

NEW ISSUE-BOOK-ENTRY ONLY

RATINGS:

	<u>Insured Bonds</u>	<u>Uninsured Bonds</u>
Moody's:	"Aaa"	"Aa3"
Standard & Poor's:	"AAA"	"AA"
Fitch:	"AAA"	"AA-"

(See "Ratings" herein)

In the opinion of Orrick, Herrington & Sutcliffe LLP, Bond Counsel, based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, compliance with certain covenants, interest on the 2001 Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986, and all of the 2001 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. In the further opinion of Bond Counsel, interest on the 2001 Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Bond Counsel observes that such interest is included in adjusted current earnings in calculating corporate alternative minimum taxable income. Bond Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the 2001 Bonds. See "TAX MATTERS" herein.

\$70,000,000
STATE OF HAWAII
Highway Revenue Bonds
Series 2001

Dated: Date of Delivery

Due: as shown on inside cover

The Series 2001 Bonds (the "2001 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 and to pay the costs of issuance. The 2001 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 2001 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. So long as DTC or its nominee is the registered owner of the 2001 Bonds, purchases of the 2001 Bonds will be made in book-entry form only, through brokers and dealers who are, or who act through, DTC participants; beneficial owners of the 2001 Bonds will not receive physical delivery of Bond certificates; payment of the principal of and interest on the 2001 Bonds will be made directly to DTC or its nominee; and 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). Purchases of the 2001 Bonds may be made in the denomination of \$5,000 or any integral multiple thereof.

Interest on the 2001 Bonds is payable on each January 1 and July 1 commencing January 1, 2002. The 2001 Bonds are subject to optional redemption prior to maturity as described herein.

The 2001 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 2001 Bonds.

The 2001 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 scheduled payment of principal of and interest on the 2001 Bonds maturing on July 1 of the years 2005 through 2022, inclusive (the "Insured Bonds") when due will be guaranteed by an insurance policy issued concurrently with the delivery of the 2001 Bonds by FINANCIAL SECURITY ASSURANCE INC.



The scheduled payment of principal of and interest on the 2001 Bonds maturing on July 1 of the years 2003 and 2004 inclusive (the "Uninsured Bonds") when due will not be guaranteed by the aforementioned 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 2001 Bonds are offered when, as and if issued and received by the Underwriter, subject to prior sale or withdrawal or modification of the offer without notice, and to the approval of legality by Orrick, Herrington & Sutcliffe LLP, San Francisco, California, Bond Counsel. Certain legal matters will be passed upon for the Underwriter by its counsel, Pillsbury Winthrop LLP, New York, New York. It is expected that the 2001 Bonds in definitive book-entry form will be available for delivery on or about October 25, 2001.

A.G. Edwards & Sons, Inc.

\$70,000,000
STATE OF HAWAII
Highway Revenue Bonds
Series 2001

MATURITY SCHEDULE

<u>Maturity Date</u>	<u>Amount</u>	<u>Rate</u>	<u>Yield</u>	<u>Maturity Date</u>	<u>Amount</u>	<u>Rate</u>	<u>Yield</u>
07/01/2003	\$ 2,235,000	3.750%	2.430%	07/01/2013	\$ 3,375,000	5.250%	4.250%
07/01/2004	2,320,000	3.750%	2.770%	07/01/2014	3,550,000	5.375%	4.390%
07/01/2005	2,405,000	4.000%	2.980%	07/01/2015	3,745,000	5.375%	4.510%
07/01/2006	2,505,000	4.000%	3.220%	07/01/2016	3,945,000	5.375%	4.620%
07/01/2007	2,605,000	4.000%	3.460%	07/01/2017	4,155,000	5.375%	4.720%
07/01/2008	2,710,000	4.000%	3.680%	07/01/2018	4,380,000	5.375%	4.810%
07/01/2009	2,815,000	5.250%	3.810%	07/01/2019	4,615,000	5.375%	4.920%
07/01/2010	2,965,000	4.000%	3.910%	07/01/2020	4,860,000	5.375%	4.980%
07/01/2011	3,085,000	4.000%	4.010%	07/01/2021	5,125,000	5.375%	5.030%
07/01/2012	3,205,000	5.250%	4.140%	07/01/2022	5,400,000	5.000%	5.050%

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 2001 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 Underwriter. This Official Statement does not constitute an offer to sell the 2001 Bonds or a solicitation of an offer to buy by any person, nor shall there be any sale of the 2001 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 Underwriter. 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.

Other than with respect to information concerning Financial Security Assurance Inc. ("FSA") contained under the caption "INSURANCE," Appendix G - "SPECIMEN OF THE BOND INSURANCE POLICY" and Appendix H - "SPECIMEN OF THE DEBT SERVICE RESERVE INSURANCE POLICY" herein, none of the information in the Official Statement has been supplied or verified by FSA and FSA makes no representation or warranty, express or implied, as to (i) the accuracy or completeness of such information; (ii) the validity of the 2001 Bonds; or (iii) the tax exempt status of the interest on the 2001 Bonds.

IN CONNECTION WITH THIS OFFERING THE UNDERWRITER MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE 2001 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.

STATE OF HAWAII

Benjamin J. Cayetano, Governor

Mazie K. Hirono, Lieutenant Governor

DEPARTMENT OF TRANSPORTATION

Brian K. Minaai, Director

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

Glenn M. Okimoto
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Department of Budget and Finance
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Honolulu, Hawaii
Paying Agent and Registrar

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TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION.....	1
THE 2001 BONDS.....	2
General.....	2
Redemption.....	3
Authority for Issuance.....	4
BOOK-ENTRY SYSTEM.....	4
DTC and its Participants.....	4
Purchase of Ownership Interests.....	5
Notices and Other Communications.....	5
Principal and Interest Payments.....	5
Discontinuance of Book-Entry System; Replacement Bonds.....	6
Use of Certain Terms in Other Sections of the Official Statement.....	6
DTC and Book-Entry Information.....	6
APPLICATION OF PROCEEDS OF THE 2001 BONDS.....	7
SECURITY FOR THE BONDS.....	7
General.....	7
Pledge of Revenues.....	8
Highway Senior Debt Service Reserve Subaccount.....	9
Funds and Accounts and Application of Revenues.....	9
Additional Bonds and Refunding Bonds.....	10
Bond Insurance.....	11
INSURANCE.....	12
Bond Insurance Policy.....	12
Debt Service Reserve Fund Policy.....	13
REVENUE SOURCES.....	14
State Highway Fund.....	13
Sources of Revenues and Pledged User Taxes.....	14
Historical Revenues.....	15
THE DEPARTMENT OF TRANSPORTATION.....	16
Department Organization.....	16
Department Management.....	16
Management Personnel.....	17
Employees.....	18
CAPITAL IMPROVEMENT PROGRAM.....	18
General.....	18
Plan of Finance.....	19
DEBT SERVICE COVERAGE.....	20
Projected Revenues.....	19
Debt Service Requirements for the Bonds.....	21
Historic and Projected Debt Service Coverage.....	21
HISTORICAL AND PROJECTED DEBT SERVICE COVERAGE.....	22
Reimbursable General Obligation Bonds.....	22
LITIGATION.....	23
TAX MATTERS.....	24
CERTAIN LEGAL MATTERS.....	25
RATINGS.....	25
UNDERWRITING.....	25
CONTINUING DISCLOSURE.....	26
FINANCIAL STATEMENTS.....	26
MISCELLANEOUS.....	26
APPENDIX A: SUMMARY OF CERTAIN PROVISIONS OF THE CERTIFICATE	
APPENDIX B: ADDITIONAL INFORMATION RELATING TO REVENUE SOURCES, THE STATE HIGHWAY SYSTEM AND THE HAWAII DEPARTMENT OF TRANSPORTATION	
APPENDIX C: THE STATE OF HAWAII	
APPENDIX D: AUDITED FINANCIAL STATEMENTS OF THE HIGHWAYS DIVISION	
APPENDIX E: PROPOSED FORM OF OPINION OF BOND COUNSEL	
APPENDIX F: PROPOSED FORM OF CONTINUING DISCLOSURE CERTIFICATE	
APPENDIX G: SPECIMEN OF THE MUNICIPAL BOND INSURANCE POLICY	
APPENDIX H: SPECIMEN OF THE MUNICIPAL BOND DEBT SERVICE RESERVE INSURANCE POLICY	

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OFFICIAL STATEMENT

\$70,000,000

STATE OF HAWAII

Highway Revenue Bonds Series 2001

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 \$70,000,000 principal amount of State of Hawaii Highway Revenue Bonds, Series 2001 (the "2001 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 2001 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 Fifth Supplemental Certificate of the Director of Transportation Providing for the Issuance of State of Hawaii Highway Revenue Bonds, Series 2001, dated as of October 1, 2001 (collectively, the "Certificate"). See "THE 2001 BONDS" for a description of the 2001 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 \$45,350,000, its Highway Revenue Bonds, Series 1996 (the "1996 Bonds"), currently outstanding in the aggregate principal amount of \$34,635,000, its Highway Revenue Bonds, Series 1998 (the "1998 Bonds"), currently outstanding in the aggregate principal amount of \$91,780,000 and its Highway Revenue Bonds, Series 2000 (the "2000 Bonds"), currently outstanding in the aggregate principal amount of \$48,940,000 (collectively, the "Outstanding Bonds"). Additional bonds and refunding bonds may subsequently be issued on a parity with the 2001 Bonds and the Outstanding Bonds (collectively with the 2001 Bonds and the Outstanding Bonds, the "Senior Bonds") or may be issued subordinate in right of payment to the 2001 Bonds and other Senior Bonds (the "Subordinate Bonds"). The 2001 Bonds and the Outstanding Bonds and any additional Senior Bonds and Subordinate Bonds are collectively referred to as the "Bonds."

The 2001 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, and to pay all or a portion of the costs of issuance. See "APPLICATION OF PROCEEDS OF 2001 BONDS." Approximately \$52 million of the \$70 million of proceeds of the 2001 Bonds will be used to repay temporary advances from the State Highway Fund to the Highway Revenue Bond Fund for fiscal year 2001 projects that were authorized by the Legislature for revenue bond funding as follows: \$19 million for various projects on the island of Oahu; \$10 million for various projects on the island of Hawaii; \$9 million for various projects on the islands of Maui and Molokai; \$10 million for various projects on the island of Kauai; and \$4 million for various statewide projects. Approximately \$18 million will be used for Fiscal year 2002 projects that were authorized by the Legislature for revenue bond funding. See "CAPITAL IMPROVEMENT PROGRAM."

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 2001 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 2001 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 2001 Bonds. See "SECURITY FOR THE BONDS" and "REVENUE SOURCES" for a description of the security for the Bonds and sources of Pledged Funds.

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 2001 Bonds are the fifth series of such revenue bonds issued to finance construction of the projects comprising the Program.

Payment of principal of and interest on the 2001 Bonds maturing on July 1 of the years 2005 through 2022, inclusive (the "Insured Bonds") will be guaranteed by an insurance policy issued concurrently with the delivery of the 2001 Bonds by Financial Security Assurance Inc. ("FSA"). Payment of principal of and interest on the 2001 Bonds maturing on July 1 of the years 2003 and 2004 (the "Uninsured Bonds") will not be guaranteed by the aforementioned insurance policy. In addition, FSA 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 FSA, 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 2001 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 2001 Bonds, the security for the Bonds and certain provisions of the Certificate. All references to the Certificate and to the 2001 Bonds are qualified by the definitive forms of such Certificate and 2001 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 2001 BONDS

General

The 2001 Bonds will be dated their date of delivery and will bear interest from such date at the rates per annum set forth on the inside 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, 2002 (each an "Interest Payment Date"). Principal of, premium, if any, and interest on the 2001 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 2001 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 2001 Bonds. Individual purchases of the 2001 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 2001 Bonds. Principal of and interest on the 2001 Bonds will be paid by the Paying Agent for the 2001 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 2001 Bonds, as described herein. See "BOOK-ENTRY SYSTEM," below.

If the Book-Entry System is discontinued for the 2001 Bonds, thereafter (i) principal of and premium, if any, on the 2001 Bonds will be payable upon presentation and surrender of the 2001 Bonds at the principal office of the Department of Budget and Finance of the State, as Paying Agent for the 2001 Bonds (together with any successor, the "Paying Agent"); and (ii) interest on each 2001 Bond will be paid on each Interest Payment Date by check mailed by the Paying Agent to the owner in whose name the 2001 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 2001 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 2001 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 2001 Bonds. So long as the 2001 Bonds are in the Book-Entry System, the registered owner of the 2001 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 2001 Bonds maturing on or before July 1, 2011 are not subject to optional redemption. The 2001 Bonds maturing on after July 1, 2011 are subject to redemption at the option of the State on and after July 1, 2011 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 2001 Bonds of a maturity are called for redemption, at a redemption price of 100% percent of the principal amount thereof plus accrued interest, if any, to the date fixed for redemption.

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 2001 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 2001 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 are not 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 2001 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 2001 Bond are held for such purpose by the Director of Finance or the Paying Agent, such 2001 Bond so called for redemption shall become due and payable, and interest on such 2001 Bond shall cease to accrue, on the redemption date designated in the notice of redemption of such Bond.

Upon surrender of any 2001 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 2001 Bond or Bonds representing the unredeemed principal amount of the 2001 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 2001 Bonds are being issued pursuant to the Certificate and under the authority of and pursuant to the General Revenue Bond Law and Act 289, Session Laws of Hawaii (“SLH”) 1993, as amended by Act 252, SLH 1994, Act 218, SLH 1995, as amended by Act 287, SLH 1996, Act 328, SLH 1997, as amended by Act 116, SLH 1998, Act 91, SLH 1999, as amended by Act 281, SLH 2000 and Act 259, SLH 2001 (the specific acts of the Legislature authorizing the 2001 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 Underwriter 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 Underwriter or the State.

DTC will act as securities depository for the 2001 Bonds. The 2001 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 2001 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 2001 Bonds under the DTC system must be made by or through Direct Participants, which will receive credit for the 2001 Bonds on DTC's records. The ownership interest of each purchaser of a beneficial interest in a 2001 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 2001 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 2001 Bonds, except in the event that use of the Book-Entry System for the 2001 Bonds is discontinued.

To facilitate subsequent transfers, all 2001 Bonds deposited by Participants with DTC are registered in the name of DTC's nominee, Cede & Co. The deposit of 2001 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 2001 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 2001 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 2001 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 2001 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 2001 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 2001 Bonds at any time by giving reasonable notice to the State or the Department. Under such circumstances, in the event that a successor securities depository is not obtained, Bond certificates are required to be printed and delivered.

The Department 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 2001 Bonds will be payable as described above under "The 2001 Bonds - General" and the following provisions will apply.

Each 2001 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 2001 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 2001 Bond for transfer or exchange, the Registrar will deliver in the name of the transferee or Owner one or more new 2001 Bonds of the same aggregate principal amount, maturity and interest rate as the surrendered 2001 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 2001 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 2001 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 2001 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 2001 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 Underwriter, the State or the Department.

Neither the State nor the Department will have any 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 2001 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 2001 Bonds, or (v) any consent given or other action taken by DTC as owner of the 2001 Bonds, or (vi) any other event or purpose.

APPLICATION OF PROCEEDS OF THE 2001 BONDS

The Department intends to use a portion of the proceeds of the 2001 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.

The following table shows the estimated application of moneys realized by the Department upon the sale of the 2001 Bonds (exclusive of any accrued interest):

Deposit to Project Fund	\$72,070,012.95
Net Original Issue Premium	2,787,592.50
Underwriter's Discount	406,000.00
Bond Insurance and Debt Service Reserve Fund Policy.....	236,579.55
Other Costs of Issuance	75,000.00
 Total	 \$72,787,592.50

SECURITY FOR THE BONDS

General

The Bonds, including the 2001 Bonds, are special limited obligations of the State, and will be payable from and secured by the Pledged Funds. The 2001 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 as 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 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 2001 Bonds, the Reserve Requirement will be satisfied by a debt service reserve fund policy (the "Reserve Fund Policy") issued by FSA. 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 2001 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.

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 2001 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 2001 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 subordinate and inferior to the payment of the Bonds from the Revenues.

Bond Insurance

Simultaneously with the delivery of the 2001 Bonds, FSA 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 2001 Bonds when due. The Bond Insurance Policy will guarantee payment of principal and interest only for the 2001 Bonds maturing July 1 of the years 2005 through 2022, inclusive (the "Insured Bonds"). Payment of principal and interest for the 2001 Bonds maturing on July 1 of the years 2003 and 2004 (the "Uninsured 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".

FSA will make such payments to the Paying 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 FSA shall have received telephonic or telegraphic notice, subsequently confirmed in writing, or written notice by registered or certified mail, from an owner of the Insured Bonds or the Paying Agent of the nonpayment of such amount by the State. The Fiscal Agent will disburse such amount due on any Insured 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 FSA. The term "nonpayment" in respect of an Insured Bond includes any payment of principal or interest made to an owner of an Insured 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-cancelable and the premium will be fully paid at the time of delivery of the Insured Bonds. The Policy covers failure to pay principal of the Insured Bonds on their respective stated maturity dates and not on any other date on which the Insured 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, FSA 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 FSA's consent, in each case so long as FSA 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 FSA's

consent. The specific rights, if any, granted to FSA in connection with its insurance of the Insured 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 State 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 Bonds and reference should be made to such section for a discussion of such ratings and the basis for their assignment to the Insured Bonds. Reference should be made to the description of the State for a discussion of the ratings, if any, assigned to such entity's outstanding parity debt that is not secured by credit enhancement.

In connection with the issuance of the Bond Insurance Policy, FSA has been granted certain rights upon events of default, as described in the following section.

INSURANCE

The following information concerning the Bond Insurance Policy and the Reserve Insurance Policy has been provided by Financial Security Assurance Inc. No representation is made by the State or the Underwriter 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 2001 Bonds, Financial Security Assurance Inc. ("FSA") will issue its municipal bond insurance policy (the "Policy") for the 2001 Bonds maturing on July 1 of the years 2005 through 2022, inclusive (the "Insured Bonds"). The Policy guarantees the scheduled payment of principal of and interest on the Insured Bonds when due as set forth in the form of the Policy included as Appendix G to this Official Statement.

The Policy is not covered by any insurance security or guaranty fund established under New York, California, Connecticut or Florida insurance law.

Financial Security Assurance Inc.

FSA is a New York domiciled insurance company and a wholly owned subsidiary of Financial Security Assurance Holdings Ltd. ("Holdings"). Holdings is an indirect subsidiary of Dexia, S.A., a publicly held Belgian corporation. Dexia, S.A., through its bank subsidiaries, is primarily engaged in the business of public finance in France, Belgium and other European countries. No shareholder of Holdings or FSA is liable for the obligations of FSA.

At June 30, 2001, FSA's total policyholders' surplus and contingency reserves were approximately \$1,481,333,000 and its total unearned premium reserve was approximately \$766,018,000 in accordance with statutory accounting principles. At June 30, 2001, FSA's total shareholder's equity was approximately \$1,589,409,000 and its total net unearned premium reserve was approximately \$632,823,000 in accordance with generally accepted accounting principles.

The financial statements included as exhibits to the annual and quarterly reports filed by Holdings with the Securities and Exchange Commission are hereby incorporated herein by reference. Also incorporated herein by reference are any such financial statements so filed from the date of this Official Statement until the termination of the offering of the 2001 Bonds. Copies of materials incorporated by reference will be provided upon request to Financial Security Assurance Inc.: 350 Park Avenue, New York, New York 10022, Attention: Communications Department (telephone (212) 826-0100).

The Policy does not protect investors against changes in market value of the 2001 Bonds, which market value may be impaired as a result of changes in prevailing interest rates, changes in applicable ratings or other causes. FSA

makes no representation regarding the 2001 Bonds or the advisability of investing in the 2001 Bonds. FSA makes no representation regarding the Official Statement, nor has it participated in the preparation thereof, except that FSA has provided the issuer the information presented under this caption for inclusion in the Official Statement.

Debt Service Reserve Fund Policy

Concurrently with the issuance of the 2001 Bonds, FSA will issue its Municipal Bond Debt Service Reserve Insurance Policy (the "Reserve Policy"). The Reserve Policy unconditionally guarantees the payment of that portion of the principal of and interest on the 2001 Bonds which has become due for payment, but shall be unpaid by reason of nonpayment by the State, 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 \$2,835,921.88. FSA will make such payments to 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 FSA 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 State. The term "nonpayment" in respect of a 2001 Bond includes any payment of principal or interest made to an owner of a 2001 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-cancelable and the premium will be fully paid at the time of delivery of the 2001 Bonds. The Reserve Policy covers failure to pay principal of the 2001 Bonds on their respective stated maturity dates 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 2001 Bonds or the date on which no 2001 Bonds are outstanding under the authorizing document.

Generally, in connection with its issuance of a Reserve Policy, FSA 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 FSA 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 FSA's consent. The specific rights, if any, granted to FSA 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 2001 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 2001 Bonds and reference should be made to such section for a discussion of such ratings and the basis for their assignment to the 2001 Bonds. Reference should be made to the description of the State 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 any insurance security or guaranty fund established under New York, California, Connecticut or Florida 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 Section 248-8, HRS. 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, 2001. 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. 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 period from 1990 to 2000. 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. Through Act 223, SLH 1999, the surcharge tax was increased from \$2.00 per day to \$3.00 per day or any portion of the day for the period of September 1, 1999 through August 31, 2007.

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.

The terrorist attacks of September 11, 2001 have resulted in a decline in tourism in the State. A continued decline in tourism may result in a reduction in rental tour vehicle surcharge revenues. At this time, neither the State nor the Department can predict the magnitude of the impact on the State's economy or the revenues of the Department.

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, 2001.

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

Fiscal Year	<u>Pledged User Taxes</u>				Sales Excise Tax(3)	Interest(4)	Misc.(5)	Total Revenues
	Fuel Taxes(1)	Registration Fees	Weight Taxes -	Rental/ Tour Vehicle Surcharge(2)				
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
1998	8,580	16,418	21,753	23,702	0	8,076	3,255	141,784
1999	67,209	16,749	22,434	23,591	0	10,535	3,885	144,403
2000	68,088	17,215	23,479	34,587	0	10,956	4,321	158,646
2001(6)	71,930	17,609	24,367	38,633	0	14,961	5,669	173,169

(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.

(6) The information for fiscal year 2001 reflects unaudited numbers.

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.

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 Administrator. Each of the major islands are is managed by a district manager with the exception of Maui District which includes the islands of Maui, 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:

Brian K. Minaai, Director, assumed his present position in January 2001. Prior to his appointment as Director, Mr. Minaai served as the Deputy Director responsible for the property management functions and capital improvement programs for the Department's three divisions – Airports, Harbors and Highways. Prior to assuming that 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.

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.

Jadine Y. Urasaki, Deputy Director, assumed her present position in January 2001. She is responsible for the Capital Improvements Programs for the Airports, Harbors and Highways Divisions. Prior to assuming this position, she worked as a Civil Engineering Aide at Parsons Brinckerhoff, Quade and Douglas, Inc. (1989-1992), Project Engineer as Koga Engineering & Construction, Inc. (1993-1995), Project Engineer at Ray Wilson Company (1995-1996), Civil Engineer at the Department of Health (1996-1997) and various positions at the Department's Highways Division, the last being Project Coordinator Section head of the Construction and Maintenance Branch. Ms. Urasaki graduated from the University of Hawaii in 1992 with a Bachelor of Science degree in Civil Engineering.

Glenn M. Yasui, Highways Division Administrator, assumed the position of Administrator on June 1, 2001. He is responsible for the operations, maintenance and management of the State Highway System and the planning, design and construction of new state highways and ancillary facilities. Prior to assuming this position, he served as the Senior Transportation Engineer with the Federal Highway Administration, Hawaii Division. Mr. Yasui has over 37 years of highway engineering and administrative experience. From 1964 to 2001, he worked for the Federal Highway Administration in progressive positions of responsibility including Highway Engineer, Assistant Area Engineer, Area Engineer, Urban Transportation Engineer and Senior Transportation Engineer/Territorial Representative. Mr. Yasui graduated from the University of Hawaii with a Bachelor of Science in Civil Engineering in 1964 and received a Master of Public Administration from the University of Southern California in 1985. He is a member of the American Society of Civil Engineers and the Institute of Transportation Engineers. Mr. Yasui is Licensed Professional Engineer (Civil) in Hawaii, California, Guam and the Commonwealth of the Northern Mariana Islands. While with the Federal Highway Administration, Mr. Yasui has guided the successful completion of the \$1.4 billion Interstate Route H-3 project and managed the marketing, technology transfer and implementation of the state-of-art Intelligent Transportation System (ITS) projects in Hawaii. He was also responsible for improving the efficiency and effectiveness of the programming, planning, design and construction processes of the Federal-aid highway programs in the State of Hawaii, the Territory of American Samoa, the Territory of Guam and the Commonwealth of the Northern Mariana Islands.

Gerald K.L. Dang, Administrative Services Officer, 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.

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 prepares a three year multimodal transportation improvement program for U.S. Department of Transportation review and approval, that is updated every two years. This program, called the Statewide Transportation Improvement Program ("STIP"), describes all 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 2002 through 2007 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 2000 session, the Legislature has appropriated a total of \$2.14 billion for the planning, design, and acquisition and construction of projects. Under Act 259, SLH 2001, an additional \$183 million was appropriated for the Program.

Approximately \$52 million of the \$70 million of proceeds of the 2001 Bonds will be used to repay temporary advances from the State Highway Fund to the Highway Revenue Bond Fund for fiscal year 2001 projects that were authorized by the Legislature for revenue bond funding as follows: \$22 million for various projects on the island of Oahu; \$10 million for various projects on the island of Hawaii; \$9 million for various projects on the islands of Maui and Molokai; \$10 million for various projects on the island of Kauai; and \$1 million for various statewide projects. Approximately \$18 million will be used for fiscal year 2002 projects that were authorized by the Legislature for revenue bond funding.

Plan of Finance

The Governor and the Legislature have approved the funding sources for all appropriations made in prior fiscal years. Of the \$2.140 billion appropriated through the 2000 session, the Department has been authorized to finance fund approximately \$1.434 billion with federal funds, approximately \$255 million with available State funds, approximately \$26 million with the proceeds from the sale of reimbursable general obligation bonds, and approximately \$408 million with the proceeds from the sale of revenue bonds and approximately \$13 million with other funds.

Of the \$183 million which was appropriated under Act 259, SLH 2001, the Department has been authorized to finance approximately \$83 million with federal funds, approximately \$3 million with State funds, approximately \$96 million with proceeds from the sale of revenue bonds, and approximately \$1 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"). In 1998, the Transportation Equity Act for the 21st Century (TEA-21) to provide for federal aid was passed by Congress, and the Department expects that the level of funding that it receives under the TEA-21 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, \$55 million in 1996, \$95 million in 1998 and \$50 million in 2000. After issuance of the 2001 Bonds, the Department's current financial plan projects that \$80 million in additional revenue bonds will be sold during 2003 fiscal year and 2005 fiscal year.

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 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.

The terrorist attacks of September 11, 2001 have resulted in a decline in tourism in the State. A continued decline in tourism may result in a reduction in rental tour vehicle surcharge revenues. At this time, neither the State nor the Department can predict the magnitude of the impact on the State's economy or the revenues of the Department.

Projected Revenues
Fiscal Years Ending June 30, 2002 through June 30, 2007
(in thousands)

Fiscal Year	Fuel Taxes	Pledged User Taxes		Tour Vehicle Surcharge(1)	Interest Earnings	Misc. (2)	Total Revenues
		Registration Fee	Weight Tax				
2002	70,665	17,647	25,789	38,201	14,900	2,870	170,072
2003	71,265	17,865	26,403	38,598	13,900	2,874	170,905
2004	71,865	18,083	27,017	38,995	12,900	2,880	171,740
2005	72,465	18,300	27,632	39,392	11,900	2,887	172,576
2006	73,065	18,517	28,246	39,788	10,900	3,056	173,572
2007	73,665	18,736	28,860	40,185	10,900	3,056	175,402

(1) Reflects \$1.00 increase in the rental car surcharge.

(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 2001 Bonds and the Outstanding Bonds:

DEBT SERVICE

<u>Date</u>	<u>Outstanding Bonds Debt Service</u>	<u>2001 Bonds Debt Service</u>			<u>Total Debt Service</u>
		<u>Principal</u>	<u>Interest</u>	<u>Total</u>	
7/1/01	17,954,646				17,954,646
7/1/02	19,107,299		2,345,683	2,345,683	23,798,664
7/1/03	19,107,299	2,235,000	3,432,706	5,667,706	30,442,712
7/1/04	19,109,927	2,320,000	3,348,894	5,668,894	30,447,714
7/1/05	19,107,152	2,405,000	3,261,894	5,668,894	30,440,939
7/1/06	19,110,422	2,505,000	3,165,694	5,670,694	30,451,809
7/1/07	19,107,937	2,605,000	3,065,494	5,670,494	30,448,924
7/1/08	19,105,199	2,710,000	2,961,294	5,671,294	30,447,786
7/1/09	19,084,324	2,815,000	2,852,894	5,667,894	30,420,111
7/1/10	19,083,169	2,965,000	2,705,106	5,670,106	30,423,381
7/1/11	19,084,344	3,085,000	2,586,506	5,671,506	30,427,356
7/1/12	19,087,962	3,205,000	2,463,106	5,668,106	30,424,174
7/1/13	19,085,724	3,375,000	2,294,844	5,669,844	30,425,411
7/1/14	19,085,206	3,550,000	2,117,656	5,667,656	30,420,519
7/1/15	19,084,550	3,745,000	1,926,844	5,671,844	30,428,238
7/1/16	19,086,650	3,945,000	1,725,550	5,670,550	30,427,750
7/1/17	19,077,175	4,155,000	1,513,506	5,668,506	30,414,188
7/1/18	19,079,013	4,380,000	1,290,175	5,670,175	30,419,363
7/1/19	4,140,475	4,615,000	1,054,750	5,669,750	15,479,975
7/1/20	4,140,875	4,860,000	806,694	5,666,694	15,474,263
7/1/21		5,125,000	545,469	5,670,469	11,340,938
7/1/22		5,400,000	207,000	5,670,000	11,340,000
TOTALS	\$350,829,346	\$70,000,000	\$45,734,758	\$115,734,758	\$582,298,862

Historic and Projected Debt Service Coverage

The following table sets forth historical and projected debt service coverage for fiscal years ending June 30, 1994 through 2007. (A fiscal year is a twelve month period ending on a June 30.) Debt service for the fiscal years ending June 30, 1994 through 2001 is based on the actual interest rates for the Outstanding Bonds. Debt service projections for future fiscal years are based on the interest rates for the Outstanding Bonds and the actual rate of 5.35% for the 2001 Bonds. Revenues for the fiscal years ending June 30, 1994 through 2001 are based on actual Revenues for such fiscal years; projected Revenues for present and future fiscal 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.)

**HISTORIC AND PROJECTED DEBT SERVICE COVERAGE
(Revenue Bond Debt Service Only)**

Date	Pledged Revenues	Outstanding Revenue Bond Debt Service	Series 2001 Revenue Bond Debt Service	Aggregate Revenue Bond Debt Service	Coverage (Revenue Debt Only)
7/1/94	133,231,000	5,865,243		5,865,243	22.72
7/1/95	141,015,000	5,864,683		5,864,683	24.04
7/1/96	142,667,000	5,868,562		5,868,562	24.31
7/1/97	144,515,000	10,003,143		10,003,143	14.45
7/1/98	141,784,000	10,434,609		10,434,609	13.59
7/1/99	144,403,000	14,408,883		14,408,883	10.02
7/1/00	158,646,000	14,965,993		14,965,993	10.60
7/1/01	173,169,000	17,954,646		17,954,646	9.64
7/1/02	170,072,000	19,107,299	2,345,683	21,452,982	7.93
7/1/03	170,905,000	19,107,299	5,667,706	24,775,006	6.90
7/1/04	171,740,000	19,109,927	5,668,894	24,778,821	6.93
7/1/05	172,576,000	19,107,152	5,666,894	24,774,046	6.97
7/1/06	173,572,000	19,110,422	5,670,694	24,781,116	6.89
7/1/07	175,402,000	19,107,937	5,670,494	24,778,431	6.89

**HISTORIC AND PROJECTED DEBT SERVICE COVERAGE
(Total Debt Service Supported by Highway Revenue)**

Date	Pledged Revenues	Outstanding Revenue Bond Debt Service	Series 2001 Revenue Bond Debt Service	Aggregate Revenue Bond Debt Service	Reimbursable GO Debt Service	Total Debt Service Supported by Highway Revenue	Coverage (Revenue and GO Bonds)
7/1/94	133,231,000	5,865,243		5,865,243	28,567,658	34,432,901	3.87
7/1/95	141,015,000	5,864,683		5,864,683	27,729,327	33,594,010	4.20
7/1/96	142,667,000	5,868,562		5,868,562	49,721,718	55,590,280	2.57
7/1/97	144,515,000	10,003,143		10,003,143	40,383,243	50,386,386	2.87
7/1/98	141,784,000	10,434,609		10,434,609	31,301,706	41,736,315	3.40
7/1/99	144,403,000	14,408,883		14,408,883	29,084,721	43,493,604	3.35
7/1/00	158,646,000	14,965,993		14,965,993	23,145,778	38,111,771	4.16
7/1/01	173,169,000	17,954,646		17,954,646	27,273,953	45,228,599	3.83
7/1/02	170,072,000	19,107,299	2,345,683	21,452,982	25,788,699	47,241,681	3.60
7/1/03	170,905,000	19,107,299	5,667,706	24,775,006	24,046,796	48,821,802	3.50
7/1/04	171,740,000	19,109,927	5,668,894	24,778,821	18,435,493	43,214,314	3.97
7/1/05	172,576,000	19,107,152	5,666,894	24,774,046	16,093,137	40,867,183	4.22
7/1/06	173,572,000	19,110,422	5,670,694	24,781,116	15,005,316	39,786,432	4.36
7/1/07	175,402,000	19,107,937	5,670,494	24,778,431	13,864,852	38,643,283	4.54

Reimbursable General Obligation Bonds

As of June 30, 2001, there were outstanding \$153,886,942 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, 2000. Debt service requirements on the reimbursable general obligation bonds are set forth in the year in which they are scheduled to be paid. There are no current legislative authorizations for additional reimbursable general obligation bond funded State highway projects.

**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>
2001	18,258,900	7,957,636	26,216,536
2002	17,781,182	6,967,046	24,748,228
2003	17,222,009	5,996,685	23,218,694
2004	13,869,690	5,186,328	19,056,018
2005	14,042,515	4,491,320	18,533,835
2006	12,886,585	3,796,506	16,683,071
2007	13,038,021	3,134,436	16,172,457
2008	13,099,373	2,463,887	15,583,260
2009	12,453,660	1,787,980	14,241,640
2010	7,251,306	1,152,053	8,403,360
2011	7,307,362	725,547	8,032,909
2012	4,539,974	357,008	4,896,982
2013	1,358,522	81,633	1,440,155
2014	478,961	31,506	510,466
2015	123,638	15,926	139,564
2016	46,899	8,849	55,748
2017	128,345	5,800	134,145
2018	0	0	0

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 2001 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 2001 Bonds or affecting the validity of the 2001 Bonds.

TAX MATTERS

In the opinion of Orrick, Herrington & Sutcliffe LLP, Bond Counsel, based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, compliance with certain covenants, interest on the 2001 Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986, and interest on the 2001 Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Bond Counsel observes that such interest is included in adjusted current earnings in calculating federal corporate alternative minimum taxable income. Bond Counsel is also of the opinion that the 2001 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 and estate taxes; provided that no opinion is expressed with respect to the franchise tax imposed on banks and other financial institutions. A complete copy of the proposed opinion of Bond Counsel is set forth in Appendix F hereto.

The Code imposes various restrictions, conditions and requirements relating to the exclusion from gross income for federal income tax purposes of interest on obligations such as the 2001 Bonds. The State has covenanted to comply with certain restrictions designed to insure that the interest on the 2001 Bonds will not be included in federal gross income. Failure to comply with these covenants may result in the interest on the 2001 Bonds being included in gross income for federal income tax purposes, possibly from the original date of issuance of the 2001 Bonds. The opinion of Bond Counsel assumes compliance with these covenants. Bond Counsel has not undertaken to determine (or to inform any person) whether any actions are taken or omitted or events occur or come to their attention after the date of issuance of the 2001 Bonds which may adversely affect the value of, or the tax status of interest on, the 2001 Bonds. Further, no assurance can be given that pending or future legislation or amendments to the Internal Revenue Code, if enacted into law, or any proposed legislation or amendments to the Code, will not adversely affect the value of, or the tax status of interest, on the 2001 Bonds. Prospective Owners of the 2001 Bonds are urged to consult their own tax advisors with respect to proposals to restructure the federal income tax.

The amount (if any) by which the amount (excluding amounts stated to be interest and payable at least annually over the term of the 2001 Bonds) to be paid at maturity of any maturity of the 2001 Bonds exceeds the issue price of such 2001 Bonds constitutes "original issue discount," the accrual of which, to the extent properly allocable to each owner thereof, is treated as interest on the 2001 Bonds which is excluded from gross income for federal income and State of Hawaii tax purposes. For this purpose, the issue price of a particular maturity of the 2001 Bonds is the first price at which a substantial amount of such maturity of the 2001 Bonds is sold to the public (excluding bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers). The original issue discount with respect to any maturity of the 2001 Bonds accrues daily over the term to maturity of such 2001 Bonds on the basis of a constant interest rate compounded semiannually (with straight-line interpolations between compounding dates). The accruing original issue discount is added to the adjusted basis of such 2001 Bonds to determine taxable gain or loss upon disposition (including sale, redemption, or payment on maturity) of such 2001 Bonds. Owners of the 2001 Bonds should consult their own tax advisors with respect to the tax consequences of ownership of 2001 Bonds with original issue discount, including the treatment of purchasers who do not purchase such 2001 Bonds in the original offering to the public at the first price at which a substantial amount of such 2001 Bonds is sold to the public.

2001 Bonds purchased, whether at original issue or otherwise, for an amount greater than their principal amount payable at maturity (or, in some cases, at their earlier call date) ("Premium Bonds") will be treated as having amortizable bond premium. No deduction is allowable for the amortizable bond premium in the case of 2001 Bonds, like the Premium Bonds, the interest on which is excluded from gross income for federal income tax purposes. However, a purchaser's basis in a Premium Bond, and under Treasury Regulations the amount of tax-exempt interest received, will be reduced by the amount of amortizable bond premium properly allocable to such purchaser. Owners of Premium Bonds should consult their own tax advisors with respect to the proper treatment of amortizable bond premium in their particular circumstances.

Certain requirements and procedures contained or referenced to in the Bond Issuance Certificate, the Tax Certificate delivered at the time of issuance of the 2001 Bonds, and other relevant documents may be changed, and certain

actions (including, without limitation, defeasance of the 2001 Bonds) may be taken or omitted, under the circumstances and subject to the terms and conditions set forth in such documents. Bond Counsel expresses no opinion as to any Bond or the interest thereon if any such change occurs or action is taken or omitted upon the advice or approval of counsel other than Orrick, Herrington & Sutcliffe LLP.

Although Bond Counsel is of the opinion that interest on the 2001 Bonds is excluded from gross income for federal income tax purposes, the ownership or disposition of, or the accrual or receipt of interest on, the 2001 Bonds, may otherwise affect a Bond Owner's federal or state tax liability. The nature and extent of these other tax consequences will depend upon each Bond Owner's particular tax status and the Bond Owner's other items of income or deduction. Bond Counsel expresses no opinion regarding any such other consequences.

CERTAIN LEGAL MATTERS

Certain legal matters incident to the authorization, issuance and sale of the 2001 Bonds are subject to the approval of Orrick, Herrington & Sutcliffe LLP, Bond Counsel to the State. Copies of the approving opinion of Bond Counsel will be available at the time of delivery of the 2001 Bonds. The form of opinion Bond Counsel proposes to render is set forth in Appendix F hereto. Bond Counsel undertakes no responsibility for the accuracy, completeness or fairness of this Official Statement. Certain legal matters will be passed upon for the Underwriter by its counsel, Pillsbury Winthrop LLP.

The Fifth Supplemental Certificate of the Director, providing for the issuance of the 2001 Bonds, will be approved as to form and legality by the Attorney General of the State.

RATINGS

Moody's Investors Service, Standard & Poor's and Fitch have assigned ratings of "Aaa", "AAA" and "AAA" respectively, to the Insured Bonds, in each case based upon the understanding that upon delivery of the 2001 Bonds, FSA will issue its Bond Insurance Policy with respect to the Insured Bonds. Moody's, Standard & Poor's and Fitch have also assigned underlying ratings of Aa3, AA and AA-, respectively, to the Uninsured Bonds, in each case determined without regard to the Bond Insurance Policy.

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; Standard & Poor's, 25 Broadway, New York, New York 10004; and Fitch IBCA, Inc., One State Street Plaza, 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 2001 Bonds.

UNDERWRITING

The 2001 Bonds are being purchased by the A.G. Edwards & Sons, Inc. (the "Underwriter"). The Underwriter has agreed to purchase the 2001 Bonds at a price of \$72,381,592.50, which includes net original issue premium, and will retain an underwriting discount of \$406,000.00. The Underwriter will be responsible for the payment of certain costs of issuing the 2001 Bonds. The Purchase Contract provides that the Underwriter will purchase all of the 2001 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 2001 Bonds may be changed from time to time by the Underwriter. The Underwriter may offer and sell the 2001 Bonds to certain dealers (including dealers depositing 2001 Bonds into unit investment trusts, certain of which may be

sponsored or managed by the Underwriter) 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 2001 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 2001 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 2001 Bonds in the secondary market. Consequently, such a failure may adversely affect the transferability and liquidity of the 2001 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 2001 Bonds are no longer Outstanding (within the meaning of the Certificate) or the Rule no longer applies to the 2001 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 2001 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 2001 Bonds then Outstanding.

FINANCIAL STATEMENTS

The financial statements of the Highways Division as of and for the fiscal year ended June 30, 2000, are set forth in Appendix D to this Official Statement. These financial statements have been audited by PricewaterhouseCoopers LLP, 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 Acts 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.

All statements in this Official Statement involving matters of opinion, estimates, forecasts, projections, or the like, whether or not expressly so stated, are intended as such and not as representations of fact. No representation is made that any such statements will be realized. The agreements of the Department and the State are fully set forth in the Certificate and the General Revenue Bond Law, and the Official Statement is not to be construed as a contract or agreement between the Department or the State and the purchasers or Holders of any of the 2001 Bonds.

DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII

By: BRIAN K. MINAAI
Director of Transportation

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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 Fifth 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 accruing during such period assuming 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 any Bond 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 in the State Highway Fund.

"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 below 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.

“Rating Agency” means Moody’s Investors Service and Standard & Poor’s Corporation and their respective successors and assigns or, if either (or both) shall for any reason no longer perform the functions of a securities rating agency, such other nationally recognized rating agency designated by the Department; provided, however, that any reference to a Rating Agency (other than in the definition of Federal Securities) shall only be effective while such Rating Agency is providing a rating on the Outstanding Bonds.

“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 Fund Facility” means each Support Facility at any time on deposit in the Highway Senior Debt Service Reserve Subaccount, including the Series 2001 Reserve Fund Policy.

“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, the 1998 Bonds and the 2001 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 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 IX 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]

For 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
- (t) 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 the Highway Senior Interest Subaccount 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 Facility 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 Senior Bonds under the Certificate in the form customarily known as "serial bonds," in order to provide for the payment of principal of such Senior Bonds, or to reimburse the Support Facility 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 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 Facility 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 described under this caption, (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 the deposits and credits required by the Certificate); (b) if at the end of any fiscal year, the moneys (taking into account the amount then available to be drawn under any Reserve Fund 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 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 any Reserve Fund 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 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 the aggregate Reserve Fund Facility Costs relating to each draw under any Reserve Fund 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; (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 Reserve Fund Facility Costs 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; and (e) any Reserve fund Facility Costs shall be paid by the Department from amounts deposited into the Highway Senior Debt Service Reserve Subaccount.

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 Reserve Fund Facility then credited to such 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 Facility 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 Facility 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 Facility provider 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 in the form customarily known as "serial bonds," in order to provide for the payment of principal of such Subordinate Bonds of such Series, or to reimburse the Support Facility 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 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 Facility 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 described under this caption, (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 be, 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 of 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 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 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 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 XI 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 all 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 all 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, 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 the Certificate 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 thereof (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 as provided in the Certificate or irrevocable provision shall have been made for the giving of such notice; provided that nothing in the foregoing 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 all 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 Provisions Regarding Support Facilities [Articles VI and VII, Fifth Supplemental Certificate]

The Policy and Reserve Policy to be issued by FSA, as described in this Official Statement, will constitute Support Facilities with respect to the 2001 Bonds for purposes of the Certificate. The following is a brief description of certain provisions of the Fifth Supplemental Certificate regarding the Policy and the Reserve Policy.

The Policy. Unless FSA fails to comply with its payment obligations under the Policy: (a) FSA will be deemed to be the holder of all Insured Bonds for the purpose of exercising, or directing or consenting to the exercise of, any remedies under the Certificate upon the occurrence of an Event of Default, including any acceleration of the Insured Bonds; (b) if the Insured Bonds are

accelerated, FSA may elect (i) to pay the accelerated principal of the Insured Bonds and the accrued interest thereon to the acceleration date, or (ii) to pay the principal of and interest on the Insured Bonds on their stated due dates as if no acceleration had occurred; (c) if FSA makes any payments under the Policy, it shall be subrogated to the rights of the recipients to the extent of such payments; (d) amendments or supplements to the Certificate will be subject to FSA's consent; (e) investments of funds held under the Certificate will be subject to certain requirements of FSA; and (f) FSA will be entitled to receive certain financial information concerning the Department (including the Department's audited financial statements and annual budgets) and notices of Events of Default and certain other material events and occurrences.

The Reserve Policy. Unless FSA fails to comply with its payments under the Reserve Policy: (a) FSA will be entitled to exercise any remedies available at law or under the Certificate in the event that the Department fails to reimburse FSA for any draws under the Reserve Policy, except that such remedies will not include (i) acceleration of the Bonds, or (ii) remedies which would adversely affect the Bondholders; (b) amendments or supplements to the Certificate will be subject to FSA's consent; and (c) FSA will be entitled to receive certain financial information concerning the Department (including the Department's audited financial statements and annual budgets) and notices of Events of Default and certain other material events and occurrences.

APPENDIX B**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, 2000.

Motor Vehicle Registration

<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>
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	17,254	23,153	907,770
1997	704,693	54	3,226	159,134	17,160	22,697	906,964
1998	713,732	61	3,084	159,614	16,936	22,326	915,753
1999	725,142	59	3,028	161,698	17,008	22,539	929,474
2000	754,840	56	2,902	165,783	17,661	23,496	964,738

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>
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
1998	520,734	98,525	84,980	42,363	746,329
1999	521,671	100,331	87,550	43,141	752,693
2000	529,890	104,058	90,964	44,471	769,383

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, ~~2000~~ 2001.

Motor Vehicle Fuel Consumption
(In Thousands of Gallons)

<u>Fiscal Year</u>	<u>Gasoline</u>	<u>Diesel</u>	<u>Liquid Petroleum</u>	<u>Total</u>
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
1998	395,866	185,612	3,821	585,299
1999	392,811	193,094	3,643	589,426
2000	391,114	310,299	3,583	704,996
2001	411,309	210,970	3,643	625,922

Source: Department of Transportation.

FACTORS THAT MAY IMPACT REVENUE SOURCES

Terrorist Attacks of September 11, 2001

The terrorist attacks of September 11, 2001 have resulted in a decline in tourism in the State. A continued decline in tourism may result in a reduction in rental tour vehicle surcharge revenues. At this time, neither the State nor the Department can predict the magnitude of the impact on the State's economy or the revenues of the Department.

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 \$.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 for each of the last ten fiscal years ended June 30, 2001.

Federal Aid Reimbursements to the State

<u>Fiscal Year</u>	<u>Interstate</u>	<u>Primary</u>	<u>Secondary</u>	<u>Other</u>	<u>Total Amount Reimbursed</u>
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
1998	66,735,974	186,552	411,853	67,257,999	134,592,378
1999	56,126,780	283,780	120,114	53,672,131	110,202,805
2000	20,813,022	307,449	283,863	57,611,498	79,015,832
2001 (1)	29,868,350	(226,626)	575,525	93,251,796	123,469,045

(1) FY2001 information is unaudited.

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.

In 1998, Congress passed an ISTEA reauthorization bill called the Transportation Efficiency Act for the 21st Century ("TEA-21"). The bill reauthorizes the federal highway program for fiscal years 1998 through 2003. Hawaii's share of federal funds under TEA-21 will increase from \$116.4 million in 1998 to \$146.5 million in 2003. The average funding for the six year period is \$137.1 million. This is an increase of \$17 million over the average funding for the last three years of ISTEA (1995, 1996 and 1997) which was \$120.2 million. The actual apportionments of federal funds received were \$118.4 million in 1998; \$140.5 million in 1999; \$156.1 million in 2000; and \$168.0 million in 2001. The estimated apportionment of federal funds for 2002 is \$153.4 million. The increase in federal apportionments is primarily due to the additional funds authorized by the Revenue Aligned Budget Authority (RABA).

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 roads 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 995.54 linear miles of roadways. The Department has classified the State Highway System as follows: interstate (55.19 miles), freeway expressway (31.61 miles), principal arterial (241.04 miles), minor arterial (398.98 miles), major collector (268.72 miles), and minor collector (0 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	55.19	0.00	0.00	0.00	0.00	0.00	55.19
Freeway Expressway	31.61	0.00	0.00	0.00	0.00	0.00	31.61
Principal Arterial	117.34	67.70	38.88	17.12	0.00	0.00	241.04
Minor Arterial	23.73	270.14	53.79	51.32	0.00	0.00	398.98
Major Collector	6.22	71.07	85.14	39.03	53.52	13.74	268.72
Minor Collector	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>
Total	234.09	408.91	177.81	107.47	53.52	13.74	995.54

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 an 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. Interstate H-201, Moanalua Freeway connects to the H-1 Freeway at the Middle Street and Halawa Interchanges.

Other major State highways on the island of Oahu include, 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. Kalaniana'ole Highway circles the eastern part of Oahu and connects eastern Honolulu to the leeward coastline.

Major State highways on the island of Hawaii include the Queen Kaahumanu Highway in North Kona, the Kuakini 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 Kaunualii 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 implementing Performance Based Budgeting that establishes Mission Statements, Goals, Objectives and Measures of Performance.

To increase efficiency for planning and maintaining highway improvements, the Department will be utilizing an integrated and automated database management system. This Coordinated Data System (CDS) 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 CDS.

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 locations 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"). The Federal Surface Transportation Assistance Act of 1973 and other federal laws require states to designate and fund a metropolitan planning organization (MPO) for any urbanized area with a population greater than 50,000 to ensure that the plans and program for each metropolitan area shall provide for the development and integrated management and operation of transportation systems and facilities that will function as an intermodal transportation system for the metropolitan area. The process for developing the plan and

program shall provide for the consideration of all modes of transportation and shall be continuing, comprehensive, and cooperative.

In 1975, the State Legislature established the Oahu Metropolitan Planning Organization (OMPO), an advisory organization responsible for coordinating transportation planning for Oahu. The decision making body of OMPO is its Policy Committee, which consists of six state legislators, five Honolulu City Council members, the Director of the State Department of Transportation and the Director of the City Department of Transportation Services.

OMPO is responsible for identifying Oahu's future transportation needs and programming the federal funds for projects and programs. The federal funds are programmed based on a process which prioritizes the projects based on needs and available funding. This is achieved through the development of the following three documents :

- (a) The Oahu Regional Transportation Plan (ORTP) – The 25 year long range transportation plan for Oahu.
- (b) The Overall Work Program (OWP) – Annual work program that identifies all of OMPOs planning activities.
- (c) The Transportation Improvement Program (TIP) - The three year multimodal transportation improvements program for Oahu, that is updated every two years.

Statewide Transportation Improvement Program (“STIP”). On December 15, 1999, the Federal Highway Administration and the Federal Transit Administration approved the STIP for Fiscal Years 1999-2002. The Department is currently working on the STIP for Fiscal Years 2002-2004 and will obtain the Federal Highway Administration and the Federal Transit Administration by October 2001.

THE STATE OF HAWAII

The statistical information presented by this Appendix C is the most current 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. It is an archipelago of eight major islands, seven of which are inhabited, plus 124 named islets, totaling 6,425 square miles in land area, located in the Pacific Ocean in the Northern Hemisphere, mostly below the Tropic of Cancer, about 2,400 statute miles from San Francisco. The State is slightly larger than the combined area of the States of Connecticut and Rhode Island and ranks forty-seventh of the fifty states in land area, being also larger in area than the State of Delaware. The island of Hawaii is the largest island, with 4,028.2 square miles in area. The other inhabited islands in the order of size are Maui, Oahu, Kauai, Molokai, Lanai and Niihau. According to the U.S. 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, 1,108,229 in 1990, and 1,211,537 in 2000 making the State the forty-second most populous state in the Union as of 2000. The City and County of Honolulu consists of the island of Oahu (plus some minor islets) with a land area of 597.1 square miles. The capital of the State and the principal port are located on Oahu. According to the 2000 U.S. Census, about 72.3% of the population of the State lives 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 mainland United States. The 2000 U.S. Census indicated that about 41.6% of the State's population is of Asian descent and about 24.3% of the State's population is Caucasian. Native Hawaiians and other Pacific Islanders constitute 9.4% of the population. The balance consists of other races, such as African American and American Indians.

State Government

The Constitution of the State provides for three separate branches of government: the legislative, the executive and the judicial. The 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. 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. Under the Constitution, the judicial power is vested in a Supreme Court, one intermediate appellate court, circuit courts, district courts, and such other courts as the Legislature may from time to time establish. Pursuant to statute, the Legislature has established four circuit courts, four district courts and an intermediate appellate court. The executive and administrative offices are limited to not more than twenty principal departments under the supervision of the Governor. The executive functions have in fact been grouped into eighteen departments. The heads of the departments are appointed by the Governor with the advice and consent of the Senate and hold office for a term to expire with the term of the Governor. The Department of Budget and Finance is one of the principal departments permitted by the Constitution of the State, with the head of said department being designated as the Director of Finance. Under the general direction of the Governor, the Department of Budget and Finance administers the State's proposed six-year program and financial plan, the State budget, and financial management programs of the State.

The Counties and Their Relationship to the State

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 of the counties has a separate charter for its

government, each of which provides for an elected mayor and an elected council. The mayor is the chief executive and the council is the legislative body. *There are no independent or separate cities or other municipalities, school districts or townships.* The State government of Hawaii has total responsibility for many functions which in most other parts of the United States are performed by or shared by local governments. For example, the State pays all costs in connection with the public school system, libraries, public welfare, and judiciary. The greatest expenditures by the State in past years have been in the areas of education and public welfare. The counties' major areas of responsibility and expenditure are in police and fire protection, waste disposal, water and sewer facilities, and secondary streets and highways.

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 "**Table 10**" has been excerpted from the June 2001 Quarterly Statistical and Economic Report ("QSER") published by the State of Hawaii Department of Business, Economic Development and Tourism ("DBEDT"). Unless otherwise stated, the following information is historical; estimated figures are used only when the definitive figures are unavailable. The text refers to certain enumerated tables found under '**GENERAL ECONOMIC INFORMATION.**' Following descriptions of the various components of the State's economy and DBEDT's outlook for the economy, there is a brief description of the impact of these components on the State's fiscal position. See "**APPENDIX B-FINANCIAL INFORMATION ABOUT THE STATE OF HAWAII.**"

DBEDT's current forecast for Gross State Product ("GSP") (the value of all goods and services produced and consumed within the State) growth in 2001 is 5.3%. In real terms (adjusting for inflation), DBEDT estimates that 2001 GSP growth over 2000 will be 3.7%.

State of the Economy

Labor markets continued the healthy pace recorded in 2000. The civilian labor force grew by a 1.2% from the first quarter of 2000 to the first quarter of 2001. Civilian employment was up 1.6%, and the unemployment rate averaged 4.1% in the quarter—down almost one-half of one percent from the same period last year. Non-agricultural wage and salary jobs grew by 2.9% in the first quarter of 2001 compared to the year-earlier period. Following growth of 3.1% in 2000, job growth has stayed remarkably strong this year. (Table 1)

Adjusting for size of industry, most of the job growth came in services at 4.7%, followed by retail trade at 3.4%. The business services component grew 7.4% in the first quarter, which is notable given that business services account for much of the high technology businesses in Hawaii. While construction job growth slowed from the pace in 2000, first quarter growth still came in at 5.6%. (Table 1)

By contrast with the private sector, government job growth was low or negative. State and local government jobs grew by 0.6% and 0.3%, respectively. Jobs in the federal government sector declined by 0.2% in the first quarter of 2001 compared to the year-earlier quarter, but a portion of this may reflect the adjustment from Census hiring in 2000. (Table 1)

Personal income grew by 4.7% in the fourth quarter of 2000—the latest data available. For the year, personal income growth was up 4.8%, the fastest growth since 1992. (Table 4)

Hawaii's tax collections also reflected an active economy. General fund revenue expanded by 7.8% in the first quarter, following 8.0% growth in 2000. General excise tax receipts grew by 3.5% while net individual income tax receipts were up 7.6%. Much of the individual income tax revenue came from withholding on wages and lower refunds compared to 2000. (Table 1)

The visitor industry was flat in the first quarter. The number of visitor arrivals was essentially unchanged from the first quarter of 2000. The number of visitors on domestic flights increased slightly, but the number on international flights declined. (Table 7)

While 2001 construction activity has not matched the pace of 2000, the growth remains healthy. The contracting tax base grew by 4.9% in the first quarter of 2001 compared to the same period in 2000. Building permits also expanded by 2.1%. The private sector has generated most of the recent construction activity as government contracts awarded and expenditures have declined. (Table 9)

Mirroring a Mainland trend, bankruptcy filings increased in the first quarter for the first time in two years. Hawaii bankruptcy filings rose by 8.7% compared to the first quarter of 2000. For the U.S. as a whole, bankruptcy filings were 17.5% in the first quarter.

Outlook of the Economy

Economic growth on the Mainland continues to be weak and Japan's economy may have slid back into recession. While Hawaii's economy has performed relatively well recently, DBEDT expects Hawaii's growth to slow.

The June 10, 2001, issue of the *Blue Chip Economic Indicators*, a consensus forecast of approximately 50 economic analysts, projects U.S. economic growth of 1.8% in 2001. Next year, economic growth should expand to 3.1% according to these projections. The 2001 projection is down from 2.6% forecast by *Blue Chip* in January 2001, while the 2002 forecast is down from 3.4% forecast in January.

In 2001, *Blue Chip* expects Mainland consumer price inflation of 3.2% and an unemployment rate of 4.6%. Inflation will look better in 2002 at 2.5%, but *Blue Chip* expects the unemployment rate to rise to 4.9%.

Preliminary estimates of Japan's economy indicate that real gross product declined in the first quarter. The *Blue Chip* consensus forecast is for growth of 0.7% in 2001 with some improvement to 1.6% in 2002.

The UCLA Anderson Forecast expects California real personal income growth to fall from a very strong 8.4% of 2000 to 1.2% in 2001. In 2002, the UCLA forecast expects growth of 2.0%.

The Japanese yen sits at about 124 per dollar. The June 2001 *Consensus Forecasts-USA* projects the same rate in September 2001 with only a slight appreciation to 121.5 in June 2002. A stronger yen usually increases Japanese economic activity in Hawaii as the cost of Hawaii goods and services falls in terms of yen.

DBEDT considered these factors in constructing the forecast of key economic variables shown in the accompanying table. DBEDT expects real personal income growth of 2.5% this year, slowing to the 2.2% range in the next few years. Job growth, which has recently run in excess of 3.0%, will slow to 2.4% this year and move closer to 2.0% thereafter. The number of visitor arrivals will grow by about 1.4% in 2001 and visitor expenditures will expand by 3.5%.

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

Table 1
SELECTED ECONOMIC ACTIVITIES: STATE

SERIES	UNIT	1ST QUARTER 2001		1ST QUARTER 2000	
		NUMBER	% CHANGE YEAR AGO	NUMBER	% CHANGE YEAR AGO
CIVILIAN LABOR FORCE ⁽¹⁾	Persons	599,850	1.2	592,600	0.3
Civilian Employment	Persons	575,000	1.6	565,750	1.8
Civilian Unemployment	Persons	24,850	-7.4	26,850	-23.3
UNEMPLOYMENT RATE ⁽²⁾	%	4.1	-8.9	4.5	-23.7
TOTAL NON-AGRICULTURE WAGE & SALARY ⁽¹⁾	Jobs	558,100	2.9	542,300	2.7
Contract Construction	Jobs	23,550	5.6	22,300	6.4
Manufacturing	Jobs	17,200	2.1	16,850	4.3
Transportation, Communication, Utilities	Jobs	43,000	3.4	41,600	2.7
Trade	Jobs	138,950	3.2	134,700	3.0
Retail	Jobs	117,100	3.4	113,250	2.9
Finance, Insurance, & Real Estate	Jobs	33,550	-0.7	33,800	-3.6
Services & Miscellaneous	Jobs	187,050	4.7	178,700	3.9
Hotels	Jobs	38,950	3.2	37,750	1.2
Health	Jobs	35,850	1.7	35,650	1.0
Government	Jobs	114,750	3.5	114,350	1.4
State	Jobs	67,900	.6	67,500	1.7
Federal	Jobs	30,450	-0.2	30,500	1.3
Local	Jobs	16,400	0.3	16,350	0.0
AGRICULTURE WAGES AND SALARIES ⁽¹⁾	Jobs	6,950	-12.6	7,950	12.8
STATE GENERAL FUND REVENUES	\$1,000	825,236	7.8	765,790	11.6
TRANSIENT ACCOMMODATIONS TAX	\$1,000	47,423	2.6	42,216	24.2
GENERAL EXCISE AND USE TAX	\$1,000	436,888	3.5	422,222	14.3

Notes: (1) Labor force and jobs are averages based on monthly rounded data.

(2) Change represents absolute change in rates rather than percentage change in rates.

Sources: Hawaii State Department of Labor & Industrial Relations; Hawaii State Department of Taxation; and Smith Travel Research, PricewaterhouseCoopers LLP. Compiled by Hawaii State Business Economic Development & Tourism Planning Information System.

Key Economic Indicators

Table 2
ACTUAL AND FORECASTED KEY ECONOMIC INDICATORS
FOR HAWAII: 2000 TO 2004

Economic Indicators	2000	%	2001	%	2002	%	2003	%	2004	%
	Actual	Change	Forecast	Change	Forecast	Change	Forecast	Change	Forecast	Change
Total population (in thousands)	1,216.4 ¹⁾	0.9 ¹⁾	1,226.1	0.8	1,235.9	0.8	1,224.6	0.7	1,253.3	0.7
Visitor arrivals (in thousands)	6,975.9	3.5	7,073.6	1.4	7,257.5	2.6	7,438.9	2.5	7,624.9	2.5
Honolulu CPI-U (1982-84=100)	176.3	1.7	179.8	2.0	183.6	2.1	187.6	2.2	192.0	2.3
Personal income (in million dollars)	34,190.8	4.8	35,729.3	4.5	37,301.4	4.4	38,942.7	4.4	40,656.2	4.4
Personal income (in \$1987 million)	30,085.9	2.9	30,838.0	2.5	31,547.3	2.3	32,241.3	2.2	32,918.4	2.1
Total wage & salary jobs (in thousands)	559.4	3.1	572.6	2.4	584.6	2.1	596.3	2.0	607.1	1.8
Gross state product (in million dollars)	39,394.3 ²⁾	5.3 ²⁾	41,188.8	4.6	42,995.9	4.4	44,877.6	4.4	48,840.0	4.4
Real gross state product (in \$1987 million)	35,142.1 ²⁾	3.7 ²⁾	36,077.6	2.7	36,946.4	2.4	37,796.7	2.3	38,629.0	2.2
Gross state product deflator (1987=100)	112.1	1.6	114.2	1.8	116.4	1.9	118.7	2.0	121.2	2.1

NA - not available.

1) This July 1, 2000 estimate has been prepared by DBEDT. Revised U.S. Census Bureau intercensal estimates (1990-2000) are forthcoming. The Census Bureau count as of April 1, 2000 is 1,211,537.

2) Revised.

Source: Hawaii Department of Business, Economic & Tourism, June 2001.

Labor Force and Jobs

Hawaii's labor market showed continuing strength in the first quarter of 2001. Non-agricultural wage and salary jobs showed healthy gains while the unemployment rate fell. Construction, retail, and services led the way in job growth.

In the first quarter of 2001, the available workforce and civilian employment rose while unemployment fell. Compared to the first quarter of 2000, the civilian labor force rose 1.2%. This was the fastest labor force increase since 1996. Civilian employment increased 1.6% from the first quarter 2000 through the first quarter of 2001 and the number of unemployed dropped by 7.4% over the same period. (Table 1) As a result, the unemployment rate fell to 4.1% in the first quarter of 2001, the lowest first-quarter rate since 1992. (Table 3)

Non-agricultural job growth continued strong. Non-agricultural wage and salary jobs rose 2.9% in the first quarter of 2001 compared to the year-earlier quarter (Table 1). This level of sustained growth in jobs has not been seen since 1990.

A number of industries showed positive job growth in the first quarter of 2001 compared to the same period in 2000. Construction jobs grew by 5.6% in the first quarter of 2001. While slower than the pace set in 2000, construction job growth remained high. Jobs in manufacturing grew by 2.1%, transportation by 4.7%, utilities by 1.5%, wholesale trade by 1.9%, hotels by 3.2%, retail trade jobs and services by 3.4% and services jobs by 4.7%. (Table 1)

On the other hand, some industries experienced job losses. Jobs in communications declined by -2.3%; finance, insurance, and real estate by -0.7%; and agriculture by -12.6%. (Table 1)

The government job sector was less active than the private sector. Federal government jobs fell 0.2% from the first quarter of 2000 to the first quarter of 2001. Small increases occurred in state government jobs (0.6%) and in local government jobs (0.3%). (Table 1)

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

Year	Civilian Labor Force	% Change Civilian Labor Force	Civilian Employment	% Change Civilian Employment	Civilian Unemployment Rate
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	593.6	3.0	555.8	2.4	6.4
1997	594.7	0.2	556.7	0.2	6.4
1998	594.4	-0.1	557.2	0.1	6.2
1999	592.8	-0.3	559.6	0.4	5.6
2000	595.5	0.4	569.9	1.8	4.3

Note: Data from 1997 were rebenchmarked by DLIR in April 2000.
Source: Hawaii State Department of Labor and Industrial Relations.

Income and Prices

Personal income grew at the fastest rate in eight years in the fourth quarter of 2000 (the latest data available). Growth was spread across the income categories, with the largest increases in wages and salaries; proprietors' income; and dividends, interest, and rent. All industries saw increases in earnings during the period.

Personal income rose 4.7% in the fourth quarter of 2000 compared to the fourth quarter of 1999. For the year, personal income growth in 2000 averaged 4.8%. This was the fastest growth rate since 1992. (Table 5) Wage and salary growth was likewise strong. Wages and salaries rose 5.7% in the fourth quarter of 2000 and 5.6% for the year as a whole. Wages and salaries account for about 57% of personal income. Proprietors' income, the income most closely related to entrepreneurial activity, grew by 4.7% in the fourth quarter of 2000 compared to the fourth quarter of 1999. For 2000, proprietors' income jumped by a 6.6%, the largest increase since 1992. (Table 4)

The two other major income types also showed healthy increases. Dividends, interest, and rent rose by 2.5% in the fourth quarter of 2000. For 2000, this income component increased by 3.3%. Transfer payments, consisting largely of retirement and medical payments, grew by 5.1% in the fourth quarter and by 4.8% for the year as a whole. Other labor income, consisting of employer payments to retirement plans, private group health insurance plans, private workers compensation plans, and so on, reversed the annual declines observed since 1997. Other labor income rose by a small 0.5% in 2000 compared to 1999. (Table 4)

Private sector earnings increased across all industries. Adjusting for the size of the industry, the largest increases came in services, construction, and retail trade. Earnings also increased in the public sector, but by a smaller percentage. (Table 4) These healthy increases in personal income would mean less if inflation were rising rapidly, but that is not the case. The Honolulu consumer price index rose by only 1.7% in the second half of 2000 compared to the same period in 1999, which was comparatively smaller than the 3.5% inflation experienced on the Mainland during the period. (Table 6)

Table 4

PERSONAL INCOME FOR HAWAII BY MAJOR SOURCES
(in millions of dollars at seasonally adjusted annual rates)

Series	Annual Average 1999	Annual Average 2000	Average % Change 2000 from 1999
Derivation of Personal Income			
Wage and salary disbursements.....	18,299	19,321	5.6
Plus: Other labor income.....	2,816	2,829	0.5
Plus: Proprietors' income.....	2,549	2,718	6.6
Less: Personal contribution for social insurance.....	1,297	1,348	3.9
Dividends, interest, rent.....	6,342	6,551	3.3
Transfer payments.....	3,933	4,121	4.8
Personal income.....	32,641	34,191	4.8
Earnings by Industry			
Farm.....	191	209	9.0
Nonfarm.....	23,472	24,658	5.1
Private.....	16,232	17,367	7.0
Agriculture forestry, fishery, other.....	143	156	9.3
Mining.....	21	23	7.1
Construction.....	1,326	1,502	13.3
Manufacturing.....	659	698	5.9
Transportation and public utilities.....	1,811	1,930	6.6
Wholesale trade.....	822	867	5.4
Retail trade.....	2,629	2,797	6.4
Finance, insurance, real estate.....	1,950	2,053	5.3
Services.....	6,872	7,342	6.8
Government & government enterprises.....	7,240	7,293	0.7
Federal, civilian.....	1,840	1,874	1.8
Federal, military.....	2,298	2,364	2.8
State and local.....	3,102	3,055	-1.5

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *State Quarterly Personal Income*, April 24, 2001, and tabulations by the Hawaii State Department of Business, Economic Development & Tourism.

Table 5
PERSONAL INCOME
(in millions of dollars at seasonally adjusted annual rates)

YEAR	ANNUAL AVERAGE	PERCENT CHANGE
1990	24,915	10.8
1991	26,198	5.1
1992	27,859	6.3
1993	29,068	4.3
1994	29,740	2.3
1995	30,202	1.6
1996	30,393	0.6
1997	31,218	2.7
1998	31,824	1.9
1999	32,641	2.6
2000	34,191	4.8

(1) percentage change from the same period in previous year.

Source: U.S. Department of Commerce, Bureau of Economic Analysis. *State Quarterly Personal Income: April 24, 2001* and tabulations by the Hawaii State Department of Business, Economic Development & Tourism.

Table 6
CONSUMER PRICE INDEX, ALL URBAN CONSUMERS (CPI-U), AND
SELECTED ITEMS, FOR U.S. AND HONOLULU: 1989-1998
[1982-1984 = 100]

Year	HONOLULU									
	U.S.	All Items	Food & Beverages	Housing	Apparel & Upkeep	Trans.	Medical Care	(1) Recreation	(1) Education & Comm.	Other Goods & Services
1992	140.3	155.1	148.5	161.7	114.2	147.4	182.6	(NA)	(NA)	189.0
1993	144.5	160.1	152.9	166.5	116.5	150.5	197.4	(NA)	(NA)	200.1
1994	148.2	164.5	153.4	171.6	118.7	156.4	206.0	(NA)	(NA)	209.6
1995	152.4	168.1	156.8	174.7	117.5	162.4	209.8	(NA)	(NA)	216.8
1996	156.9	170.7	156.6	176.8	118.5	167.0	215.0	(NA)	(NA)	226.5
1997	160.5	171.9	159.2	177.1	117.3	166.2	217.3	(NA)	(NA)	239.0
1998	163.0	171.5	159.1	176.0	112.2	162.5	226.1	100.8	99.1	256.1
1999	166.6	173.3	162.9	175.8	105.4	162.2	231.3	101.9	104.5	275.6
2000	172.2	176.3	164.8	177.9	103.5	169.6	239.8	102.8	106.5	279.7

(1) New indexes as of January 1998. Base period is December 1997.

Source: U.S. Bureau of Labor Statistics, February 21, 2001.

Tourism

Economic activity in the visitor industry slowed in the first quarter. Neither the number of visitor arrivals nor the average daily census increased from the first quarter 2000. On the other hand, hotel occupancy rates improved.

The number of visitor arrivals remained flat from the first quarter of 2000 to the first quarter of 2001. This was the slowest first-quarter growth since 1998 when Hawaii began to feel the effects of the Asian Crisis. (Table 7)

By flight type, the number of travelers on domestic flights expanded by 0.7%, while the number on international flights fell by 1.1%. Compared to 1997, this was at once the weakest first-quarter growth for domestic travelers and the strongest first-quarter growth for international travelers. (Table 7)

Across major market areas, U.S. West visitor arrivals made the strongest showing, rising by 1.4% in the first quarter of 2001 compared to the year-earlier quarter. U.S. East visitor arrivals fell by 1.7% over the period. Japan visitor arrival numbers declined by 2.9% from the first quarter of 2000 to the first quarter of 2001. This was the fourth year in which Japan visitor arrivals declined in the first quarter.

Average daily census numbers were also flat in the first quarter. The average daily census reflects both arrivals and length of stay. While negligibly larger than the first quarter of 2000, the average daily census has never been higher.

By flight type the domestic visitor census increased by 1.4% in the first quarter, while the international visitor census fell by 3.2% (Table 7).

Despite this slowdown in arrivals and visitor census, hotel occupancy rates rose slightly from 78.2% in the first quarter of 2000 to 80.5% in the first quarter of 2001 (Table 8). Occupancy rates can rise for a variety of reasons aside from arrivals or length of stay—hotels may temporarily reduce the number of available rooms due to renovation or residents may choose to vacation within state.

Table 7

VISITOR ARRIVALS ¹⁾
Average Length of Stay, Visitor Days, Average Daily Census
(Percentage Change from the Same Period in Previous Year)

	<u>1ST QUARTER 2000 ²⁾</u>	<u>1ST QUARTER 2001 ²⁾</u>	<u>% Change</u>
TOTAL ARRIVALS			
Total Visitor Arrivals.....	1,722,991	1,723,659	0.0
Domestic Flight Arrivals.....	1,071,927	1,079,762	0.7
International Flight Arrivals	651,064	643,897	-1.1
AVERAGE LENGTH OF STAY			
Total Visitor Arrivals.....	9.39	9.28	-1.1
Domestic Flight Arrivals.....	10.60	10.55	-0.5
International Flight Arrivals	7.40	7.16	-3.2
VISITOR DAYS			
Total Visitor Arrivals.....	16,175,825	15,998,683	-1.1
Domestic Flight Arrivals.....	11,359,780	11,388,465	0.3
International Flight Arrivals	4,816,044	4,610,217	-4.3
AVERAGE DAILY CENSUS			
Total Visitor Arrivals.....	177,756	177,763	0.0
Domestic Flight Arrivals.....	124,833	126,539	1.4
International Flight Arrivals	52,924	51,225	-3.2

1) *The data presented in the foregoing table reflects a new methodology to present the State's tourism status and is not comparable with earlier reports. It is believed that the new methodology will improve the accuracy and validity of the data. At this time comparable data for years prior to 1999 are not yet available.*

2) *Preliminary.*

Table 8
HOTEL OCCUPANCY RATE
(in percent)

<u>Year</u>	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>	<u>Annual</u>
1990	83.9	75.5	81.0	74.3	78.8
1991	68.2	70.7	79.7	72.5	72.4
1992	75.3	68.6	75.5	75.2	72.7
1993	75.3	67.9	73.8	72.5	72.0
1994	80.9	72.7	79.1	74.8	76.5
1995	79.5	70.3	79.2	75.1	75.8
1996	81.9	72.3	77.1	70.0	75.2
1997	79.5	70.8	75.5	69.9	73.9
1998	77.4	68.7	72.9	98.0	71.5
1999	77.1	67.5	74.8	68.9	72.1
2000	78.2	74.5	78.0	72.8	76.0
2001	80.5				

Source: Hawaii State Department of Business, Economic Development & Tourism and PKF — Hawaii and Smith Travel Research, PricewaterhouseCoopers LLP.

Construction

Construction industry activity in the first quarter continued the slowing observed at the end of last year. However, both the contracting tax base (a measure of construction put in place) and building permit values remained higher than one year ago.

The contracting tax base, the activity subject to the general excise tax, grew by 4.9% from the first quarter of 2000 to the first quarter of 2001. The contracting tax base is a proxy for completed construction. This measure grew by almost 21% in 2000. (Table 9)

Building permit values, a measure of prospective construction activity, also retained positive growth, expanding by 2.5% in the first quarter of 2001 from the year-earlier quarter. The increase in permit values came entirely in the commercial and industrial sector. Permits for residential construction and additions and alterations declined in the first quarter 2001 from the year-earlier quarter.

By county, building permits expanded in Honolulu (+18.9%) and Kauai (+38.2%). However permit values fell in Hawaii County (-22.2%) and Maui County (-12.9%). The increase in Honolulu permits reflected projects by Victoria Ward, school construction in Kapolei, and the Filipino Community Center in Waipahu. Kauai's increased activity reflected multi-family residential construction in Princeville. While permit values fell in Hawaii County and Maui County relative to 2000, the first-quarter level of permitting remained high compared to the late 1990s.

Construction jobs also showed healthy, but slower, growth in the first quarter as compared to 2000. Construction jobs rose 5.6% from the first quarter of 2000 to the first quarter of 2001 (Table 1), but this followed 8.5% growth in 2000. The fastest construction job growth came in Honolulu County (7.4%), followed by Hawaii County (5.8%) and Kauai County (5.0%). Construction jobs actually fell by 6.0% on Maui in the first quarter.

The growth in construction has come primarily from the private sector. Government contracts awarded fell by 18% from the first quarter of 2000 to the first quarter of 2001. And State Capital Improvement Projects dropped by 27.0% over the period. However, these declines are somewhat overstated because first quarter 2000 contracts awarded and CIP expenditures were particularly large.

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	Contracting Tax Base ¹⁾		Private Building Authorizations						Govt. Contracts Awarded			
		%	Private Authorizations	%	Residential	%	Commercial Industrial ²⁾	%	Additions/Alterations	%		%
1990	4,003.7	29.1	2,101.8	11.7	952.3	4.6	698.0	24.2	451.5	10.1	825.5	13.8
1991	4,334.1	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	4,012.7	-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	3,803.6	-4.2	1,496.5	-14.6	734.7	-9.4	306.3	-42.5	455.5	11.5	651.8	-43.8
1994	3,322.3	-12.4	1,612.9	7.8	849.3	15.6	370.3	20.9	393.4	-13.6	693.0	6.3
1995	3,133.5	-4.9	1,531.3	-5.1	745.5	-12.2	368.3	-0.5	417.5	6.1	490.2	-29.3
1996	3,285.1	2.8	1,117.8	-27.1	487.0	-34.7	252.8	-31.4	378.0	-9.5	885.5	80.7
1997	2,944.4	-10.4	1,179.2	5.5	542.5	11.4	264.5	4.6	372.2	-1.5	615.6	-30.5
1998	3,016.0	-1.3	1,054.3	-10.6	485.5	-10.5	205.6	-22.2	363.2	-2.4	685.5	11.3
1999	2,991.2	-0.8	1,367.6	29.7	647.4	33.3	257.7	25.3	411.8	13.4	584.8	-14.7
2000 ³⁾	3,613.5	20.8	1,512.6	14.6	800.1	27.2	246.2	-19.6	466.2	21.0	593.8	1.5

1) Formerly, this category was "Value of Construction Completed" subject to revision by the Hawaii State Department of Taxation.

2) Includes hotels.

3) Kauai data for November consist of residential data only.

Source: Hawaii State Department of Taxation; F.W. Dodge; County building departments; and First Hawaiian Bank, Building Industry (various issues) and tabulation by Hawaii State Department of Business, Economic Development & Tourism.

Table 10

ESTIMATED VALUE OF PRIVATE BUILDING CONSTRUCTION AUTHORIZATIONS, BY COUNTY
(in thousands of dollars and percentage change from the previous year)

Year	State	%	City & County of Honolulu	%	Hawaii County	%	Kauai County	%	Maui County	%
1989	1,882,397	21.7	1,048,284	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	1,496,486	-14.6	959,041	-9.6	248,236	-34.5	86,032	-22.6	203,177	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	980,703	-8.6	267,108	47.5	78,918	-52.1	204,588	5.5
1996	1,117,760	-27.0	698,697	-28.8	171,017	-36.0	101,981	29.2	146,065	-28.6
1997	1,179,182	5.4	772,825	10.6	155,776	-8.8	97,808	-4.1	152,773	4.6
1998	1,054,281	-10.5	624,227	-19.2	178,220	14.4	88,196	-9.2	163,640	7.1
1999	1,367,631	29.7	753,771	20.8	243,852	36.8	140,846	59.7	229,162	40.0
2000 ¹⁾	1,512,601	14.6	694,223	-1.7	321,704	31.9	141,313	0.3	355,360	55.1

1) Kauai County data for November consist of residential data only.

Source: County Building Permits.

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APPENDIX D

AUDITED FINANCIAL STATEMENTS OF THE HIGHWAYS DIVISION

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**Department of Transportation –
Highways Division
State of Hawaii**

Combined Financial Statements

June 30, 2000

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March 23, 2001

Mr. Brian Minaai, Director
Department of Transportation
State of Hawaii
869 Punchbowl Street
Honolulu, Hawaii 96813

Dear Mr. Minaai:

We have completed our audit of the combined financial statements of the Highways Division, Department of Transportation, component unit of the State of Hawaii, as of and for the year ended June 30, 2000, as listed in the table of contents. We transmit herewith our reports containing our opinion on those financial statements and our reports on internal controls and compliance with applicable laws and regulations in accordance with the U.S. General Accounting Office's Government Auditing Standards, Single Audit Act of 1984, as amended, and Office of Management and Budget (OMB) Circular A-133.

Objectives and Scope of Examination

The primary objective of our audit was to form an opinion as to whether the above-mentioned financial statements present fairly the financial position of the Highways Division, Department of Transportation, State of Hawaii (the Division), as of June 30, 2000.

Our audit was completed in accordance with the specifications as outlined in Specifications for the Financial and Compliance Audit of the Highways Division, Department of Transportation, State of Hawaii.

The objectives of the audit were:

1. To determine, based on an audit in accordance with auditing standards generally accepted in the United States of America and Government Auditing Standards, issued by the Comptroller General of the United States, the fairness of the presentation of the Division's financial statements in conformity with accounting principles generally accepted in the United States of America.

Mr. Brian Minaai
March 23, 2001
Page 2

2. To ascertain whether all revenues and other receipts to which the Division is entitled have been collected and accounted for in accordance with the laws, rules, regulations, policies and procedures of the State of Hawaii and, where applicable, the federal government that could have a material effect on the financial statements or on the awards tested. To determine whether federal and state funds have been expended in accordance with the terms of the applicable grant agreements and those provisions of federal and state laws and regulations that could have a material effect on the financial statements or on the awards tested.
3. To evaluate the Division's internal control and to determine whether federal award programs have been managed in compliance with the applicable federal laws and regulations.

The scope of the audit included:

1. An audit in accordance with auditing standards generally accepted in the United States of America and Government Auditing Standards, issued by the Comptroller General of the United States, of the financial statements of the Division for the period July 1, 1999 to June 30, 2000. The scope of our audit included the accounts of the Division, which are maintained by the Division's fiscal office.
2. As part of the audit of the Division's financial statements, an evaluation of the internal control to determine its adequacy in assuring that there is effective control over and proper accounting of revenues, expenditures, assets and liabilities, and whether federal award programs have been managed in compliance with the applicable federal laws and regulations.
3. Performance of additional testing and preparation of the reports required under the Federal Single Audit Act of 1984, as amended.

Organization of Report

This report is divided into four parts, as follows:

1. The combined financial statements, related notes and schedule of expenditures of federal awards of the Highways Division, State of Hawaii, as of and for the year ended June 30, 2000, and our opinion as to the fairness of the presentation of those statements.
2. Our report on compliance and internal control over financial reporting – Government Auditing Standards.

Mr. Brian Minaai
March 23, 2001
Page 3

3. Our report on compliance and internal control over compliance – OMB Circular A-133.
4. Schedule of findings and questioned costs.

We would like to take this opportunity to thank the staff of the Highways Division, State of Hawaii for their courteous cooperation and assistance during our audit.

Very truly yours,

A handwritten signature in cursive script that reads "PricewaterhouseCoopers LLP".

ATY:ery

Attachments

**Department of Transportation – Highways Division
State of Hawaii**

**Table of Contents
June 30, 2000**

PART I: FINANCIAL STATEMENTS		Page
Combined Financial Statements		
Report of Independent Accountants		1
Combined Balance Sheet – All Fund Types and Account Groups as of June 30, 2000		3
Combined Statement of Revenues, Expenditures and Changes in Fund Balances – All Governmental Fund Types For the Year Ended June 30, 2000		5
Combined Statement of Revenues and Expenditures – Budget and Actual – State Highway Fund (Non-GAAP Budgetary Basis) For the Year Ended June 30, 2000		6
Notes to the Combined Financial Statements		7
Schedule of Expenditures of Federal Awards		24
 PART II: REPORT ON COMPLIANCE AND INTERNAL CONTROL OVER FINANCIAL REPORTING – GOVERNMENT AUDITING STANDARDS		
Report of Independent Accountants on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards		27
 PART III: REPORT ON COMPLIANCE AND INTERNAL CONTROL OVER COMPLIANCE – OMB CIRCULAR A-133		
Report of Independent Accountants on Compliance with Requirements Applicable to the Major Program and Internal Control Over Compliance in Accordance with OMB Circular A-133		29
 PART IV: SCHEDULE OF FINDINGS AND QUESTIONED COSTS		31

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Part I

Financial Statements

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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, 2000, 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 auditing standards generally accepted in the United States of America 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, 2000, and the results of its operations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 23, 2001 on our consideration of the Division's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing*

Standards and should be read in conjunction with this report in considering the results of our audit.

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.

Prunswick & Cooper LLP

Honolulu, Hawaii
March 23, 2001

**Department of Transportation – Highways Division
State of Hawaii**

**Combined Balance Sheet – All Fund Types and Account Groups
June 30, 2000**

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 Long-Term Debt	General Long-Term Debt	
Cash with Director of Finance, State of Hawaii (\$9,485,350 held for others)	\$ 145,210,926	\$ 10,402,999	\$ 142,586,743	\$ -	\$ -	\$ -	\$ -	\$ 298,200,668
Receivables (net of allowance for doubtful accounts of \$442,109):								
Due from U.S. Government for federal grants-in-aid (Note 5)	5,979,835	-	7,093,407	-	-	-	-	13,073,242
Due from State of Hawaii (Note 6)	1,358,541	-	6,474,948	-	-	-	-	7,833,489
Due from others	2,470,126	-	-	-	-	-	-	2,470,126
Property and equipment (Note 8):								
Buildings and improvements	-	-	-	7,129,919	-	-	-	7,129,919
Vehicles and equipment	-	-	-	40,804,655	-	-	-	40,804,655
Work in process	-	-	-	370,723	-	-	-	370,723
Amount to be provided for the payment of general long-term debt (Note 9)	-	-	-	-	-	183,398,002	-	183,398,002
Total assets	\$ 155,019,428	\$ 10,402,999	\$ 156,155,098	\$ 48,305,297	\$ 183,398,002	\$ 183,398,002	\$ 553,280,824	

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

**Department of Transportation – Highways Division
State of Hawaii**

**Combined Balance Sheet – All Fund Types and Account Groups – Continued
June 30, 2000**

Liabilities and Fund Equity	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:						
Accounts payable	\$ 1,995,040	\$ -	\$ 4,562,362	\$ -	\$ -	\$ 6,557,402
Accrued payroll	1,840,189	-	-	-	-	1,840,189
Contracts payable - current portion	5,896,712	-	10,773,733	-	-	16,670,445
Contracts payable - retained percentage	2,527,211	-	4,843,924	-	-	7,371,135
Deposits	9,485,350	-	-	-	-	9,485,350
Other	15,300	-	-	-	-	15,300
Workers' compensation payable	-	-	-	-	4,036,000	4,036,000
Accrued vacation payable (Note 9)	-	-	-	-	7,597,002	7,597,002
Revenue bonds payable	-	-	-	-	171,765,000	171,765,000
Matured bonds and interest payable	-	10,402,999	-	-	-	10,402,999
Total liabilities	21,759,802	10,402,999	20,180,019	-	183,398,002	235,740,822
Commitments and Contingencies (Notes 2, 7 and 12)						
Fund Equity:						
Investment in general fixed assets	-	-	-	48,305,297	-	48,305,297
Fund balances:						
Reserved for encumbrances	68,729,624	-	143,403,013	-	-	212,132,637
Unreserved (Note 14)	64,530,002	-	(7,427,934)	-	-	57,102,068
Total fund balances	133,259,626	-	135,975,079	-	-	269,234,705
Total fund equity	133,259,626	-	135,975,079	48,305,297	-	317,540,002
Total liabilities and fund equity	\$ 155,019,428	\$ 10,402,999	\$ 156,155,098	\$ 48,305,297	\$ 183,398,002	\$ 553,280,824

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

**Department of Transportation – Highways Division
State of Hawaii**

**Combined Statement of Revenues, Expenditures and
Changes in Fund Balances – All Governmental Fund Types
For the Year Ended June 30, 2000**

	State Highway Fund	Debt Service Fund	Capital Projects Fund	Total (Memorandum Only)
Revenues:				
Intergovernmental:				
Federal grants-in-aid (Note 5)	\$ 21,729,120	\$ -	\$ 59,646,535	\$ 81,375,655
Taxes and fees (Note 4):				
Fuel taxes	68,087,663	-	-	68,087,663
Rental motor and tour vehicle surcharge taxes	34,586,739	-	-	34,586,739
Vehicle weight taxes	24,424,802	-	-	24,424,802
Vehicle registration fees	17,215,741	-	-	17,215,741
Other	2,000,003	-	-	2,000,003
Interest income	12,314,427	-	-	12,314,427
Rentals	857,705	-	-	857,705
Other	2,804,585	-	1,445,869	4,250,454
Total revenues	184,020,785	-	61,092,404	245,113,189
Expenditures:				
Operations and maintenance:				
Oahu highways and services	47,603,529	-	-	47,603,529
Hawaii highways and services	15,429,102	-	-	15,429,102
Maui highways and services	8,671,271	-	-	8,671,271
Kauai highways and services	5,465,808	-	-	5,465,808
Molokai highways and services	2,950,108	-	-	2,950,108
Lanai highways and services	606,291	-	-	606,291
Administration of Highways Division	22,489,204	-	-	22,489,204
Departmental administration	4,340,144	-	-	4,340,144
Motor Vehicle Safety Office	5,336,579	-	-	5,336,579
Capital projects	-	-	135,755,982	135,755,982
Debt service	-	14,965,998	-	14,965,998
Total expenditures	112,892,036	14,965,998	135,755,982	263,614,016
Excess (Deficiency) of Revenues Over Expenditures	71,128,749	(14,965,998)	(74,663,578)	(18,500,827)
Other Financing Sources (Uses) (Note 11):				
Operating transfers in	-	14,965,998	38,336,072	53,302,070
Operating transfers out	(82,033,954)	-	-	(82,033,954)
Total other financing sources (uses)	(82,033,954)	14,965,998	38,336,072	(28,731,884)
Excess Expenditures and Other Financing Uses over Revenue and Other Financing Sources	(10,905,205)	-	(36,327,506)	(47,232,711)
Fund Balances, July 1, 1999	144,164,831	-	172,302,585	316,467,416
Fund Balances, June 30, 2000	\$ 133,259,626	\$ -	\$ 135,975,079	\$ 269,234,705

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

**Department of Transportation – Highways Division
State of Hawaii**

**Combined Statement of Revenues and Expenditures – Budget and Actual -
State Highway Fund (Non-GAAP Budgetary Basis)
For the Year Ended June 30, 2000**

	Budget	Budgetary Actual	Variance - Favorable (Unfavorable)
Revenues:			
Fuel taxes	\$ 69,413,937	\$ 68,087,663	\$ (1,326,274)
Vehicle weight taxes	22,720,044	23,478,869	758,825
Rental motor and tour vehicle surcharge tax	33,466,863	34,586,739	1,119,876
Vehicle registration fees	17,209,668	17,215,741	6,073
Interest income	10,000,000	10,955,909	955,909
Enforcement fee	1,309,648	1,304,912	(4,736)
Vehicle registration penalties	1,115,734	926,878	(188,856)
Commercial drivers license fee	525,808	543,504	17,696
Rentals	750,000	857,705	107,705
Other	251,000	688,003	437,003
Total revenues	156,762,702	158,645,923	1,883,221
Expenditures:			
Operations and maintenance:			
Oahu highways and services	39,131,325	36,256,731	2,874,594
Hawaii highways and services	16,205,914	14,569,447	1,636,467
Maui highways and services	11,043,872	8,375,684	2,668,188
Kauai highways and services	8,474,531	7,023,012	1,451,519
Molokai highways and services	3,796,974	2,971,822	825,152
Lanai highways and services	1,338,325	1,074,622	263,703
Administration of Highways Division, including debt service (Note 11)	57,918,917	53,425,738	4,493,179
Departmental administration	4,903,295	4,741,896	161,399
Motor Vehicle Safety Office	5,359,797	5,279,923	79,874
Total expenditures	148,172,950	133,718,875	14,454,075
Excess of Revenues Over Expenditures	\$ 8,589,752	\$ 24,927,048	\$ 16,337,296

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

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.

**Department of Transportation – Highways Division
State of Hawaii**

Notes to the Combined Financial Statements

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 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.

The accompanying financial statements include highway projects authorized by legislative acts (Session Laws of Hawaii) through June 30, 2000.

**Department of Transportation – Highways Division
State of Hawaii**

Notes to the Combined Financial Statements

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, 2000, the Division had 838 parcels remaining with an aggregate acquisition cost of approximately \$1,381,000, 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

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 \$9,485,350 at June 30, 2000. The deposits were received on the Division's contracts with third parties. The Director of Finance is responsible for the safekeeping of all moneys paid into the State Treasury (cash pool).

Effective fiscal 2000, the Division participates in the State Treasury Investment Pool System, pursuant to Act 199, Session Laws of Hawaii 1998. The investment pool system centralizes all phases of the investment process under the direction of the Director of Finance, thereby pooling the State's cash resources to maximize investment returns. State departments and agencies are eligible to invest all funds of qualifying appropriation accounts, eliminating their responsibility for the investment of appropriated funds. The State Treasury allocates investment (interest) earnings monthly, based on the average weighted cash balance of each account. The Division's cash deposited in the State Treasury Investment Pool System at June 30, 2000 was approximately \$266,341,000, and is reflected on the combined balance sheet as Cash with Director of Finance, State of Hawaii.

Department of Transportation – Highways Division State of Hawaii

Notes to the Combined Financial Statements

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. Cash and deposits with financial institutions are collateralized in accordance with State statutes.

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.

New Accounting Pronouncements

In June 1999, the Governmental Accounting Standards Board (GASB) issued GASB No. 34 "*Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*" that will require that the basic financial statements and supplementary information for special purpose governments consist of management's discussion and analysis; basic financial statements, including a statement of net assets and a statement of activities, fund financial statements and notes to the financial statements; and supplementary information. Governments should report all capital assets, including infrastructure assets, in the government-wide statement of net assets and generally should report depreciation expense in the statement of activities. Capital assets that are not being depreciated, such as land and infrastructure assets reported using the modified approach, should be reported separately if the government has a significant amount of these assets. Infrastructure assets that are part of a network or subsystem of a network are not required to be depreciated contingent upon certain requirements. Governments with total annual revenues of \$100 million or more are required to implement this Statement for periods beginning after June 15, 2001. Prospective reporting of general infrastructure assets is required at the effective date of this Statement. Retroactive reporting of all major general governmental infrastructure assets is encouraged at that date. Retroactive reporting is required four years after the effective date on the basic provisions for all major general infrastructure assets that were acquired or significantly reconstructed, or that received significant improvements, in fiscal years ending after June 30, 1980.

In December 1998 and April 2000, the GASB issued Statement No. 33, "*Accounting and Financial Reporting for Nonexchange Transactions*" and Statement No. 36 "*Recipient Reporting for Certain Shared Nonexchange Revenues – an Amendment of GASB Statement No. 33,*" respectively. These Statements establish accounting and financial reporting standards for nonexchange transactions involving financial or capital resources. The

**Department of Transportation – Highways Division
State of Hawaii**

Notes to the Combined Financial Statements

principal issue addressed in these Statements is the timing of recognition of nonexchange transactions. The Division is required to implement the provisions of these Statements for the fiscal year ending June 30, 2001.

Management has not yet determined the effect of the implementation of these Statements to the Division's financial statements.

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 approved 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 1998 (Act 116, SLH 1998) – authorizations for expenditures for operating purposes for the Division (\$137,909,858) and the Motor Vehicle Safety Office (\$5,359,797); the allocation portion of authorization for expenditures for departmental administration (\$4,903,295).

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.

**Department of Transportation – Highways Division
State of Hawaii**

Notes to the Combined Financial Statements

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>\$ 24,927,048</u>
Federal grants-in-aid	21,729,120
Operating transfers out to State of Hawaii for debt service	23,145,785
Other adjustments to modified accrual basis of accounting	<u>1,326,796</u>
	<u>46,201,701</u>
Excess of revenues over expenditures, GAAP basis	<u><u>\$ 71,128,749</u></u>

Capital Projects Fund

Excess Capital Projects Fund appropriations lapse after completion of the project, which are 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

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, 2000, 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 0.75 - 1.25 cent per pound of net vehicle weight (depending upon the weight of the vehicle) to a maximum of \$150.

Rental Motor Vehicle Surcharge Tax

The rental motor vehicle surcharge tax is \$2 and \$3 a day or any portion of a day that a rental motor vehicle is rented or leased for the periods July 1, 1999 to August 30, 1999 and September 1, 1999 to June 30, 2000, respectively.

Vehicle Registration Fee

The vehicle registration fee is \$20 per vehicle.

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.

**Department of Transportation – Highways Division
State of Hawaii**

Notes to the Combined Financial Statements

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 accounted for in the Capital Projects and State Highway Funds. At June 30, 2000, the receivable from the U.S. Government is comprised of unbilled costs, which are eligible for reimbursement. At June 30, 2000, expenditures of approximately \$4,000,000 was not recorded 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, 2000 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, 2000, or the results of operations of such funds for the year then ended.

6. Due from State of Hawaii

The Capital Projects Fund receives funding from the State of Hawaii general fund 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, 2000 reflects the State's portion of the Division's liabilities for project expenditures at that date.

In addition, the Division earns interest on cash held in the State of Hawaii cash pool. At June 30, 2000, interest receivable was approximately \$1,358,000 which is reflected in the State Highway Fund.

7. 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

**Department of Transportation – Highways Division
State of Hawaii**

Notes to the Combined Financial Statements

employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. All contributions, benefits and eligibility requirements are established by HRS Chapter 88 and can be amended by legislative action.

The ERS is composed of a contributory retirement plan and a noncontributory retirement plan. 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. Both options provide a monthly retirement allowance based on the employee's age, years of credited service and average final compensation (AFC). The AFC is the average salary earned during the five highest paid years of service, including the vacation payment, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after that date is based on the three highest paid years of service, excluding the vacation payment.

Most members of the contributory plan are required to contribute 7.8% of their salary. The funding method used to calculate the total employer contribution requirement is the Entry Age Normal Actuarial Cost Method. Under this method, employer contributions to the ERS are comprised of normal cost plus level annual payments required to liquidate the unfunded actuarial liability over the remaining period of 18 years from July 1, 1998.

The Division's payroll for employees covered by the plan for the year ended June 30, 2000 was approximately \$36,749,000. The payroll for all the Division's employees for the year was \$37,484,000. The Division is required to contribute an actuarially determined amount to the ERS. Contributions made to the ERS by the Division for the years ended June 30, 2000, 1999 and 1998 were \$2,233,000, \$1,954,000 and \$4,758,000, respectively, and represented 6%, 6% and 15% of covered payroll, respectively. Contributions made to the ERS by the employees for the years ended June 30, 2000, 1999 and 1998 were \$331,000, \$309,000 and \$351,000, respectively, and represented 1% of covered payroll for all three years.

**Department of Transportation – Highways Division
State of Hawaii**

Notes to the Combined Financial Statements

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, 2000:

Number of employers as of March 31, 2000 was:

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

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, 2000, was approximately \$2,332,000 and is included in the financial statements.

**Department of Transportation – Highways Division
State of Hawaii**

Notes to the Combined Financial Statements

8. Changes in Property and Equipment

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

	Balance July 1, 1999	Additions	Deductions	Balance June 30, 2000
Buildings and improvements	\$ 6,906,558	\$ 223,361	\$ -	\$ 7,129,919
Vehicles and equipment	38,106,145	3,640,886	942,376	40,804,655
Work in process	-	370,723	-	370,723
	<u>-\$ 45,012,703</u>	<u>\$ 4,234,970</u>	<u>\$ 942,376</u>	<u>\$ 48,305,297</u>
Total	\$ 45,012,703	\$ 4,234,970	\$ 942,376	\$ 48,305,297

9. 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, 1999	\$ 2,572,000	\$ 7,389,727	\$ 177,605,000	\$ 187,566,727
Net increase in workers' compensation payable	1,464,000	-	-	1,464,000
Net increase in accumulated vacation	-	207,275	-	207,275
Bonds payments	-	-	(5,840,000)	(5,840,000)
	<u>-\$ 4,036,000</u>	<u>\$ 7,597,002</u>	<u>\$ 171,765,000</u>	<u>\$ 183,398,002</u>
Balance at June 30, 2000	\$ 4,036,000	\$ 7,597,002	\$ 171,765,000	\$ 183,398,002

10. 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

**Department of Transportation – Highways Division
State of Hawaii**

Notes to the Combined Financial Statements

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.

On July 1, 1998, the Division issued \$94,920,000 in State of Hawaii Highway Revenue Bonds, Series 1998 (1998 Bonds). The Bonds bear interest at rates ranging from 4.0% to 5.5% and mature in annual installments through 2018. The proceeds from the 1998 Bonds are used to finance certain highway improvements and other related projects for the State Highways System and to refund certain outstanding Highway Revenue Bonds.

The Division's revenue bonds payable at June 30, 2000 were as follows:

1993 Bonds	\$ 45,350,000
1996 Bonds	34,635,000
1998 Bonds	<u>91,780,000</u>
	<u>\$ 171,765,000</u>

The approximate maturities for revenue bonds, including interest of \$101,951,000 (debt service fund of \$4,563,000 and general long-term debt of \$97,388,000) in each of the next five years and thereafter are as follows:

Year ending June 30,	
2001	\$ 14,845,000
2002	14,813,000
2003	14,806,000
2004	14,799,000
2005	14,796,000
Thereafter	<u>205,497,000</u>
	279,556,000
Less debt service fund portion	<u>10,403,000</u>
General long-term debt portion	<u>\$ 269,153,000</u>

The 1993 Bonds maturing on and after July 1, 2004, the 1996 Bonds maturing on and after July 1, 2006, and the 1998 Bonds maturing on and after July 1, 2009 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.

**Department of Transportation – Highways Division
State of Hawaii**

Notes to the Combined Financial Statements

In 2000, \$14,965,998 was transferred from the State Highway Fund to the Debt Service Fund for repayment of Revenue Bond principal of \$5,840,000 and interest of \$9,125,998.

On October 1, 2000, the Division issued \$50,000,000 in State of Hawaii Highway Revenue Bonds, Series 2000 (2000 Bonds). The Bonds bear interest at rates ranging from 4.4% to 5.5% and mature in annual installments through 2020. The proceeds from the 2000 Bonds are used to finance certain highway capital improvement projects and related projects for the State Highways System.

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	\$ (31,706,867)	\$ -	\$ 31,706,867
State of Hawaii	(1,215,304)	-	6,629,205
Reimbursement to State of Hawaii for debt service	(23,145,785)	-	-
Transfer of funds to State of Hawaii general fund	(11,000,000)	-	-
Funding of revenue bond debt service	(14,965,998)	14,965,998	-
	<u>\$ (82,033,954)</u>	<u>\$ 14,965,998</u>	<u>\$ 38,336,072</u>

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.

**Department of Transportation – Highways Division
State of Hawaii**

Notes to the Combined Financial Statements

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. These funds can be used only for certain highway projects within 10 miles by road of an airport. At June 30, 2000, approximately \$11,000,000 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, 2000, including interest payments of \$44,190,000 are as follows:

Year ending June 30,	
2001	\$ 26,248,000
2002	24,748,000
2003	23,219,000
2004	19,056,000
2005	18,534,000
Thereafter	<u>86,350,000</u>
	<u>\$ 198,155,000</u>

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 \$14,375,703 for principal and \$8,770,082 for interest for the year ended June 30, 2000.

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 2000 fiscal year,

**Department of Transportation – Highways Division
State of Hawaii**

Notes to the Combined Financial Statements

\$11,000,000 was transferred to the General Fund. In addition, \$11,000,000 is planned to be transferred in the 2001 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.

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 deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency.

All amounts of compensation deferred under the plan, as well as property and rights purchased with those amounts and income attributable to these amounts, are held in trust by third party agents for the exclusive benefit of participants and their beneficiaries. The assets and liabilities of the plan are not reflected in the State of Hawaii or Division financial statements.

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

**Department of Transportation – Highways Division
State of Hawaii**

Notes to the Combined Financial Statements

excess layers with commercial insurance companies. At June 30, 2000, 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 \$4,036,000 for workers' compensation in the general long-term debt account group at June 30, 2000, as these losses will not be liquidated with currently expendable available financial resources. Workers' compensation expense for the year ended June 30, 2000 was approximately \$2,449,000.

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 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, 2000, aggregated approximately \$19,400,000.

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 Expense

The Division leases certain office space on a month-to-month basis. During the year ended June 30, 2000, rental expense approximated \$717,000.

14. Deficit Balance

At June 30, 2000, the Capital Projects Fund had an unreserved deficit balance of \$7,427,934. The Division intends to take corrective action to eliminate this deficit balance.

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**Schedule of Expenditures
of Federal Awards**

**Department of Transportation – Highways Division
State of Hawaii**

**Schedule of Expenditures of Federal Awards
For the Year Ended June 30, 2000**

Grant	Federal CFDA Number	Federal Expenditures
U.S. Department of Transportation:		
Highway planning and construction	20.205	\$ 79,015,832 *
State and community highway safety:		
FHWA grant		1,597
NHTSA grant		1,380,088
Fatal accident reporting system grant		29,992
Total state and community highway safety	20.600	<u>1,411,677</u>
National motor carrier safety:		
Assistance program grant	20.218	<u>189,271</u>
Total expenditures of federal awards		<u>\$ 80,616,780</u>

* Denotes major federal program.

Note 1. Basis of Presentation:

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Department of Transportation – Highways Division (the Division) and is presented on the basis of cash disbursements made by the Division. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of the combined financial statements.

¹ An additional schedule is included for the expenditures of federal awards by Highway planning and construction (see Page 25).

Department of Transportation – Highways Division
State of Hawaii

Schedule of Expenditures of Federal Awards – Highway Planning and Construction
Year Ended June 30, 2000

Code	Description	Unobligated Balance			Federal Agreement Balance			
		Balance July 1, 1999	Appropriation/Allocations	Net Obligations and Lapses	Balance July 1, 1999	Additions and Modifications	Federal Expenditures	Balance June 30, 2000
A06/010	Consolidated Primary	\$ 7,047,558	\$ (6,107)	\$ (305,166)	\$ 7,047,558	\$ (6,107)	\$ (307,449)	\$ 6,734,002
Q01	Safety Incentives	-	292,000	(45,788)	-	292,000	(62,331)	229,669
Q01	Interstate Main	1,932,899	20,766,604	(255,348)	1,017,000	21,682,504	(275,321)	22,424,183
Q05	NHS (HHS) Section 1006	-	18,237,195	(17,735)	-	14,975,195	(100,736)	14,874,459
Q08	Motor Vehicle / Intoxication	660,669	614,544	(472,532)	660,669	614,544	(488,725)	786,488
Q10	Bridge Repair	3,969,878	12,203,164	(1,373)	16,171,669	1,499,083	(1,434)	1,497,649
Q11	Bridge Replacement	28,840	1,006,544	-	28,840	1,006,544	-	1,035,384
Q21	STP, Safety	-	5,322,917	(35,832)	-	2,973,416	(40,038)	2,933,378
Q24	STP, Any Area	-	27,911,919	-	-	1,443,872	(92,036)	1,351,836
Q28	Surface Transportation Program	1,656,650	221,581	(1,044,540)	1,656,650	-	(1,259,861)	396,789
Q36	STP, 100% for Safety	-	139,178	-	-	139,178	-	139,178
Q40	Congestion Miti & Air Quality	-	3,061,250	-	-	-	-	-
Q44	Interstate Main	190,000	-	-	190,000	-	-	190,000
Q45	Metropolitan Planning	791,582	809,435	(79,507)	791,582	809,435	(79,507)	1,521,510
Q48	Disadvantaged Business Enterprise	89,410	180,000	(72,298)	89,410	180,000	(79,728)	189,682
Q55	Highway Planning and Research (HPR)	176,111	3,235,703	(153,289)	176,111	3,235,703	(159,860)	3,251,954
Q56	HPR Mandatory Studies	1,110,052	584,486	(232,247)	1,110,052	476,646	(271,158)	1,315,540
Q89	Technical Assistance Program	167,465	115,000	(78,102)	67,465	215,000	(90,898)	191,567
Q92	Demo Highway Projects	-	6,785,320	(32,688)	-	6,785,320	(36,068)	6,749,252
Q94	National Recreation Trails	337,327	449,770	(226,555)	83,048	(83,048)	-	-
W32/W33	Urban System	746,097	-	1,955	746,097	-	1,955	748,052
W36/W37	Urbanized Area	2,606,034	-	(92,729)	2,606,034	-	(92,729)	2,513,325
X44/044	Interstate System 4R	10,691,817	50,610	192,206	10,691,817	50,610	192,206	10,934,633
032	Urban	-	-	-	-	-	-	-
04M	Interstate Maintenance	35,981,696	136,247	(10,129,297)	19,378,914	16,739,029	(10,997,201)	25,120,742
042	Interstate	24,518,539	-	(1,332,018)	24,518,538	-	(1,363,225)	23,155,313
054	Interstate Discretionary	65,476,021	(2,124,711)	(8,530,819)	48,949,886	5,761,425	(8,644,802)	46,066,509
073	Rural Primary	55,727	(55,727)	-	55,727	(55,727)	-	-
075/076	Rural Secondary	6,708,028	-	(287,306)	2,176,209	-	(283,863)	1,892,346
080	Highway Planning and Research	1,037,930	-	3,652	1,037,931	(29,288)	3,631	1,012,274
081/086	Highway Planning and Research	5,235,868	606,915	(492,015)	5,235,868	89,181	(443,675)	4,881,374
082	Metropolitan Planning	62,167	(62,167)	-	62,167	(62,167)	-	-
085	Metropolitan Planning	2,209,537	-	(145,312)	2,209,537	-	(211,200)	1,998,337
	Subtotal	\$ 173,487,923	\$ 100,481,670	\$ (23,904,683)	\$ 130,587,131	\$ 78,732,348	\$ (25,184,053)	\$ 184,135,426

Note: The Schedule of Expenditures of Federal Awards – Highway Planning and Construction is prepared on the cash basis.

Department of Transportation – Highways Division
State of Hawaii

Schedule of Expenditures of Federal Awards – Highway Planning and Construction
Year Ended June 30, 2000

Code	Description	Unobligated Balance		Federal Agreement Balance		Balance June 30, 2000
		Balance July 1, 1999	Appropriation/ Allocations	Net Obligations And Lapses	Balance July 1, 1999	
	Subtotal carried forward	\$ 173,487,923	\$ 100,481,670	\$ (23,904,683)	\$ 250,064,910	\$ 184,135,426
098/09L	Emergency Relief	3,359,578	-	(160)	3,359,418	-
106	Economic Relief	49	-	-	49	-
114	Bridge Replacement - On/Off System	5,474,195	506,700	(46,751)	5,934,144	1,921,600
115	Bridge Replacement	4,814	-	(8)	4,806	-
117	Bridge Replacement - Off System	14,989,466	-	(383,958)	14,605,508	-
118	Bridge Replacement - On System	40,584,641	(668,341)	(6,646,339)	33,269,961	12,092,443
119	Bridge Replacement - Discretionary	1	-	-	1	-
141	Hazard Elimination	864,519	12,638	(10,697)	866,460	12,638
15A	Metropolitan Planning	10,403	(10,403)	-	10,403	(10,403)
18E	Public Lands	716,781	-	(126,735)	590,046	-
183	Public Lands Highway	200,370	-	-	200,370	-
212	Motor Carrier Safety Grant	393,306	375,164	(189,271)	579,199	(393,306)
308	Demonstration Project	4,769	2,549,677	-	4,769	1,295,996
309	Demonstration Project	42,513	1,529,805	(4,678)	42,513	777,597
31J	Congestion Pricing	270,000	-	-	270,000	270,000
315	National Highway System	46,910,423	(124,139)	(5,410,034)	41,376,250	16,136,574
317	Funding Restoration Alloc Form	1,937,565	338,656	(1,344,653)	931,568	931,568
32A	Congestion, Mitigation, and Air Quality	6,865,766	(571,200)	(1,340,660)	4,953,906	3,362,300
32C	Scenic Byways	183,979	-	(163)	183,979	-
Various	Surface Transportation Program	147,065,536	17,723,155	(31,857,379)	132,931,312	37,423,505
320	Air Quality	3,021,272	715,970	(962,735)	2,774,507	455,761
326	Highways Systems Activities	22,139	-	(18,199)	22,140	-
341	Highways Demo Projects	2,412,893	-	(76,215)	2,412,894	-
Various	Transportation Assistance Program	62,269	-	-	62,269	-
37T	Strategic Highway Research Program	2,900	-	-	2,900	-
Various	National Recreational Trail	53,909	-	(48,175)	53,909	(53,909)
40A	Rural Technical Assistance Program	1,032	(1,032)	-	1,032	-
413	Public Lands Highway	250,000	2,513,300	(352,439)	2,410,861	660,000
541	Highway Studies	152,498	-	(112,531)	152,498	-
9AH/96S	Disadvantaged Business Enterprise	7,134	-	(6,882)	7,134	-
Total		\$ 449,352,643	\$ 125,371,620	\$ (72,843,345)	\$ 501,880,918	\$ 153,614,712
						\$ (79,015,832)
						\$ 378,735,002

Note: The Schedule of Expenditures of Federal Awards – Highway Planning and Construction is prepared on the cash basis.

Part II

Report on Compliance and Internal Control Over Financial Reporting Government Auditing Standards

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**Report of Independent Accountants on
Compliance and on Internal
Control Over Financial Reporting Based on
an Audit of Financial Statements Performed
in Accordance with
*Government Auditing Standards***

To the Director
Department of Transportation
State of Hawaii

We have audited the combined financial statements of the Highways Division, Department of Transportation, State of Hawaii (the Division) as of and for the year ended June 30, 2000, and have issued our report thereon dated on March 23, 2001. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Division's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. However, we noted certain immaterial instances of noncompliance which we have reported to management of the Division in a separate letter dated March 23, 2001.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Division's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing

our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Division's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 00-1 and 00-2.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above is a material weakness. We also noted other matters involving the internal control over financial reporting which we have reported to management of the Division in a separate letter dated March 23, 2001.

This report is intended solely for the information of the Division's management, Department of Transportation and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

PricewaterhouseCoopers LLP

Honolulu, Hawaii
March 23, 2001

Part III

Report on Compliance and Internal Control Over Compliance OMB Circular A-133

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**Report of Independent Accountants
on Compliance with Requirements
Applicable to the Major Program and On Internal
Control Over Compliance in Accordance with
OMB Circular A-133**

To the Director
Department of Transportation
State of Hawaii

Compliance

We have audited the compliance of the Highways Division, Department of Transportation, State of Hawaii (the Division) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended June 30, 2000. The Division's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to its major federal program is the responsibility of the Division's management. Our responsibility is to express an opinion on the Division's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Division's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Division's compliance with those requirements.

In our opinion, the Division complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended June 30, 2000. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements that are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 00-3 and 00-4.

Internal Control Over Compliance

The management of the Division is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Division's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information of the Division's management, Department of Transportation and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

Prucmahaue Cooper LLP

Honolulu, Hawaii
March 23, 2001

Part IV

Schedule of Findings and Questioned Costs

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**Department of Transportation – Highways Division
State of Hawaii**

**Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2000**

Section I – Summary of Auditor’s Results

Financial Statements:

Type of auditor’s report issued	Unqualified
Internal control over financial reporting:	
Material weaknesses identified?	No
Reportable conditions identified not considered to be material weaknesses?	Yes
Noncompliance material to financial statements noted?	No

Federal Awards:

Internal control over major programs:	
Material weaknesses identified?	No
Reportable conditions identified not considered to be material weaknesses?	None reported
Type of auditor’s report issued on compliance for major programs	Unqualified
Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section 510(a)?	Yes

Identification of major program:

CFDA Number	Federal Program	
20.205	Department of Transportation – Highway planning and construction	
Dollar threshold used to distinguish between Type A and Type B programs		\$2,418,000
Auditee qualified as low-risk auditee?		No

**Department of Transportation – Highways Division
State of Hawaii**

**Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2000**

**Section II – Financial Statement Findings –
Current Year Findings**

Reportable Conditions

00-1 Accounting and Internal Reporting Procedures Should be Improved

The June 30, 2000 final trial balance was not generated until mid March 2001, several weeks before the audited financial statements were to be submitted in accordance with the Single Audit Act Amendments of 1996. The delay in generating the final trial balance was primarily due to unreconciled differences between the Division's HWYAC trial balance and the State's accounting records (FAMIS). During the year, we noted variances between the FAMIS and HWYAC payroll reports resulting primarily from retroactive payroll costs not reflected on the HWYAC system.

Additionally, we noted that the Division does not review the HWYAC "Status of Allotment by Appropriation" and FAMIS "Status of Appropriation Account Balances" to ensure that the contract agreement allotments reported on the State Department of Accounting and General Services (DAGS) Form A-15 "Allotment Advice" and the Division's Form DOT 4-116 "Job Authorization Form" were properly input into the accounting systems. Undetected differences may result in negative appropriation balances and intensive investigation if the information has not been reviewed on a timely basis.

Recommendations: We strongly recommend that the reconciliations between HWYAC and FAMIS be performed at least quarterly to ensure any differences are investigated and resolved in a timely manner. In addition, all account balances must be reviewed and reconciled regularly to ensure the monthly and year-end trial balances are accurate and generated on a timely basis. The Single Audit Act Amendments of 1996 requires the audited financial statements be submitted nine months after the year-end and failure to meet this deadline may jeopardize receiving future federal funds. We also recommend that the Division continue to investigate the unidentified difference in the cash account as of June 30, 2000.

We recommend that procedures be established to ensure that the above reports are reviewed at least on a quarterly basis to ensure the contract agreement allotments have been properly reflected in these reports. The Division should also review the reports being generated and

**Department of Transportation – Highways Division
State of Hawaii**

**Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2000**

consider customizing these reports based on the user needs to ensure that pertinent information is properly disseminated and utilized by management.

00-2 Unbilled Federal Receivables

At June 30, 2000, the Division incurred unbilled expenditures of approximately \$4 million, which may be reimbursable from the federal government and therefore have not been recorded as receivables and federal grants-in-aid revenue, pending the qualification for reimbursement by the Division. These costs were attributed to the following reasons, which the Division is currently in the process of investigating and resolving:

- The system could not distinguish which federal projects should be charged for labor costs when the projects were funded by more than one federal appropriation due to coding limitations.
- Project agreements and modifications may not have been approved, although costs were being incurred.

We also noted that as of our report date the balance of unbilled costs in the HWYAC system has not changed significantly from June 30, 2000. However, the latest request for reimbursement was January 2001.

In addition, we noted that federal reimbursements for fiscal 2000 were significantly lower than the prior year with expenditures consistent between years. We understand from the Division that there were no significant changes in federal funding. It appears that certain payroll costs may have been improperly charged to non-federal codes and therefore, these costs were not filed for reimbursements by the federal government. We did note fewer capital projects fund codes and more nonparticipating codes being charged to during our payroll testing in fiscal 2000.

Recommendation: Although the balance of unbilled costs at June 30, 2000 has decreased from previous years, we continue to recommend that these unbilled costs be reviewed by the appropriate personnel on a timely basis, be coded to the proper federal projects if eligible for reimbursement and that claims for reimbursement be filed immediately. Management should also consider strengthening current procedures to finalize or revise project agreements on a more timely basis or remediating the system to minimize the costs that are being suspended from billings. We also recommend that management ensure that project reports and timesheets be reviewed carefully to ensure that the employees time are being charged to the proper codes,

**Department of Transportation – Highways Division
State of Hawaii**

**Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2000**

especially for the federally-funded projects. Otherwise, the Division may be jeopardizing the loss of additional federal funds and related interest earnings which may be due to the Division.

**Department of Transportation – Highways Division
State of Hawaii**

**Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2000**

**Section II – Financial Statements Findings –
Status of Prior Year Findings**

The following is a brief discussion of the current status of prior year comments.

Reportable Conditions

99-1 Accounting and Internal Reporting Procedures Should be Improved

The June 30, 1999 final trial balances were not generated until mid March 2000 due to difficulties encountered in remediating the HWYAC system for the Year 2000 as well as unreconciled differences between the Division's HWYAC trial balance and the State's accounting records (FAMIS). The Division was able to identify and adjust certain unreconciled differences.

We also noted that the Division does not review the HWYAC "Status of Allotment by Appropriation" and FAMIS "Status of Appropriation Account Balances" to ensure that the contract agreement allotments reported on the State Department of Accounting and General Services (DAGS) Form A-15 "Allotment Advice" and the Division's Form DOT 4-116 "Job Authorization Form" were properly input into the respective accounting systems. Undetected differences may result in negative appropriation balances and intensive investigation if the information has not been reviewed on a timely basis.

Status:

Similar instances were noted in the current year. See current year schedule of findings and questioned costs Item 00-1.

**Department of Transportation – Highways Division
State of Hawaii**

**Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2000**

99-2 Unbilled Federal Receivables

At June 30, 1999, the Division incurred unbilled expenditures of approximately \$5 million, which may have been reimbursable from the federal government and therefore were not reflected as receivables and federal grants-in-aid revenue, pending the qualification for reimbursement by the Division. Reasons attributed were a) the system could not distinguish which federal projects should be charged for labor costs when the projects were funded by more than one federal appropriation due to coding limitations, and b) project agreements and modifications may not have been approved, although costs were being incurred.

Status:

Similar instances were noted in the current year. See current year schedule of findings and questioned costs Item 00-2.

**Department of Transportation – Highways Division
State of Hawaii**

**Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2000**

**Section III – Federal Award Findings and Questioned Costs –
Current Year Findings**

Program	Findings of Noncompliance	Questioned Costs
U.S. Department of Transportation, Highway Planning and Construction, CFDA No. 20.205	<p>00-3 For eight projects related to 20 payroll transactions tested, we reviewed compliance with the Davis-Bacon Act and noted the following instances of noncompliance:</p> <p>For five projects, 7 certified payroll reports were not submitted by the contractors within seven calendar days after the regular payment date of the payroll period and no written notifications of the delinquency of the payroll reports were submitted to the contractors or subcontractors. IM-H1-1(219), STP-0300(66), I-H3-1(75) U2, BR-H1-1(226), and STP-030-1(31).</p> <p>Additionally, for one project, the Division did not receive 3 consecutive certified payroll reports from a subcontractor as of our testing date and no written notification of delinquency was sent. STP-0360(7).</p> <p>Recommendation: We recommend that procedures be established to ensure written notifications are submitted to the contractors within a certain time period for failure to submit the certified payroll report.</p>	Not Applicable

**Department of Transportation – Highways Division
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**Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2000**

**Section III – Federal Award Findings and Questioned Costs –
Current Year Findings**

Program	Findings of Noncompliance	Questioned Costs
U.S. Department of Transportation, Highway Planning and Construction, CFDA No. 20.205	<p>00-4 For eight projects related to 20 transactions tested, we reviewed compliance with project agreements and noted the following instance of procedural noncompliance:</p> <p>For one transaction tested, the contract ledger did not reflect the quantity used to support the progress payment. STP-0360(7).</p> <p><i>Recommendation:</i> We recommend that progress payments be checked against the contract ledger to ensure that payment is made for actual quantities used.</p>	Not Applicable

**Department of Transportation – Highways Division
State of Hawaii**

**Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2000**

**Section III – Federal Award Findings and Questioned Costs –
Status of Prior Year Findings**

The following is a brief discussion of the current status of comments from the prior year schedule of federal award findings and questioned costs:

99-3 In reviewing 20 transactions relating to eight projects in the prior year, we noted that the contract ledger was not reviewed on a timely basis for two projects.

Status:

We noted no similar instances of noncompliance in the current year. As such, comment no longer applicable.

99-4 For five of the eight projects tested, the certified payroll reports were not submitted by the contractor within seven calendar days and no written notifications of delinquency of the payroll reports were submitted to the contractor or subcontractors.

Status:

We noted similar instances of noncompliance in the current year. See current year finding 00-3.

99-5 We noted in the prior year that federal reimbursement of expenses and costs incurred by the State for principal, interest and related bond costs is allowed when projects are funded by eligible debt financing instruments. However, we noted that the Division did not determine the eligibility of bond and other debt financing for federal reimbursements as construction costs in accordance with the federal regulations.

Status:

The Division has not taken further action to determine the eligibility of bond and other debt financing for federal reimbursements. However, management's position is that this finding no longer warrants further action due to the following reasons:

- Two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse;
- The Federal Highway Administration (FHWA) is not currently following up with the Division on the audit finding; and
- A management decision has not been issued by the FHWA.

**Department of Transportation – Highways Division
State of Hawaii**

**Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2000**

In accordance with OMB Circular A-133, Subpart C—Auditees, Section 315, this finding will not be reported in future reports. However, as the Division should determine whether such costs are eligible for federal reimbursement, a similar comment has been reported to management in a separate letter dated March 23, 2001.