MOODY'S INVESTORS SERVICE

New Issue: Moody's upgrades Hawaii Airport Enterprise's senior lien revenue bonds to A1, assigns A1 to parity series 2015 A & B and upgrades subordinate certificate of participation to A2; Outlook is stable

Global Credit Research - 29 Oct 2015

Airport currently has $975 million debt outstanding

HAWAII (STATE OF) AIRPORT ENTERPRISE
Airports
HI

Moody's Rating

ISSUE		RATING
Airports System Revenue Bonds, Series 2015A (AMT)		A1
Sale Amount	$236,000,000	
Expected Sale Date	11/03/15	
Rating Description	Revenue: Government Enterprise	
Airports System Revenue Bonds, Series 2015B (Non-AMT)		A1
Sale Amount	$11,000,000	
Expected Sale Date	11/03/15	
Rating Description	Revenue: Government Enterprise	

Moody's Outlook STA

NEW YORK, October 29, 2015 --Moody's Investors Service has upgraded the State of Hawaii Airport Enterprise's senior lien revenue bonds to A1 from A2 and subordinate certificate of participation (COPs) to A2 from A3. At this time we are also assigning an A1 rating to Hawaii Department of Transportation - Airports Division's $236 million and $11 million Airports System Revenue Bonds, Series 2015A and B, respectively. The rating outlook for all series is stable.

SUMMARY RATING RATIONALE

The upgrade reflects the strength of the airport system's monopoly over commercial air travel to and from the islands, the essentiality of air service for both tourism and intrastate travel, low debt position, and the solid historical financial performance. The airport system's liquidity is a key measure of its financial strength and we expect that restricted cash will decline as the system utilizes passenger facility charge (PFC) and customer facility charge (CFC) revenues in its extensive capital improvement plan (CIP), but we expect unrestricted cash to be maintained at current levels. The A1 rating also reflects the airport's move toward full cost recovery, as it has not provided rate relief to airlines since FY 2010 and does not anticipate providing relief moving forward.

The A2 rating on the COPs is based on the lease agreement payments, as junior obligations, made by the airport system to the lessor, Johnson Controls, Inc (JCI, senior unsecured rated Baa2, stable outlook). The rating also considers the strong savings in operating expenses that the airport system expects to receive as a result of this contract. The expected savings are guaranteed by JCI for the term of the contract, which extends beyond the maturity of the COPs. The rating includes our assessment that appropriation risk is low as the funds could not be shifted to non-airport purposes and because the trustee would have the ability to reclaim the equipment if non-appropriation causes the lease to default.

OUTLOOK

The stable outlook is based on Moody's expectation that system-wide enplanement levels will remain near or above current levels and airline and other revenues will maintain debt service coverage ratios (DSCRs) based on net revenues above 1.0 times. Moody's expects that the system will maintain days cash on hand above 600 days.

WHAT COULD MAKE THE RATING GO UP

- A positive change in economy of the service area that result in enplanement levels that significantly outperform projections on a sustained basis

- Net revenue DSCRs sustained above 1.25 times through the completion of the capital program, while maintaining high liquidity to manage operational risks and financial risks

WHAT COULD MAKE THE RATING GO DOWN

- Inability or unwillingness by the airport system to fully recover costs from the airlines

- Reduction of unrestricted liquidity balances below the Moody's US airport median

- Economic downturn or loss of a major carrier that negatively impacts enplanements

STRENGTHS

- Demand for air service is stabilized by Hawaii's remote location, need for inter-island travel, and a substantial military and government presence that requires frequent mainland service

- Monopoly provider for a premier international tourist destination brings high demand for overseas flights, but the economy's reliance on that industry poses significant risks

- Strong current financial position with low debt and high liquidity provides the airport financial flexibility, though these strengths are expected to wane as additional debt is issued

CHALLENGES

- The current capital improvement program is significantly larger than the airport has historically managed and will require substantial future debt issuances in order to fund

- Debt service coverage and unrestricted cash are both expected to decline somewhat over the next five years, but remain within levels commensurate with the current rating category

- Due to the significant presence of tourism, economic conditions and enplanement levels have shown above-average volatility in economic downturns

- The COPS add a layer of financing complexity that could bring additional risks to the system's finances

RECENT DEVELOPMENTS

Airport system enplanements increased 2.5% in FY 2015, bolstered by overseas travel. Enplanements at Honolulu International (HNL), the largest airport for the system, remained nearly flat at 9.7 million, with a 3.0% decrease in interisland travel being offset by a 1.6% increase in overseas bound enplaned passengers. The airport system has experienced additional overseas routes connecting primary neighbor island airports to US destinations. This has resulted in a decrease in interisland traffic to HNL, as overseas-bound passengers can access flight options at the airports on other islands without having to travel to HNL. As a result, Interisland traffic for the system decreased by 0.3% to 7.0 million in FY 2015.

The airport continues to push through its large CIP.As of June 30, 2015, the airport had expended $709 million, including $367 million from previous bond proceeds. The current estimate of the entire program is $2.6 billion, leaving $1.9 billion remaining to be expended in order to complete the program. This amount is inclusive of $511 million in future revenue bonds and $794 million of debt that will have a pledge from CFC revenue.

DETAILED RATING RATIONALE

REVENUE GENERATING BASE

Economic conditions in the State of Hawaii (GO rated Aa2) remain stable and support stability and limited passenger growth. The increase in enplanements for FY2015 was driven by stable economic conditions and strong growth in available seats from several airlines. Seats have increased 6.1% in FY 2015 driven primarily by Hawaiian Holdings, Inc. (corporate family rated B2, stable) and United Continental Holdings, Inc. (corporate family Ba3, positive), but also supported by double digit seat growth from smaller players in the market such as Delta Air Lines, Inc. (corporate family rated Ba2, positive) and American Airlines Group, Inc. (corporate family rated Ba3,stable). Visitor arrivals continued to grow in 2013 and 2014 as the US economy has begun to recover, bolstered by low oil prices making travel more affordable. Moody's Economy.com notes that domestic tourism in Hawaii is up 8% over last year, but international tourism has been weakened by the strong dollar. International entries remain flat and spending by international tourists in the area has also slowed. The low price of oil, however, is expected to outweigh the strong dollar, ensuring near-term continued demand for tourism-based air travel to the area.

FINANCIAL OPERATIONS AND POSITION

The airport system's financial position remains solid and DSCRs for all debt requirements was at 1.00 times based on Moody's net revenue calculation and 1.63 times based on the system's bond indenture calculation. The DSCR per the bond indenture has remained at similar ranges over the past 3 years, but DSCR per Moody's calculated net revenues has declined. Revenues were lower due to lower spending from Japanese tourists as a result of a weaker Yen to Dollar ratio; fewer total passengers; and lower rental car concession revenues due to operational impediments at the rental car facilities.

Net revenue DSCR was lower in FY 2014 primarily because the airport used previously collected funds from the airlines to reduce airline costs. In FY 2012 airline landing fees were over-charged due to increases in passengers, the overage was deposited into the Prepaid Airport Use Charge Fund (PAUCF) per the amended lease agreement. In FY 2014 $19 million from the PAUCF, approved by the signatory airlines, was used to reduce 2014 airline payments by applying the overage against interest expense, revenues were lower as an offset and were charged just enough to reach the 1.00 times. As a result airline cost per enplanement (CPE) only rose to $8.95 from $8.63 in 2013 despite higher operating expenses and passengers that were lower by 1.1%. In FY 2015, $18.5 million was utilized from the PAUCF (unaudited), which resulted in CPE only increasing to an estimated $9.58. Debt service coverage on a Moody's calculated net revenues basis, from unaudited results, shows coverage remaining narrow at 1.02 times, due to the utilization of the PAUCF. The airlines have also agreed to utilize another $4 million in the PAUCF in FY2016.

Moody's expects financial margins to narrow substantially as the airport system issues additional debt, but the current rating accounts for some of that additional risk. If the issuance occurs more rapidly or in a higher amount than planned there could be additional negative pressure on the credit, particularly if it is combined with lower enplanement growth or if financial liquidity is reduced. The system has received approval from the FAA to apply PFCs to pay-as-you-go projects and to debt service, primarily for the Mauka concourse project. Management states that they expect to use a small portion of PFCs for debt service in 2016, but expects to begin using them to a greater extent in FY 2017 as the project advances.

Liquidity

The airport system's cash balances help underpin the rating upgrade. The airport system's cash has consistently grown from 2009 to 2013 with a slight reduction in FY 2014. FY 2014 days cash on hand of 983 is still much higher than Moody's US airport median of 551 days. The strong cash position is due to solid financial performance and delays in CIP expenditures. Management expects to utilize restricted cash balances during the capital improvement plan, but expected to maintain unrestricted liquidity at the current level. If unrestricted liquidity falls below Moody's US airport median for days cash on hand of 560 days, the current rating on the airport system will be negatively pressured.

DEBT AND OTHER LIABILITIES

The airport continues to advance extensive capital plans to develop and improve facilities across the system. The capital improvement plan totals $2.61 billion through 2021, of which $709 million had been expended through June 2015, an increase from the $567 million that had been spent through June2013. The capital plan includes a significant amount of bond financing, as the program will be 46% funded from debt proceeds from both prior and future issuances. Along with the current issuance, the airport plans to issue $511 million in debt in 2017 and 2018. The CIP includes projects at all airports, though the majority of the plan is focused on the largest airport, with HNL accounting for $1.1 billion or 41.3% of the program. The current capital plan is significantly larger and more complex than the airport has previously managed, and Moody's believes the system's large capital program is exposed to potential cost increases, particularly if it does not remain near its original schedule.

Work on the $667 million Mauka Concourse is moving forward with a number of the enabling projects underway. The airport system is also progressing with its other major project, a consolidated rental car facility, for which it expects to issue bonds separately secured by CFC in early 2016. The project has three phases and the first, improvements to the connecting roadway system, is complete. Work on Phase 2, construction of temporary consolidated rental car maintenance facilities and modification of the existing parking structure at HNL , is nearing completion, and expected to open in December 2015. The airport expects to issue the invitation to bid for the permanent facility in early 2016, with construction commencing later in the year.

The airport system entered into a 20 year Energy Performance Contract (EPC) with Johnson Controls, Inc. (JCI, senior unsecured rated Baa2, stable) to derive operating expense savings by reducing future energy expenses. Energy costs in Hawaii are among the highest in the nation and Moody's views the move toward more efficient use as a credit positive. Not only do we expect the EPC will bring overall savings, but it also reduces the uncertainty around future energy cost increases. JCI guarantees 91.7% of the annual utility and O&M cost savings. This amounts to $15.7 million in 2017 and the guarantee escalates at 5% annually during the 18-year performance period of the contract following the two-year installation phase. The projects are currently 98% complete, with $148 million expended of $150 million. In 2014, cost savings were approximately $3.0 million, versus original savings projections of $1.9 million, demonstrating that performance of the energy savings projects is likely to be within or above projections.

Debt Structure

All of the airport's debt is fixed-rate and amortizing. FY 2016 debt service for the senior revenue bonds will increase to $80 million with the current series, and will continue to increase until reaching $89 million in FY 2019. Debt service will remain level through FY 2025, where it will step down to $51 million, with final maturity in FY 2045.

The COP lease payments escalate from $9.3 million in 2015 to $13.0 million in 2017 and continue to escalate to a peak of $24.9 million by maturity in 2029. The department issued the COPs to finance the energy savings projects. The COP structure was used because Hawaii state law (Hawaii Revised Statute 36-41) requires, among other things, an "annual dependency clause" for EPCs. This clause requires the state Legislature to appropriate lease payments annually in order to continue the lease, so the EPC cannot be paid from normal debt service or operating expenses. The COPs structure is subject to appropriation risk; however we believe the risk is limited because the appropriation for this project is from airport funds that could not be used for other non-airport purposes and the lease is essential for the airport to operate. The risk is mitigated by the lease provision that makes non-appropriation an event of default under the lease and allows the certificate trustee to remove the equipment in the event the lease is terminated. While the equipment may have little residual value for the certificate holders, it is essential for the airport and would be difficult to replace so it serves as a deterrent to non-appropriation.

Debt-Related Derivatives

None.

Pensions and OPEB

These liabilities are not a major factor in the rating; however, the underfunding of these liabilities will need to be recovered through future revenues. Currently the state's pension system is 63.9% funded on an actuarial basis and the state has enacted legislation to improve that ratio. The airport system had a required contribution of $9.0 million to the pension system in FY 2014. According to Moody's adjustments to reported state and local government pension data, the airport's share of the plan's Adjusted Net Pension Liability as of FY 2014 is $278.4 million. This incorporates certain adjustments we make to improve the comparability of reported pension information. If this amount was recovered levelly over a 20-year period, we estimate it would add an expense of $21.1 million per year or an additional $1.29 cost per enplanement.

MANAGEMENT AND GOVERNANCE

The Department of Transportation is one of 18 principal executive departments of the State of Hawaii and it is empowered to establish, maintain and operate the transportation facilities of the state, including highways, airports, harbors and other transportation facilities. The Airports Division operates all state airports as a single integrated system for management and financial purposes.

The department is headed by the director, who is appointed by the governor and confirmed by the state senate.

The governor also appoints, without state senate confirmation, four deputy directors of transportation. The director and deputy directors of transportation serve four-year terms conterminous with the governor's term.

OTHER CONSIDERATIONS

The scorecard indicated rating is different from the actual rating primarily because the scorecard is based on historical metrics which are expected to decline on a forward basis and the system has also experienced enplanement volatility higher than typical.

The grid is a reference tool that can be used to approximate credit profiles in the airport industry in most cases. However, the grid is a summary that does not include every rating consideration. Please see Airports with Unregulated Rate Setting for more information about the limitations inherent to grids.

METHODOLOGY SCORECARD FACTORS:

Factor 1 - Market Position- Total Enplanements: Aaa, 16.4 million

Factor 1 - Market Position- Size of Service Area: A, 1.4 million

Factor 1 - Market Position- Economic Strength/Diversity of Area: A

Factor 1 - Market Position- Competition for Travel: Aaa

Factor 2 - Service Offering- Carrier Base (Primary): Baa, Hawaiian 50.4%

Factor 2 - Service Offering- Enplanement 5-year CAGR: Baa, 1.97%

Factor 2 - Service Offering- O&D Passenger Mix: Aaa, 98%

Factor 3 - Capacity and Capital- Growth & Operational Restrictions: A

Factor 3 - Capacity and Capital- Construction Risk: Baa

Factor 4 - Financial Metrics - Airline Cost per Enplanement: Aa, $8.95

Factor 4 - Financial Metrics - Debt Service Coverage: Baa, 1.00x

Factor 4 - Financial Metrics - Debt per O&D Passenger: Aa, $46

Notching: 1 Notch Increase for Liquidity; 0 Notch Decrease for Reserve Weakness; 0 Notch Increase for Revenue Diversity

Scorecard Indicated Rating: Aa3

KEY STATISTICS

- Type of Airport: O&D

- Rate-making methodology: Residual

- FY 2015 Enplanements (unaudited): 16.70 million

- FY 2015 v FY 2014 Enplanements: 2.5%

- % Inter-island of Total FY2015 (unaudited): 42%

- 5-Year Enplanement CAGR 2011-2015: 2.1%

- % O&D vs. Connecting (Domestic), FY 2015: 98%

- Debt per Enplaned Passenger, FY 2014: $45.39

- Debt per O&D Enplaned Passenger, FY 2014: $46.32

- Bond Ordinance Debt Service Coverage, FY 2014: 1.63

- Net revenue Debt Service Coverage, FY 2014: 1.00

- Airline Cost per Enplaned Passenger, FY 2014: $8.95

- Airline Cost per Enplaned Passenger, FY 2015 (unaudited): $9.58

OBLIGOR PROFILE

The department operates and maintains 15 airports at various locations within the State. The airports division has jurisdiction over and control of the airports system. Virtually all non-military passenger traffic throughout Hawaii passes through the system, which includes five primary airports and ten secondary airports. The primary airports are HNL (on the Island of Oahu), Kahului (on the Island of Maui), Hilo International and Kona International (both on the Island of Hawaii), and Lihue (on the Island of Kauai).

LEGAL SECURITY

Senior lien bonds are secured by a pledge on net revenues of the airport system and aviation fuel tax revenues. The rate covenant is 125% senior debt service and 110% total with unlimited rolling coverage. The senior lien bonds have an additional bonds test (ABT) that requires revenues plus rolling coverage equal 125% of maximum annual debt service (MADS) or that the rate covenant has been met and will be met, including additional bonds, to the later of 5 years after issuance or 3 years beyond the use of capitalized interest. The bonds also have a debt service reserve that is sized at the lessor of three prong test, and is fully cash funded.

The COPS are secured by a proportionate interest in the rights of the lease agreement, including the lease agreement payments made by the airport system as a junior obligation to the lessor, Johnson Controls, Inc. JCI will assign its rights as lessor, including the right to receive rent payments, to the trustee for payment of debt service of the COPS. The airport system's obligation to make payments under the lease agreement from year to year is subject to annual appropriation by the State of Hawaii under a separate line item for capital leases in the department's budget. The payments are treated as "other lawful purposes" of the airports system. If the state fails to appropriate the lease, the EPC can be terminated at the end of the fiscal year for which money has been appropriated and the holders of the certificates would gain recourse to the equipment. Moody's believes this equipment would have little to no value outside of its use with the airport system, but its removal would be significantly detrimental to the operations of the airport system.

USE OF PROCEEDS

The Series 2015 A&B senior bonds are being issued to pay a portion of the cost of the airport's ongoing capital improvement projects at certain facilities of the airport system. The bonds are also being issued to pay $6.84 million in capitalized interest on the series, and to pay the costs of issuance.

RATING METHODOLOGY

The principal methodology used in this rating was Airports with Unregulated Rate Setting published in July 2011. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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