FitchRatings

Fitch Rates Hawaii Airport Revenue Bonds 'A'; Outlook Positive

Fitch Ratings-New York-28 October 2015: Fitch Ratings has assigned an 'A' rating to the state of Hawaii Department of Transportation's (airports division) approximately $250 million series 2015 A&B airport revenue bonds. The Rating Outlook is Positive. Fitch has also affirmed the underlying long-term ratings of the following:

--$808 million of outstanding airport system revenue bonds at 'A';
--$168 million of outstanding lease revenue certificates of participation (COPs) at 'A-'.

The Rating Outlook on all outstanding bonds has been revised to Positive from Stable.

The ratings reflect the essentiality of air traffic to an island system of airports that generates a solid base of origination and destination (O&D) traffic in a stable service area. In addition, the ratings reflect the competitive, albeit rising, cost per enplanement (CPE), low leverage, and a strong cash position serving to partially mitigate the risks associated with the operating volatility of the airport system which is due to its large base of leisure traffic. 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.

The Positive Outlook reflects favorable progress on the sizable capital improvement plan (CIP) in terms of project delivery and meeting targets. Upward rating action may be warranted should metrics continue to evolve in line with forecasts as new contracted revenues come online and the Airport Division progresses with its remaining borrowing.

KEY RATING DRIVERS

Revenue Risk - Volume: Revised to Stronger from Midrange
Monopolistic Position With Leisure Exposure: The necessity of air travel to, from and between the archipelago's various islands provides the airport system with a stable origin and destination base of approximately 16.7 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 $8.96 in fiscal 2014 and is expected to rise to $9.58 in fiscal 2015. CPE is projected to rise on a modest incline 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.

Infrastructure Development/Renewal: Midrange
Large Capital Plan Partially Debt Funded: The airports division's capital program through fiscal 2021 totals approximately $2.61 billion, with additional revenue bond borrowing of around $761 million expected over the period. Close oversight from the state government together with prudent management of capital spending and borrowings will be important to rating maintenance.

Debt Structure: Stronger

Conservative Debt Structure: Revenue bond debt is 100% fixed rate with a declining debt service profile and final maturity in 2045 including the 2015 bonds. 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. In addition to the 2015 bonds, the Airports Division expects to issue $405 million in 2017 and $106 million in 2018 to fund its CIP.

Historically Sound Financial Metrics May Face Pressure: The airports division's leverage position is currently low compared to peers with senior debt per enplanement at $48 in 2015 ($58 for senior and COPs) and net debt-to-cash flow available for debt service (CFADS) at 2.0x in fiscal 2015 for senior debt and 3.8x on an all in basis. However, airport leverage is anticipated to increase from its current level to the 6x-8x range with the borrowings associated with the capital plan. Since fiscal 2007, senior debt service coverage has ranged from 1.61x to 2.14x, and for fiscal 2015 is expected to be 1.72x (1.63x including COPs). Liquidity remains strong with 783 days cash on hand (DCOH) in fiscal 2015, and management intends to maintain liquidity at comparable levels going forward.

Peer Analysis: Hawaii's peers include 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 DCOH is the highest of the three; both Hawaii and Orlando will see rising but competitive CPE and leverage as their CIPs come online.

RATING SENSITIVITIES

Positive: Achieving Forecasted Metrics: The airport system's ability to maintain traffic and revenue growth generating operational and financial metrics consistent with forecast expectations could result in a positive rating action.

Negative - Performance Levels: A sustained decline or increased volatility in traffic performance leading to lower all-in debt service coverage levels or causing leverage metrics to remain elevated for longer periods of time may lead to rating pressure.

TRANSACTION SUMMARY

The airport system plans to issue approximately $250 million of series 2015 A&B airport revenue bonds to fund a portion of its CIP. The series 2015 A&B airport revenue bonds are fixed rate, fully amortizing in 2045 and are secured by the airports' parity debt service reserve fund. The bonds are expected to price the week of Nov. 2.

Passenger activity has recovered from the economic downturn with system enplanements growing at a 2% compound annual growth rate (CAGR) since 2010. Fiscal 2015 enplanements are estimated to reach 16.7 million (a 2.4% increase over fiscal 2014). Overseas enplanements have been more resilient than inter-island traffic, growing at a five-year CAGR of 4.1% compared to -0.5%.

Operating revenues have increased every year since 2004, except a decline of approximately $20 million in fiscal 2014 due to a decrease in landing fees, aeronautical revenues, and concession revenues resulting from a decrease in passenger traffic. Fiscal 2015 operating revenues are estimated to increase to $337.8 million, a 6.5% increase from the prior year. Operating expenses have been growing moderately with a five-year CAGR of 3.9%. Going forward, continued discipline in managing costs will be important to the 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 2014, CPE was $8.96 and is expected to increase to $9.58 in fiscal 2015, although the airports division expects an increase to the $12-$14 range as it implements its capital program.

Debt service coverage for the revenue bonds is estimated to be 1.72x in fiscal 2015, in line with the ratios seen since 2008, while COPs' coverage is 1.63x. 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 and the airlines 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 and started using PFC revenues for such purposes in fiscal 2016. The airport system also has plans to issue debt in 2017 and 2018 totaling $511 million.

The CIP through fiscal 2021 totals $2.61 billion, including $710 million already expended as of June 2015 (27%). Projects are expected to be nearly 45% bond-funded (includes past and future bonds), with the remainder funded with customer facility charges, grants, PFC funded on a 'pay as you go' basis, and also from airport cash balances.

Fitch reviewed the sponsor's traffic and financial forecasts, which includes additional debt issuances in 2017 and 2018, to be applied as the Fitch base case. This case assumes a 2.9% increase in enplanements followed by 1.5% growth through 2022 with airline revenues and non-airline revenues growing at a CAGR of 6.7% and 4%, respectively. Expenses grow at a CAGR of 4.6%. Under this scenario, coverage remains at or above 1.52x/1.35x including coverage account and all-in, respectively, while leverage reaches 6.4x on the senior lien. CPE is forecasted to reach $12 in fiscal 2022.

Fitch's rating case assumes an 8% stress to enplanements in 2017 with moderate recovery of 2.5% through 2020 followed by slight growth of 1.4% until 2022 while expenses were increased for a CAGR of 5%. DSCRs remain strong at or above 1.46x/1.27x and leverage remains moderate at 6.9x, though CPE rises to $14.

A sensitivity case was run to assess the impact of a drop in enplanements consistent with past economic downturns. Enplanements were stressed 13.7% in 2017 with moderate growth of 1.5% per year until 2022. Under this scenario, coverages remain sound at or above 1.45x/1.26x given the residual nature of the airline agreement, though CPE reaches as high as $15.

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 2045. 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.

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Applicable Criteria
Rating Criteria for Airports (pub. 13 Dec 2013)
(https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=725296)
Rating Criteria for Infrastructure and Project Finance (pub. 28 Sep 2015)
(https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=870967)

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