FitchRatings

Tagging Info

Fitch Affirms Department of Hawaiian Home Lands Revenue Bonds at 'A'; Outlook Stable

Ratings Endorsement Policy
09 Aug 2013 2:25 PM (EDT)

Fitch Ratings-New York-09 August 2013: Fitch Ratings has affirmed the 'A' rating on the state of Hawaii's $39.8 million Department of Hawaiian Home Lands (DHHL, or the department) revenue bonds, series 2009.

The Rating Outlook is Stable.

SECURITY
The bonds are special, limited obligations of the department, secured by a gross pledge on general lease and license and permit fee revenues, as well as interest income generated by the department's administration account.

KEY RATING DRIVERS

SOUND PLEDGED-REVENUES COVERAGE: The bonds are secured by a gross pledge on certain DHHL revenues including from leases and permits of state-owned lands to private parties, which provide sound debt service coverage. Additional security exists in the form of a debt service reserve fund and additional reserve holdings in a pledged fund.

DEDICATED DEBT SERVICE FUNDING: While not pledged to the bonds, debt service is expected to be funded through monies from the Office of Hawaiian Affairs (OHA, a state-financed independent agency), pursuant to an executed Memorandum of Agreement (MOA) between the two entities.

ADDITIONAL BALANCES AVAILABLE: The department controls significant balances and, while not available to bondholders, these funds offer the department operating flexibility.

STATE INVOLVEMENT: The department is a cabinet level agency with a constitutional mandate and several layers of state support including operating and capital appropriations. No direct state support is pledged to bondholders.

RATING SENSITIVITIES

CHANGES IN PLEDGED REVENUES: The rating is sensitive primarily to the performance of pledged revenues and the resulting strength of debt service coverage.

STABILITY OF ADDITIONAL SUPPORT: The rating is also sensitive to the consistency of supporting factors including the OHA transfer dedicated for debt service.

CREDIT PROFILE
The 'A' rating reflects sound debt service coverage provided by the pledged revenue stream, the additional security provided by a debt service reserve as well as a supplemental reserve, the department's overall financial resources which afford significant operating flexibility, and the state's demonstrated support of the department's mission. The rating also considers cash flow pursuant to an MOA between the department and the state's Office of Hawaiian Affairs that, while not pledged to the bonds, is the intended repayment source. Pledged revenues are derived largely from general lease payments received on department lands leased to commercial and industrial entities.

DHHL is a cabinet-level entity in Hawaii's state government, directed by the Hawaiian Homes Commission (HHC, or the commission), which operates pursuant to the Hawaiian Homes Commission Act of 1920 (HHCA). Members of the commission are appointed by the governor with the consent of the state senate. The chairman also serves as the department's director. DHHL manages more than 200,000 acres of land held in trust as Hawaiian Home Lands, and the department's primary mission is to provide qualified native Hawaiians the opportunity to own homes on the trust's lands. The series 2009 bonds financed capital improvements necessary to advance the department's primary mission. Portions of the department's lands are leased for commercial and industrial development purposes while others are utilized under license and permit arrangements for various purposes, and associated revenues generated are applied toward furthering homestead projects.

The bonds are secured by a gross pledge on the general lease and license and permit fee revenues, as well as interest income generated by the department's Hawaiian Home Administration Account (HHAA). Further security is provided by a debt service reserve funded at maximum annual debt service as well as a supplemental reserve maintained over the life of the bonds in the department's general account at 0.25x aggregate annual debt service. As of Aug. 5, 2013, the supplemental reserve held approximately $7 million.

Annual payments totaling $3 million from the state's Office of Hawaiian Affairs pursuant to an executed MOA, while not pledged to the bonds, are the intended repayment source for the bonds. The MOA term is concurrent with bond maturity and the $3 million payment is essentially equivalent to both annual and maximum annual debt service (MADS). Irrespective of this $3 million contribution, the department's pledged fiscal 2013 revenues (excluding interest income) of $13.9 million provided 4.58x coverage of MADS.

While most general leases (the dominant source of pledged revenues at $10.2 million in fiscal 2013) expire before final maturity of the bonds, Fitch anticipates adequate coverage even in stress scenarios. Approximately 72% of general leases in force as of Aug. 2, 2013 will expire prior to bond maturity (April 1, 2039), reducing general lease revenues by approximately 42% over the life of the bonds if none of the leases are successfully re-auctioned.

Further, the department recently began a review of its revocable permit (RP) program (the second largest source of pledged revenues at $3.7 million in fiscal 2013) that could lead to revocation of as much as 20% of permits. Even when applying a 15% loss factor on scheduled general lease revenue payments, and excluding 20% of license and RP revenues, Fitch estimates MADS coverage would remain above 2x through final maturity. Historically, general lease delinquencies have ranged between 3%-6%. Fitch anticipates actual coverage will likely be more in line with historical trends at or near 4x. DHHL is negotiating several leases which could substantially bolster coverage, though Fitch notes that prior department projections have proven overly optimistic.

The indenture includes an additional bonds test of 1.25x coverage for projected aggregate annual debt service from historical revenues, and the department covenants to maintain rates, rentals, fees, and charges of at least 1.25x aggregate annual debt service. While $100 million in revenue debt has been authorized, the department currently envisions no further debt under this indenture.

DHHL has access to substantial internal liquidity and other resources, providing important flexibility for the HHAA. As of June 30, 2012, the HHAA held $19.5 million in cash. Additionally, the department maintains three major funds, with cash balances totaling $145.8 million at the close of fiscal 2012, whose resources can be used at HHC discretion to support the HHAA. Further, the current state biennial budget (fiscal 2014-2015) includes $9.6 million in annual operating appropriations for DHHL, pursuant to a recent state Supreme Court decision regarding the state's constitutional duty to support the department's mission.

A recent state report on certain DHHL programs will increase scrutiny of department operations, but Fitch does not anticipate any notable negative effect for bondholders. The report published by the state auditor raised concerns about DHHL-managed loan programs that provide home financing for native Hawaiians. As of May 21, 2013 DHHL had $606.7 million in direct and indirect loans outstanding. The state auditor's concerns revolved primarily around the department's monitoring of loan performance and related enforcement actions. These loan programs do not provide any of the pledged revenues and the department maintains loan loss reserves. In addition, the state provides a $100 million guarantee on DHHL-guaranteed loans, a subset of the total loan portfolio. The loan guarantee is recognized by the state as a contingent liability and included in its statutory debt limit calculations, though it has never been activated. As of May 21, 2013, there was $50.023 million in loans covered by the state guarantee.

Contact:
Primary Analyst
Eric Kim
Director
+1-212-908-0241
Fitch Ratings, Inc.
One State Street Plaza
New York, NY 10004

Secondary Analyst

Laura Porter
Managing Director
+1-212-908-0575

Committee Chairperson
Karen Krop
Senior Director
+1-212-908-0661

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Additional information is available at 'www.fitchratings.com'

Applicable Criteria and Related Research:
--'U.S. State Government Tax-Supported Rating Criteria', dated Aug. 14, 2012.

Applicable Criteria and Related Research:
U.S. State Government Tax-Supported Rating Criteria

Additional Disclosure
Solicitation Status