | <u>\$ 254,015,000</u> |
| Less: | | | | | | | |
| Unamortized discount | | | | | | (124,544) | (1,876,967) |
| Unamortized premium | | | | | | 276,666 | 1,955,110 |
| Unamortized deferred loss on refunding | | | | | | (489,415) | (3,203,033) |
| | | | | | | <u>\$ 11,687,707</u> | <u>\$ 250,890,110</u> |

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

| <u>Fiscal Year Ending June 30</u> | <u>Principal</u> | <u>Interest</u> | <u>Total</u> |
|-----------------------------------|----------------------|-----------------------|-----------------------|
| 2009 | \$ 11,070,000 | \$ 13,219,939 | \$ 24,289,939 |
| 2010 | 10,440,000 | 12,727,149 | 23,167,149 |
| 2011 | 10,995,000 | 12,231,418 | 23,226,418 |
| 2012 | 8,880,000 | 11,673,661 | 20,553,661 |
| 2013 | 11,965,000 | 11,119,949 | 23,084,949 |
| 2014-2018 | 58,000,000 | 46,312,133 | 104,312,133 |
| 2019-2023 | 68,940,000 | 29,583,351 | 98,523,351 |
| 2024-2028 | 51,380,000 | 13,157,994 | 64,537,994 |
| 2029-2031 | 22,125,000 | 2,116,006 | 24,241,006 |
| | <u>\$253,795,000</u> | <u>\$ 152,141,600</u> | <u>\$ 405,936,600</u> |

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Notes to Financial Statements (continued)

6. Revenue Bonds Payable (continued)

The above debt service requirements reflect the sum of the amounts to be paid in accordance with the repayment schedules of the bonds issued. 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 include reserves of \$11,070,000 as of June 30, 2008, for payments due on July 1, 2008 and January 1, 2009.

7. Harbor Revenue Bond Requirements

1997 Certificate – 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 Revenue 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) 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
- (2) 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 \$24,290,000. Net revenues of the Public Undertaking, as defined by the 1997 Certificate amounted to \$55,712,000 or 2.29 times the minimum net revenue requirement for the fiscal year ended June 30, 2008 and \$65,345,000 or 2.58 times the minimum net revenue requirement for the fiscal year ended June 30, 2007.

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Notes to Financial Statements (continued)

7. Harbor Revenue Bond Requirements (continued)

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 Revenue Bonds are required to be paid into this account. This requirement was met as of June 30, 2008 and 2007.

(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 Revenue Bonds scheduled for redemption on the following July 1 and January 1. This requirement was met as of June 30, 2008 and 2007.

(3) Harbor Debt Service Reserve Account

In order to provide a reserve for the payment of the principal and interest on the Revenue 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 1 or January 1 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 Revenue Bonds of a series or a letter of credit in an amount equal to the difference between the reserve requirement and

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Notes to Financial Statements (continued)

7. Harbor Revenue Bond Requirements (continued)

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 Revenue Bonds, so long as such surety bond, insurance policy, or letter of credit is in effect, the owners of such series of Revenue 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 Revenue Bonds, nor shall the owners of Revenue 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 Revenue 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 Revenue 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 Revenue Bonds), DOT shall receive written confirmation from the rating agency that the rating on the Revenue 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 harbor debt service reserve account allocable to a series of Revenue 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.

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Notes to Financial Statements (continued)

7. Harbor Revenue Bond Requirements (continued)

(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 Revenue 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.

8. General Obligation Bonds

In fiscal 2006, the State issued \$350,000,000 of General Obligation bonds, Series DI, dated March 23, 2006; in fiscal 2007, issued \$350,000,000 of General Obligation bonds, Series DJ, dated March 28, 2007; and in fiscal 2008, issued \$375,000,000 of General Obligation bonds, Series DK, dated May 1, 2008. Interest rates on the Series DI, Series DJ, and Series DK General Obligation bonds range from 3.00% to 5.50%.

Approximately \$40,000,000 was appropriated from the Series DI, Series DJ, and Series DK General Obligation bonds for harbor improvements to support the operations of the Hawaii Superferry, Inc. (HSF). HSF began inter-island ferry service with its first ferry to Maui and Kauai from Honolulu in August 2007. Court actions halted HSF operations until the Hawaii State Legislature convened a special session and enacted Act 02, Second Special Session 2007, in November 2007, to allow larger capacity ferry vessel companies, such as HSF, to operate under certain conditions while the required environmental reviews are conducted. Daily services between Honolulu and Kahului Harbors recommenced on December 13, 2007. The Harbors Division is working to complete the environmental impact statement and is responsible for debt service payments on their portion of these bonds. The Harbors Division executed a \$38,500,000 contract for the construction of barges and ramps with the balance of the appropriation used to finance other harbor upgrades needed to support the operations of HSF. As of June 30, 2008 and 2007, approximately \$38,329,000 and \$35,631,000, respectively, have been expended under this appropriation and any unpaid interest is reflected in the Due to Department of Budget and Finance in the accompanying statements of net assets. Interest incurred from inception, of approximately \$2,899,000, was either capitalized or paid as of June 30, 2008. Specifically, approximately \$1,131,000 of the total interest incurred was capitalized to the construction project

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Notes to Financial Statements (continued)

8. General Obligation Bonds (continued)

before being placed into service in August 2007. While interest payments have commenced, principal payments are not expected to commence until March 2010. As such, the entire principal balance noted on the below debt service payment schedule is classified as noncurrent.

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

| Fiscal Year Ending June 30 | Principal | Interest | Total |
|-----------------------------------|----------------------|----------------------|----------------------|
| 2009 | \$ — | \$ 1,830,941 | \$ 1,830,941 |
| 2010 | 966,555 | 1,858,207 | 2,824,762 |
| 2011 | 1,140,760 | 1,819,229 | 2,959,989 |
| 2012 | 1,609,314 | 1,771,602 | 3,380,916 |
| 2013 | 1,678,482 | 1,702,350 | 3,380,832 |
| 2014-2018 | 9,678,838 | 7,224,986 | 16,903,824 |
| 2019-2023 | 12,288,802 | 4,614,870 | 16,903,672 |
| 2024-2028 | 10,965,833 | 1,349,968 | 12,315,801 |
| | <u>\$ 38,328,584</u> | <u>\$ 22,172,153</u> | <u>\$ 60,500,737</u> |

9. Interest Cost

Total combined interest cost incurred related to Revenue and General Obligation Bonds for the fiscal years ended June 30, 2008 and 2007 amounted to \$15,778,000 and \$16,112,000, respectively. Of this amount, \$1,982,000 and \$3,272,000 was capitalized during fiscal 2008 and 2007, respectively, as part of the construction cost of harbor facilities.

10. 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 September 2058. These leases generally call for rental increases every five to ten years based on a step-up or independent appraisals of the fair rental value of the leased property.

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Notes to Financial Statements (continued)

10. Leasing Operations (continued)

The following is a schedule of approximate future minimum lease rentals on noncancelable operating leases as of June 30, 2008.

| | <u>Amount</u> |
|----------------------------|-----------------------|
| Fiscal Year Ending June 30 | |
| 2009 | \$ 9,786,534 |
| 2010 | 8,806,171 |
| 2011 | 8,927,598 |
| 2012 | 8,832,820 |
| 2013 | 8,681,715 |
| 2014–2018 | 32,681,134 |
| 2019–2023 | 24,597,918 |
| 2024–2028 | 21,356,367 |
| 2029–2033 | 17,253,076 |
| 2034–2038 | 10,931,765 |
| 2039–2043 | 7,141,480 |
| 2044–2048 | 2,793,245 |
| 2049–2053 | 2,791,733 |
| 2054–2058 | 2,419,930 |
| 2059 | 86,515 |
| | <u>\$ 167,088,001</u> |

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 reopenings after the fifteenth year in which rental rates will be based upon the prevailing fair value.

11. Retirement Benefits

Employees' Retirement System

Substantially all eligible employees of the State, which includes 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

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Notes to Financial Statements (continued)

11. Retirement Benefits (continued)

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, noncontributory or hybrid 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 6% to the hybrid option. The Harbors Division is required to contribute to all options at an actuarially determined rate. Total contributions by the Harbors Division for the fiscal years ended June 30, 2008, 2007 and 2006, was approximately \$1,386,000, \$1,335,000 and \$1,298,000, respectively. The contribution rate for each of the fiscal years ended June 30, 2008, 2007 and 2006 was 13.75%, 13.75%, and 13.75%, respectively. The required contribution in each of those three years was 100% of the contribution rate.

Post Retirement Healthcare and Life Insurance Benefits

In addition to providing pension benefits, the State provides certain healthcare and life insurance benefits to retired State employees.

Plan Description

Chapter 87A of the HRS established the Hawaii Employer-Union Health Benefits Trust Fund of the State of Hawaii (Trust Fund). The Trust Fund is the state agency that provides eligible State and County (Honolulu, Hawaii, Maui and Kauai) employees and retirees and their eligible dependents with certain health and life insurance benefits at a cost affordable to both the public employers and participants beginning July 1, 2003. The Trust Fund administers postemployment healthcare benefits under an agent multiple-employer defined benefit plan.

As of July 1, 2007, the State and thus the Harbors Division adopted Governmental Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefit Plans Other than Pensions* (GASB 45). GASB 45 establishes standards of accounting and financial reporting by employers for plans that provide other postemployment benefits (OPEB) other than pensions. GASB 45 was implemented prospectively with a zero net OPEB obligation as of July 1, 2007.

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Notes to Financial Statements (continued)

11. Retirement Benefits (continued)

The Trust Fund is administratively attached to the Department of Budget and Finance in the executive branch of the State. The Trust Fund issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to the Trust Fund at P.O. Box 2121, Honolulu, Hawaii, 96805 or the State's website at www.eutf.hawaii.gov.

The Trust Fund is administered by a Board of Trustees (the Board) composed of ten trustees appointed by the Governor of the State of Hawaii. The Board is responsible for determining the nature and scope of benefit plans offered by the Trust Fund, negotiating and entering into contracts with insurance carriers, establishing eligibility and management policies for the Trust Fund, and overseeing all Trust Fund activities.

Funding Policy

For employees hired before July 1, 1996, the State pays the entire monthly healthcare premium for employees retiring with ten or more years of credited service, and 50% of the monthly premium for employees retiring with fewer than ten years of credited service. Additionally, a retiree can elect a family plan to cover dependents with the State paying for the coverage.

For employees hired after June 30, 1996, but before July 1, 2001, and who retire with fewer than ten years of service, the State makes no contributions. For those retiring with at least ten years but fewer than 15 years of service, the State pays 50% of the retired employees' monthly Medicare or non-Medicare premium. For employees who retire with at least 15 years but fewer than 25 years of service, the State pays 75% of the retired employees' monthly Medicare or non-Medicare premium. For employees retiring with over 25 years of service, the State pays the entire healthcare premium. Retirees in this category can elect a family plan to cover dependents with the State paying for the coverage.

The contribution rates for employees hired after June 30, 2001, are consistent with the contribution rates for those hired after June 30, 1996, but only single plan coverage is provided. These retirees can elect family coverage, but must pay the additional cost for the family coverage.

For active employees, the employer's contributions are based upon negotiated collective bargaining agreements.

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Notes to Financial Statements (continued)

11. Retirement Benefits (continued)

The State is required to contribute the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal costs each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years. The current ARC rate is 29.1% of annual covered payroll.

Annual OPEB Cost

The actuarial valuation of the Trust Fund does not provide OPEB information by department or agency. Accordingly, the State's policy on the accounting and reporting for OPEB is to allocate a portion of the State's ARC, interest, and any adjustment to the ARC, to component units and proprietary funds that are reported separately in the State's Comprehensive Annual Financial Report (CAFR) or in standalone departmental financial statements. The following table shows the components of the annual OPEB cost that have been allocated to the Harbors Division by the State:

| | <u>Amount</u> |
|--|---------------------|
| Annual required contribution | \$ 2,317,000 |
| Annual OPEB cost | <u>2,317,000</u> |
| Contributions made | <u>(866,000)</u> |
| Increase in net OPEB obligation | 1,451,000 |
| Net OPEB obligation, beginning of the year | — |
| Net OPEB obligation, end of the year | <u>\$ 1,451,000</u> |

Contributions are financed on a pay-as-you-go basis and the Harbors Division's contributions for the years ended June 30, 2008, 2007 and 2006 were \$866,000, \$687,000 and \$632,000, respectively.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

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Notes to Financial Statements (continued)

11. Retirement Benefits (continued)

Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the July 1, 2007 actuarial valuation, the entry age normal cost method was used. The actuarial assumptions included a 5.0% discount rate, annual payroll increases of 3.5% and annual healthcare trend rates increasing annually from 3% to 10%. The unfunded actuarial accrued liability is being amortized using a 30-year amortization period as a level percentage of projected payroll.

The State's CAFR includes the required footnote disclosures and required supplementary information on the State's OPEB plans. The State's CAFR can be obtained at the Department of Accounting and General Services' website: <http://hawaii.gov/dags/rpts>.

12. Risk Management

The Harbors Division is exposed to various risks of loss related to, among other risks, torts; theft of, damage to, or destruction of assets; errors and omissions; workers' compensation and acts of terrorism.

For the policy year ending December 31, 2008, the State has retained the first \$1,000,000 per occurrence of property losses, the first \$4,000,000 per occurrence with respect to general liability claims and the first \$500,000 per occurrence with respect to criminal acts. The State obtained commercial coverage for losses in excess of these retention limits. The property loss, windstorm, flood, earthquake and boiler and machinery loss limit per occurrence is \$175,000,000. The terrorism loss limit per occurrence is \$50,000,000. The State also obtained general liability insurance and crime insurance for State employees with a \$10,000,000 per occurrence or aggregate limit.

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Notes to Financial Statements (continued)

12. Risk Management (continued)

For the policy year ending December 31, 2007, the State retained the first \$1,000,000 per occurrence of property losses, the first \$3,000,000 per occurrence with respect to general liability claims and the first \$500,000 per occurrence with respect to criminal acts. The State obtained commercial coverage for losses in excess of these retention limits. The property loss limit was \$100,000,000 per occurrence, except for flood and earthquake, which had a \$40,000,000 aggregate loss limit; terrorism, which had a \$50,000,000 per occurrence limit; and machinery which had a \$40,000,000 per occurrence limit. The State also obtained general liability insurance and crime insurance for State employees with a \$10,000,000 per occurrence or aggregate limit.

The State and thus the Harbors Division is generally self-insured for workers' compensation and automobile claims. The 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 Harbors Division 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.

13. Ceded Lands

In previous years, the State was a defendant in a lawsuit filed by the Office of Hawaiian Affairs (OHA) related to the determination of ceded land payments due to OHA. During 2006, the State of Hawaii Supreme Court reaffirmed the dismissal of the lawsuit by OHA.

Included in Harbor operations expenses in the accompanying statements of revenues, expenses and changes in net assets for the fiscal years ended June 30, 2008 and 2007 are \$7,112,000 and \$7,112,000, respectively, of OHA ceded land expenses.

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Notes to Financial Statements (continued)

14. 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 approximately \$3,322,000 and \$3,024,000 for the fiscal years ended June 30, 2008 and 2007, respectively.

The Harbors Division is assessed a percentage of DOT's general administration expenses. The assessments amounted to approximately \$1,628,000 and \$1,493,000 for the fiscal years ended June 30, 2008 and 2007, respectively.

The Harbors Division incurred costs of approximately \$1,941,000 and \$1,710,000 for fireboat operation services provided by the City and County of Honolulu during the fiscal years ended June 30, 2008 and 2007, respectively.

The Hawaii Harbors Task Force was formed in April 2005 by the Governor's office to respond on a priority basis to the pressing demands for infrastructure improvements in Honolulu Harbor. The Aloha Tower Development Corporation (ATDC) was tasked to work in partnership with the Harbors Division with the executive officer of the ATDC serving as the chief executive of the Hawaii Harbors Project Office. The ATDC was assigned to plan and execute major long-term redevelopment projects such as the former Kapalama Military Reservation and various projects at Honolulu Harbor. Act 200, Session Laws of Hawaii, 2008, was enacted to authorize a statewide Harbors Modernization Plan to address harbor infrastructure improvements to Kahului Harbor on Maui, Nawiliwili Harbor on Kauai, Hilo and Kawaihae Harbors on Hawaii, and Honolulu and Kalaeloa Harbors on Oahu. In addition to the six commercial harbors included in the plan, the law placed Hana Harbor on Maui under the jurisdiction of the Harbors System and included appropriations for its upgrade. Act 200 also designated the ATDC as the entity responsible for the management and implementation of the Harbors Modernization Plan under the direction of the DOT. The Act authorizes the DOT to issue harbor revenue bonds to finance the improvements. The cost of the Harbors Modernization Plan, originally estimated at \$842 million, was revised to \$618 million.

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Notes to Financial Statements (continued)

15. Aloha Tower Complex Development

The 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 for certain 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 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 punch list have yet to be completed and are being pursued with the new operator.

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 is to be reduced by expenses incurred by ATDC for the Hawaii Harbors Project Office. 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 expenses of ATDC.

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Notes to Financial Statements (continued)

15. Aloha Tower Complex Development (continued)

These payments are to be applied to reduce the amount owed to the Harbors Division for losses in revenues by ATDC prior to July 1, 2004. The balance owed to the Harbors Division by ATDC as of June 30, 2008 and 2007 was \$7,770,626 and is included in notes receivable and the related allowance for doubtful accounts in the accompanying statements of net assets.

16. Transfer of Land to Other State Agencies

In 1990, 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).

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. 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. The Harbors Division June 30, 2006 financial statements were restated to reflect the transfer of the Kewalo Basin capital assets acquired prior to 1991 with a net book value of approximately \$1,400,000, and the transfer of Piers 1 and 2 with a net book value of approximately \$4,500,000. Kewalo Basin capital assets acquired or constructed by the Harbors Division subsequent to 1991 continue to be reflected as assets of the Harbors Division until issues relating to the termination of the Harbors Division management of Kewalo Basin is resolved. HCDA assumed management of Kewalo Basin on March 1, 2009 and transition activities are expected to be fully completed by June 30, 2009.

Due to the importance to preserve Piers 1 and 2 at Honolulu Harbor to support maritime needs, Act 165, SLH 2006, was enacted to remove this area from the jurisdiction of HCDA and convey authority back to the Harbors Division. Accordingly, Piers 1 and 2 were transferred back to the Harbors Division during fiscal 2007 at a net book value of approximately \$4,400,000.

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Notes to Financial Statements (continued)

17. 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. 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.

Plans for the future development of the KMR site will involve the creation of a new cargo container yard and vessel berthing piers. This project is a key priority under the Harbor's Modernization Plan. 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 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. Resolution of these matters is dependent upon compliance by the Airports Division and cooperating State agencies with the recommendation and requirements of the Federal Aviation Administration.

18. Arbitrage

The Harbors Division is required to annually calculate rebates to the U.S. Treasury on the Revenue Bonds issued from 1986. In accordance with the requirements of Section 148 of 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, 2008 and 2007, if any, are not material to the financial statements. Accordingly, no rebates payable have been recorded in the accompanying financial statements.

State of Hawaii
Department of Transportation
Harbors Division

Notes to Financial Statements (continued)

19. Commitments and Contingencies

Construction and Other Contracts

The Harbors Division is committed under contracts awarded for construction and other services. These commitments amounted to approximately \$39,288,000 and \$81,436,000 at June 30, 2008 and 2007, respectively.

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, 2008 and 2007 approximated \$6,512,000 and \$6,376,000, respectively.

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.

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.

State of Hawaii
Department of Transportation
Harbors Division

Notes to Financial Statements (continued)

19. Commitments and Contingencies (continued)

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 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 Harbors Division, and if there would be a material impact to the Harbors Division's financial statements. Accordingly, no estimate of loss has been recorded in the accompanying financial statements.

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.

20. Subsequent Events

On March 16, 2009, the Hawaii Supreme Court ruled that Act 02, Second Special Session 2007, is unconstitutional. The Hawaii Superferry, Inc. halted operations as of March 19, 2009, and removed its vessel from Hawaii.

Supplemental Information

State of Hawaii
Department of Transportation
Harbors Division

Cash and Cash Equivalents of the Public Undertaking

June 30, 2008

| | |
|--|------------------------------|
| Unrestricted cash and cash equivalents | <u>\$ 118,874,881</u> |
| Restricted cash and cash equivalents: | |
| For construction—special purpose funds | 33,981,375 |
| For construction—revenue bonds | 55,461,498 |
| For revenue bond debt service payments | 17,746,358 |
| For security deposits | 2,800,758 |
| For risk management | 2,930,739 |
| For revenue bond harbors reserve and contingency account | 10,897,658 |
| | <u>123,818,386</u> |
| | <u>\$ 242,693,267</u> |
| With Director of Finance, State of Hawaii | \$ 242,677,767 |
| On hand | 15,500 |
| Total | <u><u>\$ 242,693,267</u></u> |

State of Hawaii
Department of Transportation
Harbors Division

Construction in Progress of the Public Undertaking

Fiscal Year Ended June 30, 2008

| Project | Balance July 1 2007 | Additions by Source of Funds | | | | Transfer Out | Balance June 30 2008 |
|--|---------------------------|------------------------------|-------------------------------|-------------------------|-----------|-----------------|----------------------------|
| | | Harbor Special Fund | Harbor Revenue/GO Bonds | Capitalized Interest | | | |
| Statewide: | | | | | | | |
| Environmental Consultant for Commercial Harbors | \$ 26,138 | \$ — | \$ — | \$ — | \$ — | — | \$ 26,138 |
| Various Special Maintenance Projects Requiring Civil/Structural Engineering Services | 30,419 | 6,482 | — | — | — | — | 36,901 |
| Various Commercial Harbors Improvements | 641,307 | 202,274 | — | 27,982 | — | — | 871,563 |
| Screening Equipment for Neighbor Island | | | | | | | |
| Passenger Terminals: Kahului Harbor, Maui; | | | | | | | |
| Hilo Harbor, Hawaii; Nawiliwili Harbor | 22,490 | 99,970 | — | 1,135 | 123,595 | — | — |
| Maritime Workers Identification Credentialing System | 27,102 | 10,289 | — | 1,176 | — | — | 38,567 |
| Security Surveillance System for Neighbor Island Passenger Terminals: | | | | | | | |
| Kahului Harbor, Maui | 39,585 | 533,733 | — | 12,129 | — | — | 585,447 |
| Installation of Septic System at Harbor Agent's Office, Kalaeloa B.P. Harbor and Installation of Lift Station and Force Main at Port Allen | 92,927 | 3,771 | — | 1,202 | 97,900 | — | — |
| Inter-Island Ferry System | 1,999,595 | 407,036 | — | 86,291 | — | — | 2,492,922 |
| Inter-Island Ferry System Site Improvements, Honolulu & Kahului Harbors | 1,097,782 | 19,434 | 44,402 | 9,031 | 1,170,649 | — | — |
| Subtotal carried forward | 3,977,345 | 1,282,989 | 44,402 | 138,946 | 1,392,144 | — | 4,051,538 |

State of Hawaii
Department of Transportation
Harbors Division

Construction in Progress of the Public Undertaking (continued)

| Project | Balance July 1 2007 | Additions by Source of Funds | | | | Transfer Out | Balance June 30 2008 |
|--|---------------------------|------------------------------|-------------------------------|-------------------------|----|-----------------|----------------------------|
| | | Harbor Special Fund | Harbor Revenue/GO Bonds | Capitalized Interest | | | |
| Subtotal brought forward | \$ 3,977,345 | \$ 1,282,989 | \$ 44,402 | \$ 138,946 | \$ | 1,392,144 | \$ 4,051,538 |
| Statewide (continued): | | | | | | | |
| Inter-Island Ferry System Site Improvements, Nawiliwili Harbor | 9,405 | 1,410 | — | 99 | | 10,914 | — |
| Statewide Petroleum Facilities Development Plan | 90,053 | 106,865 | — | 5,839 | | — | 202,757 |
| Barges and Vehicle Ramp Systems for Inter-Island Ferry Service | (1,449) | 45,537 | 865,111 | — | | 909,199 | — |
| Environmental Engineering Service for special maintenance program | — | 1,125 | — | — | | — | 1,125 |
| Planning and Development of State Commercial Harbors | 510,847 | 234,441 | — | 25,508 | | — | 770,796 |
| Consulting Engineer's Report of the Public Undertaking | 36,394 | — | — | — | | — | 36,394 |
| Site Surveying Services for CLIP projects Statewide | 4,538 | — | — | — | | — | 4,538 |
| State Commercial Harbor Plan and Development projects | — | 431 | — | — | | — | 431 |
| Cruise ship Industry Study | — | 2,655 | — | 7 | | — | 2,662 |
| Inter-Island Ferry Environmental Services and Planning Project | — | 455,896 | — | 9,334 | | — | 465,230 |
| Subtotal carried forward | 4,627,133 | 2,131,349 | 909,513 | 179,733 | | 2,312,257 | 5,535,471 |

State of Hawaii
Department of Transportation
Harbors Division

Construction in Progress of the Public Undertaking (continued)

| Project | Balance July 1 2007 | Additions by Source of Funds | | | | Transfer Out | Balance June 30 2008 |
|--|---------------------------|------------------------------|-------------------------------|-------------------------|--------------|-----------------|----------------------------|
| | | Harbor Special Fund | Harbor Revenue/GO Bonds | Capitalized Interest | | | |
| Subtotal brought forward | \$ 4,627,133 | \$ 2,131,349 | \$ 909,513 | \$ 179,733 | \$ 2,312,257 | \$ 5,535,471 | |
| Honolulu Harbor: | | | | | | | |
| POL Study, Piers 19-35, Honolulu Harbor | — | 345,059 | — | — | 345,059 | — | |
| Reconstruction of Piers 52 and 53 Sand Island Container Yard | 6,529,942 | 96,799 | 15,468,055 | 579,788 | — | 22,674,584 | |
| Domestic Commercial Fishing Village Site improvements, Pier 36-38, Honolulu, Harbor Oahu | — | 17,683 | — | — | 17,683 | — | |
| Ferry Terminal at Pier 19, Honolulu Harbor, Oahu | — | 8,044 | — | 8 | 8,052 | — | |
| Environmental Risk Assessment Piers 36-38, Honolulu Harbor, Oahu | (4,394) | (10,177) | — | — | (14,571) | — | |
| Phase 1: Construction of Pier 2 Cruise Terminal; Honolulu Harbor, Oahu | — | 3,534 | — | — | 3,534 | — | |
| Environmental Remediations Piers 36-38, Honolulu Harbor | — | 10,177 | — | — | 10,177 | — | |
| Reconstruction of Pier 51B Container Yard | 2,716,158 | 24,091 | 14,936,501 | 428,818 | — | 18,105,568 | |
| Subtotal carried forward | 13,868,839 | 2,626,559 | 31,314,069 | 1,188,347 | 2,682,191 | 46,315,623 | |

State of Hawaii
Department of Transportation
Harbors Division

Construction in Progress of the Public Undertaking (continued)

| Project | Balance July 1 2007 | Additions by Source of Funds | | | | Transfer Out | Balance June 30 2008 |
|--|---------------------------|------------------------------|-------------------------------|-------------------------|----|-----------------|----------------------------|
| | | Harbor Special Fund | Harbor Revenue/GO Bonds | Capitalized Interest | | | |
| Subtotal brought forward | \$ 13,868,839 | \$ 2,626,559 | \$ 31,314,069 | \$ 1,188,347 | \$ | 2,682,191 | \$ 46,315,623 |
| Honolulu Harbor (continued): | | | | | | | |
| Planning Services for the Development of the New | | | | | | | |
| Kapalama Container Terminal, Honolulu | 511,372 | — | — | 20,696 | | — | 532,068 |
| Crash Barrier Gates for Container Terminal in | | | | | | | |
| Honolulu Harbor | 21,408 | 508,308 | — | 8,371 | | 538,087 | — |
| Phase 1 Environmental Assessment of the | | | | | | | |
| Former Kapalama Military Reservation Area, | | | | | | | |
| Honolulu | 99,684 | — | — | — | | — | 99,684 |
| Substructure Repairs at Pier 2, Honolulu Harbor | 4,766,448 | 177 | — | — | | 4,766,625 | — |
| Installation of Radiation Portal Monitoring System | | | | | | | |
| at Fort Armstrong, Honolulu | — | 3,148 | — | — | | 3,148 | — |
| Methane Mitigation, Piers 36-38, Lease Parcel 8, | | | | | | | |
| Honolulu Harbor, Oahu, Hawaii | — | 14,813 | — | — | | 14,813 | — |
| Construction of Miscellaneous Improvements | | | | | | | |
| for Pier 2 Cruise Terminal | 559,923 | 2,326,013 | — | 70,333 | | — | 2,956,269 |
| Passenger Gangway at Pier 2 Cruise Terminal, | | | | | | | |
| Honolulu Harbor, Oahu | — | 150 | — | — | | 150 | — |
| Subtotal carried forward | 19,827,674 | 5,479,168 | 31,314,069 | 1,287,747 | | 8,005,014 | 49,903,644 |

State of Hawaii
Department of Transportation
Harbors Division

Construction in Progress of the Public Undertaking (continued)

| Project | Balance July 1 2007 | Additions by Source of Funds | | | | Transfer Out | Balance June 30 2008 |
|--|---------------------------|------------------------------|-------------------------------|-------------------------|--------------|-----------------|----------------------------|
| | | Harbor Special Fund | Harbor Revenue/GO Bonds | Capitalized Interest | | | |
| Subtotal brought forward | \$ 19,827,674 | \$ 5,479,168 | \$ 31,314,069 | \$ 1,287,747 | \$ 8,005,014 | \$ 49,903,644 | |
| Honolulu Harbor (continued): | | | | | | | |
| Extension of Pier 38 Fender System | 17,928 | 80,524 | — | 589 | 99,041 | — | |
| Keehi Industrial Lots Dust Mitigation | 63,645 | 9,531 | — | — | 73,176 | — | |
| Construction Management & Inspection for | | | | | | | |
| Various Pier 2 Cruise Terminal Improvements | 1,062,276 | — | — | 41,932 | — | 1,104,208 | |
| Pier 29 Extension | 241,956 | — | — | 9,752 | — | 251,708 | |
| Pier 1 Yard Expansion and Lighting and Utility | | | | | | | |
| Improvements | 2,689,757 | 78,133 | — | 110,132 | — | 2,878,022 | |
| Replacement of Pier 11 Roadway Security | | | | | | | |
| Barriers | 9,715 | 13,216 | — | 656 | — | 23,587 | |
| Condominium Property Regime, Piers 30-38 | 139,571 | — | — | — | — | 139,571 | |
| Historic Documentation for the Development | | | | | | | |
| of the New Kapalama Container Terminal | 129,032 | — | — | 5,223 | — | 134,255 | |
| Subtotal carried forward | 24,181,554 | 5,660,572 | 31,314,069 | 1,456,031 | 8,177,231 | 54,434,995 | |

State of Hawaii
Department of Transportation
Harbors Division

Construction in Progress of the Public Undertaking (continued)

| Project | Balance July 1 2007 | Additions by Source of Funds | | | | Transfer Out | Balance June 30 2008 |
|--|---------------------------|------------------------------|-------------------------------|-------------------------|----|-----------------|----------------------------|
| | | Harbor Special Fund | Harbor Revenue/GO Bonds | Capitalized Interest | | | |
| Subtotal brought forward | \$ 24,181,554 | \$ 5,660,572 | \$ 31,314,069 | \$ 1,456,031 | \$ | 8,177,231 | \$ 54,434,995 |
| Honolulu Harbor (continued): | | | | | | | |
| General Engineering Services for the | | | | | | | |
| Development of the New Kapalama Container | | | | | | | |
| Terminal | 56,942 | 17,117 | - | 2,659 | | - | 76,718 |
| Methane Mitigation Piers 36-38, Lease | | | | | | | |
| Parcels 3, 4, 5 and 6 | 37,165 | 83,387 | - | 3,223 | | - | 123,775 |
| Design and construction for various KMR | | | | | | | |
| property and building adjustments, Honolulu | - | 147 | - | - | | 147 | - |
| Barge Terminal Improvements at Piers 39 and 40 | 309,498 | 16,916 | - | 12,876 | | - | 339,290 |
| Furnishing and Delivery of One | | | | | | | |
| Energy-efficient Five-passenger SUV and One | | | | | | | |
| Sedan, Harbors Division-Engineering Branch | - | 7,701 | - | - | | 7,701 | - |
| Construction of Pier 29 container yard | - | 50,728 | - | 1,050 | | - | 51,778 |
| Site monitoring, Domestic Commercial Fishing | | | | | | | |
| Village | - | 44 | - | - | | 44 | - |
| Subtotal carried forward | 24,585,159 | 5,836,612 | 31,314,069 | 1,475,839 | | 8,185,123 | 55,026,556 |

State of Hawaii
Department of Transportation
Harbors Division

Construction in Progress of the Public Undertaking (continued)

| Project | Balance July 1 2007 | Additions by Source of Funds | | | | Transfer Out | Balance June 30 2008 |
|---|---------------------------|------------------------------|-------------------------------|-------------------------|----|-----------------|----------------------------|
| | | Harbor Special Fund | Harbor Revenue/GO Bonds | Capitalized Interest | | | |
| Subtotal brought forward | \$ 24,585,159 | \$ 5,836,612 | \$ 31,314,069 | \$ 1,475,839 | \$ | 8,185,123 | \$ 55,026,556 |
| Honolulu Harbor (continued): | | | | | | | |
| Bulkhead repairs at Pier 29, Honolulu Harbor | 1,170,968 | 69,114 | — | 24,411 | | 1,264,493 | — |
| Air conditioning repairs at Harbors | | | | | | | |
| Administration Building | 376,884 | 350,009 | — | 19,499 | | — | 746,392 |
| Kalaehoa Barbers Point Harbor: | | | | | | | |
| Modifications of Pier | 840,154 | 2,308 | — | 29,167 | | — | 871,629 |
| Extend Perimeter Lighting to Pier P-9 | — | 1,500 | — | — | | 1,500 | — |
| Installation of Septic System | 2,699 | 74,292 | — | 522 | | 77,513 | — |
| Perimeter Fencing Improvements at Honolulu and | | | | | | | |
| Kalaehoa Barbers Point Harbor, Oahu | 17,180 | 6,601 | — | 801 | | — | 24,582 |
| Access and Electrical Improvements | — | 9,692 | — | 201 | | — | 9,893 |
| Testing and Disposal of Dredged Spoils Stockpiled | | | | | | | |
| at Pier 7 | — | 8,289 | — | 171 | | — | 8,460 |
| Subtotal carried forward | 26,993,044 | 6,358,417 | 31,314,069 | 1,550,611 | | 9,528,629 | 56,687,512 |

State of Hawaii
Department of Transportation
Harbors Division

Construction in Progress of the Public Undertaking (continued)

| Project | Balance July 1 2007 | Additions by Source of Funds | | | | Transfer Out | Balance June 30 2008 |
|---|---------------------------|------------------------------|-------------------------------|-------------------------|----|-----------------|----------------------------|
| | | Harbor Special Fund | Harbor Revenue/GO Bonds | Capitalized Interest | | | |
| Subtotal brought forward | \$ 26,993,044 | \$ 6,358,417 | \$ 31,314,069 | \$ 1,550,611 | \$ | 9,528,629 | \$ 56,687,512 |
| Kewalo Basin: | | | | | | | |
| Demolition and Cleaning of the Former GRG Enterprise Site | - | 13,270 | - | - | | 13,270 | - |
| Kahului Harbor: | | | | | | | |
| 2025 Master Plan Environmental Assessment | 161,005 | - | - | - | | - | 161,005 |
| Pier 1 Comfort Station, Waterline and Sewer line Improvements | (1,246) | 1,189 | - | - | | (57) | - |
| Reconstruction of Puunene Container Yard | - | 6,839 | 30,791 | 195 | | 37,825 | - |
| Replacement of Piers 2 and 3 Bull Rails, | 107,234 | 138,153 | - | 2,391 | | 247,778 | - |
| Miscellaneous Site Work at Inter-Island Barge Terminal | 10,086 | - | - | - | | 10,086 | - |
| Demolition of the Pier 2 Shed and Miscellaneous Site Work at Inter-Island Barge Terminal | - | 300,287 | - | - | | 300,287 | - |
| Pave Former Wharf Street Shed Site | 8,845 | 933,430 | - | 19,673 | | - | 961,948 |
| Pier 1 Makai comfort station and waterline improvements | - | 41,095 | - | 850 | | - | 41,945 |
| Blue Earth EIS, Maui | - | 178 | - | - | | - | 178 |
| Subtotal carried forward | 27,278,968 | 7,792,858 | 31,344,860 | 1,573,720 | | 10,137,818 | 57,852,588 |

State of Hawaii
Department of Transportation
Harbors Division

Construction in Progress of the Public Undertaking (continued)

| Project | Balance July 1 2007 | Additions by Source of Funds | | | | Transfer Out | Balance June 30 2008 |
|--|---------------------------|------------------------------|-------------------------------|-------------------------|---------------|-----------------|----------------------------|
| | | Harbor Special Fund | Harbor Revenue/GO Bonds | Capitalized Interest | | | |
| Subtotal brought forward | \$ 27,278,968 | \$ 7,792,858 | \$ 31,344,860 | \$ 1,573,720 | \$ 10,137,818 | \$ 57,852,588 | |
| Kaunapau Harbor: | | | | | | | |
| Breakwater Repair | 3,247,475 | 1,144 | — | 121,593 | — | 3,370,212 | |
| Kaunakakai Harbor: | | | | | | | |
| Commuter Ferry System Improvements | 107,486 | 9,873 | — | 4,357 | — | 121,716 | |
| Hilo Harbor: | | | | | | | |
| Pier 1 Shed Modifications | — | 9,750 | — | — | 9,750 | — | |
| Pier 3 Breasting Dolphins and Catwalks | — | 71,874 | — | 1,362 | 73,236 | — | |
| Inter-Island Barge Terminal Facility | 104,123 | (6,483) | — | — | 97,640 | — | |
| Geotechnical Engineering Study | 279 | — | — | — | 279 | — | |
| Construction of Inter-Island Cargo Terminal Facility | 903,757 | 465,857 | — | 45,998 | — | 1,415,612 | |
| Subtotal carried forward | 31,642,088 | 8,344,873 | 31,344,860 | 1,747,030 | 10,318,723 | 62,760,128 | |

State of Hawaii
Department of Transportation
Harbors Division

Construction in Progress of the Public Undertaking (continued)

| Project | Balance July 1 2007 | Additions by Source of Funds | | | | Transfer Out | Balance June 30 2008 |
|--|---------------------------|------------------------------|-------------------------------|-------------------------|---------------|-----------------|----------------------------|
| | | Harbor Special Fund | Harbor Revenue/GO Bonds | Capitalized Interest | | | |
| Subtotal brought forward | \$ 31,642,088 | \$ 8,344,873 | \$ 31,344,860 | \$ 1,747,030 | \$ 10,318,723 | \$ 62,760,128 | |
| Kawaihae Harbor: | | | | | | | |
| State Planning and Research (SPR) Project: | | | | | | | |
| Characterization of Voids | 272 | - | - | - | 272 | - | |
| Modification Feasibility Study | 552,704 | - | - | 20,719 | - | 573,423 | |
| Bathymetric and Underwater Survey at Pier 1 | 27,824 | - | - | 1,125 | - | 28,949 | |
| Pier 2A shed demolition and container yard improvement | - | 3,972 | - | - | - | 3,972 | |
| Nawiliwili Harbor: | | | | | | | |
| Environmental Risk Assessment | 134,286 | 6,834 | - | 4,198 | 145,318 | - | |
| Pier 2 extension | 3,490,565 | 79,537 | 3,063,544 | 198,913 | - | 6,832,559 | |
| Channel Modifications Feasibility Study | 253,335 | - | - | 9,313 | - | 262,648 | |
| Kauai Commercial Harbors 2020 Master Plan | 198,496 | - | - | - | - | 198,496 | |
| Replacement of Pier 3 Fendering System | - | 42,590 | - | 108 | 42,698 | - | |
| Pavement improvement along Pier 3 Bulkhead | - | 2,458 | - | - | 2,458 | - | |
| Reconstruction of Pier 2 Fendering System | - | 10,032 | - | 208 | - | 10,240 | |
| | \$ 36,299,570 | \$ 8,490,296 | \$ 34,408,404 | \$ 1,981,614 | \$ 10,509,469 | \$ 70,670,415 | |

State of Hawaii
Department of Transportation
Harbors Division

Revenue Bonds of the Public Undertaking

Year Ended June 30, 2008

| | Final Redemption Date | Interest Rate | Original Amount of Issue | Balance at June 30, 2008 | | |
|---------------|-----------------------------|------------------|--------------------------------|--------------------------|-----------------------|-----------------------|
| | | | | Current | Noncurrent | Total |
| Issue of 2000 | July 1, 2029 | 4.50-6.00% | \$ 79,405,000 | \$ 2,500,000 | \$ 59,020,000 | \$ 61,520,000 |
| Issue of 2002 | July 1, 2019 | 3.00-5.50% | 24,420,000 | 2,320,000 | 11,665,000 | 13,985,000 |
| Issue of 2004 | January 1, 2024 | 2.50-6.00% | 52,030,000 | 3,425,000 | 30,715,000 | 34,140,000 |
| Issue of 2006 | January 1, 2031 | 4.00-5.25% | 96,570,000 | 2,200,000 | 90,305,000 | 92,505,000 |
| Issue of 2007 | July 1, 2027 | 4.25-5.50% | 51,645,000 | 625,000 | 51,020,000 | 51,645,000 |
| | | | <u>\$ 304,070,000</u> | <u>\$ 11,070,000</u> | <u>\$ 242,725,000</u> | <u>\$ 253,795,000</u> |

State of Hawaii
Department of Transportation
Harbors Division

Income From Operations Before Depreciation

Year Ended June 30, 2008

| | District | | | | | | | | | | Total | |
|--------------------------|-----------|---------------|--------------|-----------|--------------|--------------|--------------|------------|-------|--------------|---------|---------------|
| | Statewide | Honolulu | Oahu | Kauai | Hilo | Kauai | Kauai | Kauai | Kauai | Kauai | | |
| Operating revenues, net: | | | | | | | | | | | | |
| Services | | | | | | | | | | | | |
| Wharfage | \$ - | \$ 31,267,905 | \$ 2,052,207 | \$ - | \$ 1,802,659 | \$ 2,063,920 | \$ 4,028,883 | \$ 179,459 | \$ - | \$ 1,642,015 | \$ - | \$ 43,037,048 |
| Pax embark/embark | - | 1,945,033 | - | - | 1,100,509 | - | 553,471 | - | - | 911,497 | - | 4,510,510 |
| Dockage | - | 3,761,452 | 640,814 | - | 381,750 | 38,298 | 674,501 | 38,915 | - | 578,553 | 6,538 | 6,120,821 |
| Demurrage | - | 705,237 | - | - | 89,107 | 160,163 | 153,211 | - | - | 41,301 | - | 1,149,019 |
| Port Entry | - | 739,694 | 111,575 | 94 | 113,456 | 33,538 | 118,931 | 11,663 | - | 86,238 | 3,400 | 1,218,589 |
| Mooring charges | - | 319,831 | - | 634,237 | 19,387 | 34 | 49 | 1,930 | - | - | 353,614 | 1,329,082 |
| Cleaning charges | - | 251,794 | 6,541 | - | (14) | - | 8,631 | - | - | 26,957 | 5,808 | 299,717 |
| Other services | - | 63,874 | 1,976 | 5,609 | 22,875 | 7,946 | 8,377 | 337 | - | 3,248 | 3,000 | 117,242 |
| Total services | - | 39,054,820 | 2,813,113 | 639,940 | 3,529,729 | 2,303,899 | 5,546,054 | 232,304 | - | 3,289,809 | 372,360 | 57,782,028 |
| Rentals | | | | | | | | | | | | |
| Wharf space and land | - | 16,265,023 | 582,116 | 430,736 | 111,891 | 197,056 | 359,464 | 14,308 | 300 | 374,310 | 175,937 | 18,511,141 |
| Storage | - | 1,903,234 | 70,290 | 7,700 | 123,854 | 122,448 | 400,107 | 2,115 | - | 347,862 | 17,995 | 2,995,605 |
| Automobile parking | - | 931,869 | - | 34,612 | 84,766 | 6,436 | 105,609 | - | - | 80,466 | 15,576 | 1,259,334 |
| Pipeline water | - | 115,026 | (17,522) | - | 49,808 | 145 | 79,124 | - | - | 61,838 | - | 288,419 |
| Other pipeline | - | 516,334 | 663,186 | - | 364,552 | 20,406 | 429,808 | 11,973 | - | 70,184 | 132,486 | 2,208,929 |
| Total rentals | - | 19,731,486 | 1,298,070 | 473,048 | 734,871 | 346,491 | 1,374,112 | 28,396 | 300 | 934,660 | 341,994 | 25,263,428 |
| Others | | | | | | | | | | | | |
| Sale of utilities | - | 1,051,028 | 116,653 | 24,849 | 67,870 | 11,462 | 165,681 | - | - | 59,095 | 3,673 | 1,500,311 |
| Miscellaneous | - | 724,845 | 375 | 29,456 | 2,872 | 653 | 112,897 | 15,206 | - | 2,826 | 12,360 | 901,490 |
| Total others | - | 1,775,873 | 117,028 | 54,305 | 70,742 | 12,115 | 278,578 | 15,206 | - | 61,921 | 16,033 | 2,401,801 |
| Total operating revenue | - | 60,562,179 | 4,228,211 | 1,167,293 | 4,335,342 | 2,662,505 | 7,198,744 | 275,906 | 300 | 4,286,390 | 730,387 | 85,447,257 |

(continued on following page)

State of Hawaii
Department of Transportation
Harbors Division

Income From Operations Before Depreciation (continued)

| | District | | | | | | | | | | Total |
|---|--------------|---------------|--------------|--------------|--------------|--------------|--------------|--------------|------------|---------------|-------|
| | Oahu | | | Hawaii | | Maui | | | Kauai | | |
| Statewide | Honolulu | Kalaheo | Kewalo | Hilo | Kawaihae | Kahului | Kaunakakai | Kaunapapa | Nawiliwili | Port Allen | |
| Operating expenses before depreciation: | | | | | | | | | | | |
| Personal services | 4,999,141 | 6,983,464 | 135,090 | 861,679 | 77,133 | 953,209 | 46,519 | - | 972,453 | 1,429 | |
| Harbor operations | 7,355,116 | 4,784,767 | 376,380 | 442,106 | 387,974 | 928,726 | 12,961 | - | 750,683 | 23,207 | |
| Maintenance | \$ 199,063 | \$ 5,610,251 | \$ 7,951 | \$ 1,210,089 | \$ 1,793,758 | \$ 832,825 | \$ 318,574 | \$ 276,520 | \$ 766,656 | \$ 351,187 | |
| State of Hawaii, surcharge for central service expenses | 3,322,223 | - | - | - | - | - | - | - | - | - | |
| Fuelboat operations | - | 1,940,911 | - | - | - | - | - | - | - | - | |
| General administration | 2,581,020 | 670,612 | 5,385 | 24,158 | 2,456 | 43,399 | 500 | - | 25,872 | 836 | |
| Department of Transportation, general administration expenses | 1,627,530 | - | - | - | - | - | - | - | - | - | |
| Operating expenses | 20,084,093 | 19,990,005 | 620,457 | 2,538,032 | 2,261,321 | 2,758,159 | 378,554 | 276,520 | 2,515,664 | 376,659 | |
| Allocation of statewide expenses (1) | (20,084,093) | 14,234,938 | 274,368 | 1,019,008 | 625,813 | 1,692,041 | 64,851 | 70 | 1,007,502 | 171,675 | |
| Total operating expenses | - | 34,224,943 | 894,825 | 3,557,040 | 2,887,134 | 4,450,200 | 443,405 | 276,590 | 3,523,166 | 548,334 | |
| Income (loss) from operations before depreciation | \$ - | \$ 26,337,236 | \$ 2,482,370 | \$ 778,302 | \$ (224,629) | \$ 2,748,544 | \$ (167,499) | \$ (276,290) | \$ 763,224 | \$ 182,053 | |
| | | | | | | | | | | \$ 32,895,779 | |

NOTES

(1) Statewide expenses are allocated to the 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

Year Ended June 30, 2008

Net revenues, as defined by the 1997 Certificate:

| | |
|--|----------------------|
| Operating income before depreciation | \$ 32,895,779 |
| Add: | |
| Interest income | 10,808,810 |
| State of Hawaii, surcharge for central service expenses | 3,322,223 |
| Cash available in the harbor reserve and contingency account | 10,897,658 |
| Deduct: | |
| General obligation bond requirements, payments | (2,212,390) |
| | <u>\$ 55,712,080</u> |
| Harbor revenue bond debt service requirements under the 1997 Certificate, including minimum sinking fund payments | <u>\$ 24,289,939</u> |
| Ratio of net revenues to harbor revenue bond debt service requirements | <u>2.29</u> |

State of Hawaii
Department of Transportation
Harbors Division

Accounts Receivable Aging

June 30, 2008

| | Total | Current | 30 Days | 60 Days | 90 Days |
|---------------------|--------------|----------------|----------------|----------------|----------------|
| Accounts receivable | \$ 9,087,048 | \$ 6,615,939 | \$ 133,305 | \$ 104,234 | \$ 2,233,570 |