S&P Global
Ratings

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Summary:
Hawaii; Gas Tax

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Summary:

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Credit Profile		
US$80.73 mil highway rev bnds ser 2019A due 06/30/2041		
Long Term Rating	AA+/Stable	New
US$24.825 mil highway rev bnds ser 2019B due 06/30/2034		
Long Term Rating	AA+/Stable	New
Hawaii		
Hawaii Dept of Transp, Hawaii		
Hawaii (Hawaii Dept of Transp) gas tax		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to the state of Hawaii's series 2019A highway revenue bonds and 2019B highway revenue bonds. At the same time, S&P Global Ratings affirmed its 'AA+' rating on Hawaii's highway revenue bonds outstanding, issued on behalf of the Department of Transportation (DOT). The outlook is stable.

The bonds are secured by a pledge of revenues deposited into the state highway fund. On deposit into the state highway fund, the pledged revenues are immediately credited to the highway revenue subaccount. Once credited, the bonds have a senior-lien claim on revenues in the subaccount.

We rate the bonds based on our "Priority-Lien Tax Revenue Debt" criteria (published Oct. 22, 2018, on RatingsDirect), which take into account both the strength and stability of the pledged revenues, as well as the general credit quality of the obligor where taxes are distributed and/or collected, in this case, the State of Hawaii (general obligation [GO] rating: 'AA+/Stable').

Bond proceeds for the 2019A will be used to finance various highway renovations and improvements. The series 2019B bonds we be used to refund outstanding highway revenue-secured debt for debt service savings.

Our key credit considerations include our view of the consolidated transportation:

- Statewide collection of a diverse group of fees and taxes associated with Hawaii's highway transportation system;
- Very strong, estimated 5.57x coverage of pro forma maximum annual debt service (MADS, 2021) by final 2019 pledged revenues (unaudited);
- Low volatility based on a diverse mix of pledged transportation-related revenue and demonstrated willingness of the state legislature to increase taxes and fees that contribute to the pledged revenue; and
- Linkage to the general creditworthiness of the State of Hawaii.

Revenue volatility: Low

We view the pledged revenue source as stable and well diversified. Pledged revenues consist of fuel taxes (29% of pledged revenues), weight taxes (29%), rental/tour vehicle surcharges (20%), registration fees (16%), other miscellaneous sources (5%), and interest earnings (1%). Since 2011, the composition of pledged revenues has migrated gradual away from fuel taxes (to 29% from 45% of the total) in favor of registration fees, vehicle weight taxes, and miscellaneous revenues, the shares of which all have increased. The weight tax share of total revenues has increased the most since 2011 to 29% in 2019 from 17% in 2011. Overall, we view the gradual diversification of the pledged revenues as favorable partly reflecting favorable economic momentum since the Great Recession, several fee and tax adjustments enacted by the legislature in 2011 have boosted the baseline level of pledged revenues. The legislatively enhanced revenues included increases to the state's vehicle weight tax (ranging between $0.0175 to $0.0225 per pound of net vehicle weight), elimination of a sunset provision that would have ended the motor and tour vehicle surcharge tax, and vehicle registration fee increases. The legislature also approved fines for drivers using mobile devices and parking in bicycle lane violations, both of which have supplement the miscellaneous revenues. Effective July 1, 2019, effectuated by Act 174 (Senate Bill 162) the surcharge tax on rental motor vehicles was raised by $2 to $5. Pledged revenue grew at a compound annual rate (CAGR) of 2.41% over a five-year period and 4.26% over a ten-year period. DOT estimates pledged revenues will grow nearly 14% in fiscal year 2020 to $327.92 million from $287,686 in 2019 (estimated final, unaudited). Rental vehicle surcharge revenues are estimated to increase by 67% to $97.1 million in 2020 from roughly $58 million. After 2020, annual pledged revenue growth is estimated to grow by just under 1% annually through 2024, which, in our view, reflects prudent conservative estimates.

Our macro volatility assessment begins with an assessment of the historical volatility of the economic activity being taxed, and includes an analysis of societal, demographic, political, and other factors that could affect these activities. Based on the variance of national economic activity that we believe most closely represents the taxing base over multiple economic cycles, it is used to inform our opinion on expectations of future volatility.

Coverage and liquidity: Very strong

One of the state's 18 executive departments, DOT has three main operating divisions that oversee the state's 15 airports, most of its harbors, and 954 linear miles of highways and roads. Within the state, the department and the counties share the responsibility for constructing and maintaining the state's total roughly 4,340 linear miles of highways, roadways, and streets with various federal agencies (e.g., National Park Service and military services) having oversight over an additional nearly 118 linear miles. All of the interstate and freeway expressways are on the island of Oahu (27% of total DOT mileage), where 70% of the state's population resides.

Legal projections are good, with a 2.0x MADS senior-lien additional bonds test. Issuance of variable-rate debt is not permitted on the senior lien. The provisions also allow for a flow of funds that requires payment of debt service before operations and maintenance and reimbursable GO bonds; in addition, there is a state covenant to impose user taxes that are at least sufficient to keep the department self-sustaining. A debt service reserve (DSR) is funded to one-half MADS, though the supplemental indenture allows for elimination of the DSR pending consent of 100% of bondholders. The coverage test relies on historical pledged revenues of 12 consecutive months of the previous 18-month period, which we view as stronger than a reliance on projected revenues.

Fiscal year 2018 pledged revenues covers a MADS by 5.6x, while estimated final fiscal 2019 pledged revenues provide

5.7x MADS coverage. Annual debt service coverage (DSC) has ranged from 4.55x-5.34x since 2014. DOT anticipates issuing $80 million in fiscal year 2020 and $200 million in 2021. Under current estimates by DOT, which assume modest pledged revenue growth after 2020, annual coverage would average 5.9x over fiscal years 2021-2024.

DOT takes a comprehensive approach to cash management and has maintained restricted and unrestricted cash balances in the range of $277 million-$455 million from fiscal years 2014-2018. On a generally accepted accounting practices basis, it reported cash and investments totaling $273.48 million at fiscal year-end 2018, with $184.78 million in its state highway fund.

Economic fundamentals: Very strong

The state's population has remained relatively flat in the past three years, totaling an estimated 1.42 million in 2019 and projected to continue to grow by 0.2% and 0.3% in 2020 and 2021, respectively. The U.S. Census Bureau reports that the state's population grew 4.4% from April 2010 to April 2018 at a modest 0.5% annual rate. By comparison, the U.S. national average was 6% over the same period with an annual average rate of 0.7%. As an island-economy state, Hawaii is inherently vulnerable to the negative effects of certain types of exogenous shock events. Certain broad economic metrics, however, suggest a more resilient economy than popularly perceived. For instance, although Hawaii was not immune to the Great Recession, relative to the nation, however, per capita personal income in the state actually increased to 105% in 2009 from 101% in 2007, although it has subsequently remained near 102% of the national level in recent years. Growth of Hawaii's gross state product (GSP), the broadest measure of its economy, suggests that the state, like much of the rest of the U.S., is near a maturing economic cycle with modest growth anticipated within the next two years. IHS Markit forecasts that Hawaii's economic growth will grow from 1.1% in 2020 and 0.8% in 2021 while the U.S. as a whole is estimated to grow 2% each year, respectively.

While the state's decelerating population growth and economic expansion could result in challenges for the state beyond its highway pledged revenues, to the extent that it navigates economic cycles, overall credit metrics should remain relatively strong, in our view.

Obligor linkage: Close

Given that the state collects the pledged revenues, we view the rating on the highway user bonds as linked to Hawaii's creditworthiness. In our establishment of a one-notch upward limitation on the highway revenue bond rating compared to the state GO rating, we included our view that the state provides critical public services into our analysis. Additionally, while we view the dedication of funds deposited into the state highway fund for highway purposes as providing a degree of uplift, the collection and distribution of pledged revenues by the state exposes the revenues to operating risk if there should be a distress situation.

For more information on the state's creditworthiness, please refer to our last GO analysis on Hawaii, published Jan. 25, 2019, on RatingsDirect.

Outlook

The stable outlook reflects our expectation of continued gradual growth of pledged revenues and very strong annual DSC as the department continues to implement its ongoing capital improvement plan. Based on current future debt offerings, we believe Hawaii can withstand somewhat lower DSC ratios, which are estimated to remain very strong even under conservative estimates. Limiting the upward potential at this point is the department's ABT which in our opinion is not commensurate with those of higher-rated peers. If future debt issuances materially exceed current plans or if the distribution of revenues to the highway fund were reduced, the rating could become subject to downward pressure. Given the ratings are linked to the rating of the state of Hawaii, if the latter were to deteriorate, we could also lower the rating, although we do not anticipate such a scenario within our outlook period.

Ratings Detail (As Of November 7, 2019)		
Hawaii Hwy GASTAX		
Long Term Rating	AA+/Stable	Affirmed
Hawaii Hwy GASTAX		
Long Term Rating	AA+/Stable	Affirmed
Hawaii Hwy GASTAX (BHAC) (SEC MKT)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.