FitchRatings

FITCH AFFIRMS HAWAII DOT'S $323MM HARBOR SYSTEM REVS AT 'A+'; OUTLOOK STABLE

Fitch Ratings-New York-29 April 2016: Fitch Ratings has affirmed the 'A+' rating of on the Hawaii Department of Transportation's (HI) $323 million in outstanding harbor system revenue bonds.

The Rating Outlook on all bonds is Stable.

The 'A+' rating reflects the harbor system's natural monopoly position serving the islands of Hawaii. The system benefits from strong volume growth since 2011 along with approved multi-year rate increases that provide revenue stability. Despite a sizeable capital plan that calls for additional borrowing, the harbor system is expected to maintain its historically robust financial profile with relatively strong coverage, moderate leverage, and high liquidity. The harbor system compares favorably with peers in terms of metrics and strong demand for port services.

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
Scheduled Tariff Increases: The harbor system has a history of adopted scheduled tariff increases for cruise, cargo, and pipelines. Recent increases included a mechanism to increase cargo tariffs annually by the greater of 3% or CPI from 2015 onwards. The harbor system is in the process of obtaining multi-year tariff increases, which it is unable to disclose specifically until it formally notifies and receives approval of those increases from governmental leaders. No material elasticity to port demand has been seen through these tariff adjustments historically.

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 $250 million in revenue bonds expected in early fiscal 2017.

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 1,500 days cash on hand (DCOH) in 2015. While balances may vary with spending for the CIP, management targets maintaining at least 1,000 days cash. Coverage has been relatively strong at over 2.0x historically (2.97x in fiscal 2015) and is expected to remain at these levels through the forecast period. Leverage is low at 1.4x for rated debt, and is expected to remain in the 2x-4x range in the next five years when incorporating additional borrowing for the CIP.

Peers: The port system's peers include the Virginia Port Authority (rated 'A+') 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.

FACT Tool: U.S. Ports

RATING SENSITIVITIES

Negative - Cargo Volatility: Stagnant growth or increased volatility in throughput volumes that result in coverage sustained at or below 1.4x could pressure the rating.

Negative - Additional Debt Eroding Cash Flow: Credit quality may be adversely affected if leverage increases to and is maintained above 5.0x net debt to cash flow available for debt service (CFADS).

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 (measured in short tons) continued to increase in fiscal 2015 by 2.3% with 20.9 million tons of cargo going through the Hawaiian ports. The system's cargo volumes have rebounded to pre-recession levels, growing at a five-year compound annual growth rate (CAGR) of 3.3%, after significant declines in 2009 and 2010. The throughput recovery that has been seen since 2011 reflects ongoing recovery in cargo levels as tourism activity rebounds in Hawaii. Fitch expects continued cargo volume stability at the harbor system given its natural monopoly as the sole transporter of goods to the island state, effectively mitigating the port's risk to fluctuations in tourism.

Fiscal 2015 revenues for the harbor system increased 1.5%, reflecting the harbor system's first year of tariff increases at the greater of 3% or CPI. 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. Likewise, passenger fees have increased $0.50 annually since 2011, and will continue to do so through 2016. The harbor system is in the process of obtaining approvals to increase tariffs from fiscal 2017 through fiscal 2019 for cargo, pipeline, and passenger tariffs, though such specific rate increases cannot yet be disclosed. These prescribed increases have provided considerable revenue flexibility to the harbor division, and are intended to support the division's sizable modernization plan. Year to date fiscal 2016 (nine months through March) revenues are 3.5% above management's budget.

Operating expenses declined 1.6% in fiscal 2015 due to decreases in fireboat operations and general administration expenses. Management continues to prudently manage costs as year to date nine months fiscal 2016 expenses are 12% below budget. Going forward, Fitch expects more normalized increases in the system's operating expense profile as harbor operations return to pre-recession levels and labor costs covered under collective bargaining agreements 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 2015 is $204.5 million, representing 1,595 DCOH. Unrestricted cash balances have increased 87% 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 2015 was robust and in line with historical levels at 2.97x. When including the system's general obligation payment requirements of approximately $3.3 million per year for obligations taken on in the context of the Superferry project, all-in coverage is slightly lower but still remains strong at 2.86x.

Fitch's base case reflects the harbor system's forecast through 2018 which includes scheduled tariff increases and 2019 performance mirroring 2018 due to similar tariff increases. Thereafter, revenues experience moderate growth of 3% per year and expenses grow at 3.5% per year. Under this scenario, total operating revenues net of tariff increases average 0.3% growth through 2021 leading to debt service coverage ratios (DSCRs) averaging 2.77x with a minimum of 2.15x in 2017.

Fitch's rating case considers a scenario of combined throughput reduction resulting in greater sustained revenue stress through 2019 and increases in operating expenses throughout the forecast period. Total operating revenues net of tariff increases averages -1.6% through 2021. Under this scenario, DSCRs average 2.52x with a minimum of 2.09x in 2017.

Both scenarios consider the harbor system's anticipated additional borrowing of $250 million in early fiscal 2017. Leverage levels are expected to initially increase from currently moderate levels (1.4x net debt to CFADS for 2015) to around 3.7x in 2017 under Fitch's rating case, but should fall to the 2.3x range by 2021.

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
Rating Criteria for Infrastructure and Project Finance (pub. 28 Sep 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=870967
Rating Criteria for Ports (pub. 20 Oct 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=872725