



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.

Contact:

Primary Analyst
Emma W. Griffith
Director
+1-212-908-9124
Fitch Ratings, Inc.
33 Whitehall Street
New York, NY 10004

Secondary Analyst
Seth Lehman
Senior Director
+1-212-908-0755

Committee Chairperson
Scott Zuchorski
Senior Director
+1-212-908-0659

Media Relations: Sandro Scenga, New York, Tel: +1 212-908-0278, Email: sandro.scenga@fitchratings.com.

Additional information is available on www.fitchratings.com

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.eyJzZXNzaW9uS2V5IjoiaRUZJNk1HWfhWRk1KSkdDN0ZPMiVnMEZHSDIJUDdBuk1UVldNWlJWRSIsImV4cCI6MTQ5OTczNTYyNSwidXNlckkljoxNTUzMzE5fQ.bA-lfioshqK67oBFOywuQGaal30nyYwODRw_i15UiGs)

Solicitation Status (https://www.fitchratings.com/gws/en/disclosure/solicitation?pr_id=1012490)

Endorsement Policy (<https://www.fitchratings.com/jsp/creditdesk/PolicyRegulation.faces?context=2&detail=31>)

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK:

[HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.fitchratings.com/understandingcreditratings)

(<https://www.fitchratings.com/understandingcreditratings>). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2016 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the

particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Solicitation Status

Fitch Ratings was paid to determine each credit rating announced in this Rating Action Commentary (RAC) by the obligator being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated, except for the following:

Endorsement Policy - Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures (<https://www.fitchratings.com/regulatory>) page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.