UHERO STATE FORECAST UPDATE, PUBLIC SUMMARY

HAWAII'S TWO-SPEED RECOVERY

DECEMBER 10, 2010

Recovery edges forward in the Islands, for now primarily in tourism and mostly on Oahu. But the very rapid tourism rebound will begin to spill over to the rest of the economy in 2011.

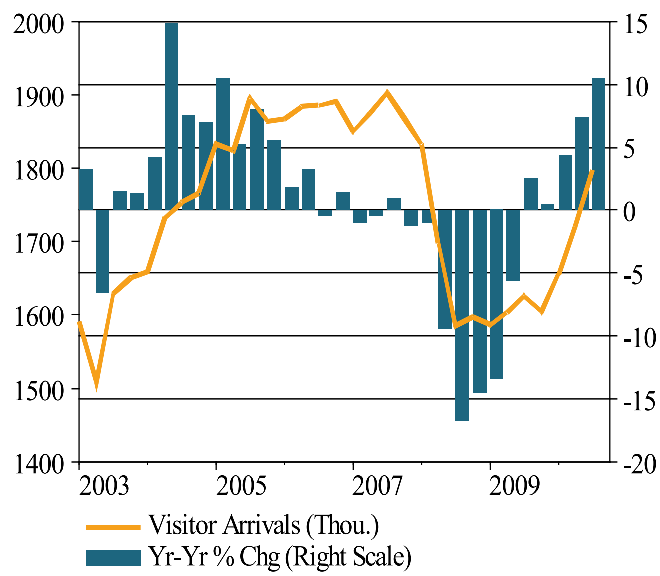
Hawaii's economy continues to recover, but in a very uneven fashion. Tourism is providing ongoing positive surprises, with recent months rivaling the level of activity prior to the Aloha and ATA failures. But so far the rest of the economy is going nowhere. The counties are also running at two speeds: Oahu is benefiting from strong international tourism and a more rapid stabilization of the broader economy, while Neighbor Island recovery lags. These differences will gradually close over the next several years.

Hawaii's largest economic driver continues to gain steam, with surprisingly large increases in both visitor spending and arrivals. Seasonally adjusted statewide arrivals and expenditures for the third quarter increased by double-digit percentages when compared to the third quarter of last year. Arrivals topped 590,000 in each of the last four months, putting the recovery back to where we were just before the Aloha/ATA shutdowns in early 2008. Visitor expenditures showed dramatic improvement over last year's anemic spending totals and also rose to pre-Aloha/ATA levels, surpassing $3 billion for the third quarter.

Tourism growth during the first half of 2010 was primarily due to international arrivals, but the upward trend in domestic visitors accelerated in the most recent quarter. International visitors were up 15% in the first half, cooling slightly to 10% in the third quarter, but not before improvements in domestic markets took hold. Previously tepid domestic arrivals growth shifted upwards to year-on-year increases of 8% or more in recent months.

Oahu has benefited from its large market share among international visitors. In the U.S. market, arrivals have grown most rapidly in Maui County, which has shown the greatest year-on-year percentage gains for seven straight months. Maui's gain in domestic visitors for the year to date exceeds even that on Oahu (72,900 on Maui versus 70,400 on Oahu). To be sure, Maui took a bigger hit during the downturn and so has further to climb during the ongoing recovery.

Recent data on visitor expenditures stands in stark contrast to conditions one year ago. In August 2009, seasonally adjusted monthly visitor expenditures dipped below $800 million for the only time in the last seven years. The state has now had five consecutive months of double-digit year-on-year growth. The most explosive source of visitor spending growth has been international travelers from markets other than Japan and Canada. Year-to-date visitor spending for these other international visitors is up about 47% compared with a 14% increase for visitor



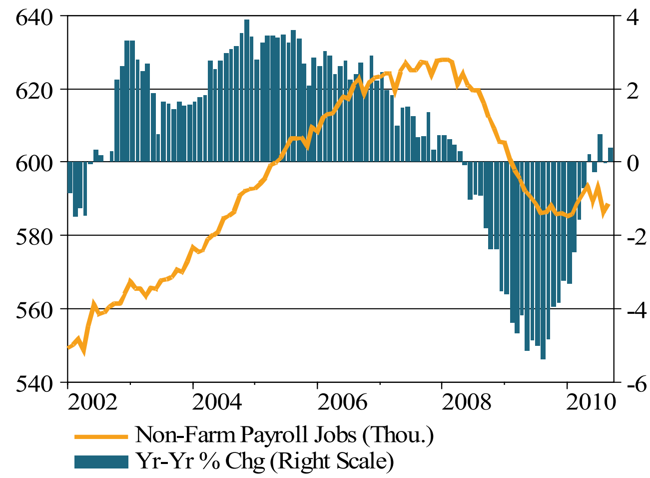
STATEWIDE VISITOR ARRIVALS

spending overall. Among the counties, current dollar Oahu visitor spending now exceeds what it was during the state's high point in 2007's third quarter. On the Neighbor Islands, expenditures remain 13-17% below the third quarter 2007 level.

While recent visitor gains have exceeded expectations, challenging global economic conditions will cause the recovery path to flatten out somewhat, particularly on Oahu where overall gains have been greatest. As we noted in the *Global Economic Forecast*, the global outlook has become clouded by a growth slowdown that is occurring in many countries. That will mean a slower expansion of world demand in 2011 before a pickup in 2012. After a sharp 8.2% gain for 2010 as a whole, arrivals growth will slow to 3.8% in 2011, dropping below 2% growth in 2012 -2013. Both U.S. and international arrivals gains will decelerate. Visitor spending will rise 9.2% next year, following this year's estimated 13.9% gain. Growth in the 4% range will occur in the following two years as total nominal spending surpasses the 2007 peak in 2012.

Conditions for hotels improved noticeably during the summer travel season, and there were continued gains in early autumn. Occupancy climbed from the low 60% range at the worst part of the recession in mid-2009 through the high 60s in the first half of 2010. By early summer, statewide occupancy exceeded 70% and Hospitality Advisors' weekly reports confirm rates remained near that level through the end of October. Even revenue per available room has finally begun to show signs of improvement, rising to $136 per room in September on a seasonally adjusted basis, up 28% from the low in August of last year.

Again, Oahu has been the primary source of visitor strength with occupancy rates above 90% for part of July and continuing near 80% We expect occupancy statewide to average just over 71% for this year as a whole, firming to 73.5% in 2011 and climbing above 75% by 2013. The occupancy rate forecast for 2012-2013 is about two percentage



STATEWIDE NON-FARM JOBS

points higher than in our third quarter forecast.

As you would expect, job creation has lagged the visitor industry revival. Since the start of summer, unemployment has been roughly 0.6 percentage points lower than last year's 7.0% peak, translating to roughly 4,500 fewer unemployed people. This reflects both modest gains in employment and the effect of individuals leaving the labor force. September's 588,500 nonfarm payroll jobs are little changed from the level that has prevailed for most of the past 14 months, in part reflecting a decline in the number of multiple job holders.

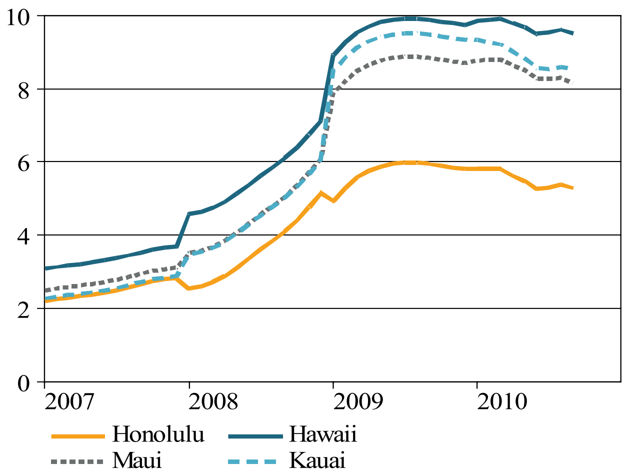
While the overall job count has not yet turned decisively upward, tourism gains have prevented additional net job losses and the resurgence of tourism spending will gradually spill over into the rest of the economy. Compared with the same time last year, September saw notable job gains in Retail Trade (1,400), Accommodations (1,460), and Food Services & Drinking Places (2,240). Job losses have been concentrated in Professional & Business Services (1,900) and State Government (2,700). All other industry groups experienced relatively small movements over the twelve-month period. Next year, positive job growth is expected in all private sectors except for Finance, Insurance & Real Estate.

Gradual progress in the transition to a jobs recovery is confirmed by lower initial unemployment insurance claims in recent months. Since the middle of June, weekly initial claims for newly unemployed workers have averaged 2,180. On average, this is about 200 fewer claims than weekly rates observed in the first half of the year, and 13% less than the same period in 2009.

Employment gains have been strongest on Oahu and slowest on the Big Island. Since the start of 2010, Oahu has added about 3,500 jobs and Kauai has remained relatively stable, while Maui and the Big Island sustained additional small net losses. Since the beginning of the year, unemployment rates have receded by half a percentage point or more in all counties except Hawaii County, where the rate has edged down just three-tenths of a percentage point to 9.5% in September (The seasonally-adjusted September unemployment rate was 5.3% on Oahu, 8.2% in Maui county and 8.5% on Kauai). However, note that the improvements on the Neighbor Islands are entirely due to a shrinking labor force, since employment in these counties has been flat or continues to drift downward.

The construction sector job count for the first nine months of the year was roughly 7% lower than for the same period in 2009, but data for September actually showed a small net year-on-year gain for the month. Monthly figures have been very volatile over the past year, and a large part of the most recent gains can be explained by two very large highway projects on the east side of Kauai near Lihue and Kapaa.

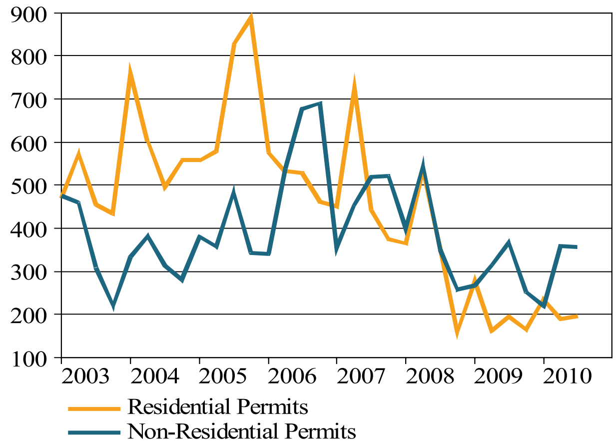
The residential segment is suffering from weak resale market conditions. On Kauai, condo resales continue to be concentrated at the lower end of the market, with about a third more sales in October but at prices about a third less than in 2009. Single-family home prices jumped temporarily in July and August but only due to a wave of discounted luxury home sales in Lihue and Koloa. On the Big Island, Hawaii Information Service data shows single-family home resales were relatively flat over the last



UNEMPLOYMENT RATE BY COUNTY

four months, with nearly identical resales and prices. As on Kauai, condominium sales on the Big Island jumped more than 20% but saw median price declines of about 20% during that same period. The Realtors Association of Maui reports median prices for both condos and single-family homes plummeted after July and remained down 11% and 20%, respectively, in October. Oahu prices have also softened: median single family home prices retreated back below 600,000 after three straight months above that level, while condo prices continue to fluctuate around $305,000 as they have for the past 20 months. Without the first time homebuyer tax credit that boosted last year's volume, Honolulu resales were savaged to the tune of 17% for single-family homes and 21% for condos in October.

Permitting activity confirms that nonresidential building will see most of the activity over the coming year, with a central contribution from public contracts. Early estimates by Building Industry magazine put third quarter government contracts at $353.6 million, a more than 51% increase over last year's level, but almost $50 million below our forecast for the quarter. This large increase included a $132 million federal ARRA contract awarded in September for the NOAA Pacific Regional Center at Ford Island. Total private permits from June to September were 12% higher than last year, powered by an 18% increase in nonresidential permitting. Nonresidential permits accounted for about half of all



PRIVATE PERMITS (2009$)

private permits from 2006 to 2008, and 60% in 2009. But in the four most recent months the nonresidential share of statewide private permits jumped to nearly 70%, with the bulk of that work (84%) on Oahu.

The decline in construction activity as measured by the general excise contracting tax base will end this year with 18% losses, rivaling those of 2009. The average construction industry job count for the year will be nearly 6% lower than the level a year ago. But we believe that we are at the cycle's bottom. We expect the real contracting tax base to rise 5.5% in 2011 and annual average construction employment to increase by 0.9%. The pace of job growth will remain muted for the next several years. Of course the medium-term outcome for Oahu will be quite different if and when construction begins on Oahu for rail mass transit; our forecast does not yet incorporate estimates for this impact.

The State revenue picture continues to improve. In September, the State Council on Revenues maintained its forecast for general fund revenue growth of a combined 12% for FY 2011 and 2012. This agrees with the most recent Department of Taxation (DoTAX) data showing consistently strong collections so far this fiscal year. Although cumulative general fund deposits are down 13.6% from last year, DoTAX indicates this is entirely due to the accrued tax refunds held over from last fiscal year (FY 2010). If we set aside those accrued refunds and concentrate on current actual collections, general fund revenues would instead be 4.2% over last year.

General excise tax receipts for the first quarter of the current fiscal year were up 5.8% from the previous year, and total tax revenues for August and September were 13.9% and 6.7% higher, respectively, than the same months in 2009. Not all of the rise in general fund revenues can be linked to improving economic conditions. Several legislative changes also played a role. Transient accommodations tax collections, aided by an additional 1% increase effective at the start of the fiscal year, are up 32.6% for FY2011 to date. (Even without that extra percentage point, though, TAT collections would still be about 18.5% higher thanks to the ongoing tourism recovery.) Increases to the unemployment insurance contribution rate caused collections for the first three months of the fiscal year to more than quadruple from $12.4 million last year to $51.1 million this year. This will jump up again in January 2011 when the UI employer contributions shift to a higher rate schedule. Fuel tax collections are also up 26.8% so far this fiscal year. Increased county fuel tax rates and the $1.05 "barrel tax" account for a little over half of that $10 million increase.

The level of general economic activity measured by personal income has yet to show significant signs of improvement. Current dollar (*nominal*) income was 1.5% higher in the first half of the year than in the first half of 2009, but an acceleration of inflation to 2.5% implies that the inflation-adjusted *real* income declined by 1%. The income picture will firm as the tourism recovery and the resumption of job growth work their way through to paychecks. After a small net increase for this year as a whole, real income will expand by 2.3% in 2011 and accelerate further to the 2.4-2.6% range in the 2012-2013 period.

The good fortunes of tourism are providing all of the lift this year as the Hawaii recovery inches forward. While there is little evidence of more widespread growth, it is only a matter of time. Progress in areas such as construction and non-tourism services will begin to take over the growth momentum as the impulse from the visitor surge begins to wane. This will be particularly important on the Neighbor Islands, which have lagged behind Oahu during the early stages of this business cycle's upswing. Further down the road there will be another necessary changeover as government construction contracts end and private home building resumes. As this process unwinds over the next several years, moderate growth will gradually take hold throughout the islands and begin to generate significant improvements in labor market conditions and in the standard of living of Hawaii residents.

HAWAII ECONOMIC INDICATORS
YEAR-OVER-YEAR PERCENT CHANGE

	2008	2009	2010	2011	2012	2013
Visitor Arrivals	-10.5	-4.4	8.2	3.8	1.6	1.9
U.S. Visitor Arrivals	-13.5	-3.9	6.4	3.7	1.2	1.6
Japan Visitor Arrivals	-9.4	-0.6	4.3	2.0	1.5	1.1
Other Visitor Arrivals	3.0	-10.5	20.6	6.1	3.3	4.0
Payroll Jobs	-0.9	-4.4	-0.5	1.3	1.8	1.8
Employment	-0.5	-4.1	-0.1	1.4	1.8	1.8
Unemployment Rate (%)	4.1	6.8	6.5	5.9	5.3	4.9
Inflation Rate, Honolulu MSA (%)	4.3	0.5	1.7	1.4	2.9	2.8
Real Personal Income	-0.3	-0.7	0.3	2.3	2.4	2.6
Real GDP	-1.5	-0.1	1.1	2.7	3.4	3.8

Note: Source is UHERO. Figures for 2010-2013 are forecasts.

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