

MOODY'S

RATINGS

Rating Action: Moody's Ratings assigns Aa2 to Hawaii's 2024 GO Bonds; affirms Aa2 issuer rating; Hawaiian Home Lands' revenue bonds upgraded to Aa3; outlook stable

14 Nov 2024

New York, November 14, 2024 -- Moody's Ratings (Moody's) has assigned a Aa2 rating to the State of Hawaii's \$750 million Taxable General Obligation Bonds of 2024 Series GN. We have also affirmed the state's Aa2 issuer rating; affirmed the Aa2 ratings on \$8.1 billion of outstanding general obligation (GO) bonds; upgraded to Aa3 from A1 the rating on the Department of Hawaiian Home Lands' \$19.3 million of outstanding revenue bonds; affirmed the Aa3 rating on the Department of Hawaiian Home Lands' \$8.3 million of outstanding certificates of participation; and affirmed the Aa2 rating on \$451.3 million of outstanding highway revenue bonds. The outlook is stable.

Affirmation of the issuer rating reflects Hawaii's solid finances, strong governance and strategic location, balanced against its very high leverage and dependence on the tourism industry that can be vulnerable to external events. The stable outlook reflects our expectation that Hawaii's prudent fiscal management will continue to help it address its long-term challenges, especially its high leverage.

RATINGS RATIONALE

The state's Aa2 issuer rating is supported by its sound financial position and strong governance (G-1 IPS), underscored by a rainy day fund strengthened to a record 15% of 2023 general fund revenue, demonstrated executive authority to amend budgets as needed and steady efforts to pay down long-term liabilities. These strengths mitigate the state's economic and revenue reliance on its tourism sector, which is sensitive to external factors. The issuer rating also considers Hawaii's slower real GDP growth relative to the US, its remote location, high living costs and demographic challenges that constrain economic diversity and growth. Positively, Hawaii's strategic location will continue to ensure a consistent federal and military presence that provide economic stability.

The issuer rating additionally reflects Hawaii's relatively weak per capita income (86% of the US) and considers the state's stronger median household income after adjusting for regional cost of living. The rating also considers the state's above average leverage (combined debt, pension, OPEB and other liabilities) that totals 250% of fiscal 2023 own-source revenue, because it is responsible for several functions typically provided by local governments in other states. Notably, Hawaii's leverage has moderated significantly from a high of 500% in fiscal 2021, partly because of recent strong revenue growth. The state's fixed costs burden, 18.1% of own-source revenue, is also well above the 50-state median but also reflects Hawaii's commitment to pay down pension and OPEB obligations.

The Aa2 rating on the state's GO bonds is equivalent to the issuer rating because of the broad full faith and credit pledge on the bonds.

The Aa3 rating on the Department of Hawaiian Home Lands' certificates of participation, one notch below the issuer rating, reflects the limited, subject to appropriation nature of the leases; the essentiality of the financed asset; and the state's obligation to fund administrative and operating costs of the department, including lease payments, from its general fund.

The upgrade to Aa3 from A1 on the Department of Hawaiian Home Lands' revenue bonds reflects the department's consistent practice of paying the bulk of annual revenue bond debt service from monies received from the Office of Hawaiian Affairs (OHA) and the expectation of long-lasting partnership between the department and OHA. The availability of this OHA revenue offsets the inherent volatility and lessee concentration of the real estate-derived revenues pledged to the bonds. The one-notch distinction from the state's issuer rating also reflects our view that both the department and OHA are essential agencies of the state because they carry out missions protected in the state's constitution.

The Aa2 rating on the highway revenue bonds reflects the bonds' priority lien on a mix of state-wide transportation revenues which we consider somewhat broad with manageable volatility, offset by strong maximum annual debt service (MADS) coverage exceeding 6 times provided by the pledged revenue. The rating also considers the state legislature's demonstrated willingness to add or modify pledged revenues as needed to fund the state's highway program, in addition to the bonding program's 2.0 times additional bonds test.

RATING OUTLOOK

The stable outlook reflects our expectation that through careful fiscal management, the state's financial position will remain healthy to safeguard against economic fluctuations. The stable outlook also reflects our expectation that the state will continue to proactively tackle its long-term challenges, including bolstering climate resilience, enhancing affordability, navigating demographic hurdles and addressing higher-than-average pension and OPEB burdens.

FACTORS THAT COULD LEAD TO AN UPGRADE OF THE RATINGS

- Stronger and more stable trend of economic growth relative to the US
- Diversification of the state's economy, including within its tourism industry
- Stronger socioeconomic profile and demographic trends
- Continued progress in reducing long-term liabilities, fixed-costs and capital asset condition that brings Hawaii closer to state sector medians

FACTORS THAT COULD LEAD TO A DOWNGRADE OF THE RATINGS

- Economic volatility that leads to material revenue declines, persistent budget imbalance, or narrower reserve and liquidity positions
- Material changes in federal policy that reduce or delay funding provided to the state
- Sustained growth in leverage to more than 500% of state own source revenue
- (Highway revenue bonds only) A severe decline in pledged revenues and/or material increase in leverage resulting in maximum annual debt service coverage falling consistently below 4.0x

LEGAL SECURITY

Hawaii's general obligation bonds are payable by the state's pledge of its full faith, credit and resources. The bonds have a first charge on all general fund resources.

The Department of Hawaiian Home Lands' COPs are payable by lease payments to be made by the state from its general fund for the use of the Department of Hawaiian Home Lands' headquarters facility in the Kapolei area of Oahu. Lease payments are subject to appropriation by the state legislature.

The Department of Hawaiian Home Lands' revenue bonds are special limited obligations of the department payable by a first lien on revenues from general leases, licenses, permits, and investment income collected from management and operation of the available lands. In addition, pursuant to a contract between the department and OHA, a separate state agency, OHA has agreed to pay the department \$3 million annually as long as the revenue bonds are outstanding. Although not pledged to the bonds, the OHA payments are specifically designated in the contract for the payment of debt service on the revenue bonds. In practice, the department has always used the OHA payments and interest earnings on the payments to pay debt service on the revenue bonds. OHA's obligation to make the annual payments is absolute and unconditional, and not subject to appropriation by the state legislature.

The highway revenue bonds are limited obligations of the state, payable by a gross pledge of highway fund revenues including fuel taxes, registration fees, weight taxes, and car rental surcharges.

USE OF PROCEEDS

Proceeds of the 2024 Series GN bonds will be used to finance or to 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, and highways, and other public purposes.

PROFILE

Hawaii is the 40th largest state by population, at 1.4 million. Its nominal state gross domestic product, \$110 billion as of 2023, is the 40th largest. The state's resident income levels are below average, with per capita personal income equal to roughly 86% of the US level after adjusting for regional cost of living. However, Hawaii has a larger average household size than the nation and as such, Hawaii's median household income is closer to 110% of the nation's even after adjusting for regional cost of living.

The state government of Hawaii has responsibility for many functions that are performed by or shared by local governments in most other parts of the US, most notably the public school system.

METHODOLOGY

The principal methodology used in these ratings was US States and Territories published in July 2024 and available at <https://ratings.moodys.com/rmc-documents/425428>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

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