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Comments and Summary
Moody's Global Credit Research dated February 4, 2010

State of Hawaii Outlook and G.O. Rating

General Comments prepared by Aquila Distributors, Inc.

- Recently, there has been media coverage of a credit research report published by Moody's on February 4, 2010 covering their outlook for the State of Hawaii and their rating of general obligation debt issued by the state.
- Moody's *affirmed* the State of Hawaii's investment grade rating of Aa2 which, by Moody's definition, "demonstrates very strong creditworthiness".
- While, in our opinion, the media chose to focus on aspects of Moody's research report that were negative, Moody's balanced their description of the issues facing Hawaii in the current economic environment with numerous positive statements regarding the steps being taken by the state to manage the budget.
- In the full research report published by Moody's, their analyst explained that "future credit reviews will focus on the state's revenue performance and success in achieving targeted spending reductions to balance the budget." The negative outlook expressed in the research report addresses the current economic realities and Moody's opinion "regarding the likely direction of a rating over the medium term".
- Steps taken by Hawaii to address fiscal challenges and strengthen the state's financial situation were discussed in Moody's research report as positive, even though some, such as delay of income tax refunds and tax increases, may not be popular with voters.
- General obligation bonds issued by the state (and discussed in the Moody's credit research report) have a first preference on tax revenue (meaning that the funds to pay interest on the bonds are set aside before any other state obligations are paid).
- S&P, another credit rating agency, recently *affirmed* Hawaii's investment grade rating at AA with a *stable* outlook. S&P explained that their opinion was based on the state's "well-established, proactive budget monitoring practices, including frequent revenue forecast updates" and "…management has been willing to implement aggressive solutions to mitigate the effects" of declines in tourism-related revenue".

Summary of Moody's Credit Research Report dated February 4, 2010

- Moody's affirmed an earlier Aa2 rating for $4.7B of outstanding G.O. State of Hawaii debt and concurrently assigned a Aa2 rating to $312M G.O. taxable series (BAB) bonds of 2010 and $225M G.O. refunding bonds of 2010.
- The Aa2 rating incorporates the state's historical fiscal conservatism; actions to address significantly lower revenue growth; a tourism-based economy that experiences volatility tied to national and international economies; and a high debt burden.
- Credit strengths:
    - Well-established multi-year and quarterly consensus forecasting by state's council on revenues
    - Strong executive power to reduce spending, including labor related expenses
    - Historical fiscal conservatism; prompt action to address revenue shortfalls
    - Continued military housing construction helps offset slow residential and commercial markets
    - Liquidity is sufficient for the state to avoid short-term borrowing for cash flow purposes
    - No exposure to variable rate debt or derivative products

- Credit challenges:
    - Vulnerability to sudden shifts and/or extended downturn in tourism-based economy, resulting in revenue falloff and budget shortfalls
    - Significantly lower reserves reduce state's ability to address further revenue erosion
    - Large state and local government employment sector contributes to spending pressure for salary and benefit settlements
    - Debt ratios likely to remain very high given state-level capital funding, especially for education
    - Low pension funding levels and high other post-employment benefit (OPEB) liability

<u>Moody's report provides detail under the following headings:</u>

- Consecutive downward revenue revisions add budget challenges
- Adopted 2010-2011 budget incorporated ongoing and one-time solutions
- Previously strong reserve levels decline; likely to remain modest over near-term
- Conservative budget controls position the state well to manage economic downturns; state constitution requires revenue forecasts
- Economy remains weak in line with nation; recovery not expected until 2011
- Large military presence provides stable employment base
- Debt burden remains among the highest in nation; low pension funded ratio

<u>Moody's Outlook</u>

- The negative outlook reflects the state's vulnerability to further downward revenue revisions given the significant reliance on the tourism industry which has slowed dramatically and could face continued near-term headwinds given the uncertainty of economic recovery at both the national and international level.
- The outlook also reflects Hawaii's narrowed financial operations as underscored by significantly lower reserve levels and payment deferrals that indicate liquidity challenges; and out-year structural gaps due to one-time solutions already incorporated in the enacted budget and proposed for the recently identified budget shortfall.
- Hawaii continues to exhibit strong management practices demonstrated in its willingness to reduce spending, and its well-established quarterly economic and revenue forecasting process enables the state to identify budget gaps that may arise.

Conclusion

Moody's affirmed their Aa2 rating of Hawaii general obligation debt and S&P recently affirmed their AA rating. The Moody's research report is balanced and addresses both the challenges presented by the current economic environment along with steps being taken by the state to manage the budget.

The circumstances described in the research report from Moody's highlight the very valid reasons for owning a diversified mutual fund with professional, local management. We **select** the bonds in our portfolios based on our assessment of the potential return and risk, and we consistently monitor those issuers in which the fund is invested – we are making active decisions about what to own and why we own it. The investment adviser of Hawaiian Tax-Free Trust, Asset Management Group of Bank of Hawaii, continues to manage the fund in a prudent manner based on the fund's objectives of providing as high a level of current income exempt from Hawaiian state and regular Federal income taxes as is consistent with preservation of capital.

Aquila Group of Funds

For over 25 years, the Aquila Group of Funds has managed single-state municipal bond funds. For more information on the Aquila Group of Funds, you may contact your local Regional Sales Manager, call us at 800-437-1020 or visit our web site at www.aquilafunds.com.

Before investing in any one of the Aquila Group of Funds, carefully read about and consider the investment objectives, risks, charges, expenses, and other information found in the Fund prospectus. The prospectus is available from your financial advisor, and when you call 800-437-1020 or visit www.aquilafunds.com.

Consideration should be given to the risks of investing including: potential loss of value, market risk, interest rate risk, credit risk, and geographic concentration. Insurance on an obligation is intended to mitigate credit risk; it does not insure the market price of the obligation.