FitchRatings

Fitch Affirms Hawaii Airport Revenue Bonds at 'A'; Outlook Positive

Fitch Ratings-New York-30 September 2016: Fitch Ratings has affirmed the following state of Hawaii Department of Transportation's (airports division) underlying long-term ratings:

--$1.015 billion of outstanding airport system revenue bonds at 'A';
--$167 million of outstanding series 2013 lease revenue certificates of participation (COPs) at 'A-'.

The Rating Outlook on all bonds remains Positive.

The airports division also has $8 million outstanding in parity COPs that are not rated by Fitch.

The Positive Outlook reflects the improving financial metrics of the airport system which are expected to continue as new contracted revenues come online and the Airport Division progresses with its remaining borrowing. The Outlook also takes into account favorable progress on the sizable capital improvement plan (CIP) in terms of meeting budget and project delivery targets.

The ratings reflect the essentiality of air traffic to an island system of airports that generates a solid base of origination and destination (O&D) traffic in a stable service area. The ratings also incorporate the competitive, albeit rising cost per enplanement (CPE), low leverage, and strong cash position which partially mitigate the risks associated with the airport system's predominantly leisure traffic base. The rating distinction between the revenue bond liens reflects the subordinated nature of the obligation securing the COPs, and weaker coverage covenants when compared to those of the senior debt.

KEY RATING DRIVERS

Revenue Risk - Volume: Stronger
Monopolistic Position; Leisure Exposure: The necessity of air travel to, from and between the archipelago's various islands provides the airport system with a stable origin and destination base of approximately 17.2 million enplaned passengers. The economy is anchored by tourism, but the large military presence somewhat stabilizes the traffic base. The monopolistic nature of the system further mitigates risk surrounding slightly elevated carrier concentration, with Hawaiian Airlines ('B+'/Outlook Stable) accounting for approximately half of total system enplanements.

Revenue Risk - Price: Stronger
Rolling Airline Agreement Imposing Reasonable Rates: The hybrid airline use and lease agreement, covering more than 60% of operating costs, does not have an expiration date and automatically extends quarterly. CPE remains competitive at $9.24 in fiscal 2015 and is expected to slightly increase to $9.37 in fiscal 2016. CPE is projected to rise on a modest incline to the $12-$14 range as capital spending occurs; however, it is not anticipated to affect traffic demand given Hawaii's continued attractiveness as a tourist destination.

Infrastructure Development/Renewal: Midrange
Large Capital Plan Partially Debt Funded: The Airport Division's capital program through fiscal 2021 totals approximately $2.6 billion, with additional revenue bond borrowing of approximately $551 million expected over the period. Close oversight from the state government together with prudent management of capital spending and borrowings will be important to rating maintenance. The timing and amount of borrowing is subject to change prior to issuance.

Debt Structure: Stronger (Senior); Midrange (Subordinate)
Conservative Debt Structure: Revenue bond debt is 100% fixed rate with a declining debt service profile and final maturity in 2045. The COPs are fixed rate with final maturity in 2029, and have an increasing debt service profile that is structured to match the increase in the annual energy savings guarantee from Johnson Controls Inc. (JCI) under the energy performance contract.

Historically Sound Financial Metrics May Face Pressure: DOTA's leverage position is currently low compared to peers with net debt-to-cash flow available for debt service (CFADS) at 1.9x in fiscal 2015 for senior debt and 3.8x on an all in basis. However, airport leverage is anticipated to increase from its current level to the 6x-8x range with the borrowings associated with the capital plan. Since fiscal 2007, senior debt service coverage has ranged from 1.61x to 2.14x, with fiscal 2015 at 1.75x (1.66x including COPs). Liquidity remains strong with 792 days cash on hand (DCOH) in fiscal 2015. Management intends to maintain liquidity at comparable levels going forward, though some cash could be used to offset additional borrowing costs.

Peer Analysis: Hawaii's peers include Greater Orlando Aviation Authority (rated 'AA-'/'A'+; Stable Outlook) and Broward County

(Fort Lauderdale, rated 'A'; Positive Outlook) given similar enplanement bases and traffic trends as well as debt amounts. Hawaii's DCOH is the highest of the three; both Hawaii and Orlando will see rising but competitive CPE and leverage as their CIPs progress.

FACT Tool: U.S. Airports (https://www.fitchratings.com/site/fitch-home/re/876822.html)

RATING SENSITIVITIES

Positive - Achieving Forecasted Metrics: The airport system's ability to maintain traffic and revenue growth generating senior and subordinate coverage in the 1.6x and 1.4x range, respectively, with CPE at or below $12.

Negative - Performance Levels: A sustained decline or increased volatility in traffic performance leading to lower all-in debt service coverage levels or sustained CPE in the $14 range could pressure the current rating.

CREDIT UPDATE

Total system enplanements and carrier service continue to trend positively and are generally at pre-recession levels. Traffic has grown at an annual rate of 2.4% from 2011 to 2016, and increased 3.2% in fiscal 2016 to 17.2 million. Overseas enplanement activity continues to outpace interisland travel, as carriers add direct overseas service to additional island airports. This is viewed positively by Fitch as it diversifies traffic across the system and reduces exposure to a single airport.

Passenger growth in 2015 had positive effects on non-aviation revenue, which increased 2.7% to $175 million. Aviation and fuel tax revenue increased 6.7% to $162 million. The airports division expects aviation related revenue to continue to increase as additional portions of the CIP come on line. As such, Fitch views positively the system's ability to generate additional non-aviation revenue, as any increases can be used to offset increasing airline costs.

Continued discipline in managing costs will be important to the maintenance of the rating. Operating expenses have been increasing moderately with annual growth of 3.5% from 2010-2015 after experiences significant annual growth nearly a decade ago. However, utility savings from the energy conservation project should help to offset increasing expenses, and the airlines currently support the system's costs under a strong hybrid agreement. In fiscal 2015, CPE was $9.24 and is expected to increase to $9.37 in fiscal 2016, although Fitch expects an increase to the $12-$14 range through 2022 as the airports division progresses with its capital program.

Debt service coverage for the revenue bonds totaled 1.75x in fiscal 2015, generally in line with the ratios seen since 2008, while all-in coverage including COPs totaled 1.66x. The airports division and the airlines agreed to apply $18.5 million of prepaid interest to reduce airline rates for fiscal 2015 and an additional $4 million for fiscal 2016. If billing leads to an over-collection, the airports division and the airlines may continue applying this money to reduce airline rates and charges. Separately, the airports division received approval from the Federal Aviation Administration to use $414 million of passenger facility charge (PFC) revenues for PFC-eligible debt service and started using PFC revenues for such purposes in fiscal 2016.

The CIP through fiscal 2021 totals $2.6 billion, including $832 million already expended as of June 2016 (32%). Projects are expected to be funded with additional debt issued in 2017 and 2018 totaling $551 million, customer facility charges, grants, PFCs funded on a 'pay as you go' basis, and also from airport cash balances.

Fitch's base case assumes a flat traffic growth in 2017 followed by 1.5% growth through 2022. Airline revenues and non-airline revenues increase at an annual growth rate of 7% and 4.2%, respectively. Expenses grow at an annual growth rate of 4.8%. Under this scenario, coverage remains at or above 1.56x/1.35x including the coverage account and all-in, respectively, while leverage reaches 6.6x on the senior lien. CPE is forecasted to reach $12.21 in fiscal 2022.

Fitch's rating case assumes an 8% stress to enplanements in 2017 with moderate recovery of 2.5% through 2020 followed by slight growth of 1.4% until 2022. Expenses were increased at an annual growth rate of 5.2%. Coverage is held flat at 1.60x on the senior lien, causing airline costs to increase at a greater rate than the base case. In this scenario, CPE rises to the $14 range by 2021, and total leverage to approximately 8x in 2018, before falling to the 3x range by 2022.

SECURITY

The revenue bonds are secured by net revenues of the airport system and aviation fuel taxes with final maturity expected in 2045. The lease revenue COPs are secured by payments pursuant to the lease, and payable by revenues of the airport system, junior to the position of the outstanding revenue bonds and subject to annual appropriation. The projects associated with the COPs have been approved by the carriers serving the airport system and can be included in airline charges to support repayment of the COPs.

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Applicable Criteria
Rating Criteria for Airports (pub. 25 Feb 2016) (https://www.fitchratings.com/site/re/877676)
Rating Criteria for Infrastructure and Project Finance (pub. 08 Jul 2016) (https://www.fitchratings.com/site/re/882594)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form (https://www.fitchratings.com/creditdesk/press_releases/content/ridf_frame.cfm?pr_id=1012490&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJzZXNzaW9uS2V5IjoiRUZJNk1HWFhWRk1KSkdDN0ZPMlVNMEZHSDlJUDdBUk1UVldNWlJWRSIsImV4cCI6MTQ5OTczNTYyNSwidXNlcklkIjoxNTUzMzE5fQ.bA-IfioshqK67oBFOywuQGaal30nyYwODRw_i15UiGs)
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