# FITCH AFFIRMS HAWAII DOT'S $351MM HARBOR SYSTEM REVS AT 'A+'; OUTLOOK STABLE

Fitch Ratings-New York-04 March 2015: Fitch Ratings has affirmed the 'A+' rating of on the Hawaii Department of Transportation's (HI) $351 million in outstanding harbor system revenue bonds.

The Rating Outlook on all bonds is Stable.

The rating affirmation reflects the harbor system's natural monopoly position serving the islands of Hawaii. The rating is also supported by increased volume levels in fiscal 2014 along with continued revenue growth due to the system's scheduled tariff increases. Despite the harbor system's substantial $618 million capital plan that calls for additional borrowing, the system is expected to maintain its historically strong financial profile with relatively strong coverage, moderate leverage, and high liquidity.

KEY RATING DRIVERS

Revenue Risk: Volume - Stronger
Stable Volume Supported by Natural Monopoly: Port volumes are rising and are also anchored by the essentiality of the port to the State's economy. The port system provides essential maritime services and serves a state without an efficient alternative means of transporting goods to and throughout it. This partially mitigates the system's exposure to fluctuations in the tourism industry.

Revenue Risk: Price - Midrange
Approved Tariff Increases: The harbor system has adopted scheduled tariff increases for cruise, cargo, and pipelines. Escalations have been underway since 2010 and are scheduled to continue through 2015. The increases include a mechanism to increase cargo tariffs annually by the greater of 3% or CPI from 2015 onwards. No material elasticity to port demand has been seen through these tariff adjustments.

Infrastructure Development & Renewal - Midrange
Considerable Capital Plan: The port system's sizable and evolving capital improvement plan (CIP), currently sized at $618 million, is progressing on schedule. It is expected that the plan will necessitate additional leverage, with $200 million in revenue bonds expected in late fiscal 2015.

Debt Structure - Stronger
Conservative Debt Structure: The harbor system has relatively low leverage consisting of all fixed rate bonds with a rapid amortization schedule on existing debt, somewhat mitigating the limited protection provided by the 1.25x rate covenant and additional bonds test (1.0x excluding contingency account and other allowable funds).

Strong Financial Profile: The harbor system benefits from stable operating margins with a sizable liquidity cushion, with unrestricted liquidity providing more than 1000 days cash on hand in 2014. Coverage is relatively strong at over 2.0x historically (2.8x in fiscal 2014) and is expected to remain at these levels through the forecast period. Leverage is low at 2.0x for rated debt, and is expected to remain in the 2x-4x range in the next five years even with additional borrowing for the CIP.

Peers: The port system's peers include the Virginia Port Authority (rated 'A+' by Fitch) and the San Diego Unified Port District (rated 'A+'). The peers share solid demand and utilization of their port systems, along with consistency of favorable metrics on senior obligations. Like Virginia, the Hawaii Harbors Department is a vital entity of the state.

RATING SENSITIVITIES

Negative: Stagnant growth or increased volatility in throughput volumes may erode pricing flexibility. Limitations to the ability to manage continued price increases may affect ratings.

Negative: Credit quality may be adversely affected to the extent increasing debt service requirements from the harbor system's capital program outpace revenue generation.

Positive: Positive rating action is considered unlikely in the near term due to the system's sizable capital improvement plan that calls for additional borrowing.

CREDIT UPDATE

Overall cargo volumes for the harbor system (measured in short tons) have increased steadily in recent years, with 2014 volumes rising to 20.4 million short tons. This represents a 3.6% increase over a year prior and a 15.2% increase from a low of 17.7 million in 2009. Historically, cargo volumes have been steady, but declined in the 2008 to 2010 period as the recession took hold. The throughput recovery that has been seen since 2011 reflects ongoing recovery in cargo levels as tourism activity rebounds in Hawaii.

Fiscal 2014 revenues for the harbor system increased 7.7% to $121.3 million. Year to date for fiscal 2015, revenues are up a further 4%. While the recession caused declines in operating revenues in the 2008-2010 period, multi-year tariff increases starting in 2010 have led to a healthy rebound in operating revenues. The scheduled tariff increases, developed with concurrence from primary harbor system users, were the first increases to have been implemented since 1997. Cargo rates have increased incrementally each year starting in 2010, initially increasing 20% and stepping down on an annual basis to 5% in 2014. The plan also includes 3% or CPI increases from 2015 onwards. Likewise, passenger fees have increased $0.50 annually since 2011, and will continue to do so through 2016. These prescribed increases have provided considerable revenue flexibility to the harbor division, and are intended to support the division's sizable modernization plan.

Operating expenses were $47.6 million in 2014, growing 0.8% over the year prior and reflecting increases in harbor operations costs, personnel services costs, and costs of fireboat operations. Management indicates that costs are in line with budget expectation for 2015 year to date. Going forward, Fitch expects more normalized increases in the system's operating expense profile as harbor operations return to pre-recession levels. Deferred maintenance funding and labor costs covered under collective bargaining agreements will also drive future operating costs.

The harbor division has historically recorded strong cash levels and healthy debt service coverage ratios. The division's unrestricted cash as of fiscal 2014 is $165.4 million. This represents 1,269 days cash on hand. Unrestricted cash balances have increased 51% since 2011, and liquidity levels are supportive to the current rating level. Fitch believes cash balances will remain adequate, although they may decline some as management executes the harbor modernization plan over the next several years.

Debt service coverage in fiscal 2014 was in line with historical levels at 2.8x. When including the system's general obligation payment requirements of roughly $3.3 million per year for obligations taken on in the context of the Superferry project, all-in coverage is slightly lower at 2.7x.

Under Fitch's base case forecast, with the implementation of scheduled tariff increases through 2016 and modest growth thereafter for a net revenue compound annual growth rate (CAGR) of 3.7%, the harbor division projects coverage of 2.0x or higher (1.9x including general obligation [GO] debt). Under Fitch's rating case scenario, including a combination of throughput reductions in 2016 resulting in a 10% revenue reduction and a 100-basis point increase in annual operating expense growth, debt coverage would still remain robust at 1.55x or higher (1.48x including GO debt).

Both scenarios include the anticipated additional borrowing of $200 million in fiscal 2015 in the context of the harbor system's CIP. Leverage levels are expected to initially increase from currently moderate levels (2x net debt to CFADS for 2014) to around 8x in 2016, but should fall to the 3x-4x range by 2020. However, Fitch anticipates that the harbor division will manage the timing and sizing of borrowing for its capital program in order to maintain sufficient levels of coverage and liquidity.

The current capital program focuses largely on the Harbors Modernization Plan (formerly known as the New Day Work Projects). The plan consists of various projects to enhance the system's efficiency and capacity by addressing long-term capital needs. The plan is expected to cost $618 million, and funding is expected to come largely from revenue bond proceeds, though grant and port funds could also be used.

The State of Hawaii Department of Transportation harbors division consists of 10 commercial harbors on six islands, with Honolulu serving as the state's principal port and trans-shipment station for cargo that is bound for the other islands. As a monopoly, the harbor system benefits from the lack of alternative means of transporting cargo to and throughout the state, as well as the state's limited commodity and manufacturing base, which results in an inelastic demand for imported goods.

SECURITY

The revenue bonds are special limited obligations of the State of Hawaii, payable from and secured solely by net revenue generated by the harbor system.

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Applicable Criteria and Related Research:
--'Rating Criteria for Infrastructure and Project Finance' (Jul. 12, 2012);
--'Rating Criteria for Ports' (Oct. 16, 2014).

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http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=682867
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