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Summary:

Hawaii Airport System; Non-Recourse Proj, Single or Multi Tenants, Entert

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Credit Profile		
US$254.0 mil airports sys customer fac charge rev bnds ser 2017A due 07/01/2047		
Long Term Rating	A+/Stable	New

Rationale

S&P Global Ratings assigned its 'A+' long-term rating to the State of Hawaii (Department of Transportation) Airport System's $254 million series 2017A (taxable) customer facility charge (CFC) revenue bonds. The outlook is stable.

The rating reflects our view of:

- The airport's monopolistic position and very high essentiality for transport within, to, and from the state, given that it serves a niche travel market with five primary airports and 10 secondary airports throughout Hawaii, with strong tourism trends;
- Hawaii's status as one of the most active rental car markets in the U.S., with annual rental car transaction days increasing to a robust 15.2 million days in fiscal 2016, largely as a result of the airport system's consistently strong and resilient demand from a large market of 14.7 million annual origin-and-destination (O&D) enplanements;
- The department's strong financial flexibility given its full autonomy to raise the rental motor vehicle CFC on rental car transactions as needed without limit, rule-making, or legislative approval to meet bond covenants, and a modest CFC level of $4.50 per transaction day (although there are no plans to increase the CFC level);
- Strong airport system and overall state visitor trends, which correlate highly with rental car transactions and, in turn, pledged CFC revenue;
- Good project funding with cash CFC collections forecast to account for almost 50% of the total project costs of $948 million (with the remainder debt-financed), with the department having collected the CFC since 2008;
- Good legal provisions with a fully funded debt service reserve fund at maximum annual debt service (MADS), a 1.40x rate covenant including the cash-funded rolling coverage fund at 25% of annual debt service (1.15x on CFCs alone), and a good 1.25x historical or projected additional bonds test;
- Generally good enplanement growth during fiscal years 2011 through 2016 with a five-year compound annual growth rate of 2.5%, including good 2.4% and 3.2% rebounds in enplanements in fiscal years 2015 and 2016, respectively, after a 1.5% decline in fiscal 2014, with forecast enplanement growth of 4.3% for fiscal 2017;
- Good annual debt service coverage (DSC) by gross CFC revenue alone (excluding the rolling coverage fund) projected by management at 2.2x by fiscal 2020, when all proposed series 2017 and future series 2019 debt service is expected to be fully on line, with DSC net of operations-and-maintenance (O&M) expenses (although paid after debt service according to the flow of funds) also good per management's estimates at no less than 1.6x through 2023; and
- Rental car companies' requirement to make deficiency payments in the event that CFC revenue is insufficient to fund required deposits, including payments for debt service.

Partly offsetting the above strengths, in our view, are:

- The susceptibility of the pledged CFC revenue to economic cycles, discretionary travel, and disposable income, with coverage metrics heavily reliant on tourism;
- Additional debt planned in fiscal 2019 to complete the project, and the potential for additional costs and debt related to future consolidated rent-a-car (ConRAC) facilities at Lihue Airport on the island of Kauai (at a cost still to be determined) as well as at Kona and Hilo airports on the Big Island (although much smaller in scope and size) that would dilute DSC;
- The potential for cost overruns given the large size of the project;
- A narrow revenue pledge securing the bonds when compared with other, more diverse airport-related pledges, such as general airport revenue bonds; and
- A state-levied $3 daily rental motor vehicle surcharge tax on all rental car transactions in the state, and other incremental taxes that push the overall daily CFC with taxes to more than $8, among the highest daily "add-ons" in the sector.

The bonds are payable solely from CFCs imposed by the department on rental motor vehicle customers who use or benefit from rental car facilities at all airports in the state airports system, including the ConRACs, and from certain payments by the rental car operators (RACs), including deficiency payments, and any amounts necessary to maintain the CFC stabilization fund and the capital improvement, repair, and replacement fund at their respectively required levels. The RACs that use the facilities will remit CFC revenue on a monthly basis to the trustee. The CFC, which does not expire, was imposed in 2008 and is designed to be sufficient to pay parity debt service at no less than 1.15x as well as operating costs and repairs. Bond provisions are favorable with a fully funded debt service reserve fund at MADS, a 1.40x rate covenant including the cash-funded rolling coverage fund at 25% of annual debt service (1.15x on CFCs alone), and a good 1.25x historical or projected additional bonds test.

The $254 million in bond proceeds, issued pursuant to the indenture, will partly fund the cost of the overall ConRAC System project (operated collectively as a single integrated system across all islands), which is budgeted at $901 million. The department plans to issue an additional $225 million to fund the remainder of the projects and pay off an initial $76 million loan (the EB-5 Agreement) with Hawaii Regional Center L.P. 1, Hawaii Regional Center L.P. 1A, and CamAm Hi G.P. 1 LLC in August 2014. The CFC indenture governs the issuance of the EB-5 bonds. As such, there are no contingent liquidity risks related to those lenders that have access to more favorable remedies in the event of a default versus parity series 2017 bondholders and future series 2019 bondholders.

The series 2017 revenue bond proceeds will fund $230 million in a deposit to the project fund as well as a deposit to the debt service reserve fund (at MADS estimated at about $17.4 million) and rolling coverage fund (25% of annual debt service), and pay certain costs of issuance. The 2017 bonds represent the authority's second debt issuance secured by CFCs assessed to the airport rental car customers. The 2017 bonds will be fixed rate with level debt service and mature in July 1, 2047. An additional $225 million in parity debt is planned in fiscal 2019 to complete the projects and to pay off the EB-5 loan.

In our view, the underlying strength of the Hawaii market--with steady population growth and strong tourism and enplanement trends--help provide consistent and growing demand for car rental activity. We also see benefits of diversification of the CFC revenue stream given that the CFC is collected at six airports on five islands, including mainly at Honolulu International Airport (HNL, on Oahu) and Kahului Airport (OGG, on Maui), where two ConRACs are being constructed for efficiencies and economies of scale. Three main factors help determine the level of CFC rental car transaction days and, in turn, CFC revenue: visitor arrivals, CFC car rentals (ratio of visitors who rent a car), and the average duration of each rental car transaction. Airport visitors totaled 12.3 million in fiscal 2016, and CFC transactions totaled 2.5 million, such that the CFC car rental ratio system wide was 20.2% (one in five visitors rented a car). The average duration of each transaction systemwide was 6.12 days in fiscal 2016, producing 15.2 million transaction days, up from 14.4 million in fiscal 2015 and 12.0 million in fiscal 2013. Transaction days totaled just 8.5 million in 2009, and were up 78% as of fiscal 2016, representing a compound annual growth rate of 9%. CFC transaction days rose 79% in 2015 and 7% in fiscal 2016 at HNL alone given that off-airport operations of signatory RACs began paying CFCs. The airport system has the highest number of transaction days per O&D enplanement in the U.S. at over 1.0 days; with the next highest airports Tampa International Airport at about 0.85, San Diego at 0.62, and Phoenix at 0.58. Systemwide transaction days are forecast to grow 5.2% in fiscal 2017, 3.3% in fiscal 2018, 1.6% in fiscal 2019, and 1.8% thereafter through 2023. By comparison, enplanements are forecast to grow 4.3% in fiscal 2017, 1.6% in fiscal 2018, 1.5% annually from 2019 to 2022, and 1.4% in 2023. In fiscal 2016, transaction days grew 5.2% and enplanements grew 3.2%.

Rental car ratios differ substantially by airport, with HNL at 13.8%, Hilo at 18.8%, Kona at 25.8%, Maui at 27.0%, and Lihue at 29.7% (the highest, at almost one in three). The average rental car contract duration is the highest at Maui at 6.69 days, compared with HNL at 5.58 and Hilo at 3.85. Systemwide rental car ratios have grown to 20.2% in fiscal 2016 from 17.3% in 2013, and are forecast to conservatively decline gradually to 20.1% by 2023 given various factors, including competition from transportation network companies such as Uber and Lyft.

Supporting the demand for rental cars in Hawaii is the area's strong tourism market, with a record 8.9 million-plus annual visitor arrivals to the state (removing double-counting for those visiting more than one airport) as of 2016, up from 7.3 million in 2011. This stems primarily from the state's favorable year-round climate, wide array of tourist attractions, growing retail and visitor expenditures, luxury hotels and condos, strong underlying economic base, diverse labor market, good income levels, and newly added air seats, including a growing number of nonstop flights to the neighboring islands (including several to Kona). Revenue per available room grew to $202 as of 2016 from $139 in 2011. Enplanements (86% O&D) reached 17.2 million in fiscal 2016, up 16% since fiscal 2009. Mass transit options are also somewhat limited, especially on the neighboring islands, which makes renting a car very attractive and convenient. The U.S. mainland represented 63% of 2016 visitor arrivals, followed by Japan at 16.9% and Canada at 5.4%. Hawaii's unemployment rate was just 2.7%, not seasonally adjusted, in May 2017, the lowest in the nation, and payroll job counts are at record levels.

The department began CFC collections at $1 per transaction day on Sept. 1, 2008, and raised the CFC rate to $4.50 on Sept. 1, 2010. From July 1, 2011 to June 30, 2012, the CFC collection was eliminated while the motor vehicle surcharge tax was increased to $7.50 per day from $3 per day, such that the equivalent of $4.50 per day was deposited in the general fund to bolster soft revenue. Future legislations cannot violate the contractual obligation to use CFC revenue as pledged repayment for the bonds; the department has covenanted to set the CFC and minimum annual requirement deficiency payments from the RACs at the level necessary to meet the annual rate covenant. The motor vehicle surcharge is now $3 per day on top of the CFC. The $4.50 CFC is considered moderate in the context of CFC rates charged at other airport ConRACs, which range from $2.15 per day at Denver International to $9 per day at San Diego International Airport (capped at five days).

A feasibility study performed in conjunction with the series 2017 bonds shows DSC (gross CFC revenue plus rolling coverage fund balance) at 2.5x in 2020, when the series 2017 and 2019 debt service is fully on line. We calculate gross DSC excluding the rolling coverage fund balance at 2.2x in that year, gradually rising to 2.3x by 2023. MADS coverage using fiscal 2016 pledged CFC revenue alone is approximately 2.0x, while DSC net of O&M costs and excluding rolling coverage fund balance is projected at 2.0x in 2020, declining to 1.6x by 2023 given that O&M costs are projected to increase as facilities come on line at a faster pace than CFC revenue growth. Under a stress test scenario in which the number of visitors hypothetically declines 20% in fiscal 2019, gross DSC of MADS excluding rolling coverage fund balance is 1.7x in 2019 while DSC net of O&M costs is 1.7x, declining to about 1.2x by 2022 as O&M costs grow and visitor levels slowly rebound. Under an additional stress scenario in which capital costs grow by $150 million (as a result of either additional facilities being built or overruns), MADS coverage in fiscal 2016 excluding rolling coverage fund balance is 1.5x, growing to 1.8x by 2023. In that same scenario, DSC net of O&M hits a low point of 1.2x in 2022. According to our calculation, excluding rolling coverage fund balance, projected pledged CFC revenue could withstand an approximate 53% decline in fiscal 2018 and still provide 1x MADS coverage. We believe the fiscal consultant's forecast is conservative on visitors, enplanements, transaction days, and debt interest rate assumptions, and we believe that this will likely lead to coverage metrics exceeding projections.

In May 2015, five RACs representing 13 brands to be operating at the two new facilities executed concession and long-term lease agreements for a period of 30 years from the date of occupancy of the facilities. Under the agreement, the companies are required to collect the CFCs, and then remit them in full to the bond trustee monthly. If CFCs are not sufficient to pay debt service or make other required deposits into various funds, the RACs have agreed to make deficiency payments to the trustee. These companies also pay ground rent and reimbursable operating costs after debt service. The five RACs and the 13 brands they represent are as follows: Hertz (which includes Hertz, Dollar, Thrifty, and Firefly), EAN Holdings LLC (which includes Enterprise, Alamo, and National), Avis (which includes Avis, Budget, Payless, and Zipcar), Simply Wheelz LLC doing business as Advantage Rent A Car, and E-Z Rent-A-Car Group Holdings LLC (which was purchased by Simply Wheelz following execution of the lease). As of fiscal 2016, Enterprise held the largest market share at Hawaii Airports system airports at 35%, followed by Hertz at 33%, Avis Budget at 30%, and Advantage at 2%. Overall U.S. rental car industry revenue grew at an annual rate of 4.8% in 2009 to 2016, to $28.4 billion.

Although the narrow security pledge is typical of ConRAC facilities constructed fully or partly with CFC-backed bond proceeds, we still consider a single revenue stream a weakness, regardless of collection history or DSC. The 1.4x rate covenant allows the rolling coverage fund to cover as much as 25% of annual debt service. Although we view this as weak, it is not uncommon for CFC financings, and overall compares favorably to other CFC financings.

The flow of funds directs revenue first into the CFC revenue fund and then monthly to the senior debt service fund, rolling coverage fund, senior reserve fund, subordinate debt service fund, subordinate reserve fund, the rebate fund, CFC administrative costs, the renewal and replacement fund, the O&M fund, and then to the CFC stabilization fund. The final two flows go to the unreimbursed minimum annual requirement deficiency payments and O&M requests fund, and finally the discretionary fund. The last makes the project a closed fund, and all liquidity is held there and is an additional pledged source of funds (totaling $216 million in fiscal 2016).

Outlook

The stable outlook reflects our anticipation that demand for rental cars at the airports will not materially differ from forecasts.

Upside scenario

We do not anticipate raising the rating during the two-year outlook period given the uncertainty about final costs to complete the projects, the potential for additional ConRAC projects to dilute coverage, and the limitations of the narrow revenue pledge.

Downside scenario

We could lower the rating if the project comes to require significant additional debt or demand slips significantly, resulting in DSC that is materially lower than forecast.