

Fitch Ratings

Fitch Affirms Hawaii Airport Rev Bonds & Lease Rev COPs at 'A'/'A-'; Outlook Stable Ratings Endorsement Policy

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Fitch Ratings-New York-13 November 2014: Fitch Ratings has affirmed the following state of Hawaii Department of Transportation (airports division) underlying long-term ratings:

--\$878 million of outstanding airport system revenue bonds at 'A';
--\$170 million of outstanding lease revenue certificates of participation (COPs) at 'A-'.

The Rating Outlook on all bonds is Stable.

KEY RATING DRIVERS

The ratings reflect the airports division's monopoly position as a system of airports in a stable service area that generates a solid base of origination and destination (O&D) traffic. In addition, the ratings reflect the competitive, albeit rising, cost per enplanement (CPE; \$8.63 in fiscal 2013), low leverage (under 2x net debt-to-cash flow available for debt service [CFADS]), and a strong cash position that has represented more than 800 days cash on hand since fiscal 2011. This cash position serves to partially mitigate risks associated with the operating volatility of the airport system which is due to its large base of leisure traffic. Credit concerns center on the overall decline in health of the U.S. and Asian Pacific economies and tourism industries and a sizable capital program. 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.

Revenue Risk Resilience: Midrange.

Monopolistic Position With Leisure Exposure: Air travel is essential for Hawaii due to a lack of alternative forms of transportation, providing the airport system with a stable O&D base of approximately 16.5 million enplaned passengers. The economy is anchored by tourism, but the large military presence somewhat stabilizes the traffic base.

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 \$8.63 in fiscal 2013 and is expected to drop to \$7.77 in fiscal 2014. CPE is projected to rise 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 and the necessity of air travel to, from and between the archipelago's various islands.

Infrastructure Development/Renewal Risk: Midrange.

Large Capital Plan Partially Debt-Funded: The airports division's capital program through fiscal 2019 totals approximately \$2.63 billion, with additional revenue bond borrowing of around \$740 million expected over the period. Prudent management of capital spending and borrowing will be important to rating maintenance.

Debt Structure Risk: Stronger.

Conservative Debt Structure: Revenue bond debt is 100% fixed rate with a declining debt service profile and final maturity in 2039. The COPs are fixed rate with a 15-year maturity, 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. Additional airport revenue bonds related to the capital improvement plan (CIP) will be issued beginning in late 2015.

Historically Sound Financial Metrics May Face Pressure: The airports division's leverage position is currently low compared to peers with debt per enplanement at \$53 and net debt-to-CFADS at 1.75x in fiscal 2013. However, airport leverage is anticipated to increase from its current level to the 6x range with the borrowings

associated with the capital plan. Since fiscal 2007, debt service coverage has ranged from 1.61x to 2.14x, and fiscal 2014 is expected to be 1.56x. Liquidity remains strong, with 853 days cash on hand in fiscal 2013.

Peers: Hawaii's peers include the Fitch-rated Greater Orlando Aviation Authority (rated 'AA-'; Stable Outlook) and Broward County (Fort Lauderdale, rated 'A'; Stable Outlook) given similar enplanement bases and traffic trends as well as debt amounts. Hawaii's cash on hand is the highest of the three but it has a higher CPE by several dollars.

RATING SENSITIVITIES

--Negative: Material increases in overall capital spending plans or higher leveraging to support the current CIP could lower the rating.

--Negative: All-in debt service coverage levels, including future debt, that are projected to remain under 1.25x without commensurate increases in airline payments may lead to rating pressure.

--Negative: A sustained decline or higher volatility in airport traffic performance could weaken credit quality.

--Positive: Given the airport system's exposure to tourism and planned additional borrowing for the large capital plan, upward rating movement is unlikely at this time.

CREDIT UPDATE:

Passenger activity has slowly recovered following the severe decline of 15.2% in fiscal 2009, with system enplanements growing at a 2.7% compound annual growth rate (CAGR) since then, and in fiscal 2013 enplanements reached 16.54 million (a 6.1% increase over fiscal 2012). Enplanements are down 1.0% year-to-date (YTD) fiscal 2014 (through February) and the airports division expects the year to end with a 1.5% decline over 2013 to 16.3 million. Overseas enplanements have been more resilient than inter-island traffic, growing at a five-year CAGR of 1.6% as compared to an annual decline of 4.1% for the latter.

Operating revenues have increased in recent years despite fluctuations in enplanements, growing at a CAGR of 6.7% between fiscal years 2008 and 2013. Although operating expenses in 2013 were 7.3% higher than the year prior, they are largely flat on a five-year basis. Going forward, continued discipline in managing costs will be important to maintenance of the rating. Should expense escalation return to levels seen prior to 2009 (7.8% CAGR from 2003-2008) the rating may be pressured. Nevertheless, the airlines currently support the airports' costs under a strong hybrid agreement. In fiscal 2013, CPE was \$8.63 and is expected to decline to \$7.77 in fiscal 2014, although the airports division expects an increase to the \$12-\$14 range as it implements its capital program.

Debt service coverage was 1.75x in fiscal 2013, in line with the ratios seen since 2008, but is expected to decline to the 1.5x range for the revenue bonds in the coming years as debt service requirements increase. COPs coverage is expected to be in the 1.4x range. The airports division and the airlines agreed to apply \$19 million of prepaid interest to reduce airline rates for fiscal 2014 and an additional \$18.5 million for fiscal 2015. If billing leads to an over-collection, the airports division 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 which is currently expected to begin in 2015 as approved PFC project expenditures are incurred.

The CIP through fiscal 2019 totals \$2.63 billion, including \$638 million already expended as of June 2014 (24%). Projects are expected to be nearly 50% bond-funded, with the remainder funded with customer facility charges (CFCs), grants, PFC funded on a 'pay as you go' basis, and also from airport cash balances.

In addition to the 2013 COPs issuance for energy efficiency projects, near-term debt issuances are expected to include \$250 million of CFC-backed bonds for consolidated rental car facility improvements in early 2016 and possibly \$740 million in airport system revenue bonds for other airport projects in late 2015 through 2018. As a result of the expected revenue bonds, Fitch anticipates leverage will increase to the 6x range by 2019 from the current level of under 2x.

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

SECURITY

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

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Applicable Criteria & Related Research:

--'Rating Criteria for Infrastructure and Project Finance' (July 11, 2012);
--'Rating Criteria for Airports' (Dec. 13, 2013).

Applicable Criteria and Related Research:

Rating Criteria for Infrastructure and Project Finance
Rating Criteria for Airports

Additional Disclosure
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