FitchRatings

FITCH AFFIRMS HAWAII HARBOR SYSTEM REV BONDS AT 'A+'; OUTLOOK STABLE

Fitch Ratings-New York-08 November 2011: Fitch Ratings affirms its 'A+' rating of $379 million in outstanding Hawaii Department of Transportation (HI), harbor system revenue bonds. The Rating Outlook on all bonds is Stable.

Key Rating Drivers:
Strong State Economy: Stability of the state's underlying economy through the downturn with signs of stabilization and return to growth in recent periods.
Natural Monopoly: 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.
Approved Tariff Increases: The harbor system has adopted scheduled tariff increases for cruise, cargo, and pipelines, with escalations underway since 2010 and scheduled to continue through 2016, including a mechanism to increase cargo tariffs annually by 3% or CPI, from 2016 onwards.
Considerable Capital Plan: Sizable and evolving capital improvement plan (CIP) that will necessitate increasing leverage.
Conservative Debt Structure: Moderate leverage (5.7 times [x] net debt to CFADS [cash flow available for debt service] in 2010) with all fixed-rate debt, providing adequate coverage for both senior and general obligation bonds. This mitigates the somewhat limited protection provided by the 1.0x rate covenant and additional bonds test.
Strong Financial Profile: Stable operating margins with a sizable liquidity cushion, with unrestricted liquidity providing more than 800 days cash on hand. Coverage is adequate at over 2.0x historically.

What Could Trigger a Rating Action:
While fluctuations in throughput may negatively impact revenues, the legally adopted rate increases over the next five years and ongoing from the sixth year forward serve to mitigate this risk, as does the continued presence of anchor carriers with long histories serving the Hawaiian market. However, absent improved growth in throughput volumes, management's ability to manage continued price increases as it progresses with the harbor system's capital program may impact ratings.

The harbor system's capital program is considerable and calls for sizable borrowing in the medium term. Should increasing debt service requirements outpace revenue generation, this may affect credit quality. Fitch gives credit to management's ability to moderate the progression of the capital plan in a way that maintains the harbor division's financial profile at or near historical levels.

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.

Credit Summary:
After remaining steady over the past decade and a half, overall cargo volume for the harbor system declined in each of fiscal 2008, 2009, and 2010 (2.0%, 13.1%, and 3.5%, respectively) as the recession took hold. Preliminary throughput figures indicate that volume is up 1.3% for fiscal 2011, reflecting a slight recovery in cargo levels as tourism activity rebounds somewhat in Hawaii. While operating revenues likewise declined over the 2008-2010 period (dropping 0.3%, 12.7%, and 1.8%, respectively), 2010's more moderate drop in revenue relative to volume indicates the effect of the first of a series of multi-year tariff increases, first implemented in 2010. Preliminary results for 2011 indicate an increase of 17.2% to $85.9 million, reflecting the 20% cargo and pipeline tariff increase from July 2010.

The scheduled tariff increases, developed with concurrence from primary harbor system users, are the first increases to be implemented since 1997. Cargo rates will increase incrementally between 2010 and 2014 at rates starting at 20% and stepping down on an annual basis to 5%. The plan also includes 3% or CPI increases from 2015 onwards. Likewise, passenger fees will increase $0.50 per year through 2016. These prescribed increases provide considerable revenue flexibility to the harbor division going forward, and are intended to support the division's sizable modernization plan.

While operating expenses saw sizable increases historically, management has worked to contain spending since 2006, and has moderated its spending through the downturn. Operating expenses excluding depreciation decreased by 4.4% in fiscal 2009 over the previous year, and dropped a further 22.1% in fiscal 2010 due to a large portion of capitalized maintenance expenses. Preliminary figures for fiscal 2011 indicate operating expenses are up 15.5% to $45.2 million, largely due to fewer capitalized expenses. However, expenses remain 10% below 2009 levels. In the medium to long term, Fitch expects some increases in the system's operating expense profile as harbor operations return to pre-recession levels, as deferred maintenance is funded, and as labor costs under collective bargaining agreements come online.

The harbor division has historically recorded strong cash levels and healthy debt service coverage ratios. The division's unrestricted cash as of June 2011 is $107.7 million, representing 860 days cash on hand based on preliminary 2011 results. This represents an increase in cash balances, which had fallen slightly over the previous three years, and remains consistent with the 'A' rating category. Fitch believes cash balances will remain adequate, although they may decline some as management executes the harbor modernization plan over the next several years.

Debt service coverage in fiscal 2010 and 2009 was slightly lower than historical levels at 2.1x and 1.9x, respectively, largely due to lower cargo throughput and the related drop in cargo-related revenues. Preliminary fiscal 2011 figures show an increase in coverage to 2.4x. When including the system's general obligation payment requirements of roughly $3.3 million per year for obligations taken on in the context of the Superferry project, all-in coverage is slightly lower at 2.3x. With the implementation of scheduled tariff increases through 2016, the harbor division projects coverage of 1.9x or higher with throughput increases of on average 2% per year (1.8x including general obligation debt). Under Fitch's various stress scenarios, including a double-dip in 2012, no revenue growth above the scheduled tariff increases and a 100-basis point increase in annual operating expense growth, coverage remains robust at 1.6x or higher (1.5x including general obligation debt). Fitch anticipates additional borrowing in the context of the harbor system's CIP, which may increase leverage levels from currently moderate levels (5.7x net debt to CFADS for 2010). However, Fitch anticipates that the harbor division will manage the timing and sizing of borrowing for its capital program in order to maintain sufficient levels of coverage and liquidity.

The current capital program for the harbors division covers the period through 2015, with the main focus being the harbors modernization plan, currently known as the New Day Work Projects (NDWP). Working in partnership with the Hawaii Harbor Users Group (HHUG), a non-profit maritime transportation industry group comprised of key harbor users and state officials from the department of transportation and other departments, the NDWP consists of various projects to enhance the system's efficiency and capacity by addressing long-term capital needs. The plan is expected to cost $618 million, and will extend until at least 2016. Funding for the NDWP is expected to come largely from revenue bond proceeds, including the 2010 series bonds.

Issuance of additional debt will be dependent upon the harbor system's revenues, as timing and progression of NDWP projects is flexible (additional bonds will only be issued if revenues are sufficient to meet additional debt service requirements). The next issue is proposed for 2014-2015, provided revenue requirements are met. Fitch will continue to monitor the developments of the system's capital planning and revenue profile as annual tariff increases go into effect.

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.

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Additional information is available at 'www.fitchratings.com'. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

Applicable criteria and related Research:
--'Rating Criteria for Infrastructure and Project Finance', dated 16 Aug. 2011;
--'Rating Criteria for Ports', dated 29 Sept. 2011.

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Rating Criteria for Ports
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=652165
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