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.

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