FITCH AFFIRMS HAWAII DOT'S HARBOR SYSTEM REVS AT 'AA-'; OUTLOOK STABLE

Fitch Ratings-New York-22 February 2019: Fitch Ratings has affirmed the 'AA-' rating on Hawaii Department of Transportation's (HI) $160.3 million of outstanding harbor system revenue bonds. The Rating Outlook is Stable.

KEY RATING DRIVERS
The rating reflects the harbor system's natural monopoly position serving the islands of Hawaii. The system benefits from positive revenue trends supported by stable volume growth, along with an enacted tariff rate mechanism. Despite a sizeable capital plan that calls for additional borrowing, the harbor system is expected to maintain its historically robust financial profile with strong coverage, relatively low leverage, and high liquidity providing over 1,000 days cash on hand (DCOH). Recent coverage levels have been above 3.0x and leverage has been trending downward to below 1.0x. While the port's outstanding debt balance is projected to increase in the near term with the anticipated borrowing of $260 million in fiscal 2020, leverage will remain supportive of the current rating level given the port's high liquidity levels.

Stable Volume Supported by Natural Monopoly - Revenue Risk (Volume): Stronger
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.

Scheduled Tariff Increases - Revenue Risk (Price): Midrange
The harbor system has a history of adopted scheduled tariff increases for cruise, cargo, and pipelines. Recent increases were implemented starting in fiscal 2017 (17% increase in cargo tariffs), followed by 15% increases in cargo tariffs in both fiscal 2018 and 2019. From fiscal 2020 onwards, rates will be increased annually on July 1 by the greater of 3% or CPI. No material elasticity to port demand has been observed in response to historical tariff adjustments.

Considerable Capital Plan - Infrastructure Development and Renewal: Midrange
The five-year capital improvements program (CIP) of $554 million, with approximately $463 million remaining from 2019-2024, focuses largely on the Harbors Modernization Plan and consists of various projects to enhance the system's efficiency and capacity by addressing long-term capital needs. While management is focused on cash funding an increasing share of the projects, the plan is expected to necessitate additional leverage, with $260 million in revenue bonds anticipated in early calendar year 2020.

Conservative Debt Structure - Debt Structure: Stronger
The harbor's outstanding debt consists of all fixed-rate bonds with a rapid amortization schedule. Bond covenants are typical for a port credit with a 1.25x rate covenant and additional bonds test (1.0x excluding contingency account and other allowable funds), and debt service reserves funded by a combination of cash and a surety policy. With the additional borrowing of $260 million in the near term, annual debt service is expected to step up beginning in 2020.

Financial Profile
The harbor system benefits from stable operating margins with a sizable liquidity cushion of approximately 1,136 DCOH in fiscal 2018. While future balances may vary with spending for the upcoming CIP, management targets retaining strong reserves of at least 1,000 DCOH. Coverage has been strong at over 2.0x historically (4.4x in fiscal 2018), and is expected to remain at or above

these levels through the forecast period. All-in leverage is expected to remain in the 1x-3x range in the next five years when incorporating additional borrowing for the CIP.

PEER GROUP
San Diego Unified Port District (rated A+/Stable) serves as a comparable peer to the harbor system. The district has a strong total debt service coverage ratio (DSCR) of 4.2x and a cash position greater than its net debt for fiscal 2017. The Hawaii Harbor System has similar strong metrics with a DSCR of 4.4x and low leverage of 0.8x. Hawaii and San Diego both have solid demand and utilization, along with consistency of favorable metrics on total obligations. However, Hawaii Harbor System has greater passenger and cargo levels than San Diego, and also has less revenue risk given its essentiality in serving island populations.

RATING SENSITIVITIES

Future Developments That May, Individually or Collectively, Lead to Negative Rating Action:
--Increased volatility in throughput volumes that result in coverage sustained below 2.0x.
--Leverage that increases to and is maintained above 5.0x net debt to CFADS.

Future Developments That May, Individually or Collectively, Lead to Positive Rating Action:
--Given the current rating level and the ongoing capital program with additional borrowings expected, further upward rating migration is unlikely.

CREDIT UPDATE

Performance Update

Overall cargo volumes (measured in short tons) decreased in fiscal 2018 by 2.5% with 20.3 million tons of cargo moving through the Hawaii ports. Despite this decrease, the system's cargo volumes have rebounded to pre-recession levels, growing at a five-year CAGR of 0.5%. The throughput recovery since 2012 reflects the rebound of tourism activity in Hawaii.

The fiscal 2018 decrease in cargo volumes is offset by annual tariff rate increases as wharfage revenue from cargo movements increased approximately 24%. The harbor system has implemented annual cargo and pipeline tariff rate increases of 17%, 15%, and 15% from fiscal 2017 through fiscal 2019. Passenger tariffs were flat at $7.50 in fiscal 2018. Starting in fiscal 2020, cargo and pipeline tariffs will be increased each year on July 1 by the greater of 3% or CPI. In addition, the Harbors Division received approval for increases in port entry fees and dockage fees. These fee increases of 20% (fiscal 2020), 15% (fiscal 2021) and 15% (fiscal 2022) will occur annually and will commence on July 1, 2019. Revenues from these fees comprise a small share of total revenues and, as such, will have a smaller impact on revenue growth than the scheduled cargo and pipeline tariff increases implemented in previous years.

Total operating revenues for the harbor system increased 20% in fiscal 2018, largely reflecting the 15% increase in cargo and pipeline tariff rates that took effect on Oct. 1, 2017. Service revenues, which account for 82% of operating revenues, increased by 20.2% and rental revenues (17% of total operating revenues) increased by 21%. Passenger volumes were flat from fiscal 2017 to fiscal 2018. Operating expenses increased by 3.5% in fiscal 2018, largely due to increases in harbor operations and personnel services costs. Future personnel cost increases are expected, as the result of Collective Bargaining Agreements.

Debt service coverage in fiscal 2018 was robust at 4.4x, and higher than Fitch's prior year base case forecast of 3.2x. The stronger DSCR in comparison to expectations is attributed to significantly lower than expected expenses, which were 16% below the forecast. The system has

strong liquidity with approximately 1,136 DCOH in fiscal 2018. Management intends to maintain at least 1,000 DCOH going forward.

Fitch Cases

Fitch's base case reflects the harbor system's forecast through 2022, which includes annual tariff increases of 3% and scheduled port entry and dockage fee increases. Thereafter, revenues experience moderate growth of 3.0% per year and expenses grow at 3.5% per year. The base case scenario also considers the harbor system's anticipated borrowing of $260 million in late fiscal 2020, reflected in increased debt service payments commencing fiscal 2020 and increased debt outstanding. Under this scenario, total operating revenues net of tariff increases remain flat, averaging -0.1% growth through 2024. DSCRs average 3.9x, with a minimum of 3.3x in 2021. Leverage levels average 1.5x through the forecast period, reaching a maximum of 2x in 2020 when the additional borrowing is anticipated.

Fitch's rating case considers a scenario of combined throughput reduction resulting in greater sustained revenue stress and operating expense increases throughout the forecast period. The rating case also includes the anticipated borrowing of $260 million in fiscal 2020. Total growth in operating revenues net of tariff increases averages -2.4% through 2024. Under this scenario, DSCRs average 3.4x with a minimum of 2.7x in 2021. Leverage levels are expected to initially increase to approximately 2.3x in fiscal 2020 due to anticipated borrowing but should fall to 1.6x by 2024, averaging 1.8x throughout the forecast period.

ASSET DESCRIPTION

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.

Contact:

Primary Analyst
Jennie Mu
Analyst
+1-646-582-4748
Fitch Ratings, Inc.
33 Whitehall Street
New York, NY 10004

Secondary Analyst
Emma Griffith
Senior Director
+1-212-908-9124

Committee Chairperson
Seth Lehman

Senior Director
+1-212-908-0755

Media Relations: Elizabeth Fogerty, New York, Tel: +1 212 908 0526, Email: elizabeth.fogerty@thefitchgroup.com.

Additional information is available on www.fitchratings.com

Applicable Criteria
Ports Rating Criteria (pub. 23 Feb 2018)
https://www.fitchratings.com/site/re/10021628
Rating Criteria for Infrastructure and Project Finance (pub. 27 Jul 2018)
https://www.fitchratings.com/site/re/10038532

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.
Copyright © 2019 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.
The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.
For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001
Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.