

# State of Hawaii

## Department of Transportation, Airports Division New Issue Report

### Ratings

#### New Issue

\$250,175,000 Airports System  
Customer Facility Charge  
Revenue Bonds, Series 2017A A

### Rating Outlook

Stable

### Peer Group

Massachusetts Port Authority  
(Conrac Project Bonds) A  
Charlotte, NC A



### Related Criteria

Rating Criteria for Airports  
(December 2016)

Rating Criteria for Infrastructure and  
Project Finance (July 2016)

### Related Research

Fitch Rates Hawaii Airport System  
Conrac Bonds 'A'; Outlook Stable  
(July 2017)

Peer Review of U.S. Airports (Attribute  
Assessments, Metrics and Ratings)  
(December 2016)

Fitch Affirms Hawaii Airport Revenue  
Bonds at 'A'; Outlook Positive  
(September 2016)

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### Key Rating Drivers

**Summary:** The rating reflects a strong origin and destination (O&D) market supporting robust rental car transaction day performance and customer facility charge (CFC) collections at the statewide consolidated rental car facility system (Conrac).

Strengths consider the broad CFC collection authority across five main Hawaiian airports, strong coverage at existing transaction levels, favorable progression of the construction program, and conservative covenants and reserves. Strong rating case coverage of 2.0x, excluding rolling coverage, and leverage of 4x–5x support the rating, taking into account future borrowing to fund remaining project costs.

**Multi-Airport CFC Base:** The Conrac benefits from average annual transaction day growth of 8.5% since CFCs were first collected in 2008, rising to 15.2 million in fiscal 2016 across the multi-airport system. Transactions are supported by strong domestic and international visitor arrivals across Hawaii. The airport system's ratio of rental car transaction days to O&D enplaned passengers at over 120% is high, relative to other facilities, due to strong rental demand. The rental market benefits from a balanced and diverse rental car operator presence.

**Strong Concession, Ratemaking Ability:** Fitch Ratings views the 30-year concession and lease agreements, effective upon project completion and extending through bond maturity, as providing considerable stability. The Department of Transportation, Airports Division (the department) has collected CFCs since 2008, and has the authority to increase rates as necessary, partially mitigating the narrowness of the CFC revenue stream.

The moderate \$4.50 CFC compares favorably with rates at other facilities. No increases are anticipated for projected Conrac costs. Under the agreement, should CFC revenue be insufficient to cover 1.15x debt service, signatory rental car companies must also pay a minimum annual required deficiency payment (MARDP). Rental car companies are responsible for project operating costs but can be reimbursed from surplus CFCs after debt service.

**New Facilities Under Construction:** The facilities will be new upon completion in 2018 for Maui and 2020 for Honolulu, and are currently at 35% and 10% completion, respectively. Half of the overall project cost is expected to be funded with cash CFC collections, with initial funding provided by past collections and an interim loan. Additional facilities may be constructed at other Hawaiian airports such as Lihue, Hilo, Kona, but are expected to be limited in scope, reducing needs for future borrowing.

**Conservative Debt Structure:** The project's debt structure is conservatively established, featuring senior, fixed-rate debt and flat amortization. Structural features are strong relative to similar transactions, including a 1.4x rate covenant, including 25% rolling coverage, maximum annual debt service (MADS) based additional bonds test (ABT), and cash funded reserves. Obligations under bond documents are incorporated into the rental car concession agreement.

**Financial Profile:** Financial metrics are relatively strong for a CFC transaction with fiscal 2016 CFC revenue sufficient to provide 2.0x or better cash debt service coverage ratios (DSCRs) on all expected program borrowings. Fitch's rating case DSCR averages 2.7x through 2023, excluding rolling coverage, which contemplates an 8% drop in transaction days and related revenue, and no increase in the CFC rate. Leverage is initially moderate at 4.0x, rising to 5.0x by 2023 under the rating case as 2019 bonds come online.

**Peer Group**

The Hawaii Conrac system ranks among the largest for rated financing in terms of CFC transactions and collections. Comparable Fitch-rated peer Conrac facilities include the Massachusetts Port Authority (Massport; A/Stable) and Charlotte (A/Stable). Both projects have similar leverage levels of 4.0x–5.0x. Massport, Charlotte and Hawaii all benefit from coverage levels at or above 2.0x, excluding the coverage account, with Charlotte’s leverage being slightly lower.

**Rating Sensitivities**

**Future Developments That May, Individually or Collectively, Lead to A Negative Rating Action:**

- Coverage levels falling below 1.7x resulting from a significant drop in rental car transactions without a corresponding increase in the CFC rate.
- Additional future borrowings that increase leverage above 7.0x for a sustained period, without corresponding increases to net revenue.

**Future Developments That May, Individually or Collectively, Lead to A Positive Rating Action:**

- While a positive rating action is not likely in the near term, sustained outperformance of CFC collection, successful completion of construction on the two facilities and greater clarity on financing plans for other Hawaiian airports could lead to a positive rating action in the future.

**Enterprise Summary**

Project Summary Data		Financial Summary Data	
Project Type	Airport Consolidated Rental Car Facility	Rated Debt Terms	\$250 million in CFC revenue bonds, final maturity 2047. Fixed rate at 4.42% TIC.
Project Location	Honolulu and Kahului Airports, HI	Amortization Profile	Level debt service through 2047.
Status	Construction	Tail Before Concession Maturity	No tail, lease/concession agreement coterminous with bonds.
Revenue Basis	Volume	Reserves	<b>DSRF:</b> Cash funded at 1.0x MADS. <b>Rolling Coverage Account:</b> Cash funded at 25% MADS. <b>Capital Improvement Repair and Replacement Fund:</b> O&M Fund to be built up from 2019 onward.
Concession Maturity	30 years from completion of Conracs	Transaction Triggers	<b>Rate Covenant:</b> The sum of CFCs and MARDP, together with the funds in the rolling coverage fund, at up to 25% of the aggregate debt service, and no less than 1.4x aggregate debt service; 1.15x excluding rolling coverage.
Concession Granting Authority	Hawaii Department of Transportation	Additional Bonds Test	Projected 1.25x MADS inclusive of new debt, or CFCs for 12 consecutive months of the last 18 months equal to 1.25x MADS inclusive of the new debt.

DSRF – Debt service reserve fund. CFC – Customer facility charge. TIC – True interest cost. O&M – Operating and maintenance fund. MADS – Maximum annual debt service. MARDP – Minimum annual requirement deficiency payments. Source: Hawaii Department of Transportation, Fitch.

**Overview**

**Transaction Summary**

Proceeds of the series 2017 bonds will defray costs of design, development and construction of consolidated rental car facility projects at Honolulu and Kahului airports, operated by the department. Bond proceeds will fund the rolling coverage fund requirement, cash funded at 25% of MADS at closing, and the debt service reserve fund (DSRF) requirement, equal to

1.0x MADS, and cover the costs of issuance. The bonds are fixed rate with level debt service of roughly \$15 million through final maturity in July 2047.

### **Conrac System**

The overall \$901 million Hawaii Conrac program, with approximately 50% to be funded outside of borrowing sources, includes several rental car related projects within the Hawaiian airports system, with the main construction projects under contract. Major program elements include \$438.0 million for a Conrac at Honolulu, currently 10% complete and expected to be substantially completed by June 2020; and \$436 million for a Conrac at Kahului in Maui, currently 35% complete and expected to be substantially completed by October 2018. The project also includes \$21.0 million for land acquisition at Lihue for potential future Conrac development. The department expended approximately \$205.1 million on the Conrac system through December 2016. The department estimates the remaining cost to complete the Conrac system is \$696.3 million. Roughly half of the total project cost is expected to be cash funded.

### **Security**

The bonds are special limited obligations of the State of Hawaii, payable solely from and secured solely by the CFC and payment by the rental car companies (RACs) of the MARDP at project completion at each airport.

### **Project Analysis**

#### **Ownership and Legal Structure**

Hawaii's airports, and Conracs, are owned by the State of Hawaii, and operated by the department.

#### ***The Department***

The department is one of 18 principal executive departments of the state. Chapter 26, HRS, empowers the department to establish, maintain and operate the transportation facilities of Hawaii, including highways, airports, harbors and other transportation facilities. The department's activities are carried out through three primary operating divisions: Airports, Harbors and Highways.

#### ***Airports Division***

Through the Hawaii Airports Division, the department has general supervision of aeronautics within the state, exercising jurisdiction and control over all state airways and all state owned or managed airports and air navigation facilities. The department operates and maintains 15 airports across Hawaii.

The five primary airports, which account for 98% of system traffic and drive rental car demand, are Honolulu, Oahu; Kahului, Maui; Hilo and Kona, Hawaii; and Lihue, Kauai. All primary airports provide facilities for inter-island flights along with in-state flights among the airports in the airports system and direct overseas flights to the continental U.S. In addition, international flights are available to the Pacific Rim from Honolulu, to Japan from Kona, and to Canada from Lihue and Kahului via preclearance arrangements. Honolulu and Maui are the largest and busiest airports; although Honolulu has the most visitor traffic, Maui has the most rental car transaction days.

Fitch views the concession agreement and lease which govern the Conracs favorably, as it broadens the revenue base available for debt service by expanding CFC collection to include all RACs signatory to the Conrac leases, including those currently operating off airport. In 2015 the department entered into leases with five rental car concessionaires controlling 13 brands. These leases cover access to state-wide car rental facilities, including the Conracs under construction at Honolulu International and Kahului. Once completed, all on-airport rental car concessions at Honolulu and Kahului will operate from the Conracs under terms of the Conrac leases for a period of 30 years, or through retirement of the bonds, whichever is later. As the agreements are coterminous with the bonds, tail risk is eliminated.

**Revenue Risk — Volume**

Fitch considers Hawaii's strong visitor arrival levels as a credit strength underpinning ongoing CFC collections. Transactions are ultimately supported by domestic and international visitor arrivals across Hawaii. CFCs are collected at the five largest Hawaiian airports, providing broad revenue support to bondholders. The airport system's ratio of rental car transaction days to O&D enplaned passengers is high, relative to other facilities, due to strong rental demand.

**Visitor Arrivals Versus Transaction Days**



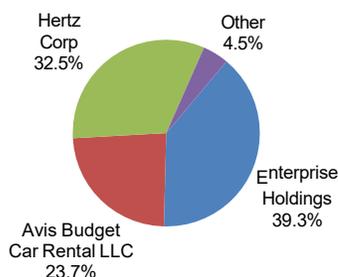
Note: In 2012, no customer facility charges were collected. Collections resumed in 2013.  
Source: Hawaii Airports Division.

Historical passenger traffic demonstrated volatility during economic cycles evidenced by enplanement losses with total enplanements of 14.9 million in 2009, a drop from 17.5 million in 2008. Traffic levels have since recovered steadily increasing by 16% and current visitor levels have reached record highs. For fiscal 2016, total enplaned passenger counts increased to 17.2 million from 16.7 million in fiscal 2015 due to higher overseas traffic.

Rental demand has been strong in recent years, driving robust CFC revenue. In fiscal 2016 the system-wide number of rental car transaction days was 15.167 million, up 5% yoy. Kahului accounted for 5.1 million transaction days, or 1/3 of the total compared with 1/5 enplanements; Honolulu had 58% of system-wide enplaned passengers, but only 29.7% of system-wide rental car transaction days. This reflects Oahu's visitor mix, more diverse transportation options in Waikiki and other factors.

Fitch considers Hawaii's rental market as benefitting from a balanced and diverse rental car operator presence, with the largest operator, Enterprise Holdings, holding 39.3% of the market by transaction days, followed by Hertz Corp. at 32.5% and Avis/Budget Car Rental LLC at 23.7%. There is limited off-airport competition for rentals as pertains to CFC collections, as under the new lease agreements many off-airport RACs with sister companies operating on-airport such as Alamo, Dollar, Thrifty at Honolulu and Advantage at Kahului began paying the CFC. Only local RACs which operate outside airports entirely and pay no concession fees or CFCs to the Airport Division will remain truly off-airport. These companies comprise an extremely small portion of the overall market.

**Rental Car Market Share — Hawaii Airport Systems (2016)**



Source: Hawaii Airports Division.

**Revenue Risk — Price**

The department charged a CFC since 2008, and the CFC rate is \$4.50 as of 2010, excluding 2012, when CFCs were not charged for one year. Compared to rates charged at other U.S. Conrac facilities, Fitch considers Hawaii’s CFC to be relatively low. When considered together with other costs associated with visiting the Hawaiian Islands, price elasticity due to nominal changes in the \$4.50 CFC rate is expected to be low.

Fitch views favorably the department’s CFC ratemaking ability, as the department has the power to adjust the CFC rate without rule making or legislative approval. The department is authorized to increase the CFC rate and to require payment of an additional MARDP by the RACs sufficient to pay debt service on the bonds and to pay costs of operation, maintenance and repair of the Conrac. Based on both sponsor projections and Fitch sensitivity scenarios, the CFC rate does not need upward adjustments to meet project obligations.

Fitch considers requirements upon signatory RACs under the lease as providing protection to bondholders. The leases require RACs to report and pay CFCs collected from customers to the department on a monthly basis, and to pay a MARDP in the event annual CFC revenue is lower than the sum of 1.15x debt service plus other required fund deposits. Both these revenue streams are pledged to the bonds. In addition the leases govern payment of ground rent and concession fees, a minimum annual guarantee, or 10% of gross receipts, which are paid to the airport revenue fund and are not pledged to the bonds.

CFC revenue grew 8.9%, from 2011–2016, reflecting an increase in the CFC rate in 2010 and the addition of off-airport transaction days to the revenue base beginning in 2015 with the new lease agreement. A 5.0% increase in CFC revenue occurred in 2016 yoy, tracking transaction day growth of 5.2% and outperforming visitor arrival growth of 2.5%.

**Hawaii — Consolidated Rental Car Facility System**

(000)	2009	2010	2011	2012	2013	2014	2015	2016	CAGR (%)
Visitor Arrivals	10,180	10,391	10,587	10,934	11,591	11,577	11,971	12,275	2.7
Visitor Arrivals % Growth	—	2.1	1.9	3.3	6.0	(0.1)	3.4	2.5	—
Rental Car Transaction Days	8,541	10,777	11,774	10	12,389	12,020	14,410	15,167	8.5
Rental Car Transaction Days % Growth	—	26.2	9.3	—	5.2	(3.0)	19.9	5.2	—
CFC Rate	1.00	1.00	3.92	—	4.50	4.50	4.50	4.50	—
Annual CFC Revenue	8,541	10,777	44,560	49	55,390	54,083	64,992	68,250	34.6
CFC Rate % Growth	—	26.2	313.5	—	24.3	(2.4)	20.2	5.0	—
Ending Cash CFC Balance	7,682	16,135	46,064	45,388	78,165	127,794	182,170	216,467	—

CFC – Customer facility charge.  
Source: Hawaii Airports Division.

Fitch views the levels of CFC collections as providing strong support to the project, with 2016 CFC revenue sufficient to cover future expected debt obligations by 2.0x on a cash basis. Existing CFC fund balances of \$216 million further support the project, with balances expected to draw down during construction before building up to over \$100 million by 2022.

**Infrastructure Development and Renewal Risk**

The \$901 million Conrac program is a major component of the department’s Airports Modernization Program launched in 2007. Sources of funding include \$76 million in outstanding EB-5 loans at 8%; current 2017 bonds at 25%; additional CFC bonds to be issued in 2019 at 14%; and existing and future pay go CFC collections at 52%. The \$438 million Honolulu project, with an interim facility already in place and the permanent facility 10% complete, consists of a new customer service building (CSB); ready/return area; quick turn-around (QTA) area; overflow vehicle storage and service yard; bus operations to bring

passengers to the new Conrac; a ground transportation center; and a pedestrian underpass. Substantial completion is expected in 2020.

The Kahului project, which is 35% complete, consists of a CSB; ready/return area; QTA area; overflow vehicle storage lot; employee parking; an electric tram to bring passengers to the Conrac; and related landscaping. Fitch views favorably the progress made to date on both facilities, and the buildup of capital improvement and operating reserves post-completion to ensure ongoing maintenance and development of Conrac facilities.

Of the total estimated cost of the Conrac system the department expended approximately \$205.1 million through December 2016. The department estimates the remaining cost to complete the Conrac system is \$696.3 million given the executed contracts in place.

### Sources and Uses of Funds — Hawaii Airports System

(000, As of May 2017)	EB-5 Bonds	2017 CFC Bonds	2019 CFC Bonds	Others	Total
<b>Sources of Funds</b>					
Bond Proceeds	76,000	253,990	225,980	—	555,970
Premium	—	—	—	—	—
Interest Earnings	—	—	—	—	—
Cash and Grants	—	—	—	1,076	1,076
CFC Collected as of December 2016	—	—	—	—	342,515
Future CFC Collection	—	—	—	124,804	124,804
<b>Total Sources of Funds</b>	<b>76,000</b>	<b>253,990</b>	<b>225,980</b>	<b>468,395</b>	<b>1,024,365</b>
<b>Uses of Funds</b>					
Deposit to Project Fund	76,000	230,000	127,000	468,395	901,395
Refunding EB-5 Bonds	—	—	76,000	—	76,000
Capitalized Interest	—	—	—	—	—
Deposit to Debt Service Reserve Fund	—	17,364	16,623	—	33,987
Deposit to Rolling Coverage Fund	—	4,341	4,155	—	8,497
Costs of Issuance	—	2,284	2,202	—	4,486
<b>Total Uses of Funds</b>	<b>76,000</b>	<b>253,990</b>	<b>225,980</b>	<b>468,395</b>	<b>1,024,365</b>

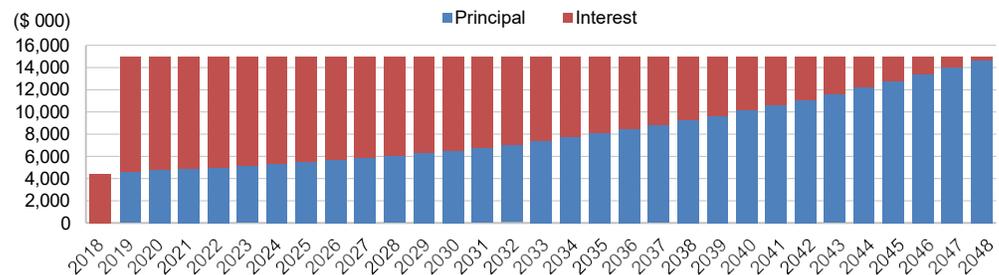
CFC – Customer facility charge.  
Source: Public Financial Management, Inc.

### Financial Analysis

#### Debt Structure

Fitch considers the project’s debt structure to be conservative, benefiting from all senior, fixed-rate debt and a relatively flat amortization profile. The 2017 bonds are fixed rate with level debt service of roughly \$15 million through final maturity in July 2047, with an expected all in true interest cost of 4.42%. Fitch expects the proceeds of the 2017 bonds, together with cash CFC receipts, will be sufficient to cover Conrac-related construction costs through year-end 2018.

#### Hawaii Conrac Debt Service Schedule



Source: Hawaii Airports Division.

The 2017 bonds constitute the first series of long-term bonds under the indenture and will be on parity with \$76 million in EB-5 bonds, issued in 2014 under the Immigration Investor Program. The bonds are fixed rate at 1.2% with principal due at maturity in 2019. The department plans to issuing approximately \$226 million of additional bonds in 2019 to refund the EB-5 bonds and to pay additional costs of the Conrac system.

The structural features of the bonds compare favorably to other rated Conrac facilities in Fitch's portfolio, with a 1.15x rate covenant excluding rolling coverage, 1.40x including rolling coverage, and a 1.25x additional bonds test. The DSRF is cash funded at 1.0x MADS at closing, approximately \$17 million, while the rolling coverage fund is cash funded at 25% MADS at closing, approximately \$4 million. The capital improvement repair and replacement fund and operating and maintenance fund both begin building from 2019 onward. These funds, together with substantial cash CFC balances accumulated by the department to date, and a \$216 million ending balance in 2016, provide additional funds to support the project in the future.

### Fitch Cases

Fitch's base case adopts the sponsor's assumptions, which were viewed to be conservative. In Fitch's base and rating cases, the \$4.50 CFC rate is held constant, as no rate changes are anticipated. The base case assumes visitor arrivals grow at 4.5% in 2017 and 2.0% in 2018, then at a rate of 1.8% through 2023, consistent with historical average growth rates. Rental car transaction days grow more slowly in 2017, then track visitor arrivals through 2023. Debt service reflects annual obligations on the 2017 and 2019 bonds, and debt service on the EB-5 bonds through 2019. Rolling coverage is applied at 0.25x annual debt service.

The rating case follows similar assumptions but applies an 8.0% decline in transaction days and visitor arrivals in 2019, followed by recovery at the 1.8% rate seen in the base case. This represents a slightly more modest reduction in traffic than was experienced during the most recent recession, as Fitch expects future recessions to be less severe.

In the base and rating cases, coverage remains strong, averaging 2.92x, without the coverage account, and 2.72x respectively. By 2023, leverage is 5.20x in the base case and 5.60x in the rating case. The leverage calculation is conservative in that it gives no credit for any buildup of excess CFC revenue as an offset to debt outstanding; leverage may fall more quickly on a net basis should excess CFC revenue accumulate over the forecast period.

Fitch considered a sensitivity case, mirroring the base case, but included an additional \$150 million of debt issued in 2021 to fund future Conrac developments. Under this scenario, with no increase in the CFC rate and no draw on deficiency payments, coverage remains at or above 1.69x without rolling coverage. Should the department choose to increase the CFC rate modestly to \$5.50 in this case, coverage would again rise to 2.1x or higher.

## Fitch Rating Cases

(000)	2016	2017	2018	2019	2020	2021	2022	2023	2016–2023
<b>Base Case</b>									
Visitor Arrivals	12,275	12,826	13,079	13,317	13,556	13,797	14,040	14,283	2.2
Visitor Arrivals % Change	—	4.5	2.0	1.8	1.8	1.8	1.8	1.7	—
Rental Car Transaction Days	15,167	15,671	15,925	16,216	16,508	16,803	17,101	17,399	2.0
Rental Car Transaction Days % Change	—	3.3	1.6	1.8	1.8	1.8	1.8	1.7	—
CFC Rate	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.50	—
Required Deficiency Payments	—	—	—	—	—	—	—	—	—
Total Operating Revenue	68,250	70,520	71,663	72,970	74,287	75,616	76,953	78,293	2.0
Annual Debt Service	524	685	12,812	26,205	33,471	33,473	33,473	33,466	—
Rolling Coverage Account	—	—	3,203	6,551	8,368	8,368	8,368	8,367	—
DSCR (Cash Flow) (x)	—	—	—	2.78	2.22	2.26	2.30	2.34	—
DSCR (Includes Rolling) (x)	—	—	—	3.03	2.47	2.51	2.55	2.59	—
ND/CFADS (x)	—	—	4.26	5.89	5.69	5.53	5.37	5.21	—
Coverage with 2017 Revenue (x)	—	—	—	2.69	2.11	2.11	2.11	2.11	—
<b>Rating Case</b>									
Visitor Arrivals	12,275	12,826	13,079	12,033	12,250	12,469	12,690	12,911	0.7
Visitor Arrivals % Change	—	—	2.0	(8.0)	1.8	1.8	1.8	1.7	—
Rental Car Transaction Days	15,167	15,671	15,925	14,651	14,915	15,182	15,451	15,720	0.5
Rental Car Transaction Days % Change	—	—	1.6	(8.0)	1.8	1.8	1.8	1.7	—
CFC Rate	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.50	—
Required Deficiency Payments	—	—	—	—	—	—	—	—	—
Total Operating Revenue	68,250	70,520	71,663	65,930	67,120	68,320	69,528	70,739	0.5
Annual Debt Service	524	685	12,812	26,205	33,471	33,473	33,473	33,466	—
Rolling Coverage Account	—	—	3,203	6,551	8,368	8,368	8,368	8,367	—
DSCR (Cash Flow) (x)	—	—	—	2.52	2.01	2.04	2.08	2.11	—
DSCR (Includes Rolling Coverage) (x)	—	—	—	2.77	2.26	2.29	2.33	2.36	—
ND/CFADS (x)	—	—	4.26x	6.52	6.30	6.12	5.94	5.77	—

CFC – Customer facility charge. DSCR – Debt service coverage ratio. ND – Net debt. CFADS – Cash flow available for debt service.

Source: Hawaii Airports Division.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

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