S&P Global Ratings

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Hawaii; Gas Tax

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US$144.975 mil hwy rev bnds ser 2021 due 01/01/2046		
Long Term Rating	AA+/Stable	New
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
Hawaii (AGM)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating to the State of Hawaii's $144.98 million series 2021 highway revenue bonds. At the same time, S&P Global Ratings affirmed its 'AA+' rating on the state's highway revenue bonds outstanding, issued for the Hawaii Department of Transportation (DOT). The outlook is stable.

We rate the bonds based on our "Priority-Lien Tax Revenue Debt" criteria (published Oct. 22, 2018), 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+/Negative').

Bond proceeds will be used to finance various highway renovations and improvements.

Credit overview

Pledged revenues have shown strong growth since 2011, increasing 46% to $288 million in fiscal 2020. Pledged revenues consist of fuel taxes (27% of pledged revenues), vehicle weight taxes (27%), rental/tour vehicle surcharges (25%), registration fees (15%), other miscellaneous sources (3%), and interest earnings (3%). The legislature has a history of adjusting rates and recently passed HB 485 HD1 SD1 CD1 (HB 485), which will raise the rental motor vehicle surcharge by 50 cents each year from Jan. 1, 2022 through Dec. 31, 2027, to $8/day from $5/day (awaiting governor's approval). However, pledged revenues are forecast to decline 21% in fiscal 2021. Projected revenues show strong growth of 20% in 2022 and 9.3% in 2023, reflecting higher activity in the state combined with planned increases in rental/tour motor vehicle surcharges. One of Hawaii's 18 executive departments, DOT has three main operating divisions that oversee the state's 15 airports, most of its harbors, and 949 linear miles of highways and roads. The department and the counties share the responsibility for constructing and maintaining Hawaii's approximately 4,369 linear miles of highways, roadways, and streets; various federal agencies (e.g., National Park Service and military services) have oversight over an additional almost 130 linear miles.

A pledge of revenues deposited into the state highway fund secures the bonds. 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.

Key credit considerations include our view of the following:

- Statewide collection of a diverse group of fees and taxes associated with Hawaii's highway transportation system;
- Very strong debt service coverage (DSC) maintained above 4.5x over the past five years and projected at 4.5x in 2021, and then expected to increase to above 5.0x in 2022 and strong ABT at 2.0x maximum annual debt service (MADS);
- 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.

The stable outlook reflects very strong annual DSC including the impact of lower pledged revenues in fiscal 2021, with incremental new revenues and recovery in pledged revenues expected to return coverage to historical levels above 5x as the department implements its ongoing capital improvement plan. Based on planned future debt offerings, in our opinion, Hawaii can withstand somewhat lower DSC ratios, which are expected to remain very strong even under conservative estimates.

Environmental, social, and governance (ESG) factors

The rating incorporates our view regarding the health and safety risks posed by the COVID-19 pandemic. Absent the implications of COVID-19, we consider the state's social risks slightly higher than the sector given slower growth trends, an older population, and significantly higher living costs limiting in-migration. Hawaii's location also exposes it to considerable environment-related risks such as hurricanes, which could dampen its tourism-based economy in the short term, although the state has generally displayed resilience over the longer term as demand for tourism has remained strong despite periodic challenges. We view the state's governance risks as being in line with the sector.

Stable Outlook

Upside scenario

We do not expect to raise the rating during the two-year outlook period. Limiting upward rating potential at this point is the department's additional bonds test (ABT), which in our opinion is not commensurate with those of higher-rated peers.

Downside scenario

If future debt issuances materially exceed current plans or if the distribution of revenues to the highway fund declines, we could lower the rating. Given the rating is linked to the rating on Hawaii, if we lowered the rating on the state, we could also lower the rating on the department's debt.

Credit Opinion

Revenue volatility: Low

We view the pledged revenue source as stable and well diversified. Pledged revenues consist of fuel taxes (27% of pledged revenues), vehicle weight taxes (27%), rental/tour vehicle surcharges (25%), registration fees (15%), other miscellaneous sources (3%), and interest earnings (3%). Since 2011, the composition of pledged revenues has migrated gradually away from fuel taxes (to 27% from 45% of the total) in favor of registration fees, vehicle weight taxes, and miscellaneous revenues. HB 485 will increase the rental motor vehicle surcharge by 50 cents each year from Jan. 1, 2022 through Dec. 31, 2027, to $8/day from $5/day (awaiting governor's approval). As a result of the planned increase, rental/tour taxes are forecast to increase and will become the largest revenue source. Overall, we view the gradual diversification of the pledged revenues as favorable. Partially 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. In addition to planned increases from HB 485, historical legislative enhancements include increases to the state's vehicle weight tax ($0.0175-$0.0225 per pound of net vehicle weight), elimination of a sunset provision that would have ended the motor and tour vehicle surcharge, and vehicle registration fee increases. The legislature also approved fines for drivers using mobile devices and parking in bicycle lanes , both of which have supplemented the miscellaneous revenues. Effective July 1, 2019, under Act 174, Session Laws of Hawaii 2019 the surcharge tax on rental motor vehicles was raised by $2 to $5 and will be adjusted further with HB 485. Pledged revenue increased at a compound annual rate of 1.4% over a five-year period and 4.3% over a 10-year period. DOT estimates pledged revenues will decline by 21% in fiscal 2021 and then increase 20% in 2022 and 9.3% in 2023 to $298.5 million, exceeding pre-pandemic levels. Rental vehicle surcharges are projected to become the largest contributor to pledged revenues, increasing to $149.5 million in 2027 from $72.5 million in 2020, reflecting rate adjustments and increased activity.

Our macroeconomic 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

Legal protections are good, with a 2.0x MADS senior-lien ABT. 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, although the supplemental indenture allows for elimination of the DSR with consent of 100% of bondholders. Upon consent of bondholders we do not believe the elimination of the DSR will result in a rating change given the strong historical and projected DSC. 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 2020 pledged revenues cover MADS by 5.85x. Pledged revenues are projected to be 21% lower in fiscal 2021, with coverage expected to decline to 4.46x. Annual DSC has ranged from 4.55x-6.07x since 2014. DOT anticipates issuing $80 million of debt in fiscal 2023 to fund additional projects. Under current department estimates, which include incremental new revenues from HB 485 and anticipated recovery in pledged revenues, annual coverage would range from 5.23x to 5.84x over fiscal years 2022-2027.

DOT takes a comprehensive approach to cash management and has maintained restricted and unrestricted cash balances of $277 million-$455 million from fiscal years 2014-2020.

Economic fundamentals: Very strong

The state's population has been relatively flat over the past three years, totaling an estimated 1.43 million in 2020, and is projected to decline modestly by 0.4% in 2021 and remain flat in 2022. As an island-economy state, Hawaii is inherently vulnerable to the negative effects of exogenous shock events, including the current pandemic. Hawaii's gross state product (GSP), the broadest measure of its economy, is expected to decline 8% in 2020, followed by projected growth of 6.0% in 2021 and 6.6% in 2022, suggesting a fairly sharp recovery.

While Hawaii's generally flat population growth and economic contraction could result in challenges for the state beyond its highway pledged revenues, the early signs of recovery should allow the state to navigate the current economic cycle and 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 revenue bonds as linked to Hawaii's creditworthiness. In our establishment of a one-notch upward limitation on the highway revenue bond rating compared with the state GO rating, we included our view that the state provides critical public services in our analysis. In addition, 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 general credit characteristics, please refer to our most recent analysis, published Oct. 16, 2020, on RatingsDirect.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020