FitchRatings

RATING ACTION COMMENTARY

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

Wed 28 Feb, 2024 - 11:15 AM ET

Fitch Ratings - New York - 28 Feb 2024: Fitch Ratings has affirmed the 'AA-' rating on Hawaii Department of Transportation, HI's (DOT) $260.6 million of outstanding harbor system revenue bonds. The Rating Outlook is Stable.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Hawaii Department of Transportation (HI) [Port Facilities]				
Hawaii Department of Transportation (HI) /Port Facility Revenues - First Lien/1 LT	LT	AA- Rating Outlook Stable	Affirmed	AA- Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

RATING RATIONALE

The rating reflects the harbor system's natural monopoly position serving the islands of Hawaii. The system benefits from an enacted tariff rate mechanism and a history of positive revenue trends supported by stable volume growth. The harbor system is expected to maintain its historically robust financial profile with strong coverage, low leverage, and high liquidity of more than the internal target minimum 1,000 days cash on hand (DCOH).

Metrics remain supportive of the current rating level, with no additional borrowing expected in the medium term. Under Fitch's rating case, coverage levels average 6.2x and leverage is consistently below 1.0x, reaching 0.2x by 2028.

KEY RATING DRIVERS

Revenue Risk - Volume - Stronger

Volumes Supported by Natural Monopoly: Port volumes are anchored by the essentiality of the harbor system 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 offsets 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. The implementation of annual cargo and pipeline tariff increases have stabilized and strengthened revenues in recent years. Rates are increased annually on July 1 by the greater of 3% or CPI, effectively hedging against inflation. No material elasticity to port demand has been observed in response to historical tariff adjustments. While the harbor system lacks long-term leases/agreements, its long and established history with its top shippers have provided for revenue stability that Fitch expects will continue.

Infrastructure Dev. & Renewal - Midrange

Manageable Capital Plan: The harbor system's capital improvements program (CIP) has a high degree of flexibility, totaling $1.9 billion through fiscal 2041, and is primarily funded with cash. The capital plan focuses largely on the Harbors Modernization Plan, a plan developed in conjunction with key harbor users and state officials and consisting of various projects to enhance the system's efficiency and capacity by addressing long-term capital needs. The current largest project is the Honolulu Inter-Island Barge Terminal Development totaling $479.5 million, which has begun in February 2023 and is expected to be completed in December of 2031.

Debt Structure - 1 - Stronger

Conservative Debt Structure: Outstanding debt consists of all fixed-rate bonds with a rapid amortization schedule. Bond covenants provide adequate protections to bondholders and 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 a common maximum annual debt service (MADS)-based debt service reserve requirement that is met through a combination of cash and surety policies.

Financial Profile

The harbor system benefits from stable operating margins with a sizable liquidity cushion of approximately 1,780 DCOH in fiscal 2023. Future balances may vary with spending for the CIP, but management targets maintenance of reserves at or above 1,000 DCOH. Coverage has been strong at over 5.0x in recent years, and is expected to remain above this level through the forecast period. Coverage was 5.7x in FY 2023, reflecting a combination of robust revenues and lower annual debt service following 2020 refunding transactions. Under Fitch's rating case, coverage levels average 6.2x and leverage is consistently below 1.0x, reaching 0.2x by 2028.

PEER GROUP

San Diego Unified Port District (A+/Stable) serves as a comparable peer to the harbor system. The district has a total debt service coverage ratio (DSCR) of 5.8x and a cash position greater than its debt for fiscal 2022. The Hawaii Harbor System has comparable coverage metrics and benefits from low leverage of 0.5x. 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 supporting a stronger volume assessment and also has less revenue risk given the essentiality of the service it provides to island populations, reflected in its higher rating.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

--Increased volatility in throughput volumes or changes in net revenues that result in coverage sustained below 2.0x;

--Leverage that increases to and is maintained above 5.0x net debt to CFADS.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--Given the current rating level and potential for volatility in leisure market related revenue streams, upward rating movement is unlikely at this time.

CREDIT UPDATE

The harbor system benefits from a natural monopoly position, providing for delivery of essential commodities to the State of Hawaii. Cargo volumes have recovered to pre-pandemic levels, albeit with a greater share of empty containers in 2023, and a drop in dry bulk cargos reflecting the cessation of coal cargos following the September 2022 power plant closure. Cargo-related revenues continue to rise yoy due to rates which increase annually at the greater of 3% or Honolulu CPI; most recently, a 5.2% increase for cargo and pipeline rates took effect in July 2023 for fiscal 2024.

Cruise activity has continued to rebound following the return of services in fiscal 2022, with passengers reaching 90% of pre-pandemic levels in fiscal 2023 and generating $8 million in revenues. Management indicates they expect cruise activity to continue to grow in Hawaii in the coming years. Overall, fiscal 2023 operating revenues reached $214 million, a yoy increase of 6% over the year prior, though were 2% lower than Fitch's prior base case revenue expectations.

Operating expenses grew by 9% in fiscal 2023 relative to fiscal 2022, largely reflecting increases in personnel services and harbor operations, as well as costs related to the resumption of cruise activity. Management expects operating expenses to moderate from 2024 onwards, having incorporated recent cost step-ups associated with a return to full staffing levels post-pandemic and associated benefit costs.

Debt service coverage in fiscal 2023 was healthy at 5.7x, reflecting stable revenue trends supported by the essentiality of the harbor system, coupled with lower annual debt service following refunding transactions in 2020. The coverage level exceeded Fitch's base case expectations of 5.0x in fiscal 2023. The system continues to maintain high levels of liquidity, with over 1,780 DCOH in fiscal 2023. Even as the harbors division funds upcoming capital projects with cash, management indicates they will target maintenance liquidity at or above 1,000 DCOH.

The harbor's current capital plan runs through 2041 with an estimated cost of approximately $1.9 billion. Management indicates projects are primarily expected to be funded through cash from operation, together with harbor revenue bonds and federal funds. The DOT has made progress in completing the first phase of the Kapalama Container Wharf/Yard construction project; with landside improvements substantially complete and phase 2 wharf improvements expected to be completed by June 2025. Most of the harbor's priority projects are anticipated to be completed by 2030. The largest three projects are pier and wharf improvements at Honolulu ranging from $320 million to $480 million, with projects focused on modernization of facilities and sea level rise mitigation over the longer term.

FINANCIAL ANALYSIS

Fitch Base Case

Fiscal 2024 (June 30 YE) revenue performance is based on year to date performance through December and management's expectations. Fitch's base case reflects the harbor system's forecast through 2028, with operating revenues growing at a five-year CAGR of 4.2%, while operating expenses grow at a CAGR of 7.0% (3.1% when backing out the 2024 increase). Under these assumptions, DSCR averages 7.0x and leverage declines to 0.2x by 2028.

Fitch Rating Case

Fitch's rating case considers the effects of a hypothetical recessionary stress to cargo operations in fiscal 2025, resulting in a 5% decrease in revenues followed by a modest two-year recovery period. Revenues grow by 2.8% per annum in 2026 and 2027, resulting in a five-year CAGR of 1.6%, while operating expenses are stressed by 1.0% above base case assumptions and grow at a 7.9% five-year CAGR through 2028 (4.1% from 2024). Under this scenario, DSCR averages 6.2x through the forecast period and leverage declines to 0.2x by 2028. Metrics remain robust under the recessionary conditions contemplated in the rating case, and are supportive of the rating level.

SECURITY

The bonds are special limited obligations of the state, payable from and secured solely by net revenues derived by the state from the ownership or operation of the statewide system of commercial harbors after payment of the costs of operation and maintenance.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

FITCH RATINGS ANALYSTS

Emma Griffith
Senior Director
Primary Rating Analyst
+1 212 908 9124
emma.griffith@fitchratings.com
Fitch Ratings, Inc.
33 Whitehall Street New York, NY 10004

Jennie Mu
Associate Director
Secondary Rating Analyst
+1 646 582 4748
jennie.mu@fitchratings.com

Jeffrey Lack
Senior Director
Committee Chairperson
+1 312 368 3171
jeffrey.lack@fitchratings.com

MEDIA CONTACTS

Sandro Scenga
New York
+1 212 908 0278
sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

Infrastructure & Project Finance Rating Criteria (pub. 17 May 2023) (including rating assumption sensitivity)

Transportation Infrastructure Rating Criteria (pub. 18 Dec 2023) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

GIG AST Model, v1.3.1 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Hawaii Department of Transportation	EU Endorsed, UK Endorsed

DISCLAIMER & DISCLOSURES

All Fitch Ratings (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, the following https://www.fitchratings.com/rating-definitions-document details Fitch's rating definitions for each rating scale and rating categories, including definitions relating to default. ESMA and the FCA are required to publish historical default rates in a central repository in accordance with Articles 11(2) of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 and The Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019 respectively.

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 or ancillary service to the rated entity or its related third parties. Details of permissible or ancillary service(s) for which the lead analyst is based in an ESMA- or FCA-registered Fitch Ratings company (or branch of such a company) can be found on the entity summary page for this issuer on the Fitch Ratings website.

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. Fitch Ratings makes routine, commonly-accepted adjustments to reported financial data in accordance with the relevant criteria and/or industry standards to provide financial metric consistency for entities in the same sector or asset class.

The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. Sector-specific best- and worst-case scenario credit ratings are listed in more detail at https://www.fitchratings.com/site/re/10238496 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.

dv01, a Fitch Solutions company, and an affiliate of Fitch Ratings, may from time to time serve as loan data agent on certain structured finance transactions rated by Fitch Ratings.

READ LESS

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained by Fitch at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's Regulatory Affairs page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.