Fitch Ratings

19 Oct 2020 | Downgrade

Fitch Rates Hawaii's $1B GOs 'AA'; Downgrades IDR to 'AA'; Revises Outlook to Stable

Fitch Ratings-San Francisco-19 October 2020:

Fitch Ratings has assigned 'AA' ratings to the following State of Hawaii (state) general obligation (GO) bonds:

--$147 million GO bonds of 2020, series GA;

--$600 million taxable GO bonds of 2020, series GB;

--$300 million taxable GO refunding bonds of 2020, series GC.

In addition, Fitch has downgraded the following state ratings:

--Issuer Default Rating (IDR) to 'AA' from 'AA+';

--$7.7 billion in outstanding GO bonds to 'AA' from 'AA+'.

Fitch has also affirmed the following rating:

--$431 million in outstanding highway revenue bonds at 'AA'.

The Rating Outlook for the IDR and the GO bonds is revised to Stable from Negative. The Outlook for the highway revenue bonds remains Stable.

The 2020 series GA, GB, and GC bonds are scheduled to be sold via negotiation on Oct. 20-21, 2020.

SECURITY

The GO bonds are general obligations of the state that carry the full faith and credit pledge of the state.

The highway revenue bonds are special, limited obligations of the state, payable from pledged funds that consist primarily of the fuel license (gas) tax, vehicle registration fees and weight taxes, and rental motor vehicle, tour vehicle, and car-sharing vehicle surcharges.

IDR ANALYTICAL CONCLUSION

The downgrade of the state's IDR and GO bond rating to 'AA' from 'AA+' reflects the outsized impact of the coronavirus pandemic on Hawaii's economy and workforce, particularly its large leisure and hospitality sector. The sudden economic shock brought by the pandemic and the subsequent severe recession is well beyond the routine cyclicality faced by state governments and reflected in IDRs. While Hawaii has a track record of very strong operating performance, its ability to absorb the shock and maintain financial resilience will be tested by the duration of pandemic-related disruptions and the eventual strength of the state's recovery, which Fitch expects will span multiple years. Hawaii's globally important tourism industry, a pillar of the economy, is most affected, and its recovery will depend in part on public health and economic conditions in markets from which visitors originate and a rebound in domestic and international travel demand.

The Stable Outlook and evaluation of the state's credit quality going forward are informed by Fitch's coronavirus baseline and downside Fitch Analytical Stress Test (FAST) scenarios as described further below. In the near-term, the state will need to carefully manage the considerable economic and fiscal uncertainty caused by the pandemic. However, the state has already demonstrated considerable flexibility in its budgetary responses and has a wide array of budget balancing options available to it.

The state's increasingly diversified economic base will help the state maintain its financial flexibility in the medium-term as it works to absorb the costs arising from its pension and other post-employment benefit (OPEB) liabilities. The state's commitment to elevating pension contributions and a requirement to report to the legislature annually on a range of pension stresses establish a solid basis for managing the risks posed by its retirement obligations, which Fitch expects to remain high for the foreseeable future. Short- to medium-term suspension of OPEB prefunding will bolster the state's liquidity in the near term at the cost of prolonging paydown of, and potentially increasing, its OPEB liabilities.

DEDICATED TAX ANALYTICAL CONCLUSION

The 'AA' rating and Stable Outlook on the state's highway revenue bonds reflects Fitch's assessment of the strong resiliency of the structure and slow prospects for further growth of the pledged revenue stream. The rating is capped by the state's 'AA' IDR and Stable Outlook.

(SEE BELOW FOR DEDICATED TAX ANALYSIS)

Economic Summary

The State of Hawaii encompasses seven inhabited islands and a total population of 1.4 million, over two-thirds of whom reside on Oahu. The state's employment base and economy are diverse, with key sources of external support provided by tourism and a substantial federal presence. In the past two years, the state experienced small population declines, atypical relative to historically steady to strong annual population growth. These declines appear largely tied to military redeployments to the mainland (which are not expected to continue), reduced international in-migration (in response to current federal immigration policy), and a slightly declining birthrate.

In recent years, Hawaii's economic performance has been solid with increasing economic diversification, steady growth in tourism, and a continued substantial military presence. As evidence of increasing economic diversification, state officials calculate tourism's current share of GDP at 16%, compared to 33% in 1988. This means that economic activity generated by its own residents has become increasingly important to the state. For the first quarter of 2020, state officials estimated that the leisure and hospitality sector accounted for 18% of the state's employment, comparable to the trade, transportation and utilities sector (17%) but noticeably less than the government/military sector (26%). While tourism activity has been subject to periodic declines historically, it has proven resilient over the long term. Historical data indicate that major economic shocks suppress visitor arrival growth for around three years at the most, before resumption of the upward growth trend. However, the current downturn in tourist activity is unprecedently severe and might take longer to rebound.

Although personal income levels are above average on a nominal basis, real spending power is curtailed by the state's high cost of living. Housing affordability is a significant issue for Hawaii with well above average median single-family house prices (when comparing Honolulu with other comparably sized U.S. cities). State officials advise that considerably fewer houses are being constructed than local and out-of-state demand could absorb. Despite the pandemic, many residential, commercial, and hotel projects are currently underway and significant public sector capital investments are being made in transportation infrastructure, schools and universities, and water and wastewater systems. The military continues to make sizeable capital investments in its Hawaiian bases.

IDR KEY RATING DRIVERS

Revenue Framework::'aa'

General excise taxes (GET) and corporate and personal income taxes provided around 88% of Hawaii's fiscal 2019 general fund revenues. Total general fund revenues have performed solidly historically but it is likely that they will take some time to rebound from the current economic downturn. Medium-term prospects for revenue gains appear solid based on the state's economy where long-term diversification trends have bolstered economic resiliency. The state has full control over its revenues with no legal limits on potential increases.

Expenditure Framework::'aa'

Over the medium term, Fitch expects that state expenditure increases will be in line with to marginally above revenue growth absent offsetting policy action. Carrying costs for debt service and retiree benefits are somewhat elevated for a U.S. state. Future increases to retiree benefit contributions and debt service for deficit borrowing, significantly offset by the suspension of OPEB prefunding, could further constrain spending flexibility.

Long-Term Liability Burden::'a'

Long-term liabilities for debt and retiree pension benefits are well above the median for U.S. states and are elevated but still in the moderate range relative to total personal income. Fitch's long-term liability burden calculation includes liabilities for the state's public schools, which are paid for by local governments in most other jurisdictions. Reforms to retiree benefits and higher contributions have helped to slow the growth of related liabilities. However, considerable progress on pension system funding will take place only gradually.

Operating Performance::'aaa'

The state is well-positioned to address economic challenges given its increased reserves prior to the current downturn and control over a broad array of budget balancing options. Budget management is guided by frequent revenue forecasts and multi-year financial plans that provide input for policy adjustments as required.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to a positive rating action/upgrade:

--The state effectively absorbs the fiscal challenges triggered by the current economic contraction and rebuilds its financial resilience.

--The state closes its budget gap by enhancing existing revenue sources and/or creating new revenue opportunities, while continuing to control its expenditure growth.

--The state's actions in managing retiree obligations reduce those long-term liabilities over time.

Factors that could, individually or collectively, lead to a negative rating action/downgrade:

--An inability to address effectively the fiscal challenges triggered by the current economic contraction, as evidenced by failure to achieve consensus on budget modifications necessary to enact a structurally balanced fiscal 2021-2023 biennium budget, leaving the state less financially resilient at the end of the recovery period.

--Deterioration in operating performance tied to economic cyclicality beyond Fitch's expectations and a slower than expected return to revenue growth and financial resilience.

--A diminished commitment to addressing the state's retiree liabilities.

Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579].

CURRENT DEVELOPMENTS

Sectorwide Coronavirus Implications

The outbreak of coronavirus and related government containment measures worldwide have created an uncertain global environment for U.S. state and local governments and related entities.

Fitch's ratings are forward-looking in nature, and Fitch will monitor the severity and duration of the budgetary impact on state and local governments and incorporate revised expectations for future performance and assessment of key risks.

While the initial phase of economic recovery has been faster than expected, GDP in the U.S. is projected to remain below its 4Q19 level until at least 4Q21. In its baseline scenario, Fitch assumes continued strong GDP growth in 3Q20 followed by a slower recovery trajectory from 4Q20 onward amid persisting social distancing behavior and restrictions, high unemployment and a further pullback in private-sector investment. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the report "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases - Update", published on Sept. 8, 2020, and "Fitch Ratings Updates Coronavirus Scenarios for U.S. State and Local Tax-Supported Issuers", published on Oct. 1, 2020 on www.fitchratings.com.

Coronavirus Impacts on Hawaii Economy

The state continues to experience the severe economic impact of the pandemic. World-wide containment efforts have particularly affected the state's tourism sector, one of the pillars of its economy. In the first eight months of 2020, total visitor arrivals dropped 69% compared to the same period in 2019. State officials estimate that each month of tourism losses at the current magnitude represents around $176 million in foregone tax revenues. Visitor numbers have slowly increased to less around 2,000 per day in October, far fewer than the 30,000 to 35,000 arrivals per day in early March. After many of the state's major hotels closed, almost 78% had reopened by early July.

Approximately three-quarters of businesses have reopened since the most recent stay-at-home order, though many have done so at reduced capacity. Public schools reopened for the 2020-21 school year under a blended learning model. The University of Hawaii system reopened its 10 campuses for the fall 2020 semester with a mixture of online instruction and limited in-person instruction only where necessary. To date, the property tax base remains healthy, with rising residential housing prices and a considerable private sector construction pipeline. The size of the construction sector workforce remains stable, supported by both private sector demand and numerous public sector projects being undertaken or planned by the state, the counties, and the military.

The state's seasonally adjusted unemployment rate was nearly 13% in August (third highest of the states, equal with the state of New York), compared to less than 4% a year prior. While the August unemployment rate represents considerable improvement over the historic high of almost 24% in April, Hawaii was one of three states that actually reported employment declines in August. Initial unemployment claims were still above 5,000 per week in September. As explained in the commentary "True Unemployment Effects on US States Masked by Workforce Exits," published on Sept. 24 on www.fitchratings.com, Fitch estimates that the state's August unemployment rate would be closer to 17% (fourth highest among the states) when factoring in the state's almost 5% labor force decline since February (the eighth biggest decline among the states).

The state has recovered just 13% of the jobs lost since the start of the pandemic. Leisure and hospitality job losses account for 50% of total job losses in the state. As noted in the commentary "Differences in US States' Employment Recovery Persist; HI, NY, MA Lag", published on Oct. 6 on www.fitchratings.com, Fitch expects persistent weakness in the leisure and hospitality sector will be a significant drag on the state's economic recovery.

Oct. 15 Launch of a Trans-Pacific Pre-Travel Coronavirus Testing Program

To safeguard state residents' health while reactivating trans-Pacific tourism, the state implemented a pre-travel testing program on Oct. 15, whereby travelers from mainland U.S. (and shortly from Japan) can avoid a 14-day mandatory quarantine requirement with evidence of a negative coronavirus test taken up to 72 hours prior to travel. This requirement will be supplemented by random testing of visitors four days after arrival. Implementation of such a program has been delayed since Aug. 1 due to increased outbreaks in some of the state's main travel markets and within the state itself. Similarly, the quarantine requirements for inter-island travelers were initially suspended on June 16 but then reinstated on Aug. 11 for travelers to all islands except Oahu. (Counties can adopt a negative test exception process for people obliged to travel between the islands for certain purposes.)

The state considers itself better positioned now to operate successfully a trans-Pacific pre-travel testing program due to the testing arrangements implemented on the mainland, cooperation from the airlines and originator airports, its own enhanced testing and contact tracing capacity, and the health care system's strengthened ability to handle caseload surges. Counties are empowered to implement secondary testing of trans-Pacific travelers moving between the islands. All parties view the resumption of trans-Pacific tourism as key to rebuilding their economies. The state is projecting a slow but steady rebuilding of travel to pre-pandemic levels over the next three to four years as airline seats are reinstated. Travel industry surveys and consumer bookings made in advance of earlier attempts to implement the trans-Pacific pre-travel testing program indicate considerable pent-up demand.

Federal Aid Provides Some Support for State Budgets

Federal aid measures since the pandemic's onset have provided significant benefit to state budgets and economies. The Families First Coronavirus Response included a 6.2 percentage point (pp) increase in the Federal Medical Assistance Percentage (FMAP) for Medicaid for every quarter of the national public health emergency. FMAP is the rate at which the federal government reimburses states for Medicaid spending. The state expects to receive an estimated $32 million for each quarter of the national emergency. The ultimate value of the FMAP rate increase will depend primarily on state's actual Medicaid spending and the extent of the national public health emergency, which has been extended at least into the current quarter ending on Dec. 31.

Under the Coronavirus Aid, Relief and Economic Security (CARES) Act enacted on March 27, the U.S. Treasury department distributed $150 billion to state and local governments from the Coronavirus Relief Fund (CRF) using a population-based formula. The statute limits the use of the CRF to coronavirus expense reimbursement rather than to offset anticipated state tax revenue losses. Hawaii received $1.25 billion from the CRF, with almost $863 million allocated to the state and over $387 million allocated to the city and county of Honolulu, the state's sole local government with more than 500,000 residents. The state allocated $175 million to the counties of Hawaii, Kauai, and Maui on a formulaic basis. The majority of the state's remaining $688 million is designated for public health, economic revival, and community programs. According to the state, any funds unspent by Dec. 30 will be placed in the state's unemployment insurance trust fund and used to help repay the $1 billion loan that was secured to pay unemployment benefits to state residents.

The CARES Act also provides for supplemental federal aid for local school districts, passed through state departments of education with the Elementary and Secondary School Emergency Relief Fund (ESSER). The act allocates over $43 million to the state, with a minimum of approximately $39 million designated for local school districts, all to be spent within one year of receipt for a fairly broad set of allowable uses.

The Federal Reserve's $500 billion Municipal Lending Facility (MLF) provides a potential source of short-term liquidity for state and local governments. Under the MLF program, Hawaii could borrow up to $2.1 billion for three years to address the state's own cashflow needs and the legislature authorized borrowing up to that limit. However, the administration currently plans to borrow $750 million for five years from the public market, rather than the MLF, for operating expenses while it makes necessary budget and service adjustments ahead of the fiscal 2021-2023 biennium.

Coronavirus - Hawaii Liquidity Impacts

Fitch anticipates that Hawaii, consistent with all states, will address short-term liquidity pressure with no interruption in timely payments for key operating expenses, including debt service. During fiscal years 2016 to 2019, the state consistently ended each year with between 184 and 186 days cash on hand. As of Sept. 30, 2020 the state's treasury portfolio had a total market value of approximately $6.9 billion, primarily consisting of 'AAA' rated U.S. treasuries and agency securities, plus bank CDs.

The state made key improvements to financial flexibility in the wake of the previous recession, increasing budgetary and emergency reserves. The Emergency Budget and Reserve Fund (EBRF) balance rose to almost $404 million in fiscal 2020, from just under $10 million in fiscal 2011. However, due to a $345 million transfer to the general fund, the current balance in the EBRF is just under $59 million and the state expects to slowly increase it to around $92 million in fiscal 2025.

The state also has just over $191 million in its Hawaii Hurricane Relief Fund (HHRF), which functions as an additional working reserve in times of economic stress. The 2020 legislature provided the governor with the option of using HHRF funds by appropriating $183 million for fiscal 2021 coronavirus-related budget shortfalls, without any statutory repayment mechanism. However, the current plan is not to use the HHRF appropriation, subject to future needs, and maintain it at the $191 million level through fiscal 2025.

Coronavirus - Hawaii Budgetary Update

Preliminary general fund tax revenues for fiscal 2020 indicate a decline of 7% compared to fiscal 2019. The state council on revenues' Sept. 9 forecast projects tax revenues will decrease by a further 11% in fiscal 2021. The combined forecast general fund revenue decrease for fiscal years 2020 and 2021 is approximately $1.3 billion. The council on revenues' revised forecast projects growth of less than 9% in fiscal 2022, 6% in fiscal 2023, 4% in fiscal 2024, and 3% annually for each of fiscal years 2025 to 2027. The actual revenue rebound will be subject to many variables, particularly related to the return of domestic and international tourism.

The governor has the executive authority to control spending by restricting, delaying, or suspending appropriations. Although the governor cannot make supplemental appropriations without the legislature's approval, he does have sufficient authority to make budget balancing decisions for the rest of the fiscal 2019-2021 biennium. This includes the power to pass emergency actions to achieve necessary labor and non-labor cost savings. The governor suspended collective bargaining, although his administration continues to work with the bargaining units on potential labor concessions.

For fiscal 2020, the administration and legislature reduced expenditures, authorized $686 million in fund transfers, including the transfer of $345 million from the EBRF to the general fund. For fiscal 2021, the administration and legislature eliminated $197 million in supplemental budget requests and proposed legislation, reduced the base budget by $205 million, and authorized $40 million in fund transfers. The administration has begun negotiating with the bargaining units to institute two furlough days per month beginning in December 2020 through the end of fiscal 2024.

If necessary, the governor could implement all four years of furloughs through an emergency declaration.

The state made its full legislatively required contributions to the pension system in fiscal 2020 and budgets to do so again in fiscal 2021, with no plans to modify outyear contributions. However, the governor used his emergency powers to suspend prefunding of retiree health care benefits in fiscal 2021, and will seek legislative approval for further such suspensions through fiscal 2025.

For the 2021 legislative session, the administration is undertaking a program review to ensure state expenditures are in line with reduced revenue projections for the fiscal 2021-2023 biennium. If implemented as planned, the combination of furloughs, suspended OPEB prefunding, and program review reductions would more than offset new five-year borrowing costs and unemployment insurance loan interest payments to ensure positive, albeit declining, general fund ending balances during fiscal years 2022 to 2025. Acknowledging that it will likely take some years for the state to return to former revenue levels, the governor is seeking to use the fiscal 2021-2023 biennium budget process as an opportunity to consider a variety of revenue enhancements and expenditure curtailments.

While the legislature would need to approve the program review reductions through the biennial budgeting process, the governor retains budget control authority and could line item veto budget items he disagrees with, and restrict funding and spending thereafter. In the event the administration's budget balancing initiatives are insufficient, the state could reduce its general fund balance further or borrow more. The governor could also implement layoffs and freeze vacant positions. The legislature has the ability to increase taxes and authorize debt without voter approval. It can also unilaterally adjust the county transient accommodations tax allocation, which it has done since May.

The state does not anticipate needing to provide extraordinary support for any of its four counties that would not be reimbursed by federal moneys, since the counties are in good financial position and supported by stable property tax revenues, or for its department of transportation, since the airports, harbors, and highways each have sufficient cash to fund operations and are receiving federal funding support. While the Hawaii Health Systems Corporation could require state support, given losses from cancelled elective procedures and unbudgeted coronavirus-related expenses, eligible costs will likely be reimbursable by federal funds.

Updated FAST Analysis for Hawaii

The FAST scenario analysis tool, which relates historical tax revenue volatility to GDP to support the assessment of operating performance under Fitch's criteria, has now been adjusted to reflect GDP parameters consistent with Fitch's global coronavirus forecast assumptions. The FAST is not a forecast, but it represents Fitch's estimate of possible revenue behavior in a downturn, based on historical revenue performance. Hence, actual revenue declines will vary from FAST results, and Fitch expects the state will implement decisive corrective actions to offset them. The FAST does provide a relative sense of the risk exposure of a particular local government entity compared to other local government entities.

The state's unaddressed FAST results under both the coronavirus baseline and downside scenarios indicate pressure on the state's financial resilience in the medium-term, absent policy interventions. The state is working to counteract the downward pressure caused by the current sharp economic downturn. Nevertheless, the state's financial flexibility, particularly in the face of ongoing expenditure increases to address pension and OPEB liabilities, could be pressured by reduced revenue growth, expenditure growth that outpaces revenues, and/or sustained reductions in reserves. The state's projected $992 million ending general fund balance for fiscal 2020 on a cash basis (13% of projected general fund spending) provides some initial cushion in conjunction with the EBRF and HHRF. However, the state's own financial plan indicates that the general fund balance could be nearly drawn down by fiscal 2025.

The state has already identified budgetary offsets to the majority of the tool's first year revenue contraction and significant portions of projected funding shortfalls in the outyears. The state has significant policy tools at its disposal, including its high independent revenue-raising capacity and options for further expenditure reductions. Notably, it has considerable flexibility in relation to its personnel budget. The state's response to revenue declines in the previous recession points to its ability to address significant revenue downturns. The state reduced its general fund spending by approximately 14% during fiscal years 2010 and 2011, largely due to employee furloughs and executive department spending restrictions. Nevertheless, the state's current financial plan relies on significant reserve drawdowns, which suggests that at the end of the recovery period the state's financial resilience could be weakened.

IDR CREDIT PROFILE

DEDICATED TAX KEY RATING DRIVERS

RATING CAPPED BY STATE CREDIT QUALITY: The highway revenue bond rating is capped by the state's general credit quality. Pledged revenues, a relatively narrow basket of motor vehicle-related taxes and user charges, are structurally protected from general government operations and restricted to the support of the state highways system.

SLOW PLEDGED REVENUE PERFORMANCE: The pledged revenues' historically solid revenue growth rate will be sharply affected by the pandemic in the near-term, followed by what the state expects to be a strong recovery in the medium term. Pledged revenues provide robust coverage of debt service in both moderate and more severe coronavirus stress scenarios.

DEDICATED TAX CREDIT PROFILE

The dedicated tax bond rating is capped by the state's 'AA' IDR and Stable Outlook. While pledged highway revenues are structurally protected from general government operations and restricted to supporting the state highways system, the state has considerable discretion over the appropriation of state highway fund moneys. Transfers out of the state highway fund are permitted once certain conditions are met, and in 2017 the fund received support from the general fund.

Legal provisions for the bonds provide solid protection for bondholders. Senior bonds (the only active lien) have a first lien on the pledged funds once deposited in the state highway fund. Subordinate lien debt is permitted, though none has been issued. Hawaii's general revenue bond law requires the state to maintain pledged revenues in amounts sufficient to meet commitments to bondholders. While not anticipated, such commitments could be modified by the state legislature. Pledged revenues are not subject to annual appropriation by the state legislature.

Transfers out of the state highway fund are permitted, but only after senior and subordinate debt service obligations, operations and maintenance expenses, and required capital improvements have been funded. Further, transfers are only allowable if monies remaining in the fund exceed 135% of the next year's revenue requirements. Since 2006, the legislature has supported revenue increases to support the highway fund and transferred $37 million from the general fund to the highway fund in fiscal 2017.

Highway revenue bonds are supported by a cash-funded debt service reserve and sureties sized at 50% of maximum annual debt service (MADS). The state has proposed to eliminate the reserve on future debt issuances upon receipt of 100% bondholder consent, which is not expected to occur until the series 2005, 2011, and 2014 highway revenue bonds mature or are refunded. Such changes are not a rating consideration given the credit's underlying strength.

Pledged revenues consist of highway fuel license taxes assessed at a per-gallon rate; a fixed per vehicle registration fee; a tax based on motor vehicle weight; surcharges on rental motor vehicles, tour vehicles, and car-sharing vehicles applied on a per day, month, or hour basis; and other miscellaneous fines, charges, and fees. Consequently, pledged revenues are sensitive to fuel usage and efficiency, vehicle ownership levels, motor vehicle size, total mileage, and tourism activity. Revenues dipped by a cumulative 13% between fiscal years 2008 and 2010, during the previous recession, but the combination of subsequent economic recovery and repeated state policy actions resulted in cumulative growth of almost 56% over the following nine years.

Between 2009 and 2019, pledged revenues rose at a compound annual growth rate (CAGR) of 4.3%, above national economic growth. Previously, the 10-year CAGR had been well above inflation but below GDP growth.

A 67% increase in the rental motor vehicle surcharge enacted on July 1, 2019 (Act 174), generated an additional $25 million in fiscal 2020 (less than the $33 million originally projected due to a pandemic-related 22% reduction in rental car transaction days year-over-year). Despite this, overall pledged revenues are projected to remain flat in fiscal 2020, before experiencing a sharp 20% decline in fiscal 2021. The state anticipates a strong rebound over fiscal years 2022 to 2024, but this will inevitably depend on the state's overall economic recovery, particularly in relation to tourism.

The 'a' assessment for growth prospects reflects the expectation that the pledged revenues will experience a strong recovery in the medium-term.

To evaluate the sensitivity of the dedicated tax revenue stream to a moderate recessionary decline, Fitch considers both revenue sensitivity results (using a 1% decline in national GDP scenario) and the largest net pledge revenue decline in revenues over the period covered by the revenue sensitivity analysis. Based on this history, Fitch's analytical sensitivity stress test (FAST) generates an almost 7% decline in pledged revenues during the first year of a moderate recession while the largest cumulative revenue decline historically was the 13% described above.

Management typically aims to maintain debt service coverage to no lower than 5.0x to ensure sufficient funding for operations and maintenance. However, management is considering temporarily lowering debt service coverage to 4.0x to facilitate public infrastructure investment, with its associated economic and employment benefits, during the pandemic. Based on current outstanding debt and an expected 20% drop in pledged revenues in fiscal 2021, management projects that MADS coverage will drop to 4.5x. Debt service coverage is expected to rebound to at least 5.0x the following year and thereafter, even with the issuance of a substantial amount of additional revenue bonds in 2021 and 2023. The pro forma debt amortization schedule, which shows pledged revenues more than fully rebounding in fiscal years 2022 to 2024, projects that pledged revenues will maintain a minimum of 5.3x MADS coverage.

Applying Fitch's 34% uniform stress for surface transportation-related revenues, MADS coverage would be 3.3x and pledged revenues could withstand a 70% drop before ceasing to cover MADS fully. This represents 10.3x the scenario-generated decline and 5.2x the largest recorded decline, with both metrics supporting a financial resilience assessment of 'aaa'.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

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

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

Hawaii, State of (HI) [General Government]; Long Term Issuer Default Rating; Downgrade; AA; Rating Outlook Stable
----Hawaii, State of (HI) /General Obligation - Unlimited Tax/1 LT; Long Term Rating; Downgrade; AA; Rating Outlook Stable
----Hawaii, State of (HI) /State Highway Fund/1 LT; Long Term Rating; Affirmed; AA; Rating Outlook Stable

Contacts:
Primary Rating Analyst
Alan Gibson,
Director
+1 415 732 7577
Fitch Ratings, Inc.
One Post Street, Suite 900

San Francisco, CA 94104

Secondary Rating Analyst
Douglas Offerman,
Senior Director
+1 212 908 0889

Committee Chairperson
Amy Laskey,
Managing Director
+1 212 908 0568

Media Relations: Sandro Scenga, New York, Tel: +1 212 908 0278, Email:
sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com

Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

Applicable Model

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

FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form
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