STANDARD & POOR'S
RATINGS SERVICES
McGRAW HILL FINANCIAL

RatingsDirect®

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

Table Of Contents

Rationale

Outlook

Capital Plan

Economic Rebound Continues

Bond And Certificate Provisions

Related Criteria And Research

Hawaii Airport System; Airport

Credit Profile		
US$170.0 mil lse rev certs of part ser 2013 due 08/01/2028		
Long Term Rating	A-/Stable	New
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 assigned its 'A-' long-term rating to Hawaii Airport System's $170 million series 2013 lease revenue subordinate-lien certificates of participation (COPs). Standard & Poor's also affirmed its 'A' long-term rating and underlying rating (SPUR) on Hawaii Airport System's senior-lien airport system revenue bonds. The outlook is stable.

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

- Historically very strong liquidity position for the rating, including $571 million, or about 853 days of expenditures, in unrestricted cash as of unaudited fiscal 2013;
- Monopolistic position and very high essentiality for transport within the state, serving a unique travel market with 15 airports throughout Hawaii and with no significant concentration of carriers;
- Strong enplanement growth of 6.3% in fiscal 2013, above the 5.0% growth previously projected, with continued enplanement growth of about 1.2% a year anticipated through fiscal 2019;
- Low cost per enplanement (CPE) of $8.56 in fiscal 2013, with CPE projected to remain in a range of $8.31 to $12.14 despite a relatively large $2.7 billion capital improvement program;
- Good debt service coverage (DSC) under our methodology of 1.4x in fiscal 2012 and 1.5x in fiscal 2013, 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 in light of the system's essentiality that it will maintain a strong base level of demand;
- DSC that we anticipate will decline on an all-in basis when subordinate-lien debt service comes on line in fiscal 2016 (dipping to a low as 1.11x in fiscal 2018), although we project senior-lien DSC to remain at or above 1.25x under our methodology; and
- Sizable 10-year capital improvement program totaling $2.7 billion, 47% of which will be debt-financed.

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 COPs are being issued to fund $150 million in costs related to the implementation of an energy performance contract (EPC) between the department and Johnson Controls Inc. (JCI). We anticipate that net energy savings will offset the cost of the additional debt and provide substantial savings 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 savings could be higher depending on the rate at which utility costs would otherwise grow had the project not been completed. We anticipate that energy usage will decrease by 49%, and the project includes proven equipment with a strong track record of generating anticipated energy efficiencies. Management anticipates that the project will begin in December 2013 and be completed by December 2015. The agreement with JCI spans 20 years, consisting of a two-year construction period and an 18-year performance period. JCI will provide an energy savings guarantee at 91.7% of estimated annual energy savings and will pay shortfall payments to the extent that actual savings are less than the guaranteed amount. JCI is the largest ESCO in North America, with an 18% market share, and has demonstrated success in projecting and implementing savings measures, as evidenced by its record of having to make shortfall payments on less than 0.5% of total guarantees outstanding.

JCI will lease the equipment to the department under a lease agreement between JCI, as lessor, and the department, as lessee. JCI assigns to the trustee the lease and the right to lease revenue, under an assignment agreement, so lease payments will not flow through JCI. The department will include the lease payments in its annual budget, which is subject to appropriation by the State Legislature, but this annual appropriation by the State Legislature is the same process as the department's overall budget which includes revenue bond debt service. Appropriation and payment of debt service is not contingent on verification of energy savings or receipt of any energy savings shortfall payments, and the project has strong, unanimous support and approval through a concurrence letter from the signatory airlines, which have agreed to include lease payments in their rates and charges. The project is also an integral part of the airport system and the state's clean energy initiatives, and we view the airport system as highly essential to the state and its economy. The airport system is the third-largest consumer of energy in the state.

The system's total debt (airport system revenue bonds) as of Nov. 1, 2013 was $878 million, all fixed-rate bonds, with total debt to enplaned passenger a low $53, or an also low $63 when including the $170 million in to-be-issued series 2013 COPs.

Since the 15.2% decline in enplanements in 2009 caused by the Great Recession, the airport system has 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. The decline in 2009 was significant, being larger than the 12.2% decline in fiscal 2002 after the terrorist attacks of Sept. 11, 2001. Responsible for the most recent, fiscal 2013 increase was a 6.4% increase in enplanements at Honolulu International Airport (HNL), generally the result of improving U.S. and overseas economics. Management forecasts 0.9% enplanement growth for fiscal 2014 and 1.3% thereafter through fiscal 2019. This growth rate, although conservative, is still slightly higher than the compounded annual growth rate of the past 10 years. Systemwide

enplanements in fiscal 2013 totaled 16.54 million, which is still 10% 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, which 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 includes 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 international flights and flights from the mainland U.S., and this helps to diversify system risk. In 2012, Hawaii was the fourth-most-visited state in the U.S. after New York, Florida, and California.

The system's key strengths include its critical support of the tourism industry and its essential position providing transportation infrastructure within the state. HNL, serving the state's largest population center, has by far the largest share of systemwide traffic, covering 60% of enplanements in fiscal 2013 with long (12,000-foot) parallel runways and ample gate capacity, including 29 overseas gate positions, 13 inter-island gate positions, and 11 commuter aircraft parking positions. HNL was the 27th-largest airport in the U.S. by enplaned passengers in calendar 2012 (according to the Federal Aviation Administration) and has adequate airline diversity, in our view, with the largest airline -- Hawaiian Airlines Inc. -- having a 49% market share in fiscal 2013 across the system.

The system largely handles origin-and-destination passengers, with such passengers representing 98% of enplaned passengers in 2012. 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 2013 it enplaned 9.9 million passengers, up 6.4% from 2012. In fiscal 2013, the system's other four other primary airports enplaned 6.7 million passengers, up 6% from fiscal 2012, accounting for 40% of systemwide passenger traffic. As the visitor infrastructure continues to rebound from the Great Recession, these airports have seen an increase in direct overseas flights. Several new destinations have been added in 2013, with a total of 516,207 direct flight air seats added as of September 2013. Scheduled air seats for 2013 are projected at 10.768 million, and this number, if achieved, would eclipse the previous peak in 2006 of 10.361 million. Management anticipates that Air China will begin service from Beijing to HNL in January 2014, with Hawaiian Airlines to follow in April 2014. In addition, China Eastern is expanding its service to Shanghai to 5x weekly in December 2013. Hawaiian Airlines also began direct service to Taipei in 2013.

In terms of visitor activity, westbound visitors from the U.S. accounted for 62.0% of total visitors in the 12 months through September 2013, with 19.0% from Japan and 6.3% from Canada. Visitors from Taiwan accounted for just 0.2% of the total during this period, but management anticipates an increasing number of Taiwanese visitors given the visa waiver program that began on Nov. 1, 2012. 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, and 10.0% in 2012 and projected to increase 4.2% in 2013 to 8.4 million.

For 2012, the state reports total population growth of 1.0%, above the 0.8% growth in 2011; a surge in visitor spending of 18.2%; and personal income growth of 3.9%. Continued upward momentum is projected for 2013, with 1.1%

population growth, a 5.3% increase in visitor expenditures, and a 4.5% increase in personal income. Occupancy reached 85% for 2012, and total wage and salary jobs are also growing, by 0.9% in 2011 and 1.9% in 2012 and a forecast 1.8% in 2013 and 2014. Through the first eight months of 2013, the state's unemployment rate was just 4.8%, which was the fifth-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 2013, 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, up slightly from 1.67x in 2012. Indenture-based coverage is forecast at 1.5x to 1.8x through fiscal 2019, or 1.4x to 1.7x for subordinate-lien debt. We forecast coverage at 1.3x to 1.5x for senior-lien debt, or 1.1x to 1.4x for subordinate-lien debt, and our calculation excludes the funded coverage account. Although low, this subordinate-lien DSC range is less of a concern when liquidity is very strong. But it could become more of a concern 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 $571 million, equal to 853 days' cash, as of fiscal 2013. Management plans to maintain unrestricted cash near current levels, which we consider extremely strong.

Under a scenario in which energy savings are less than forecast and JCI is unable to provide guarantee payments, we believe the airport system has the financial capacity to maintain coverage of more than 1x. Assuming energy savings at just 50% of the forecast level and assuming no guarantee payment, DSC is no less than 1.19x on a senior-lien basis through fiscal 2019, or no less than 1.05x on a subordinate-lien basis.

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. Despite the steady income stream from the division's mix of operational revenue sources, reduced passenger traffic resulting from the downturn has required the system to implement increases in signatory airline fees to sustain decreases in concession revenue, interest income, and federal operating grants. Management has, however, been instrumental in implementing operational cost savings measures relating mainly to personnel, security, and utilities.

In the face of enplanements that are still 10% below peak levels of fiscal 2000 (18.3 million), the system is undertaking a number of improvement and modernization projects totaling $2.7 billion, including the energy efficiencies project. 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 $8.74 by 2016, well below the previous forecast of $9.99, which was also revised downward from a forecast of $14.50. Nevertheless, among our rating concerns is an increasing debt burden with plans to issue more than $870 million in bonds through fiscal 2019.

Airlines serving the airport system operate either under an airline agreement (28 signatory airlines) or in accordance with state administrative rules (nonsignatory airlines). In light of the economic slowdown and operating challenges of the airline tenants, the system took action to substantially reduce airline rates and charges through fiscal 2010 by applying cash to reducing debt service requirements. This reduces rates such as landing and terminal rental fees. We had previously taken a positive view of the new airline lease agreements for the system as of Jan. 1, 2008 because the adoption of industry-accepted standards relative to rate-setting and cost recovery methodologies were likely to produce more predictable financial results. The system reports that it did not provide rate mitigation in 2011 and 2012 and that it has no plans to do so.

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 currently 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 improving enplanement and tourism trends, we are unlikely to lower the rating during the next two years.

Capital Plan

The airport system's CIP totals $2.7 billion through fiscal 2018, but the system has already expended $567 million as of June 2013. That leaves a balance of about $2.2 billion, of which $2.0 billion is subject to airline review, including the $150 million for energy savings projects (which the 2013 COP proceeds will fund). Approximately $722 million of the CIP will be funded by customer facility charges (CFCs) for the planned construction of a consolidated rental car facility. The airport plans to issue $250 million in bonds to fund that project in the summer of 2014. Management anticipates that airport bond proceeds will fund about $1.26 billion, or 63%, of the $2 billion CIP that does not include the CFC-funded project, and this is consistent with previous CIP estimates. The next airport system revenue bond issue is estimated at $252 million and is tentatively scheduled for late 2014 or early 2015. Other funding sources for the $2 billion CIP net of the CFC-funded project include federal grants (18%), PFC revenue (11%), and cash on hand (7%).

Economic Rebound Continues

Although the state is exposed to risk given its concentration in tourism, some economic metrics during the recent recession indicate that the state was relatively more resilient than the national economy. Job counts fell 0.4% in 2008 and 3.9% in 2009, but grew 1.8% in both 2010 and 2011 before a slight dip of 0.2% in 2012. The projection for job

growth in both 2013 and 2014 is 1.8%. Unemployment, at 4.4% in October 2013, was still well below the national rate of 7.3% for that month. Since 2003, Hawaii's unemployment rate has generally been 2% to 3% below the national rate.

Where Hawaii's economy remains most vulnerable, and perhaps where it has been most affected, is tourism, an industry that is vulnerable to reduced consumer spending, job losses, events in Japan, and competitive marketing campaigns from multiple tourism destinations (e.g., Las Vegas). However, tourism has rebounded in recent years, and, according to management, the visitor industry will likely set new records in 2013 for arrivals, spending, hotel occupancy, and revenue per available room. After visitor arrivals declined 10.6% in 2008 (versus 12.2% for the U.S.) and 4.5% in 2009, they rebounded by a moderate 7.7% in 2010, 4.0% in 2011, and 10.0% in 2012. Hotel occupancy fell to 64.8% in 2009 from 70.4% in 2008, but rebounded to 70.7% in 2010, 73.2% in 2011, and 76.9% in 2012, the highest level since 2006. Visitor spending, after declining 12.3% in 2009, rose 16.0% in 2010, 11.0% in 2011, and 18.0% in 2012.

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 will be capitalized until Aug 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 operations and maintenance 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 use of certain unencumbered funds to satisfy the rate covenant calculation occurred in fiscal years 2009 and 2010, when the system deposited $17.5 million and $16.8 million, respectively, to the interest account to mitigate airline rates. The system does not anticipate any further rate mitigation. 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

General Criteria: Airport Revenue Bonds In The U.S. And Canada, Nov. 15, 2013

Copyright © 2013 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED, OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription) and www.spcapitaliq.com (subscription) and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.