S&P Global
Ratings

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Summary:
Hawaii; General Obligation

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Credit Profile		
US$600.0 mil taxable GO bnds ser 2020-GB due 10/01/2026		
Long Term Rating	AA+/Negative	New
US$300.0 mil taxable GO bnds ser 2020-GC due 10/01/2041		
Long Term Rating	AA+/Negative	New
US$147.15 mil GO bnds ser 2020-GA due 10/01/2022		
Long Term Rating	AA+/Negative	New
Hawaii GO		
Long Term Rating	AA+/Negative	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA+' rating to Hawaii's $1.05 billion general obligation (GO) bonds series 2020 GA, taxable GO bonds series 2020 GB, and taxable GO bonds series 2020GC. We also affirmed our 'AA+' long-term rating and underlying rating (SPUR) on Hawaii's GO bonds outstanding. The outlook on all ratings is negative.

The negative outlook reflects our view that the local economy's significant exposure to the tourism industry has resulted in fiscal and economic pressures for Hawaii from the global COVID-19 pandemic and the subsequent recession. It reflects our view that without significant budgetary adjustments in the current year to address its significant revenue gap, the state's financial profile could weaken to levels no longer in line with its current rating. Our rating on Hawaii reflects our long-cited view of the state's susceptibility to exogenous shocks that have the potential to hurt its tourism sector, which accounts for 17% of state GDP, along with elevated fixed costs as it continues to address its weak pension funding and large other postemployment benefit (OPEB) obligation. Furthermore, the magnitude of the effects on Hawaii's finances will depend on the severity and duration of the effects of the pandemic on the state's tourism industry. Prolonged budgetary pressure could limit the state's flexibility in addressing the potential loss in revenues in future years. The outlook reflects our view that the social risks posed by COVID-19 to public health and safety will likely have a direct and material effect on the state's economy and budget performance for the next few years, which is reflected in our view of environmental, social, and governance (ESG)-related risks within the analytic factors we evaluate for states.

All GO bonds are secured by Hawaii's full faith and credit, which the state considers its highest payment priority, according to its constitution. The proceeds of the 2020 series GA and GB bonds are expected to be used to fund working capital operation needs. Proceeds from the 2020 series GC bonds are expected to be used to refund the state's outstanding bond anticipation notes.

Credit overview

As an island-economy state, Hawaii is inherently vulnerable to the negative effects of certain types of exogenous shock events. Although its economy has proved relatively resilient to prior shocks, including the Great Recession, we believe social distancing measures and the restriction of visitor arrivals to contain the COVID-19 pandemic present unique challenges to the leisure and hospitality industry and the state as a whole. The Bureau of Labor Statistics reports that leisure and hospitality accounts for a significant 19% of the state's 2019 employment.

For the foreseeable future, restrained and restricted economic activities resulting from the COVID-19 pandemic will translate directly into contracted economic output and general revenue declines. Although the state is now focused on the gradual reopening of its economy, it is our view that the economic toll on Hawaii will be substantial and its recovery will be protracted compared to that of other states. We believe that Hawaii's economy remains sensitive to a dampened appetite for tourism globally and demand for travel will remain depressed and experience tepid growth until the risk of the pandemic subsides internationally. We note, however, that the state is proactively negotiating travel protocols for lifting quarantine requirements for travel between Hawaii and certain countries, including South Korea and Japan, which could help boost tourism. The ability of the state to attract non-U.S. visitors in the near term may slightly improve its recovery prospects beginning in 2021.

Based on S&P Global Economics' most recent baseline forecast, we believe national GDP could contract 4% in 2020 and the economic recovery will be slow over the next few years. We do not expect the national economy to get back to its pre-pandemic levels until late 2021, with an annual GDP growth rate for next year at 3.9%. Additionally, recent signs of economic momentum could stall as a lack of federal stimulus could have spillover effects that further strain state and local government revenues and budgets. For more information, see "The U.S. Economy Reboots, With Obstacles Ahead" (published on Sept. 24, 2020, on RatingsDirect). IHS Markit projects a 9.6% decline in Hawaii's gross state product in calendar year 2020 compared to a forecast 4.2% decline in GDP for the nation and does not expect growth to reach pre pandemic levels until 2023.

Hawaii's financial management, however, has reflected an alignment with its economic realities with a commitment to growing its balances and reducing its long-term liabilities to prepare for an economic slowdown. After having used a significant portion of its emergency budget reserve fund (EBRF) and Hawaii Hurricane Relief Fund (HHRF) during and after the Great Recession, Hawaii has rebuilt these balances went into the recession in a strong position. The estimated EBRF balance at the end of fiscal 2020 was $59 million; when combined with general fund balance, combined reserves declined to $1.05 billion, which we still consider strong at 13.1 % of expenditures compared to $1.1 billion at the start of the fiscal year. The state also has reserved funds in its HHRF ($183 million), which equaled an additional 2.5% of general fund expenditures. Hawaii has generally accumulated these balances in recent years by maintaining conservative fiscal practices even when the economy expanded.

The state's ability to navigate budgetary pressures in the current year will weigh heavily on its rating. The state's Council on Revenues (COR) revised its revenue forecast for fiscal years 2021 and 2022 in September to reflect the continued severity of the containment efforts on statewide revenues. The most recent revised forecast shows a 11% decline in revenues in 2021 compared to fiscal 2020, followed by 8.5% growth for fiscal 2022. The revenue shortfall translates to $3.1 billion in a budget shortfall through 2022, before budget adjustments.

Although the state's prior revenue forecast in May projected a 7% decline in tax revenues for fiscal 2020, actual collections reflected slightly less dire declines of 6.3% compared to the prior year. The legislature reconvened after the

May COR projections to address revenue shortfalls through 2021 and amend the adopted budget for fiscal 2021. The state relied mainly on the authorized transfer of $345 million of its emergency budget reserve fund (EBRF) balance (or 4% of annual general fund expenditures) and fund transfers to address its fiscal 2020 deficit.

For fiscal 2021, the legislature authorized a combination of reduced appropriations and the governor authorized suspension of its OPEB prefunding to address some of the year's deficits. The state also authorized some budget measures, which we consider one-time in nature, including the authorization of $2.1 billion working capital borrowing (of which it intends to use $750 million in the current fiscal year) and use of its $183 million in the HHRF. The state has represented that its financial plan does not include the use of the HHRF currently. We calculate the structural deficit (which does not include anticipated resources from working capital borrowing) in the general fund for fiscal 2021 to be $1.3 billion, or about 15% of annual expenditures. Without further action, the state's combined reserves could weaken to 7.3% by the end of 2021, leaving less flexibility to deal with additional budget pressures in the next fiscal years and pressure our rating on the state.

While use of reserves in an economic downturn is reasonable, we expect a commensurate demonstrated commitment to sustainable budgetary adjustments to maintain the current rating. We understand that beyond the legislative actions, the governor has executive authority to make additional restrictions without legislative approval and the state is currently reviewing cost-saving measures to reduce deficits in the current year. The state also plans to plans to address projected revenue shortfalls for the next few years in its next legislative session in January. During periods of economic stress, including the Great Recession, the state has demonstrated a willingness to make necessary adjustments to correct structural imbalances, which we expect to continue as the current economic cycle evolves. Hawaii's financial management has also reflected an alignment with its economic realities with a commitment to growing its balances and reducing its long-term liabilities during the last economic expansion to prepare for a slowdown.

We also particularly view the use of working capital borrowing by the state a sign of budgetary pressure, which could change our view of its debt profile in the near term. Should the issuance of working capital borrowing lead to significantly increased fixed costs for Hawaii, it could pressure our credit rating on the state.

The 'AA+' GO rating reflects our view of:

- The state's strong financial position, which has weathered several major economic stressors during the past 15 years;
- Economic contraction in the near term based on a higher-than-average concentration in the tourism sector, although we expect demographic changes to level out growth over time;
- Management's well-established, proactive budget monitoring practices, including frequent revenue forecast updates from the independent COR, which facilitates prompt identification of potential budget adjustments for budget alignment;
- The governor's executive authority to restrict all executive branch expenditures through such actions as cutting spending midyear without legislative approval or cutting or delaying disbursements during the course of a fiscal year; and
- Other strong constitutional protections, including requiring budget balance, that allow for tax increases with

legislative approval and give GO bonds first-lien priority before all other disbursements.

Partly offsetting the above strengths is our view of:

- Hawaii's inherent susceptibility to exogenous shocks that have the potential to hurt its tourism sector, which accounts for 19% of state employment;
- The weak funded status of the state's retirement system and generally higher-than-average debt ratios because of its centralized provision of public-sector services; and
- Large OPEB liability despite statutory annual contributions which equal the actuarially required levels.

Based on the analytic factors we evaluate for states, we have assigned Hawaii a composite score of '1.8' on a four-point scale in which '1' is strongest.

Environmental, social, and governance factors

The negative outlook 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 and it has historically maintained a strong management and policy framework to respond to environmental risks.

Negative Outlook

Our negative outlook reflects at least a one-in–three chance that we could lower the rating if the state is unable to address its revenue shortfalls through sustainable budget adjustments. Our ratings on Hawaii reflect its currently strong financial reserves, which remain particularly important for the state, given our expectation of a structural gap through 2023 and its above-average fixed costs stemming from its high debt and relatively large long-term liabilities. Deteriorating fiscal performance, evidenced by large structural deficits and strong reliance on current reserves not accompanied by structural budget adjustments, could lead to a downgrade. We also expect the ratings will be sensitive to either a weaker debt profile or any material deterioration its pension-funded status from its current level due to weak market returns or a change in the state's plans of significantly higher contribution rates to balance future budgets.

Return to stable scenario

If Hawaii is able to adequately manage its budget through the recession without depleting reserves to levels no longer in line with our view for its current rating, as well as position itself to build up reserves when its economy stabilizes, we could revise the outlook back to stable.

For more information on our GO rating on the state, see the full analysis on Hawaii (published April 21, 2020, on RatingsDirect).

Related Research

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

Ratings Detail (As Of October 16, 2020)		
Hawaii GO (FGIC) (National)		
Unenhanced Rating	AA+(SPUR)/Negative	Affirmed
Hawaii GO (MBIA) (National)		
Unenhanced Rating	AA+(SPUR)/Negative	Affirmed
Many issues are enhanced by bond insurance.		

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.