FITCH AFFIRMS DEPARTMENT OF HAWAIIAN HOME LANDS REVENUE BONDS AT 'A'; OUTLOOK STABLE

Fitch Ratings-San Francisco-04 August 2015: Fitch Ratings has affirmed the 'A' rating on the State of Hawaii's $38.3 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 (HHAA). Additional security exists in the form of a debt service reserve fund and additional reserve holdings in a pledged fund.

KEY RATING DRIVERS

SOUND COVERAGE: Coverage continues to improve and remains sound based on pledged DHHL revenues from leases and permits of state-owned lands to private parties.

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 between the two entities.

ADDITIONAL SUPPORT AVAILABLE: The department controls significant balances and, while not directly 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

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. Associated revenues generated are applied toward furthering homestead projects.

SOUND COVERAGE, CONCENTRATION RISK

The department's pledged fiscal 2015 revenues (excluding interest income) of $17.8 million provided 5.9x coverage of MADS, representing a notable improvement from 4.6x in 2013. This is due to a significant new lease starting in December 2014 related to the Ka Makana Ali'i project by DeBartolo Hawaii LLC in Kapolei paying $3.6 million annually with an additional $1.1 million expected starting in 5 years.

Revenues are somewhat concentrated. The new lease currently accounts for 26% of general lease revenues (20% of total pledged revenues) and the top 10 lessees together make up 56% (46% of total pledged revenues). Other top lessees include Waiakea Center, Ho Retail Properties, Safeway/Target and Home Depot. While 67% of general leases as of July 2015 expire before final maturity of the bonds (April 1, 2039), Fitch considers risk related to non-renewal to be manageable. Further, revenue solely from those leases with expirations after final maturity cover MADS at a still sufficient 1.5x.

To assess risks related to non-payment, Fitch developed an additional stress scenario with a 15% haircut on DHHL's projected pledged revenues through fiscal 2019 (DHHL's projection period), followed by 5% year-over-year annual declines through final maturity. MADS coverage remains above 2x through final maturity. In comparison, general lease delinquencies have ranged between 3 - 8% historically. Recent delinquency rate increased to 10.2% in fiscal 2015 mostly due to one defaulted lease. The lease has been reassigned in June 2015 to a new lessee with a lower rent, and the delinquency rate is expected to fall back into historical range.

Fitch anticipates actual coverage will likely be over 6x. DHHL is negotiating several leases which could substantially bolster coverage, though Fitch notes that prior department projections have sometimes proven optimistic.

ADDITIONAL SUPPORT

The rating also reflects the debt service reserve as well as a supplemental reserve, the department's overall financial resources which afford significant operating flexibility, the state's demonstrated support of the department's mission, as well as cash flow pursuant to a Memorandum of Agreement between the department and the state's Office of Hawaiian Affairs.

In addition to the pledged revenues, bondholders also benefit from 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 0.25 times (x) aggregate annual debt service. As of July 2015, the two reserves together held $8.8 million, equivalent to more than 2 years' worth of debt service.

Annual $3 million payments from the state's Office of Hawaiian Affairs pursuant to an executed Memorandum of Agreement (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). DHHL receives the payment approximately one year in advance of each scheduled debt service payment.

DHHL has access to substantial internal liquidity and other resources, providing important flexibility for the HHAA. As of June 30, 2014, the HHAA held $29.3 million in cash. Additionally, the department maintains three major funds, with cash balances totaling $168.8 million at the close of fiscal 2014, whose resources can be used at HHC discretion to support the HHAA. Further, the current state biennial budget (fiscal 2016-2017) 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.

NO DEBT PLANS

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 was authorized, the department currently envisions no further debt under this indenture.

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Applicable Criteria
Tax-Supported Rating Criteria (pub. 14 Aug 2012)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015
U.S. State Government Tax-Supported Rating Criteria (pub. 14 Aug 2012)
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