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Summary:

Hawaii Airport System; Airport

Primary Credit Analyst:
Paul J Dyson, San Francisco (1) 415-371-5079; paul.dyson@standardandpoors.com

Secondary Contact:
Mary Ellen E Wriedt, San Francisco (1) 415-371-5027; maryellen.wriedt@standardandpoors.com

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Summary:

Hawaii Airport System; Airport

Credit Profile		
Hawaii Arpt Sys lse rev certs of part ser 2013 due 08/01/2028		
Long Term Rating	A-/Stable	Affirmed
Hawaii		
Hawaii Arpt Sys, Hawaii		
Hawaii (Hawaii Airport System)		
Long Term Rating	A/Stable	Affirmed
Hawaii (Hawaii Airport System) (AGM) (SEC MKT)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services affirmed its 'A' long-term rating and underlying rating (SPUR) on Hawaii Airport System's senior-lien airport system revenue bonds and its 'A-' long-term rating on the system's series 2013 lease revenue subordinate-lien certificates of participation (COPs). The outlook is stable.

The rating reflects our view of the airport system's:

- Historically very strong liquidity position for the rating, including $570 million, or about 843 days of expenditures, in unrestricted cash as of unaudited fiscal 2014;
- Monopolistic position and very high essentiality for transport within the state, serving a niche travel market with 15 airports throughout Hawaii and with only moderate carrier concentration;
- Generally good enplanement growth during fiscal years 2010 through 2014 averaging 1.9%, although enplanements declined 1.5% in fiscal 2014 after strong growth of 6.3% in fiscal 2013, with continued enplanement growth of about 1.3% a year forecast through fiscal 2020;
- Low cost per enplanement (CPE) of $8.95 in fiscal 2014, with CPE projected to remain in a range of $9.46 to $12.74 through 2020 despite a relatively large $2.7 billion capital improvement program;
- Good debt service coverage (DSC) of 1.5x in fiscal 2013 and 1.3x in fiscal 2014 under our methodology, when the funded coverage account balance is excluded; and
- Low leverage combined with a good mix of capital program funding sources.

Partly offsetting the above strengths, in our view, are the airport system's:

- Dependence on a tourism-concentrated economy exposed to downturns associated with U.S. and global economic events, although we anticipate that the system will maintain a strong base level of demand in light of the system's essentiality;
- DSC that we anticipate will decline on an all-in basis when subordinate-lien debt service comes on line in fiscal 2016 (dipping to as low as 1.1x in fiscal 2018), although we project senior-lien DSC to remain at or above 1.23x under our methodology; and

- Sizable 10-year capital improvement program totaling $2.7 billion, 47% of which will be debt financed.

The senior-lien airport revenue bonds are secured by senior-lien system revenue and aviation fuel tax revenue after operations and maintenance (O&M) costs. The COPs are special limited obligations of the airports division (the department) and represent assignment of a proportionate interest in the lease and in the right to receive rent payments under the lease. Lease payments are secured solely by revenue and aviation fuel taxes, but are junior in priority to the pledge of the revenue securing the airport system revenue bonds outstanding, which are rated one notch higher at A/Stable.

The COP proceeds were used to fund $150 million in costs related to the implementation of an energy performance contract (EPC) between the department and Johnson Controls Inc. (JCI). Hawaii Revised Statute 36-41 requires and the EPC guarantees that net energy savings will offset the cost of the installation, energy saving equipment, and additional debt and provide substantial savings. Net overall savings is estimated at $160 million through fiscal 2034 (net of COP debt), with the majority of savings realized in fiscal years 2030 through 2034, when COP debt has matured. The project is also referred to as the ESCO (Energy Service Co.) project.

The system's total debt (airport system revenue bonds and COPs) as of June 30, 2014 was $1.07 billion, all fixed rate, with total debt to enplaned passenger a low $66.

After the 15.2% decline in enplanements in 2009 resulting from the Great Recession (which was actually larger than the 12.2% decline in 2002), the airport system realized four consecutive fiscal years of positive enplanement growth -- 1.6% in 2010, 0.9% in 2011, 2.5% in 2012, and 6.3% in 2013 -- but a decline of 1.5% in fiscal 2014. The generally positive growth since fiscal 2009 is generally the result of improving U.S. and overseas economics, and despite the overall enplanement decline in fiscal 2014, international enplanements rose 4.3%. Management forecasts 1.5% enplanement growth for fiscal 2015 and 1.3% each year thereafter through fiscal 2020. This growth rate, although conservative, is still slightly higher than the compounded annual growth rate of the past 10 years. Systemwide enplanements in fiscal 2014 totaled 16.29 million, which is still 11% off the fiscal 2000 peak of 18.28 million. The enplaned passengers consisted of 57% overseas passengers and 43% inter-island passengers traveling among the Hawaiian Islands.

The State of Hawaii owns and operates the system through its Department of Transportation. The system includes all commercial facilities in the state, and the state accounts for them as a single integrated enterprise fund. The department has the authority to levy rates and charges that, along with aviation fuel taxes, are sufficient to comply with the bond indenture. The extensive 15-airport system consists of one large-hub airport, one medium-hub airport, three small-hub airports, and 10 nonhub or small secondary airports. It is the sole provider of commercial aviation facilities in the state, and we believe this a key credit strength that few other U.S. airports or systems share. Multiple airports in the system can accommodate overseas flights and inter-island flights, and this helps to diversify system risk. Hawaii continues to be one of the most-visited states in the U.S.

The system's key strengths include its critical support of the tourism industry and its essential position providing transportation infrastructure within the state. Honolulu International Airport (HNL), serving the state's largest population center, has by far the largest share of systemwide traffic, covering 60% of enplanements in fiscal 2014 with long (12,000-foot) parallel runways and ample gate capacity, including 29 overseas gate positions, 13 inter-island gate

positions, and 10 commuter aircraft parking positions. HNL was the 27th-largest airport in the U.S. by enplaned passengers in calendar 2013 (according to the Federal Aviation Administration) and has adequate airline diversity, in our view, with the largest airline -- Hawaiian Airlines Inc. -- having a 51% market share in fiscal 2014 across the system.

The system largely handles origin-and-destination passengers, with such passengers representing 86% of enplaned passengers in fiscal 2014. HNL serves as the hub of Hawaiian Airlines, is the largest of the system's five primary airports, and is classified as a large hub. In fiscal 2014 it enplaned 9.7 million passengers, down 1.6% from 2013. The system's other four other primary airports enplaned 6.4 million passengers, down 1.4% from fiscal 2013, accounting for 39% of systemwide passenger traffic. These airports have continued to increase direct overseas flights. Several new destinations have been added in 2014, including Seattle and San Francisco. Scheduled air seats for fiscal 2015 are projected at 11.3 million, and this number, if achieved, would eclipse fiscal 2014 seats by 5.2%.

In terms of visitor activity, westbound visitors from the U.S. accounted for 60% of total visitors in calendar 2014, with 18% from Japan and 6% from Canada. Following visitor arrival declines of 10.6% in 2008 and 4.5% in 2009, visitor arrivals have rebounded well, increasing 7.7% in calendar 2010, 4.0% in 2011, 10.0% in 2012, 1.8% in 2013, and 1.3% in 2014 to 8.3 million.

For 2014, the state reports total population growth of 0.8% (a decline from the 1.2% growth in 2013), an increase in visitor spending of 2.3%, and personal income growth of 4.0%. Continued upward momentum is projected for 2015, with 1.0% population growth, a 3.4% increase in visitor expenditures, and a 4.5% increase in personal income. Occupancy reached 84.4% for the fourth quarter of 2014, and total wage and salary jobs are also growing, by 1.9% in 2013, 1.2% in 2014, and a forecast 1.5% in 2015. The state's unemployment rate was just 4.3% in 2014, one of the lowest in the U.S.

Despite its essential role, the system and the state it serves remain exposed to cyclicality associated with the tourism industry. In our view, the system has performed better than the U.S. in recent good periods and worse during recent bad periods. The system has historically experienced larger passenger volume swings because of U.S. and international economic fluctuations; security, weather, and geological events such as the March 2011 earthquake and tsunami in Japan; health concerns (e.g., H1N1 and SARS); and airline service-level decisions.

The system's financial performance has been good in recent years, with DSC ranging from 1.3x to 1.7x per our calculations during fiscal years 2010 to 2014, improving from just 1.08x in 2008 and 0.96x in 2009. Financial performance has generally mirrored operational performance, with generally good margins before rate mitigation offsets and extremely strong liquidity during the growth years of 2005 through 2008, but with some erosion in both metrics in 2009 as operations weakened and as the system spent down cash on capital. Indenture-based DSC includes the funded coverage account as revenue and includes rate mitigation, available passenger facility charge (PFC) revenue, and airline-contributed interest as offsets to debt service. Indenture-based DSC was 1.75x in 2013 and 1.63x in 2014, and is forecast at 1.5x to 1.6x through fiscal 2019, or around 1.4x for subordinate-lien debt. We forecast coverage at 1.2x to 1.4x for senior-lien debt, or 1.1x to 1.2x for subordinate-lien debt, and our calculation excludes the funded coverage account. This low subordinate-lien DSC range is less of a risk when liquidity is very strong, but could become more of a risk if the system spends down liquidity. System liquidity has improved significantly since 2009,

when it dipped to $337 million, or 526 days' cash. Since then, cash balances have risen by $234 million to $570 million, equal to 843 days' cash, as of fiscal 2014. Management plans to maintain unrestricted cash near current levels, which we consider extremely strong.

The system has taken steps to control expenditure growth, and anticipates that the overall cost structure will increase gradually as it addresses capital needs and as airline-generated revenue from increased rates becomes a larger proportion of the total. In the face of enplanements that are still 11% below the peak in fiscal 2000 (18.3 million), the system is undertaking a number of improvement and modernization projects totaling $2.7 billion over the next 10 years, with about $700 million already spent. We have cautioned in previous reports that these projects are exposed to potential cost increases that could pressure the system's cost structure. However, despite its projected large capital improvement plan (CIP), and given revised cost estimates and enplanement forecasts, management projects that CPE will rise to only $10 by 2016. Nevertheless, among credit risks is an increasing debt burden, as airport bonds will fund about $1.3 billion, or 63%, of non-CFC-funded capital needs. The airport system anticipates issuing airport revenue bonds in July 2015, to fund approximately $250 million of project costs.

Outlook

The stable outlook reflects our anticipation that the capital program will not pressure the cost structure significantly more than forecast, that liquidity will remain at or near very strong levels, that DSC will be maintained at adequate levels, and that demand will not significantly deteriorate. We do not anticipate raising the rating during the next two years, given the system's large CIP and additional bond issuance plans that will increase the system's overall cost structure and debt ratios. At the same time, given the system's robust cash position and generally good enplanement and tourism trends, we are unlikely to lower the rating during the next two years.

Bond And Certificate Provisions

Certificate provisions include a debt service reserve fund funded at the least of 10% of par, 125% of average annual debt service, or maximum annual debt service (MADS). COP interest was partly capitalized until Feb. 1, 2015. The COPs are structured to be retired after 13 years of the 18-year "performance period" (15 years from date of issuance), and this reduces financing costs and results in substantial cost savings in the final years of the performance period, while remaining compliant with Hawaii Revised Statute 36-41.

The senior-lien airport revenue bonds are secured by senior-lien system revenue and aviation fuel tax revenue after O&M costs. The COP payments are junior to revenue bond debt service; to payments to the maintenance, renewal, and replacement account; and to transfers to the state's general fund for reimbursable GO bonds, improvements to the system, and transfers to special reserves. PFC revenue is excluded from revenue unless explicitly identified in a supplemental certificate.

Bond provisions for the recently issued series 2010 bonds are, in our view, weaker than the industry standard, mostly because of the system's ability to add to operating revenue and reduce the debt service requirements to satisfy the rate covenant. In our view, these modifications, in combination with existing certificate provisions, reduce the system's

cash flow from rates and charges.

The senior-lien bond rate covenant requirement is set to 1.25x annual adjusted debt service requirements for the next 12 months and allows for the use of unencumbered funds to meet the test, and we consider these provisions permissive. Although the 1.25x rate covenant does not include COP debt service in the calculation of the annual adjustment debt service requirement, the signatory airlines have consented to the ESCO project, and payments under the lease are included in the department's expenses for purposes of the rate covenant. The additional bonds test is industry standard and is a two-part historical or prospective test. The historical test requires that net revenue and taxes -- plus unencumbered funds in the airport revenue fund not exceeding 25% of the adjusted MADS requirement -- are not less than 125% of the total adjusted MADS requirement for issued and proposed debt. The prospective test requires both satisfaction of the rate covenant and a consulting engineer's projections of 125% coverage of annual adjusted debt service by net revenue and tax revenue for three years after construction of the financed projects.

Related Criteria And Research

Related Criteria

- Criteria: Airport Revenue Bonds In The U.S. And Canada, Nov. 15, 2013
- USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011

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