# FITCH RATES HAWAII AIRPORT REV REFUNDING BONDS 'A'; AFFIRMS OUTSTANDING REVS AT 'A'; OUTLOOK STABLE

Fitch Ratings-New York-09 September 2011: Fitch Ratings has assigned an 'A' rating to the State of Hawaii (Airport Division) airport system's (the system) $298 million in airport system revenue bonds, refunding series 2011.

Fitch also affirms its 'A' rating on the system's approximately $645 million of outstanding airport system revenue bonds. The Rating Outlook on all bonds remains Stable.

KEY RATING DRIVERS:

--Natural monopoly providing essential air passenger service without any real alternative and efficient means of travel.

--Large origination and destination (O&D) base related to the visitor industry, while also serving as a hub for Hawaiian Airlines.

--Uneven traffic performance evidenced by a sharp decline of 15.2% in enplanements for fiscal 2009, followed by a 1.6% increase in enplanements for fiscal 2010. Enplanements ended fiscal year 2011 virtually flat, up 0.9%.

--Strong liquidity position that provides some protection against negative externalities (835 days cash on hand [DCOH] as of June 2011, and an internal policy to maintain at least 400 DCOH).

--An economy that is anchored by tourism and is thus prone to swings caused by events out of the state's control, yet is somewhat stabilized by its large military presence.

--Sizable capital plan of $1.3 billion for which additional borrowing will be required, increasing net debt to cash flow available for debt service (CFADS) from its current level of 3.6 times (x) to 8.0x. $350 million of planned spending requires signatory airline approval.

--Rising debt service costs and increasing cost per enplaned passenger (CPE) associated with the system's capital program.

WHAT COULD TRIGGER A RATING ACTION:

--Meaningful change in airport traffic performance. Fitch will continue to monitor whether the modest recovery in international enplanement levels seen in recent months following the Japanese earthquake and tsunami will be sufficient to prevent material adverse effect on aggregate traffic levels.

--With additional leveraging planned in the near term and with a discontinuation of rate mitigation practices back to the signatory carriers, prudent management of operating expenses will be of vital importance to sustain the rating as debt service rises.

SECURITY:

The bonds are secured by revenues of the airport system and aviation fuel taxes with final maturity expected in 2039.

CREDIT SUMMARY:

The current transaction consists of the issuance of an estimated $298 million of airport system revenue refunding bonds, issued to refund $323 million in outstanding series 2001 bonds and to pay costs related to issuance. There will be a modest extension in final maturity post refunding, from 2021 to 2024. This will reduce maximum annual debt service (MADS) from nearly $100 million to $78 million. The airport system expects to achieve present value savings of $20.7 million through the refunding, or 6.4%.

System-wide enplanements increased 0.9% in fiscal year 2011, building on a 1.6% increase in fiscal 2010; 2009 saw a relatively severe decrease of 15.2%. 2011's modest gain was driven by a 6.3% increase in overseas enplanements, contrasted with a 5.2% decrease in inter-island enplanements. This marks a continuation of 2010's trends, with overseas enplanements increasing 3.8% and inter-island falling 0.6% over the same period.

Traffic levels reflect a 3.4% increase in aggregate visitor arrivals to Hawaii for the first seven months of calendar 2011, offset somewhat by a sharp reduction in visitor arrivals from Japan immediately following April's Sendai Earthquake. Following the earthquake, a 10.5% reduction in scheduled airseats from Japan was expected for the April to June period; however, the impact has been less severe than anticipated, and overall international arrivals have increased 1.1% for the first seven months of 2011.

Operating revenues have increased in recent years despite declines in enplanement levels and changes in air service. Based on unaudited results, fiscal 2011 operating revenues are up 8.1%; fiscal 2010 saw operating revenues increase 2.2%, and the compound annual growth rate (CAGR) for the fiscal 2006 to 2010 period was 5.6%. The airport system has also managed expenses in recent years, decreasing operating expenses by 2.5% and 9.6% in 2009 and 2010, respectively. Unaudited results for fiscal 2011 indicate a 2.1% increase in operating expenses. This compares favorably to previous expense growth of 12.2% between 2004 and 2009 (CAGR). Continued discipline in managing costs will be important to maintenance of the rating; should expense escalation return to levels seen prior to 2009, negative rating pressure may result.

The airport's net operating revenues provided debt service coverage of 2.15x in fiscal 2010, up from 1.74x coverage in fiscal 2009. Unaudited results for fiscal 2011 indicate coverage of 1.99x, higher than expected for the year. Coverage is expected to decline to the 1.3x to 1.4x range in coming years as debt service requirements increase. From fiscal 2013 onwards, certain passenger facility charge (PFC) funds will become eligible to offset debt service, providing additional financial flexibility. The airlines currently support the full airport costs under a strong residual agreement. The CPE was $8.78 for fiscal 2011, up from $7.65 in fiscal 2010 and $7.47 in fiscal 2009. CPE is expected to climb to the $14 range over the next six years, reflecting an increase in cost sharing with carriers as the airport executes its capital program.

The airport's capital program totals $1.3 billion, extending through 2016. Projects focus on modernizing facilities, enhancing security, and providing adequate parking. As of August 2011, the Airport Division expects the projects to be 52% bond funded, 17% grant funded, 17% PFC funded on a 'pay as you go' basis, and the balance to be funded with airport cash balances. Grant funding has been somewhat reduced due to reductions in AIP funding, with the associated projects to be funded by PFCs and bond proceeds. An additional $426 million in bonds is expected to be issued in fiscal 2013 as a part of the capital program. While the capital plan remains sizable and rising debt service costs are a concern, Fitch views management's decision to defer non-essential projects as favorable to bondholders given the economic environment.

The airport system consists of 15 airports located throughout the state operating under the Airport Division. Hawaii's location (over 2,000 miles away from the nearest continent) combined with the distance between the islands make commercial air service essential for both inter- and intra-state travel.

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Applicable Criteria and Related Research:
--'Rating Criteria for Infrastructure and Project Finance', Aug. 16, 2011;
--'Rating Criteria for Airports', Nov. 29, 2010.

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http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=648832
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http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=578745

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