

In the opinion of McCorriston Miho Miller Mukai, Bond Counsel, under existing law and assuming compliance with certain covenants and the accuracy of certain representations, (i) interest on the 1998 Bonds is excluded from gross income for federal income tax purposes and is not an item of tax preference for purposes of the alternative minimum tax imposed on individuals and corporations under the Internal Revenue Code of 1986, as amended, and (ii) the 1998 Bonds and the income therefrom are exempt from all taxation by the State of Hawaii or any county or other political subdivision thereof, except inheritance, transfer, estate and certain franchise taxes. Interest on the 1998 Bonds may be subject to certain federal taxes imposed on certain corporations, including imposition of the corporate alternative minimum and environmental taxes on a portion of that interest. (For a more complete discussion of tax aspects, see "TAX MATTERS" herein.)

New Issue—Book-Entry Only

\$94,920,000
STATE OF HAWAII
Highway Revenue Bonds
Series 1998

Dated: July 1, 1998

Due: July 1, as shown below

The Series 1998 Bonds (the "1998 Bonds") are being issued for the purpose of providing funds to finance certain highway improvements and other related projects for the state-wide system of highways in the State, to refund certain outstanding Highway Revenue Bonds, and to pay the costs of issuance. The 1998 Bonds are special limited obligations of the State, payable solely from and secured by the Pledged Funds under the Certificate as described herein, consisting principally of highway fuel license taxes, vehicle registration fees, vehicle weight taxes and rental motor vehicle and tour vehicle surcharge taxes, as more fully described in this Official Statement.

The 1998 Bonds are issuable in fully registered form and when initially issued will be registered in the name of Cede & Co., as nominee of The Depository Trust Company ("DTC"), New York, New York. Purchases of the 1998 Bonds will be made in book-entry form only, through brokers and dealers who are, or who act through, DTC participants. Purchase of the 1998 Bonds may be made in the denomination of \$5,000 or any integral multiple thereof. Beneficial owners of the 1998 Bonds will not receive physical delivery of Bond certificates so long as DTC or a successor securities depository acts as the securities depository with respect to the 1998 Bonds. So long as DTC or its nominee is the registered owner of the 1998 Bonds, payment of the principal of and interest on the 1998 Bonds will be made directly to DTC or its nominee. Disbursement of such payments to DTC participants is the responsibility of DTC and disbursement of such payments to the beneficial owners is the responsibility of DTC participants (See "BOOK-ENTRY SYSTEM" herein).

Interest on the 1998 Bonds is payable on January 1, 1999 and semiannually thereafter on each July 1 and January 1. The 1998 Bonds are subject to optional and mandatory redemption prior to maturity as described herein.

The 1998 Bonds do not constitute a general or moral obligation of the State nor a charge upon the general fund of the State. The full faith and credit of the State are not pledged to the payment of the principal of or interest on the 1998 Bonds.

The 1998 Bonds are being issued pursuant to the Certificate of the Director of Transportation Providing for the Issuance of State of Hawaii Highway Revenue Bonds, dated as of August 1, 1993 (as supplemented, the "Certificate"). Purchasers of the 1998 Bonds are advised that they will be deemed to have consented, by their purchase, to an amendment to the Certificate which would change the circumstances under which moneys may be transferred from the Highway Special Revenue Account, as defined hereinbelow. See "SECURITY FOR THE BONDS—Funds and Accounts and Application of Revenues" herein.

Payment of the principal of and interest on the 1998 Bonds maturing on July 1, 1999 through July 1, 2016 when due will be guaranteed by a municipal bond insurance policy issued simultaneously with the delivery of the 1998 Bonds by Financial Guaranty Insurance Company.

 **Financial Guaranty Insurance
Company**

FGIC is a registered service mark used by Financial Guaranty Insurance Company,
a private company not affiliated with any U.S. Government agency.

Payment of the principal of and interest on the 1998 Bonds maturing on July 1, 2017 and July 1, 2018 will not be guaranteed by the aforementioned bond insurance policy.

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

MATURITY SCHEDULE—See Inside Cover Page

The 1998 Bonds are offered when, as and if issued and received by the Underwriters, subject to prior sale or withdrawal or modification of the offer without notice, and to the approval of legality by McCorriston Miho Miller Mukai, Honolulu, Hawaii, Bond Counsel. Certain legal matters will be passed upon for the Underwriters by their counsel, Watanabe, Ing & Kawashima, Honolulu, Hawaii. It is expected that the 1998 Bonds in definitive book-entry form will be available for delivery on or about July 21, 1998.

Merrill Lynch & Co.

A.G. Edwards & Sons, Inc.

July 1, 1998

Prudential Securities Incorporated

PaineWebber Incorporated

Raymond James & Associates, Inc.

\$94,920,000
STATE OF HAWAII
Highway Revenue Bonds
Series 1998

MATURITY SCHEDULE
\$92,300,000 Serial Bonds

<u>Maturity (July 1)</u>	<u>Amount</u>	<u>Rate</u>	<u>Yield/ Price</u>	<u>Maturity (July 1)</u>	<u>Amount</u>	<u>Rate</u>	<u>Yield/ Price</u>
1999.....	\$ 350,000	4.00%	3.60%	2010.....	\$ 1,440,000	5.00%	4.75 %
2000.....	2,790,000	4.00	4.00	2011.....	1,510,000	5.00	101.344
2001.....	6,080,000	5.00	4.10	2012.....	1,585,000	5.00	100.443
2002.....	6,385,000	5.00	4.20	2013.....	1,670,000	5.00	5.03
2003.....	6,705,000	5.00	4.30	2014.....	7,615,000	5.25	101.505
2004.....	3,415,000	5.00	4.37	2015.....	8,015,000	5.25	101.058
2005.....	3,580,000	5.00	4.42	2016.....	8,440,000	5.00	5.16
2006.....	3,765,000	5.00	4.47	2017.....	13,420,000	5.50	5.01
2009.....	1,375,000	4.60	4.65	2018.....	14,160,000	5.50	5.03

\$2,620,000 4.50% Term Bond due July 1, 2008—Yield 4.53%

(accrued interest from July 1, 1998 to be added)

STATE OF HAWAII

Benjamin J. Cayetano, Governor

Mazie K. Hirono, Lieutenant Governor

DEPARTMENT OF TRANSPORTATION

Kazu Hayashida, Director

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

**Glenn M. Okimoto
Brian Minaai
Jerry M. Matsuda
Thomas T. Fujikawa
Pericles Manthos**

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Donald A. Segawa**

SPECIAL SERVICES

**Department of Budget and Finance
of the State of Hawaii
Honolulu, Hawaii
Paying Agent and Registrar**

**McCorriston Miho Miller Mukai
Honolulu, Hawaii
Bond Counsel**

No dealer, broker, salesman or other person has been authorized to give any information or to make any representations, other than those contained in this Official Statement, in connection with the offering of the 1998 Bonds described in this Official Statement, and, if given or made, such information or representations must not be relied upon as having been authorized by the State of Hawaii or the Underwriters. This Official Statement does not constitute an offer to sell the 1998 Bonds or a solicitation of an offer to buy by any person, nor shall there be any sale of the 1998 Bonds by any person, in any jurisdiction in which it is unlawful for such person to make such offer, solicitation or sale. The information set forth in this Official Statement has been furnished by the State and other sources which are believed to be reliable but it is not guaranteed as to accuracy or completeness, and is not to be construed as a representation, by the Underwriters. The information and expressions of opinion in this Official Statement are subject to change without notice and neither the delivery of the Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the State since the date of this Official Statement.

IN CONNECTION WITH THIS OFFERING THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE 1998 BONDS OFFERED HEREBY AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

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OFFICIAL STATEMENT

\$94,920,000

STATE OF HAWAII

Highway Revenue Bonds Series 1998

INTRODUCTION

This Official Statement, which includes the cover page and appendices (the "Official Statement"), provides information with respect to the issuance and sale by the State of Hawaii (the "State") of \$94,920,000 principal amount of State of Hawaii Highway Revenue Bonds, Series 1998 (the "1998 Bonds"). Capitalized terms not otherwise defined in this Official Statement shall have the respective meanings given to such terms in Appendix A — "SUMMARY OF CERTAIN PROVISIONS OF THE CERTIFICATE — Definitions of Certain Terms."

The State will issue the 1998 Bonds pursuant to the Constitution, the laws of the State and the Certificate of the Director of Transportation Providing for the Issuance of State of Hawaii Highway Revenue Bonds dated as of August 1, 1993, as heretofore supplemented and as supplemented by a Third Supplemental Certificate of the Director of Transportation Providing for the Issuance of State of Hawaii Highway Revenue Bonds, Series 1998, dated as of June 1, 1998 (collectively, the "Certificate"). See "THE 1998 BONDS" for a description of the 1998 Bonds. Under the Certificate, the State has previously issued its Highway Revenue Bonds, Series 1993 (the "1993 Bonds"), currently outstanding in the aggregate principal amount of \$61,295,000, and its Highway Revenue Bonds, Series 1996 (the "1996 Bonds"), currently outstanding in the aggregate principal amount of \$51,570,000 (collectively, the "Outstanding Bonds"). Additional bonds and refunding bonds may subsequently be issued on a parity with the 1998 Bonds and the Outstanding Bonds (collectively with the 1998 Bonds and the Outstanding Bonds, the "Senior Bonds") or may be issued subordinate in right of payment to the 1998 Bonds and other Senior Bonds (the "Subordinate Bonds"). The 1998 Bonds and the Outstanding Bonds and any additional Senior Bonds and Subordinate Bonds are collectively referred to as the "Bonds."

The 1998 Bonds are being issued to provide funds to finance certain highway capital improvement projects and related projects comprising portions of the state-wide system of highways, streets and roads (the "State Highway System"), to satisfy the Reserve Requirement, to provide funds for the refunding of \$9,965,000 aggregate principal amount of the 1993 Bonds and \$15,145,000 aggregate principal amount of the 1996 Bonds (collectively, the "Refunded Bonds"), and to pay all or a portion of the costs of issuance. See "APPLICATION OF PROCEEDS OF 1998 BONDS."

The Bonds are special limited obligations of the State, payable from and secured by Pledged Funds as provided under the Certificate, consisting of moneys held in the funds and accounts under the Certificate, revenues derived by the State from the ownership and operation of the State Highway System and receipts of Pledged User Taxes related thereto, consisting principally of the highway fuel license taxes, vehicle registration fees, the vehicle weight tax, and the rental motor vehicle and tour vehicle surcharge taxes, as described in this Official Statement under "SECURITY FOR THE BONDS." All Senior Bonds, including the 1998 Bonds, are and will be secured equally and ratably by the Pledged Funds. Receipts of the Pledged User Taxes are deposited into the State Highway Fund, a special fund created by State law in the State Treasury, for credit to the Highway Revenue Special Account created by the Certificate. The 1998 Bonds do not constitute a general or moral obligation of the State nor a charge upon the general fund of the State. The full faith and credit of the State are not pledged to the payment of or as security for the 1998 Bonds. See "SECURITY FOR THE BONDS" and "REVENUE SOURCES" for a description of the security for the Bonds and sources of Pledged Funds.

The Certificate allows the Department to transfer moneys from the Highway Revenue Special Account after satisfying certain debt service and other expense requirements. Previously, the Certificate allowed such transfer

only of moneys determined to be in excess of 150% of the requirements for the ensuing 12 months. However, in connection with the issuance and sale of the 1998 Bonds, the Certificate will be amended to allow the Department to transfer moneys in excess of 135%, or such other percentage as may be authorized by law. Purchasers of the Bonds will be deemed to have consented, by their purchase, to such amendment. See "SECURITY FOR THE BONDS" below.

The State Highway System is owned, operated, maintained and improved by the Department of Transportation of the State (the "Department"). The Department maintains an ongoing capital improvement program (the "Program") to improve, renew and renovate the State Highway System. See "CAPITAL IMPROVEMENT PROGRAM" for a description of the Program and Appendix B - "ADDITIONAL INFORMATION RELATING TO REVENUE SOURCES, THE STATE HIGHWAY SYSTEM AND THE DEPARTMENT OF TRANSPORTATION" for a description of the State Highway System.

Every other Fiscal Year, the Department prepares a program of proposed capital improvement projects to the State Highway System for approval of the Governor and the Legislature of the State. The Program is funded on a biennial basis through Legislative appropriations. In the first year of a biennium budget, the Department may revise the second year of that biennium budget for presentation to the Governor for approval and to the Legislature for subsequent authorization.

The State has determined to finance portions of the State's share of future Program expenditures through the issuance of revenue bonds secured by the Pledged Funds, rather than from the proceeds of reimbursable general obligation bonds as had historically been the case (see "DEBT SERVICE COVERAGE - Reimbursable General Obligations Bonds"). The 1998 Bonds are the third series of such revenue bonds issued to finance construction of the projects comprising the Program.

Payment of principal of and interest on the 1998 Bonds maturing on July 1, 1999 through July 1, 2016 when due will be guaranteed by a municipal bond insurance policy issued simultaneously with the delivery of the 1998 Bonds by Financial Guaranty Insurance Company. *Payment on the 1998 Bonds maturing on July 1, 2017 and July 1, 2018 will not be guaranteed by such insurance policy.* In addition, Financial Guaranty Insurance Company will issue a debt service reserve fund policy to satisfy the Reserve Requirement for the Highway Senior Debt Service Reserve Subaccount, as defined in the Certificate. For additional information concerning the policies to be issued by Financial Guaranty Insurance Company, see "INSURANCE" herein, and Appendix G - "SPECIMEN OF THE BOND INSURANCE POLICY" and Appendix H - "SPECIMEN OF THE DEBT SERVICE RESERVE FUND POLICY".

The cover page and this Introduction contain certain information for general reference only. They are not intended to be a summary of the 1998 Bonds. Investors are advised to read this entire Official Statement to obtain information essential to the making of an informed investment decision. This Official Statement contains descriptions of the Department and the Program, summaries of the 1998 Bonds, the security for the Bonds and certain provisions of the Certificate. All references to the Certificate and to the 1998 Bonds are qualified by the definitive forms of such Certificate and 1998 Bonds, copies of which may be obtained from the Department at 869 Punchbowl Street, 5th floor, Honolulu, Hawaii 96813. Any statement or information involving matters of opinion or estimates are represented as opinions or estimates made in good faith, but no assurance can be given that facts will materialize as so opined or estimated.

THE 1998 BONDS

General

The 1998 Bonds will be dated the date of their delivery and will bear interest from such date at the rates per annum set forth on the cover page of this Official Statement, and will mature on July 1 in the years and in the principal amounts set forth on the cover of this Official Statement. Interest will be payable on each January 1 and July 1, commencing January 1, 1999 (each an "Interest Payment Date"). Principal of, premium, if any, and interest on the 1998 Bonds will be payable in any coin or currency of the United States of America which at the time of payment is legal tender for public and private debts.

The 1998 Bonds, when issued, will be registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York ("DTC"). DTC will act as securities depository for the 1998 Bonds. Individual purchases of the 1998 Bonds will be made in book-entry form only (the "Book-Entry System"), in the principal amount of \$5,000 or integral multiples thereof. Purchasers will not receive certificates representing their interest in the 1998 Bonds. Principal of and interest on the 1998 Bonds will be paid by the Paying Agent for the 1998 Bonds to DTC, which will in turn remit such principal and interest to its Participants (as hereinafter defined), for subsequent distribution to the Beneficial Owners (as hereinafter defined) of the 1998 Bonds, as described herein. See "BOOK-ENTRY SYSTEM," below.

If the Book-Entry System is discontinued for the 1998 Bonds, thereafter (i) principal of and premium, if any, on the 1998 Bonds will be payable upon presentation and surrender of the 1998 Bonds at the principal office of the Department of Budget and Finance of the State, as Paying Agent for the 1998 Bonds (together with any successor, the "Paying Agent"); and (ii) interest on each 1998 Bond will be paid on each Interest Payment Date by check mailed by the Paying Agent to the owner in whose name the 1998 Bond is registered upon the books of registry to be kept and maintained by the Department of Budget and Finance of the State, as registrar for the 1998 Bonds (the "Registrar"), as of the close of business on the 15th day of the calendar month (whether or not a business day) next preceding each Interest Payment Date at such owner's address as shown on the Bond Register.

The Department, the Registrar and the Paying Agent may deem and treat the person in whose name any 1998 Bond is registered upon the Bond Register (an "Owner" or "Holder") as the absolute owner of such Bond for all purposes of the Certificate, including receiving payment of the principal of, premium, if any, and interest due on the 1998 Bonds. So long as the 1998 Bonds are in the Book-Entry System, the registered owner of the 1998 Bonds in the Bond Register will be Cede & Co., and all such payments will be made to Cede & Co., as registered Owner.

Redemption

Optional Redemption. The 1998 Bonds maturing on or before July 1, 2008 and the 1998 Bonds maturing on or after July 1, 2017 are not subject to optional redemption. The 1998 Bonds maturing on July 1, 2009 through July 1, 2016, are subject to redemption at the option of the State on and after July 1, 2008, from moneys other than moneys required to be credited to the Highway Senior Principal Subaccount, as a whole or in part at any time, in such order of maturities as the State shall determine, and within any maturity by lot if less than all of the 1998 Bonds of a maturity are called for redemption, at the following redemption prices (expressed as a percentage of principal amount) plus accrued interest, if any, to the date fixed for redemption:

<u>Redemption Period</u> <u>(Both Dates Inclusive)</u>	<u>Redemption</u> <u>Price</u>
July 1, 2008 through June 30, 2009	101.0 %
July 1, 2009 through June 30, 2010	100.5
July 1, 2010 and thereafter	100.0

Sinking Fund Redemption. The Series 1998 Bonds maturing on July 1, 2008, are term bonds and are subject to mandatory sinking fund redemption on July 1 of each of the years, and in the amounts, set forth below:

<u>Years</u>	<u>Principal Amounts</u>
2007	\$ 1,285,000
2008 ⁽¹⁾	1,335,000

⁽¹⁾ Maturity

The Director of Finance may apply amounts available for the retirement of such term bonds to purchase such Bonds as described in Appendix A — "SUMMARY OF CERTAIN PROVISIONS OF THE CERTIFICATE — Highway Senior Principal Subaccount."

Notice of Redemption. Notice of redemption is required to be mailed not less than 30 days prior to the redemption date, by first class mail, to each Owner of a 1998 Bond at its address appearing on the books of registry maintained by the Registrar and by registered or certified mail to certain securities depositories and bond information services. See "BOOK-ENTRY SYSTEM" for a discussion of the notice of redemption to be given to Beneficial Owners (as therein defined for the purposes of such discussion) of the 1998 Bonds when the Book-Entry System for the Bonds is in effect.

Any notice of optional redemption may state that such redemption shall be conditional upon the receipt by the Director of Finance of the State or the Paying Agent for the Bonds proposed to be redeemed on the date fixed for redemption of moneys sufficient to pay in full the redemption price of the Bonds proposed to be redeemed. If the notice contains such condition, and moneys sufficient to pay in full the redemption price of the Bonds proposed to be redeemed shall not be received on or prior to the date fixed for redemption, such notice of redemption shall be null and void and of no force and effect, the State shall not redeem or be obligated to redeem any Bonds, and the State or the Paying Agent at the State's direction shall give notice, in the same manner a notice of redemption is given, that moneys sufficient to pay in full the redemption price of the Bonds proposed to be redeemed were not received on or prior to the date fixed for redemption and such redemption did not occur. In the event of the failure to redeem, any Bonds surrendered for redemption shall be promptly returned to the registered owners thereof by the State or the Paying Agent for the Bonds.

Effect of Redemption. If a 1998 Bond is subject by its terms to redemption and has been duly called for redemption in accordance with the Certificate, and if sufficient moneys available for the payment of the redemption price and interest to accrue to the redemption date on such 1998 Bond are held for such purpose by the Director of Finance or the Paying Agent, such 1998 Bond so called for redemption shall become due and payable, and interest on such 1998 Bond shall cease to accrue on the redemption date designated in the notice of redemption of such Bond.

Upon surrender of any 1998 Bond to be redeemed in part only, the Department and the Director of Finance will execute and the Registrar will authenticate and deliver to the Owner a new 1998 Bond or Bonds representing the unredeemed principal amount of the 1998 Bond surrendered.

Authority for Issuance

Article VII, Section 12 of the State Constitution and Part III, Chapter 39, Hawaii Revised Statutes ("HRS"), as amended (collectively the "General Revenue Bond Law"), permit the issuance of revenue bonds of the State payable from and secured by the Pledged Funds upon the approval of a majority of the members of each house of the Legislature and pursuant to a certificate of the Director of the Department (the "Director"), which becomes effective upon filing with the Director of Finance. The General Revenue Bond law does not limit the aggregate principal amount of revenue bonds that may be issued, but does limit the maximum maturity of revenue bonds and also sets forth provisions for the sale, method of execution and other details of all revenue bonds. The Legislature from time to time enacts laws (including the general appropriations acts) authorizing the issuance of revenue bonds (without fixing any particular details), defining the purposes for which the bonds are to be issued and specifying the amount of the proceeds of such bonds which may be applied to such purposes. Pursuant to the General Revenue Bond Law, the Director has issued the Certificate, which under State law constitutes the security document pursuant to which all Bonds are issued and secured. The Certificate provides the terms of the Bonds, including principal amounts, interest rates, maturities, redemption provisions and the covenants of the Department.

The 1998 Bonds are being issued pursuant to the Certificate and under the authority of and pursuant to the General Revenue Bond Law and Act 328, Session Laws of Hawaii ("SLH") 1997, Act 218, SLH 1995, as amended by Act 287, SLH 1996, and Act 289, SLH 1993, as amended by Act 252, SLH 1994 (the specific acts of the Legislature authorizing the 1998 Bonds).

BOOK-ENTRY SYSTEM

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

DTC will act as securities depository for the 1998 Bonds. The 1998 Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee). One fully registered Bond certificate will be issued for each maturity of the 1998 Bonds in the aggregate principal amount of such issue, and will be deposited with DTC.

DTC and its Participants

DTC is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds securities that its participants ("Participants") deposit with DTC. DTC also facilitates the settlement among Participants of securities transactions such as transfers and pledges, in deposited securities through electronic computerized book-entry changes in Participants' accounts, thereby eliminating the need for physical movement of securities certificates. "Direct Participants" include securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is owned by a number of its Direct Participants and by the New York Stock Exchange, Inc., the American Stock Exchange, Inc., and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as securities brokers and dealers, banks, and trust companies that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). The Rules applicable to DTC and its Participants are on file with the Securities and Exchange Commission.

Purchase of Ownership Interests

Purchases of 1998 Bonds under the DTC system must be made by or through Direct Participants, which will receive credit for the 1998 Bonds on DTC's records. The ownership interest of each purchaser of a beneficial interest in a 1998 Bond (for the purposes of the discussion under "Book-Entry System," a "Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase, but Beneficial Owners are expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of beneficial interests in the 1998 Bonds are to be accomplished by entries made on the books of Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their beneficial interests in 1998 Bonds, except in the event that use of the Book-Entry System for the 1998 Bonds is discontinued.

To facilitate subsequent transfers, all 1998 Bonds deposited by Participants with DTC are registered in the name of DTC's nominee, Cede & Co. The deposit of 1998 Bonds with DTC and their registration in the name of Cede & Co. effect no change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the 1998 Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Notices and Other Communications

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

Redemption notices shall be sent by the Paying Agent only to Cede & Co., as registered Owner. If less than all of the 1998 Bonds are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. will consent or vote with respect to the 1998 Bonds. Under its usual procedures, DTC mails an Omnibus Proxy to the State as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the 1998 Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and Interest Payments

Principal, premium, if any, and interest payments on the 1998 Bonds will be made by the Paying Agent only to Cede & Co., as registered Owner. DTC's practice is to credit Direct Participants' accounts on the payable date in accordance with their respective holdings shown on DTC's records unless DTC has reason to believe that it will not receive payment on the payable date. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name", and will be the responsibility of such Participant and not of DTC, or the State or the Department, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal, premium, if any, and interest to DTC is the responsibility of the State, disbursement of such payments to Direct Participants shall be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners shall be the responsibility of Direct and Indirect Participants.

Discontinuance of Book-Entry System; Replacement Bonds

DTC may discontinue providing its services as securities depository with respect to the 1998 Bonds at any time by giving reasonable notice to the State. Under such circumstances, in the event that a successor securities depository is not obtained, Bond certificates are required to be printed and delivered.

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

In the event the Book-Entry System is discontinued, the principal of, premium, if any, and interest on the 1998 Bonds will be payable as described above under "THE 1998 BONDS - General" and the following provisions will apply.

Each 1998 Bond may be transferred or exchanged upon the books of registry by the registered Owner, in person or by its duly authorized attorney, upon surrender of such 1998 Bond for cancellation, accompanied by a written instrument of transfer or exchange satisfactory in form to the Registrar, duly executed by the registered owner or its duly authorized attorney. Upon the surrender of any 1998 Bond for transfer or exchange, the Registrar will deliver in the name of the transferee or Owner one or more new 1998 Bonds of the same aggregate principal amount, maturity and interest rate as the surrendered 1998 Bond, in any authorized denomination and in the manner and subject to the conditions set forth in the Certificate.

All such transfers and exchanges will be made without expense to the owner of such Bonds, except that the Registrar shall require the payment by the owner requesting such transfer of any tax or other governmental charges required to be paid with respect to such transfer. No owner may require an exchange or transfer of 1998 Bonds to be made during the 15 days next preceding an Interest Payment Date or during a period beginning at the opening of business 15 days before the mailing of a notice of redemption of Bonds selected for redemption and ending on the close of business on the day of such mailing, or an exchange or transfer to be made of any 1998 Bond or portion thereof which has been selected for redemption.

Use of Certain Terms in Other Sections of the Official Statement

In reviewing this Official Statement it should be understood that so long as Cede & Co. is the registered Owner of the 1998 Bonds, references herein to the registered Owners or Holders will mean Cede & Co. and will not mean the Beneficial Owners. Under the Certificate, payments made by the State or the Paying Agent to Cede & Co. will satisfy the State's obligations under the Certificate to the extent of the payment. The Beneficial Owners will not be, and will not be considered by the State or the Paying Agent to be, and will not have any rights as, the Holders of the 1998 Bonds under the Certificate, but (i) all rights of ownership, must be exercised through DTC and the Book-Entry System and (ii) notices that are to be given to Owners by the State or the Paying Agent will be given only to DTC. DTC will forward (or cause to be forwarded) the notices to the Participants by its usual procedures so that such Participants may forward (or cause to be forwarded) such notices to the Beneficial Owners.

DTC and Book-Entry Information

Information concerning DTC and the Book-Entry System contained in this Official Statement has been obtained from DTC and is not guaranteed as to accuracy or completeness by, and is not to be construed as a representation by, the Underwriters or the State.

The State will have no responsibility or obligation to Direct Participants, to Indirect Participants or to Beneficial Owners with respect to (i) the accuracy of any records maintained by DTC, any Direct Participants or Indirect Participants, or (ii) the payment of any amount due by DTC to a Direct Participant, or the payment by any Direct Participants or any Indirect Participants of any amount in respect of principal or redemption price of or interest on the 1998 Bonds, or (iii) delivery of any notice by DTC to any Direct Participant or by any Direct Participant or Indirect Participant to any Beneficial Owner, which is required or permitted to be given to registered Owners under the Certificate, or (iv) the selection by DTC of any Participant to receive payment in the event of a partial redemption of the 1998 Bonds, or (v) any consent given or other action taken by DTC as owner of the 1998 Bonds, or (vi) any other event or purpose.

APPLICATION OF PROCEEDS OF THE 1998 BONDS

The Department intends to use a portion of the proceeds of the 1998 Bonds to provide funds to finance certain highway capital improvement projects and related projects comprising portions of the state-wide system of highways, streets and roads (the "State Highway System"). See "CAPITAL IMPROVEMENT PROGRAM" below.

In addition, a portion of the proceeds of the 1998 Bonds will be deposited with and held in trust by Bank of Hawaii, acting through its Pacific Century Trust division, as Refunding Trustee, to be invested in non-callable direct obligations of the United States of America (the "Federal Securities"). The principal and interest on the Federal Securities will be sufficient to pay the interest on the Refunded Bonds due on and prior to their maturity dates, and the principal amounts of the such bonds upon their respective maturity dates. See "ESCROW VERIFICATION" below.

The Refunded Bonds include \$9,965,000 aggregate principal amount of the 1993 Bonds and \$15,145,000 aggregate principal amount of the 1996 Bonds. The 1993 Bonds to be refunded will mature on July 1 of the years 2001 through 2003. The 1996 Bonds to be refunded will mature on July 1 of the years 2000 through 2006.

Upon such deposit of moneys with the Refunding Trustee and the investment in the Federal Securities as described above, the Refunded Bonds shall be effectively defeased and shall no longer be deemed outstanding under the Certificate.

The following table shows the estimated application of moneys realized by the Department upon the sale of the 1998 Bonds (exclusive of any accrued interest):

Costs of Capital Improvement Projects	\$ 71,339,036
Deposit to Refunding Bonds Trust Fund	25,414,129
Underwriters' Discount	486,688
Other Costs of Issuance	<u>302,568</u>
 Total	 <u>\$ 97,542,421</u>

SECURITY FOR THE BONDS

General

The Bonds, including the 1998 Bonds, are special limited obligations of the State, and will be payable from and secured by the Pledged Funds. The 1998 Bonds, the Outstanding Bonds and any Additional Senior Bonds that may subsequently be issued under the Certificate are collectively referred to as "Senior Bonds." The Senior Bonds are equally and ratably secured by a lien and charge on the Pledged Funds prior and paramount to the lien thereon of any other bonds.

"Pledged Funds" is defined in the Certificate to include the Revenues held in the Highway Revenue Special Account created in the Certificate and the Highway Bond Proceeds Account in the State Bond Fund. "Revenues" is defined to include the following when deposited in the State Highway Fund: Pledged User Taxes, certain revenues derived from the ownership or operation of, or disposition of properties constituting part of, the State Highway System, and certain investment earnings. "Pledged User Taxes" is defined to include the receipts of the highway fuel license taxes, vehicle registration fees, the vehicle weight tax, and the rental motor vehicle and tour vehicle surcharge taxes. See "REVENUE SOURCES" below.

The Bonds do not constitute general or moral obligations of the State nor a charge upon the general fund of the State. The full faith and credit of the State are not pledged to the payment of the principal of or interest on the Bonds. The real property and improvements comprising the State Highway System have not been pledged or mortgaged to secure payment of the Bonds.

State law creates a special fund in the Treasury of the State designated the State Highway Fund. The Certificate creates the Highway Revenue Special Account in the State Highway Fund and requires that the Highway Revenue Special Account be continued as long as any Bonds remain outstanding and provides that all Revenues will be deposited in the State Highway Fund for credit to the Highway Revenue Special Account. The Certificate further provides that amounts deposited in the Highway Revenue Special Account will be used in the order of priority established by the Certificate. Payment of principal of and interest on the Senior Bonds is the first priority and charge against the Highway Revenue Special Account. See "Funds and Accounts and Application of Revenues" below.

In the event of a default, the Holders of at least 25% in principal amount of the Senior Bonds then outstanding and the Holders of at least 25% in principal amount of the Subordinate Bonds outstanding may declare an immediate acceleration of maturities by written notice to the Department, which notice shall also be filed with the Director of Finance of the State.

Under the doctrine of sovereign immunity, a state of the Union (including the State) cannot be sued by its own citizens. Under the United States Constitution, a state (including the State) cannot be sued by citizens of another state of the Union or by citizens or subjects of any foreign state. A state (including the State) may waive its immunity and consent to a suit against itself. The State has waived by statute its immunity from contractual claims. However, such waiver and consent may subsequently be withdrawn by the State. Such immunity from and constitutional prohibition against suits against a state extends to officers of a state acting in their official capacity.

Therefore, there can be no assurance that in the event the State fails to make timely payment of principal of or interest on the Bonds, a right of action would lie against the State or State officials to enforce such payment.

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

Pledge of Revenues

Under the Certificate, the State and the Department pledge and grant a lien on the Pledged Funds to secure the Senior Bonds, which pledge and lien are superior and prior to the pledge of and lien upon the Pledged Funds in respect of the Subordinate Bonds; and pledge and grant a lien on the Pledged Funds to secure the Subordinate Bonds, which pledge and lien are inferior and subordinate to the pledge of and lien upon the Pledged Funds in respect of the Senior Bonds. The Certificate provides that the lien on the Pledged Funds to secure the Bonds is a prior and paramount lien, subject only to the provisions of the Certificate permitting the application of such funds for the purposes and on the terms and conditions thereof.

The Certificate further provides that the moneys in the State Highway Fund shall, until used, applied and disbursed in accordance with the provisions of the Certificate, be held in trust: (1) for the equal benefit and security of the Holders of the Senior Bonds; and (2) subject to the prior and senior rights, benefits and security of the Holders of the Senior Bonds, for the equal benefit and security of the Holders of the Subordinate Bonds. Subject to the provisions of the Certificate concerning application of amounts on deposit in the subaccount relating to the Senior Bonds, all Senior Bonds have a prior and paramount lien on the Revenues paid into the Highway Revenue Special Account for credit to such subaccount and the investments in which such Revenues may be invested, over and ahead of all Subordinate Bonds and all bonds, notes or other evidences of indebtedness which may subsequently be issued. Subject to the prior and paramount lien provided in respect of the Senior Bonds and further subject to the provisions of the Certificate concerning application of amounts on deposit in the subaccount relating to the Subordinate Bonds, all Subordinate Bonds have a prior and paramount lien on the Revenues paid into the Highway Revenue Special Account for credit to such subaccount and the investments in which such Revenues may be invested, over and ahead of all bonds, notes or other evidences of indebtedness which may subsequently be issued.

Under the General Revenue Bond Law, the Department is obligated to impose, prescribe and collect rates, rents, fees, or charges for the use and services of, and the facilities and commodities furnished by, the State Highway System which, together with the proceeds of the Pledged User Taxes derived from the State Highway System, are at least sufficient: (1) to make the required payments of principal and interest on all Bonds, including reserves therefor; (2) to pay the costs of operation, maintenance and repair of the State Highway System, including reserves therefor; and (3) to carry out the covenants of the Certificate.

The State has considered but does not presently anticipate imposing any tolls, rates, rentals, fees or charges for the use and services provided by the State Highway System and, as indicated, expects that the principal source of payment of the Bonds will derive from the Pledged User Taxes imposed pursuant to law.

The State Constitution defines a "user tax" as a tax on goods or services or on the consumption thereof, the receipts of which are substantially derived from consumption, use or sale of goods and services in the utilization of the functions or services furnished by a public undertaking (an "Undertaking"), improvement or system. The specific acts of the Legislature authorizing Highway Revenue Bonds direct that they shall be payable from and secured by the revenues derived from highways and related facilities under the ownership of the State or operated and managed by the Department comprising the State Highway System, and from the highway fuel license taxes, vehicle registration fees, the vehicle weight tax, and the rental motor vehicle and tour vehicle surcharge taxes levied and paid pursuant to Sections 243-4, 248-8, 249-31, 249-33, and 251-2, HRS, and federal moneys received by the State or any department thereof which are available to pay principal of and interest on indebtedness of the State, and other user taxes, fees or charges currently or hereafter derived from or arising through the ownership, operation, and management of highways and related facilities and the furnishing and supplying of the services thereof. Each of the aforesaid taxes and fees constitutes a "user tax" within the meaning of the State Constitution.

Under the General Revenue Bond Law, the Legislature has covenanted, pledged and obligated the Legislature, whenever the Legislature shall have authorized the issuance of bonds for an Undertaking such as the State Highway System, payable from and secured by the user taxes derived with respect to such Undertaking, or

by both revenues and user taxes, or by any combination of both, to impose or continue to impose user taxes with respect to such Undertaking in amounts at least sufficient, together with the revenue of the Undertaking, to make the payments described above. These provisions would not prohibit the Legislature from changing the rate of existing Pledged User Taxes or other user taxes or fees or from deleting some or all of existing Pledged User Taxes or other user taxes or fees and substituting other or different user taxes or fees.

There is no requirement under the General Certificate or the General Revenue Bond Law that the Legislature levy and deposit Pledged User Taxes into the State Highway Fund in excess of the amount necessary to make the deposits described in paragraphs FIRST through FIFTH under "Funds and Accounts and Application of Revenues" below.

Highway Senior Debt Service Reserve Subaccount

In order to provide a reserve for the payment of the principal of and interest on the Senior Bonds, the Certificate creates a Highway Senior Debt Service Reserve Subaccount in the Highway Revenue Special Account. The Certificate requires that moneys on deposit in the Highway Senior Debt Service Reserve Subaccount shall be maintained in an amount at least equal to one-half (1/2) of the maximum Aggregate Bond Service for the Senior Bonds at the time outstanding for any Bond Year (the "Reserve Requirement"), beginning with the Bond Year in which such determination is made. In lieu of the deposit of moneys to the Highway Senior Debt Service Reserve Subaccount, the Certificate allows the Department to credit one or more Support Facilities in an amount equal to the difference between the Reserve Requirement and the aggregate of (1) moneys already deposited in such Subaccount and (2) amounts available to be drawn under any Support Facility already credited to such Subaccount. See "Highway Senior Debt Service Reserve Subaccount" and definitions of Aggregate Bond Service and Bond Year in Appendix A — "SUMMARY OF CERTAIN PROVISIONS OF THE CERTIFICATE."

At the time of the delivery of the 1998 Bonds, the Reserve Requirement will be satisfied by a debt service reserve fund policy (the "Reserve Fund Policy") issued by Financial Guaranty Insurance Company. See "INSURANCE - Reserve Fund Policy" herein and Appendix H - "SPECIMEN OF THE RESERVE FUND POLICY".

Funds and Accounts and Application of Revenues

The Certificate creates the Highway Revenue Special Account, comprised of the subaccounts listed below, within the State Highway Fund and provides that, so long as any Bonds are Outstanding: (1) the State Highway Fund and the Highway Revenue Special Account shall both be continued; and (2) all Revenues deposited in the State Highway Fund shall be credited to the Highway Revenue Special Account. Revenues from specified sources are deposited into the State Highway Fund. See "REVENUE SOURCES" below. Moneys that are paid into and are on deposit in the State Highway Fund constitute the Revenues that are pledged to the payment of the Bonds. Effective with the issuance of the 1998 Bonds, the Revenues credited or to be credited to the Highway Revenue Special Account will be required to be applied and used in the following order of priority:

FIRST: For further credit to the following subaccounts in the following order of priority in the amounts required pursuant to the provisions of the Certificate:

- (a) Highway Senior Interest Subaccount;
- (b) Highway Senior Principal Subaccount; and
- (c) Highway Senior Debt Service Reserve Subaccount;

SECOND: For further credit to the following subaccounts in the following order of priority in the amounts required pursuant to the provisions of the Certificate:

- (a) Highway Subordinate Interest Subaccount;
- (b) Highway Subordinate Principal Subaccount; and
- (c) Highway Subordinate Debt Service Reserve Subaccount;

THIRD: For payment of operation and maintenance expenses of the State Highway System;

FOURTH: For payment of the costs of acquisition, construction, addition, expansion, improvement, renewal, replacement, reconstruction, engineering, investigation and planning for the State Highway System;

FIFTH: To reimburse the general fund of the State for reimbursable general obligation bonds of the State;

SIXTH: All or any portion of available moneys credited to the Highway Revenue Special Account, after satisfying the requirements of priority items FIRST through FIFTH above, determined in conformance with law by the Director of Transportation to be in excess of 135% of the requirements for the ensuing 12 months for the Highway Revenue Special Account, or such other percentage as may be authorized by law, may be transferred from the Highway Revenue Special Account as permitted by and in accordance with State law; and

SEVENTH: To provide funds for other special reserve funds and other special funds as may be created by law.

Amendment to Certificate Regarding Transfer of Moneys from State Highway Fund. Prior to 1997, State law authorized the Director of Transportation to transfer from the State Highway Fund moneys in excess of 150% of the requirements of the State Highway Fund for the ensuing twelve months. Pursuant to Act 270, SLH 1997 ("Act 270"), the State Legislature amended the existing law to authorize the Director to transfer from the State Highway Fund moneys in excess of 135% of such requirements.

The Certificate will be amended to conform to this and possible future changes in the State law. The Certificate currently allows the Department to transfer from the Highway Revenue Special Account, after satisfying the requirements of priority items FIRST through FIFTH identified above, only those moneys in excess of 150% of the requirements for the ensuing 12 months for the Highway Revenue Special Account. In connection with the issuance and sale of the 1998 Bonds, the Certificate will be amended to allow the Department to transfer moneys in excess of 135% of such requirements, or such other percentage as may be authorized by law.

The Certificate requires the consent of the Holders of not less than a majority of the principal amount of the Bonds then Outstanding to effect the foregoing amendment. Upon the sale of the 1998 Bonds and the defeasance of the Refunded Bonds, the principal amount of the 1998 Bonds will constitute a majority of the aggregate principal amount of the Bonds then Outstanding, so that the consent of DTC or its nominee, as registered owner of the 1998 Bonds, will be sufficient to effect an amendment to the Certificate. *Purchasers of the 1998 Bonds will be deemed to have consented to such amendment by their purchase of the Bonds and to have authorized DTC or its nominee, as registered owner of the 1998 Bonds, to consent to and authorize such amendment. It is anticipated that DTC will consent to such amendment upon the issuance of the 1998 Bonds and that such amendment will become effective immediately upon such issuance.*

Also pursuant to Act 270, the State Legislature appropriated from the State Highway Fund certain amounts of money to be transferred to the State general fund for fiscal years 1997, 1998 and 1999. The amounts appropriated for fiscal years 1997 and 1998 were based upon a determination that such amounts were in excess of 150% of the requirements of the State Highway Fund. The amount appropriated for fiscal year 1999 was based upon a determination that such amount was in excess of 135% of the requirements of the State Highway Fund, as is permitted under the proposed amendment to the Certificate. The amounts appropriated by the State Legislature determined to be in excess of the specified requirements of the State Highway Fund have been or will be transferred to the State general fund.

Additional Bonds and Refunding Bonds

The Certificate permits the issuance of Additional Bonds payable from and secured by Pledged Funds on a parity with the 1998 Bonds, the Outstanding Bonds and other Senior Bonds, or the issuance of Additional Bonds which are Subordinate Bonds, for the purpose of paying or reimbursing the cost of acquisition or construction of properties to constitute part of the State Highway System or the making of additions to, expansions of, improvements of, renewals of or reconstructions of the State Highway System. Additional Bonds which are Senior Bonds must be fixed rate bonds. Additional Bonds which are Subordinate Bonds may be fixed rate bonds or

variable rate bonds. The conditions for issuance of Additional Bonds include, among other things, that the Director certify that:

(1) no default in the payment of any Bond has occurred and is continuing; no deficiency exists in the State Highway Fund or the Highway Revenue Special Account; and there does not exist any Event of Default under the Certificate or a condition which upon the passage of time would constitute such an Event of Default;

(2) upon delivery of such Bonds, there shall be credited to the Highway Revenue Special Account for credit to the Highway Senior Debt Service Reserve Subaccount and the Highway Subordinate Debt Service Reserve Subaccount an amount equal to, in each case, the Reserve Requirement; provided that such requirement may be satisfied by a deposit of proceeds of such Bonds or a support facility; and

(3) in the case of Additional Bonds, the Revenues for any consecutive twelve-month period out of the last eighteen consecutive calendar months immediately preceding the date of issuance of such Bonds shall be at least equal to: (a) in the case of Senior Bonds proposed to be issued, two times maximum Aggregate Bond Service for any future Fiscal Year on all Senior Bonds to be outstanding after the issuance of such Additional Senior Bonds; and (b) in the case of Subordinate Bonds proposed to be issued, 1.30 times maximum Aggregate Bond Service for any future Fiscal year on all Bonds to be outstanding after the issuance of such Additional Subordinate Bonds.

The Certificate permits the issuance of Refunding Bonds payable from and secured by Pledged Funds on a parity with the 1998 Bonds and other Senior Bonds, or Refunding Bonds which are Subordinate Bonds, for the purpose of refunding any then outstanding Bonds, so long as the State has satisfied the requirement set forth in the first and second subparagraphs described above and without satisfying any financial tests. See Appendix A — "SUMMARY OF CERTAIN PROVISIONS OF THE CERTIFICATE - Conditions Precedent to Issuance of Additional Bonds and Refunding Bonds."

The Certificate permits the issuance of other bonds or obligations payable from the Revenues junior and inferior to the payment of the Bonds from the Revenues.

Bond Insurance

Simultaneously with the delivery of the 1998 Bonds, Financial Guaranty Insurance Company will issue a municipal bond insurance policy (the "Bond Insurance Policy") which will guarantee the payment of principal of and interest on certain of the 1998 Bonds when due. The Bond Insurance Policy will guarantee payment of principal and interest only for the 1998 Bonds maturing July 1, 1999 through July 1, 2016 (the "Insured 1998 Bonds"). *Payment of principal and interest for the 1998 Bonds maturing on July 1, 2017 and July 1, 2018 (the "Uninsured 1998 Bonds") will not be guaranteed by the Bond Insurance Policy.* See "INSURANCE - Bond Insurance Policy" herein and Appendix G - "SPECIMEN OF THE BOND INSURANCE POLICY".

In connection with the issuance of the Bond Insurance Policy, Financial Guaranty has been granted certain rights upon events of default and with respect to any proposed amendments to the Certificate, as described in the following section.

INSURANCE

The following information concerning the Bond Insurance Policy and the Reserve Fund Policy has been provided by Financial Guaranty Insurance Company. No representation is made by the State or the Underwriters as to the accuracy, completeness or adequacy of such information, or as to the absence of material adverse changes in such information subsequent to the date hereof.

Bond Insurance Policy

Concurrently with the issuance of the 1998 Bonds, Financial Guaranty Insurance Company ("Financial Guaranty") will issue its Municipal Bond New Issue Insurance Policy for the Insured 1998 Bonds (the "Policy"). The Policy unconditionally guarantees the payment of that portion of the principal of and interest on the Insured 1998 Bonds which has become due for payment, but shall be unpaid by reason of nonpayment by the issuer of the Insured 1998 Bonds (the "Issuer"). Financial Guaranty will make such payments to State Street Bank and Trust Company, N.A., or its successor as its agent (the "Fiscal Agent"), on the later of the date on which such principal

and interest is due or on the business day next following the day on which Financial Guaranty shall have received telephonic or telegraphic notice, subsequently confirmed in writing, or written notice by registered or certified mail, from an owner of Insured 1998 Bonds or the Paying Agent of the nonpayment of such amount by the Issuer. The Fiscal Agent will disburse such amount due on any Insured 1998 Bond to its owner upon receipt by the Fiscal Agent of evidence satisfactory to the Fiscal Agent of the owner's right to receive payment of the principal and interest due for payment and evidence, including any appropriate instruments of assignment, that all of such owner's rights to payment of such principal and interest shall be vested in Financial Guaranty. The term "nonpayment" in respect of an Insured 1998 Bond includes any payment of principal or interest made to an owner of an Insured 1998 Bond which has been recovered from such owner pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final, nonappealable order of a court having competent jurisdiction.

The Policy is non-cancellable and the premium will be fully paid at the time of delivery of the 1998 Bonds. The Policy covers failure to pay principal of the Insured 1998 Bonds on their respective stated maturity dates or dates on which the same shall have been duly called for mandatory sinking fund redemption, and not on any other date on which the Insured 1998 Bonds may have been otherwise called for redemption, accelerated or advance in maturity, and covers the failure to pay an installment of interest on the stated date for its payment.

Generally, in connection with its insurance of an issue of municipal securities, Financial Guaranty requires, among other things, (i) that it be granted the power to exercise any rights granted to the holders of such securities upon the occurrence of an event of default, without the consent of such holders, and that such holders may not exercise such rights without Financial Guaranty's consent, in each case so long as Financial Guaranty has not failed to comply with its payment obligations under its insurance policy; and (ii) that any amendment or supplement to or other modification of the principal legal documents be subject to Financial Guaranty's consent. The specific rights, if any, granted to Financial Guaranty in connection with its insurance of the Insured 1998 Bonds are set forth in the description of the principal legal documents appearing elsewhere in this Official Statement. Reference should be made as well to such description for a discussion of the circumstances, if any, under which the Issuer is required to provide additional or substitute credit enhancement, and related matters.

This Official Statement contains a section regarding the ratings assigned to the Insured 1998 Bonds and reference should be made to such section for a discussion of such ratings and the basis for their assignment to the Insured 1998 Bonds. Reference should be made to the description of the Issuer for a discussion of the ratings, if any, assigned to such entity's outstanding parity debt that is not secured by credit enhancement.

The Policy is not covered by the Property/Casualty Insurance Security Fund specified in Article 76 of the New York Insurance Law.

Financial Guaranty is a wholly-owned subsidiary of FGIC Corporation (the "Corporation"), a Delaware holding company. The Corporation is a subsidiary of General Electric Capital Corporation ("GE Capital"). Neither the Corporation nor GE Capital is obligated to pay the debts of or the claims against Financial Guaranty. Financial Guaranty is a monoline financial guaranty insurer domiciled in the State of New York and subject to regulation by the State of New York Insurance Department. As of March 31, 1998, the total capital and surplus of Financial Guaranty was \$1,267,900,134. Financial Guaranty prepares financial statements on the basis of both statutory accounting principles and generally accepted accounting principles. Copies of such financial statements may be obtained by writing to Financial Guaranty at 115 Broadway, New York, New York 10006, Attention: Communications Department (telephone number: 212-312-3000) or to the New York State Insurance Department at 25 Beaver Street, New York, New York 10004-2319, Attention: Financial Condition Property/Casualty Bureau (telephone number: 212-480-5187).

Debt Service Reserve Fund Policy

Concurrently with the issuance of the 1998 Bonds, Financial Guaranty will issue its Municipal Bond Debt Service Reserve Fund Policy (the "Reserve Policy"). The Reserve Policy unconditionally guarantees the payment of that portion of the principal of and interest on the 1998 Bonds which has become due for payment, but shall be unpaid by reason of nonpayment by the Issuer, provided that the aggregate amount paid under the Reserve Policy may not exceed the maximum amount set forth in the Reserve Policy, which maximum amount represents \$8,000,000.00. Financial Guaranty will make such payments to the paying agent (the "Paying Agent") for the

Bonds on the later of the date on which such principal and interest is due or on the business day next following the day on which Financial Guaranty shall have received telephonic or telegraphic notice subsequently confirmed in writing or written notice by registered or certified mail from the Paying Agent of the nonpayment of such amount by the Issuer. The term "nonpayment" in respect of a 1998 Bond includes any payment of principal or interest made to an owner of a 1998 Bond which has been recovered from such owner pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final nonappealable order of a court having competent jurisdiction.

The Reserve Policy is non-cancellable and the premium will be fully paid at the time of delivery of the 1998 Bonds. The Reserve Policy covers failure to pay principal of the 1998 Bonds on their respective stated maturity dates, or dates on which the same shall have been called for mandatory sinking fund redemption, and not on any other date on which the Bonds may have been accelerated, and covers the failure to pay an installment of interest on the stated date for its payment. The Reserve Policy shall terminate on the earlier of the scheduled final maturity date of the 1998 Bonds or the date on which no 1998 Bonds are outstanding under the authorizing document.

Generally, in connection with its issuance of a Reserve Policy, Financial Guaranty requires, among other things, (i) that, so long as it has not failed to comply with its payment obligations under the Reserve Policy, it be granted the power to exercise any remedies available at law or under the authorizing document other than (A) acceleration of the Bonds or (B) remedies which would adversely affect holders in the event that the issuer fails to reimburse Financial Guaranty for any draws on the Reserve Policy; and (ii) that any amendment or supplement to or other modification of the principal legal documents be subject to Financial Guaranty's consent. The specific rights, if any, granted to Financial Guaranty in connection with its issuance of the Reserve Policy are set forth in the description of the principal legal documents appearing elsewhere in this Official Statement. Reference should be made as well to such description for a discussion of the circumstances, if any, under which the issuer of the 1998 Bonds is required to provide additional or substitute credit enhancement, and related matters.

This Official Statement contains a section regarding the ratings assigned to the 1998 Bonds and reference should be made to such section for a discussion of such ratings and the basis for their assignment to the 1998 Bonds. Reference should be made to the description of the Issuer for a discussion of the ratings, if any, assigned to such entity's outstanding parity debt that is not secured by credit enhancement.

The Reserve Policy is not covered by the Property/Casualty Insurance Security Fund specified in Article 76 of the New York Insurance Law.

REVENUE SOURCES

State Highway Fund

The State imposes taxes, fees and charges relating to the operation and use of motor vehicles on the public highways of the State. These funds are deposited into the State Highway Fund established under HRS §248-8. Moneys deposited in the State Highway Fund are used for acquisition, planning, design, construction, operation, repair and maintenance of the State Highway System.

The current taxes, fees and charges deposited to the State Highway Fund consist of: (1) the highway fuel license taxes; (2) vehicle registration fees; (3) the vehicle weight tax; and (4) the rental motor vehicle and tour vehicle surcharge taxes. Together, these taxes, fees and charges accounted for most of the receipts of the State Highway Fund in the Fiscal Year ended June 30, 1997. See "Historical Revenues" below. Other sources of Revenues include interest earnings on moneys previously credited to the State Highway Fund, vehicle weight tax penalties, certain rental income from State Highway System properties, passenger motor vehicle inspection charges, overweight permits, sales of surplus lands, commercial license fees and other miscellaneous Revenues. There are no toll roads or bridges in the State. The primary sources of Revenues are further described below.

Sources of Revenues and Pledged User Taxes

The following is a summary of the sources of Revenues that are deposited to the State Highway Fund. This summary does not purport to be a complete description of each of these Revenue sources and accordingly is qualified by reference to the Hawaii Revised Statutes regarding sources of Revenues. The Legislature has altered and may in the future alter the statutes governing these Revenue sources, the rates of the Pledged User Taxes and their allocation.

Highway Fuel License Taxes. Highway fuel license taxes consist of license taxes on fuel sold to motor vehicle operators pursuant to Chapter 243, HRS. The distributor of motor vehicle fuel pays the fuel license tax for liquid fuel produced or imported by the distributor to be sold or used by the distributor. Highway fuel license taxes are assessed at a rate of \$0.16 per gallon of gasoline and diesel oil (highway use), \$0.11 per gallon of liquid petroleum gas (highway use), and \$0.01 per gallon of gasoline, diesel oil and liquid petroleum gas (non highway use). The highway fuel license taxes are collected by the Department of Taxation, which then transfers the receipts to the State Highway Fund. The counties have a similar tax that is not included in the State's fuel license tax rate, as described in Appendix B — "ADDITIONAL INFORMATION RELATING TO REVENUE SOURCES, THE STATE HIGHWAY SYSTEM AND THE DEPARTMENT OF TRANSPORTATION." Receipts of aviation fuel taxes and taxes collected with respect to liquid fuel sold for use in small boats are transferred to the Airport Revenue Fund and the Boating Special Fund, respectively, and not to the State Highway Fund.

Vehicle Registration Fees. All vehicles, including motor vehicles, must be registered annually with one of the four counties of the State. The vehicle owner must pay a State registration fee of \$20 for each vehicle, pursuant to Section 249-31, HRS. The four counties each collect the vehicle registration fee along with their respective county registration fees and transfer the State's vehicle registration fee to the State Highway Fund. (See Appendix B — "ADDITIONAL INFORMATION RELATING TO REVENUE SOURCES, THE STATE HIGHWAY SYSTEM AND THE DEPARTMENT OF TRANSPORTATION.")

Vehicle Weight Taxes. All vehicles, including motor vehicles, are assessed an annual State vehicle weight tax. The tax rate is \$0.0075 per pound for vehicles less than 4,000 pounds; \$0.01 per pound for vehicles between 4,001 and 7,000 pounds, \$0.0125 per pound for vehicles between 7,001 and 10,000 pounds, and \$150.00 per vehicle for vehicles over 10,000 pounds. The four counties each collect the vehicle weight tax along with their respective county vehicle taxes and transfer the State's vehicle weight tax to the State Highway Fund. (See Appendix B — "ADDITIONAL INFORMATION RELATING TO REVENUE SOURCES, THE STATE HIGHWAY SYSTEM AND THE DEPARTMENT OF TRANSPORTATION.")

Rental Motor Vehicle and Tour Vehicle Surcharge Taxes. Chapter 251, HRS, imposes a surcharge tax on all rental motor vehicles and tour vehicles. The rental motor vehicle surcharge tax is imposed on the owner of the rental company when a rental motor vehicle is rented or leased. The surcharge tax is \$2.00 per day or any portion of the day.

The tour vehicle surcharge tax is imposed on the tour vehicle operator. The surcharge tax is \$65.00 per month for each tour vehicle used or partially used during the month.

All rental and tour companies must register with the State. The registration fee is a one-time \$20.00 fee.

Interest Earnings. Interest income is derived from the investment of moneys on deposit in the Highway Special Fund.

Historical Revenues

The following table sets forth the sources of Revenues which were deposited into the State Highway Fund for each of the last ten (10) Fiscal Years ended June 30, 1997.

Sources of Revenues Deposited in the State Highway Fund
(in thousands)

Fiscal Year	Pledged User Taxes			Rental/ Tour Vehicle Surcharge ⁽²⁾	Sales Excise Tax ⁽³⁾	Interest ⁽⁴⁾	Misc. ⁽⁵⁾	Total Revenues
	Fuel Taxes ⁽¹⁾	Registration Fees	Weight Taxes					
1988	\$42,031	\$7,271	\$11,088	0	\$14,328	\$ 841	\$ 749	\$ 76,308
1989	43,080	7,528	11,535	0	14,103	1,031	2,226	79,503
1990	44,818	7,842	12,086	0	15,581	1,731	2,084	84,142
1991	45,010	8,190	12,667	0	18,904	1,955	3,034	89,760
1992	63,513	13,753	17,956	\$6,479	0	11,254	3,685	116,640
1993	66,151	16,104	20,316	20,914	0	6,094	2,815	132,394
1994	68,525	15,733	20,377	20,366	0	5,022	3,208	133,231
1995	67,702	17,352	21,013	21,465	0	9,924	3,559	141,015
1996	69,010	16,130	21,055	21,951	0	11,054	3,468	142,667
1997	69,880	16,245	21,363	22,600	0	10,961	3,323	144,515

⁽¹⁾ Fuel tax rates were increased effective July 1, 1991.

⁽²⁾ Surcharge took effect January 1, 1992.

⁽³⁾ Transfer to State Highway Fund of 4% excise tax on fuel terminated June 30, 1991.

⁽⁴⁾ The increase in interest income in 1992 was attributable to the transfer of \$250 million from the Airport (Special) Fund of the State to the Highway (Special) Fund on June 28, 1991, to finance highway capital improvement projects within ten miles by road of an airport.

⁽⁵⁾ Miscellaneous Revenues include vehicle weight tax penalties, periodic motor vehicle inspection charges, rents from State Highway System properties, commercial license fees, and other miscellaneous Revenues.

Source: Department of Transportation

The rate of taxation on fuel and the registration fee and taxes on motor vehicles has changed and increased significantly over the past twenty years. Highway fuel license taxes have increased from \$0.085 per gallon of gasoline and diesel oil and \$0.060 per gallon of liquid petroleum gas in 1975, to \$0.110 per gallon of gasoline and diesel oil and \$0.080 per gallon of liquid petroleum gas in 1985, to the present rate of \$0.160 per gallon of gasoline and diesel oil and \$0.110 per gallon of liquid petroleum gas, which became effective on July 1, 1991.

The State vehicle registration fee has been increased from \$1.00 per vehicle in 1979 to \$10.00 per vehicle in 1985 to the present \$20.00 per vehicle in 1991. Vehicle weight taxes increased from a minimum rate of \$0.0045 per pound to \$0.0050 per pound to \$0.0075 per pound and a maximum charge of \$36.00 per vehicle to \$65.00 per vehicle to \$150.00 per vehicle over the same period.

In 1981 the State transferred receipts of the four percent general excise tax on the sale of motor vehicle fuel from the general fund to the State Highway Fund. Although the Legislature transferred the excise tax on fuel back to the general fund effective June 30, 1991, the resulting decrease in revenue to the State Highway Fund was more than offset by the increases in the rate of the highway fuel license taxes, vehicle registration fees and the vehicle weight tax in 1991 and the creation of the rental motor vehicle and tour vehicle surcharge tax effective January 1, 1992. An increase in the fuel tax is currently scheduled for submission by the Department to the State Legislature in 1999.

See "DEBT SERVICE COVERAGE" for a discussion of projected Revenues.

THE DEPARTMENT OF TRANSPORTATION

Department Organization

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

Through the Highways Division (the "Highways Division"), the Department has general supervision of the management and maintenance of the State Highway System and the location, design and construction of new highways and facilities. The Highways Division provides supervision to assure completion of State highway contracts in accordance with plans and specifications.

The Department also has an Administration Division which is responsible for Department-wide administrative functions and has general responsibility for multi-modal statewide transportation planning. See Appendix B — "ADDITIONAL INFORMATION RELATING TO REVENUE SOURCES, THE STATE HIGHWAY SYSTEM AND THE DEPARTMENT OF TRANSPORTATION" for additional information regarding the Department.

Department Management

The Department is headed by the Director, a single executive appointed by the Governor and confirmed by the State Senate. The Governor also appoints, without State Senate confirmation, two Deputy Directors of Transportation. The Director and Deputy Directors of Transportation serve four-year terms coterminous with the Governor's term.

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

The Highways Division is managed by the Highways Division Chief. Each island in the system is managed by a district manager with the exception of Maui District which includes the islands of Molokai and Lanai. The Staff Services Office, headed by the Administrative Services Officer, is responsible for personnel, budget, procurement, financial management and method, standards and evaluation functions of the Highways Division. Other major functional operations within the Highways Division include Landscape Services Office, Motor Vehicle Safety Office, Planning Branch, Design Branch, Materials Testing and Research Branch, Construction and Maintenance Branch, Traffic Branch and Rights of Way Branch.

Management Personnel

The following are the senior executives of the Department responsible for the management of the State Highway System:

Kazu Hayashida, Director, was appointed by the Governor in November 1994, which appointment became effective January 1995. Prior to his appointment as Director, Mr. Hayashida held the following positions with the City and County of Honolulu: Manager and Chief Engineer for the Board of Water Supply from 1978 to 1994; and Director and Chief Engineer from 1974 to 1976, and Deputy Director from 1973 to 1974, for the Department of Public Works. Mr. Hayashida began his career as an Engineer with the State of Hawaii, Department of Land and Natural Resources, after graduating with a civil engineering degree from the University of Hawaii in 1956.

Glenn Okimoto, Deputy Director, assumed his present position in 1994. He is responsible for administrative functions of the Department, including budget, fiscal and personnel matters. Prior to assuming this position, he served as the Program Evaluation Analysis Manager (1989-1994) and Economist (1981-1989) for the Department. Before joining the Department, Dr. Okimoto was a research assistant at the University of Hawaii. Dr. Okimoto received a Masters of Science and Doctor of Philosophy, degree in Resource Economics from the University of Hawaii.

Brian Minaai, Deputy Director, assumed his present position in 1997. He is responsible for the property management functions and capital improvement programs for the Department's three divisions - Airports, Harbors and Highways. Prior to assuming this position, he was the Chief Clerk of the Hawaii Senate Committee on Ways and Means, and was responsible for the development of the State operational and capital improvement budgets, taxation, and finance legislation for the Senate. In addition, he was the Project Manager with West Beach Estates for the Ko Olina Resort (1984-1989) and the Project Manager with Haseko, Inc. (1989-1996). Mr. Minaai received a Masters in Business Administration, as well as a Masters of Arts and Economics from the University of Hawaii.

Pericles (Peri) Manthos, Highways Division Administrator, took over as Administrator on January 26, 1998, following the retirement of Hugh Ono. Prior to assuming this post, Manthos had spent a year and a half as Oahu District Engineer for the Department's Highways Oahu District Office. He came to the Department from the Department of Land and Natural Resources, where he served as Design and Construction Engineer for the Division of Water and Land Development from 1993. Before coming to Hawaii, Manthos spent a year with D'Leon Consulting Engineering in Los Angeles, as the Office Engineer in the Systems Office of Construction for the Metro Red Line. From 1989 to 1992, he was the Office Engineer in the Systemwide Office of Construction (subway construction) for the Washington Metropolitan Area Transit Authority in Washington, D.C. Manthos worked for EDAW, Inc. in Alexandria, Virginia, as Design & Resident Engineer for Landscape Architects for the Bethesda Streetscape project, Phase II, in 1988-1989. From 1984 to 1988, he was an Inspection and Estimating Engineer for the Multi-Family Housing with DRG Financial Corporation in Washington, D.C. He holds a B.S. in Civil Engineering from the University of Maryland and has been registered as a Professional Engineer in both Virginia and Hawaii.

Gerald K.L. Dang, Administrative Services Officer (currently on leave and expected to return in or before September), became the head of the Staff Services Office of the Highways Division in July 1995. He is responsible for project programming, budgeting, fiscal and personnel activities of the Highways Division. Prior to joining the Department, Mr. Dang served as the Administrative Services Officer for the Department of Business, Economic Development and Tourism (1993-1995), and Budget and Accounting Officer for the Department of Accounting and General Services (1990-1993), and Accountant for various state agencies from 1980-1990. Mr. Dang received a bachelor's degree in Business Administration from the University of Hawaii.

Roy Nagasako, Acting Administrative Services Officer, assumed his present position in September 1997. He is responsible for project programming, budgeting, fiscal and personnel activities of the Highways Division. Prior to assuming this position, he served as the Highways Division Capital Improvement Program Manager and Legislative Coordinator (1995-1997), Computer Aided Drafting and Design (CADD) Manager (1988-1995), Design Project Manager (1985-1988) and Project Engineer (1970-1988). Mr. Nagasako received a bachelor's degree in civil engineering from the University of Hawaii in 1969.

Employees

The Highways Division presently has approximately 900 employees. Hawaii law grants public employees in Hawaii, except appointed officials and division administrators, the right to organize for the purpose of collective bargaining. Each recognized bargaining unit designates an employee organization as the exclusive representative of all employees of such unit, which organization negotiates with the public employer.

Substantially all of the Highways Division employees are represented by bargaining units. Generally, blue collar workers are represented by United Public Workers, Local 606. Blue collar supervisors, white collar workers and white collar supervisors are represented by Hawaii Government Employees' Association, Local 152, American Federation of State, County and Municipal Employees. See Appendix C — "THE STATE OF HAWAII — Labor Contracts" for the current status of and other information regarding State employee bargaining agreements.

CAPITAL IMPROVEMENT PROGRAM

General

Every other Fiscal Year, the Department prepares for the Governor's approval a capital improvements program for the next six Fiscal Years, describing ongoing and proposed State Highway System capital improvement projects which the Department proposes to undertake during that period (the "Program"). After the Governor's review, the current two Fiscal Year's expenditures for capital improvement projects for the State Highway System are submitted to the Legislature as a part of the Administration's biennium budget. The Legislature reviews the biennium budget in detail and authorizes all or a portion of the biennium budget by individual capital improvement project. Subsequently, in the first year of a biennium budget, the Department may revise the second year of that biennium budget for presentation to the Governor for approval and to the Legislature for supplemental authorization.

Authorization of a capital improvement project by the Legislature as a part of the biennium budget includes the appropriation of moneys from a designated source to pay for that project. Since the Legislature only appropriates for a two-year period, appropriations to complete capital improvement projects extending beyond that period must be approved by subsequent Legislatures. An appropriation of bond funds to match federal funds does not lapse.

The Legislature can appropriate funds for the State Highway System capital improvement projects from five sources: bonds (either general obligation bonds, reimbursable general obligation bonds or revenue bonds), federal funds, the State general fund, special funds and private contributions (such as private development impact fees). The Legislature also authorizes the issuance of bonds to fund the appropriation for which bond funds are designated as the source for payment of a capital improvement project.

The Department annually prepares a multimodal capital improvements program for U.S. Department of Transportation review and approval. This program, called the Statewide Capital Improvement Program ("STIP"), describes all capital improvement projects for which the Department will request federal aid during the current federal fiscal year. See Appendix B — "ADDITIONAL INFORMATION RELATING TO REVENUE SOURCES, THE STATE HIGHWAY SYSTEM AND THE DEPARTMENT OF TRANSPORTATION" for additional information regarding STIP.

The Program includes many capital improvement projects still in the preliminary stage. As the Program is continuously developed and revised, the individual capital improvement projects included in the Program undergo many changes in scope, priority, timing and cost. The current Program for Fiscal Years 1998 through 2003 provides authorization for completion of previously approved capital improvement projects, for new capital improvement projects, and for certain additional capital improvement projects which have not yet been authorized.

The Program consists of separate capital improvement projects on the six major islands of the State. Through the 1997 session, the Legislature has appropriated a total of \$1.57 billion for the planning, design, and acquisition and construction of projects. Under the 1998 supplemental budget bill currently under consideration by the Governor, an additional \$337 million would be appropriated for the Program.

Plan of Finance

The Governor and the Legislature have approved the funding sources for all appropriations made in prior Fiscal Years. Of the \$1.57 billion appropriated through the 1997 session, the Department has been authorized to finance approximately \$1.1 billion with federal funds, approximately \$267 million with available State funds, approximately \$26 million with the proceeds from the sale of reimbursable general obligation bonds, and approximately \$177 million with the proceeds from the sale of revenue bonds.

Of the \$337 million which would be appropriated under the 1998 budget bill, the Department has been authorized to finance approximately \$221.5 million with federal funds, approximately \$4.5 million with State funds, approximately \$98 million with proceeds from the sale of revenue bonds, and approximately \$13 million with other funds.

The Department has previously received federal funds for surface transportation projects under the Intermodal Surface Transportation Efficiency Act of 1991 ("ISTEA"). A new act to provide for such federal aid was recently passed by Congress, and the Department expects that the level of funding that it will be receiving under the new legislation will be the same as or greater than the levels it has received in the past. Accordingly, the Department does not expect any material adverse impact as a result of such new legislation.

Historically the Department financed a major portion of the State's share of the cost of capital improvement projects using reimbursable general obligation bonds. The Department is required to reimburse the State general fund for the payment of the principal of and interest on such bonds. See "DEBT SERVICE COVERAGE - Reimbursable General Obligation Bonds" for additional information.

Beginning in 1993, the State determined to finance the Program by issuing revenue bonds secured by a pledge of the Pledged Funds rather than by issuing reimbursable general obligation bonds. The Department has previously issued \$75 million in such revenue bonds in 1993 and \$55 million in 1996. After issuance of the 1998 Bonds, the Department's current financial plan projects that \$40 million in additional revenue bonds will be sold during each of the fiscal years 2000 and 2001, and \$50 million will be sold during each of the fiscal years 2002 and 2003.

DEBT SERVICE COVERAGE

Projected Revenues

The Department's current forecast of Revenues assumes that future Revenues will grow at the same rate as historical growth. The Department's forecast is based on the growth of fuel consumption and the number of vehicles subject to the fees and taxes and assumes an increase in the fuel license tax of \$0.04 per gallon effective July 1, 2001. The forecast reflects a steady upward growth trend, with Revenues increasing at an average annual rate of one and one-fourth percent (1.25%), exclusive of any fuel tax increase.

The actual Revenues which will be collected and deposited into the State Highway Fund may vary from this projection because of fluctuating economic conditions, changes by the Legislature in the laws governing the Pledged User Taxes and other variables affecting Revenues. *Such variances could be material.*

Projected Revenues
Fiscal Years Ending June 30, 1998 through June 30, 2003
(in thousands)

Fiscal Year	Pledged User Taxes				Interest Earnings	Misc. ⁽²⁾	Total Revenues
	Fuel Taxes	Registration Fee	Weight Tax	Tour Vehicle Surcharge			
1998	\$ 71,260	\$17,578	\$22,894	\$22,956	\$7,200	2,487	\$144,375
1999	72,323	17,884	23,581	23,453	5,400	2,529	145,170
2000	73,386	18,189	24,297	23,948	5,200	2,733	147,753
2001 ⁽¹⁾	93,743	18,800	25,909	24,939	5,200	2,584	171,175
2002	95,106	19,106	26,732	25,436	5,200	2,605	174,185
2003	96,516	19,411	27,597	25,931	5,200	2,613	177,268

⁽¹⁾ Assumes fuel tax increase of \$0.04 per gallon.

⁽²⁾ Miscellaneous Revenues include vehicle weight tax penalties, periodic motor vehicle inspection charges, rents from State Highway System properties, commercial license fees and other miscellaneous revenues.

Source: Department of Transportation

Debt Service Requirements for the Bonds

The following table sets forth the principal and interest requirements for the 1998 Bonds and the Outstanding Bonds:

Bond Year Ending July 1	Outstanding Bonds Debt Service ⁽¹⁾	Debt Service			Total Debt Service
		1998 Bonds Debt Service			
		Principal	Interest	Total	
1999	9,185,908	350,000	4,872,975	5,222,975	14,408,883
2000	7,317,018	2,790,000	4,858,975	7,648,975	14,965,993
2001	4,137,393	6,080,000	4,747,375	10,827,375	14,964,768
2002	4,137,393	6,385,000	4,443,375	10,828,375	14,965,768
2003	4,137,393	6,705,000	4,124,125	10,829,125	14,966,518
2004	7,762,393	3,415,000	3,788,875	7,203,875	14,966,268
2005	7,767,018	3,580,000	3,618,125	7,198,125	14,965,143
2006	7,764,618	3,765,000	3,439,125	7,204,125	14,968,743
2007	10,430,593	1,285,000	3,250,875	4,535,875	14,966,468
2008	10,437,105	1,335,000	3,193,050	4,528,050	14,965,155
2009	10,433,305	1,375,000	3,132,975	4,507,975	14,941,280
2010	10,433,555	1,440,000	3,069,725	4,509,725	14,943,280
2011	10,435,355	1,510,000	2,997,725	4,507,725	14,943,080
2012	10,436,243	1,585,000	2,922,225	4,507,225	14,943,468
2013	10,430,180	1,670,000	2,842,975	4,512,975	14,943,155
2014	4,568,450	7,615,000	2,759,475	10,374,475	14,942,925
2015	4,569,413	8,015,000	2,359,688	10,374,688	14,944,100
2016	4,567,850	8,440,000	1,938,900	10,378,900	14,946,750
2017	0	13,420,000	1,516,900	14,936,900	14,936,900
2018	0	14,160,000	778,800	14,938,800	14,938,800
TOTALS	138,951,178	94,920,000	64,656,263	159,576,263	298,527,440

⁽¹⁾ Assumes the refunding of the Refunded Bonds with a portion of the proceeds of the 1998 Bonds.

Source: Department of Transportation

Historical and Projected Debt Service Coverage

The following table sets forth historical and projected debt service coverage for Bond Years ending July 1, 1994 through 2003. (A Bond Year is a twelve month period ending on a July 1.) Debt service projections for the Bond Years indicated in the first column are based on twenty-year maturities, a level debt service structure, and annual revenue bond issuances to pay for the Program expenditures described under "Plan of Finance for the Program" under "CAPITAL IMPROVEMENT PROGRAM" herein. Debt service for the Bond Years ending July 1, 1994 through 1998 is based on the actual interest rates for the Outstanding Bonds. Debt service projections for future Bond Years are based on the interest rates for the Outstanding Bonds, the actual rate for the 1998 Bonds, and an assumed interest rate of 6.0% for future issues of revenue bonds. Revenues for the Bond Years ending July 1, 1994 through 1997 are based on actual Revenues for such Bond Years; projected Revenues for present and future Bond Years are based on the Department's projections identified in the table entitled "Projected Revenues" under "DEBT SERVICE COVERAGE" herein. (The Department calculates Revenues on the basis of its Fiscal Year, but the amounts would be substantially the same for the corresponding Bond Year.)

HISTORICAL AND PROJECTED DEBT SERVICE COVERAGE

<u>July 1</u>	<u>Debt Service⁽¹⁾</u>	<u>Revenues⁽²⁾</u>	<u>Coverage⁽²⁾</u>
1994	\$ 5,865,277	\$133,231,000	22.72
1995	5,864,683	141,015,000	24.04
1996	5,868,563	142,667,000	24.31
1997	10,003,151	144,515,000	14.45
1998	13,264,618	144,375,000	10.88
1999	14,408,883	145,170,000	10.08
2000	18,453,375	147,753,000	8.01
2001	21,939,532	171,175,000	7.80
2002	26,299,760	174,185,000	6.62
2003	30,659,738	177,268,000	5.78

⁽¹⁾ Actual for 1995 through 1998; projected for 1999 through 2003.

⁽²⁾ Actual for 1995 through 1997; projected for 1998 through 2003.

Source: Department of Transportation.

Reimbursable General Obligation Bonds

As of June 30, 1997, there were outstanding \$280,536,810.38 reimbursable general obligation bonds issued for the State Highway System. These bonds are general obligation bonds of the State, but since the proceeds of these bonds were used to finance improvements to the State Highway System, the Department is required to reimburse the State general fund for the payment of the principal of and interest on such bonds. Reimbursement currently is made principally from the Pledged User Taxes, and occurs after the payment of the principal of and interest on the Bonds, including reserves therefor, and the costs of operation and maintenance and improvement of the State Highway System.

The following table sets forth the principal and interest requirements for all outstanding reimbursable general obligation bonds as of June 30, 1997. On April 29, 1998, the State of Hawaii issued additional general obligation bonds, the proceeds of which were used in part to restructure the State's existing debt; such restructuring may have resulted in changes to the Department's requirements which are not reflected in the following table. Debt service requirements on the reimbursable general obligation bonds are set forth in the year in which they are scheduled to be paid.

**STATE HIGHWAY SYSTEM REIMBURSABLE
GENERAL OBLIGATION BOND DEBT SERVICE**

<u>Fiscal Year Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total Reimbursable General Obligation Bond Debt Service</u>
1998	\$20,272,714	\$11,270,085	\$31,542,799
1999	20,192,617	10,206,252	30,398,868
2000	20,909,065	9,156,163	30,065,228
2001	19,281,874	7,992,079	27,273,953
2002	18,840,159	6,948,541	25,788,699
2003	18,192,572	5,854,224	24,046,796
2004	13,511,800	4,923,694	18,435,493
2005	11,857,034	4,236,102	16,093,137
2006	11,422,453	3,582,863	15,005,316
2007	10,903,076	2,961,776	13,864,852
2008	10,953,891	2,347,634	13,301,525
2009	10,199,293	1,728,520	11,927,813
2010	7,366,777	1,152,083	8,518,860
2011	7,427,931	718,812	8,146,743
2012	4,523,890	345,170	4,869,060
2013	456,107	70,757	526,864
2014	456,107	21,836	477,943
2015	96,958	7,888	104,846
2016	96,958	2,634	99,592
2017	46,899	1,524	48,423

Source: Department of Transportation

LITIGATION

The State is subject to litigation in connection with the day-to-day operation of the State Highway System by the Department. There are no claims or judicial proceedings affecting the State Highway System or the Pledged Funds, except for claims incidental to the operation of the State Highway System. The State is self-insured with respect to tort claims against the Department and the State Highway System. To pay for tort judgments and settlements involving the State Highway System, the Legislature appropriates money from the State Highway Fund after providing for payment of the Bonds and required reserves. There is no litigation now pending or threatened to restrain or to enjoin the issuance and delivery of the 1998 Bonds or the power and authority of the Department or the State to impose, prescribe or collect Pledged User Taxes or in any manner questioning the power and authority of the Department or State to impose, prescribe or collect such Pledged User Taxes or to issue and deliver the 1998 Bonds or affecting the validity of the 1998 Bonds.

LEGALITY FOR INVESTMENT

The 1998 Bonds are legal investments for the funds of all public officers and bodies and all political subdivisions of the State, and for the funds of all insurance companies and associations, banks, savings banks, savings institutions, including building or savings and loan associations, credit unions, trust companies, personal representatives, guardians, trustees and all other persons and fiduciaries in the State who are regulated by law as to the character of their investment.

The 1998 Bonds may be deposited by banks with the Director of Finance as security for State moneys deposited in such banks.

TAX MATTERS

In the opinion of McCorriston Miho Miller Mukai, Bond Counsel, under existing law, (i) interest on the 1998 Bonds is excluded from gross income for federal income tax purposes under Section 103(a) of the Internal Revenue Code of 1986, as amended (the "Code"), and is not an item of tax preference under Section 57 of the Code for purposes of the alternative minimum tax imposed on individuals and corporations, and (ii) the 1998 Bonds and the income therefrom are exempt from all taxation by the State or any county or other political subdivision thereof, except inheritance, transfer and estate taxes, and the franchise tax imposed on banks and other financial institutions. Bond Counsel will express no opinion as to any other tax consequences regarding the 1998 Bonds.

The opinion on tax matters will be based on and will assume the accuracy of certain representations and certifications as to facts, circumstances, estimates and expectations and compliance with certain covenants of the State to be contained in the Certificate for the 1998 Bonds and the transcript of proceedings, and which area intended to evidence and assure the foregoing, including that the 1998 Bonds are and will remain obligations the interest on which is excluded from gross income for federal income tax purposes. Bond Counsel will not independently verify the accuracy of the certifications and representations made by the State.

The Code prescribes a number of qualifications and conditions for the interest on state and local government obligations, including the 1998 Bonds, to be and to remain excluded from gross income for federal income tax purposes, some of which, including provisions for potential payments by the State to the federal government, require future or continued compliance after issuance of the obligations in order for the interest to be and to remain so excluded from the date of issuance. Noncompliance with these requirements could cause the interest on the 1998 Bonds to be included in gross income for federal income tax purposes and thus to be subject to federal income tax retroactively to the date of their issuance. The State has covenanted to take all such actions that may be required of it for the interest on the 1998 Bonds to be and to remain excluded from gross income for federal income tax purposes and not to take any actions that would adversely affect that exclusion.

Under the Code provisions applicable only to corporations (as defined for federal income tax purposes), 75% of the excess of adjusted current earnings (which includes interest that is excluded from gross income under Section 103(a) of the Code, including interest on the 1998 Bonds) over other alternative minimum taxable income is included in (i) alternative minimum taxable income which may be subject to a corporate alternative minimum tax, and (ii) modified alternative minimum taxable income which may be subject to an environmental tax imposed on certain corporations for certain taxable years. In addition, the interest on the 1998 Bonds may be subject to a branch profits tax imposed on certain foreign corporations doing business in the United States and a tax imposed on excess net passive income of certain S corporations.

Under the Code, the exclusion of interest from gross income for federal income tax purposes can have certain adverse federal income tax consequences on items of income, deductions or credits for certain taxpayers, including financial institutions, certain insurance companies, recipients of Social Security and Railroad Retirement benefits, those that are deemed to incur or continue indebtedness to acquire or carry tax-exempt obligations and individuals otherwise eligible for the earned income tax credit. The applicability and extent of these other tax consequences will depend upon the particular tax status or other tax items of the owner of the 1998 Bonds. Bond Counsel expresses no opinion regarding those consequences.

From time to time there are legislative proposals in Congress which, if enacted, could alter or amend one or more of the federal tax matters referred to or adversely affect the market value of the 1998 Bonds. It cannot be predicted whether or in what form any such proposal might be enacted and whether, if enacted, it would apply to obligations (such as the 1998 Bonds) issued prior to enactment of such proposal.

Original Issue Discount

Certain of the 1998 Bonds ("Discount Bonds") may be offered and sold to the public at an original issue discount ("OID"). OID is the excess of the stated redemption price at maturity (the original principal amount) over the "issue price" of such Discount Bonds. The issue price of a Discount Bond is the initial offering price to the public (other than to bond houses, brokers or similar persons acting in the capacity of original purchasers or wholesalers) at which a substantial amount of the Discount Bonds of the same maturity are sold pursuant to that offering. For federal income tax purposes, OID accrues to the owner of a Discount Bond over the period to maturity based on the constant yield method, compounded semiannually (or over such shorter permitted compounding interval selected by the owner). With respect to a purchaser of a Discount Bond at its issue price in the initial offering, the portion of OID that accrues during the period that the purchaser owns the Discount Bonds, (i) is interest excludable from that purchaser's gross income for federal income tax purposes to the same extent and subject to the same considerations discussed above as to other interest on the 1998 Bonds, and (ii) is added to that purchaser's tax basis for purposes of determining gain or loss on the maturity, redemption, prior sale or other disposition of that Discount Bond.

Owners of Discount Bonds should consult their own tax advisers as to the determination for federal income tax purposes of the amount of OID properly accruable each year with respect to the Discount Bonds and as to other federal tax consequences and the treatment of OID for state and local tax purposes.

Premium Bonds

Certain of the 1998 Bonds ("Premium Bonds") may be offered and sold to the public at an issue price in excess of their stated redemption price (the principal amount) at maturity. This excess constitutes amortizable bond premium. For federal income tax purposes, bond premium is amortized over the period to maturity of a Premium Bond, based on the constant yield method, compounded semiannually. No portion of such bond premium is deductible by an owner of Premium Bonds. For purposes of determining the owner's gain or loss on the sale, redemption (including redemption at maturity) or other disposition of a Premium Bond, the owner's tax basis in a Premium Bond is reduced by the amount of bond premium that accrues during the period of ownership. As a result, an owner may realize taxable gain for federal income tax purposes upon the sale of a Premium Bond for an amount equal to or less than the amount paid by that owner for the Premium Bond. An owner who purchases a Premium Bond in the initial public offering of such Premium Bonds at their issue price and who holds such Premium Bonds to maturity will realize no gain or loss upon the retirement of the Premium Bonds.

Owners of Premium Bonds should consult their own tax advisers as to the determination for federal income tax purposes of the amount of amortizable bond premium properly accruable in any period with respect to the Premium Bonds and as to other federal tax consequences and the treatment of amortizable bond premium for state and local tax purposes.

The form of opinion Bond Counsel proposes to render is set forth in Appendix E this Official Statement.

CERTAIN LEGAL MATTERS

Legal matters incident to the issuance of the 1998 Bonds and with regard to the exclusion of interest from gross income for federal income tax purposes (see "TAX MATTERS") are subject to the legal opinion of McCorriston Miho Miller Mukai, Bond Counsel whose legal services have been retained by the Department. The signed legal opinion, dated and premised on law in effect as of the date of original delivery of the 1998 Bonds, will be delivered to the Department at the time of original delivery. The text of that opinion will be printed on the 1998 Bonds. Certain legal matters will be passed upon for the State by the Attorney General of the State and for the Underwriters by their counsel, Watanabe, Ing & Kawashima.

The proposed text of the legal opinion of Bond Counsel is set forth as Appendix E. The legal opinion to be delivered may vary from that text if necessary to reflect facts and law on the date of delivery. The opinion will speak only as of its date, and subsequent distribution of it by recirculation of the Official Statement or otherwise

shall create no implication that Bond Counsel has reviewed or expresses any opinion concerning any of the matters referred to in the opinion subsequent to its date.

In its capacity as Bond Counsel, Bond Counsel has participated in the preparation of, and has reviewed those portions of, this Official Statement pertaining to the 1998 Bonds, the Certificate, the Third Supplemental Certificate, the Disclosure Certificate, as hereinafter defined, and the tax-exempt status of interest on the 1998 Bonds contained under the captions "THE 1998 BONDS," "APPLICATION OF PROCEEDS OF THE 1998 BONDS," "SECURITY FOR THE BONDS," "TAX MATTERS" and "CONTINUING DISCLOSURE" herein and Appendices A, E and F. Bond Counsel has not been retained to pass upon, and will not express any opinion upon, any other information in this Official Statement or any other information pertaining to the 1998 Bonds, the State or the Department that may be made available to the prospective purchasers of the 1998 Bonds or to others. In addition to rendering its legal opinion, Bond Counsel will assist in the preparation of, and advise the Department concerning, documents for the bond transcript.

The Third Supplemental Certificate of the Director, providing for the issuance of the 1998 Bonds, will be approved as to form and legality by the Attorney General of the State.

RATINGS

Moody's Investors Service and Standard & Poor's have assigned ratings of "Aaa" and "AAA," respectively, to the Insured 1998 Bonds, in each case based upon the understanding that upon delivery of the 1998 Bonds, Financial Guaranty will issue its Bond Insurance Policy with respect to the Insured 1998 Bonds. Moody's Investors Service and Standard & Poor's have assigned ratings of "Aa3" and "AA," respectively, to the Uninsured 1998 Bonds.

Such ratings reflect only the views of such organizations and any desired explanation of the significance of such ratings should be obtained from the rating agency furnishing the same, at the following addresses: Moody's Investors Service, 99 Church Street, New York, New York 10007; and Standard & Poor's, 25 Broadway, New York, New York 10004. Generally a rating agency bases its rating on the information and materials furnished to it and on investigations, studies and assumptions of its own. There is no assurance that either of such ratings will continue for any given period of time or that such ratings will not be revised downward, suspended or withdrawn entirely by the rating agencies if, in the judgment of such rating agencies, circumstances so warrant. The State undertakes no responsibility to oppose any such revision, suspension or withdrawal. Any such downward revision, suspension or withdrawal of such ratings may have an adverse effect on the market price of the 1998 Bonds.

ESCROW VERIFICATION

Prior to the delivery of the 1998 Bonds, the Department will select an independent certified public accountant to verify the mathematical accuracy of the computations concerning the adequacy of the maturing principal amounts of and interest earned on the Federal Securities, together with other moneys, to be placed in the Refunding Bonds Trust Fund to pay when due pursuant to stated maturity or call for redemption the principal of and interest on the Refunded Bonds. Such verification shall be based in part upon information provided by the Underwriters.

UNDERWRITING

The 1998 Bonds are being purchased by the underwriters listed on the cover page (the "Underwriters"). The Underwriters have jointly and severally agreed to purchase the 1998 Bonds at a price of \$97,055,733.30, plus accrued interest, if any, and will retain an underwriting discount of \$486,687.60. The Purchase Contract provides that the Underwriters will purchase all of the 1998 Bonds, if any are purchased, the obligation to make such purchase being subject to certain terms and conditions set forth in the Purchase Contract, the approval of certain legal matters by counsel and certain other conditions. The initial public offering prices of the 1998 Bonds may be changed from time to time by the Underwriters. The Underwriters may offer and sell the 1998 Bonds to certain

dealers (including dealers depositing 1998 Bonds into unit investment trusts, certain of which may be sponsored or managed by the Underwriters) at prices lower than the public offering prices stated on the cover of this Official Statement.

CONTINUING DISCLOSURE

The Department has executed a Continuing Disclosure Certificate (the "Disclosure Certificate") for the benefit of the Holders and beneficial owners of the 1998 Bonds to provide certain financial information and operating data relating to the Department to certain information repositories annually and to provide notice to the Municipal Securities Rulemaking Board of the occurrence of certain enumerated events, if material, pursuant to the requirements of Section (b)(5)(i) of Securities and Exchange Commission Rule 15c2-12 (17 C.F.R. § 240.15c2-12) (the "Rule"). See Appendix F - "FORM OF CONTINUING DISCLOSURE CERTIFICATE."

A failure by the Department to comply with the Disclosure Certificate will not constitute an event of default under the Certificate or on the 1998 Bonds. Any such failure must be reported in accordance with the Rule and must be considered by any broker, dealer or municipal securities dealer before recommending the purchase or sale of the 1998 Bonds in the secondary market. Consequently, such a failure may adversely affect the transferability and liquidity of the 1998 Bonds and their market price. The State has never failed to comply in all material respects with any previous undertakings with regard to the Rule to provide annual reports or notices of material events. The Department has not entered into any previous undertaking under the Rule with respect to the Highways Division.

The obligations of the Department described in the Disclosure Certificate will remain in effect until the 1998 Bonds are no longer Outstanding (within the meaning of the Certificate) or the Rule no longer applies to the 1998 Bonds. Any provision of the Disclosure Certificate may be amended or waived upon the conditions set forth therein.

The Disclosure Certificate is solely for the benefit of the Holders and beneficial owners from time to time of the 1998 Bonds. The exclusive remedy for any breach of the Disclosure Certificate by the Department is limited to the right of the Holders and beneficial owners to cause to be instituted and maintained proceedings to obtain specific performance by the Department of its obligations under the Disclosure Certificate. Any such proceedings challenging the adequacy of the information provided in accordance with the Disclosure Certificate may be instituted and maintained only by Holders and beneficial owners of not less than 25% in principal amount of the 1998 Bonds then Outstanding.

FINANCIAL STATEMENTS

The financial statements of the Highways Division as of and for the Fiscal Year ended June 30, 1997, are set forth in Appendix D to this Official Statement. These financial statements have been audited by Coopers & Lybrand, Honolulu, Hawaii, independent certified public accountants, whose report is set forth in Appendix D.

MISCELLANEOUS

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

SUMMARY OF CERTAIN PROVISIONS OF THE CERTIFICATE

For purposes of this Appendix A, Certificate means the Certificate of the Director of Transportation Providing for the Issuance of State of Hawaii Highway Revenue Bonds, dated as of August 1, 1993, as heretofore supplemented and as further supplemented by the Third Supplemental Certificate. The following is a summary of certain of the provisions of the Certificate. The summary does not purport to be complete or to follow the exact language of the Certificate, and, accordingly, is qualified by reference thereto and is subject to the full text thereof. Capitalized terms not otherwise previously defined in this Official Statement or defined below have the meanings set forth in the Certificate. For the complete provisions of the Certificate and the precise wording thereof, reference should be made to the Certificate, copies of which are available upon request at the office of the Department. Unless clearly indicated otherwise, all section references are to the Certificate only.

Definitions of Certain Terms [Certificate Section 1.01]

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

"Aggregate Bond Service" means, as of any date of calculation and with respect to any period, the sum of the amounts of Bond Service for all Series of Bonds for such period.

"Average Annual Bond Service" of a Series of Bonds means the result obtained by dividing (A) the aggregate Bond Service for such Series for the period from the date of issuance of such Series until the final maturity date of such Series by (B) the number of Bond Years in such period.

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

The Bond Service definition contains additional provisions concerning the calculation of debt service on Variable Rate Bonds and Capital Appreciation Bonds.

"Code" means the Internal Revenue Code of 1986, as from time to time amended, and any successor statute thereto, and any Treasury regulations or proposed regulations thereunder.

"Federal Securities" means any of the following:

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

(ii) obligations issued or guaranteed by any of the following federal agencies, provided that such obligations are backed by the full faith and credit of the United States of America; Export-Import Bank of the United States (backed by the full faith and credit of USA); Government National Mortgage Association (Ginnie Mae) (backed by the full faith and credit of USA); Public Housing Authority (backed by the full

faith and credit of USA); Farm Credit System Financial Assistance Corporation (senior debt rated in highest category by the Rating Agencies); Student Loan Marketing Association (Sallie Mae) (senior debt rated in highest category by the Rating Agencies); Tennessee Valley Authority (senior debt rated in highest category by the Rating Agencies); Inter-American Development Bank (senior debt rated in highest category by the Rating Agencies); World Bank (International Bank for Reconstruction & Development) (senior debt rated in highest category by the Rating Agencies); Federal Farm Credit Banks (Consolidated Systemwide Bonds) (senior debt rated in highest category by the Rating Agencies); Federal Home Loan Banks (consolidated debt of banks and deposits of 8 of the 12 individual banks rated in highest category by the Rating Agencies); Federal Home Loan Mortgage Corp. (senior debt (not subordinated debt) rated in highest category by the Rating Agencies); Federal National Mortgage Association (senior debt (not subordinated debt) rated in highest category by the Rating Agencies); and Resolution Funding Corporation (Refcorp) (rated in highest category by the Rating Agencies);

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

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

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

"Highway Bond Proceeds Account" means the special account created in the State Bond Fund into which shall be credited proceeds of Bonds for the payment of the costs of highway and road projects, and other related facilities and properties constituting a part of the Undertaking.

"Highway Revenue Special Account" means the special account of that name created in the Certificate.

"Highway Senior Debt Service Reserve Subaccount" means the separate special subaccount of the Department created pursuant to the Certificate in the Highway Revenue Special Account and designated as the "Highway Senior Debt Service Reserve Subaccount".

"Highway Senior Interest Subaccount" means the separate special subaccount of the Department created pursuant to the Certificate in the Highway Revenue Special Account and designated as the "Highway Senior Interest Subaccount".

"Highway Senior Principal Subaccount" means the separate special subaccount of the Department created pursuant to the Certificate in the Highway Revenue Special Account and designated as the "Highway Senior Principal Subaccount".

"Highway Subordinate Debt Service Reserve Subaccount" means the separate special subaccount of the Department created pursuant to the Certificate in the Highway Revenue Special Account and designated as the

"Highway Subordinate Debt Service Reserve Subaccount".

"Highway Subordinate Interest Subaccount" means the separate special subaccount of the Department created pursuant to the Certificate in the Highway Revenue Special Account and designated as the "Highway Subordinate Interest Subaccount".

"Highway Subordinate Principal Subaccount" means the separate special subaccount of the Department created in the Highway Revenue Special Account and designated as the "Highway Subordinate Principal Subaccount".

"Operation and Maintenance Expenses" means the expenses of operation, maintenance and repair of the properties constituting the Undertaking, including without limitation, the cost of equipment and general administrative overhead in connection with those properties, but excluding any (i) arbitrage earnings which are required to be paid to the United States Government pursuant to Section 148 of the Code, (ii) depreciation expense, and (iii) surcharges imposed by the State for central services relating to administration of funds of the Department.

"Outstanding", when used with respect to any Bond, shall have the construction given to such word in Section 11.01 of the Certificate, as described herein under "Discharge of Obligations of the State Under the Certificate".

For purposes of the Certificate, in the event any Bonds of a Series are issued and sold at a price such that a portion or all of the interest thereon is intended to be earned by accrual of original issue discount or the compounding of interest, the amount of such Bonds deemed to be Outstanding for the purpose of calculating the principal amount of any such Bonds and the principal amount of Bonds Outstanding in connection with the exercise of any voting right or privilege, the giving of any consent or direction or the taking of any other action that the Holders of the Bonds are entitled to take pursuant to Articles X and XI of the Certificate or otherwise, shall be the accreted value thereof.

"Pledged Funds" means the Revenues and the moneys held in the Highway Revenue Special Account, the Highway Bond Proceeds Account and such other funds and accounts which may be hereafter pledged to the payment of the principal of and interest on the Bonds.

"Pledged User Taxes" means the highway fuel license taxes, the vehicle weight taxes, the vehicle registration fees, the rental motor vehicle surcharge taxes and tour vehicle surcharge taxes, respectively levied and paid pursuant to Sections 243-4, 249-33, 249-31, and 251-2, Hawaii Revised Statutes, and other user taxes, fees or charges currently or hereafter derived from or arising through the ownership, operation, and management of the Undertaking and the furnishing and supplying of the services thereof, which are deposited in the State Highway Fund and made available pursuant to State law for the payment of the Bonds.

"Principal Installment" means, as of any date of calculation and with respect to any Series of Bonds, so long as any Bonds thereof are Outstanding: (i) the principal amount of Bonds of such Series due on a certain future date for which no Sinking Fund Installments have been established, or (ii) the unsatisfied balance (determined as provided in the definition of "Sinking Fund Installment") of any Sinking Fund Installment due on a certain future date for Bonds of such Series which would be applicable upon redemption of such Bonds on such future date in a principal amount equal to such unsatisfied balance of such Sinking Fund Installment, or (iii) if such future dates coincide as to different Bonds of such Series, the sum of such principal amount of Bonds and of such unsatisfied balance of such Sinking Fund Installment due on such future date.

"Reimbursable General Obligation Bonds" means general obligation bonds of the State to which the State has pledged its full faith and credit and which are payable from the general fund of the State, the proceeds of which were or are to be used to finance highway and road projects with respect to properties constituting part of the Undertaking, and with respect to which the general fund of the State is to be reimbursed from Revenues, except insofar as the obligation or reimbursement has been or is canceled by the State Legislature.

"Reserve Requirement" means with respect to Senior Bonds or Subordinate Bonds, an amount, as of any date of determination, equal to one-half (1/2) of the maximum Aggregate Bond Service for Senior Bonds or

Subordinate Bonds, as the case may be, in any Bond Year, beginning with the Bond Year in which the date of determination occurs and ending with the Bond Year after which no Senior Bonds or Subordinate Bonds, as the case may be, are Outstanding.

"Revenues" means and includes the items set forth below when and to the extent the same are deposited in the State Highway Fund to the credit of the Highway Revenue Special Account: (A) all income, revenues and moneys collected by the State from the ownership or operation of the Undertaking or the supplying and furnishing of the services, facilities and commodities thereof, and without limiting the generality of the foregoing, shall include all income, revenues and moneys derived from rates, rentals, fees, tolls and charges prescribed for the uses and services of, and the facilities and commodities furnished by, the Undertaking; (B) earnings on the investment of moneys held under the Certificate and the proceeds of the sale of any such investments; (C) income, revenues and moneys paid to the State or the Department with respect to properties that constitute part of the Undertaking on the effective date of the Certificate but are sold, leased or otherwise disposed of or transferred pursuant to the provisions of the Certificate so as to no longer constitute part of the Undertaking; (D) the Pledged User Taxes; and (E) any other moneys or funds deposited by the State or the Department into the Highway Revenue Special Account; provided, however, that the term "Revenues" shall not include: (i) moneys received as proceeds from the sale of Bonds; (ii) condemnation proceeds or insurance proceeds except insurance proceeds received from rental or business interruption insurance; (iii) grants-in-aid or similar payments received from the Federal Government or public agencies if (1) the application of such moneys are restricted to a specific purpose other than payment of principal of and interest on indebtedness of the State, or (2) such grants or payments constitute a reimbursement to the State for expenditures previously made from the State Highway Fund or the Highway Revenue Special Account; (iv) moneys or securities received by the State or the Department as gifts or grants, the use of which is restricted by the donor or grantor; (v) investment income derived from any moneys or securities which may be placed in escrow or trust to defease bonds of the State, including the Bonds, or which may be held in the Highway Bond Proceeds Account; (vi) any arbitrage earnings which are required to be paid to the United States Government pursuant to Section 148(f) of the Code; and (vii) the proceeds of any Support Facility.

"Senior Bond" or "Senior Bonds" means any bond, some of the bonds or all of the bonds issued under and at any time Outstanding pursuant to the Certificate, being the 1993 Bonds, the 1996 Bonds and the 1998 Bonds issued pursuant to of the Certificate, any Additional Senior Bonds issued pursuant to the Certificate, and any Refunding Senior Bonds issued pursuant to the Certificate.

"Sinking Fund Installment" means, with respect to each Series of Bonds, the amount designated as such in the Supplemental Certificate authorizing such Series of Bonds. The portion of any such Sinking Fund Installment remaining after the deduction of any such amounts credited toward the same (as the original amount of any such Sinking Fund Installment if no such amounts shall have been credited toward the same) shall constitute the unsatisfied balance of such Sinking Fund Installment for the purpose of calculation of Sinking Fund Installments due on a future date.

"Subordinate Bond" or "Subordinate Bonds" means any bond, some of the bonds or all of the bonds issued under and at any time Outstanding pursuant to the Certificate, being any Additional Subordinate Bonds issued pursuant to the Certificate, and any Refunding Subordinate Bonds issued pursuant to the Certificate.

"Supplemental Certificate" or "Certificate supplemental to the Certificate", means a certificate duly issued by the Director of Transportation for any of the purposes of Article X of the Certificate or otherwise amendatory of or supplemental to the Certificate but only if and to the extent specifically authorized thereunder.

"Support Facility" means any instrument such as a letter of credit, a committed line of credit, an insurance policy, a surety bond or a standby bond purchase agreement, or any combination of the foregoing, issued by a bank or banks, other financial institution or institutions, or any combination of the foregoing, which provides for: (i) with respect to any series of Bonds, the payment of all or a portion of the purchase price or principal, premium, if any, or interest due or to become due on specified Bonds of such series, or providing for the purchase of such Bonds or a portion thereof by the issuer of such Support Facility; or (ii) with respect to the Highway Senior Debt Service Reserve Subaccount or the Highway Subordinate Debt Service Reserve Subaccount, the funding, in whole or in part, of the Reserve Requirement.

"Undertaking" means and includes all highways and roads, and other related facilities and properties (real, personal or mixed) now belonging to or controlled by the State and under the administration, jurisdiction, control and management of the Department, and all improvements, betterments or extensions thereto hereafter constructed or acquired, except bikeways, and without limiting the generality of the foregoing, the term "Undertaking" shall include each and every, all and singular, the properties and facilities constructed or acquired from the proceeds of Bonds issued under the Certificate or constructed or acquired from the proceeds of any other bonds, notes or other evidences of indebtedness payable, or the principal and interest of which is reimbursable, from the State Highway Fund or from a fund maintained therefrom, or constructed or acquired from moneys in the State Highway Fund or in any other fund maintained therefrom.

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

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

Allocation and Application of Revenues [Certificate Section 5.01]

Upon issuance of the 1998 Bonds, and so long as any Bonds are Outstanding, (1) the State Highway Fund and the Highway Revenue Special Account shall both be continued and (2) all Revenues that are deposited in the State Highway Fund shall be immediately credited to the Highway Revenue Special Account. The Revenues credited or to be credited to the Highway Revenue Special Account shall be applied, used and disposed of as follows, and in the following order of priority:

FIRST: For further credit to the following subaccounts in the following order of priority in the amounts required pursuant to the provisions of the Certificate:

- (a) Highway Senior Interest Subaccount;
- (b) Highway Senior Principal Subaccount;
- (c) Highway Senior Debt Service Reserve Subaccount;

SECOND: For further credit to the following subaccounts in the following order of priority in the amounts required pursuant to the provisions of the Certificate:

- (d) Highway Subordinate Interest Subaccount;
- (e) Highway Subordinate Principal Subaccount; and
- (f) Highway Subordinate Debt Service Reserve Subaccount;

THIRD: For payment of Operation and Maintenance Expenses;

FOURTH: For payment of the costs of acquisition (including real property and interests therein), construction, addition, expansion, improvement, renewal, replacement, reconstruction, engineering, investigation,

and planning for the Undertaking and bikeways, all or any of which in the judgment of the Department are necessary to the performance of its duties or functions;

FIFTH: To reimburse the general fund of the State for Reimbursable General Obligation Bonds;

SIXTH: All or any portion of available moneys credited to the Highway Revenue Special Account, after satisfying the requirements of priority items **FIRST** through **FIFTH** above, determined in conformance with Section 248-9, Hawaii Revised Statutes, as amended, or any successor statute thereto, by the Director of Transportation to be in excess of 135% of the requirements for the ensuing 12 months for the Highway Revenue Special Account may be transferred from the Highway Revenue Special Account as permitted by and in accordance with Section 37-53, Hawaii Revised Statutes, as amended, or any successor statute thereto; and

SEVENTH: To provide funds for other special reserve funds and other special funds as may be created by law.

Highway Senior Interest Subaccount [Certificate Section 5.02]

The moneys credited to such account shall be disbursed solely for the purpose of paying interest on the Senior Bonds as the same becomes due. In each month, commencing with the first Business Day of the month which follows the last month for which interest on a Series of Senior Bonds, if any, is provided for from the proceeds of a Series of Senior Bonds, with respect to each Series of Senior Bonds, commencing on such first Business Day and continuing on the first Business Day of each month thereafter so long as any of the Senior Bonds of such Series are Outstanding, the Department shall credit to the Highway Senior Interest Subaccount from amounts credited to the Highway Revenue Special Account an amount such that, if the same amount were so credited on the first Business Day of each succeeding month thereafter, the aggregate of such amounts credited on the first Business Day of the month preceding an Interest Payment Date will be equal to the installment of interest falling due on the Senior Bonds on such Interest Payment Date or the amount required to reimburse the Support Provider for a draw on the Support Facility made to provide funds for the payment thereof. In making the credits to the Highway Senior Interest Subaccount required by this paragraph, consideration shall be given to and allowance made for accrued interest received upon the sale of a Series of Senior Bonds, and for interest capitalized from the proceeds of a Series of Senior Bonds (which accrued or capitalized interest shall in each case be deposited in the Highway Revenue Special Account for credit to the Highway Senior Interest Subaccount), and for any other credits otherwise made to said account.

Highway Senior Principal Subaccount [Certificate Section 5.03]

In the event of the issuance of any Series of Senior Bonds maturing at times customarily known as maturing serially, in order to provide for the payment of principal of such Senior Bonds of such Series, or to reimburse the Support Provider for a draw on the Support Facility made to provide funds for the payment of such Senior Bonds maturing serially, commencing with the month which is 12 months prior to the first principal payment date of any of such Senior Bonds maturing serially and in each month thereafter so long as any of such Senior Bonds so maturing are Outstanding, there shall be credited to the Highway Senior Principal Subaccount an amount such that, if the same amount were so credited to this account on the first Business Day of such first month and each succeeding month thereafter prior to the next date upon which the principal of any of said Senior Bonds maturing serially becomes due and payable, the aggregate of the amounts on credit will on the first Business Day of the month preceding each such next principal payment date be equal to the principal amount of said Senior Bonds becoming due on such principal payment date.

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

Sinking Fund Installment falls due, the aggregate of the amounts so credited will on the first Business Day of the month preceding each such next date upon which a Sinking Fund Installment falls due be sufficient to redeem the term Senior Bonds of each Series in the principal amounts and at the times specified in the Supplemental Certificate authorizing the issuance thereof.

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

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

Highway Senior Debt Service Reserve Subaccount [Certificate Section 5.05]

The Highway Senior Debt Service Reserve Subaccount shall be maintained in an amount equal to the Reserve Requirement and shall be disbursed solely for the purpose of paying principal of and interest on Senior Bonds for the payment of which there shall be insufficient money in the Highway Senior Interest Subaccount or Highway Senior Principal Subaccount. The Reserve Requirement shall be determined at the time of issuance of a Series of Senior Bonds, the deposit therein of any Support Facility, July 1 of each year, and such other time or times as the Department shall determine and shall be funded upon the issuance of each Series of Senior Bonds.

Subject to the remaining provisions of this paragraph, (a) if at any time during a Fiscal Year the moneys on credit to the Highway Senior Debt Service Reserve Subaccount are less than the Reserve Requirement (including any deficiency in a Support Facility used to fund all or a portion of the Reserve Requirement), the amount of the deficiency shall be restored from the first available Pledged Funds (after making credits required to the Highway Senior Principal and Interest Subaccounts); (b) if at the end of any Fiscal Year, the moneys and any Support Facility credited to the Highway Senior Debt Service Reserve Subaccount are less than the Reserve Requirement, the Department shall (after making the deposits and credits to other subaccounts or purposes as required by the Certificate) credit an amount to the Highway Senior Debt Service Reserve Subaccount from Pledged Funds credited

to the Highway Revenue Special Account so that there shall then be credited to the Highway Senior Debt Service Reserve Subaccount an amount equal to the Reserve Requirement; (c) if the deficiency in the Highway Senior Debt Service Reserve Subaccount is due to the application of moneys credited thereto or payments under a Support Facility to pay principal of or interest on any Senior Bonds, then in each month, commencing with the month which follows the month in which such application is made from the Highway Senior Debt Service Reserve Subaccount, the Department shall (after making the deposits and credits to other subaccounts or purposes as required by the Certificate) credit from the Pledged Funds credited to the Highway Revenue Special Account to the Highway Senior Debt Service Reserve Subaccount the greater of (1) 1/12 of amounts due as a result of any draw under a Support Facility (which amounts will be used by Department to pay amounts due under a Support Facility) or (2) an amount which, if the same amount were so credited in each month thereafter until such day as the Department shall determine, which day shall not be more than 60 months from the making of the first of such credits, there shall be credited to such Subaccount on such day an amount not less than the Reserve Requirement; and (d) if at any time and for so long as the moneys credited to the Highway Senior Debt Service Reserve Subaccount are at least equal to the Reserve Requirement and all amounts due to any issuer of a Support Facility have been paid, then no further credits shall be made to the Subaccount, and any amounts in excess of the Reserve Requirement may be retained in the Highway Revenue Special Account for use and application as are all other moneys on deposit therein.

When Senior Bonds are refunded in whole or in part or are otherwise paid so that all or a portion of the Senior Bonds are no longer Outstanding and all amounts due to any issuer of a Support Facility are paid, then moneys credited to the Highway Senior Debt Service Reserve Subaccount in excess of the Reserve Requirement may be withdrawn from the Highway Revenue Special Account to pay or provide for the payment of such Senior Bonds or refunded Senior Bonds, as the case may be, or may be transferred and applied by the Department to make up any deficiency in any other subaccounts under the Certificate or to any other account in the State Highway Fund; provided that immediately after such withdrawal or transfer there shall be on credit to the Highway Senior Debt Service Reserve Subaccount an amount equal to the Reserve Requirement.

In lieu of the credit of moneys to the Highway Senior Debt Service Reserve Subaccount, the Department may cause to be so credited one or more Support Facilities in an amount equal to the difference between the Reserve Requirement and the aggregate of (1) amounts then credited to the Highway Senior Debt Service Reserve Subaccount and (2) the amounts then available to be drawn under any Support Facility then credited to such Reserve Subaccount. In the event a Support Facility is obtained to satisfy a portion of the Reserve Requirement so long as such Support Facility is in effect any moneys in the Reserve Subaccount shall be used to make up any deficiency in the Highway Senior Principal and Interest Subaccounts prior to any draw on any Support Facility. The Support Facility shall be payable (upon the giving of notice as required thereunder) on any date on which moneys will be required to be applied from the Highway Senior Debt Service Reserve Subaccount to the payment of the principal of or interest on any Senior Bonds. Prior to the use of a Support Facility pursuant to the provisions of this paragraph, the Department shall receive written confirmation from the Rating Agency that the rating on the Senior Bonds Outstanding as then in effect shall not be reduced as a result of such use. If a disbursement is made pursuant to a Support Facility provided pursuant to this paragraph, the Department shall be obligated either (i) to reinstate the maximum limits of such Support Facility or (ii) to credit to the Highway Senior Debt Service Reserve Subaccount, funds in the amount of the disbursement made under such Support Facility, or a combination of such alternatives, as shall provide that the amount credited to the Highway Senior Debt Service Reserve Subaccount equals the Reserve Requirement for all Senior Bonds; 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 described in the second preceding paragraph. Notwithstanding the provisions of said second preceding paragraph, the Department shall not permit any Support Facility which has been established in lieu of a deposit into the Highway Revenue Special Account for credit to the Highway Senior Debt Service Reserve Subaccount to terminate or expire prior to depositing to such Subaccount for credit to such Subaccount the amount satisfied previously by such Support Facility.

Highway Subordinate Interest Subaccount [Certificate Section 5.06]

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

Highway Subordinate Principal Subaccount [Certificate Section 5.07]

In the event of the issuance of any Series of Subordinate Bonds under the Certificate maturing at times customarily known as maturing serially, in order to provide for the payment of principal of such Subordinate Bonds of such Series, or to reimburse the Support Provider for a draw on the Support Facility made to provide funds for the payment of such Subordinate Bonds maturing serially, commencing with the month which is 12 months prior to the first principal payment date of any of such Subordinate Bonds maturing serially and in each month thereafter so long as any of such Subordinate Bonds so maturing are Outstanding, there shall be credited to the Highway Subordinate Principal Subaccount an amount such that, if the same amount were so credited to this account on the first Business Day of such first month and each succeeding month thereafter prior to the next date upon which the principal of any of said Subordinate Bonds maturing serially becomes due and payable, the aggregate of the amounts on credit will on the first Business Day of the month preceding each such next principal payment date be equal to the principal amount of said Subordinate Bonds becoming due on such principal payment date.

In the event of the issuance of any Series of Subordinate Bonds under the Certificate in the form customarily known as "term bonds", for the purpose of retiring such Subordinate Bonds, or to reimburse the Support Provider for a draw on the Support Facility made to provide funds for the payment of such term Subordinate Bonds, commencing with the month which is 12 months immediately prior to the date upon which the first Sinking Fund Installment to provide for the retirement of such term Subordinate Bonds is due, and in each month thereafter so long as any of such Subordinate Bonds are Outstanding, there shall be credited to the Highway Subordinate Principal Subaccount from amounts credited to the Highway Revenue Special Account an amount such that, if the same

amount were so credited on the first Business Day of such first month and each succeeding month thereafter prior to the next date upon which a Sinking Fund Installment falls due, the aggregate of the amounts so credited will on the first Business Day of the month preceding each such next date upon which a Sinking Fund Installment falls due be sufficient to redeem the term Subordinate Bonds of each Series in the principal amounts and at the times specified in the Supplemental Certificate authorizing the issuance thereof.

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

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

Highway Subordinate Debt Service Reserve Account [Certificate Section 5.09]

The Highway Subordinate Debt Service Reserve Account shall be maintained in an amount equal to the Reserve Requirement and shall be disbursed solely for the purpose of paying principal of and interest on Subordinate Bonds for the payment of which there shall be insufficient money in the Highway Subordinate Interest Subaccount or Highway Subordinate Principal Subaccount. The Reserve Requirement shall be determined at the time of issuance of a Series of Subordinate Bonds, July 1 of each year, at the time any Variable Rate Subordinate Bonds of a Series cease to be Variable Rate Subordinate Bonds, and such other time or times as the Department shall determine and shall be funded upon the issuance of each Series of Subordinate Bonds.

Subject to the remaining provisions of this paragraph, (a) if at any time during a Fiscal Year the moneys on credit to the Highway Subordinate Debt Service Reserve Subaccount are less than the Reserve Requirement (including any deficiency in a Support Facility used to fund all or a portion of the Reserve Requirement), the amount of the deficiency shall be restored from the first available Pledged Funds; (b) if at the end of any Fiscal Year, the moneys credited to the Highway Subordinate Debt Service Reserve Subaccount are less than the Reserve

Requirement, the Department shall (after making the deposits and credits to other subaccounts and purposes as required by the Certificate) credit an amount to the Highway Subordinate Debt Service Reserve Subaccount from Pledged Funds credited to the Highway Revenue Special Account so that there shall then be credited to the Highway Subordinate Debt Service Reserve Subaccount an amount equal to the Reserve Requirement; (c) if the deficiency in the Highway Subordinate Debt Service Reserve Subaccount is due to the application of moneys credited thereto to pay principal of or interest on a Series of Subordinate Bonds, then in each month, commencing with the month which follows the month in which such application is made from the Highway Subordinate Debt Service Reserve Subaccount, the Department shall (after making the deposits and credits to other subaccounts and purposes as required by the Certificate) credit from the Pledged Funds credited to the Highway Revenue Special Account to the Highway Subordinate Debt Service Reserve Subaccount an amount which, if the same amount were so credited in each month thereafter until such day as the Department shall determine, which day shall not be more than 60 months from the making of the first of such credits, there shall be credited to such account on such day an amount not less than the Reserve Requirement; and (d) if at any time and for so long as the moneys credited to the Highway Subordinate Debt Service Reserve Subaccount are at least equal to the Reserve Requirement, no further credits shall be made to the account, and any amounts in excess of the Reserve Requirement may be retained in the Highway Revenue Special Account for use and application as are all other moneys on deposit therein.

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

In lieu of the credit of moneys to the Highway Subordinate Debt Service Reserve Subaccount, the Department may cause to be so credited a Support Facility in an amount equal to the difference between the Reserve Requirement and the amounts then credited to the Highway Subordinate Debt Service Reserve Subaccount. In the event a Support Facility is obtained to satisfy a portion of the Reserve Requirement allocable to a Series of Subordinate Bonds, so long as such Support Facility is in effect, the Owners of such Series of Subordinate Bonds shall not be entitled to payment from or a lien on the funds credited to the Highway Revenue Special Account credited to the Highway Subordinate Debt Service Account to satisfy that portion of the Reserve Requirement allocable to other Series of Subordinate Bonds, nor shall the Owners of Subordinate Bonds of such other Series be entitled to any payment from such Support Facility. The Support Facility shall be payable (upon the giving of notice as required thereunder) on any date on which moneys will be required to be applied from the Highway Subordinate Debt Service Reserve Subaccount to the payment of the principal of or interest on any Subordinate Bonds of such Series and such withdrawals may not be made from amounts credited to the Highway Subordinate Debt Service Reserve Subaccount for such Series of Subordinate Bonds. Prior to the use of a Support Facility pursuant to the provisions of this paragraph, the Department shall receive written confirmation from the Rating Agency that the rating on the Subordinate Bonds Outstanding as then in effect shall not be reduced as a result of such use. If a disbursement is made pursuant to a Support Facility provided pursuant to this paragraph, the Department shall be obligated either (i) to reinstate the maximum limits of such Support Facility or (ii) to credit to the Highway Subordinate Debt Service Reserve Subaccount, funds in the amount of the disbursement made under such Support Facility, or a combination of such alternatives, as shall provide that the amount credited to the Highway Subordinate Debt Service Reserve Subaccount allocable to a Series of Subordinate 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 described in clause (b) under "Events of Default; Remedies--Events of Default" below. Notwithstanding the provisions of said clause (b), the Department shall not permit any Support Facility which has been established in lieu of a deposit into the Highway Revenue Special Account for credit to the Highway Subordinate Debt Service Reserve Subaccount to terminate or expire prior to depositing to such fund for credit to such account the amount satisfied previously by the Support Facility.

Investment of Moneys [Certificate Section 5.10]

Moneys in the Highway Revenue Special Account credited to the Highway Senior Interest Subaccount, the Highway Senior Principal Subaccount, the Highway Subordinate Interest Subaccount, and the Highway Senior Subordinate Principal Subaccount therein shall be invested by the Director of Finance in Investment Securities which have ratings provided by Moody's and S&P that are not less than the ratings given to the Senior Bonds then Outstanding and which mature in such amounts and at such times so that the principal of and interest and premium, if any, on the Bonds can be paid when due, whether at maturity or upon the redemption thereof. Moneys in the Highway Revenue Special Account credited to the Highway Senior Debt Service Reserve Subaccount and the Highway Subordinate Debt Service Reserve Subaccount therein shall be invested by the Director of Finance in Federal Securities which have ratings provided by Moody's and S&P that are not less than the ratings given to the Senior Bonds then Outstanding and which have maturities or are redeemable at the option of the Holder thereof in not more than 5 years from the date of investment, but in any event by no later than the last or final maturity date of the Senior Bonds or Subordinate Bonds then Outstanding, as the case may be. The Department in the Certificate grants its approval for all investments made by the Director of Finance pursuant to the Certificate, and no further approvals of the Department shall be necessary therefor.

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

All moneys in the Highway Revenue Special Account and the Highway Bond Proceeds Account, the investment of which is not otherwise provided for in the Certificate, may be invested, and the income from such investments disbursed or applied, as may be provided by applicable law.

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

The Department will maintain records to enable it to cause to be made the computations necessary to determine whether a Series of Bonds the interest on which is intended to be excludable from gross income for federal income tax purposes meets the requirements of Section 148 of the Code, including, but not limited to, records showing the dates and amounts of all investments of funds credited to a subaccounts in the Highway Revenue Special Account and the Highway Bond Proceeds Account.

Revenues Held in Trust, Lien of Bondholders [Certificate Section 5.11]

The moneys in the State Highway Fund shall, until used, applied and disbursed in accordance with the provisions of the Certificate, be held in trust: (i) for the equal benefit and security of the Holders from time to time of the Senior Bonds; and (ii) subject to the prior and senior rights, benefits and security of the Holders from time to time of the Senior Bonds, for the equal benefit and security of the Holders from time to time of the Subordinate Bonds. Subject to the provisions of the Certificate relating to application of moneys, all Senior Bonds shall have a prior and paramount lien on the Revenues paid into the Highway Revenue Special Account for credit to the Highway Senior Interest Subaccount, the Highway Senior Principal Subaccount and the Highway Senior Debt Service Reserve Subaccount therein and the investments in which such Revenues may from time to time be invested, over and ahead of all Subordinate Bonds and all bonds, notes or other evidences of indebtedness which may subsequently be issued, and over and ahead of any claims, encumbrances or obligations subsequently arising or subsequently incurred, and all the Senior Bonds shall be equally and ratably secured, without priority by reason of series, number, date of execution or of any Supplemental Certificate providing for the issuance thereof, date of Senior Bonds, date of issuance, date of sale, date of execution, date of authentication, or date of delivery, by such lien in accordance with the provisions of the Certificate. Subject to the prior and paramount lien provided in the preceding sentence in respect of the Senior Bonds and further subject to the provisions of the Certificate relating to application of moneys, all Subordinate Bonds shall have a lien on the Revenues paid into the Highway Revenue Special Account for credit to the Highway Subordinate Interest Subaccount, the Highway Subordinate Principal Subaccount and the Highway Subordinate Debt Service Reserve Subaccount therein and the investments in which such Revenues may from time to time be invested, over and ahead of all bonds, notes or other evidences of indebtedness which may subsequently be issued, and over and ahead of any claims, encumbrances or obligations subsequently arising or subsequently incurred, and all the Subordinate Bonds shall be equally and ratably secured, without priority by reason of series, number, date of execution or of any Supplemental Certificate providing for the issuance thereof, date of Subordinate Bonds, date of issuance, date of sale, date of execution, date of authentication, or date of delivery, by such lien in accordance with the provisions of the Certificate. Subject to the provisions the Certificate relating to application of moneys, no claim, encumbrance or obligation against the Pledged Funds subsequently arising or incurred shall be secured by or entitled to a lien or charge thereon prior to or equal with the payments required by the Certificate to be made from the Pledged Funds to provide for the payment of the Bonds.

Conditions Precedent to Issuance of Additional Bonds and Refunding Bonds [Certificate Section 4.02]

The Department at any time and from time to time may authorize the issuance of one or more Series of: (i) additional Senior Bonds ("Additional Senior Bonds") or refunding Senior Bonds ("Refunding Senior Bonds") payable from the Highway Revenue Special Account on a parity with all other Senior Bonds then Outstanding and equally and ratably secured therewith, or (ii) additional Subordinate Bonds ("Additional Subordinate Bonds") or refunding Subordinate Bonds ("Refunding Subordinate Bonds") payable from the Highway Revenue Special Account on a parity with any Additional Subordinate Bonds or Refunding Subordinate Bonds then Outstanding and equally and ratably secured therewith, in each case upon compliance with the following conditions:

1. The issuance of the Additional Bonds or Refunding Bonds shall have been authorized by law and are issued under and pursuant to a Supplemental Certificate or Certificates.
2. The Supplemental Certificate providing for the issuance of such Bonds shall provide that any accrued interest received upon the sale of said Bonds or any interest capitalized from the proceeds of said Bonds shall be paid into the Highway Revenue Special Account for credit to the Highway Senior Interest Subaccount or the Highway Subordinate Interest Subaccount;
3. At the time of the issuance of such Bonds, no default exists in the payment of the principal of and premium, if any, and interest on any Bond; no deficiencies exist in the State Highway Fund or the Highway Revenue Special Account; and there does not exist an "Event of Default" or a condition which upon the passage of time would constitute such an "Event of Default";
4. Upon the delivery of such Bonds, there shall be credited to the Highway Revenue Special

Account for credit to the Highway Senior Debt Service Reserve Subaccount and the Highway Subordinate Debt Service Reserve Subaccount an amount equal to, in each case, the Reserve Requirement; provided however, that the Supplemental Certificate providing for the issuance of such Series of Bonds may provide that part of the proceeds thereof shall be paid or a Support Facility may be deposited, into the Highway Revenue Special Account for credit to the Highway Senior Debt Service Reserve Subaccount or the Highway Subordinate Debt Service Reserve Subaccount, as the case may be.

5. In the case of the issuance of Additional Bonds, upon compliance with the additional conditions summarized below.

6. In the case of the issuance of Refunding Bonds, upon compliance with the additional conditions summarized below.

Additional Conditions for the Issuance of Additional Bonds [Certificate Section 4.03]

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

(a) Such Bonds shall be issued only for the purpose of the payment or reimbursement of the cost of the acquisition or construction of properties to constitute part of the Undertaking or the making of additions to, expansions of, improvements of, renewals of, replacements of, or reconstructions of, the Undertaking or of properties which shall constitute part of the Undertaking; and

(b) The Revenues for any twelve (12) consecutive calendar month's period out of the last eighteen consecutive (18) calendar month's period immediately preceding the date of issuance of the Series of Bonds, as derived from the most recent publicly available financial statements of the Department, shall be at least equal to: (i) in the case of Senior Bonds proposed to be issued, two (2) times maximum Aggregate Bond Service for any future Fiscal Year on a Senior Bonds to be Outstanding after the issuance of such Additional Senior Bonds; and (ii) in the case of Subordinate Bonds proposed to be issued, one and thirty-hundredths (1.30) times maximum Aggregate Bond Service for any future Fiscal Year on all Bonds to be Outstanding after the issuance of such Additional Subordinate Bonds.

Additional Conditions for the Issuance of Refunding Bonds [Certificate Section 4.04]

The following conditions, in addition to those set forth above under "Conditions Precedent to Issuance of Additional Bonds and Refunding Bonds," shall be met upon the issuance of Refunding Bonds:

(a) Such Refunding Bonds are being issued for the purpose of refunding at their maturity or at any time within one year prior to their maturity, any of the then Outstanding Bonds, for the payment of which sufficient funds are not available, which Bonds to be refunded shall be specified in the Supplemental Certificate providing for the issuance of the Refunding Bonds; and

(b) Refunding Bonds may be issued to refund prior to maturity all or part of the Outstanding Bonds, including therein amounts to pay principal of, and redemption and acquisition premium and interest on the Bonds to be refunded, which Bonds to be refunded shall be specified in the Supplemental Certificate providing for the issuance of the Refunding Bonds.

Variable Rate Bonds [Certificate Section 4.02]

Nothing in the Certificate shall prohibit or prevent, or be deemed or construed to prohibit or prevent, the Department from issuing Variable Rate Bonds; provided, however, that no Variable Rate Bond may be issued as a Senior Bond. The Supplemental Certificate providing for the issuance of such Variable Rate Bonds may provide for, without limitation, the following: Support Facilities or alternative Support Facilities and support agreements in connection therewith; remarketing agreements and the appointment of remarketing agents; the appointment of tender agents to accept mandatory or optional tenders of Variable Rate Bonds; the payment, redetermination and accrual over specified periods of interest; the establishment, use, composition, adjustment and change of interest indices or modes or the establishment and use of alternative interest indices or modes or the establishment of a fixed interest rate or rates; the establishment of special funds and accounts in connection with the issuance of such Variable Rate Bonds; special redemption or purchase provisions for such Variable Rate Bonds and notice provisions in connection with the purchase, redemption, delivery or tender of such Variable Rate Bonds; and any other terms and provisions not in conflict with the Certificate.

Annual Audit [Certificate Section 6.04]

The Department shall maintain and keep, or cause to be maintained and kept, proper books, records and accounts in which complete and correct entries shall be made of all dealings and transactions relating to the Undertaking. Such accounts shall show the amount of the Revenues and the application of such Revenues to the purposes specified in the Certificate and all financial transactions in connection therewith, including all deposits into and disbursements from the State Highway Fund, the Highway Revenue Special Account and the Highway Bond Proceeds Account.

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

Annual Budget [Certificate Section 6.05]

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

Amending Certificate Without Consent of Bondholders [Certificate Section 9.01]

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

1. To make any changes or corrections in the Certificate or any supplement thereto as to which it shall have been advised by its counsel that the same are minor clerical or typographical corrections or changes or are required for the purpose of curing or correcting any ambiguity or defective or inconsistent provision or omission or mistake or manifest error contained therein or in any such supplement thereto, or to insert in the Certificate such provisions clarifying matters or questions arising under the Certificate as are necessary or desirable;
2. To add additional covenants and agreements of the State for the purpose of further securing the payment of the Bonds, provided that such additional covenants and agreements are not contrary to or inconsistent with the covenants and agreements contained in the Certificate as originally issued or as amended with the consent of Bondholders;
3. To surrender any right, power or privilege reserved to or conferred upon the State by the terms of the Certificate or any supplement hereto;
4. To confirm as further assurance any lien, pledge or charge, or the subjection of any additional revenue, property or collateral to any lien, pledge or charge, created or to be created by the provisions of the Certificate or any supplement thereto;
5. To grant to or confer upon the Holders of the Bonds or any Support Provider, any additional rights, remedies, powers, authority or security that lawfully may be granted to or conferred upon them;
6. To prescribe further limitations and restrictions upon the issuance of Bonds and the incurring of indebtedness by the State payable from the Revenues;
7. To include any modifications, amendments or supplements as may be required with respect to any Series of Bonds in order to obtain a favorable rating or ratings from any Rating Agency;
8. To add or modify any provision of the Certificate as a result of enactment of any State or federal law which changes the treatment of the Bonds or interest thereon for tax purposes;
9. To include any modifications, amendments or supplements as may be required with respect to any Series of Bonds in order to permit such Series to be available through a book-entry system maintained by, or to be cleared through, The Depository Trust Company, New York, New York, or other securities depository, clearing corporation, or clearing agency;
10. To make any changes or corrections to the Certificate as are necessary to provide for the issuance of Bonds in a form not contemplated by the express provisions of the Certificate, including without limitation in the form of commercial paper, indebtedness which converts from a variable rate to a fixed rate, indebtedness which initially compounds or accrues interest and then converts to a current interest-bearing instrument, and a Series of Bonds whereby the State pays a particular rate of interest and such interest payment is divided in a manner such that certain Bondholders receive a variable interest rate determined by the market and other Bondholders receive a residual interest rate approximating the difference between the interest payment paid by the State and such variable rate of interest; or

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

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

Amending Certificate With Consent of Bondholders [Certificate Section 9.02]

With the consent of the Holders of not less than a majority of the principal amount of the Bonds then Outstanding, the State, acting by and through the Department or as may otherwise then be provided by law, from time to time and at any time, may make and execute an instrument or certificate amending or supplementing the provisions of the Certificate for the purpose of adding any provisions to, or changing in any manner or eliminating any of the provisions of, the Certificate or of any supplement thereto, or modifying or amending the rights and obligations of the Department thereunder, or modifying in any manner the rights of the Holders of the Bonds; provided, however, that, without the specific consent of the Holder of each Bond which would be affected thereby, whether or not such Bond shall then be deemed to be Outstanding thereunder, no such instrument or certificate amending or supplementing the provisions thereof shall: (1) extend the fixed maturity date for the payment of the principal of any Bond, or reduce the principal amount of any Bond, or reduce the rate or extend the time of payment of interest thereon, or reduce any premium payable upon the redemption or prepayment thereof, or advance the date upon which any Bond may first be called for redemption prior to its fixed maturity date; (2) reduce the aforesaid percentage of Bonds, the Holders of which are required to consent to any such instrument or certificate amending or supplementing the provisions thereof; (3) give to any Bond or Bonds, whether Series 1998 Bonds, Additional Bonds or Refunding Bonds, any preference over any other Bond or Bonds secured by the Certificate; (4) authorize the creation of any pledge of the Revenues or any lien or charge thereon prior or superior to or on a parity with the pledge of and lien and charge thereon created in the Certificate for the payment of the Bonds except to the extent provided in Article II of the Certificate; or (5) deprive any Holder of the Bonds of the pledge and lien created by the Certificate; and provided further, that if moneys or Federal Securities shall have been deposited in accordance with the provisions of the Certificate for the payment of particular Bonds and such Bonds shall not in fact have been paid, no amendments or supplements to the provisions of Article XII of the Certificate shall be made without the specific consent of the Holder of each Bond which would be affected thereby. A modification or amendment of the provisions of Article V of the Certificate with respect to any of the accounts therein shall not be deemed a change in the terms of payment of the Bonds; provided, however, that no such modification or amendment shall, except upon the consent of the Holders of a Bonds then Outstanding affected thereby, reduce the amount or amounts required to be deposited in the Highway Revenue Special Account for credit to all accounts therein.

Events of Default; Remedies [Certificate Sections 10.01 to 10.05]

Events of Default. The following shall constitute "Events of Default":

(a) If payment of the interest on, or principal (including any Sinking Fund Installment) or premium (if any) of any Bond, whether at maturity or by proceedings for redemption, by declaration, or otherwise, shall not be made after the same shall become due and payable; or

(b) If the Department shall default in the due and punctual performance of any of the covenants, conditions, agreements and provisions contained in the Bonds or in the Certificate or in any Certificate supplemental thereto, on the part of the Department to be performed, and such default shall continue for 90 days after written notice specifying such default and requiring the same to be remedied shall have been given to the Department by the Holders of not less than 20% in principal amount of the Bonds then Outstanding, or any trustee or committee therefor; provided, however, that if such failure shall be such that it cannot be corrected within such 90-day period, it shall not constitute an Event of Default if correction action is instituted within such period and diligently pursued until the failure is corrected; or

(c) If any proceedings shall be instituted, with the consent or acquiescence of the State, for the purpose of effecting a composition between the State and its creditors and if the claim of such creditors is in any circumstance payable from any of the Revenues or any other moneys pledged and charged in the Certificate or in any Certificate supplemental thereto, or for the purpose of adjusting the claims of such creditors, pursuant to any federal or State statute now or hereafter enacted; or

(d) If, under the provision of any other law for the relief or aid of debtors, any court of competent jurisdiction shall assume custody or control of the Undertaking or any of the buildings and facilities thereof, and such custody or control shall not be terminated within 90 days from the date of assumption of such custody or control; or

(e) If the Department or the State shall for any reason be rendered incapable of fulfilling its obligations under the Certificate.

Declaration of Principal and Interest as Due. Upon the occurrence and continuation of an Event of Default, then and in each and every case the Holders of not less than 25% in principal amount of the Senior Bonds then Outstanding and the Holders of not less than 25% in principal amount of the Subordinate Bonds then Outstanding may, by written notice to the Department filed in the office of the Department and with the Director of Finance, proceed to declare the principal of all Bonds then Outstanding, together with a accrued and unpaid interest thereon and together with all other moneys secured thereby, if not already due, to be due and payable immediately, and upon any such declaration the same shall become and be due and payable immediately, anything in the Certificate, any Supplemental Certificate, or in any of the Bonds contained to the contrary notwithstanding, except to the extent otherwise provided in connection with a Support Facility. This provision is subject, however, to the condition that, if at any time after the principal of the Bonds, together with accrued and unpaid interest thereon shall have been so declared due and payable and before any further action has been taken (other than the making of the above declaration), the principal amount of all Bonds which have matured either according to the maturity date or dates specified therein or otherwise (except as a result of such declaration) and all arrears of interest upon all Bonds, except interest accrued but not yet due on said Bonds, shall be paid or caused to be paid, and all other Events of Default, if any, which shall have occurred shall have been remedied, cured or secured, then and in every such case the Holders of a majority in principal amount of the Senior Bonds then Outstanding and not less than 25% in principal amount of the Subordinate Bonds then Outstanding, by notice in writing delivered to the Department and the Director of Finance, may waive such default and its consequences and rescind such declaration. No such waiver or rescission or annulment shall extend to or affect any subsequent default or impair or exhaust any right or power consequent thereon.

Bondholders' Committee. Upon the occurrence of an Event of Default and at any time such Event of Default shall be continuing, the Holders of not less than 20% in principal amount of the Senior Bonds then Outstanding and not less than 20% in principal amount of the Subordinate Bonds then Outstanding may call a meeting of the Holders of Bonds for the purpose of electing a Bondholders' Committee. Such meeting shall be called and proceedings thereat shall be conducted as provided for other meetings of Bondholders pursuant to the Certificate. At such meeting the Holders of not less than a majority of the principal amount of the Senior Bonds then Outstanding and not less than a majority of the principal amount of the Subordinate Bonds then Outstanding must be present in person or by proxy in order to constitute a quorum for the transaction of business, less than a quorum, however, having power to adjourn from time to time without any notice. A quorum being present at such meeting, the Bondholders present in person or by proxy may, by the votes cast by the Holders of a majority in principal amount of the Senior Bonds and by the Holders of a majority in principal amount of the Subordinate Bonds so present in person or by proxy, elect one or more persons who may or may not be Bondholders to the Bondholders' Committee which shall act as trustee for a Bondholders. The Bondholders present in person or by proxy at said meeting, or at any adjourned meeting thereof, shall prescribe the manner in which the successors of the persons elected to the Bondholders' Committee at such Bondholders' meeting shall be elected or appointed, and may prescribe rules and regulations governing the exercise by the Bondholders' Committee of the power conferred upon it herein, and may provide for the termination of the existence of the Bondholders' Committee.

Suits at law or Equity and Mandamus. In case any one or more of the Events of Default shall happen and be continuing, then and in every such case, but subject to the provisions, limitations and conditions contained in the Certificate so far as the remedies provided in said Sections are concerned, the Holder of any Bond at the time

Outstanding shall be entitled, for the equal benefit and protection of all Holders of the Bonds similarly situated to proceed and protect and enforce the rights vested in such Holder by the Certificate by such appropriate judicial proceeding as such Holder shall deem most effectual to protect and enforce any such right, either by suit in equity or by action of law, whether for the specific performance of any covenant or agreement contained in the Certificate, or in aid of the exercise of any power granted in the Certificate, or to enforce any other legal or equitable right vested in the Holders of Bonds by the Certificate or by law.

Remedies Not Exclusive: Effect of Waiver of Default; Effect of Abandonment of Proceedings or Adverse Determination. The Holders from time to time of the Bonds shall be entitled to all the remedies and benefits of the Certificate as is and as shall be provided by law, and nothing herein shall be construed to limit the rights or remedies of any such Holders under any applicable statute that may now exist or be enacted hereafter. The remedies prescribed by the Certificate shall not be exclusive of any other remedy or remedies, and each and every such remedy shall be cumulative and shall be in addition to every other remedy given thereunder, or now or hereafter existing at law or in equity or by statute and may be exercised without exhausting and without regard to any other remedy.

No waiver of any default or breach of duty or contract by any Holder or any Bond shall extend to or affect any subsequent default or breach of duty or contract, or shall impair any rights or remedies thereon. No delay or omission of any Holder of a Bond to exercise any right or power accruing upon any default shall impair any such right or power or shall be construed to be a waiver of any such default or acquiescence therein. Every substantive right and remedy conferred upon the Holders of the Bonds may be enforced from time to time and as often as may be deemed expedient. In case any suit, action or proceeding to enforce any right or exercise any remedy shall be brought or taken and then discontinued or abandoned, or shall be determined adverse to the Holders of the Bonds, then and in every such case the State and such Holders shall be restored to their former positions and rights and remedies as if no suit, action or proceeding had been brought or taken.

Discharge of Obligations of the State Under the Certificate [Certificate Section 11.01]

The obligations of the State, including, without limiting the generality of the foregoing, of the Department, under the Certificate and the liens, pledges, charges, trusts, assignments, covenants and agreements of the State, including the Department, therein made or provided for, shall be fully discharged and satisfied as to any Bond and such Bond shall no longer be deemed to be Outstanding under the Certificate,

(A) if such Bond shall have been purchased and cancelled by the State or surrendered to the Director of Finance or other Paying Agent, transfer agent or Registrar for cancellation or be subject to cancellation by him or it, or

(B) as to any Bond not theretofore purchased and cancelled, surrendered for cancellation or subject to cancellation, when payment of the principal of and the applicable redemption premium, if any, on such Bond, plus interest on such principal (calculated, in the case of Variable Rate Bonds, at the maximum numerical rate permitted by the terms thereof) to the due date there (whether such due date be by reason of maturity or upon redemption or prepayment or by declaration as provided in the Certificate, or otherwise) either

(1) shall have been made or caused to be made when due and payable in accordance with the terms thereof, or

(2) shall have been provided by irrevocably depositing with the Director of Finance or other Paying Agent therefor, in trust solely for such payment, either (i) moneys sufficient to make such payment or (ii) Federal Securities maturing as to principal and interest in such amounts and at such times as will insure the availability of sufficient moneys to make such payment, or (iii) a combination of both moneys and Federal Securities, and all necessary and proper fees, compensation and expenses of any Paying Agent, transfer agent or Registrar appointed by the State pertaining to the Bond with respect to which such deposit is made shall have been paid or the payment thereof provided for to the satisfaction of such Paying Agent, transfer agent or Registrar. At such time as a Bond shall be deemed to be no longer Outstanding under the

Certificate, as aforesaid, except for the purpose of any such payment from such moneys or Federal Securities, such Bond shall no longer be secured by or entitled to the benefits of the Certificate and shall cease to accrue interest from the due date thereof (whether such due date be by reason of maturity or upon redemption or prepayment or by declaration as provided therein, or otherwise).

Notwithstanding the foregoing, with respect to Bonds which by their terms may be redeemed or otherwise prepaid prior to the stated maturities thereof and which the State elects to so redeem or prepay, no deposit under clause (2) of subparagraph (B) above shall constitute such discharge and satisfaction as aforesaid until such Bonds shall have matured or shall have been irrevocably called or designated for redemption or prepayment and proper notice of such redemption or prepayment shall have been given or irrevocable provision shall have been made for the giving of such notice; provided that nothing shall require or be deemed to require the State to elect to redeem or prepay such Bonds or, in the event the State shall elect to redeem or prepay such Bonds, shall require or be deemed to require the redemption or prepayment as of any particular date or dates.

Any such moneys so deposited with the Director of Finance or other Paying Agents as described above may at the direction of the Department be invested and reinvested in Federal Securities, maturing in the amounts and times as hereinbefore set forth, and all income from a such Federal Securities in the hands of the Director of Finance and other Paying Agents which is not required for the payment of the Bonds and interest and premium, if any, thereon with respect to which such moneys shall have been so deposited, shall, to the extent permitted by law, be deposited in the Highway Revenue Special Account as and when realized and collected for use and application as are other moneys deposited in such Fund.

Notwithstanding the foregoing, the payment of (i) the purchase price of and interest on Variable Rate Bonds tendered for purchase pursuant to the terms thereof and of a remarketing agreement, or similar agreement, or (ii) principal of or interest on any Variable Rate Bonds with a draw, borrowing or payment under a Support Facility shall not be deemed payment of such Variable Rate Bonds pursuant to the Certificate; provided, however, that with respect to (ii) above, a reimbursement or other payment by the State with respect to a draw, borrowing or payment under a Support Facility for the payment of principal, premium, if any, or interest on Variable Rate Bonds when due, shall be deemed to the payment of such Variable Rate Bonds for the purpose of said provision.

All moneys or Federal Securities set aside and held in trust pursuant to the foregoing provisions for the payment of Bonds (including interest and premium thereon, if any) shall be applied to and used solely for the payment of the particular Bonds (including interest and premium thereon, if any) with respect to which such moneys and Federal Securities have been so set aside in trust.

If moneys or Federal Securities have been deposited or set aside with the Director of Finance or other Paying Agent pursuant to the Certificate for the payment of Bonds and such Bonds shall be deemed to have been paid and be no longer Outstanding, but such Bonds shall not have in fact been actually paid in full, no amendment to the provisions of the Certificate relating to the defeasance of Bonds shall be made without the consent of the Holder of each Bond affected thereby and such Bonds shall be considered to be Outstanding for purposes of the Certificate.

The State may at any time surrender to the Director of Finance for cancellation by him any Bonds previously executed and delivered, which the State may have acquired in any manner whatsoever, and such Bonds upon such surrender for cancellation shall be deemed to be paid and no longer Outstanding.

**ADDITIONAL INFORMATION RELATING TO REVENUE SOURCES,
THE STATE HIGHWAY SYSTEM AND
THE DEPARTMENT OF TRANSPORTATION**

This Appendix B contains additional information relating to Revenue sources and other factors affecting the Department's ability to raise Revenues, federal aid to Hawaii, the State Highway System and the Department of Transportation.

INFORMATION RELATING TO REVENUE SOURCES

Motor Vehicle Registration. The following table sets forth the total number of motor vehicle registrations subject to renewal in the State by type of vehicle for each of the last ten calendar years ending December 31, 1997.

Motor Vehicle Registration⁽¹⁾

<u>Calendar Year</u>	<u>Passenger Vehicles</u>	<u>Ambulances & Hearses</u>	<u>Buses</u>	<u>Trucks</u>	<u>Motorcycles & Scooters</u>	<u>Trailers</u>	<u>Total</u>
1988	670,877	52	4,215	130,921	11,544	20,718	838,327
1989	695,397	54	4,203	143,244	12,159	21,791	876,848
1990	718,204	55	4,308	153,809	12,720	22,187	911,283
1991	717,907	54	4,309	161,126	13,797	22,931	920,124
1992	703,983	53	4,282	162,121	15,322	22,977	908,738
1993	693,283	48	4,032	165,209	16,540	23,398	903,550
1994	691,158	53	3,772	163,227	16,934	22,864	898,008
1995	694,239	54	3,660	162,415	17,388	23,535	901,291
1996	703,094	59	3,468	160,742	17,109	23,153	907,625
1997	704,693	54	3,226	159,134	17,160	22,697	906,964

⁽¹⁾ Number of registered vehicles includes official and other vehicles in each classification exempt from taxation pursuant to State Law.

Source: Department of Business, Economic Development and Tourism, Research and Economic Analysis Division, Statistics Branch. Department of Transportation Motor Vehicle Safety Office.

Licensed Drivers. The following table sets forth the total number of drivers licenses in force in the State for the last ten calendar years.

Drivers Licenses in Force

<u>Year</u>	<u>Oahu</u>	<u>Hawaii</u>	<u>Maui</u>	<u>Kauai</u>	<u>Total</u>
1988	465,331	74,545	61,997	33,007	634,880
1989	478,078	78,448	65,667	34,963	657,156
1990	488,119	82,730	69,751	37,026	677,626
1991	501,260	86,181	73,329	38,894	699,664
1992	510,901	89,436	76,261	39,947	716,545
1993	522,016	92,264	78,191	41,910	734,381
1994	527,756	94,257	80,643	42,736	745,392
1995	516,780	94,048	79,639	42,041	732,508
1996	515,780	94,943	80,998	41,775	733,496
1997	517,904	96,665	82,217	42,079	738,865

Source: Department of Transportation, Motor Vehicle Safety Office.

Fuel Consumption. The following table is a summary of the gallons of motor vehicle fuels imported into and consumed in the State, subject to the motor vehicle fuel tax for the last ten fiscal years ending June 30, 1997.

**Motor Vehicle Fuel Consumption
(In Thousands of Gallons)**

<u>Fiscal Year</u>	<u>Gasoline⁽¹⁾</u>	<u>Diesel⁽¹⁾</u>	<u>Liquid Petroleum⁽²⁾</u>	<u>Total</u>
1988	353,492	154,672	4,056	512,220
1989	361,848	150,665	5,277	517,790
1990	373,617	169,510	4,074	547,201
1991	374,065	180,142	5,795	560,002
1992	378,839	189,648	4,240	572,727
1993	382,857	191,376	4,028	578,261
1994	394,081	181,457	4,065	579,603
1995	389,029	200,373	3,364	592,766
1996	397,078	177,883	3,665	578,626
1997	399,327	197,140	3,827	600,294

⁽¹⁾ Includes sales for highway use, presently taxed at \$0.16 per gallon, and for non-highway use, presently taxed at \$0.01 per gallon.

⁽²⁾ Includes sales for highway use, presently taxed at \$0.11 per gallon, and for non-highway use, presently taxed at \$0.01 per gallon.

Source: Department of Transportation.

FACTORS THAT MAY IMPACT REVENUE SOURCES

Federal and County Fuel and Weight Taxes

Fuel taxes are presently imposed by federal, State and county governments. The retail price of a gallon of gasoline in the City and County of Honolulu presently includes fuel taxes of \$0.466 per gallon plus the State's 4% general excise tax, of which taxes only \$0.16 is the State fuel license tax. The feasibility of imposing additional taxes and fees on fuel and motor vehicles is affected in part by the amount and rate of fuel and other taxes and fees imposed by federal and county governments. These other taxes and fees are not pledged to the payment of the Bonds and are not available for such payment. The following is a summary of the various fuel taxes presently imposed by the federal government and fuel and vehicle taxes presently imposed by county governments:

Federal Fuel Taxes. The Internal Revenue Code imposes federal fuel taxes at the rate of \$0.184 per gallon of gasoline and \$0.244 per gallon of diesel fuel.

State General Excise Tax. The State's 4% general excise tax on goods and services extends to gasoline, diesel fuel and liquid petroleum gas. Since 1991, general excise tax collections have been paid to the State general fund not the State Highway Fund.

County Fuel Taxes. Each county imposes a tax on gasoline, diesel oil and liquid petroleum gas for highway use. County fuel taxes are collected by the Department of Taxation together with the fuel license taxes and deposited into the respective county highway funds to be expended by each county on county highway improvements. The fuel tax rates for the County of Hawaii are \$0.088 per gallon of gasoline and diesel oil, and \$0.06 per gallon of liquid petroleum gas. The fuel tax rates for the City and County of Honolulu are \$0.165 per gallon of gasoline and diesel oil, and \$0.11 per gallon of liquid petroleum gas. The fuel tax rates for the County of Maui are \$0.11 per gallon of gasoline and diesel oil, and \$0.08 for liquid petroleum gas. The fuel tax rates for the County of Kauai are \$0.10 per gallon of gasoline and diesel oil, and \$0.07 per gallon of liquid petroleum gas.

County Vehicle Weight Taxes. Each county imposes and collects a tax on all vehicles, including motor vehicles, based on weight. Each county collects both State and county vehicle taxes and remits the State vehicle weight tax to the State to be paid into the State Highway Fund.

The county vehicle tax rates for the City and County of Honolulu are \$0.0125 per pound for passenger motor vehicles and noncommercial vehicles not exceeding 6,500 pounds, and \$0.02 per pound for commercial vehicles and all other motor vehicles, with a minimum of \$12.00 annually for all motor vehicles and \$1.00 annually for other vehicles.

The tax rates for the County of Maui are \$0.0075 per pound for passenger motor vehicles and noncommercial motor vehicles not exceeding 6,500 pounds, and \$0.015 per pound for nonpassenger commercial vehicles and all other motor vehicles, with a minimum of \$6.00 annually for all vehicles.

The tax rates for the County of Kauai are \$0.0075 per pound for passenger motor vehicles and noncommercial motor vehicles not exceeding 6,500 pounds, and \$0.02 per pound for nonpassenger vehicles and all other motor vehicles, with a minimum of \$12.00 annually for all vehicles.

The tax rates for the County of Hawaii are \$0.005 per pound for passenger motor vehicles and noncommercial motor vehicles not exceeding 6,500 pounds, and \$0.01 per pound for nonpassenger motor vehicles and commercial vehicles and motor vehicles over 6,500 pounds, with a minimum of \$6.00 annually for all vehicles.

County Vehicle Registration Fees

Each county imposes various registration fees for vehicles, including fees for certificates of registration, license plates and decals. Each county collects both State and county vehicle registration fees and remits the State vehicle registration fees and reimbursements for State-incurred expenses to the State to be paid into the State Highway Fund. The fees range from \$0.50 for decals, between \$2.00 to \$3.00 for registration certificates and between \$3.50 to \$5.00 for license plates.

None of such federal or county taxes or fees, nor the State general excise tax, is pledged to the payment of the Bonds or provides a source of revenues for such payment, but such taxes and fees do affect the feasibility of imposing additional charges on the use of vehicles.

FEDERAL AID TO HAWAII

Federal Aid Reimbursements

Generally the costs of financing highways for which the federal government provides assistance is undertaken on a shared basis with the State, with the federal government providing reimbursement to the State for 90% of eligible costs of construction when federal-aid funding is used on Interstate Highways and 80% of the costs on other highways and streets not functionally classified as local or rural minor collector roads. Federal aid reimbursements are deposited in the State Highway Fund. Such amounts are not Pledged Funds under the Certificate.

The following table sets forth federal aid reimbursements to the State Highway Fund for each of the last ten Fiscal Years ended June 30, 1997.

Federal Aid Reimbursements to the State Highway Fund

<u>Fiscal Year</u>	<u>Interstate</u>	<u>Primary</u>	<u>Secondary</u>	<u>Other</u>	<u>Total Amount Reimbursed</u>
1988	26,400,711	11,356,922	4,587,972	14,250,357	56,595,962
1989	34,038,336	9,559,302	2,309,804	19,177,956	65,085,398
1990	94,926,431	11,303,888	3,064,012	9,471,721	118,766,052
1991	130,340,451	8,089	1,344,780	20,909,149	152,602,469
1992	160,569,828	16,532,060	971,118	8,534,312	186,607,318
1993	193,360,869	10,876,505	395,445	8,936,008	213,568,827
1994	180,269,823	3,382,703	1,237,141	33,131,081	218,020,748
1995	129,850,812	196,001	100,936	50,366,387	180,514,136
1996	114,012,607	4,039,307	1,195,734	69,686,057	188,933,705
1997	129,155,903	1,336,632	1,329,788	76,519,728	208,342,051

Source: Department of Transportation

Intermodal Surface Transportation Efficiency Act of 1991

A significant portion of the federal aid reimbursements to the Department has been received pursuant to the Intermodal Surface Transportation Efficiency Act of 1991 ("ISTEA"). The stated purpose of said Act was "to develop a National Intermodal Transportation System that is economically efficient, environmentally sound, provides the foundation for the Nation to compete in the global economy and will move people and goods in an energy efficient manner." The major effect of ISTEA was to reorganize the manner in which federal aid for surface transportation projects, including highways, would be provided to state and local governments. ISTEA provided

authorization for federal assistance for highways, highway safety and mass transportation for federal fiscal years 1992 through 1997.

On May 22, 1998, Congress passed the ISTEA reauthorization bill, now referred to as the Transportation Efficiency Act for the 21st Century or TEA-21. Although President Clinton has not yet signed the bill, he has indicated that he will do so. The bill reauthorizes the federal highway program for fiscal years 1998 through 2003. Although some changes are made, the structure set up under the original ISTEA is for the most part kept intact. Hawaii's share of federal funds under TEA-21 is expected to average \$135,502,000 annually, representing an increase of approximately 7.3% over the annual funding received under the original ISTEA.

THE STATE HIGHWAY SYSTEM

General

In the State, three levels of government have authority to construct and maintain public highways, streets and roads. These levels of government are the State, the counties and various federal agencies. The State is served by approximately 4,455 linear miles of public highways, streets and road administered by the Department and the counties. An additional 138 miles of public highways, streets and roads open to the public in national parks and military reservations are the responsibility of various federal agencies, including the United States National Park Service and the military services.

There are four counties in the State: the City and County of Honolulu includes the entire island of Oahu and the uninhabited leeward islands, Kauai County includes the islands of Kauai and Niihau, Maui County includes the islands of Molokai, Maui, Lanai and Kahoolawe, and Hawaii County is comprised of the island of Hawaii. There are no roadways or bridges connecting one island to another.

Honolulu, on Oahu, is the State's only major metropolitan area. Approximately 73% of the population of the State lives on Oahu.

The State's highways, streets and roads are discussed below, first by the level of government responsible for administering the roadways, followed by a discussion of the federal aid system and the functional classifications. The State Highway System receives most of the federal aid highway funds made available to the State.

State Highway System

The State Highway System, which is administered by the Department, consists of 1,049 linear miles of roadways. The Department has classified the State Highway System as follows: interstate (55.5 miles), freeway expressway (33.7 miles), principal arterial (231.1 miles), minor arterial (422.3 miles), major collector (291.8 miles), and minor collector (14.5 miles).

The following tables set forth the number of miles of the various categories of public highways, streets and roads, comprising the State Highway System.

State Highway System

<u>Functional Classification</u>	<u>Oahu</u>	<u>Hawaii</u>	<u>Maui</u>	<u>Kauai</u>	<u>Molokai</u>	<u>Lanai</u>	<u>Total</u>
Interstate	55.5	0.0	0.0	0.0	0.0	0.0	55.5
Freeway Expressway	33.7	0.0	0.0	0.0	0.0	0.0	33.7
Principal Arterial	115.1	69.3	29.6	17.1	0.0	0.0	231.1
Minor Arterial	31.9	264.3	51.4	50.7	0.0	0.0	398.3
Major Collector	7.5	85.5	90.0	39.2	55.8	13.8	291.8
Minor Collector	<u>0.0</u>	<u>14.5</u>	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>14.5</u>
Total	243.7	433.6	171.0	107.0	55.8	13.8	1,024.9

Source: Department of Transportation

The most important component of the State Highway System is the interstate system on Oahu. Interstate H-1 is a 27 mile freeway through the major populated areas of Honolulu, from Ewa on the western end of Oahu to Kahala on the eastern end. Interstate H-2 is a eight mile freeway from the H-1 freeway at Pearl City to the U.S. Army's Schofield Barracks in Wahiawa. Interstate H-3 is a recently-completed 16 mile freeway from the H-1 freeway at Halawa Valley in Pearl Harbor through the Koolau mountains to the U.S. Marine Corps Air Station at Kaneohe in windward Oahu.

Other major State highways on the island of Oahu include Moanalua Freeway (a portion of Interstate Route H-1), the Pali Highway and Likelike Highway which connect Honolulu to the Windward Oahu communities of Kailua and Kaneohe, respectively, and Kamehameha Highway and Farrington Highway, which circle Oahu's windward and leeward coastline.

Major State highways on the island of Hawaii include the Queen Kaahumanu Highway in North Kona, the Kunkini Highway in South Kona, the Mamalahoa Highway in West Hawaii, and portions of the Hawaii Belt Road in East Hawaii.

Major State highways on the island of Kauai include Kaumualii Highway in west Kauai and Kuhio Highway in east Kauai.

Major State highways in Maui County, include on the island of Maui Honoapiilani Highway and Kahekili Highway in West Maui and Hana Highway, Haleakala Highway and Piilani Highway in east Maui. Maunaloa Highway and Kamehameha V Highway are the major State roads on the island of Molokai.

Federal Agencies

Various federal agencies have jurisdiction over certain public highways, streets and roads open to the public in national parks and military reservations in the State, including the United States National Park Service and the military services. The United States National Park Service also builds and maintains roads within the boundaries of the national parks.

THE DEPARTMENT OF TRANSPORTATION

Management Directions. The Department continues to focus its management efforts on programs that will bring about operational improvements and cost efficiencies through innovation and new technology. The Department implemented a new concept approach to working with the private sector referred to as "partnering." All parties must agree to commit to the quality, safety, timeliness and cost efficiency of the project. Secondly, the Department is considering implementing a structured organization system called Total Quality Management System ("TQM"). TQM is a structured system involving all Department employees and management to provide proactive problem prevention, fact based decisions, customer focus, reduced errors and waste, long term planning to improve performance of mission and strive to attain vision and teamwork.

To increase efficiency for planning and maintaining highway improvements, the Department will be utilizing an integrated and automated database management system. This Pavement Management System will compile all highway improvement data (e.g., road inventory, pavement condition survey, vehicular traffic, highway improvement and maintenance expenditure) provided by the various offices within the Department. Updating and maintenance of such data will be transmitted electronically to the Pavement Management System.

The Department also installed two computer systems to increase design accuracy and efficiency: The Intergraph Computer-Aided Drafting and Design ("CADD") and the Interactive Visualization of Traffic Impacts ("IVTI"). The CADD system automates drafting of contract plans, right-of-way plans, maps, roadway design and surveying. The CADD system consists of 35 CADD workstations, 6 servers, plotters and peripherals. The IVTI is a computer system which simulates the design and impacts of proposed highway improvements. The IVTI provides moving components (including traffic), the ability to project "before and after" pictures side-by-side, and compiles facts of the project from which a cost estimate can be given, including costs to businesses if no improvements are made.

To service the general public more efficiently, the Department installed electronic highway message signs at various location on Oahu to forewarn motorists of lane closures, obstructions or accidents ahead. The Department also keeps the employees and general public informed on projects, events, public hearings and departmental news with weekly, bi-weekly, monthly and quarterly newsletters and provides telephone hotlines for instant information and feedback.

Oahu Metropolitan Planning Organization ("OMPO"). Section 112 of the Federal-Aid Highway Act of 1973, Section 9 of the Urban Mass Transportation Act of 1964 and other federal laws require states to designate and fund a metropolitan planning organization as an advisory urban transportation planning organization. Also, the Federal Highway Administration and the Urban Mass Transportation Administration requires designation of a metropolitan planning organization or similar program to provide a continuing, comprehensive, and cooperative state-wide transportation planning in order for the State to receive federal certification of its transportation programs submitted for federal funding. State law has established a Metropolitan Planning Organization to comply with such requirements.

The State has established the OMPO, an advisory body to the State legislature, the Honolulu City Council and state and county agencies in affairs involving transportation planning for Honolulu. OMPO's functions include:

- (a) formulating advisory short-range six-year and a master multimodal long range transportation plans and updates for the City and County of Honolulu;
- (b) reviewing capital improvement programs for the urbanized and rural areas of the State and the City and County of Honolulu;
- (c) integrating transportation planning among the State and the City and County of Honolulu;
- (d) developing recommendations regarding transportation policies, plans, projects and programs being considered by the State Legislature and county councils and submitted for review by OMPO; and

(e) receiving and managing federal funds and other moneys to support metropolitan transportation.

OMPO consists of a policy committee and a full-time staff funded by the State Highway Fund.

Statewide Transportation Improvement Program ("STIP"). On May 29, 1996, the Federal Highway Administration and the Federal Transit Administration gave partial approval for the Department's STIP for Fiscal Years 1996-1998. The partial approval was for projects located in the counties of Maui, Kauai and Hawaii. Federal approval for Oahu Projects cannot be given until the Oahu Metropolitan Planning Organization Policy Committee endorses, and the Governor or designee signs, the Metropolitan Transportation Improvement Program.

THE STATE OF HAWAII

This Appendix C contains demographic and economic information concerning Hawaii that may be relevant in evaluating the economic and financial condition of the State. This information is furnished as background information and is not intended to be a complete description or evaluation of Hawaii's economic or financial condition. The 1998 Bonds are not a general obligation of the State and are special limited obligations payable solely from Pledged Funds. See "SECURITY FOR THE BONDS."

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

INTRODUCTION

General

The State was admitted into the Union on August 21, 1959, as the fiftieth state. The State is an archipelago of eight major islands, seven of which are inhabited, plus 124 named islets, totalling 6,425 square miles in land area, located in the Pacific Ocean in the Northern Hemisphere, below the Tropic of Cancer, about 2,400 statute miles from San Francisco. The State is a little larger in area than the combined area of the States of Connecticut and Rhode Island and ranks forty-seventh in area of the fifty states. The Island of Hawaii, with an area of 4,134 square miles, is the largest island. The other inhabited islands in decreasing order of size are Maui, Oahu, Kauai, Molokai, Lanai and Niihau. The City and County of Honolulu consists of the Island of Oahu (plus some minor islets), with a land area of 596.3 square miles. According to the United States Census, the total population of the State was 422,770 in 1940, 499,794 in 1950, 632,772 in 1960, 769,913 in 1970, 964,691 in 1980 and 1,112,932 in 1990. According to the United States Bureau of the Census, in 1995 the total State population was approximately 1,186,600, making the State the fortieth most populous in the Union, and approximately 73% of the population of the State lived on Oahu. Hawaii's population shows greater ethnic diversity than other states because it is descended from immigrants from the Far East as well as from Europe and the continental United States. The 1990 United States Census indicated about 33.4% of the State's population is Caucasian and about 22.3% of the population is Japanese. Other ethnic backgrounds include Filipino, Chinese, Hawaiian, Samoan and others. A significant proportion of the population is of mixed ethnic background, in which part-Hawaiians predominate.

State Government

The State Constitution provides for three separate branches of government: the legislative, the executive and the judicial. Legislative power is vested in a bicameral Legislature consisting of a Senate of twenty-five members elected for four-year terms and a House of Representatives of fifty-one members elected for two-year terms. The Legislature convenes annually. The executive power is vested in a Governor elected for a four-year term. The Governor is prohibited by the State Constitution from serving more than two consecutive full terms in office. In the event of the absence of the Governor from the State, or his inability to exercise and discharge the powers and duties of his office, the Lieutenant Governor, also elected for a four-year term, serves as the chief executive. The judicial power is vested in a Supreme Court, one intermediate appellate court, four circuit courts and four district courts. The executive and administrative offices are divided among 18 principal executive departments under the supervision of the Governor. The heads of the departments are appointed by the Governor with the advice and consent of the Senate and hold office for four-year terms expiring with the term of the Governor. The Department is one of the principal departments permitted by the State Constitution, with the Director designated as the head of the Department.

County Government

There are four counties in the State, being the City and County of Honolulu, the County of Maui, the County of Hawaii and the County of Kauai, and one quasi-county, Kalawao. Each county has a separate charter for its government, providing for an elected mayor who is the chief executive, and an elected council which is the legislative body. There are no independent or separate cities or other municipalities, school districts or townships.

GENERAL ECONOMIC INFORMATION

General

Certain of the following material pertaining to economic factors in the State under the captions "State of the Economy" through and including "Tax Base" has been excerpted from the December 1997 *Quarterly Statistical and Economic Report* ("QSR") published by the State of Hawaii Department of Business, Economic Development and Tourism ("DBEDT"). Additional material has been extracted from The State of Hawaii Data Book 1996, the reports and monthly review published by the Bank of Hawaii and from the other sources indicated including unpublished data compiled by DBEDT. Unless otherwise stated, the following information is historical; estimated figures are used only when the definitive figures are unavailable.

DBEDT estimates that the total Gross State Product (the value of all goods and services produced and consumed within the State) totaled approximately \$34.2 billion in fiscal year 1997, which is an increase of 2.2 percent over fiscal year 1996. Due to low growth in personal income during the first nine months of 1996 and continuing declines in the number of jobs, the annual Real Gross State Product (measured in constant 1987 dollars) is estimated to have grown 0.9 percent in 1996. For 1997, Real Gross State Product is projected by DBEDT to increase 1.5 percent.

State of the Economy

Through 1997 Hawaii's economic recovery continued to be slow and uneven. While certain labor market indicators declined, the number of nonagricultural wage and salary jobs increased 0.2 percent. Personal income growth was modest and tax revenues were down. Visitor arrivals grew modestly and construction activity declined. Civilian employment grew while the unemployment rate remained at 6.0 percent.

Outlook of the Economy

The economic growth for the State of Hawaii has historically depended on the health of the U.S. economy, the State of California, and the Japanese economy. Although economic growth on the U.S. Mainland continues to be robust, financial and economic events in Southeast Asia and Japan suggest lower rates of forecast growth for Hawaii.

As of December 10, 1997, the Blue Chip Economic Indicators projected real gross domestic product (GDP) growth of 3.7 percent for 1997 and 2.5 percent for 1998 for the U.S. economy. The Blue Chip Indicators also forecast inflation, as measured by the GDP deflator, at 2.0 percent in 1997 and 2.1 percent in 1998. Unemployment in the United States is expected to remain low at 5.0 percent in 1997 and 4.9 percent in 1998.

Real economic growth in California is expected to expand by 4.8 percent in 1997 and 3.3 percent in 1998. Unemployment is expected to be at 6.38 percent in 1997, down from 7.2 percent in 1996. The 1998 forecast for unemployment in California is 5.85 percent. Employment in nonagricultural establishments is expected to rise by 3.3 percent in 1997 and by 5.9 percent in 1998.

The Blue Chip forecasts for real economic growth in the Japanese economy were lowered to 1.3 percent in 1997 and 2.0 percent in 1998. Inflation is expected to remain low at 1.6 percent and 1.3 percent in 1997 and 1998, respectively. The Blue Chip consensus forecasts for the average yen-dollar exchange rate in 1997 is 123.0 and in 1998 the forecast rate is 120.6.

In 1997, Hawaii's visitor arrivals grew 0.7% and are forecasted to grow 1.0 percent in 1998. Real gross state product is projected to grow over 1.0 percent through 1999. Job growth is projected to turn slightly positive next year and expand slowly in 1999 and 2000. Inflation is projected to remain near 1.0 percent through 1998 and accelerate modestly thereafter.

Statistical Summary of Hawaii's Economy

The following table prepared by Bank of Hawaii presents a statistical summary of Hawaii's economy.

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STATISTICAL SUMMARY OF HAWAII'S ECONOMY

	1993	1994	1995	1996	% Change 1996/1995
RESIDENT POPULATION (As of July 1st)	1,159,964 E	1,172,645 N	1,179,198	1,183,723	0.4
Civilian	1,050,868 R	1,071,096 N	1,089,567	1,080,400	-0.8
Military dependents	62,166 R	54,338 N	46,519	55,337	19.0
Armed forces	52,674 R	52,845	50,729	47,986	-5.4
CIVILIAN LABOR FORCE	586,000	580,150	577,100	590,900	2.4
Employment	560,900	545,000	543,250	553,200	1.8
Unemployment	4.3%	6.1%	5.9%	6.4%	8.5
INCOME					
Gross state product	\$31,171.9	\$31,965.3	\$32,723.7	\$33,509.1	2.4
GSP in 1987 dollars	23,180.1	23,190.3	23,297.8	23,504.0	0.9
Total personal income	27,505.0	28,304.0	29,184.0	29,782.0	2.0
Per capital personal income	23,712.0	24,137.0	24,749.0	25,159.0	1.7
CONSUMER PRICE INDEX	160.1	164.5	168.1	170.7	1.5
Food items	152.9	153.4	156.8	156.6	-0.1
Housing	166.5	171.6	174.7	176.8	1.2
MANUFACTURING SALES	\$2,106.6	\$2,026.1	\$2,045.0	\$1,719.8	-15.9
Sugar	292.9	290.2	226.5	N/A	—
Pineapple	86.6	81.1	72.5	N/A	—
Petroleum	1,007.3	1,044.8	1,114.0	1,118.0	0.4
Diversified manufacturing	719.7	610.0	632.0	601.8	-4.8
TOTAL DIVERSIFIED AGRICULTURE	\$263.6	\$264.8	\$275.6	N/A	—
Crops (pineapple & sugar excluded)	178.7	186.8	204.0	N/A	—
Livestock products	84.9	76.6	71.6	N/A	—
Pineapple (fresh market)	54.0	53.0	62.5	N/A	—
CONSTRUCTION					
Construction completed	\$3,785.4	\$3,317.3	\$3,153.3	\$3,196.4	1.4
Private construction authorizations	1,878.9	1,705.3	1,535.5	1,133.9	-26.2
Residential	1,226.8	1,115.8	926.3	661.8	-28.6
Nonresidential	652.2	589.5	609.2	472.1	-22.5
Government contract awards	1,027.2	1,094.4	796.2	966.9	21.4
Construction employment	32,300.0	29,200.0	26,300.0	23,450.0	-10.8
Housing inventory (April 1 st)	413,830.0	420,748.0	430,417.0	N/A	—
TRADE					
Foreign imports	\$2,218.1	\$2,530.8	\$2,703.6	N/A	—
Foreign exports	1,099.7	985.4	1,072.2	N/A	—
Retail sales	14,380.7	15,237.7	15,693.3	16,110.9	2.7
Wholesale sales	11,133.1	11,454.5	11,974.0	12,338.4	3.0
FEDERAL GOVERNMENT	\$7,052.0	\$7,603.0	\$7,449.9	\$7,990.2	7.3
Defense expenditures	2,928.0	3,196.0	2,900.6	3,258.1	12.3
Non-defense expenditures	4,124.0	4,407.0	4,549.3	4,732.1	4.0
Civilian employment	31,800.0	31,250.0	31,050.0	31,250.0	0.6
FINANCE (As of Dec. 31st)					
Bank deposits	\$11,667.0	\$11,557.1	\$11,815.3	N/A	—
Bank loans	13,826.5	14,661.8	13,526.7	N/A	—
Deposits of all financial institutions	22,619.1	22,377.1	23,062.5	N/A	—
Loans of all financial institutions	22,489.7	25,269.3	27,110.7	N/A	—
Debits to demand deposits	N/A	N/A	N/A	N/A	—
Investments of insurance companies	4,263.2	N/A	N/A	N/A	—
TRANSPORTATION					
Air passenger movements	\$33,821.1	\$35,587.0	\$36,735.0	\$37,548.0	2.2
Interisland	18,690.6	19,842.0	20,776.0	21,164.0	1.9
Overseas	15,130.5	15,745.0	15,959.0	16,384.0	2.7
Air cargo movements	428.5	473.0	455.8	486.9	6.8
Interisland	147.1	149.0	149.2	160.8	7.8
Overseas	281.4	324.0	306.6	326.1	6.4
UTILITIES					
Telephone access lines	\$ 649.3	\$ 666.2	\$ 668.8	N/A	—
Volume of electricity sold	8,657.9	8,948.5	9,187.5	9,378.9	2.1
Volume of gas sold	56.6	59.8	55.4	55.5	0.2
STATE AND LOCAL GOVERNMENTS					
Revenues	\$6,159.9	\$6,538.0	\$6,423.6	\$7,141.1	11.2
Expenditures	6,551.9	6,980.6	7,237.3	N/A	—
Tax collections (Fiscal Year)	\$8,033.4	\$8,346.6	N/A	N/A	—
Federal	4,489.1	4,613.6	N/A	N/A	—
State	2,829.7	2,991.8	N/A	N/A	—
Counties	714.5	741.1	N/A	N/A	—

N = Not strictly comparable to earlier data; E=Bank of Hawaii estimate; R=Revised; N/A=Not Available
 [Dollars in millions except for per capital personal income]

Information on 1997 Employment, Wages and Salaries, Tax Revenues and Tax Base

Table 1

SELECTED ECONOMIC ACTIVITIES: STATE

SERIES	UNIT	1997 TOTAL	
		NUMBER	% CHANGE YEAR AGO
CIVILIAN LABOR FORCE 1/	1,000	592.0	0.3
Civilian Employment	1,000	554.2	0.3
Civilian Unemployment	1,000	37.9	0.7
UNEMPLOYMENT RATE 2/	%	6.4	0.0
TOTAL NON-AGR. WAGE & SALARY 1/	1,000	531.9	0.2
Contract Construction	1,000	22.3	-5.7
Manufacturing	1,000	16.6	-0.3
Trans., Comm., Utilities	1,000	41.4	0.9
Trade	1,000	134.6	-0.5
Retail	1,000	113.6	-0.2
Finance, Insurance, & Real Estate	1,000	36.1	-2.2
Services & Miscellaneous	1,000	169.2	1.5
Hotels	1,000	38.5	0.3
Government	1,000	111.7	1.0
State	1,000	64.3	2.3
Federal	1,000	30.7	-1.4
AGRICULTURE WAGES AND SALARIES 1/	1,000	7.2	-2.7
STATE GENERAL FUND TAX REVENUES	\$MILL	2,756.6	-1.5
TRANS. ACCOM. TAX REVENUES	\$MILL	126.9	2.3
GENERAL EXCISE & USE TAX BASE	\$MILL	46,864.2	-3.0
Retailing Tax Base	\$MILL	15,713.6	-2.3
Services Tax Base	\$MILL	5,343.7	-4.9
Contracting Tax Base	\$MILL	2,871.4	-12.6
Hotel Rental Tax Base	\$MILL	2,040.5	-0.8
Producing Tax Base	\$MILL	495.2	3.4

- Notes: 1/ Labor force and jobs averages are based on monthly rounded data. Labor force data were also rebenchmarked in March of 1998.
 2/ Change represents absolute change in rates rather than percentage change in rates.

Sources: Hawaii Department of Labor & Industrial Relations; Department of Taxation; Hawaii Visitors and Convention Bureau and PKF-Hawaii. Compiled by Economic Planning Information System, READ, DBEDT.

Key Economic Indicators

Table 2

ACTUAL AND FORECASTED KEY ECONOMIC INDICATORS FOR HAWAII: 1996 TO 1999

ECONOMIC INDICATORS	1996	%	1997	%	1998	%	1999	%
	ACTUAL	CHANGE	ACTUAL	CHANGE	FORECAST	CHANGE	FORECAST	CHANGE
TOTAL POPULATION (in thousands)	1,182.9	0.3	1,186.6	0.3	1,191.3	0.4	1,198.5	0.6
VISITOR ARRIVALS (in thousands)	6,829.8	3.0	6,877.5	0.7	6,946.3	1.0	7,050.5	1.5
HONOLULU CPI-U (1982-84=100)	170.7	1.5	171.9	0.7	173.6	1.0	175.7	1.2
PERSONAL INCOME (in millions dollars)	30,072.0	1.6	30,823.8*	2.5*	31,625.2	2.6	32,479.1	2.7
PERSONAL INCOME (in \$1987 million)	20,241.8	0.1	20,603.0*	1.8*	20,929.4	1.6	21,239.6	1.5
TOTAL WAGE & SALARY JOBS (in thousands)	538.2	-0.4	539.1	0.2	541.3	0.4	544.5	0.6
GROSS STATE PRODUCT (in million dollars)	33,509.1	2.4	34,238.6*	2.2*	34,999.4	2.2	35,902.3	2.6
REAL GROSS STATE PRODUCT (in \$1987 million)	23,504.4	0.9	23,859.7*	1.5*	24,170.9	1.3	24,523.4	1.5
GROSS STATE PRODUCT DEFLATOR (1987=100)	142.6	1.5	143.5*	0.6*	144.8	0.9	146.4	1.1

* Preliminary, subject to change

Source: Research and Economic Analysis Division, DBEDT.

Labor Force and Jobs

The civilian labor force increased 0.3 percent in 1997 compared to 1996. Civilian employment grew 0.3 percent over the same period (Table 3). Both indicators have grown steadily since the second half of 1995. The number of unemployed fell by 3.1 percent in the third quarter of 1997 relative to the year-earlier quarter. However, since the labor force increased faster than jobs, the unemployment rate of 6.4 percent at the close of 1997 was the same as it was at the close of 1996.

The number of non-agricultural wage and salary jobs increased slightly. These jobs were up 0.2 percent in 1997 compared to 1996. The construction industry lost more than 10,000 jobs during the last five years, from 33,600 in its peak year of 1991 to 23,500 in 1996. In 1997, construction jobs fell 5.7 percent from the levels in 1996. With the closure of sugar plantations on Hawaii and Oahu starting in 1993, the manufacturing industry also experienced significant job loss. Manufacturing declined 0.3 percent in 1997 from 1996. In addition, there were wage and salary job losses in agriculture, finance, insurance, real estate, and retail trade. Industries showing job growth from 1996 to 1997 include transportation, communications, and utilities, wholesale, hotel, services, state government and miscellaneous industries. (Table 1)

Table 3
CIVILIAN LABOR FORCE AND EMPLOYMENT
(in thousands of persons)

Year	Civilian Labor Force	% Change	Civilian Employment	% Change	Civilian Unemployment Rate
		Civilian Labor Force		Unemployment Employment	
1988	518.0	0.8	502.0	1.6	3.1
1989	524.0	1.2	511.0	1.8	2.5
1990	542.0	3.4	527.0	3.1	2.8
1991	573.8	5.9	557.8	5.8	2.8
1992	584.0	1.8	557.4	-0.1	4.6
1993	586.0	0.3	560.9	0.6	4.3
1994	580.2	-1.0	545.0	-2.8	6.1
1995	576.4	-0.6	542.7	-0.4	5.9
1996	590.2	2.4	552.6	1.8	6.4
1997	592.0	0.3	554.2	0.3	6.4

Source: Hawaii State Department of Labor and Industrial Relations.

Income and Prices

According to data released by the U.S. Bureau of Economic Analysis (BEA), Hawaii's personal income increased 2.6 percent in the first nine months of 1997 relative to the first nine months of 1996. While modest, this rate of growth exceeded those experienced by the State in each quarter of last year. Other components of personal income showing growth in the first nine months of 1997 over the first nine months of 1996 include dividends, interest, and rent, up 4.0 percent, and transfer payments, up 3.8 percent. Other labor income decreased 1.5 percent during the same period. (Table 4)

Earnings fell from the first nine months of 1996 to the first nine months of 1997 in mining (-13.8 percent); construction (-7.4 percent); manufacturing (-0.5 percent); and agriculture services, forestry and fishery (-0.9 percent). Industries that experienced increases in earnings were services (3.7 percent); transportation, communications and utilities (3.4 percent); retail trade (1.5 percent); wholesale trade (0.5 percent), finance, insurance and real estate (1.5 percent), federal civilian (3.1 percent); federal military (3.0 percent); and state and local government (3.0 percent). (Table 4)

Hawaii's consumer inflation rate, as measured by the change in Honolulu Consumer Price Index for urban consumers, increased 0.7 percent in 1997 from 1996 (Table 6). This is the lowest annual inflation rate since 1964. Among the major consumer expenditure categories, apparel and upkeep and transportation experienced slight price drops (-1.0 and -0.5 percent, respectively) in 1997 from the 1996 level. Prices for food and beverages increased 1.7 percent, housing increased 0.2 percent, and medical care increased 1.1 percent over the same period.

Table 4
PERSONAL INCOME FOR HAWAII BY MAJOR SOURCES
(in millions of dollars)

Series	First 9 Months of 1996	% Change from Previous Year	First 9 Months of 1997	% Change from Previous Year
Derivation of Personal Income				
Wage and salary disbursements	16,974	0.9	17,387	2.6
Plus: Other labor income	1,804	-3.7	1,782	-1.5
Plus: Proprietors' income	2,466	0.5	2,471	0.0
Total earnings	21,243	0.5	21,481	1.4
Less: Personal contrib. for social insurance	1,366	0.2	1,390	1.8
Net earnings	19,877	0.5	20,100	1.4
Plus: Dividends, interest, rent	5,321	4.2	5,521	4.0
Plus: Transfer payments	4,874	3.6	5,055	3.8
Personal income	30,072	1.6	30,827	2.6
Total Earnings by Industry	21,243	0.5	21,640	1.9
Farm	184	-2.0	189	3.3
Nonfarm	21,059	0.5	21,452	1.9
Private	15,742	0.7	15,985	1.6
Agriculture forestry, fishery, other	142	-1.2	143	-0.9
Mining	19	-11.8	17	-13.8
Construction	1,460	-7.9	1,369	-7.4
Manufacturing	793	-0.2	786	-0.5
Transportation, communication, utilities	1,746	2.7	1,801	3.4
Wholesale trade	791	-0.1	795	0.5
Retail trade	2,621	0.1	2,655	1.5
Finance, insurance, real estate	1,757	3.1	1,783	1.5
Services	6,415	2.4	6,636	3.7
Government & government enterprises	5,317	-0.3	5,467	3.0
Federal civilian	1,221	2.1	1,258	3.1
Federal military	1,584	1.1	1,631	3.0
State and local	2,512	-2.2	2,578	3.0

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

Table 5
PERSONAL INCOME

<u>YEAR</u>	<u>ANNUAL PERSONAL INCOME (in millions of dollars)</u>	<u>PERCENT CHANGE</u>
1988	19,260	10.6
1989	21,249	10.3
1990	23,992	12.9
1991	25,168	4.9
1992	26,464	5.1
1993	27,666	4.5
1994	28,469	2.9
1995	29,593	3.9
1996	30,072	1.6
1997	NA	NA

NA: Not available

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

Table 6
CONSUMER PRICE INDEX, ALL URBAN CONSUMERS (CPI-U), AND
SELECTED ITEMS, FOR U.S. AND HONOLULU: 1988-1997
[1982-1984 = 100]

<u>Period</u>	<u>HONOLULU</u>							
	<u>U.S.</u>	<u>All Items</u>	<u>Food & Beverages</u>	<u>Housing</u>	<u>Apparel & Upkeep</u>	<u>Transportation</u>	<u>Medical Care</u>	<u>Entertainment</u>
1988	118.3	121.7	120.3	123.0	106.8	116.1	132.5	122.9
1989	124.0	128.7	128.1	131.1	104.3	123.9	139.3	124.3
1990	130.7	138.1	137.8	141.5	107.0	131.1	154.2	128.4
1991	136.2	148.0	145.9	152.8	110.5	139.3	171.3	134.3
1992	140.3	155.1	148.5	161.7	114.2	147.4	182.6	136.3
1993	144.5	160.1	152.9	166.6	116.5	150.5	197.4	138.4
1994	148.2	164.5	153.4	177.6	118.7	156.4	206.0	142.3
1995	152.4	168.1	156.8	174.7	117.5	162.4	209.8	144.2
1996	156.9	170.7	156.6	176.8	118.5	167.0	215.0	147.8
1997	160.6	171.9	159.2	177.2	117.3	166.2	217.4	147.9

Source: U.S. Department of Labor, Bureau of Labor Statistics.

Tourism

According to the Hawaii Visitors and Convention Bureau (HVCB), visitor arrivals to Hawaii increased 0.7 percent in 1997 from 1996. Eastbound arrivals decreased 0.9 percent and westbound visitors increased 1.8 percent in 1997 over 1996. Total visitors to Hawaii reached 6.88 million in 1997, the third highest level in Hawaii's history. (Table 7)

The annual average hotel occupancy rate in 1997 was 74.0 percent, down from 76.0 percent in 1996 (Table 8).

On September 9, 1997, the Governor announced a two-year moratorium on landing fees paid by air carriers in Hawaii beginning September 1, 1997. Landing fees, which total approximately \$40.0 million per year, are deposited into the Airport Revenue Fund, which as of June 30, 1997 had a \$218.0 million unreserved cash balance.

The State anticipates that the new Convention Center, which was completed in October 1997 and is scheduled to officially open on July 1, 1998, will boost tourism. In 1998, Convention Center delegates and exhibitors are projected to spend between \$0.5 to \$0.8 billion, rising to \$1.3 to \$1.9 billion by 2008 (in 1994 dollars). By 2008, the Convention Center is expected to bring between 633,000 to 774,000 additional visitors.

Table 7
VISITOR ARRIVALS

Visitors Staying Overnight or Longer and
Percentage Change from the Same Period in Previous Year

<u>Year</u>	<u>Westbound</u>	<u>%</u>	<u>Eastbound</u>	<u>%</u>	<u>Total</u>	<u>%</u>
1988	4,264,730	1.4	1,877,690	17.7	6,142,420	5.9
1989	4,705,320	10.3	1,936,500	3.1	6,641,820	8.1
1990	4,719,730	0.3	2,251,450	16.3	6,971,180	5.0
1991	4,584,460	-2.9	2,289,430	1.7	6,873,890	-1.4
1992	3,980,120	-13.2	2,533,760	10.7	6,513,880	-5.2
1993	3,764,520	-5.4	2,359,710	-6.9	6,124,230	-6.0
1994	3,997,820	6.2	2,432,480	3.1	6,430,300	5.0
1995	3,933,110	-1.6	2,696,070	10.8	6,629,180	3.1
1996	4,004,450	1.8	2,825,350	4.8	6,829,800	3.0
1997	4,076,520	1.8	2,800,950	-0.9	6,877,470	0.7

Average Daily Visitor Census and
Percentage Change from the Same Period in Previous Year

<u>Year</u>	<u>Westbound</u>	<u>%</u>	<u>Eastbound</u>	<u>%</u>	<u>Total</u>	<u>%</u>
1988	115,739	-1.0	25,650	46.7	141,389	5.2
1989	128,173	10.7	34,190	33.3	162,363	14.8
1990	125,626	-2.0	36,441	6.6	162,067	-0.2
1991	121,172	-3.5	36,158	-0.8	157,330	-2.9
1992	113,806	-6.1	39,526	9.3	153,332	-2.5
1993	108,122	-5.0	40,613	2.8	148,735	-3.0
1994	115,281	6.6	43,966	8.3	159,247	7.1
1995	113,040	-1.9	46,020	4.7	159,060	-0.1
1996	114,440	1.2	47,170	2.5	161,610	1.6
1997	115,526	0.9	43,351	-8.1	158,877	-1.7

Note: Visitor arrivals for 1995 and 1996 revised by Hawaii Visitors and Convention Bureau on August 29, 1997.
Sources: Hawaii Visitors and Convention Bureau; State of Hawaii Data Book 1987, 1993-1994; Department of Business Economic Development and Tourism.

Table 8
HOTEL OCCUPANCY RATE
(Percentage)

Year	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Annual
1988	81.7	75.1	81.3	75.1	78.3
1989	85.9	73.9	81.0	75.7	79.1
1990	83.9	75.5	81.0	74.3	78.7
1991	68.2	70.7	79.7	72.5	72.8
1992	75.3	68.6	75.5	75.2	73.6
1993	75.3	67.9	73.8	72.5	72.4
1994	80.9	72.7	79.1	74.8	76.9
1995	80.2	72.6	80.4	75.4	77.2
1996	82.1	72.5	78.5	71.0	76.0
1997	79.3	70.3	76.2	70.0	74.0

Source: PKF — Hawaii.

Construction

For the calendar year of 1997, most indicators in the construction industry remained at higher levels than for the calendar year 1996.

The value of construction completed, which is estimated as a one-month lag of the value of construction subject to the general excise tax, fell 11.6 percent in 1997 relative to 1996. The value of private building authorizations, an indicator of future construction activity, rose by 4.8 percent in 1997 compared to 1996. Most of this increase in 1997 was provided by the value of residential building authorizations which rose 11.1 percent in 1997. [Table 9]

There was a decline in 1997 ranging from 2.0 percent to 14.1 percent in the value of private building authorizations in the counties of Hawaii, Kauai and Maui, with Hawaii County at a high 14.1 percent decline and Maui County at a low 2.0 percent decline. Honolulu County experienced a 2.1 percent rise in the value of private building authorizations in 1997. [Table 10]

Table 9
ESTIMATED VALUE OF COMPLETED CONSTRUCTION, NEW PRIVATE
BUILDING AUTHORIZATIONS, AND GOVERNMENT CONTRACTS AWARDED
(in millions of dollars and the percentage change from the previous year)

Year	Value of Construction Completed (1)		Total Private Authorizations		Residential		Commercial and Industrial (2)		Additions and Alterations		Government Contracts Awarded	
	(1)	%		%		%		%		%		%
1988	2,529.0	17.9	1,546.5	33.1	689.2	35.9	541.2	57.1	316.1	1.8	665.0	79.3
1989	3,193.1	26.3	1,882.4	21.7	910.7	32.1	561.8	3.8	409.9	29.7	725.2	9.1
1990	4,121.6	29.1	2,101.8	11.7	952.3	4.6	698.0	24.2	451.5	10.1	825.5	13.8
1991	4,305.3	4.5	2,151.8	2.4	1,192.0	25.2	556.2	-20.3	403.7	-10.6	729.4	-11.6
1992	3,950.4	-8.2	1,751.9	-18.6	811.1	-32.0	532.3	-4.3	408.5	1.2	1,159.1	58.9
1993	3,785.4	-4.2	1,496.5	-14.6	734.7	-9.4	306.3	-42.5	455.5	11.5	651.8	-43.8
1994	3,317.3	-12.4	1,612.9	7.8	849.3	15.6	370.3	20.9	393.4	-13.6	693.0	6.3
1995	3,153.4	-4.9	1,531.3	-5.1	745.5	-12.2	368.3	-0.5	417.5	6.1	490.2	-29.3
1996	3,241.5	2.8	1,117.8	-27.1	487.0	-34.7	252.8	-31.4	378.0	-9.5	885.5	80.7
1997	2,865.0(3)	-11.6(4)	1,140.6(3)	4.8(4)	519.5(3)	11.1(4)	257.7(3)	3.3(4)	363.7(3)	-1.9(4)	NA	NA

(1) Value of Construction subject to State excise tax adjusted to reflect reporting delay of about one month.

(2) Includes hotels.

(3) Maui County Data not available for 4th quarter of 1997. Total excludes 4th Quarter Maui County.

(4) Percentage change was calculated by using adjusted 1996 data. Data for 1996 and 1997 excludes 4th quarter Maui County data.

Source: Hawaii State Department of Taxation; F.W. Dodge; County building departments; and First Hawaiian Bank.

Table 10
**ESTIMATED VALUE OF PRIVATE BUILDING CONSTRUCTION
 AUTHORIZATIONS, BY COUNTY: 1980 TO 1997**
 (and percentage change from the same period in previous year)

Year	City & County of									
	State	%	Honolulu	%	Hawaii County	%	Kauai County	%	Maui County	%
1988	1,546,474	33.1	743,056	-0.9	181,228	24.8	213,678	106.5	408,508	149.4
1989	1,882,397	21.7	1,047,747	41.0	338,060	86.5	178,689	-16.4	317,364	-22.3
1990	2,101,767	11.7	998,921	-4.7	429,964	27.2	238,968	33.7	433,916	36.7
1991	2,151,849	2.4	1,462,676	46.4	369,454	-14.1	118,547	-50.4	201,174	-53.6
1992	1,751,871	-18.6	1,060,700	-27.5	379,158	2.6	111,098	-6.3	200,916	-0.1
1993	1,496,483	-14.6	959,043	-9.6	248,239	-34.5	86,010	-22.6	203,179	1.1
1994	1,612,899	7.8	1,073,264	11.9	181,059	-27.1	164,681	91.5	193,894	-4.6
1995	1,531,317	-5.1	980,757	-8.6	267,108	47.5	78,918	-52.1	204,588	5.5
1996	1,117,760	-27.3	698,697	-28.8	171,017	-36.0	101,981	27.0	146,065	-28.6
1997	1,140,550 (1)	4.8 (2)	772,825	2.1	155,777	-14.1	97,161	-4.7	114,788(1)	-2.0(2)

(1) Maui County data not available for 4th quarter, 1997. Totals exclude 4th quarter Maui County data.

(2) Percent change was calculated by using adjusted 1996 data. Data for 1996 and 1997 excludes 4th quarter Maui County data.

Source: F.W. Dodge; County Building Permits.

Table 11
HONOLULU CONSTRUCTION COST INDEX: 1988-1997
 (Jan. 1992 = 100)

Year	HIGH-RISE BUILDING		SINGLE FAMILY RESIDENCE	
	Annual	% Change	Annual	% Change
1988	84.6	4.4	86.7	5.6
1989	89.4	5.7	90.5	4.4
1990	95.4	6.7	95.1	5.1
1991	99.2	4.0	98.4	3.5
1992	99.4	0.2	102.7	4.4
1993	103.9	4.5	111.5	8.6
1994	109.9	5.8	121.2	8.7
1995	114.1	3.9	118.2	-2.4
1996	116.9	2.4	125.5	6.1
1997	NA	NA	NA	NA

NA: Not available

Source: First Hawaiian Bank

Tax Base

The general excise tax (GET), which accounts for more than half of general fund revenues, were 3.0 percent lower in 1997 than in 1996. In 1996, the GET revenues were larger by approximately \$30 million due to a conversion to electronic fund transfers. From 1996 to 1997, this technical change contributed to negative growth rates for the GET base and all but two of its components: the GET base fell 3.0 percent, the retailing base fell 2.3 percent, the services base fell 4.9 percent, the contracting base fell 12.6 percent, and the hotel base fell .8 percent. The use tax base increased 1.8 percent and the producing tax base increased 3.4 percent.

Table 12
TAX BASE
(Millions of Dollars)

Year	General Excise and Use	Retailing	Services	Contracting	Hotel Room	Producing	4% Use
1988	31,560	10,386.0	3,287.7	2,487.6	1,408.9	298.3	449.5
1989	35,779	11,607.8	3,699.0	3,112.8	1,505.1	326.4	477.1
1990	40,460	12,827.9	4,276.9	4,003.6	1,573.0	317.3	501.9
1991	43,132	13,398.4	4,888.2	4,334.1	1,513.0	301.9	446.0
1992	43,247	13,846.3	5,032.7	4,012.7	1,621.8	408.7	419.4
1993	44,287	13,976.0	5,092.7	3,803.6	1,527.0	474.9	436.7
1994	44,520	14,569.8	5,270.8	3,322.3	1,666.4	467.2	484.2
1995	45,577	15,050.1	5,351.1	3,133.5	1,776.5	457.5	461.2
1996	48,337	16,091.4	5,618.0	3,285.1	2,057.8	479.0	478.4
1997	46,864	15,713.6	5,343.7	2,871.4	2,040.5	495.2	487.0

Source: Hawaii State Department of Taxation

Federal Government Expenditures

Total expenditures by the federal government in the State for the fiscal years 1992 to 1996 were \$6.5 billion, \$7.0 billion, \$7.6 billion, \$7.5 billion and \$8.0 billion, respectively. In calendar year 1996, the federal government employed 30,700 civilian and military personnel with a total payroll of \$2.41 billion. Federal government outlays for both defense and nondefense activities are among the largest expenditures in the State.

Defense expenditures fluctuated between \$2.9 billion in 1992 and \$3.3 billion in 1996. The federal government maintains 26 military installations in the State, encompassing approximately 5 percent of the land area of the State. To reduce the number of military installations in the United States, and to ensure the impartiality of the decision-making process, the Defense Base Closure and Realignment Commission (the "Commission") was established pursuant to the Defense Base Closure and Realignment Act of 1993. On July 1, 1995, the Commission reported to President Clinton its final determinations as to the timely closure and realignment of domestic military installations. Barbers Point Naval Air Station will be closed in 1999. Air squadrons stationed at Barbers Point will be redeployed to Seattle, Washington and to the Marine Corps Base Hawaii, Kaneohe Bay.

Banks and Other Financial Institutions

As of June 30, 1997, total assets of all State-chartered financial institutions, including banks, trust companies, savings and loan associations and industrial loan companies were reported at \$25.8 billion, a 4.13 percent increase over 1996. The five State-chartered banks accounted for \$21.2 billion of such assets.

Transportation

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

Sea Transportation. The State is dependent on regular shipping service for overseas lifeline support. While nearly all visitors to the State arrive by air, surface transportation provides the State with the bulk of both its imported goods and delivery of exported local products. Overseas cargo shipments for the fiscal years 1995, 1996 and 1997 amounted to 9.1 million short tons, 8.7 million short tons and 8.9 million short tons.

The State has seven deep draft harbors to facilitate the movement of goods from the mainland, foreign and interisland ports: Honolulu and Barbers Point (Oahu), Kahului (Maui), Hilo and Kawaihae (Hawaii), and Nawiliwili and Port Allen (Kauai). The State also has two medium draft harbors: Kaunakakai (Molokai) and Kewalo Basin (Oahu). The number of commercial vessels entering all ports was 9,102 in fiscal year 1995, 8,640 in fiscal year 1996, and 8,245 in fiscal year 1997.

Honolulu Harbor is the hub of the State's Statewide System of Harbors, where it serves as a major distribution point of overseas cargo to the neighbor islands and a primary consolidation center for export overseas cargo. Overseas and interisland cargo tonnage handled through the Honolulu Harbor was 8.2 million short tons in fiscal year 1995, 8.5 million short tons in fiscal year 1996, and 8.6 million short tons in fiscal year 1997. The harbors are continuously maintained through the issuance of appropriate special maintenance contracts to ensure the availability of safe and effective harbor facilities.

Air Transportation. The State operates and maintains sixteen airports at various locations within the State. The principal airport which provides facilities for overseas flights (i.e., other than interisland flights within the State) is Honolulu International Airport (HIA) on the island of Oahu. HIA is located approximately seven miles by highway from the center of the downtown area of Honolulu. It has four runways, two of which (12,000 feet and 12,357 feet) are among the nation's longest. Approximately 60 aircraft can be handled at one time at the terminal complex, including 36 wide-bodied aircraft. With 29 overseas gate positions, 20 inter-island and commuter positions and public parking stalls for 5,300 vehicles, HIA is the most important in the State airports system. The airfield at Barbers Point Naval Air Station will become Kalaeloa Airport, a general aviation reliever airport for HIA, in July, 1999.

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

According to the most recent publication of the Airports Council International, HIA is one of the busiest air terminals in the world, ranking 30th in the world and 19th in the United States in total passengers serviced in 1996. HIA is the fifth busiest airport in the Pacific Rim, after Los Angeles International Airport, Tokyo International Airport (Haneda), San Francisco International Airport and New Tokyo International Airport (Narita). In 1996, HIA recorded 372,268 aircraft operations.

Statewide, combined incoming and outgoing overseas air cargo increased from 306,591 tons in 1995 to 326,161 tons in 1996. Statewide, combined overseas and intrastate air cargo, increased from 455,765 tons in 1995 to 486,945 tons in 1996. Although of high unit value, air cargo still remains relatively insignificant compared with surface shipping.

Land Transportation. The State has 4,455 miles of streets and highways, which include 138 miles of roads in State parks and national parks, and military roads open to the public. The State has an ongoing program of new construction, maintenance and upgrading to improve traffic flow and safety and relieve congestion. The H-3 freeway, recently completed, connects the Kaneohe Marine Corps Air Station with the Halawa Interchange, which is adjacent to Pearl Harbor and Hickam Air Force Base.

Hawaii's major bus system operates island-wide on Oahu under the jurisdiction of the City and County of Honolulu. As of June 30, 1997, the bus system operated 525 buses. In FY 1997, the buses carried an estimated 75.0 million passengers over a total of 19.6 million revenue miles.

Motor vehicle registration peaked in 1991 at 897,193 vehicles. It decreased to 885,761 in 1992, 880,152 in 1993, 875,144 in 1994, 877,756 in 1995, and amounted to 884,267 in 1997.

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**AUDITED FINANCIAL STATEMENTS
OF THE HIGHWAYS DIVISION**

REPORT OF INDEPENDENT ACCOUNTANTS

To the Director
Department of Transportation
State of Hawaii

We have audited the accompanying combined financial statements of the Highways Division, Department of Transportation, State of Hawaii (the Division), as of and for the year ended June 30, 1997, as listed in the table of contents. These combined financial statements are the responsibility of the Division's management. Our responsibility is to express an opinion on these combined financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards 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 combined financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the combined financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall combined financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 2, the combined financial statements of the Division are intended to present the financial position and results of operations of only that portion of the funds and account groups of the State of Hawaii that is attributable to the transactions of the Division.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of the Division as of June 30, 1997, and the results of its operations for the year then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued a report dated March 26, 1998 on our consideration of the Division's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants.

Our audit was performed for the purpose of forming an opinion on the combined financial statements of the Division, taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the combined financial statements. Such information has been subjected to the auditing procedures applied in the audit of the combined financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the combined financial statements taken as a whole.

Coppen & Lyman L.L.P.

Honolulu, Hawaii
March 26, 1998

COMBINED BALANCE SHEET - ALL FUND TYPES AND ACCOUNT GROUPS

HIGHWAYS DIVISION, DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII

June 30, 1997

Assets	Governmental Fund Types				Account Groups			Total (Memorandum Only)
	State Highway Fund	Debt Service Fund	Capital Projects Fund	General Fixed Assets	General Long-Term Debt	General Assets	Long-Term Debt	
Cash with Director of Finance, State of Hawaii (\$3,334,160 held for others)	\$ 226,220,309	\$ 8,426,021	\$ 138,613,925	\$ --	\$ --	\$ --	\$ --	\$ 373,260,255
Receivables (net, where applicable, of allowance for uncollectibles totaling \$554,000):								
Due from U.S. Government for federal grants-in-aid (Note 5)	3,040,730	--	10,379,034	--	--	--	--	13,419,764
Due from Capital Projects Fund (Note 6)	28,616,951	--	--	--	--	--	--	28,616,951
Due from County	21,761	--	--	--	--	--	--	21,761
Due from State of Hawaii (Note 7)	--	--	2,477,925	--	--	--	--	2,477,925
Due from others	5,970,734	--	--	--	--	--	--	5,970,734
Property and equipment (Note 9):								
Buildings and improvements	--	--	--	6,847,498	--	--	--	6,847,498
Vehicles and equipment	--	--	--	33,786,403	--	--	--	33,786,403
Amount to be provided for the payment of general long-term debt (Note 10)	--	--	--	--	127,229,694	--	--	127,229,694
Total assets	\$ 263,870,485	\$ 8,426,021	\$ 151,470,884	\$ 40,633,901	\$ 127,229,694	\$ 40,633,901	\$ 127,229,694	\$ 591,630,985

The accompanying notes are an integral part of the combined financial statements.

COMBINED BALANCE SHEET - ALL FUND TYPES AND ACCOUNT GROUPS - Continued

HIGHWAYS DIVISION, DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII

June 30, 1997

	Governmental Fund Types				Account Groups			Total (Memorandum Only)
	State Highway Fund	Debt Service Fund	Capital Projects Fund	General Fixed Assets	General Long-Term Debt			
Liabilities And Fund Equity								
Liabilities:								
Accounts payable	\$ 886,229	\$ --	\$ 156,787	--	\$ --		\$ 1,043,016	
Contracts payable - current portion	3,249,747	--	10,011,996	--	--		13,261,743	
Contracts payable - retained percentage	2,885,863	--	5,153,165	--	--		8,039,028	
Due to State Highway Fund (Note 6)	--	--	28,616,951	--	--		28,616,951	
Deposits	3,334,160	--	--	--	--		3,334,160	
Other	15,300	--	--	--	--		15,300	
Workers' compensation payable	--	--	--	--	2,161,000		2,161,000	
Accrued vacation payable (Note 10)	--	--	--	--	7,668,694		7,668,694	
Revenue bonds payable	--	--	--	--	117,400,000		117,400,000	
Matured bonds and interest payable	--	8,426,021	--	--	--		8,426,021	
	10,371,299	8,426,021	43,938,899	--	127,229,694		189,965,913	
Total liabilities								
Contingent liabilities and commitments (Notes 2, 8, 12 and 13)								
Fund equity:								
Investment in general fixed assets	--	--	--	40,633,901	--		40,633,901	
Fund balances:								
Reserved for encumbrances	29,354,741	--	32,487,073	--	--		61,841,814	
Unreserved	224,144,445	--	75,044,912	--	--		299,189,357	
Total fund balances	253,499,186	--	107,531,985	--	--		361,031,171	
Total fund equity	253,499,186	--	107,531,985	40,633,901	--		401,665,072	
Total liabilities and fund equity	\$ 263,870,485	\$ 8,426,021	\$ 151,470,884	\$ 40,633,901	\$ 127,229,694		\$ 591,630,985	

The accompanying notes are an integral part of the combined financial statements.

**COMBINED STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCES - ALL GOVERNMENTAL FUND TYPES**

**HIGHWAYS DIVISION, DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Year Ended June 30, 1997

	State Highway Fund	Debt Service Fund	Capital Projects Fund	Total (Memorandum Only)
Revenues:				
Intergovernmental:				
Federal grants-in-aid (Note 5)	\$ 35,771,229	\$ --	\$ 140,347,071	\$ 176,118,300
Taxes and fees (Note 4):				
Fuel taxes	69,880,639	--	--	69,880,639
Rental motor and tour vehicle surcharge taxes	22,600,428	--	--	22,600,428
Vehicle weight taxes	22,227,426	--	--	22,227,426
Vehicle registration fees	16,209,652	--	--	16,209,652
Other	1,787,465	--	--	1,787,465
Interest income	10,961,329	--	--	10,961,329
Rentals	540,429	--	--	540,429
Other	1,816,856	--	--	1,816,856
Total revenues	181,795,453	--	140,347,071	322,142,524
Expenditures:				
Operations and maintenance:				
Oahu highways and services	36,200,768	--	--	36,200,768
Hawaii highways and services	30,171,510	--	--	30,171,510
Maui highways and services	14,964,686	--	--	14,964,686
Kauai highways and services	7,898,615	--	--	7,898,615
Molokai highways and services	1,460,831	--	--	1,460,831
Lanai highways and services	490,127	--	--	490,127
Administration of Highways Division	10,545,788	--	--	10,545,788
Departmental administration	1,831,765	--	--	1,831,765
Motor Vehicle Safety Office	4,959,818	--	--	4,959,818
Capital projects	--	--	207,133,597	207,133,597
Debt service	--	10,003,142	--	10,003,142
Total expenditures	108,523,908	10,003,142	207,133,597	325,660,647
Excess (deficiency) of revenues over expenditures	73,271,545	(10,003,142)	(66,786,526)	(3,518,123)
Other financing sources (uses) (Note 11):				
Proceeds from revenue bonds	--	--	54,776,708	54,776,708
Operating transfers in	--	10,003,142	16,222,653	26,225,795
Operating transfers out	(104,545,735)	--	--	(104,545,735)
Total other financing sources (uses)	(104,545,735)	10,003,142	70,999,361	(23,543,232)
Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses	(31,274,190)	--	4,212,835	(27,061,355)
Fund balances, July 1, 1996	284,773,376	--	103,319,150	388,092,526
Fund balances, June 30, 1997	\$ 253,499,186	\$ --	\$ 107,531,985	\$ 361,031,171

The accompanying notes are an integral part of the combined financial statements.

**STATEMENT OF REVENUES AND EXPENDITURES - BUDGET AND ACTUAL -
STATE HIGHWAY FUND (NON-GAAP BUDGETARY BASIS)**

**HIGHWAYS DIVISION, DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Year Ended June 30, 1997

	Budget	Budgetary Actual	Variance - Favorable (Unfavorable)
Revenues:			
Fuel taxes	\$ 70,659,813	\$ 69,880,639	\$ (779,174)
Vehicle weight taxes	21,354,334	21,304,746	(49,588)
Rental motor and tour vehicle surcharge tax	20,648,400	22,600,428	1,952,028
Vehicle registration fees	16,701,332	16,209,652	(491,680)
Interest income	9,244,000	10,961,329	1,717,329
Enforcement fee	1,262,630	1,242,268	(20,362)
Vehicle registration penalties	727,693	888,232	160,539
Commercial drivers license fee	363,923	375,753	11,830
Rentals	500,000	540,429	40,429
Other	242,818	511,760	268,942
	<hr/>	<hr/>	<hr/>
Total revenues	141,704,943	144,515,236	2,810,293
Expenditures:			
Operations and maintenance:			
Oahu highways and services	34,143,822	28,934,479	5,209,343
Hawaii highways and services	22,244,682	17,154,705	5,089,977
Maui highways and services	12,917,560	9,112,379	3,805,181
Kauai highways and services	6,673,744	5,538,895	1,134,849
Molokai highways and services	2,279,450	1,285,364	994,086
Lanai highways and services	626,758	422,471	204,287
Administration of Highways Division, including debt service (Note 11)	62,491,789	60,736,007	1,755,782
Departmental administration	3,110,327	2,177,861	932,466
Motor Vehicle Safety Office	5,225,632	4,384,938	840,694
	<hr/>	<hr/>	<hr/>
Total expenditures	149,713,764	129,747,099	19,966,665
Excess (deficiency) of revenues over expenditures	<u>\$ (8,008,821)</u>	<u>\$ 14,768,137</u>	<u>\$ 22,776,958</u>

The accompanying notes are an integral part of the combined financial statements.

**DEPARTMENT OF TRANSPORTATION - HIGHWAYS DIVISION
STATE OF HAWAII**

NOTES TO THE COMBINED FINANCIAL STATEMENTS

June 30, 1997

1. Financial Reporting Entity

Act 1, Session Laws of Hawaii (SLH), Second Special Session 1959, the Hawaii State Government Reorganization Act of 1959 (Act), established the Department of Transportation (Department) whose function is to establish, maintain and operate transportation facilities of the State of Hawaii (State), including highways, airports, harbors and such other transportation facilities and activities as may be authorized by law. The Department's activities are carried out through three primary operating divisions: Airports, Harbors and Highways. Through the Highways Division (Division), the Department has general supervision of the management and maintenance of the State Highway System and the location, design and construction of new highways and facilities. The Highways Division provides supervision to assure completion of State highway contracts in accordance with plans and specifications.

Taxes, fees and charges authorized and collected relating to the operation and use of motor vehicles on public highways of the State are deposited into the State Highway Fund, and expenditures for purposes of the Act are made from the State Highway Fund.

The State Highway Fund also includes the Motor Vehicle Safety Office (MVSO). MVSO was originally established as the Highway Safety Coordinator's Office to implement the 1967 Hawaii Highway Safety Act. It was reorganized by the 1977 State Legislature to encompass the additional duty of the safety of operations of heavy motor vehicles. The MVSO is assigned as a staff office under the Highways Division.

2. Summary Of Significant Accounting Policies

Basis Of Presentation -

The accounts of the Division are organized on the basis of funds and account groups, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures. Governmental resources are allocated to and accounted for in individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled.

Amounts in the "Total--Memorandum Only" columns in the combined financial statements represent summations of the financial statement line items of the fund types and account

DEPARTMENT OF TRANSPORTATION - HIGHWAYS DIVISION
STATE OF HAWAII

NOTES TO THE COMBINED FINANCIAL STATEMENTS

June 30, 1997

groups included in those statements, and are presented only for analytical purposes. Those summations may include fund types and account groups that use different bases of accounting. Consequently, amounts shown in the "Total--Memorandum Only" columns are not comparable to a consolidation and do not represent the total resources available or total revenues and expenditures of the Division.

For financial reporting purposes, the Division includes all funds and account groups that are controlled by or dependent on the Division's administrative head. Control by or dependence on the Division was determined on the basis of statutory authority and moneys flowing through the Division to each fund or account.

The Division uses the following fund types and account groups:

Governmental Fund Types

State Highway Fund: The State Highway Fund generally accounts for revenues and expenditures for highway operations and maintenance and administration.

The State Highway Fund is a special revenue fund of the State established by Section 248-8, Hawaii Revised Statutes (HRS). All fuel taxes collected under Section 243-4, HRS except county fuel taxes, aviation fuel taxes, and taxes on fuel sold for use in small boats are deposited in the State Highway Fund.

Section 248-9, HRS provides that moneys in the State Highway Fund shall be expendable by the Department of Transportation for the design, construction, reconstruction, repair and maintenance, and for acquisition of rights-of-way for public highways included in the State Highway System established under Section 264-41, HRS.

Debt Service Fund: The Debt Service Fund accounts for the Division's financial resources obtained and used for the payment of principal and interest on State of Hawaii Highway Revenue Bonds.

Capital Projects Fund: The Capital Projects Fund accounts for the Division's highway construction projects and the related sources of financing.

DEPARTMENT OF TRANSPORTATION - HIGHWAYS DIVISION
STATE OF HAWAII

NOTES TO THE COMBINED FINANCIAL STATEMENTS

June 30, 1997

The accompanying financial statements include highway projects authorized by legislative acts (Session Laws of Hawaii) through June 30, 1997.

General Fixed Asset Account Group

The General Fixed Asset Account Group is used to account for property and equipment used in the operations of the Division.

Buildings And Improvements, Vehicles And Equipment: Property and equipment used in operations, other than land, are valued at cost or estimated cost in the General Fixed Assets Account Group. Depreciation is not recorded on the Division's assets.

Highway Construction Expenditure: Acquisition costs of land remnants (comprised of land areas acquired in excess of rights-of-way needs which were purchased in connection with the construction of highway projects) and land for highways, related bridges, landscaping, drainage, lighting systems, curbs and gutters, and sidewalks have been excluded from property and equipment. These costs are recorded as expenditures as incurred.

At June 30, 1997, the Division had 846 parcels remaining with an aggregate acquisition cost of approximately \$1,250,000, which is not included in the combined balance sheet. Upon sale of a parcel to a private party, the proceeds are accounted for as a recovery of expenditures of the applicable capital projects fund if the project has not been closed; otherwise, the proceeds are accounted for as revenues of the State Highway Fund.

General Long-Term Debt Account Group

The General Long-Term Debt Account Group accounts for liabilities associated with State of Hawaii Revenue Bonds, workers' compensation and compensated absence programs which are not expected to be liquidated with expendable available resources.

**DEPARTMENT OF TRANSPORTATION - HIGHWAYS DIVISION
STATE OF HAWAII**

NOTES TO THE COMBINED FINANCIAL STATEMENTS

June 30, 1997

Basis Of Accounting -

Except for the statement of revenue and expenditures - budget and actual - State Highway Fund (non-GAAP budgetary basis) (Note 3), the accompanying financial statements are prepared on the modified accrual basis of accounting. Under the modified accrual basis:

- Revenues are recognized when received in cash except for those accruable, which are recorded as receivables when measurable and available. For financial statement purposes, unbilled reimbursable costs at year-end are accrued and recorded as revenue and receivable from the U.S. Government for federal grants-in-aid.
- Expenditures are recorded on the accrual basis except that (1) disbursements for inventory are considered expenditures at the time of purchase, (2) prepaid expenses are not normally recognized, and (3) sick pay is not normally accrued.

Encumbrances -

The Division's accounting procedures provide for the recording of commitments as encumbrances at the time contracts are awarded and executed. Purchase orders issued for materials, supplies and services chargeable to annual appropriations for operating costs which are outstanding at the end of the year are also encumbered. Encumbrances are recorded as a reservation of fund balance.

Cash -

Cash reported in the combined balance sheet includes cash in the State Treasury, including repurchase agreements with maturities of three months or less, and deposits received and held for others in the amount of \$3,334,000 at June 30, 1997. The deposits were received on the Division's contracts with third parties.

The State of Hawaii maintains a cash pool that is available for all funds. Each fund type's portion of this pool is displayed on the combined balance sheet as Cash with Director of Finance. Those funds are pooled with funds from other State of Hawaii agencies and departments and deposited in approved financial institutions by the Director of Finance. Deposits not covered by federal deposit insurance are fully collateralized by government securities held in the name of the State of Hawaii by third party custodians.

**DEPARTMENT OF TRANSPORTATION - HIGHWAYS DIVISION
STATE OF HAWAII**

NOTES TO THE COMBINED FINANCIAL STATEMENTS

June 30, 1997

The Hawaii Revised Statutes authorize the Director of Finance to invest in obligations of or guaranteed by the U.S. Government, obligations of the State, federally-insured savings and checking accounts, time certificates of deposit and repurchase agreements with federally-insured financial institutions.

Departmental Administration -

The departmental administration expenditures represent the Division's share of the operating costs incurred by the administrative functions of the Department of Transportation, State of Hawaii. The departmental costs, which are funded by the operating divisions of the Department, have been allocated to the State Highway Fund on a consistent basis from year to year.

3. Budgets And Budgetary Accounting

State Highway Fund -

In the statement of revenues and expenditures - budget and actual - State Highway Fund (non-GAAP budgetary basis), amounts reflected as budgeted revenues are the official estimates as compiled by the State Department of Budget and Finance at the time of budget consideration and adoption by the State Legislature. Revenue received from federal grants-in-aid is not included in the statement of revenues and expenditures - budget and actual - State Highway Fund (non-GAAP budgetary basis) since such grants are normally reimbursements of costs incurred on projects.

In the case of expenditures, the budgeted amounts reflected on the statement of revenues and expenditures - budget and actual - State Highway Fund (non-GAAP budgetary basis) are derived from: the Supplemental Appropriations Act of 1996 (Act 287, SLH 1996) - authorizations for expenditures for operating purposes for the Division (\$141,377,805) and the Motor Vehicle Safety Office (\$5,225,632); the allocation portion of authorization for expenditures for departmental administration (\$3,110,327).

DEPARTMENT OF TRANSPORTATION - HIGHWAYS DIVISION
STATE OF HAWAII

NOTES TO THE COMBINED FINANCIAL STATEMENTS

June 30, 1997

Appropriations are made and expenditures are controlled at the program level reflected in the statement of revenues and expenditures - budget and actual - State Highway Fund (non-GAAP budgetary basis). State Highway Fund appropriations lapse at year-end.

With reference to the statement of revenues and expenditures - budget and actual - State Highway Fund (non-GAAP budgetary basis), budget and actual amounts for expenditures include encumbrances and exclude expenditures charged to prior years' appropriations and unbudgeted federally funded expenditures.

The reconciliation of the actual excess of revenues over expenditures as shown on the statement of revenues and expenditures - budget and actual - State Highway Fund (non-GAAP budgetary basis) to the combined statement of revenues, expenditures, and changes in fund balances - all governmental fund types is as follows:

Excess of revenues over expenditures, non-GAAP budgetary basis	<u>\$ 14,768,137</u>
Federal grants-in-aid	35,771,229
Operating transfers out to State of Hawaii for debt service	40,383,243
Other adjustments to modified accrual basis of accounting	<u>(17,651,064)</u>
	<u>58,503,408</u>
Excess of revenues over expenditures, GAAP basis	<u><u>\$ 73,271,545</u></u>

Capital Projects Fund -

Excess Capital Projects Fund appropriations lapse after completion of the project which is generally two or three years subsequent to appropriation. Funds appropriated as part of a qualified federal award program do not lapse.

DEPARTMENT OF TRANSPORTATION - HIGHWAYS DIVISION
STATE OF HAWAII

NOTES TO THE COMBINED FINANCIAL STATEMENTS

June 30, 1997

4. Tax And Fee Revenues

State Fuel Tax -

The primary source of revenue for the State Highway Fund is the state tax on liquid (motor vehicle) fuel. For the year ended June 30, 1997, the tax imposed on each gallon of fuel is as follows:

Gasoline	16 cents
Diesel fuel:	
Non-highway use	1 cent
Highway use	16 cents
Liquefied petroleum gas:	
Non-highway use	1 cent
Highway use	11 cents

Vehicle Weight Tax And Penalties -

The vehicle weight tax is .75 - 1.25 cent per pound of net vehicle weight (depending upon the weight of the vehicle) to a maximum of \$150.

Delinquent penalties determined by counties, are assessed at 10%-20% of the tax imposed or are a flat charge of \$8 or \$20, depending on the type of vehicle.

Rental Motor Vehicle Surcharge Tax -

The rental motor vehicle surcharge tax is \$2 a day or any portion of a day that a rental motor vehicle is rented or leased.

Vehicle Registration Fee -

The vehicle registration fee is \$20 per vehicle.

**DEPARTMENT OF TRANSPORTATION - HIGHWAYS DIVISION
STATE OF HAWAII**

NOTES TO THE COMBINED FINANCIAL STATEMENTS

June 30, 1997

Tour Vehicle Surcharge Tax -

The tour vehicle surcharge tax is \$65 a month for tour vehicles categorized by the public utilities commission as an over twenty-five passenger carrier vehicle and \$15 a month for tour vehicles categorized as an eight to twenty-five passenger carrier vehicle.

Other Taxes And Fee -

The motor carrier safety inspection fee is \$1.50 per vehicle every six months.

5. Federal Grants-In-Aid

The Division has projects in progress in which part of the funding is being provided by the Federal Highway Administration (FHWA) through grants-in-aid. Such projects are generally accounted for in the Capital Projects Fund. At June 30, 1997, the receivable from the U.S. Government is comprised of unbilled costs which are eligible for reimbursement. At June 30, 1997, cost of approximately \$28,644,000 were not reflected as receivables and as federal grants-in-aid revenue, pending qualification for reimbursement by the Division. In addition, the MVSO has projects in progress in which part of the funding is being provided through federal grants-in-aid. The grants contain various compliance requirements which must be met by the MVSO, including a matching of the grant amounts with state and local highway safety expenditures as defined in a formula. MVSO's matching requirement is met through the expenditures of the Division of Driver Education, The Judiciary, State of Hawaii. Costs reimbursement by the FHWA and National Highway Traffic Safety Administration (NHTSA) are subject to final audit by federal agencies. In addition, FHWA and NHTSA reserve the right to examine the Division for economy, efficiency and program results. The Division's management believes that any federal aid received as of June 30, 1997 which might be required to be repaid to the FHWA or NHTSA based on federal audits would not be material to the financial position of the various funds and account groups of the Division at June 30, 1997, or the results of operations of such funds for the year then ended.

**DEPARTMENT OF TRANSPORTATION - HIGHWAYS DIVISION
STATE OF HAWAII**

NOTES TO THE COMBINED FINANCIAL STATEMENTS

June 30, 1997

6. Due From Capital Projects Fund/Due To State Highway Fund

The Division advances moneys from the revenues of the State Highway Fund to fund expenditures of highway construction projects of the Capital Projects Fund if project funds become insufficient to meet current expenditure requirements. The advances are repayable to the State Highway Fund when federal-aid moneys have been received or when increases in the affected project funds have been authorized.

7. Due From State Of Hawaii

The Capital Projects Fund receives funding from the State for the State's portion of expenditures for highway construction projects, which is accounted for as an operating transfer in the combined statement of revenues, expenditures, and changes in fund balances (see Note 11). The amount due from the State at June 30, 1997 reflects the State's portion of the Division's liabilities for project expenditures at that date.

8. Retirement Benefits

Employees' Retirement System -

Substantially all eligible employees of the Division are members of the Employees' Retirement System of the State of Hawaii (ERS), a cost-sharing multiple-employer public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. Prior to June 30, 1984, the plan consisted of only a contributory option. In 1984, legislation was enacted to add a new noncontributory option for members of the ERS who are also covered under Social Security. Persons employed in positions not covered by Social Security are precluded from the noncontributory option. The noncontributory option provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory option or to elect the new noncontributory option and receive a refund of employee contributions. All benefits vest after five and ten years of credited service under the contributory and noncontributory options, respectively.

The ERS provides basic pension benefits to individuals receiving pensions. Employer contributions to the ERS are comprised of normal cost plus level annual payments required to liquidate the unfunded accrued liability of the ERS. The ERS uses the frozen entry age

DEPARTMENT OF TRANSPORTATION - HIGHWAYS DIVISION
STATE OF HAWAII

NOTES TO THE COMBINED FINANCIAL STATEMENTS

June 30, 1997

method (formerly known as the frozen initial liability method) to calculate the unfunded accrued liability.

In November 1994, the Governmental Accounting Standards Board (GASB) issued Statement No. 25, "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans," which establishes a financial reporting framework for defined benefit plans that distinguishes between two categories of information: (a) current financial information about plan assets and financial activities and (b) actuarially determined information, from a long-term perspective, about the funded status of the plan and the progress being made in accumulating sufficient assets to pay benefits when due. The ERS adopted the provisions of this statement effective July 1, 1996.

Effective July 1, 1997, the actuarial valuation method was changed to the entry age normal cost funding method. Such change will result in a decrease in required employer contributions in 1998.

The Division's payroll for employees covered by the plan for the year ended June 30, 1997 was approximately \$29,499,000. The payroll for all the Division's employees for the year was \$30,048,000. Contributions made to the ERS by the Division and employees for the year ended June 30, 1997 were \$4,146,000 and \$356,000, respectively. The contributions represented 14% and 1% of covered payroll, respectively.

ERS issues a Comprehensive Annual Financial Report (CAFR) that includes financial statements and required supplementary information which may be obtained from the following address:

Employees' Retirement System of the State of Hawaii
201 Merchant Street, Suite 1400
Honolulu, Hawaii 96813

The following data was obtained from the disclosures contained in the CAFR for the year ended June 30, 1997:

Number of employers as of March 31, 1997 was:

State	1
Counties	<u>4</u>
Total employers	<u>5</u>

**DEPARTMENT OF TRANSPORTATION - HIGHWAYS DIVISION
STATE OF HAWAII**

NOTES TO THE COMBINED FINANCIAL STATEMENTS

June 30, 1997

Basis of Accounting - The financial statements of the ERS are prepared using the accrual basis of accounting. Employer and member contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

Method Used to Value Investments - Plan investments are reported at fair value. Where appropriate, the fair value includes disposition costs. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Mortgages are valued on the basis of future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. The fair value of real estate investments and real estate owned are based on independent appraisals and estimated values.

Post-Retirement Health Care And Life Insurance Benefits -

In addition to providing pension benefits, the State provides certain health care and life insurance benefits for retired state employees. Contributions are based upon negotiated collective bargaining agreements, and are funded by the State as accrued. The Division's post-retirement health care and life insurance benefits expense for the year ended June 30, 1997, was approximately \$1,460,000 and is included in the financial statements.

9. Changes In Property And Equipment

Changes in property and equipment during the year are as follows:

	Balance July 1, 1996	Additions	Deductions	Balance June 30, 1997
Buildings and improvements	\$ 6,905,498	\$ --	\$ 58,000	\$ 6,847,498
Vehicles and equipment	<u>32,394,814</u>	<u>2,288,096</u>	<u>896,507</u>	<u>33,786,403</u>
Total	<u>\$ 39,300,312</u>	<u>\$ 2,288,096</u>	<u>\$ 954,507</u>	<u>\$ 40,633,901</u>

DEPARTMENT OF TRANSPORTATION - HIGHWAYS DIVISION
STATE OF HAWAII

NOTES TO THE COMBINED FINANCIAL STATEMENTS

June 30, 1997

10. Changes In General Long-Term Debt

Changes in general long-term debt during the year are as follows:

	Workers' Compensation Payable	Accrued Vacation Payable	Revenue Bonds Payable	Total
Balance at July 1, 1996	\$ 3,033,000	\$ 6,397,513	\$ 66,820,000	\$ 76,250,513
Net decrease in workers' compensation payable	(872,000)	--	--	(872,000)
Net increase in accumulated vacation	--	1,271,181	--	1,271,181
Bonds issued	--	--	55,000,000	55,000,000
Bonds retired	--	--	(4,420,000)	(4,420,000)
Balance at June 30, 1997	<u>\$ 2,161,000</u>	<u>\$ 7,668,694</u>	<u>\$ 117,400,000</u>	<u>\$ 127,229,694</u>

11. Other Financing Sources And Uses

Operating transfers, accounted for in the combined statement of revenues, expenditures, and changes in fund balances as other financing sources and uses, are summarized as follows:

Description	Transfers In (Out)		
	State Highway Fund	Debt Service Fund	Capital Projects Fund
Funding of highway capital projects:			
State Highway Fund	\$ (12,455,614)	\$ --	\$ 12,455,614
State of Hawaii	(144,736)	--	3,767,039
Reimbursement to State of Hawaii for debt service	(40,383,243)	--	--
Transfer of funds to State of Hawaii general fund	(41,559,000)	--	--
Funding of revenue bond debt service	(10,003,142)	10,003,142	--
	<u>\$ (104,545,735)</u>	<u>\$ 10,003,142</u>	<u>\$ 16,222,653</u>

**DEPARTMENT OF TRANSPORTATION - HIGHWAYS DIVISION
STATE OF HAWAII**

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The amount of the Division's reimbursement to the State for debt service is primarily determined by the Director of Finance, State of Hawaii.

Funding Of Highway Capital Projects -

Funding of highway capital projects by the State Highway Fund is recognized when received by the Capital Projects Fund. Funding by the State is recognized as a transfer in when authorized expenditures are incurred.

In fiscal 1991, \$250,000,000 was transferred to the State Highway Fund from the Department's Airports Division pursuant to Act 309, SLH 1989 as amended, in 1991. These funds can be used only for certain highway projects within 10 miles by road of an airport. At June 30, 1997, approximately \$100,000,000 is uncommitted and is included in the State Highway Fund unreserved fund balance.

Reimbursement To State of Hawaii For Debt Service -

Allocated portions of the State's general obligation bonds have been designated to be reimbursed from the State Highway Fund by the Director of Finance, State of Hawaii. The proceeds from these bonds are related to the above funds transferred from the State to the Division for highway capital projects. These bonds are the obligations of the State and are not included in these financial statements.

The annual amounts required to amortize the designated portions of general obligation bonds as of June 30, 1997, including interest payments of \$73,527,000 are as follows:

Year ending June 30,	
1998	\$ 31,543,000
1999	30,399,000
2000	30,065,000
2001	27,274,000
2002	25,789,000
Thereafter	<u>135,418,000</u>
	<u>\$ 280,488,000</u>

DEPARTMENT OF TRANSPORTATION - HIGHWAYS DIVISION
STATE OF HAWAII

NOTES TO THE COMBINED FINANCIAL STATEMENTS

June 30, 1997

Debt service reimbursements are accounted for as expenditures of the "Administration of Highways Division" program on the statement of revenues and expenditures - budget and actual - State Highway Fund (non-GAAP budgetary basis) and are accounted for as "Operating transfers out" of the State Highway Fund on the combined statement of revenues, expenditures, and changes in fund balances - all governmental fund types. Reimbursement payments consisted of \$23,864,673 for principal and \$16,518,570 for interest for the year ended June 30, 1997.

Transfer Of Funds To State Of Hawaii General Fund -

Section 248-9, Hawaii Revised Statutes authorizes the Director of Transportation to transfer from the State Highway Fund moneys in excess of 135% of the requirements for the ensuing twelve months for the Fund to the State of Hawaii General Fund. For the 1997 fiscal year, \$41,559,000 was transferred to the General Fund, which includes a \$19,000,000 transfer as authorized by Act 213 of the 1996 Session Laws of Hawaii. In addition, \$23,414,000 is planned to be transferred in the 1998 fiscal year, and \$24,268,000 is planned to be transferred in the 1999 fiscal year.

12. Commitments And Contingencies

Litigation -

The State is the defendant in lawsuits seeking damages allegedly related to State highways and highway construction contracts. No provision for any liability which may result from these lawsuits has been made in the Division's financial statements since any such liabilities are normally paid from the State's General Fund, should the State of Hawaii be found liable.

Condemnation Proceedings -

The Division occasionally finds it necessary to condemn property for construction of highways. These proceedings require the Division to compensate the existing property owner for the fair market value of the real property. Prior to the determination of the fair market value, the Division is required to deposit funds in State courts for these proceedings. Such funds deposited may not be sufficient to cover the full amount required for compensation purposes. Management, however, believes any additional compensation in excess of amounts deposited with State courts will not be material to the financial statements of the Division.

DEPARTMENT OF TRANSPORTATION - HIGHWAYS DIVISION
STATE OF HAWAII

NOTES TO THE COMBINED FINANCIAL STATEMENTS

June 30, 1997

Deferred Compensation Plan -

The State established a deferred compensation plan (plan) in accordance with Section 457 of the Internal Revenue Code which enables State employees to defer a portion of their compensation. The State of Hawaii, Department of Human Resources and Development, has the fiduciary responsibility of administering the plan. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency.

All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights (until paid or made available to the employee or other beneficiary) are solely the property and rights of the State, subject to the claims of the State's general creditors. Participants' rights under the plan are equal to those of the general creditors of the State in an amount equal to the fair market value of the deferred account for each participant. The assets of the plan and the deferred compensation payable are recorded in the State of Hawaii's Employee Benefits Agency Fund.

Insurance -

The State maintains certain insurance coverages to satisfy bond indenture agreements as well as for other purposes, but is substantially self-insured for all other perils including workers' compensation. The State records a liability for risk financing and insurance related losses, including incurred but not reported, if it is determined that a loss has been incurred and the amount can be reasonably estimated. The State retains various risks and insures certain excess layers with commercial insurance companies. At June 30, 1997, the State recorded an estimated liability for workers' compensation, automobile and general liability claims in the general long-term debt account group. The estimated losses will be paid from legislative appropriations of the State's general fund.

As the Division is responsible for funding certain workers' compensation benefit payments, the Division recorded an estimated liability of \$2,161,000 for workers' compensation in the general long-term debt account group at June 30, 1997, as these losses will not be liquidated with currently expendable available financial resources. Workers' compensation expense for the year ended June 30, 1997 was approximately \$761,000.

Accumulated Sick Pay -

Sick leave accumulates at the rate of one and three-quarters working days for each month of service without limit. It may be taken only in the event of illness and is not convertible to pay upon termination of employment. However, a state employee who retires or leaves

DEPARTMENT OF TRANSPORTATION - HIGHWAYS DIVISION
STATE OF HAWAII

NOTES TO THE COMBINED FINANCIAL STATEMENTS

June 30, 1997

government service in good standing with sixty days or more of unused sick leave is entitled to additional service credits in the Employee's Retirement System. Accumulated sick leave at June 30, 1997, aggregated approximately \$17,000,000.

Vacation -

Employees are credited with vacation at a rate of 168 hours per calendar year. Accumulation of such vacation credits is limited to 720 hours at calendar year-end and is convertible to pay upon termination of employment.

13. Lease Commitments

The State, through the Division, leases certain offices from four landlords. The leases, which expire at various dates through 2000, provide space primarily for administrative employees of the Division. During the year ended June 30, 1997, rental expense approximated \$417,000. The approximate future minimum rent at June 30, 1997 is as follows:

Year ending June 30,	
1998	\$ 404,000
1999	132,000
2000	<u>76,000</u>
	<u>\$ 612,000</u>

14. Revenue Bonds

On September 1, 1993, the Division issued \$75,000,000 in State of Hawaii Highway Revenue Bonds, Series of 1993 (1993 Bonds). The Bonds bear interest at rates ranging from 2.6% to 5.0% and mature in increasing annual installments through 2013. On September 1, 1996, the Division issued \$55,000,000 in State of Hawaii Highway Revenue Bonds, Series of 1996 (1996 Bonds). The Bonds bear interest at rates ranging from 3.8% to 6.0% and mature in increasing annual installments through 2016. The proceeds from the 1993 and 1996 Bonds are used to finance certain highway improvements and other related projects for the State Highways System. The Bonds are payable solely from and collateralized by the revenues consisting primarily of highway fuel taxes, vehicle registration fees, vehicle weight taxes and rental motor vehicle and tour vehicle surcharge taxes.

DEPARTMENT OF TRANSPORTATION - HIGHWAYS DIVISION
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The approximate maturities for revenue bonds, including interest of \$67,266,000 (debt service fund of \$4,006,000 and general long-term debt of \$63,260,000) in each of the next five years and thereafter are as follows:

Year ending June 30,	
1998	\$ 11,376,000
1999	10,343,000
2000	10,336,000
2001	10,330,000
2002	10,323,000
Thereafter	<u>136,378,000</u>
	189,086,000
Less debt service fund portion	<u>8,426,000</u>
General long-term debt portion	<u>\$ 180,660,000</u>

The 1993 Bonds maturing on and after July 1, 2004 and the 1996 Bonds maturing on and after July 1, 2006, are subject to redemption at the option of the State during specific years ranging from 102 to 100 percent of face amount plus any accrued interest.

In 1997, \$10,003,142 was transferred from the State Highway Fund to the Debt Service Fund for repayment of Revenue Bond principal of \$4,420,000 and interest of \$5,583,142.

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PROPOSED FORM OF OPINION OF BOND COUNSEL

To: Director of Transportation
Department of Transportation
Honolulu, Hawaii

July 21, 1998

We have examined the transcript of proceedings (the "Transcript") relating to the issuance by the State of Hawaii (the "State") of \$94,920,000 aggregate principal amount of its bonds designated the State of Hawaii Highway Revenue Bonds, Series 1998 (the "1998 Bonds"), dated as of July 1, 1998. The 1998 Bonds are issued under the Constitution and statutes of the State, including particularly Part III of Chapter 39, Hawaii Revised Statutes, as amended (the "Act"), and under and pursuant to the Certificate of the Director of Transportation of the State, dated as of August 1, 1993 (the "Certificate"), as heretofore amended and supplemented and as further amended and supplemented by the Third Supplemental Certificate of said Director, dated as of June 1, 1998 (the "Third Supplemental Certificate"). The documents in the Transcript include a certified copy of the Certificate and the Third Supplemental Certificate. We have also examined a certified specimen of a 1998 Bond. All capitalized terms not defined herein shall have the meanings set forth in the Certificate, as supplemented by the Third Supplemental Certificate.

Based on this examination, we are of the opinion that, under existing law:

1. The 1998 Bonds and the Certificate, as amended and supplemented by the Third Supplemental Certificate, are valid, legal and binding in accordance with their respective terms, subject to bankruptcy laws and other laws affecting creditors' rights, to the exercise of judicial discretion and to the sovereign police powers of the State.
2. The 1998 Bonds constitute special obligations of the State, and the principal of and the premium, if any, and interest on the 1998 Bonds, together with all other series of Senior Bonds now or hereafter issued and Outstanding under the Certificate on a parity with the 1998 Bonds, are payable, as provided in the Certificate, solely from and secured solely by a lien on the Pledged Funds being, generally, certain Pledged User Taxes paid into the State Highway Fund to the credit of the Highway Revenue Special Account (all as defined and provided in the Certificate). The 1998 Bonds and the payment of the principal of and the premium, if any, and interest thereon are not secured by an obligation or pledge of any moneys raised by taxation other than the Pledged User Taxes, and the 1998 Bonds do not represent or constitute a general or moral obligation of the State, nor a charge upon the general fund of the State, nor a pledge of the full faith and credit of the State.
3. The Certificate creates a valid lien and pledge on the moneys that constitute Revenues paid into the State Highway Fund to the credit of the Highway Revenue Special Account, which lien and pledge is subject to no prior liens or pledges granted by the Certificate.

Director of Transportation
Department of Transportation
July 21, 1998
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4. The interest on the 1998 Bonds is excluded from gross income for federal income tax purposes under Section 103(a) of the Internal Revenue Code of 1986, as amended (the "Code"), and is not an item of tax preference under Section 57 of the Code for purposes of the alternative minimum tax imposed on individuals and corporations. The 1998 Bonds and the income therefrom are exempt from all taxation by the State or any county or other political subdivision thereof, except inheritance, transfer and estate taxes, and the franchise tax imposed on banks and other financial institutions pursuant to H.R.S. Ch. 241. We express no opinion as to any other tax consequences regarding the 1998 Bonds.

Under the Code, portions of the interest on the 1998 Bonds earned by certain corporations (as defined for federal income tax purposes) may be subject to a corporate alternative minimum tax and an environmental tax imposed on certain corporations for certain taxable years, and interest on the 1998 Bonds may be subject to a branch profits tax imposed on certain foreign corporations doing business in the United States and to a tax imposed on excess net passive income of certain S corporations.

In giving the foregoing opinions with respect to the treatment of the interest on the 1998 Bonds and the status of the 1998 Bonds under the federal tax laws, we have assumed and relied upon compliance with the State's covenants and the accuracy, which we have not independently verified, of the State's representations and certifications as to facts, circumstances, estimates and expectations contained in the Transcript. The accuracy of those representations and certifications, and the State's compliance with those covenants, may be necessary for the interest on the 1998 Bonds to be and to remain excluded from gross income for federal income tax purposes and for certain of the other tax effects stated above. Failure to comply with certain of those covenants subsequent to issuance of the 1998 Bonds could cause interest thereon to be included in gross income for federal income tax purposes retroactively to the date of issuance of the 1998 Bonds.

Respectfully submitted,