S&P Global
Ratings

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Hawaii; General Obligation

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Credit Profile		
US$750.0 mil taxable GO bnds ser 2023 GM due 10/01/2042		
Long Term Rating	AA+/Stable	New
Hawaii GO		
Long Term Rating	AA+/Stable	Affirmed

Credit Highlights

- S&P Global Ratings assigned its 'AA+' long-term rating to the State of Hawaii's approximately $750 million taxable general obligation (GO) bonds, 2023 series GM.
- We also affirmed our 'AA+' long-term rating and underlying rating (SPUR) on the state's GO bonds outstanding.
- The outlook is stable.

Security

The 2023 series GM bonds and GO debt outstanding are secured by Hawaii's full faith and credit, which the state considers its highest payment priority, according to its constitution.

Proceeds from the series 2023 bonds will be used to finance, or reimburse the state for the costs of acquisition, construction, extension, or improvement of various public improvement projects, including public buildings and facilities, elementary and secondary schools, community college and university facilities, public libraries, parks, highways, and other public purposes.

Credit overview

The 'AA+' rating is supported by Hawaii's proactive financial management and oversight, which incorporates our view of its demonstrated commitment to sustainable adjustments to close budgetary gaps and the state's use of comprehensive long-term forecasting to align its finances with evolving economic conditions and manage its elevated long-term liabilities. While the state's economy has experienced some pressure from pandemic related contraction in its leisure and hospitality sector as well as recent wildfires, the long-term rating is supported by recent recovery in the sector that has been fueled by rebounding domestic and international tourism activity, and visitor spending that has contributed to substantial growth in its revenue base. We expect Hawaii's economy to remain on an improving trajectory, supporting its ability to maintain structural budget performance and build on already very strong reserve and liquidity levels, which are at historic highs.

Following the wildfires in Maui County on Aug. 8, 2023, we continue to monitor near- and long-term effects on the state's financial and economic profiles. Assessments of the damage are developing, but current capital exposure is estimated at $5.5 billion, with insured losses of approximately $3.2 billion. We view the timing and magnitude of federal emergency aid and the state's redirection of appropriations to its major disaster fund as critical pieces to facilitate reimbursements to residents and assist infrastructure rebuilding and economic recovery efforts. For more information, see "Hawaii Wildfires: Strong Reserves Position Governments And Related Credits Well In Short Term

Despite Pressures And Uncertainty," published Aug. 23, 2023. The University of Hawaii Economic Research Organization (UHERO) estimates that the short-term statewide economic effect was a displacement of nearly 7,000 individuals and the loss of 10,000 direct jobs in the area. UHERO also forecasted that the wildfires could dampen Hawaii's gross state product (GSP) growth rate by 0.5% for both calendar years 2023 and 2024.

On Sept. 7, 2023, Hawaii's Council on Revenue's (COR) also revised its general fund revenue forecast to reflect the potential revenue effects of the wildfire and the state revised its long-term financial plan to reflect changes to expenditures over the next two biennium. Beyond the $164.1 million that the state will redirect from one-time and special funds to cover the state's share of wildfire-related response and recovery costs in fiscal 2024, the state set aside $200 million for fiscal 2025, and approximately $200 million during the fiscal 2025-2027 biennium for the state's portion of economic aid and rebuilding of public infrastructure in Maui (although some of these costs may be funded or reimbursed by the federal government). Coinciding with the COR's expectation for softening state tax collections and reduced economic activity in areas affected by the wildfire, general fund tax growth was revised downward to 1.3% from 4.0%, or approximately $316 million in total revenues. However, the COR anticipates the influx of federal and state resources and recovering economic activity will shift revenue-growth expectations upward in 2025, to 5.2% from 3.5%, before normalizing at 3.5% growth from 2026-2030, assumptions that we view as reasonable. Fiscal year-to-date (2024) revenues continue to perform approximately 7.7% above the September 2023 forecast, and, in our view, the state has not required adjustments to recurring expenditures to close potential operating gaps.

We believe the state remains well-positioned to respond to short-to-medium-term effects of the wildfires and softening economic growth expectations, given its strong financial footing at the conclusion of the fiscal 2021-2023 biennium. On a budgetary basis, the state ended fiscal 2023 with a $360 million general fund surplus (net of one-time contributions to the state's emergency and budget reserve fund [EBRF] and a deposit to the state's pension accumulation fund). Year-end results were propelled by robust revenue performance and controlled expenditure growth. As the state's post-pandemic economy moves closer to full recovery, a key driver of budgetary stability has been the state's general excise taxes (GET), which are its largest revenue source and supported by both residents of the state and visitors. GET collections outperformed the previous fiscal year by $432.7 million, or 10.8%.

At the end of the fiscal 2021-2023 biennium, Hawaii's EBRF had a balance of $973.8 million, or a what we consider a very strong 9.2% of fiscal 2023 expenditures. Combined with a general fund balance of approximately $2.18 billion (excluding $750 million in working capital), reserves exceeded pre-pandemic levels and equaled 29.7% of fiscal 2023 adjusted actual expenditures, which we also view as very strong. The state deposited an additional $500 million to the EBRF in the current biennium, increasing EBRF balances to $1.5 billion. In addition, liquidity within the state's treasury portfolio totals approximately $10.8 billion and $420 million in demand deposits. This level of reserves and liquidity, in our view, provides the state with a substantial cushion to aid short-term recovery efforts and offset temporary revenue losses from reduced economic activity.

Hawaii's Department of Business, Economic Development, and Tourism reports that visitor arrivals recovered to about 90% of 2019 levels in September 2023, although this reflects a temporary dip due to the wildfires. While international travel continues to lag in its recovery (64% of 2019 levels), domestic visitors are at 110% of their 2019 levels and visitor spending has risen to nearly 134% of 2019 levels due to pent-up demand for travel and inflationary price effects.

Following the wildfires, visitors to Hawaii fell approximately 15% below the same month (August) of the previous year, but the state estimates visitor arrivals rebounded to 3% below the previous year in October 2023. We believe Hawaii remains inherently vulnerable to negative exogenous shock events as an island-economy with a broad tourism sector, which if prolonged, could continue to present unique challenges and pressure state finances if material event risks dampen tourism-related activities.

We view Hawaii's long-term economic and demographic trends as a potential pressure to credit quality--including a lagging economic recovery, limited population growth, and an aging cohort compared with those of similarly rated peers. We believe recent declines in population on a one- and five-year basis (0.5% and 0.25%, respectively), if sustained, could hamper future economic development prospects and pressure state finances over time. S&P Global Market Intelligence estimates that Hawaii's population losses could reverse and grow modestly between 2026-2029, which could bring stability in the long term. Although Hawaii's recovery was marginally slower compared with that of the nation over the past two years, its GDP growth rate (2.0% in 2023 and 1.5% in 2024) is expected to keep pace with the U.S. growth rate. S&P Global Economics projects U.S. real GDP growth will slow to 1.3% in 2024 from 2.3% in 2023 (see "Economic Outlook U.S. Q4 2023: Slowdown Delayed, Not Averted," published Sept. 25, 2023, on RatingsDirect). In addition, Hawaii's employment growth is expected to be 2.4% in 2023 and slow to 1.1% in 2024, matching or exceeding national levels of 2.4% and 0.7% for 2023 and 2024, respectively.

In our view, Hawaii's elevated debt, pension, and other postemployment benefits (OPEB) liabilities, which are among the highest in the nation, remain long-term pressures for the state's credit profile. Hawaii's high per capita debt reflects its issuance for many functions that, in other states, are generally financed by local governments. Nevertheless, the state's debt ratios, which we measure at $6,450 per capita, 10.4% of total state personal income, and 9.2% of state GDP, are among the highest of all the U.S. states. Including its comparatively elevated fixed costs, particularly its very high debt levels, we believe active management will be required to avoid future budget stress as Hawaii continues to implement reforms to improve its historically weak pension funding and large OPEB obligations.

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 and severe physical risk events;
- Management's well-established, proactive budget-monitoring practices, including frequent revenue forecast updates from the independent COR, and the state's identification of potential expenditures adjustments for budget alignment through its long-term financial plan;
- The governor's executive authority to restrict executive branch expenditures, including midyear cuts to spending without legislative approval or delaying disbursements during the course of a fiscal year; and
- Other strong constitutional protections, including a balanced budget requirement, simple majority approval of the legislature to raise taxes, and a first-lien priority for GO bond debt repayment before all other disbursements.

Partially offsetting these 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 18% of state employment in 2022;

- The relatively weak funded status of the state's retirement system compared to peers, coupled with a very high debt burden because of its centralized provision of public-sector services on behalf of local governments; and
- Comparatively large OPEB liability despite statutory annual contributions, which equal the actuarially required levels, although the state has made progress by prefunding payments to limit future growth.

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 nearly one-third higher than our weakest score for certain 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+'.

Environmental, social, and governance

Hawaii's exposure to acute physical risk events, including hurricane and wildfires, and chronic physical risks from rising sea levels could lead to economic and budgetary stress following a high-impact event, which we view as a moderately negative consideration in our credit rating analysis. We view several mitigants, including the state's strong financial management incorporating physical risks into its long-term planning, the establishment of a hurricane-relief fund to support private property insurance, and statewide coordination and oversight through its Emergency Management Agency, as helping to alleviate additional pressure. While we view social capital factors as neutral within our credit rating analysis, Hawaii's aging demographics and substantially elevated cost-of-living and housing price pressure could affect its economy if long-term 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 reflects Hawaii's 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 regress, resulting in a deterioration of its financial performance and lower-than-projected reserves, we could lower the rating. These downside risks could intensify if the state's economic metrics and future growth expectations do not improve relative to the nation as it approaches full recovery. In addition, growth in its debt and long-term liability profile escalating to a level that we no longer believe is sustainable, despite the state's proactive management, would also likely lead to a downgrade.

Upside scenario

Despite Hawaii's demonstrated commitment and progress with respect to its elevated long-term liabilities, we believe currently high debt levels, coupled with slowing demographic growth trends relative to those of peers and a higher reliance on tourism-related activities make improvement of the rating unlikely. We do not expect to raise the rating unless the state demonstrates substantial and sustained improvement of these metrics to levels commensurate with those of higher-rated peers, which we believe is beyond the current outlook period.

Credit Opinion

Economy

Hawaii's economic indicators such as GDP, personal income, and population growth have slowed relative to those of similarly rated peers. Hawaii's population is growing older, putting the state in a slightly weaker demographic position, in our view, than the nation as a whole. This could result in a challenge for the state in funding government services and anticipated increases in longer-term health care costs for the elderly as the working-age population will barely increase over the next decade.

We expect Hawaii's economy will experience stronger growth than the nation over the near-term, given that its economic trough was deeper than the U.S. as a whole during the pandemic-induced recession. However, prior to the pandemic, state output grew more slowly than U.S. GDP, and the gap widened more recently. Over the past 10 years, state GSP grew in real terms at a compounded average annual rate of 1.7%, which was below the average U.S. annual rate of GDP growth of 3.0%. In 2024, 2025, and 2026, S&P Global Market Intelligence estimates that Hawaii's real GSP will increase to 1.5%, 2.1%, and 2.4%, at or above national growth figure over the same period.

Hawaii's population growth rates have also slowed recently, with 2022 growth estimates, according to S&P Global Market Intelligence, showing modest declines through 2026. Over the past decade, Hawaii's population compounded annual growth rate increased 0.25% per year, on average, versus 0.60% for the nation. The state's age-dependency ratio increased to 68.6% in 2021 from 58.4% in 2012, higher than the nation as a whole, which has a ratio of 63.9%. S&P Global Market Intelligence estimates that Hawaii's aging, 65-plus population could grow to nearly 22% of its total population by 2027, ranking it as one of the highest proportions of individuals in this age cohort among all the states. Should its population growth continue to fall behind the rest of the country, we would likely revise our assessment of its overall economic score to weaker levels.

In our view, the presence of military facilities and corresponding federal spending anchors its economic profile. While susceptible to fluctuations in national defense spending, military payrolls have remained stable over the past two decades, which collectively with contract spending accounted for 11.2% of state GSP, ranking Hawaii second among all states. In our view, incomes from federal and military personnel and households have generally been a stabilizing influence on the state economy.

On a four-point scale in which '1.0' is strongest, we have revised our score of Hawaii's economy to '2.2'.

Governmental Framework

Hawaii's constitution requires that the state operate on a balanced budget, including on an intra-year basis, as it monitors revenues and expenditures throughout the year and makes necessary adjustments to ensure that general fund expenditures do not exceed current general fund revenues and unencumbered cash balances. There are no constitutional restrictions on the state's ability to raise taxes or other revenues, and approval of taxes requires only a simple majority vote of the legislature. The governor has broad legal authority to adjust spending levels and restrict all executive branch expenditures and to cut spending midyear without legislative approval, including reducing or delaying education spending education, although this has proven difficult in practice.

Hawaii state government is highly centralized, and the level of services provided on behalf of local governments is higher than in most other states. The state directly runs the public school system, as well as the university and community college systems. It also administers public welfare and operates prisons, harbors, and airport systems. Hawaii is not a voter-initiative state, and there are no voter-approval requirements to issue GO bonds or increase taxes. GO bonds in Hawaii have a first-lien status, prior to all other payments, and the issuance of GO bonds must be authorized by a majority vote of the legislature.

On a four-point scale in which '1.0' is the strongest, we have assigned a score of '1.7' to Hawaii's governmental framework.

Financial Management

Hawaii's management practices are strong under our Financial Management Assessment methodology, indicating our view that practices are well embedded and likely sustainable. In accordance with statute, Hawaii is required to develop six-year operating and capital budgets that are updated by the governor and finance staff annually for legislative approval. The finance staff and treasury adhere to an official investment policy, and investment performance is disclosed monthly.

There are statutory debt caps, including a calculation to ensure that the total amount of debt service payments required will not cause the state to exceed its debt limit of 18.5% of the average of three previous years' general fund revenues. The state constitution requires that all GO state debt begin to amortize principal within five years of issuance, mature within 25 years, and have either level debt service or level principal payments. The legislature created the EBRF. In 2022, the state modified its formal reserve target to 20%-25% (including the EBRF, HHRF, and unassigned carryover general fund balance), up from the previous 15% target. Pursuant to the policy, the state shall maintain an overall target balance of either 25% of general fund revenue or, if the EBRF's 10% fund balance objective is met, 20% of general fund revenue. Adopted in 2017, legislatively mandated debt policies restricting the amount and types of bonds issued by the state and a debt-affordability study, which measures compliance with its debt limit.

Budget management framework

The COR, a seven-member, independent body, provides quarterly revenue forecasts for inclusion in the biennial budget, identification of budget variances throughout the year, and the multiyear financial forecast, but also in special sessions when fiscal conditions warrant. The executive branch and legislature are required to consider the council's estimates in the budget process. In our view, Hawaii has demonstrated willingness to provide timely and structural budget solutions when confronting previously projected budget deficits in the past decade. Generally, enacted deficit-closing solutions have been mostly structural, although one-time solutions (e.g., reserve use, working capital issuance) were deployed most recently in response to forecasted pandemic-related revenue declines.

Spending is controlled through an allotment system, and the Hawaii Department of Budget and Finance monitors expenditures throughout the year. Budget adjustments are implemented periodically throughout the fiscal year as the state considers necessary. Adjustments requiring legislative action are handled during the legislative session, which begins shortly after the start of the third quarter; in extraordinary circumstances, a special legislative session could be called.

On a four-point scale in which '1' is the strongest, we have assigned a score of '1' to Hawaii's financial management.

Budgetary Performance

In our view, Hawaii's budget performance is strong and historically resilient. During periods of economic stress, the state has maintained regular and comprehensive revenue and expenditure forecasting practices and demonstrated a willingness to make necessary adjustments to correct structural imbalances, which we expect will continue as economic conditions evolve and as the state continues to assess future recovery costs following recent wildfires on Maui.

The enacted 2023-25 biennium general fund budget totals approximately $22.5 billion, or about 15.8% above the previous biennium's actual appropriations. The COR estimates revenue growth rates of 1.3% for fiscal 2024 and 5.2% for fiscal 2025. Although the state's financial plan projects a deficit through 2025, we note that the enacted spending plan includes conservative revenue assumptions and a considerable $1.23 billion of non-recurring expenditures in fiscal 2024. This includes a $500 million deposit of general fund carryover balances to the EBRF in each year and a $300 million deposit to the Pension Accumulation Fund, which we view as favorable. Other one-time investments in education, housing, and general government total $727 million during fiscal 2024, although the state expects to redirect a portion on these funds to wildfire recovery costs.

Financial reserves remain particularly important for Hawaii given its elevated fixed costs. The state relied on its EBRF in fiscal year 2020 to temporarily support operations but has rebuilt reserves to levels that we view as very strong. Hawaii estimates that its fiscal biennium-end combined reserve balances (EBRF and Hawaii Hurricane Relief Fund [or HHRF]) will increase to $1.72 billion, or approximately 14.7% of budgeted fiscal 2024 expenditures. Combined EBRF, HHRF, and carryover balances (excluding $750 million in working capital funds) total approximately $3.2 billion, or 28.5% of fiscal 2024 expenditures. Although the state has used the fund for general reserves in the past, we do not currently consider the HHRF in our calculation of its fund balances but recognize its availability in the event of budget or liquidity pressures. We view large carryover balances and very strong reserve levels as prudent given the inherent cyclicality associated with the state's revenues derived from tourism activity and income-tax collections, which the state projects will soften over the near term. We anticipate Hawaii will remain committed to strengthening reserves, which provides additional flexibility to shifts in budgetary performance.

Audited financial statements (generally accepted accounting principles fiscal 2022)

On a generally accepted accounting principles basis, audited fiscal 2022 results show a general fund surplus of $1.56 billion, or an approximately 20.5% of general fund expenditures. General fund tax revenues consisted primarily of individual and corporate income tax (approximately 43% of revenues) and general excise and use taxes (43%). The audited combined ended assigned and unassigned fund balance in fiscal 2022 was $3.14 billion, or 47.7% of expenditures before other financing sources.

On a four-point scale in which '1.0' is strongest, we have assigned a score of '1.4' to Hawaii's budgetary performance.

Debt And Liability Profile

Hawaii's debt ratios, as of June 30, 2022, on a per capita and percent basis were high, in our view, with direct state debt (including GO and highway debt) approximately $9.3 billion, or $6,450 per capita, 10.4% of total state personal income, and 9.2% of state GDP, which ranks among the highest of all the U.S. states. In our view, Hawaii's high per capita debt reflects its capital finance responsibilities for many functions that, in other states, are generally financed by local governments, including education, health, and welfare. Debt amortization is rapid, with 69% of principal repaid within 10 years. Total annual tax-supported debt service (GO bonds, appropriation-backed debt, and the state highway fund) equaled $1.01 billion in fiscal 2022, or about 12.8% of the expenditures, which we consider high.

Pension liabilities

Pension benefits are administered by the Employees' Retirement System (ERS) of the State of Hawaii, a cost-sharing, multiple-employer, defined-benefit pension plan that covers all regular employees of the state and each of its counties, including judges and elected officials. Incorporating a 0.8% investment return in fiscal 2022, the highest return of any public pension fund, the state recognized a net pension liability of $13.5 billion. This translates to $5,105 on a per capita basis and 8.3% of total personal income, both of which we view as high.

We consider the state's three-year average pension funded ratio relatively weak at 60.1%, but we expect the pension funding will improve as the state continues to adhere to recent reforms. In 2017, the legislature restored the ERS to full funding within a statutorily required 30 years by phasing in higher systemwide contribution rates through 2021. The bill required contribution rates to increase to 24% by fiscal 2021 for the general plan, with a more aggressive jump to 41% by fiscal 2021 for police and fire. Despite annual valuations, the state historically does not adjust its pension contributions mid-biennium, resulting in a delayed response to required contribution increases.

We believe that management factors and actuarial inputs do not change our view of the state's overall pension funding discipline, which we view as weak. However, we also believe that recent pension reforms could improve our opinion of funding discipline over time. The ERS sets statutory contribution rates based on a 30-year amortization period and a level percent-of-pay method, which assumes rising future payroll and results in escalating pension contributions over time. In addition, the plan smooths assets based on a four-year window of actuarial value of assets. This means significant costs are being deferred when investment losses occur. However, the state's phased-in statutory contributions currently meet its actuarially determined contribution. The plan's ratio of active members to beneficiaries equals 1.19, which is below with the median national ratio (1.26).

OPEB risk assessment

Under Act 268 (2013), Hawaii initiated a schedule for prefunding its retiree health care benefit liability. Under the legislation, the state instituted a 20-year closed amortization period (through 2044) with ramped-up prefunding of the OPEB liability to 100% of the annual required contribution (ARC) by fiscal 2019 from 20% of the ARC in fiscal 2015. Since 2015, the state contributed approximately $325 million in excess of the Act 268 funding requirement, yielding a balance of $3.82 billion (or approximately 35% of the total OPEB liability) in its trust fund as of June 30, 2022. The state made its prefunding requirement of $411 million for fiscal year 2023. We believe it illustrates the policymakers' ongoing commitment to addressing the state's OPEB liabilities.

It is common that pension and OPEB reform efforts produce material improvement in key metrics only as a result of sustained commitment on the part of policymakers and sometimes over many years. While the effects of Hawaii's Act 268 and its various pension reforms do not result in an immediate improvement to our rating on the state, we view them as important to its ability to maintain the current rating through economic cycles while also enhancing its potential for a higher rating.

We have assigned a score of '3.2' out of '4.0' to Hawaii's debt and liability profile, on a scale where '1.0' is the strongest score and '4.0' the weakest.

Related Research

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

Ratings Detail (As Of November 15, 2023)		
Hawaii GO		
Long Term Rating	AA+/Stable	Affirmed
Hawaii GO		
Long Term Rating	AA+/Stable	Affirmed
Hawaii GO		
Long Term Rating	AA+/Stable	Affirmed
Hawaii GO		
Long Term Rating	AA+/Stable	Affirmed
Hawaii GO		
Long Term Rating	AA+/Stable	Affirmed
Hawaii GO (MBIA) (National)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.