

Financial statements and report of independent certified public accountants

State of Hawaii, Department of Transportation, Harbors Division

June 30, 2005 and 2004

**Submitted by
The Auditor
State of Hawaii**

C O N T E N T S

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS	3
MANAGEMENT'S DISCUSSION AND ANALYSIS	5
FINANCIAL STATEMENTS	
STATEMENTS OF NET ASSETS OF THE PUBLIC UNDERTAKING	13
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS OF THE PUBLIC UNDERTAKING	14
STATEMENTS OF CASH FLOWS OF THE PUBLIC UNDERTAKING	15
NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING	16
SUPPLEMENTARY INFORMATION	
SCHEDULE 1 – CASH AND CASH EQUIVALENTS OF THE PUBLIC UNDERTAKING	41
SCHEDULE 2 – CONSTRUCTION IN PROGRESS OF THE PUBLIC UNDERTAKING	42
SCHEDULE 3 – GENERAL OBLIGATION BONDS OF THE PUBLIC UNDERTAKING	47
SCHEDULE 4 – REVENUE BONDS OF THE PUBLIC UNDERTAKING	48
SCHEDULE 5 – INCOME FROM OPERATIONS BEFORE DEPRECIATION	49
SCHEDULE 6 – HARBOR REVENUE BONDS 1997 CERTIFICATE – MINIMUM NET REVENUE REQUIREMENT OF THE PUBLIC UNDERTAKING	50

Report of Independent Certified Public Accountants

The Auditor
State of Hawaii

We have audited the accompanying statements of net assets of the Harbors Division, Department of Transportation of the State of Hawaii, relating to the Public Undertaking (Harbors Division) as of June 30, 2005 and 2004, and the related statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the management of the Harbors Division. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America as established by the Auditing Standards Board of the American Institute of Certified Public Accountants and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Harbors Division's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note A, the financial statements of the Harbors Division, are intended to present the financial position, and the changes in financial position and cash flows, of only that portion of the business-type activities of the State of Hawaii that is attributable to the transactions of the Harbors Division. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2005 and 2004, and the changes in its financial position and its cash flows for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Harbors Division as of June 30, 2005 and 2004, and the changes in its net assets and its cash flows for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in note O to the financial statements, the State of Hawaii is a defendant in a lawsuit filed by the Office of Hawaiian Affairs (OHA) related to the inclusion of certain revenues received by the State of Hawaii through the Harbors Division in determination of ceded lands payments due to OHA.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 15, 2005, on our consideration of the Harbors Division's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that

The Auditor
State of Hawaii

report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The Management's Discussion and Analysis on pages 5 through 12 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements. The supplementary information included in Schedules 1 through 6 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

A handwritten signature in black ink that reads "Grant Thornton LLP". The signature is fluid and cursive, with "Grant" on the top line, "Thornton" on the middle line, and "LLP" on the bottom line.

Honolulu, Hawaii
November 15, 2005

State of Hawaii
Department of Transportation
Harbors Division

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2005 and 2004

This section of the Harbors Division, Department of Transportation of the State of Hawaii, relating to the Public Undertaking (Harbors Division) financial report, presents the reader with an introduction and overview of the Harbors Division's financial performance for the fiscal years ended June 30, 2005 and 2004. This discussion has been prepared by management and should be read in conjunction with the financial statements, and the notes thereto, which follow this section.

The statewide system of commercial harbors consists of ten harbors on six islands. The system plays a vital role in Hawaii's economy as the ports serve as the primary means for goods to enter and exit the state. Hawaii imports approximately 80% of what it consumes, the majority of which enters the state through the commercial harbors system.

The Harbors Division is self-sustaining. The Department of Transportation (DOT) is authorized to impose and collect rates and charges for the harbors system services and properties to generate revenues to fund operating expenses. The Capital Improvements Program (CIP) is also funded by the Harbors Division's revenues and proceeds from the issuance of harbors system revenue bonds.

FINANCIAL HIGHLIGHTS

- The Harbors Division's net assets were \$574.1 million in 2005 compared to \$559.1 million in 2004, an increase of 2.7%.
- Wharfage revenues were \$39.9 million in 2005 compared to \$36.9 million in 2004, an increase of 8.1%.
- Total expenses were \$64.7 million in 2005 compared to \$54.4 million in 2004, an increase of 18.9%.

Total operating revenues, decreased by 0.4% from \$74.8 million in fiscal year 2004 to \$74.5 million in fiscal year 2005. Total operating revenues increased by 1.6% from \$73.6 million in fiscal year 2003 to \$74.8 million in fiscal year 2004.

The majority of operating revenues are directly related to cargo and ship operations. Service revenues, which include wharfage, dockage and passenger fees, generated \$52.9 million in fiscal year 2005, an increase of \$4.2 million or 8.6% over fiscal year 2004. The increase in revenues was primarily due to a \$3.0 million increase in wharfage revenue due to a 7% rise in container movements and a 3.5% increase in auto activities. During the fiscal year 2005, Matson Navigation Company, Inc. (Matson), our largest customer, replaced two older ships with larger capacity ships and Young Brothers, Ltd. chartered two additional barges. Pasha Hawaii Transport Lines introduced auto service to the State in March 2005, offering roll on/roll off service for vehicles between the U.S. Mainland and Hawaii. In addition, Matson continues to report growth after expanding its auto service in 2004. Service revenues increased \$1.1 million or 2.3% from fiscal year 2003 to 2004 mainly due to an increase in wharfage revenues. In 2004, Matson expanded its auto service by adding a roll-on/roll-off vessel enhancing its auto-carrying capability.

Approximately 1.5 million passengers (inbound and outbound) passed through these harbors in fiscal year 2005, an increase of 15.4% over fiscal year 2004's 1.3 million passengers. Fiscal year 2004's 1.3 million passengers was a decrease of 18.8% over fiscal year 2003's 1.6 million passengers. Passenger fee revenue for fiscal years 2005, 2004 and 2003 were \$3.6 million, \$3.3 million and \$4.2 million respectively. The 9.6% revenue increase from 2004 to 2005 is

State of Hawaii
Department of Transportation
Harbors Division

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2005 and 2004

due to growth in the number of cruise ship passengers. The drop in passengers and revenues from 2003 to 2004 were primarily the result of Norwegian Cruise Line's (NCL) reduction from two to one ship in 2004.

Since December, 2001, NCL has operated passenger cruises that included a required stopover in the Republic of Kirabati (Fanning Island) to comply with federal restrictions on foreign flagged vessels. In 2003, NCL obtained an exemption from federal maritime law to operate three foreign built ships under the U.S. flag in Hawaii. One of these ships, the Pride of Aloha, commenced service among the islands in July 2004. Passengers on the Pride of Aloha taking a continuous trip whose point of origin and termination is a state port were charged a total in-transit fee of \$1.85 under the tariff for disembarking and embarking. Other passengers are assessed a \$2.50 passenger fee for embarking and a \$2.50 for disembarking under the tariff. While passenger counts increased by 15.4% in 2005 over 2004, revenues increased by 9.6% as approximately 20.6% of the 2005 passengers were in-transit. NCL's second U.S. flagged vessel, the Pride of America, began service in Hawaii in July, 2005. NCL expects to commence service with its third U.S. flagged ship, the Pride of Hawaii, in June, 2006.

Gross rental revenues in fiscal years 2005, 2004 and 2003, were \$27.3 million, \$27.4 million and \$25.4 million respectively. The increase of \$2.0 million or 7.9% from fiscal years 2003 to 2004 was primarily due to Matson Terminal Inc.'s rental of exclusive use of space to support their roll-on/roll-off operations. Net rental revenues after deducting the provision for doubtful accounts were \$20.3 million for 2005 and \$25.1 million in 2004 and 2003. The provision for doubtful accounts for the fiscal year ending June 30, 2005, was approximately \$7.0 million. During 2005, allowances were made for various long-standing doubtful accounts, including the Aloha Tower Development Corporation. See note Q.

Operating expenses excluding depreciation increased by 31.1% from \$29.6 million in fiscal year 2004 to \$38.8 million in fiscal year 2005. Expenses decreased by \$7.5 million or 20.2% from 2003 to 2004. The increase from 2004 to 2005 of \$9.2 million is primarily due to an approximate \$7.1 million increase in maintenance expenses. The increase is primarily due to a greater number of special maintenance and repair projects undertaken in the fiscal year. Operational expenses increased by \$1.5 million from 2004 to 2005 primarily due to approximately \$831,000 in additional security expenses, increases in utilities costs and other expenses. Personnel services expenses increased by approximately \$785,000 primarily due to collective bargaining pay increases and increases in accrued vacation. The decrease from 2003 to 2004 is primarily due to the reduction in ceded land assessments of \$11.7 million (which included fiscal year 2003 and 2002 assessments) paid by the Harbors Division in fiscal year 2003 compared to \$6.5 million paid in fiscal year 2004, a decrease of \$5.2 million. The remaining \$2.3 million decrease in operating expenses were primarily due to delays in completing special maintenance projects. These delays were due to problems encountered in obtaining permits and the long construction cycle to complete major projects.

The Harbors Division issued \$52,030,000 Harbor System Revenue Bonds, Series A and B, 2004, in June 2004 to refund bonds issued in 1993 and 1994 at higher interest rates. The refunding will realize cash flow savings of approximately \$7.6 million over the next twenty years. There were no bonds issued in fiscal year 2005.

On September 18, 2003, outstanding \$16,500,000 Special Facility Revenue Bonds, Matson Terminals, Inc., Refunding Series 1993 were redeemed in full at a price of 102% of the principal together with interest accrued to the redemption

State of Hawaii
 Department of Transportation
 Harbors Division

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2005 and 2004

date. The remaining net investment in direct lease financing on the date of redemption was reclassified to buildings during 2004.

A summary of operations and changes in net assets for the fiscal years ended June 30, 2005, 2004 and 2003 follows:

Table 1
 Condensed Statements of Revenues,
 Expenses and Changes in Net Assets
 (in thousands of dollars)

	As of June 30,			2005 – 2004		2004 – 2003	
	2005	2004	2003	Increase (decrease)	% Change	Increase (decrease)	% Change
Operating revenues	\$74,527	\$74,768	\$73,605	\$ (241)	0%	\$ 1,163	2%
Non-operating revenues	4,791	3,900	5,043	891	23%	(1,143)	(23%)
Total revenues	79,318	78,668	78,648	650	1%	20	0%
Depreciation	15,998	13,766	13,367	2,232	16%	399	3%
Other operating expenses	38,752	29,575	37,119	9,177	31%	(7,544)	(20%)
Non-operating expenses	9,989	11,102	11,698	(1,113)	(10%)	(596)	(5%)
Total expenses	64,739	54,443	62,184	10,296	19%	(7,741)	(12%)
Income before capital contributions	14,579	24,225	16,464	(9,646)	(40%)	7,761	47%
Capital contributions	385	737	2,542	(352)	(48%)	(1,805)	(71%)
INCREASE IN NET ASSETS	<u>\$14,964</u>	<u>\$24,962</u>	<u>\$19,006</u>	<u>\$ (9,998)</u>	<u>(40%)</u>	<u>\$ 5,956</u>	<u>31%</u>

State of Hawaii
 Department of Transportation
 Harbors Division

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2005 and 2004

A condensed summary of the Harbors Division's net assets at June 30, 2005, 2004 and 2003 are shown below.

Table 2
Condensed Statements of Net Assets
 (in thousands of dollars)

	Year ended June 30,			2005 – 2004		2004 – 2003	
	2005	2004	2003	Increase (decrease)	% Change	Increase (decrease)	% Change
Current and other assets	\$193,157	\$178,332	\$184,524	\$14,825	8%	\$ (6,192)	(3%)
Capital assets	584,730	587,445	584,206	(2,715)	0%	3,239	1%
Total assets	<u>777,887</u>	<u>765,777</u>	<u>768,730</u>	<u>12,110</u>	<u>2%</u>	<u>(2,953)</u>	<u>0%</u>
Long-term debt outstanding	184,434	192,509	219,406	(8,075)	(4%)	(26,897)	(12%)
Other liabilities	19,367	14,146	15,164	5,221	37%	(1,018)	(7%)
Total liabilities	<u>203,801</u>	<u>206,655</u>	<u>234,570</u>	<u>(2,854)</u>	<u>(1%)</u>	<u>(27,915)</u>	<u>(12%)</u>
Net assets							
Invested in capital assets, net of related debt	402,787	397,549	367,169	5,238	1%	30,380	8%
Restricted	10,898	10,898	10,898	–	0%	–	0%
Unrestricted	<u>160,401</u>	<u>150,675</u>	<u>156,093</u>	<u>9,726</u>	<u>6%</u>	<u>(5,418)</u>	<u>(3%)</u>
Total net assets	<u>\$574,086</u>	<u>\$559,122</u>	<u>\$534,160</u>	<u>\$14,964</u>	<u>3%</u>	<u>\$ 24,962</u>	<u>5%</u>

The largest portion of the Harbors Division's net assets (70% at June 30, 2005) represents its investment in capital assets (e.g., land, wharves, buildings, improvements, and equipment), less related indebtedness outstanding to acquire those capital assets. The Harbors Division uses these capital assets to provide services to its users of the harbors system; consequently, these assets are not available for future spending. Although the Harbors Division's investment in its capital assets is reported net of related debt, the resources required to repay this debt must be provided annually from operations, since it is unlikely the capital assets themselves will be liquidated to pay such liabilities.

The change in net assets is an indicator of whether the overall fiscal condition of the Harbors Division improved or worsened during the fiscal year. The change in net assets may serve over time as a useful indicator of the Harbor Division's financial position. The total assets exceeded liabilities by approximately \$574 million at June 30, 2005, and net assets increased by approximately \$15 million from June 30, 2004, and by \$25 million from June 30, 2003 to June 30, 2004.

State of Hawaii
 Department of Transportation
 Harbors Division

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2005 and 2004

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

As of June 30, 2005, the Harbors Division had \$585 million invested in capital assets as shown in Table 3. There was a net decrease (additions, deductions and depreciation) of \$2.7 million from the end of the prior fiscal year.

Table 3
 Capital Assets
 (in thousands of dollars)

	Year ended June 30,			2005 – 2004		2004 – 2003	
	2005	2004	2003	Increase (decrease)	% Change	Increase (decrease)	% Change
Land and land improvements	\$ 364,872	\$ 360,237	\$347,038	\$ 4,635	1%	\$ 13,199	4%
Wharves	222,065	221,285	190,499	780	0%	30,786	16%
Other improvements	74,908	74,908	74,636	–	0%	272	0%
Buildings and improvements	51,238	51,077	48,425	161	0%	2,652	5%
Equipment	9,997	10,769	10,876	(772)	(7%)	(107)	(1%)
Subtotal	723,080	718,276	671,474	4,804	1%	46,802	7%
Less accumulated depreciation	(173,081)	(157,697)	(144,101)	(15,384)	10%	(13,596)	9%
Subtotal	549,999	560,579	527,373	(10,580)	(2%)	33,206	6%
Construction in progress	34,731	26,866	56,833	7,865	29%	(29,967)	(53%)
Total	<u>\$ 584,730</u>	<u>\$ 587,445</u>	<u>\$ 584,206</u>	<u>\$ (2,715)</u>	<u>0%</u>	<u>\$ 3,239</u>	<u>1%</u>

Major capital asset additions to the statewide harbors system for the fiscal year ended June 30, 2005, included the following:

- \$724,000 Methane Mitigation, Piers 36-38, Honolulu Harbor, Oahu
- \$304,000 Methane Mitigation, Parcels 2 and 38, Honolulu Harbor, Oahu
- \$378,000 Upgrade Perimeter Fencing at Nawiliwili Harbor, Kauai

In addition to these capital asset additions, the Harbors Division is currently constructing the following projects statewide:

- \$25.0 million Pier 2 Cruise Terminal, Honolulu Harbor, Oahu
- \$2.1 million Replacement of Pier 3 Fendering System at Nawiliwili Harbor, Kauai
- \$4.3 million Ferry Terminal at Pier 19, Honolulu Harbor, Oahu.
- \$2.2 million Pier 1 Comfort Station, waterline and sewer line improvements, Kahului Harbor, Maui

State of Hawaii
Department of Transportation
Harbors Division

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2005 and 2004

- \$4.0 million Pier 3 breasting dolphins and catwalks, Hilo Harbor, Hawaii
- \$3.6 million Reconstruction of Puunene Container Yard, Kahului Harbor, Maui
- 5.5 million Segmented Pier 3 improvements, Nawiliwili Harbor, Kauai

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

- \$20.0 million Reconstruction of Pier 51B Container Yard, Honolulu Harbor, Oahu
- \$26.0 million Reconstruction of Pier 52 & 53 Container Yard, Sand Island, Oahu
- \$35.0 million Construction of Inter-Island Cargo Terminal Facility at Hilo Harbor, Hawaii
- \$6.0 million Construction of CBP Facilities and Other Improvements for Pier 2 Cruise Terminal, Honolulu Harbor, Oahu
- \$1.0 million Passenger Gangway at Pier 2 Cruise Terminal, Honolulu Harbor, Oahu
- \$600,000 Methane Mitigation, Pier 38, Lease Parcel 8, Honolulu Harbor, Oahu
- \$550,000 Security Surveillance System for Neighbor Island Passenger Terminals, Statewide
- \$750,000 Statewide Maritime Identification Credentialing System
- \$315,000 Crash Barrier Gates for Container Terminals, Honolulu Harbor
- \$37.4 million Design and Build Barges and Vehicle Ramp Systems for Inter-Island Ferry Service, Statewide

The Harbors Division is committed under contracts awarded for capital improvement projects totaling approximately \$39.3 million as of June 30, 2005.

Additional information regarding the Harbors Division's capital assets can be found in note D.

Indebtedness

Harbors System Revenue Bonds and Reimbursable General Obligation Bonds

As of June 30, 2005, \$189,890,000 of harbors system revenue bonds was outstanding compared to \$198,440,000 as of June 30, 2004. The last series of "new money" bonds to fund capital improvement projects, was issued in April 2000. The Harbors Division has managed its debt levels by issuing refunding bonds and defeasing bonds with unencumbered cash from the Harbors Revenue Fund. On June 10, 2004, Harbors issued Harbor System Revenue Bond Series 2004 A and B, in the amount of \$52,030,000, for the purpose of refunding outstanding Harbor Revenue Bond Series 1994 and Refunding Series 1993.

As of June 30, 2005, \$111,281 of reimbursable general obligation bonds issued for the harbors system was outstanding, compared to \$130,743 as of June 30, 2004. These bonds are general obligations of the State. Since the

State of Hawaii
Department of Transportation
Harbors Division

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2005 and 2004

proceeds were used to finance improvements to the harbors system, Harbors Division is required to reimburse the State General Fund for the payment of the principal and interest on such bonds.

Special Facility Lease and Revenue Bonds

As of June 30, 2005 and 2004, there were no outstanding bond obligations compared to the June 30, 2003 outstanding balance of \$16,500,000. On September 18, 2003, outstanding \$16,500,000 Special Facility Revenue Bonds, Matson Terminals, Inc. (MTI), Refunding Series 1993 were redeemed in full by MTI at a price of 102% of the principal with interest accrued to the redemption date.

Additional information regarding the Harbors Division's indebtedness can be found in notes E, F, G, H, and I.

Credit Rating and Bond Insurance

All harbor system revenue bonds issued since 1997 have been issued with bond insurance. As of June 30, 2005, the underlying ratings for harbor system revenue bonds were as follows:

- Standard and Poor's A+
- Moody's Investors Service A1
- Fitch IBCA, Inc. A+

Ratings made by Standard and Poor's, Moody's Investors Service, and Fitch IBCA, Inc. may be changed, suspended or withdrawn as a result of changes in, or unavailability of, information. Ratings provided by these rating companies are not "market ratings," as the ratings are not a recommendation to buy, hold, or sell any security.

Bond Covenants

Bond covenants allow the issuance of additional debt, on parity, as to a lien on the net revenues of the Harbors Division provided certain net revenue ratios are met. Net revenues of the Harbors Division must be at least 1.35 or 1.25 times the debt service requirements under the 1990 and 1997 Harbor Revenue Bond Certificates, respectively. As a result of the issuance of Harbor System Revenue Bonds, Series A and B, 2004, none of the 1990 Certificate Harbors Revenue Bonds remained outstanding upon the issuance of the Series 2004 Bonds. No further bonds will be issued under the 1990 Certificate.

The Harbors Division currently enjoys a coverage ratio of 2.82 under the 1997 Harbor Revenue Bond Certificate as compared to the prior fiscal year's ratio of 2.42.

Currently Known Facts, Decisions, or Conditions

Act 178, Session Laws of Hawaii 2005, appropriated reimbursable general obligation bonds of \$20 million each year, FY 2006 and FY 2007, for harbor improvements needed to support the operations of Hawaii Superferry, Inc. (HSF).

State of Hawaii
Department of Transportation
Harbors Division

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2005 and 2004

Details on the reimbursement schedule are still being determined by the Department of Budget and Finance. The Harbors Division expects interest only repayments to begin in FY 2006. See Note V.

REQUEST FOR INFORMATION

The financial report is designed to provide a general overview of the Harbors Division's finances for all interested parties. Questions concerning any of the information provided in this report or requests for additional information should be addressed in writing to the Harbors Administrator, State of Hawaii, Department of Transportation, Harbors Division, 79 S. Nimitz Highway, Honolulu, Hawaii 96813, or by e-mail to glenn.okimoto@hawaii.gov.

State of Hawaii
Department of Transportation
Harbors Division

STATEMENTS OF NET ASSETS OF THE PUBLIC UNDERTAKING

June 30,

ASSETS	2005	2004	LIABILITIES AND NET ASSETS	2005	2004
CURRENT ASSETS			CURRENT LIABILITIES (payable from current assets)		
Cash and cash equivalents (notes B and C)	\$ 89,201,548	\$ 76,192,844	Accounts payable	\$ 1,662,302	\$ 1,734,202
Receivables			Accrued workers' compensation	149,442	155,189
Accounts receivable, less allowance for doubtful accounts of \$14,681,000 in 2005 and \$9,896,000 in 2004	7,228,293	10,757,205	Contracts payable, including retainages	946,903	332,552
Interest	1,174,219	802,679	Accrued vacation (notes B and E)	595,178	525,105
Grant	724,589	1,040,168	Due to Department of Budget and Finance	1,238,703	1,261,993
Other	177,327	299,631			
Materials and supplies, at cost	28,449	45,495	Total current liabilities (payable from current assets)	4,592,528	4,009,041
Prepaid insurance and others	23,800	23,800			
Total current assets	98,558,225	89,161,822			
RESTRICTED ASSETS			CURRENT LIABILITIES (payable from restricted assets)		
Current			Contracts payable, including retainages	4,878,762	1,759,953
Cash and cash equivalents (notes B and C)	92,107,590	86,556,797	Matured revenue bonds and interest payable	5,100	10,200
Total current restricted assets	92,107,590	86,556,797	Revenue bonds payable, current maturities (note F)	8,475,257	8,029,313
			General obligation bonds payable, current maturities (note I)	20,688	19,462
			Accrued interest payable	5,086,683	4,191,580
			Security deposits	2,715,237	2,606,788
			Total current liabilities (payable from restricted assets)	21,181,727	16,617,296
CAPITAL ASSETS (notes B and D)			LONG-TERM LIABILITIES		
Non-depreciable facilities			Accrued workers' compensation	303,615	222,881
Land	164,404,484	164,404,485	Long-term debt, less current maturities		
Land improvements	76,086,739	74,223,157	Revenue bonds payable, net (note F)	175,847,237	184,348,867
Other improvements	66,908	66,908	General obligation bonds payable (note I)	90,593	111,281
	240,558,131	238,694,550	Accrued vacation (notes B and E)	1,784,800	1,345,363
Depreciable facilities			Total non-current liabilities	178,026,245	186,028,392
Land improvements	124,313,276	121,542,847			
Wharves	222,064,599	221,284,577	Total liabilities	203,800,500	206,654,729
Other improvements	74,907,783	74,907,783			
Buildings	51,238,436	51,077,048			
Equipment	9,997,197	10,769,362			
	482,521,291	479,581,617			
Less accumulated depreciation	173,080,604	157,697,125			
	309,440,687	321,884,492			
Construction in progress	34,731,207	26,866,167			
OTHER ASSET			NET ASSETS		
Unamortized bond issue costs	2,490,975	2,613,075	Invested in capital assets, net of related debt	402,787,225	397,549,361
			Restricted - reserved for revenue bond requirements	10,897,658	10,897,658
			Unrestricted net assets	160,401,432	150,675,155
			Total net assets	574,086,315	559,122,174
	\$777,886,815	\$765,776,903			

The accompanying notes are an integral part of these statements.

State of Hawaii
 Department of Transportation
 Harbors Division

**STATEMENTS OF NET ASSETS OF THE PUBLIC UNDERTAKING
 OF THE PUBLIC UNDERTAKING**

Fiscal year ended June 30,

	2005	2004
Operating revenues, net		
Services	\$ 52,922,707	\$ 48,657,768
Rentals	20,256,475	25,125,270
Others	1,347,501	985,135
	<u>74,526,683</u>	<u>74,768,173</u>
Operating expenses before depreciation		
Personal services	11,541,230	10,756,552
Harbor operations	10,824,219	9,277,336
Maintenance	9,979,185	2,915,374
State of Hawaii, surcharge for central service expenses (note P)	2,698,964	2,766,405
Fireboat operations (note P)	1,596,781	1,704,790
General administration	1,138,582	1,420,991
Department of Transportation, general administration expenses (note P)	972,529	733,531
	<u>38,751,490</u>	<u>29,574,979</u>
Income from operations before depreciation	35,775,193	45,193,194
Depreciation	<u>15,998,257</u>	<u>13,766,433</u>
Income from operations	19,776,936	31,426,761
Nonoperating income (expense)		
Interest income		
Deposits in investment pool	4,791,636	3,664,514
Investment in direct financing lease	-	236,050
Interest expense (note J)		
Revenue bonds	(9,197,432)	(10,246,336)
Special facility revenue bonds	-	(207,945)
General obligation bonds	(4,888)	(5,647)
Amortization of bond discount, issue costs and loss on refunding	(616,414)	(630,998)
Loss on disposal of capital assets	(170,599)	(12,064)
	<u>(5,197,697)</u>	<u>(7,202,426)</u>
Income before contributions	14,579,239	24,224,335
Capital contributions	<u>384,902</u>	<u>737,366</u>
INCREASE IN NET ASSETS	14,964,141	24,961,701
Net assets at beginning of year	<u>559,122,174</u>	<u>534,160,473</u>
Net assets at end of fiscal year	<u>\$574,086,315</u>	<u>\$559,122,174</u>

The accompanying notes are an integral part of these statements.

State of Hawaii
Department of Transportation
Harbors Division

STATEMENTS OF NET ASSETS OF THE PUBLIC UNDERTAKING

Fiscal year ended June 30,

	<u>2005</u>	<u>2004</u>
Cash flows from operating activities:		
Cash received from customers	\$ 78,286,348	\$ 74,188,910
Cash paid to suppliers	(23,480,257)	(17,760,562)
Cash paid to employees	(11,031,720)	(10,893,276)
Net cash provided by operating activities	<u>43,774,371</u>	<u>45,535,072</u>
Cash flows from capital and related financing activities:		
Government grants received in aid of construction	700,485	1,442,076
Acquisition and construction of capital assets	(13,453,676)	(14,721,646)
Proceeds from sale of revenue bonds	-	53,315,009
Principal paid on bonds	(8,574,562)	(63,094,929)
Premium paid on bond refunding	-	(949,330)
Interest paid on bonds	(8,307,217)	(12,004,895)
Bond issuance costs paid	-	(843,407)
Net cash used in capital and related financing activities	<u>(29,634,970)</u>	<u>(36,857,122)</u>
Cash flows from investing activities		
Interest received on investments	<u>4,420,096</u>	<u>3,659,510</u>
Net cash provided by investing activities	<u>4,420,096</u>	<u>3,659,510</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	<u>18,559,497</u>	<u>12,337,460</u>
Cash and cash equivalents at beginning of fiscal year	<u>162,749,641</u>	<u>150,412,181</u>
Cash and cash equivalents at end of fiscal year	<u>\$ 181,309,138</u>	<u>\$ 162,749,641</u>
Reconciliation of operating income to net cash provided by operating activities:		
Income from operations	\$ 19,776,936	\$ 31,426,761
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation	15,998,257	13,766,433
Provision for doubtful accounts	6,998,851	2,253,832
Changes in assets and liabilities:		
(Increase) decrease in:		
Receivables, net	(3,347,635)	(2,939,225)
Materials and supplies	17,046	(7,899)
Increase (decrease) in:		
Payables	3,661,260	1,065,764
Accrued vacation	509,510	(136,724)
Accrued workers' compensation	74,987	-
Due to Department of Budget and Finance	(23,290)	-
Security deposits	108,449	106,130
Net cash provided by operating activities	<u>\$ 43,774,371</u>	<u>\$ 45,535,072</u>
Supplemental disclosure of noncash capital and related financing activities:		
Principal payments relating to special facility bonds	\$ -	\$ 16,500,000
Interest payments related to special facility revenue bonds	-	207,945
Amortization of bond discount, issue costs and loss on refunding	616,414	630,998
Transfer of net investment in lease financing to harbor facilities	-	2,296,279

The accompanying notes are an integral part of these statements.

State of Hawaii
Department of Transportation
Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING

June 30, 2005 and 2004

NOTE A – FINANCIAL REPORTING ENTITY

In 1959, the Harbors Division was established within the Department of Transportation of the State of Hawaii (DOT) effective July 1, 1961. All functions and powers to administer, control and supervise all State of Hawaii (State) harbors and water navigational facilities were assigned to the Director of DOT on that date.

The Harbors Division is part of DOT which is part of the executive branch of the State. The Harbors Division's financial statements reflect only its portion of the proprietary fund type. The State Comptroller maintains the central accounts for all state funds and publishes financial statements for the State annually, which include the Harbors Division's financial activities.

The "Certificate of the Director of Transportation Providing for the Issuance of 1997 State of Hawaii Harbor Revenue Bonds," dated March 1, 1997 (1997 Certificate), define the "Undertaking" as all of the harbor and waterfront improvements and other properties under the jurisdiction, control and management of the Harbors Division, except those principally used for recreation and the landing of fish.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Measurement Focus and Basis of Accounting

The accounting policies of the Harbors Division conform to accounting principles generally accepted in the United States of America as applicable to enterprise activities of governmental units as promulgated by the Governmental Accounting Standards Board (GASB). In accordance with GASB standards, the Harbors Division has elected not to apply the Financial Accounting Standards Board pronouncements on accounting and financial reporting that were issued after November 30, 1989.

An enterprise fund is used to account for the acquisition, operation and maintenance of government facilities and services that are entirely or predominantly supported by user charges. The Harbors Division's operations are accounted for on the flow of economic resources measurement focus and the accrual basis of accounting is utilized. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

2. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

3. Cash and Cash Equivalents

Cash and cash equivalents, for the purpose of the statements of cash flows, include all cash and investments with original maturities of three months or less. Cash and cash equivalents also include investments of pooled cash balances. The Director of Finance invests state treasury cash surpluses where funds can be disbursed at any time without prior notice or penalty. As a result, the cash balances are not reduced for these investments.

State of Hawaii
Department of Transportation
Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4. Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are reported at their gross value when earned, reduced by an allowance for doubtful accounts.

Accounts are written-off upon the approval of the Department of the Attorney General, when it believes, after considering economic conditions, business conditions, and collection efforts, that the accounts are uncollectible.

The allowance for doubtful accounts is increased by charges to operating income and decreased by charge-offs (net of recoveries). Management's periodic evaluation of the adequacy of the allowance is based on the adverse situations that may affect the customer's ability to repay, historical experience and current economic conditions. Past due status is determined based on contractual terms.

5. Risk Management

The Harbors Division is exposed to various risks for losses related to torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees. A liability for a claim for a risk of loss is established if information indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss is reasonably estimable.

6. Capital Assets and Depreciation

Capital assets are stated at cost. Depreciation of capital assets is computed using the straight-line method over the estimated useful lives of the assets. Depreciation is not provided for in the year of acquisition, but is provided for the entire year in the year of disposal. Disposals of assets are recorded by removing the cost and related accumulated depreciation from the accounts with the resulting gain or loss reflected in non-operating income or expense.

Capital assets and their related straight-line rates used to compute depreciation are as follows:

	Rates	Capitalization Threshold
Land improvements	1.0% – 4.0%	\$100,000
Wharves	1.0% – 10.0%	100,000
Buildings	1.5% – 20.0%	100,000
Other improvements	2.0% – 20.0%	100,000
Equipment	8.0%	5,000

Maintenance and repairs, as well as minor replacements, renewals and betterments, are charged to operations. Major renewals, replacements and betterments are capitalized in the year incurred. Interest cost is capitalized during the period of construction for all capital improvement projects except those projects funded by grants from the State or the federal government.

State of Hawaii
Department of Transportation
Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

7. Bond Issue Costs

Costs relating to the issuance of bonds are recognized using the interest method over the term of the obligations.

8. Unamortized Debt Premium (Discount)

Debt premium (discount) is amortized ratably over the term of the related debt, and the unamortized balance is reflected as an offset against the related long-term liabilities in the statements of net assets.

9. Refunding of Debt

The difference between the reacquisition price and the net carrying amount of the old debt is deferred and amortized as a component of interest expense in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter. The deferred amount is reported as a deduction from or an addition to the new debt liability.

10. Accrued Vacation

The Harbors Division accrues all vacation and compensatory pay at current salary rates, including additional amounts for certain salary-related expenses associated with the payment of compensated absences, in accordance with GASB Statement No. 16, *Accounting for Compensated Absences*. Vacation is earned at the rate of 168 hours per calendar year, depending on employee's date of hire. Accumulation of such vacation credits is limited to 720 hours at calendar year end and is convertible to pay upon termination of employment.

11. Operating Revenues

Operating revenues are those that result from providing goods and services. It excludes revenues related to capital and related financing activities, noncapital financing activities, or investing activities. Operating revenues are reported net of the provision for doubtful accounts which were \$6,998,851 and \$2,253,832 for the years ended June 30, 2005 and 2004, respectively.

12. Capital Contributions

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

13. Reclassifications

Reclassifications have been made to the 2004 financial statements to conform to the classifications used in 2005.

State of Hawaii
 Department of Transportation
 Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE C – CASH AND INVESTMENTS

At June 30, 2005 and 2004, information relating to the insurance and collateral of cash deposits is not available since such information is determined on a statewide basis and not for individual departments or divisions. Cash deposits of the State are either federally insured or collateralized with obligations of the State or the United States. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State.

Statutes authorize the Harbors Division to invest, with certain restrictions, in obligations of the State or the United States, in federally insured savings accounts, time certificates of deposit and repurchase agreements with federally insured banks and savings and loan associations authorized to do business in the State. Money held as reserves may be invested in obligations of the United States, the State or any subdivision of the State. Investments are insured or collateralized with securities held by the State or by its agent in the State's name.

NOTE D – CAPITAL ASSETS

The changes in capital assets were as follows:

	Balance July 1, 2004	Additions	Deductions	Balance June 30, 2005
Nondepreciable assets				
Land and improvements	\$238,694,550	\$ 1,863,581	\$ –	\$240,558,131
Depreciable assets				
Land improvements	121,542,847	2,770,429	–	124,313,276
Wharves	221,284,577	780,022	–	222,064,599
Other improvements	74,907,783	–	–	74,907,783
Buildings	51,077,048	161,388	–	51,238,436
Equipment	10,769,362	89,437	861,602	9,997,197
Total at historical cost	718,276,167	5,664,857	861,602	723,079,422
Less accumulated depreciation for:				
Land improvements	27,934,288	5,000,701	–	32,934,989
Wharves	73,805,986	6,453,153	–	80,259,139
Other improvements	25,415,470	2,366,282	–	27,781,752
Buildings	21,772,282	1,431,711	–	23,203,993
Equipment	8,769,099	746,410	614,778	8,900,731
Total accumulated depreciation	157,697,125	15,998,257	614,778	173,080,604
Construction in progress	26,866,167	18,563,768	10,698,728	34,731,207
	\$587,445,209	\$ 8,230,368	\$10,945,552	\$584,730,025

State of Hawaii
 Department of Transportation
 Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE D – CAPITAL ASSETS (continued)

	Balance July 1, 2003	Additions	Deductions	Balance June 30, 2004
Nondepreciable assets				
Land and improvements	\$238,694,550	\$ –	\$ –	\$238,694,550
Depreciable assets				
Land improvements	108,342,951	13,199,896	–	121,542,847
Wharves	190,499,253	30,785,324	–	221,284,577
Other improvements	74,636,071	271,712	–	74,907,783
Buildings	48,425,083	2,651,965	–	51,077,048
Equipment	<u>10,875,730</u>	<u>75,888</u>	<u>182,256</u>	<u>10,769,362</u>
Total at historical cost	671,473,638	46,984,785	182,256	718,276,167
Less accumulated depreciation for:				
Land improvements	23,803,713	4,130,575	–	27,934,288
Wharves	68,743,714	5,062,272	–	73,805,986
Other improvements	23,139,295	2,276,175	–	25,415,470
Buildings	20,229,924	1,542,358	–	21,772,282
Equipment	<u>8,184,238</u>	<u>755,053</u>	<u>170,192</u>	<u>8,769,099</u>
Total accumulated depreciation	144,100,884	13,766,433	170,192	157,697,125
Construction in progress	<u>56,833,027</u>	<u>14,705,389</u>	<u>44,672,249</u>	<u>26,866,167</u>
	<u><u>\$584,205,781</u></u>	<u><u>\$47,923,741</u></u>	<u><u>\$44,684,313</u></u>	<u><u>\$587,445,209</u></u>

Depreciation expense was \$15,998,257 and \$13,766,433 for the fiscal years ended June 30, 2005 and 2004, respectively.

NOTE E – LONG-TERM LIABILITIES

The changes in long-term liabilities were as follows:

	Balance July 1, 2004	Additions	Deductions	Balance June 30, 2005	Current	Noncurrent
Accrued vacation	\$ 1,870,468	\$ 1,708,762	\$ 1,199,252	\$ 2,379,978	\$ 595,178	\$ 1,784,800
Accrued workers' compensation	378,070	233,145	158,158	453,057	149,442	303,615
Revenue bonds	198,440,000	–	8,550,000	189,890,000	9,025,000	180,865,000
General obligation bonds	<u>130,743</u>	<u>–</u>	<u>19,462</u>	<u>111,281</u>	<u>20,688</u>	<u>90,593</u>
Subtotal carried forward	\$200,819,281	\$ 1,941,907	\$ 9,926,872	\$192,834,316	\$ 9,790,308	\$183,044,008

State of Hawaii
 Department of Transportation
 Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE E – LONG-TERM LIABILITIES (continued)

	Balance July 1, 2004	Additions	Deductions	Balance June 30, 2005	Current	Noncurrent
Subtotal brought forward	\$200,819,281	\$ 1,941,907	\$ 9,926,872	\$192,834,316	\$9,790,308	\$183,044,008
Less						
Unamortized discount	(2,054,400)	–	(142,940)	(1,911,460)	(141,418)	(1,770,042)
Unamortized premium	1,384,600	–	189,102	1,195,498	231,816	963,682
Unamortized deferred loss on refunding	<u>(5,392,020)</u>	<u>–</u>	<u>(540,476)</u>	<u>(4,851,544)</u>	<u>(640,141)</u>	<u>(4,211,403)</u>
	<u>\$194,757,461</u>	<u>\$ 1,941,907</u>	<u>\$ 9,432,558</u>	<u>\$187,266,810</u>	<u>\$9,240,565</u>	<u>\$178,026,245</u>
	Balance July 1, 2003	Additions	Deductions	Balance June 30, 2004	Current	Noncurrent
Accrued vacation	\$ 2,007,192	\$ 697,732	\$ 834,456	\$ 1,870,468	\$ 525,105	\$ 1,345,363
Accrued workers' compensation	–	663,854	285,784	378,070	155,189	222,881
Revenue bonds	209,185,000	52,030,000	62,775,000	198,440,000	8,550,000	189,890,000
Special facility revenue bonds	16,500,000	–	16,500,000	–	–	–
General obligation bonds	<u>149,772</u>	<u>–</u>	<u>19,029</u>	<u>130,743</u>	<u>19,462</u>	<u>111,281</u>
	<u>227,841,964</u>	<u>53,391,586</u>	<u>80,414,269</u>	<u>200,819,281</u>	<u>9,249,756</u>	<u>191,569,525</u>
Less						
Unamortized discount	(2,854,894)	–	(800,494)	(2,054,400)	(142,940)	(1,911,460)
Unamortized premium	111,849	1,285,009	12,258	1,384,600	189,102	1,195,498
Unamortized deferred loss on refunding	<u>(3,685,828)</u>	<u>(2,184,199)</u>	<u>(478,007)</u>	<u>(5,392,020)</u>	<u>(566,849)</u>	<u>(4,825,171)</u>
	<u>\$221,413,091</u>	<u>\$52,492,396</u>	<u>\$79,148,026</u>	<u>\$194,757,461</u>	<u>\$8,729,069</u>	<u>\$186,028,392</u>

NOTE F – REVENUE BONDS PAYABLE

Pursuant to authorization from the State Legislature, the Director of DOT issued the 1997 Certificate, which provides for the issuance of bonds at any time and from time-to-time upon compliance with certain conditions of the respective Certificate.

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

The Bonds are subject to redemption at the option of the Director of DOT and the State during specific years at prices ranging from 102-1/2% to 100% of face value.

State of Hawaii
 Department of Transportation
 Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE F – REVENUE BONDS PAYABLE (continued)

The following is a summary of the Bonds issued and outstanding at June 30, 2005:

Year of issue	Final redemption date	Interest rates	Original amount of issue	Current		Total Current	Noncurrent
				Principal due July 1, 2005	Principal due January 1, 2006		
1997	July 1, 2027	3.95 – 5.75%	\$ 56,290,000	\$ 485,000	\$ –	\$ 485,000	\$ 52,915,000
2000	July 1, 2029	4.50 – 6.00%	79,405,000	2,140,000	–	2,140,000	66,145,000
2002	July 1, 2019	3.00 – 5.50%	24,420,000	2,010,000	–	2,010,000	18,290,000
2004	January 1, 2024	2.50 – 6.00%	52,030,000	–	4,390,000	4,390,000	43,515,000
			<u>\$212,145,000</u>	<u>\$4,635,000</u>	<u>\$4,390,000</u>	9,025,000	180,865,000
Less:							
		Unamortized discount				(141,418)	(1,770,042)
		Unamortized premium				231,816	963,682
		Unamortized deferred loss on refunding				(640,141)	(4,211,403)
						<u>\$8,475,257</u>	<u>\$175,847,237</u>

The following is a summary of the Bonds issued and outstanding at June 30, 2004:

Year of issue	Final redemption date	Interest rates	Original amount of issue	Current		Total Current	Noncurrent
				Principal due July 1, 2004	Principal due January 1, 2005		
1997	July 1, 2027	3.95 – 5.75%	\$ 56,290,000	\$ 470,000	\$ –	\$ 470,000	\$ 53,400,000
2000	July 1, 2029	4.50 – 6.00%	79,405,000	2,035,000	–	2,035,000	68,285,000
2002	July 1, 2019	3.00 – 5.50%	24,420,000	1,920,000	–	1,920,000	20,300,000
2004	January 1, 2024	2.50 – 6.00%	52,030,000	–	4,125,000	4,125,000	47,905,000
			<u>\$212,145,000</u>	<u>\$4,425,000</u>	<u>\$4,125,000</u>	8,550,000	189,890,000
Less:							
		Unamortized discount				(142,940)	(1,911,460)
		Unamortized premium				189,102	1,195,498
		Unamortized deferred loss on refunding				(566,849)	(4,825,171)
						<u>\$8,029,313</u>	<u>\$184,348,867</u>

State of Hawaii
 Department of Transportation
 Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE F – REVENUE BONDS PAYABLE (continued)

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

<u>Fiscal year ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	\$ 9,345,000	\$ 9,879,000	\$ 19,224,000
2007	9,803,000	9,462,000	19,265,000
2008	9,500,000	8,982,000	18,482,000
2009	7,993,000	8,523,000	16,516,000
2010	8,425,000	8,139,000	16,564,000
2011 – 2015	41,885,000	33,835,000	75,720,000
2016 – 2020	45,683,000	21,891,000	67,574,000
2021 – 2025	37,193,000	9,028,000	46,221,000
2026 – 2029	<u>13,235,000</u>	<u>1,478,000</u>	<u>14,713,000</u>
	<u>\$183,062,000</u>	<u>\$111,217,000</u>	<u>\$294,279,000</u>

The above debt service requirements are set forth based upon funding requirements. Principal and interest payments are required to be funded in the 12-month and 6-month periods, respectively, preceding the date on which the payments are due. Accordingly, the above debt service requirements do not include debt service reserves as of June 30, 2005 which are held in anticipation of principal and interest payments due on July 1, 2005 and January 1, 2006.

On June 10, 2004, the Harbors Division issued \$5,730,000 in Bonds, Series A of 2004, and \$46,300,000 in Bonds, Series B of 2004. Series A of 2004 Bonds will mature through the year 2008 at an average interest rate of 4.20%, and Series B of 2004 Bonds will mature through the year 2024 at an average interest rate of 5.12%. The 2004 Series, totaling \$52,030,000 were issued at an average interest rate of 4.98% to refund \$5,760,000 of Bonds, 1993 Series (average interest rate of 6.09%) and \$45,765,000 of Bonds, 1994 Series (average interest rate of 6.20%). Total net proceeds of \$52,474,330 (including a premium of \$1,285,009 and after payment of \$840,679 in underwriting fees, insurance, and other issuance costs), along with an additional \$5,323,718 from the debt service reserve account, was deposited into an irrevocable trust with an escrow agent to provide for the redemption of the refunded portion of the Bonds, 1993 Series and 1994 Series, on July 1, 2004.

Although the refunding resulted in the recognition of a deferred loss of \$2,184,199, the Harbors Division in effect reduced its aggregate debt service payments by approximately \$7,573,128 over the next 20 years and obtained an economic gain (difference between present values of the old and new debt service payments) of approximately \$4,129,526.

State of Hawaii
Department of Transportation
Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE G – HARBOR REVENUE BOND REQUIREMENTS

1. 1997 Certificate

a. Minimum Net Revenue Requirement

Pursuant to Section 6.03 of the 1997 Certificate, the Harbors Division covenants and agrees that so long as any of the Bonds remain outstanding, it will enforce and collect fees, rates, rents and charges for the Public Undertaking that will yield net revenue, as defined by the 1997 Certificate, for the immediately ensuing 12 months, in an amount at least sufficient to:

- (1) The amount computed in accordance with Section 6.03 of the 1997 Certificate:
 - (a) Together with funds legally available therefore including any amounts on deposit in the harbor reserve and contingency account; an aggregate sum equal to at least 1.25 times the total amount of: (i) the interest payments for such 12 months on all the Bonds outstanding under the 1997 Certificate, (ii) the principal amount of the Bonds maturing by their terms during such 12 months and (iii) the minimum sinking fund payments for all Bonds required to be made during such 12 months; and
 - (b) Without consideration of other funds, shall be at least equal to 1.00 times the bond service for such 12 months.

The harbor revenue bond debt service requirements, including minimum sinking fund payments during the current fiscal year, computed in accordance with Section 6.03 of the 1997 Certificate totaled \$19,224,013. Net revenues of the Public Undertaking amounted to \$54,163,450 or 2.82 times the minimum net revenue requirement for the fiscal year ended June 30, 2005.

b. Harbor Special Fund

All revenues are deposited into this fund and applied in the order of priority set forth under the 1997 Certificate. Section 5.01 of the 1997 Certificate requires that the following accounts be established:

(1) Harbor Interest Account

Equal monthly installments sufficient to pay for the interest next becoming due on the Bonds are required to be paid into this account. This requirement was met as of June 30, 2005.

(2) Harbor Principal Account

Commencing with the first business day of each fiscal year, equal monthly payments are required to be made to this account sufficient to redeem the Bonds scheduled for redemption on the following July 1 and January 1. This requirement was met as of June 30, 2005.

State of Hawaii
Department of Transportation
Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE G – HARBOR REVENUE BOND REQUIREMENTS (continued)

1. 1997 Certificate (continued)

b. Harbor Special Fund (continued)

(3) Harbor Debt Service Reserve Account

In order to provide a reserve for the payment of the principal and interest on the Bonds, the Harbors Division is required to deposit in the harbor revenue special fund an amount equal to the lesser of: (a) the average annual bond service on such series and (b) the amount permitted by the Internal Revenue Code of 1986 in order that the interest on such series is excluded from gross income for federal income tax purposes.

Furthermore, the Harbors Division is required to satisfy the reserve requirement of maximum aggregate bond service by no later than the first date on which a principal installment is payable on July 1st or January 1st of each fiscal year.

In lieu of the credit of monies to the harbor debt service reserve account, the Harbors Division may cause to be so credited a surety bond or an insurance policy payable to the Harbors Division for the benefit of the holders of the Bonds of a series or a letter of credit in an amount equal to the difference between the reserve requirement and the amounts then on credit to the harbor debt service reserve account. In the event a surety bond, insurance policy, or letter of credit is secured to satisfy that portion of the reserve requirement allocable to a series of Bonds, so long as such surety bond, insurance policy, or letter of credit is in effect, the owners of such series of Bonds shall not be entitled to payment from or a lien on the funds on deposit in the harbor revenue special fund credited to the harbor debt service reserve account to satisfy that portion of the reserve requirement allocable to other series of Bonds, nor shall the owners of Bonds of such other series be entitled to any payment from such surety bond, insurance policy, or letter of credit. The surety bond, insurance policy, or letter of credit shall be payable (upon the giving of notice as required thereunder) on any date on which monies will be required to be applied from the harbor debt service reserve account to the payment of the principal or interest on any Bonds of such series and such withdrawals may not be made from amounts credited to the harbor debt service reserve account for such series of Bonds.

Prior to the use of a surety bond, insurance policy, or letter of credit pursuant to the provisions of this paragraph (other than any such use at the time of issuance of the 1997 Series bonds), DOT shall receive written confirmation from the rating agency that the rating on the Bonds outstanding as then in effect shall not be reduced as a result of such use. If a disbursement is made pursuant to a surety bond, an insurance policy, or a letter of credit provided pursuant to this paragraph, the Harbors Division shall be obligated either (a) to reinstate the maximum limits of such surety bond, insurance policy, or letter of credit or (b) to credit to the harbor debt service reserve account, funds in the amount of the disbursement made under such surety bond, insurance policy, or letter of credit, or a combination of such alternatives, as shall provide that the amount credited to the

State of Hawaii
Department of Transportation
Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE G – HARBOR REVENUE BOND REQUIREMENTS (continued)

1. 1997 Certificate (continued)

b. Harbor Special Fund (continued)

(3) Harbor Debt Service Reserve Account (continued)

harbor debt service reserve account allocable to a series of Bonds equals that portion of the reserve requirement allocable to such series; provided, however, a failure to immediately restore such reserve requirement shall not constitute an event of default if the reserve requirement is restored within the time period permitted by Section 11.01(c) (90 days following the required notice). Notwithstanding the provisions of Section 11.01(c), the Harbors Division shall not permit any surety bond, insurance policy, or letter of credit which has been established in lieu of a deposit into the harbor revenue special fund for credit to the harbor debt service reserve account to terminate or expire prior to depositing to such fund for credit to such account the amount satisfied previously by the surety bond, insurance policy, or letter of credit.

(4) Harbor Reserve and Contingency Account

Monies on credit to the harbor reserve and contingency account may be used to make up any deficiency with respect to any series of Bonds in the harbor interest account, the harbor principal account and the harbor debt service reserve account. To the extent not used to make up any such deficiencies, monies on credit to the harbor reserve and contingency account may be used for any other purpose within the jurisdiction, powers, duties and functions of the Harbors Division.

NOTE H – SPECIAL FACILITY LEASE AND REVENUE BONDS

The State Legislature, in its 1980 session, authorized the issuance of special facility revenue bonds for the construction, acquisition, remodeling, furnishing and equipping of state-owned special facilities for lease to parties engaged in maritime operations.

Pursuant to this authorization, \$15,700,000 of 8-1/2% special facility revenue bond anticipation notes were issued in 1981 to finance the construction of container terminal facilities on Sand Island for the exclusive use of Matson Terminals, Inc. In 1983, special facility revenue bonds of \$16,750,000 were issued to refund the notes and to provide additional funds for construction. On April 15, 1993, special facility revenue bonds of \$16,500,000 were issued to refund the outstanding 1983 Series bonds. The special facility lease with Matson Terminals, Inc. was accounted for as a direct financing lease.

These bonds, which bear interest at 5.75% per annum, mature on March 1, 2013, subject to optional redemption on or after March 1, 2003 at prices ranging from 102% to 100% of face value. Matson Navigation Company, Inc., parent company of the lessee, has provided a guaranty agreement as to payment of principal and interest on the bonds.

State of Hawaii
 Department of Transportation
 Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE H – SPECIAL FACILITY LEASE AND REVENUE BONDS (continued)

On September 18, 2003, the bonds were redeemed in full at a price of 102% of the principal together with interest accrued to the redemption date. The remaining net investment in direct lease financing on the date of redemption was reclassified to buildings.

NOTE I – GENERAL OBLIGATION BONDS PAYABLE

The Harbors Division is required to reimburse the State General Fund for principal and interest on the following state general obligation bonds authorized and issued to finance certain capital improvement projects of the Public Undertaking:

The following is a summary of general obligation bonds issued and outstanding at June 30, 2005:

Year of issue	Last installment due date	Interest rates	Original amount of issue	Current	Noncurrent
1992	March 1, 2012	5.15 – 6.40%	\$ 12,870	\$ 715	\$ 4,289
1993	November 1, 2010	4.00 – 5.00%	160,901	10,725	53,627
1998	April 1, 2009	5.00 – 5.25%	64,631	9,196	30,511
2001	August 1, 2015	3.40 – 5.50%	737	52	685
2002	February 1, 2015	3.60 – 5.75%	1,481	—	1,481
			<u>\$240,620</u>	<u>\$20,688</u>	<u>\$90,593</u>

The following is a summary of general obligation bonds issued and outstanding at June 30, 2004:

Year of issue	Last installment due date	Interest rates	Original amount of issue	Current	Noncurrent
1992	March 1, 2012	5.15 – 6.40%	\$ 12,870	\$ —	\$ 5,004
1993	November 1, 2010	4.00 – 5.00%	160,901	10,725	64,352
1998	April 1, 2009	5.00 – 5.25%	64,631	8,737	39,707
2001	August 1, 2015	3.40 – 5.50%	737	—	737
2002	February 1, 2015	3.60 – 5.75%	1,481	—	1,481
			<u>\$240,620</u>	<u>\$19,462</u>	<u>\$111,281</u>

State of Hawaii
Department of Transportation
Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE I – GENERAL OBLIGATION BONDS PAYABLE (continued)

Debt service requirements to maturity for general obligation bonds are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Fiscal year ending June 30,			
2006	\$ 20,866	\$ 4,151	\$ 25,017
2007	21,432	3,330	24,762
2008	21,932	2,493	24,425
2009	19,655	1,634	21,289
2010	11,663	840	12,503
2011 – 2015	5,990	339	6,329
2016	7	–	7
	<hr/> <u>\$101,545</u>	<hr/> <u>\$12,787</u>	<hr/> <u>\$114,332</u>

The above debt service requirements are set forth based upon funding requirements. Principal and interest payments are required to be funded in the 12-month and 6-month periods, respectively, preceding the date on which the payments are due. Accordingly, the above debt service requirements do not include debt service reserves as of June 30, 2005, which are held in anticipation of principal and interest payments due during the fiscal year ended June 30, 2006.

NOTE J – INTEREST COST

Total interest cost incurred for the fiscal years ended June 30, 2005 and 2004, amounted to \$10,847,813 and \$12,527,950, respectively. Of this amount, \$1,029,080 and \$1,437,024 were capitalized in the respective fiscal years as part of the construction cost of harbor facilities.

NOTE K – LEASING OPERATIONS

The Harbors Division's leasing operations consist principally of the leasing of land, wharf and building space under revocable permits and long-term leases. The revocable permits provide for tenancy on a month-to-month basis and are renewable annually at the option of the State. The long-term leases, which are classified as operating leases, expire in various years through 2058. These leases generally call for rental increases every five to ten years based on independent appraisals of the fair rental value of the leased property.

State of Hawaii
Department of Transportation
Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE K – LEASING OPERATIONS (continued)

The following is a schedule of approximate future minimum lease rentals on noncancelable operating leases as of June 30, 2005:

	<u>Amount</u>
Fiscal year ending June 30,	
2006	\$ 9,052,000
2007	8,473,000
2008	8,291,000
2009	8,356,000
2010	8,276,000
Thereafter	<u>313,155,000</u>
	<u><u>\$355,603,000</u></u>

The above schedule does not include estimated future rental revenue for certain leases beyond their first 15 years. An estimate could not be made due to rental re-openings after the fifteenth year in which rental rates will be based upon the prevailing fair value.

The Harbors Division estimates that approximately 10% of the land area (excluding submerged lands) and floor space of the harbor facilities is leased or held for lease. Information regarding the cost and related accumulated depreciation of these facilities, which is required by Statement of Financial Accounting Standards No. 13, *Accounting for Leases*, to be disclosed, is not provided because the accumulation of such data was not considered practical and because the information, when compared to the future minimum lease rentals to be received, would not be an accurate indication of the productivity of the property on lease or held for lease, due to the methods by which and the long period of time over which the properties were acquired.

NOTE L – RETIREMENT BENEFITS

1. Employees' Retirement System

Substantially all eligible employees of the Harbors Division are required by Chapter 88, Hawaii Revised Statutes (HRS), to become members of the Employees' Retirement System of the State of Hawaii (ERS), a cost-sharing multiple-employer public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. The ERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to the ERS at City Financial Tower, 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

Members of the ERS belong to either a contributory or noncontributory option. Only employees of the Harbors Division hired on or before June 30, 1984 are eligible to participate in the contributory option. Members are required by State statute to contribute 7.8% of their salary to the contributory option and the Harbors Division is required to contribute to both options at an actuarially determined rate. Contributions by

State of Hawaii
Department of Transportation
Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE L – RETIREMENT BENEFITS (continued)

1. Employees' Retirement System (continued)

the Harbors Division for the fiscal years ended June 30, 2005, 2004 and 2003 were approximately \$766,000, \$734,000 and \$738,000, respectively. The contribution rate for the fiscal years ended June 30, 2005, 2004 and 2003 was 10.82%, 9.14% and 8.87%, respectively.

2. Post-Retirement Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State provides certain health care and life insurance benefits to retired State employees. Contributions are financed on a pay-as-you-go basis. The Harbors Division's share of the expense for post-retirement health care and life insurance benefits for the fiscal years ended June 30, 2005 and 2004, was approximately \$599,000 and \$595,000, respectively.

NOTE M – COMMITMENTS

1. Construction and Other Service Contracts

The Harbors Division is committed under contracts awarded for construction and other services. These commitments amounted to approximately \$49,496,000 at June 30, 2005.

2. Accumulated Sick Leave Pay

Employees earn sick leave credits at the rate of 14 hours for each month of service depending on the employee's hire date. Unused sick leave may be accumulated without limitation and is not convertible to pay upon termination of employment. Accordingly, no liability for sick pay is recorded. However, for public employees who retire or leave government service in good standing with sixty days or more of unused sick leave, the unused sick leave is converted to additional retirement service credit at the rate of one additional month of service for each 20 days of unused sick leave. Accumulated sick leave as of June 30, 2005 approximated \$5,726,000.

3. Deferred Compensation Plan

The State offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all state employees, permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

All plan assets are held in a trust fund to protect them from claims of general creditors. The State has no responsibility for loss due to the investment or failure of investment of funds and assets in the plan, but does have the duty of due care that would be required of an ordinary prudent investor. Accordingly, the assets and liabilities of the State's deferred compensation plan are not reported in the State's or Harbors Division's financial statements.

State of Hawaii
Department of Transportation
Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE N – RISK MANAGEMENT

The Harbors Division is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; workers' compensation and acts of terrorism. The State generally retains the first \$250,000 per occurrence of property losses and the first \$3 million with respect to general liability claims. Losses in excess of those retention amounts are insured with commercial insurance carriers. The limit per occurrence for property losses is \$25 million (\$10 million for earthquake, named hurricane, and flood) and the annual aggregate for general liability losses per occurrence is \$7 million.

The State is generally self-insured for workers' compensation and automobile claims. The State's estimated reserve for losses and loss adjustment costs includes the accumulation of estimates for losses and claims reported prior to fiscal year end, estimates (based on projections of historical developments) or claims incurred but not reported, and estimates of costs for investigating and adjusting all incurred and unadjusted claims. Amounts reported are subject to the impact of future changes in economic and social conditions. The State believes that, given the inherent variability in any such estimates, the reserves are within a reasonable and acceptable range of adequacy. Reserves are continually monitored and reviewed, and as settlements are made and reserves adjusted, the differences are reported in current operations. A liability for a claim is established if information indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss is reasonably estimable.

NOTE O – CEDED LANDS

In 1898, the former Republic of Hawaii transferred certain lands to the United States. Upon Hawaii's admission to the Union 1959, the United States reconveyed title to those lands (collectively, the ceded lands) to the State to be held as a public trust for five purposes: (1) public education; (2) betterment of the conditions of native Hawaiians; (3) development of farm and home ownership; (4) making public improvements; and (5) provision of land for public use. In 1978, the State Constitution was amended expressly to provide that the ceded lands were to be held as a public trust for native Hawaiians and the general public, and to establish the Office of Hawaiian Affairs (OHA) to administer and manage the proceeds and income derived from a pro rata portion of the ceded lands to better the conditions of native Hawaiians.

In 1979, the State Legislature adopted HRS Chapter 10 (Chapter 10), which, as amended in 1980, specified, among other things, that OHA expend 20% of all funds derived by the State from the ceded lands for the betterment of native Hawaiians.

In 1987, in *Trustees of the Office of Hawaiian Affairs v. Yamasaki*, 69 Haw. 154 (1987), the Hawaii Supreme Court concluded that Chapter 10 was insufficiently clear regarding the amount of monies OHA was entitled to receive from the public trust lands.

In 1990, in response to *Yamasaki*, the State Legislature adopted Act 304, Session Laws of Hawaii 1990, which (1) defined "public land trust" and "revenue," (2) reiterated that 20% of the now defined "revenue" derived from the "public land trust" was to be expended by OHA for the betterment of native Hawaiians, and (3) established a

State of Hawaii
Department of Transportation
Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE O – CEDED LANDS (continued)

process for OHA and the Director of Finance to jointly determine the amount of monies which the State would pay OHA to retroactively settle all of OHA's claims for the period June 16, 1980 through June 30, 1991. Since fiscal year 1992 and until the first quarter of fiscal year 2002, the State, through its departments and agencies, paid 20% of "revenues" to OHA on a quarterly basis.

In 1993, the State Legislature enacted Act 35, Session Laws of Hawaii 1993, appropriating \$136.5 million to pay the amount determined to be OHA's claims, with interest, for the period June 16, 1980 through June 30, 1991.

On January 14, 1994, OHA and its Board of Trustees (the Plaintiffs) filed suit against the State (*OHA, et al. v. State of Hawaii, et al.*, Civil No. 94-0205-01 (First Circuit)) (OHA I), claiming that the amount paid to OHA was inadequate and alleging that the State had failed to properly account for and fully pay the pro rata share of proceeds and income derived from the public land trust. Among other things, the Plaintiffs sought an accounting of all proceeds and income, funds and revenue derived from the public land trust since 1978, and restitution or damages amounting to 20% of the proceeds and income derived from the public land trust, as well as interest thereon. In its answer to OHA's complaint, the State denied all of the Plaintiff's substantive allegations, and asserted its sovereign immunity from suit and other jurisdictional and claim-barring defenses.

The Plaintiffs thereafter filed four motions for partial summary judgment as to the State's liability to pay OHA 20% of monies it receives from (1) the Department of Transportation Airports Division's in-bound duty free airport concession (including receipts from the concessionaire's off-airport sales operations), (2) the State-owned and operated Hilo Hospital, (3) the State's public rental housing projects and affordable housing developments, and (4) interest income, including investment earnings (collectively, the Sources). In response, the State filed a motion to dismiss on the basis of sovereign immunity and opposed Plaintiff's four motions on the merits and raised several affirmative defenses.

On October 24, 1996, the Circuit Court filed an order denying the State's motion to dismiss and rejecting its affirmative defenses. Also on October 24, 1996 the Circuit Court filed an order granting Plaintiff's four motions for partial summary judgment with respect to the State's liability to pay OHA 20% of the monies it receives from each of the Sources, and deferred establishing amounts owed from those Sources for further proceedings or trial. The State's motion for leave to file an interlocutory appeal from both the order denying its motion to dismiss and the order granting Plaintiff's four partial summary judgments was granted and all proceedings in the suit were stayed pending the Hawaii Supreme Court's disposition of the State's appeal.

On September 12, 2001, the Hawaii Supreme Court concluded OHA I by holding in *OHA v. State of Hawaii* 96 Haw. 388 (2001) that Act 304 was effectively repealed by its own terms, and that there was no judicially manageable standard by which to determine whether OHA was entitled to the revenues it sought from the Sources because the repeal of Act 304 revived the law which the Hawaii Supreme Court in *Yamasaki* had previously concluded was insufficiently clear to establish how much OHA was entitled to receive from the ceded lands. The Hawaii Supreme Court dismissed the case for lack of justiciability, that is, that the case was not appropriate for review by the Court, noting that it was up to the State Legislature to enact legislation to give effect to the right of native Hawaiians to benefit from the ceded lands under the State Constitution. Immediately thereafter, agencies ceased paying OHA the receipts from the ceded lands.

State of Hawaii
Department of Transportation
Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE O – CEDED LANDS (continued)

The State Legislature took no action during the 2002, 2003 and 2004 legislative sessions to establish a new mechanism for establishing how much OHA was entitled to receive from the ceded lands. On January 10, 2003, and pending legislative action to establish such a mechanism, the Governor issued Executive Order No. 03-03 directing state agencies to resume transferring 20% of receipts from leases, licenses and permits indisputably paid for the use of improved or unimproved parcels of ceded lands to OHA, if federal or state law did not preclude all or any portion of the receipt from being used to better the conditions of native Hawaiians, and the transfer of all or any portion of the receipt to OHA would not cause the agency to renege on a preexisting pledge, rate covenant, or other preexisting obligation to holders of revenue bonds or other indebtedness of the State or the agency. During the 2003 legislative session, the State Legislature appropriated moneys from the various funds into which the ceded lands receipts had been deposited after the decision in *OHA I* was issued and agencies ceased making payments to OHA, and directed the agencies to pay them to OHA.

OHA continues to pursue its claims for a portion of the revenues from the Sources and other Ceded Lands that it made to *OHA I*. On July 21, 2003, OHA filed a new lawsuit, *OHA et al. V. State of Hawaii, et al.*, Civil No. 03-1-1505-07 (*OHA II*). There follows additional background information pertinent to *OHA II*. In September 1996, the Office of the Inspector General of the U.S. Department of Transportation (DOT) issued a report (the IG Report) concluding that from 1992 to 1995, the Hawaii Department of Transportation's payment to OHA of \$28.2 million was a diversion of airport revenues in violation of applicable federal law as OHA provided no airport services in return. The Attorney General of Hawaii disagreed with the IG Report's conclusion, stating in November 1996 that the payments to OHA were simply an operating cost of the airports, and thus not a diversion of airport revenues in violation of federal law. In April 1997, the Acting Administrator of the FAA concurred in writing (the FAA Memorandum) with the IG Report and opposed the Hawaii Attorney General's position. In support of its appeal of the circuit court's *OHA I* decision to the Hawaii Supreme Court, but differing with the original position of the Attorney General, the State noted in its May 1997 amended opening brief that "unless the federal government's position set forth in the IG Report changes, Act 304 prohibits the State from paying OHA airport-related revenues." In its June 1997 reply brief, the State stated that the "DOT Inspector General's determination shows that the federal government is on its way to finding such payments illegal and requiring the State to reimburse past payments of airport-related revenues to OHA." In October 1997, the Department of Transportation and Related Agencies Appropriation Act, 1998, PL 105-66, 1997 HR 2169 (the DOT Appropriation Act) was enacted into federal law. Section 340 of the DOT Appropriation Act (Section 340) essentially provides that in exchange for there being no further payments of airport revenues for claims related to Ceded Lands, any such payments received prior to April 1, 1996 need not be repaid. The Hawaii Attorney General submitted enactment of Section 340 to the Hawaii Supreme Court in December 1997, "for the Court's use" in conjunction with the *OHA I* appeal, whereupon the Court requested the parties to submit supplemental briefs to address whether Section 340 affected the Court's interpretation of Act 304. The State, in its March 1998 supplemental brief, stated, inter alia, that paying OHA a pro rata share of airport monies violated federal law, and that there was no live, ripe controversy regarding those payments because the DOT appropriation Act relieved the State and OHA of any obligation to return improper past payments.

Despite the adverse *OHA I* decision, the Plaintiffs in *OHA II* sued the State for alleged breaches of fiduciary duties as purported trustee of the Ceded Lands public trust, alleged violations of Act 304, Chapter 10, and Article

State of Hawaii
Department of Transportation
Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE O – CEDED LANDS (continued)

XII, Sections 4, 5 and 6 of the Hawaii Constitution, violations of the Contract Clause of the U.S. Constitution, and misrepresentation and non-disclosure, by the following alleged acts (but not limited to these acts): (1) failing to oppose the positions set forth in the FAA Memorandum; (2) resolving its dispute with the FAA by obtaining a forgiveness of the prior \$28.2 million payment in exchange for a promise not to make future airport revenue payments to OHA and not to appeal the positions set forth in the FAA Memorandum; (3) breaching the trust duty of impartiality by not opposing the positions set forth in the FAA Memorandum in order to use them as a sword in *OHA I*; (4) failing to timely advise OHA that the State was not going to continue to oppose the positions set forth in the FAA Memorandum or IG Report, and that it was planning to settle with the federal government, in order to provide OHA with a fair opportunity to take measures to step into the State's position to oppose the FAA; and (5) failing to obtain instructions from the Court on how to proceed given the State's conflict between defending the State against OHA in *OHA I*, and having a duty to oppose the positions set forth in the FAA Memorandum.

OHA further alleges that these alleged “breaches, errors and omissions” were substantial factors that resulted in the passing of Section 340 and the issuance of the Hawaii Supreme Court’s opinion in *OHA I*. Plaintiffs claim that, accordingly, the State is liable to OHA for damages including, but not limited to: (1) the damages alleged by OHA in *OHA I*, and (2) amounts payable under Act 304 that have not been paid, including but not limited to, airport landing fees. Plaintiffs also sought declaratory and injunctive relief ordering the State to reinstate Act 304, pay airport-related revenues to OHA from sources other than airport revenues (and enjoining the State and its agents, employees, and officials from opposing any of the above), and sought appointment of an independent trustee to temporarily replace the State as trustee of the native Hawaiian public trust with respect to matters relating to reinstatement of Act 304 and the payment of airport-related revenues to OHA from sources other than airport revenues. The State filed a motion to dismiss OHA’s complaint in *OHA II* which the Court granted in an order filed on December 26, 2003. The Court entered a final judgment on May 19, 2004, encompassing the order dismissing the complaint and several procedural orders. On June 8, 2004, OHA filed a notice of appeal from the portions of the May 19, 2004 judgment dismissing its complaint in *OHA II*, denying leave to amend the complaint and denying a request for bifurcation of OHA’s claims for liability and damages. The Hawaii Supreme Court affirmed the Circuit Court’s order dismissing OHA’s complaint in a decision issued September 9, 2005. OHA has asked the Court to reconsider its decision, and the Court has given itself until November 15, 2005 to respond to the request.

The State intends to vigorously defend against all of OHA’s claims. It is currently unable to predict with reasonable certainty the magnitude of its potential liability for such claims, if any. Accordingly, no estimate of loss has been recorded in the accompanying financial statements of the Harbors Division. The State Attorney General is of the view that the claims asserted by OHA in *OHA II* are meritless. Resolution of all of the OHA’s claims could have a material adverse effect on the Harbors Division’s financial condition.

In a second lawsuit, OHA and four individuals filed complaints for declaratory and injunctive relief on November 4, 1994, and November 9, 1994 (*OHA v. Housing Finance and Development Corporation et al.*, Civil No. 94-4207-11 (1st Cir.)) to enjoin the State from alienating any Ceded Lands and extinguishing any rights Hawaiians may have in Ceded Lands that may be alienated. Alternatively, OHA sought a declaration that the amounts the

State of Hawaii
Department of Transportation
Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE O – CEDED LANDS (continued)

Housing Finance and Development Corporation (now, the Housing and Community Development Corporation of Hawaii or the Corporation) and the State paid to OHA for Ceded Lands the Corporation planned to use to develop and sell housing units pursuant to Act 318, 1992 Session Laws of Hawaii, were insufficient. Act 318 established a separate process for valuing the Ceded Lands the Corporation used for its two housing developments at Kealakehe and Lahaina, and quantifying the amounts of income and proceeds from the Ceded Lands that the Corporation and State were required to pay to OHA for conveying and using the parcels for the Corporation's two projects.

In December 2002, following a trial on the issues, the trial court confirmed the State's authority to sell ceded lands, denied the declaratory ruling that the sale of ceded lands did not directly or indirectly release or limit Hawaiians' claims to those lands which the plaintiffs requested, and ordered that judgment be entered in the State's and Corporation's favor as to Counts I, II, and III of the Amended Complaint. The plaintiffs moved for and were granted leave to file immediate appeals from the court's rulings to the Hawaii Supreme Court. Those appeals are now pending. Trial to determine the sufficiency of the proceeds paid to OHA from the sale of the particular parcels of ceded lands at issue has not been scheduled.

In a third lawsuit, OHA filed suit against the Hawaii Housing Authority (HHA and now the Corporation), the executive director of the HHA, the board members of the HHA and the Director of Finance on July 27, 1995 (OHA v. HHA, et al., Civil No. 95-2682-07 (1st Cir)) to secure additional compensation and an itemized accounting of the sums previously paid to OHA for five specifically identified parcels of Ceded Lands which were transferred to the HHA for its use to develop, construct, and manage additional affordable public rental housing units under HRS Chapter 201G. On January 11, 2000, all proceedings in this suit were stayed pending the Hawaii Supreme Court's decision in the State's appeal in *OHA I*. OHA disagrees that the repeal and revival of the pre-Yamasaki law by the Hawaii Supreme Court's September 12, 2001 decision in *OHA I* should also require dismissal of the claims OHA makes in OHA v. HHA, and the case remains pending.

Amounts payable to OHA are treated as operating expenses of DOT's commercial harbors system. Assessments of \$6,520,111 and \$6,517,123 for the fiscal years ended June 30, 2005 and 2004, respectively, are included as an operating expense in the statements of revenues, expenses and changes in net assets.

NOTE P – TRANSACTIONS WITH OTHER GOVERNMENT AGENCIES

The State assesses a surcharge of 5% for central service expenses on all receipts of the Harbors Division, after deducting any amounts pledged, charged or encumbered for the payment of bonds and interest during the fiscal year. The assessments amounted to \$2,698,964 and \$2,766,405 for the fiscal years ended June 30, 2005 and 2004, respectively.

The Harbors Division is assessed a percentage of DOT's general administration expenses. The assessments amounted to \$972,529 and \$733,531 for the fiscal years ended June 30, 2005 and 2004, respectively.

The Harbors Division incurred costs of \$1,596,781 and \$1,704,790 for fireboat operation services provided by the City and County of Honolulu during the fiscal years ended June 30, 2005 and 2004, respectively.

State of Hawaii
Department of Transportation
Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE P – TRANSACTIONS WITH OTHER GOVERNMENT AGENCIES (continued)

The Small Boat Harbors Boating Program (Program) was transferred from DOT to the Department of Land and Natural Resources (DLNR) in fiscal year 1992. Services performed by the Harbors Division for the Program are fully reimbursed by the Program. Services rendered to the Program during the fiscal years ended June 30, 2005 and 2004 amounted to \$96,140 and \$100,636, respectively.

NOTE Q – ALOHA TOWER COMPLEX DEVELOPMENT

The Aloha Tower Development Corporation (ATDC) is a state agency established under HRS Chapter 206J, primarily to redevelop the Aloha Tower complex. The complex encompasses Piers 5 to 23 of Honolulu Harbor. In September 1993, the Harbors Division entered into a lease with ATDC transferring to ATDC portions of the Aloha Tower complex. ATDC is required annually to reimburse the Harbors Division for any losses in revenues during the term of the lease caused by any action of ATDC or the developer and to provide replacement facilities for maritime activities at no cost to the Harbors Division.

In September 1993, the ATDC subleased lands surrounded by Piers 8 and 9 and a portion of land surrounded by Pier 10 to a developer. The sublease required the developer to construct, at the developer's cost, various facilities including a Marketplace. The developer and the Harbors Division entered into a capital improvements, maintenance, operations and securities agreement (Operations Agreement). The Operations Agreement allows the Harbors Division to operate the harbor facilities.

The developer later went into bankruptcy. The subsequent operator of the Marketplace assumed the obligations of the sublease and the Operations Agreement in March of 1998. This replacement operator has also gone through a bankruptcy proceeding and there is a new operator who has assumed the same obligations. Although the Marketplace construction was substantially completed, several items on a Harbors Division construction punchlist have yet to be completed and are being pursued with the new operator.

Discussions have been on-going between the Harbors Division and ATDC to revise the provisions in the lease requiring ATDC to annually reimburse the Harbors Division for any losses in revenues during the term of the lease. The outcome of these discussions may result in an amendment of the lease which will alter the obligations of ATDC to reimburse the Harbors Division on an annual basis from and after July 1, 2004.

Revenues for the fiscal years ended June 30, 2005 and 2004 amounted to \$1,848,086 and \$1,763,995, respectively, and have been included in rental revenues in the respective fiscal year. As of June 30, 2005 and 2004, amounts due to the Harbors Division were \$9,899,449 and \$8,051,363, respectively.

NOTE R – TRANSFER OF LAND TO OTHER STATE AGENCIES

In the 1990 legislative session, the State Legislature enacted Act 86, which transferred certain lands at Kewalo Basin and Fort Armstrong under the jurisdiction of the Harbors Division to the Hawaii Community Development Authority (HCDA), a state agency which oversees the development of the Kakaako Community Development District (District).

State of Hawaii
Department of Transportation
Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE R – TRANSFER OF LAND TO OTHER STATE AGENCIES (continued)

Approximately 73 acres of the Harbors Division's land was transferred to HCDA under Act 86. Act 86 provides for HCDA to ensure due and adequate satisfaction of provisions for any covenant between the State or any county or any department or board thereof and the holders of bonds issued by the State or such county, department or board, if any.

As part of HCDA's development of the District, the western portion of the Kewalo Basin area is scheduled for redevelopment. HCDA has selected a master developer for the waterfront around Kewalo Basin. The Harbors Division has long been negotiating with HCDA to resolve issues relating to the Harbors Division's continued operation and management of Kewalo Basin until HCDA was ready to proceed with its redevelopment plans. By an informal understanding, the Harbors Division retained all revenues generated from its management of Kewalo Basin and continued to manage maritime operations and provide for maintenance and capital improvements during this interim period. While fee title to Kewalo Basin was transferred to HCDA under Act 86, SLH 1990, the law was silent as to the transfer of the improvements. As of June 30, 2005, the Harbors Division recorded approximately \$4.5 million as the remaining depreciated value of its Kewalo improvements. Legal advice has been rendered that all improvements as well as the fee simple title transferred as a result of the law. The Harbors Division is discussing the orderly transfer of all responsibilities relating to Kewalo Basin to HCDA in light of HCDA's development schedule. Issues to be resolved include whether HCDA will provide compensation to the Harbor Division for the remaining depreciated value of the Kewalo improvements. The outcome of these discussions may result in a loss on disposal of the Kewalo improvements in future financial statements and the elimination of the Harbors Division's management and operation of Kewalo Basin, and all revenues therefrom, as of June 30, 2006.

Within the Fort Armstrong area, consisting of Piers 1 and 2 at Honolulu Harbor, HCDA has extended Ilalo Street and realigned Forrest Avenue, both of which are major circulatory roadways in the District. Because the realignment of Forrest Avenue affected certain facilities and improvements used by harbor users, HCDA has replaced such facilities and improvements at HCDA's cost. With respect to Fort Armstrong, the Harbors Division also expects to continue operating the harbor facilities, managing adjacent land areas, and enforcing its applicable administrative rules.

The legal advice rendered on the Kewalo improvements is also applicable to the Fort Armstrong area. The Harbors Division is preparing legislation to be considered by the 2006 Legislature to return Piers 1 and 2 to the jurisdiction of the Harbors Division.

NOTE S – KAPALAMA LAND DEVELOPMENT

Between 1990 and 1993, the State acquired three parcels of land totaling approximately 61.8 acres within the Kapalama Military Reservation area, comprised primarily of areas adjacent or near to Piers 39 through 41 at Honolulu Harbor (the "KMR site"). Governor's Executive Order No. 3497 set aside two parcels comprising 40.6 acres to the Harbors Division for harbor purposes on September 24, 2002. The set-aside of the remaining 21.2-acre parcel is pending. This parcel was purchased for approximately \$34.9 million and involved the use of approximately \$8.2 million of the Department of Transportation, Airports Division's (Airports Division) funds.

State of Hawaii
Department of Transportation
Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE S – KAPALAMA LAND DEVELOPMENT (continued)

There have been ongoing efforts between the Harbors Division and Airports Division to designate the portion of the parcel to be used for their respective purposes. Discussions have also been explored regarding the possibility of the Airports Division selling its interest in the parcel to the Harbors Division. As a result, action on the issuance of a further Executive Order for the remaining parcel has been deferred until the matter could be resolved.

During the past year, the Harbors Division intensified its efforts to plan for the future development of the KMR site. The intended improvements will involve the creation of a new cargo container yard and vessel berthing piers. In support of this development effort, the Harbors Division established the Hawaii Harbors Project Office to lead and coordinate the development of the KMR site improvements. Legal advice has been rendered that current efforts seeking an Executive Order for the remaining parcel as noted above should cease and that in order to transfer Airports Division's interest in the KMR site to Harbors, Airports Division must be repaid \$8.2 million, the amount it contributed to the purchase price of the KMR site.

The Harbors Division is also seeking the transfer of approximately 11.344 acres of ceded lands that were previously promised to the Airports Division near the KMR site to consolidate the lands needed for the future development. The resolution of this matter is dependent upon Airports Division's compliance with certain steps outlined in the legal advice rendered, based on a clarification from the FAA on the State's land ownership procedures and the FAA's requirement of receipt of fair market value on land disposal.

NOTE T – ARBITRAGE

The Harbors Division is required to annually calculate rebates to the U.S. treasury on the harbor revenue bonds issued from 1986. In accordance with the requirements of Section 148 of the Internal Revenue Code of 1986, as amended, rebates are calculated by bond series based on the amount by which the cumulative amount of investment income exceeds the amount that would have been earned had funds been invested at the bond yield. In the opinion of management, rebates payable as of June 30, 2005, if any, are not material to the financial statements. Accordingly, no rebates payable have been recorded in the accompanying financial statements.

NOTE U – CONTINGENCIES

1. Environmental Issues

The Harbors Division is subject to laws and regulations relating to the protection of the environment. The Harbors Division has been identified by the State Department of Health as a potentially responsible party, for petroleum contamination in the Honolulu Harbor/Iwilei area. Pursuant thereto, the Harbors Division entered into a voluntary agreement with the Department of Health and other third parties to share in the responsibility for the investigation and potential remediation of petroleum contamination in the Iwilei District. This group of potentially responsible parties known as the Iwilei District Participating Parties ("IDPP"), has conducted various investigations to determine potential contamination in the Iwilei area from 1997 to present, which investigations have determined the existence of petroleum contamination at various

State of Hawaii
Department of Transportation
Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2005 and 2004

NOTE U – CONTINGENCIES (continued)

1. Environmental Issues (continued)

locations. Potential remedial alternatives are still being studied. At this stage, the project has not yet advanced to the stage where total costs to the IDPP can reasonably be estimated, due to (1) the extent of environmental impact, (2) the undetermined allocation among the potentially responsible parties, (3) the ongoing review of reasonable remediation alternatives, and (4) continued discussion with the regulatory authorities. As a result, it is not possible to reasonably estimate the amount of the potential cost to the IDPP and of the share of the Harbor's Division; and if there would be a material impact to the Harbor's Division's financial statements. Accordingly, no estimate of loss has been recorded in the accompanying financial statements.

2. Litigation

The Harbors Division is subject to a number of lawsuits arising in the ordinary course of its operations. While the ultimate liabilities, if any, in the disposition of these matters are presently difficult to estimate, it is management's belief that the outcomes are not likely to have a material adverse effect on the Harbors Division's financial position. Accordingly, no provisions for any liabilities that might result have been made in the accompanying financial statements.

NOTE V – SUBSEQUENT EVENTS

Act 178, Session Laws of Hawaii 2005, appropriated reimbursable general obligation bonds of \$20.0 million each year, FY 2006 and FY 2007, for harbor improvements needed to support the operations of Hawaii Superferry, Inc. (HSF). HSF plans to begin inter-island ferry service with its first ferry to Maui and Kauai from Honolulu in April, 2007 and to the island of Hawaii approximately 18 months later. The Harbors Division will be responsible for debt service payments on the bonds. The Harbors Division has executed a \$37.5 million contract for the construction of barges and ramps with a current authorized expenditure limitation of \$20 million, with an additional \$17.5 million to be encumbered in FY 2007. Expenditure of the balance of this appropriation is planned to finance other harbor upgrades needed to support the operations of HSF.

SUPPLEMENTARY INFORMATION

State of Hawaii
 Department of Transportation
 Harbors Division

CASH AND CASH EQUIVALENTS OF THE PUBLIC UNDERTAKING

June 30, 2005

Unrestricted cash and cash equivalents	<u>\$ 89,201,548</u>
Restricted cash and cash equivalents	
For construction	66,613,879
For matured revenue bonds and interest coupons payable	5,100
For general obligation bond debt service payments	10,655
For revenue bond debt service payments	11,915,794
For security deposits	2,664,504
For revenue bond harbors reserve and contingency account	<u>10,897,658</u>
	<u>92,107,590</u>
	<u><u>\$ 181,309,138</u></u>
With Director of Finance, State of Hawaii	\$ 181,288,538
With fiscal agents	5,100
On hand	<u>15,500</u>
TOTAL	<u><u>\$ 181,309,138</u></u>

State of Hawaii
Department of Transportation
Harbors Division

CONSTRUCTION IN PROGRESS OF THE PUBLIC UNDERTAKING

Fiscal year ended June 30, 2005

Project	Balance at July 1, 2004	Additions by source of funds				Transfer out	Balance June 30, 2005
		Harbor Special Fund	Harbor Revenue Bonds	Capitalized interest			
Statewide:							
Removal of architectural barriers	\$ 445,916	\$ 24,312	\$ -	\$ -	\$ 470,228	\$ -	
Site survey and installation of controls	969	-	-	-	969	-	
Various commercial harbor improvements	15,418	467,646	-	12,939	-	496,003	
Screening Equipment for Neighbor Island Passenger Terminals	-	4,255	-	110	-	4,365	
Maritime Workers Identification System, Statewide	-	8,789	-	228	-	9,017	
Security Surveillance System for Neighbor Island Passenger Terminals	-	18,161	-	472	-	18,633	
Installation of Septic System at Harbor Agent's Office, Kalaeloa BP &	-	45,713	-	1,189	-	46,902	
Inter-Island Ferry System, Statewide	-	100,827	-	2,621	-	103,448	
Barges & Vehicle Ramp Systems for Inter-Island Ferry Service, Statewide	-	2,564	-	67	-	2,631	
Honolulu Harbor:							
Repair and Repaint Exterior of CFS No. 2, Fort Armst	2,611	110,347	-	-	112,958	-	
Petroleum, oil and lubricant remediation study	858,667	88,629	-	-	-	947,296	
Lead paint and asbestos study	220,730	5,746	(4,200)	-	222,276	-	
Sand Island tunnel feasibility study	1,111,152	-	-	11,608	-	1,122,760	
Piers 24-29 shed demolition and site improvement	1,800,549	473	-	-	1,801,022	-	
Sand Island container yard reconstruction	2,137,421	-	-	91,594	-	2,229,015	
Harbor planning	253,447	-	-	-	-	253,447	
Demolition of storage tanks	112,454	414,520	8,260	15,496	-	550,730	
Pier 19 ferry and cruise passenger terminal	5,792,797	172,008	-	99,516	-	6,064,321	
Pier 2 cruise ship terminal	1,474,750	9,929,328	-	314,199	-	11,718,277	
Risk assessment for Piers 36-38	464,052	(18,039)	-	-	446,013	-	
Substructure Repairs at Piers 8 and 9	185	216,594	-	-	216,779	-	
Replace lift station at Pier 27	228,962	16,285	-	-	245,247	-	
Bulkhead improvements at Piers 25-28	1,013,077	6,239	-	-	1,019,316	-	
Bullrail installation	1,106,578	1,249	-	54,714	-	1,162,541	
Environmental investigation near Pier 32	6,971	1,392	-	359	-	8,722	
Revetment Repairs at Pier 39, Honolulu Harbor	-	12,268	-	-	12,268	-	
Dredge Ewa end of Pier 51A	596,896	9,634	-	29,357	-	635,887	
Environmental Remediations Piers 36-38	849,808	87,067	-	18,164	955,039	-	
Video monitoring system	81,735	293	-	3,736	-	85,764	
Relamp floodlights at Piers 51-53	86,975	-	-	-	86,975	-	
Pile improvements at Pier 40	133,936	125	-	-	134,061	-	
Subtotal carried forward	\$ 18,796,056	\$ 11,726,425	\$ 4,060	\$ 656,369	\$ 5,723,151	\$ 25,459,759	

State of Hawaii
Department of Transportation
Harbors Division

CONSTRUCTION IN PROGRESS OF THE PUBLIC UNDERTAKING (continued)

Fiscal year ended June 30, 2005

Project	Balance at July 1, 2004	Additions by source of funds			Transfer out	Balance June 30, 2005
		Harbor Special Fund	Harbor Revenue Bonds	Capitalized interest		
Subtotal brought forward	\$ 18,796,056	\$ 11,726,425	\$ 4,060	\$ 656,369	\$ 5,723,151	\$ 25,459,759
Honolulu Harbor (continued):						
Reroof Pier 40 office building	3,597	5,543	-	-	9,140	-
Pavement improvements at Fort Armstrong	314,627	45,410	-	-	360,037	-
Risk assessment for Pier 29	55,550	2,692	-	2,816	-	61,058
Keehi Industrial Park drainage improvements	187,570	97,551	-	11,970	-	297,091
Methane Mitigation, Pier 38, Parcel 2	327,435	23,911	-	9,201	360,547	-
Piers 1-2 substructure barrier	32,188	325,319	-	2,904	360,411	-
Security surveillance system	528,218	23,992	-	4,519	-	556,729
Reconstruction of Pier 51B Container Yard	9,598	268,656	-	7,470	-	285,724
Replace Fire Alarm system at Piers 19-21	1,239	282,578	-	-	283,817	-
Replace Fire Alarm System at Pier 32 Shed	901	91,718	-	-	92,619	-
Repair Roll-up Doors at Piers 13-14 Shed	1,314	80,390	-	-	81,704	-
Construction of Mooring Bollards at Piers 19-21	8,377	51,358	-	1,759	-	61,494
Replace Fenders at Pier 39E	263	109,716	-	-	109,979	-
Repair Gutter System at Pier 39 Shed	225	113,388	-	-	113,613	-
Environmental Soil Testing and Soil Disposal	109,847	-	-	2	109,849	-
Installation of RPM system at Fort Armstrong	1,513	20,632	-	609	-	22,754
Replacement of Fireboat	-	-	(74,225)	-	(74,225)	-
Tank Farm Demolition & Pipeline Removal Near Pier 32	-	-	62,560	-	62,560	-
Repaint Shed at Piers 10 & 11	-	842	-	-	842	-
Fender Repairs at Pier 39	-	6,422	-	-	6,422	-
Crash Barriers Gates for Container Terminal	-	7,022	-	183	-	7,205
Channel Barrier	-	14,240	-	370	-	14,610
Ph I Environmental Site Assessment of the Former Kapalama Military Reserv	-	51,979	-	1,165	-	53,144
Substructure Repairs at Pier 2	-	9,678	-	-	9,678	-
Perimeter Fencing Improvement at Honolulu & Kalaeloa BPT Harbors	-	5,818	-	151	-	5,969
Methane Mitigation, Pier 38, Lease Parcel 8	-	8,657	-	225	-	8,882
Construction of CBP Facilities and Misc Improvement for Pier 2 Cruise Termi	-	89,142	-	2,318	-	91,460
Methane Mitigation Pier 38 Lease Parcel 9	-	1,782	-	47	-	1,829
Passenger gangway at Pier 2 Cruise Terminal	-	1,029	-	27	-	1,056
Extension of Pier 38 Fender System	-	4,416	-	115	-	4,531
Keehi Industrial Park Dust Mitigation	-	2,569	-	67	-	2,636
Subtotal carried forward	\$ 20,378,518	\$ 13,472,875	\$ (7,605)	\$ 702,287	\$ 7,610,144	\$ 26,935,931

State of Hawaii
Department of Transportation
Harbors Division

CONSTRUCTION IN PROGRESS OF THE PUBLIC UNDERTAKING (continued)

Fiscal year ended June 30, 2005

Project	Balance at July 1, 2004	Additions by source of funds			Transfer out	Balance June 30, 2005
		Harbor Special Fund	Harbor Revenue Bonds	Capitalized interest		
Subtotal brought forward	\$ 20,378,518	\$ 13,472,875	\$ (7,605)	\$ 702,287	\$ 7,610,144	\$ 26,935,931
Honolulu Harbor (continued):						
Construction Management & Inspection for Various Pier 2 Cruise Terminal In	-	1,598	-	42	-	1,640
Pier 29 Extension	-	3,523	-	92	-	3,615
Pier 1 lighting Improvements	-	448	-	12	-	460
Replacement of Fort Street Security Barriers at Pier 11	-	1,004	-	26	-	1,030
Removal of Petroleum Contaminated Soil from Domestic Commercial Fishing	-	121	-	3	-	124
Kewalo Basin:						
Electrical improvements	103,928	42	-	-	103,970	-
Demolition of former GRG Enterprise	93,380	22,275	-	4,838	-	120,493
Electrical repairs to Pier A	3,723	274,144	-	-	277,867	-
Substructure repairs to piers A and B	75	216,167	-	-	216,242	-
Electrical Repairs to Piers A, B & D	-	9,563	-	-	9,563	-
Kalaeloa Barbers Point Harbor:						
Modifications of Pier	491,353	283,614	-	29,283	-	804,250
Extend perimeter lighting to pier P-9	15,714	130,566	-	3,985	-	150,265
Repaint Light Poles and Service Enclosures a piers P-1, P-5, and P-6	113	88,741	-	-	88,854	-
Installation of Septic System	606	158	-	30	-	794
Pier P-7 and Storage Yard S-6	-	437	-	-	437	-
Kahului Harbor:						
Cargo yard expansion	322,777	-	-	-	322,777	-
Drainage master plan	119,193	-	-	-	119,193	-
Environmental assessment master plan	109,249	39,000	-	6,318	-	154,567
Substructure Repairs at Pier 2 extension- Phase 2	191	217,809	-	-	218,000	-
Replace air conditioning unit at Maui District Office	41	41,287	-	-	41,328	-
Pier 1c comfort station waterline and sewerline improvements	254,067	25,904	-	13,843	-	293,814
Upgrade perimeter fencing	75,636	222,229	-	9,538	-	307,403
Reconstruction of Puunene Container Yard	172,263	111,003	-	11,585	-	294,851
Construction of mooring dolphin at Pier 1c	3,551	6,493	-	324	-	10,368
Pavement repairs at Pier 1 Container Yard	41	111,063	-	-	111,104	-
Subtotal carried forward	\$ 22,144,419	\$ 15,280,064	\$ (7,605)	\$ 782,206	\$ 9,119,479	\$ 29,079,605

State of Hawaii
Department of Transportation
Harbors Division

CONSTRUCTION IN PROGRESS OF THE PUBLIC UNDERTAKING (continued)

Fiscal year ended June 30, 2005

Project	Balance at July 1, 2004	Additions by source of funds				Transfer out	Balance June 30, 2005
		Harbor Special Fund	Harbor Revenue Bonds	Capitalized interest			
Subtotal brought forward	\$ 22,144,419	\$ 15,280,064	\$ (7,605)	\$ 782,206	\$ 9,119,479	\$ 29,079,605	
Kahului Harbor (continued):							
Pier 1-C Extension	-	(3,990)	(5,939)	-	(9,929)	-	
Passenger Cruise Terminal at Pier 1A Shed	-	3,462	-	-	3,462	-	
Reconstruction of Pier 3 Container Yard	-	8,438	-	-	8,438	-	
Replace Fender System at Pier 2	-	30	-	-	30	-	
Kaumalapau Harbor							
Breakwater Repair	1,542,548	645,354	-	94,710	-	2,282,612	
Kaunakakai Harbor:							
Substructure improvement	27	-	-	-	27	-	
Commuter Ferry System Improvements	-	276	-	7	-	283	
Hilo Harbor:							
Pier 1 shed modifications	716,277	6,043	-	33,303	-	755,623	
Pier 3 breasting dolphins and catwalks	405,328	53,437	-	20,346	-	479,111	
Interisland Barge Terminal Facility	73,954	11,320	-	3,591	-	88,865	
Bullrail installation	307,701	19,401	-	5,168	332,270	-	
Substructure repairs at Piers 2 & 3	1,863	2,568	-	-	4,431	-	
Pier 1 shed waterline improvements	2,469	129,782	-	-	132,251	-	
Upgrade perimeter fencing	26,883	222,074	-	5,720	254,677	-	
Construction of Inter-island cargo terminal	4,397	7,676	-	421	-	12,494	
Geotechnical Engineering Study, Hilo Harbor	-	272	-	7	-	279	
Kawaihae Harbor:							
Repair cut-off wall	1,000	-	-	-	1,000	-	
Modifications project	246,732	215,812	-	18,033	-	480,577	
Removal of architectural barriers at overseas terminal	53	52,284	-	-	52,337	-	
Nawiliwili Harbor:							
Environmental risk assessment	39,663	78,647	-	3,757	-	122,067	
	\$ 25,513,314	\$ 16,732,950	\$ (13,544)	\$ 967,269	\$ 9,898,473	\$ 33,301,516	

State of Hawaii
Department of Transportation
Harbors Division

CONSTRUCTION IN PROGRESS OF THE PUBLIC UNDERTAKING (continued)

Fiscal year ended June 30, 2005

Project	Balance at July 1, 2004	Additions by source of funds			Transfer out	Balance June 30, 2005
		Harbor Special Fund	Harbor Revenue Bonds	Capitalized interest		
Subtotal brought forward	\$ 25,513,314	\$ 16,732,950	\$ (13,544)	\$ 967,269	\$ 9,898,473	\$ 33,301,516
Nawiliwili Harbor (continued):						
Pier 2 extension	661,335	216,500	-	36,826	-	914,661
Commercial Harbors 2020 Master Plan	63,533	119,488	-	6,320	-	189,341
Pavement Repairs at Pier 2	20,739	2,110	-	-	22,849	-
Replacement of Pier 3 fendering system	92,214	(5,036)	-	4,497	-	91,675
Upgrade perimeter fencing	208,528	231,960	-	8,169	448,657	-
Nawiliwili Harbor Channel Modifications Feasibility Study	-	225,053	-	5,850	-	230,903
Port Allen:						
Replace siding	166,443	16,673	-	-	183,116	-
Replace fireline	137,099	8,534	-	-	145,633	-
Installation of lift station and force main	2,962	-	-	149	-	3,111
	\$ 26,866,167	\$ 17,548,232	\$ (13,544)	\$ 1,029,080	\$ 10,698,728	\$ 34,731,207

State of Hawaii
 Department of Transportation
 Harbors Division

GENERAL OBLIGATION BONDS OF THE PUBLIC UNDERTAKING

June 30, 2005

State of Hawaii General Obligation Bonds	Date of Bonds	Last installment due date	Interest rate	Original amount of issue	Amount repaid	Balance at June 30, 2005		
						Current	Noncurrent	Total
Series BW	March 1, 1992	March 1, 2012	5.15 - 6.40%	\$ 12,870	\$ 7,866	\$ 715	\$ 4,289	\$ 5,004
Series CI	November 1, 1993	November 1, 2010	4.00 - 5.00%	160,901	96,549	10,725	53,627	64,352
Series CS	April 1, 1998	April 1, 2009	5.00 - 5.25%	64,631	24,924	9,196	30,511	39,707
Series CW	August 1, 2001	August 1, 2015	3.40 - 5.50%	737	-	52	685	737
Series CY	February 1, 2002	February 1, 2015	3.60 - 5.75%	1,481	-	-	1,481	1,481
				<u>\$ 240,620</u>	<u>\$ 129,339</u>	<u>\$ 20,688</u>	<u>\$ 90,593</u>	<u>\$ 111,281</u>

State of Hawaii
 Department of Transportation
 Harbors Division

REVENUE BONDS OF THE PUBLIC UNDERTAKING

June 30, 2005

	Final redemption date	Interest rate	Original amount of issue	Balance at June 30, 2005		
				Current	Noncurrent	Total
Issue of 1997	July 1, 2027	3.95 - 5.75%	\$ 56,290,000	\$ 485,000	\$ 52,915,000	\$ 53,400,000
Issue of 2000	July 1, 2029	4.50 - 6.00%	79,405,000	2,140,000	66,145,000	68,285,000
Issue of 2002	July 1, 2019	3.00 - 5.50%	24,420,000	2,010,000	18,290,000	20,300,000
Issue of 2004	January 1, 2024	2.50 - 6.00%	52,030,000	4,390,000	43,515,000	47,905,000
			<u>\$ 212,145,000</u>	<u>\$ 9,025,000</u>	<u>\$ 180,865,000</u>	<u>\$ 189,890,000</u>

State of Hawaii
Department of Transportation
Harbors Division

INCOME FROM OPERATIONS BEFORE DEPRECIATION

Fiscal year ended June 30, 2005

	Statewide	District										Total		
		Oahu			Hawaii			Maui			Kauai			
		Honolulu	Kalaao	Kewalo	Hilo	Kawaihae	Kahului	Kaunakakai	Kaumalapau	Nawiliwili	Port Allen			
Operating revenues:														
Services:														
Wharfage	\$ -	\$ 28,958,620	\$ 1,475,295	\$ -	\$ 1,640,005	\$ 2,184,955	\$ 3,979,468	\$ 147,076	\$ -	\$ 1,499,969	\$ -	\$ 39,885,388		
Passenger debark/embark	-	1,259,848	-	-	1,002,672	-	407,500	-	-	954,626	-	3,624,646		
Dockage	-	3,273,612	556,311	-	315,533	51,251	401,870	42,358	-	318,924	11,855	4,971,714		
Demurrage	-	630,184	-	-	432,454	161,903	124,623	-	-	38,837	-	1,388,001		
Port entry	-	649,046	124,850	500	96,816	38,725	105,619	12,781	-	71,800	3,162	1,103,299		
Mooring charges	-	302,348	-	753,663	44,050	-	275	10,320	-	50	305,873	1,416,579		
Cleaning wharves	-	133,185	5,435	-	-	-	1,334	-	-	8,934	3,139	152,027		
Other	-	215,434	33,303	113,984	853	10,505	756	466	-	2,638	3,114	381,053		
Total services	-	35,422,277	2,195,194	868,147	3,532,383	2,447,339	5,021,445	213,001	-	2,895,778	327,143	52,922,707		
Rentals:														
Wharf space and land	-	11,283,001	981,969	470,649	104,767	158,540	233,834	13,664	300	364,180	167,224	13,778,128		
Storage	-	2,119,055	20,015	1,350	96,012	102,279	236,066	2,113	-	323,175	12,382	2,912,447		
Automobile parking	-	800,602	-	58,150	76,607	5,566	64,736	-	-	84,551	14,364	1,104,576		
Pipelines	-	628,163	681,533	-	417,063	37,273	485,042	19,030	-	104,174	89,046	2,461,324		
Total rentals	-	14,830,821	1,683,517	530,149	694,449	303,658	1,019,678	34,807	300	876,080	283,016	20,256,475		
Others:														
Sale of utilities	-	581,071	120,786	28,803	65,171	3,278	93,168	-	-	47,174	3,815	943,266		
Miscellaneous	-	307,486	11,543	58,354	5,371	2,329	(4,474)	11,518	-	11,571	537	404,235		
Total others	-	888,557	132,329	87,157	70,542	5,607	88,694	11,518	-	58,745	4,352	1,347,501		
Total operating revenues	-	51,141,655	4,011,040	1,485,453	4,297,374	2,756,604	6,129,817	259,326	300	3,830,603	614,511	74,526,683		
Operating expenses before depreciation:														
Personal services	4,121,763	5,067,750	87,281	109,468	700,609	48,073	600,877	56,618	-	692,440	56,351	11,541,230		
Harbor operations	19,532	7,951,256	435,801	655,892	356,617	697,840	220,729	71,861	-	399,546	15,145	10,824,219		
Maintenance	477,159	5,808,148	156,177	873,492	525,171	677,123	621,437	83,512	837	276,057	480,072	9,979,185		
State of Hawaii, surcharge for central service expenses	2,698,964	-	-	-	-	-	-	-	-	-	-	2,698,964		
Fireboat operations	-	1,596,781	-	-	-	-	-	-	-	-	-	1,596,781		
General administration	914,600	150,481	309	5,924	21,130	3,536	20,619	21	-	20,472	1,490	1,138,582		
Department of Transportation, general administration expenses	972,529	-	-	-	-	-	-	-	-	-	-	972,529		
Operating expenses	9,204,547	20,574,416	679,568	1,644,776	1,603,527	1,426,572	1,463,662	212,012	837	1,388,515	553,058	38,751,490		
Allocation of statewide expenses (Note 1)	(9,204,547)	6,316,339	495,390	183,463	530,755	340,459	757,074	32,029	37	473,105	75,896	-		
Total operating expenses	-	26,890,755	1,174,958	1,828,239	2,134,282	1,767,031	2,220,736	244,041	874	1,861,620	628,954	38,751,490		
Income from operations before depreciation	\$ -	\$ 24,250,900	\$ 2,836,082	\$ (342,786)	\$ 2,163,092	\$ 989,573	\$ 3,909,081	\$ 15,285	\$ (574)	\$ 1,968,983	\$ (14,443)	\$ 35,775,193		

NOTES:

(1) Statewide expenses are allocated to the harbors based upon their respective current-year operating revenues to total current-year operating revenues for all harbors.

State of Hawaii
 Department of Transportation
 Harbors Division

**HARBOR REVENUE BONDS 1997 CERTIFICATE - MINIMUM NET
 REVENUE REQUIREMENT OF THE PUBLIC UNDERTAKING**

Fiscal year ended June 30, 2005

Net revenues, as defined by the 1997 Certificate:

Income from operations before depreciation	\$ 35,775,193
Add:	
Interest income	\$ 4,791,636
State of Hawaii, surcharge for central service expenses	2,698,964
Cash available in the harbor reserve and contingency account	<u>10,897,658</u>
	<u>18,388,258</u>
	<u><u>\$ 54,163,451</u></u>

Harbor revenue bond debt service requirements under the 1997 Certificate,
 including minimum sinking fund payments for the immediately ensuing 12 months

\$ 19,224,013

Ratio of net revenues to harbor revenue bond debt service requirements

2.82