

# RatingsDirect®

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## Summary:

# Hawaii Harbor Division; Ports/Port Authorities

### **Primary Credit Analyst:**

Paul J Dyson, San Francisco (1) 415-371-5079; paul.dyson@standardandpoors.com

### **Secondary Contact:**

Mary Ellen E Wriedt, San Francisco (1) 415-371-5027; maryellen.wriedt@standardandpoors.com

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## Summary:

# Hawaii Harbor Division; Ports/Port Authorities

### Credit Profile

#### Hawaii

Hawaii Harbor Div, Hawaii

Hawaii (Hawaii Harbor Division)

<i>Long Term Rating</i>	A+/Stable	Affirmed
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#### Hawaii (Hawaii Harbor Div)

<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Affirmed
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Many issues are enhanced by bond insurance.

## Rationale

Standard & Poor's Ratings Services affirmed its 'A+' long-term rating and underlying rating (SPUR) on Hawaii's harbor system revenue bonds issued for Hawaii Harbor Division. The outlook is stable.

The rating reflects our view of the port system's:

- Dominant business position and importance to Hawaii's economy, as approximately 80% of the total volume of goods consumed in Hawaii is imported and roughly 98% is processed through the system;
- Monopolistic position as Hawaii's sole provider of maritime facilities and services;
- Recent and frequent tariff increases that have allowed for consistently strong debt service coverage given rising costs, with incremental revenue providing key funding support for the Harbor Division's capital improvement program;
- Very strong liquidity, with \$165 million in unrestricted cash, equal to 1,269 days of operating expenses, as of audited fiscal 2014 and an estimated \$204 million, or 1,436 days' cash, estimated for fiscal 2015; and
- Strong all-in debt service coverage (DSC) in audited fiscal 2014 of 2.13x that includes both revenue bond debt and the system's share of state-issued general obligation (GO) bonds, estimated at 2.10x for fiscal 2015.

Partly offsetting the above strengths, in our view, are the system's significant capital needs to address the large port system's expansion and maintenance requirements, with debt service projected to increase 11% in fiscal 2016 and likely further in subsequent fiscal years with all-in DSC projected to decline to 1.6x in fiscal 2016. We understand that the capital plan is prioritized and that projects will be undertaken as funding becomes available.

A senior lien on the system's net revenue secures the bonds. All revenue-secured debt outstanding is fixed rate, with descending debt service that has a final maturity in 2041. In addition to the revenue-secured bonds, the division is obligated to pay from revenue on a subordinated basis annual debt service associated with approximately \$29 million in reimbursable state GO bonds outstanding whose proceeds it used to finance harbor and waterfront improvements.

The division oversees a system of 10 harbors on six islands throughout the state and is a landlord port operator with terminal operators directly hiring stevedoring firms. Unlike other large landlord container ports, the division is more

exposed to revenue swings associated with volume fluctuations, with containers alone accounting for about 70% of operating revenue. The two harbor facilities supporting the most populous island, Oahu, were responsible for 79% of operating revenue in fiscal 2014. Honolulu Harbor, the system's largest, was the 14th-largest port in North America by 20-foot equivalent units (TEUs) in 2014 (1.13 million), accounts for approximately 55% of system tonnage, and operates as the trans-shipment hub for cargo to all islands but Oahu from the U.S. mainland. It has a main harbor basin with a depth of 40 feet, 5 linear miles of berthing space, 27 acres of covered storage, and more than 200 acres of cargo handling area. Some facilities are owned by the federal government and private companies, and the state owns the majority of the land although both the U.S. Coast Guard and Chevron Corp. have significant holdings.

Cargo volume tonnage has grown steadily since 2010. Cargo volume in short tons rose 6% in fiscal 2011, 1% in fiscal 2012, 4% in fiscal 2013, and 3% in fiscal 2014 to 20,395 short tons. Cargo volume experienced a significant decline in the recent recession, declining 2% in 2008, 13% in 2009, and 3% in 2010 to 17,706 short tons. For container volume alone, growth has also been good since the 2008-2010 recession, with TEUs increasing 6% in 2011, declining 3% in 2012, and increasing 3% in 2013 and 7% in 2014 to 1.405 million TEUs, though falling short of the peak of 1.5 million TEUs in 2007. Container TEU growth is estimated at 3% for fiscal years 2015 and 2016. Cruise passengers declined significantly by 19% in 2008 and 43% in 2009 to 1.15 million passengers, with very little growth since, although cruise passengers represent a small 8% of total operating revenue (and were just 11% in 2007).

The port system is extremely important to Hawaii, as the state imports 80% of its required goods, 98% of which are shipped by water. We view the division's monopolistic position and essential role as fundamental credit strengths. But despite the harbor division's near-monopoly (private operators largely handle oil), operating performance reflects statewide economic trends. Hawaii's harbor system was not alone in the port sector when it experienced large declines in operating performance measures (tonnage, ship calls, and cruise passengers, for instance) as a result of the recent recession, resulting in lower revenue (13% decline in 2009) and eroded financial metrics (all-in DSC fell to 1.2x in 2009 from 1.7x in 2008), but fairly large and frequent tariff increases in fiscal years 2011 through 2015 and improved economic activity have resulted in improved revenue, coverage, and operating performance. We take a positive view of management's actions to adjust tariffs to compensate for volume declines and finance needed capital improvements.

Management began implementing tariff increases effective March 1, 2010. (The most recent prior increase was 25% in 1997.) The higher tariffs support new debt associated with the capital program and have bolstered financial performance. The rate structure simplifies and equalizes rates of some cargo types, with intra-island cargo still charged lower tariffs and with empty containers charged no fee. Most important, in our opinion, cargo rates have increased annually, by 20% in fiscal 2011, 15% in fiscal 2012, 10% in fiscal 2013, 7% in fiscal 2014, 5% in fiscal 2015, and will increase 3% or at a Consumer Price Index escalator thereafter, whichever is higher. Cruise passenger fees increased to \$5 per person beginning in 2012 and are increasing 50 cents per year through 2017.

Total operating revenue declined 14% to \$73 million in fiscal 2010 (similar to fiscal 2003 results) from a peak of \$86 million in fiscal 2007. However, as a result of the tariff increases and steady growth in volume, total operating revenue grew by a very strong 17% to \$86 million in fiscal 2011, and by an even stronger 21% in fiscal 2012 to \$104 million. In fiscal years 2013 and 2014, revenue increased 8% each year to a total of \$121 million. Estimated results for fiscal 2015 indicate operating revenue growth of 4%, projected at 5% annually for fiscal years 2016 and 2017.

Revenue-bond-only (excluding subordinate-lien state GO debt service requirements) DSC excluding eligible fund balances was strong in fiscal 2014, in our view, at 2.4x, up from 1.3x to 2.1x in fiscal years 2009 to 2013, and is estimated at 2.3x in fiscal 2015. Projections on revenue bond coverage indicate 1.7x DSC in fiscal 2016. DSC of revenue-bond-only debt including eligible fund balances was also strong in fiscal 2014, in our view, at 2.8x, up from 1.9x to 2.7x in fiscal years 2009 to 2013, and is estimated at 2.8x in fiscal 2015, with a projection of 2.1x DSC in fiscal 2016. We calculate all-in DSC including reimbursable state GO debt service at 2.1x in fiscal 2014, up from 1.9x in fiscal 2013 and a low of 1.2x in fiscal 2009. Fiscal 2015 estimated all-in DSC is 2.1x, projected at 1.6x in 2016. Management forecasts that debt service requirements will increase 11% in fiscal 2016 and likely further in subsequent years as a result of additional bond issuance to fund capital projects. Despite tariff increases, the added leverage will lower DSC metrics moderately. Unrestricted cash and investments increased to \$165 million, or 1,269 days' cash, which we consider very strong, in fiscal 2014. Management estimates that unrestricted cash totals \$204 million, or 1,436 days' cash, for fiscal 2015. The port is creating a reserve policy and reports that the policy may mirror what the Airports Division follows, which is three years of operating cash. The port has maintained no less than two years' operating cash since at least 2007.

In our view, the division's capital plan is large and could pressure debt levels (and possibly liquidity) in the medium term, but management operates the system with a prudent approach toward fiscal and capital issues. The division's five-year capital improvement plan totals \$632 million, the largest project of which is the first, \$248 million phase of a container terminal facility, known as Kapalama Container Terminal (KCT), at Kapalama military reservation in Honolulu Harbor. Harbors Division is integrating the container handling needs of two of its leading 10 customers, Young Brothers Ltd. and Pasha Hawaii Transport Lines LLC, in a phased approach to the development of KCT. The Harbors Division estimates a bond issuance, refunding, and use of cash to support the first phase, and \$250 million bonds may be sold in 2016 with the potential for an additional bond sale in 2017. The Harbors Division is re-prioritizing its capital plan to take into account the latest master plans, development plans, and customer needs. Management expects that the various modernization projects will enhance the Harbors Division's efficiency and future capacity, and reports that it will take a disciplined approach with the phasing of projects to ensure the system has the capacity for the required debt. Although the system's expansive and essential nature provides for a strong business position, it also requires significant investment in facilities that individually sometimes do not have the commercial activity to fully support capital and operational costs.

In our opinion, Hawaii's economy is very closely tied to traffic at the system's ports, more so than for many other port credits, because of its location more than 2,000 miles from the nearest continent. It imports much of what it needs to support 1.4 million residents and 8.2 million annual visitors, so the state economy directly affects port volumes and overall financial performance. As the state continues to rebound from the recent recession, several positive trends are emerging and some economic metrics indicate that the state was relatively more resilient than the national economy during the recession. Since 2003, Hawaii's unemployment rate has generally been 2% to 3% below the national rate. Wage and salary job count grew 1.2% during the first eight months of 2015, exceeding its prior peak in 2007, and the statewide unemployment rate of 3.9% was the sixth lowest in the nation for the first eight months of 2015. Since 2010, Hawaii's population has grown by 4.1% compared with 3.0% for the U.S. overall. The value of building permits in 2015 have reached the levels achieved in 2006.

Where Hawaii's economy historically has been most affected is tourism, an industry that weakened during the recent recession as a result of reduced consumer spending, job losses, the recent seismic and tsunami events in Japan, and competitive marketing campaigns from multiple tourism destinations (e.g., Las Vegas). However, visitor arrivals, visitor spending, and revenue per available room (RevPAR) have all grown in 2010 through 2014 (and, as projected by management, in 2015). Visitor arrivals declined 10.9% in 2008 (versus 12.2% for the U.S.) and 4.5% in 2009 to 6.5 million, but increased in 2010 through 2014 to a total of 8.3 million. Visitor expenditures fell to \$10.0 billion in 2009 but rose to \$14.9 billion in 2014, and RevPAR declined to \$115 in 2009 but grew to \$187 in 2014. The state's economy continues to diversify through 2015, with more than 80% of economic activity in nontourism sectors. In addition to the ongoing diversification of the state economy away from tourism-based industries, the state has experienced growing diversity within its tourism base. We note that despite these positive trends, the port's revenue remains vulnerable to economic cycles that affect the state's key economic drivers, including tourism.

## Outlook

The stable outlook reflects our anticipation that the capital program will not pressure the cost structure significantly more than forecast by management, that liquidity will remain near very strong levels, that DSC will remain strong, and that volume will not significantly deteriorate.

### Upside scenario

If volume increases considerably and DSC materially exceeds forecasts, we could raise the rating, assuming very strong liquidity is maintained. Nevertheless, we do not anticipate raising the rating during the next two years given the system's sizable capital plan and projected decline in DSC.

### Downside scenario

Given the system's robust cash position and improving demand, as well as the state's positive economic trends, we are unlikely to lower the rating during the next two years. But if capital needs grow and affect DSC ratios or liquidity materially, we could lower the rating.

## Related Criteria And Research

### Related Criteria

- Criteria: Port Facilities Revenue Bonds In The U.S. And Canada, March 19, 2014
- USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

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