S&P Global
Ratings

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Summary:

Hawaii; General Obligation

Primary Credit Analyst:
Ladunni M Okolo, Dallas + 1 (212) 438 1208; ladunni.okolo@spglobal.com

Secondary Contact:
Oscar Padilla, Dallas + 1 (214) 871 1405; oscar.padilla@spglobal.com

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Credit Profile		
US$740.0 mil taxable GO bnds ser 2022GK due 10/01/2042		
Long Term Rating	AA+/Stable	New
US$62.145 mil GO bnds ser 2022GL due 04/01/2023		
Long Term Rating	AA+/Stable	New

Credit Highlights

- S&P Global Ratings assigned its 'AA+' long-term rating to the state of Hawaii's taxable general obligation (GO) bonds, series GK 2022 and GL 2022.
- The outlook is stable.

Security

The GO bonds are secured by Hawaii's full faith and credit, which the state considers its highest payment priority, according to its constitution.

Credit overview

Despite the country's strictest pandemic response measures and continued controlled reopening of its economy, Hawaii's economic momentum has shifted sufficiently upward to provide a more manageable operating environment. While we believe the state remains susceptible to evolving pandemic-related pressures in the short term--most acutely to its broad leisure and hospitality sector--its economic recovery to date has strengthened sufficiently to offer Hawaii a more predicable budgetary planning backdrop to achieve lasting structural balance in the future, in our view.

During periods of economic stress, 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. While the use of reserves in an economic downturn is reasonable, a commensurate demonstrated commitment to sustainable budgetary adjustments support the current rating.

After having used a significant portion of its Emergency Budget Reserve Fund (EBRF) and Hawaii Hurricane Relief Fund (HHRF) in the past, Hawaii entered the pandemic-induced recession from a strong position, having steadily rebuilt its balances. After a draw of $345 million from EBRF balance in fiscal year 2020, a deposit of $250 million in fiscal year 2021 brought the balance back to $319.5 million. For fiscal year 2022, estimated balances in the EBRF increased to $326 million. Combined with a general fund balance of roughly $1.9 billion (excluding $750 million in working capital), reserves exceeded pre-pandemic levels and equaled 24.8% of fiscal year 2022 total expenditures, which we view as very strong. The state also held reserved funds in its HHRF ($173 million), which equaled an additional 1.6% of total general fund expenditures for the year.

The state's Council on Revenue (COR) forecasted (September 2022) 6.5% growth in total general tax revenues in fiscal year 2023 (compared to fiscal year 2022), as a result of continued strong recovery in tourism and stronger tax collections due to inflation. The support of extraordinary federal aid boosted the state's ability to manage through the volatility presented by the pandemic-induced recession, in our view, and the state has not required significant budgetary adjustments to date to narrow operating gaps. Hawaii has generally accumulated these balances in recent years by maintaining conservative fiscal practices even when the economy expanded. For fiscal year 2023, the legislature approved a $500 million transfer to its EBRF which will increase the EBRF's balance to $831 million. The state anticipates an additional deposit of $130 million from the general fund to the EBRF, which could result in an ending EBRF balance for fiscal 2023 of about $961 million.

Nevertheless, pressures on the state's overall credit profile persist, including its comparatively elevated fixed costs, which are among the highest in the nation, particularly its debt levels, as it continues to address its weak pension funding and large other postemployment benefit (OPEB) obligation, which will require ongoing active budgetary management to avoid future budgetary stress. Hawaii's debt ratios--at $6,251 per capita, 10.4% of total state personal income, and 10 % of state gross domestic product (GDP)--are among the highest of all the U.S. states. We note, however, that the state's excise taxes, which are its second-largest revenue source, are supported by residents of the state and visitors, which are not captured in its population but which represents a significant portion of the state's economic activity. Based on the state's data, about 30% of annual tax revenues are supported by tourists rather than residents themselves. Additionally, Hawaii's high per capita debt reflects its assumption of many functions that, in other states, are generally financed by local governments, including education, health, and welfare.

Another pressure to credit quality, and more imminent, in our view, is Hawaii's weakened economic and demographic trends (including lagging economic recovery and limited population growth, coupled with an elevated age dependency cohort compared to its similarly rated peers) could lead to stagnant economic development and consequently, lasting budgetary pressure. To the extent the state's active budget management (including its commitment to rebuild its reserves while addressing its longer-term liabilities) will remain a priority to its executive and legislative leadership, we believe its overall credit profile will remain stable within our outlook period.

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, we believe this will continue to present unique challenges to the state, notably its broad tourism sector. That said, the state's Department of Business, Economic Development and Tourism reports that total passenger arrivals have continued to show strong improvement since the pandemic, and in May 2022 were back to 92.1% of 2019 levels. While international travel continues to lag in recovery, domestic visitors have now exceeded their 2019 levels.

On the employment side, the Bureau of Labor Statistics reports leisure and hospitality payrolls remain depressed, standing at 89% of their peak levels just before the onset of the pandemic. They've nevertheless continued to improve substantially month over month. Hawaii's GDP growth is expected to exceed the nation's 2.8% and 2.1% growth in 2022 and 2023, respectively. S&P Global Economics' baseline forecast is for U.S. GDP to grow 1.6% (annual) in 2022, a tepid rate compared to 5.7% in 2021. By 2023, the U.S. economy is forecast to grow even more slowly at 0.2%, as the economy falls into a shallow recession for the first half of the year. (For additional information, see "Economic Outlook U.S. Q4 2022: Teeter Totter," published Sept. 26, 2022, on RatingsDirect.) In tandem, employment growth is expected to grow in 2022 at 4.2% and slow down to 3.2 % in 2022, again exceeding the national levels of 3.9% and 0.9% for 2022 and 2023, respectively. As the state continues to recover, we anticipate that relative to its peers, it will be marginally slower to reach its pre-pandemic output but will catch up to the nation in the next two years.

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

- The state's strong financial position, which has weathered several major economic stressors, including the most recent pandemic-induced recession;
- 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 weaken its broad tourism sector, which accounted for 16% of state employment in 2021;
- 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
- Comparatively large OPEB liability despite statutory annual contributions, which equal the actuarially required levels, though the state is making progress by making pre-funding payments to limit growth in the future.

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, which aligns with an 'AA+' indicative rating. We have also incorporated our view of state's significantly high debt profile, which is measured at higher than one-third above our weakest score for most of the metrics. However, in consideration of factors discussed in our credit overview and using our notch flexibility on the indicative rating, we have affirmed our final rating of 'AA+'.

For more information on our GO rating on the state, see the full analysis on Hawaii, published Sept. 1, 2022, on RatingsDirect.

Environmental, social, and governance

ESG credit indicators: E-3, S-2, G2

Environmental factors are a moderately negative consideration in our credit rating analysis for Hawaii. The state is exposed to acute and chronic physical climate risks that could lead to economic and budgetary stress following a high-impact event. However, we view the following mitigants as helping alleviate additional pressure within our credit rating analysis: strong financial management incorporating these risks into its long-term plan, including establishing a hurricane relief fund to support private property insurance, and statewide coordination and oversight through its Emergency Management Agency. While we view social factors as neutral overall, its social capital risks are slightly higher than the sector given somewhat elevated aging demographics and substantially higher cost-of-living metrics that could affect the state's economy in the long term if trends intensify. We view the state's governance risks as neutral in our credit rating analysis given that it has historically maintained a strong management and policy framework to respond to pressures posed by high fixed costs.

Outlook

The stable outlook on Hawaii's ratings reflects its strong financial management and very strong reserves, which remain particularly important for the state given its reliance on tourism and somewhat cyclical economy. It also reflects our expectation that the state's debt levels will moderate after repayment of its working capital debt.

Downside scenario

Should the state's economic recovery stumble, leading to deteriorating fiscal performance and lower-than-projected reserves, we could lower the rating. Additional downside potential exists should the state's economic profile not improve relative to the nation as it approaches full recovery. Further growth in its debt and long-term liability profile escalating to a level we no longer believe is sustainable, despite the state's proactive management, would also likely lead to a downgrade.

Upside scenario

Despite the progress and commitment Hawaii has demonstrated with respect to its pension and other long-term liabilities, we believe these obligations currently represent a constraint on upward movement of the ratings. We specifically do not expect to raise the rating until the state has shown a steady trend toward a well-funded pension system, which we believe is beyond the current outlook period.

Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022