FitchRatings

Fitch Affirms Hawaii DOT's Harbor System Revs at 'AA-'; Outlook Stable

Fitch Ratings - New York - 13 February 2020:

Fitch Ratings has affirmed the 'AA-' rating on Hawaii Department of Transportation's (HI) $154.5 million of outstanding harbor system revenue bonds. The Rating Outlook is Stable.

RATING RATIONALE

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 sizable 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 consistently well 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 $120 million in fiscal 2020, leverage will remain supportive of the current rating level given the port's high liquidity levels.

KEY RATING DRIVERS

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 in fiscal 2017 (17% increase in cargo tariffs), followed by 15% increases in cargo tariffs in both fiscal 2018 and 2019. Beginning in fiscal 2020, rates are 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 $608 million, with approximately $482 million remaining from 2020-2024, 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 using restricted cash, the plan is expected to necessitate additional leverage, with $120 million in revenue bonds anticipated in 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 $120 million in the near term, annual debt service is expected to step up beginning in fiscal 2020.

Financial Summary

The harbor system benefits from stable operating margins with a sizable liquidity cushion of approximately 1,516 DCOH in 2019. While future balances may vary with spending for the CIP, management targets retaining strong reserves of at least 1,000 DCOH. Coverage has been strong at over 2.0x historically and over 3.0x in more recent years (5.6x in fiscal 2019). Throughout the forecast period, coverage is expected to remain above these levels, averaging 3.8x under the rating case. All-in leverage is expected to remain below 1x over the next five years despite 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 4.0x and a cash position greater than its net debt for fiscal 2018. The Hawaii Harbor System has similar strong metrics with a DSCR of 5.6x and low leverage of 0.2x. Hawaii and San Diego both have solid demand and utilization, along with consistently 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

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.

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.

CREDIT UPDATE

Overall cargo volumes (measured in short tons) grew 5.6% in fiscal 2019 with 21.5 million tons of cargo moving through the Hawaii ports. The system's cargo volumes have rebounded to pre-recession levels and have grown at a five-year CAGR of 1.0%. The harbor system implemented annual cargo and pipeline tariff rate increases of 17%, 15% and 15% in fiscal 2017 through fiscal 2019. A combination of cargo volume growth and the tariff increase contributed to 19% wharfage revenue growth in fiscal 2019. Starting in fiscal 2020, cargo and pipeline tariffs are increased each year on July 1 by the greater of 3% or CPI; the first 3% increase took effect on July 1, 2019.

Passenger tariffs were also increased in fiscal 2019, growing from $7.50 in fiscal 2018 to $15 for Honolulu Harbor and $8 for all other harbors. Lastly, the Harbors Division has scheduled annual increases in port entry fees and dockage fees (20%, 15%, and 15% for fiscal 2020 through fiscal 2022), which commenced on July 1, 2019. Revenues from these fees comprise a small share of total revenues and, as such, have a smaller impact on revenue growth than the scheduled cargo and pipeline tariff increases.

Total operating revenues for the harbor system increased 15.5% to $190.7 million in fiscal 2019, largely reflecting the 15% increase in cargo and pipeline tariff rates that took effect on July 1, 2018. Service revenues, which account for 83.5% of operating revenues, increased by 17% and rental revenues (15.7% of total operating revenues) increased by 7.9%. Operating expenses declined 8.3% to $54.7 million, largely due to decreases in harbor operations costs and maintenance costs. Future personnel cost increases are expected, as the result of Collective Bargaining Agreements, and are incorporated into the sponsor's projections.

Debt service coverage in fiscal 2019 was robust at 5.6x, and higher than Fitch's prior year base case forecast of 4.8x. The stronger DSCR in comparison to expectations is attributed to higher revenues and lower than expected expenses, which came in 15% below the forecast. The system continues to have strong liquidity, with approximately 1,516 DCOH in fiscal 2019, consistent with management intentions to maintain at least 1,000 DCOH.

FINANCIAL ANALYSIS

Fitch's base case reflects the harbor system's forecast through 2023, which includes annual tariff increases of 3% and scheduled port entry and dockage fee increases. Operating revenues grow at a five-year CAGR of 3.5% (0.5% net of tariff increases), while operating expenses grow by a CAGR of 5.7%. The base case scenario also considers the harbor system's anticipated borrowing of $120 million in late fiscal 2020, reflected in increased debt service payments commencing fiscal 2020 and increased debt outstanding. Debt service savings resulting from an anticipated refunding of the

2010A bonds in fiscal 2020 are also incorporated into the forecast. Under these assumptions, DSCR averages 4.4x and leverage declines to 0.2x by 2024, remaining below 1x even with the anticipated additional borrowing.

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. Operating revenues experience a 5% stress in fiscal 2021 and recover to 2019 levels by 2023, which results in a five-year CAGR of 0.8% (-2.2% net of tariff increases). Operating expenses are elevated 0.5% above base case assumptions. The rating case also includes the anticipated $120 million issuance and series 2010A refunding in fiscal 2020. Under this scenario, DSCR averages 3.8x and leverage falls to 0.2x by 2024.

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.

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.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3. This signals that ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity.

For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING		PRIOR
Hawaii Department of Transportation (HI) [Port Facilities]			
	LT AA-		AA-

Hawaii Department of Transportation (HI) /Port Facilities Revenues/1 LT	Affirmed		

Additional information is available on www.fitchratings.com

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Applicable Criteria

Ports Rating Criteria (pub. 23 Feb 2018)
Rating Criteria for Infrastructure and Project Finance (pub. 27 Jul 2018)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form
Solicitation Status
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