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CREDIT OPINION
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Hawaii (State of) Airport Enterprise

Update to credit analysis

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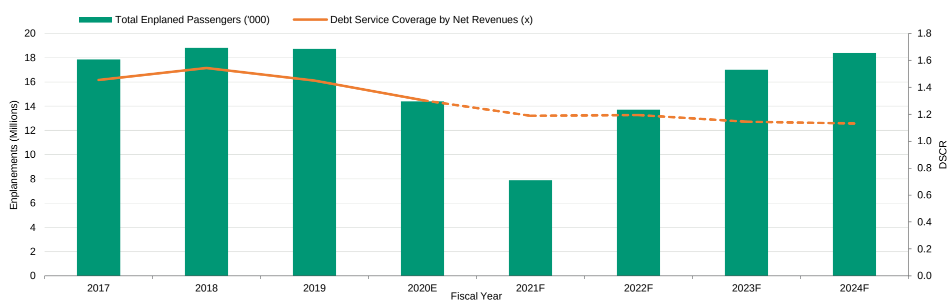
Summary

Hawaii (State of) Airport Enterprise's (A1 stable) credit profile remains strong, despite severe reductions in revenue in 2020 due to lower enplanement volumes caused by the coronavirus outbreak. Contractual mechanisms of the system's airline agreement require increased airline rates and charges to cover insufficient non-airline revenue from the system and thus provide revenue stability during the outbreak. The system's strong liquidity mitigates the risk of slower than anticipated revenue recovery following the pandemic and against failure of airlines to make increased payments. The airport system's recovery prospects are comparatively higher after quarantine restrictions are relaxed because demand for leisure travel to other tourism destinations has been strong. The system is lowly leveraged, with adjusted debt per O&D enplanement of $122 well below the large hub median of $153. Leverage will increase modestly as a result of the Series 2020A, 2020B, and 2020C debt because of portions of the debt will be used for ongoing portions of the $1.6 billion capital improvement plan

Exhibit 1

Total DSCR will decline due to an escalating debt service profile but will remain well above the 1.25x covenant and above 1.0x on our net revenue basis



*2022-2024 DSCR forecasts include airport consultant projected debt service increases from planned future issuances associated with the capital improvement plan
**2020 is based on unaudited financials
Source: Moody's Investors Service and Hawaii Airport Enterprise

Credit strengths

» The state's remote location, popularity as a tourist destination, need for interisland travel, and a substantial military and government presence that requires frequent mainland service bolsters passenger recovery

» Very strong liquidity of 729 days cash on hand as of June 30, 2020 mitigates slower than expected recovery or inability to recover costs from airlines

» Well-managed capital planning

» A large portion of capital expenditure (about $1 billion outside of the CIP) is financed on a stand alone basis by the Hawaii (State of) Airport Enterprise Customer Facility Charge (A2 stable), which has strong collections to support high DSCRs and project pay-go funding

Credit challenges

» Travel demand to the State will remain subject to local quarantine and testing requirements, which are subject to change. Though restrictions are scheduled to loosen in October, demand could remain below peers if opening is rolled back.

» The current CIP is large and will require an additional $635 million in debt through 2022

» The certificates of participation (COPs) add a layer of financing complexity that could bring additional risks

Rating outlook

The stable outlook reflects our expectation that leisure travel demand will show strong recovery to the island when quarantine requirements are eased, but that strong rate recovery provisions and liquidity mitigate a slower than expected recovery.

Factors that could lead to an upgrade

» Return to near normal operating conditions and passenger levels at the airport

» Further progress on the capital plan financing that provides for expected net revenue debt service coverage ratios above 1.3x on revenue bonds and total coverage of 1.15x while maintaining strong liquidity

» Demonstrated willingness to exercise rate setting to sustain key financial metrics amid enplanement volatility or economic pressure

Factors that could lead to a downgrade

» Significant reduction in enplanement levels and slower than anticipated recovery following the coronavirus outbreak

» Failure to roll the current favorable use and lease agreement, or a new agreement that increases rate recovery risks

» Additional debt-funded capital improvements that raise debt per O&D enplanement above $200

» Reduced liquidity below 300 days cash on hand

Key indicators

Exhibit 2

Hawaii (State of) Airport Enterprise	2015	2016	2017	2018	2019
Enplanement Annual Growth (%)	2.0	3.2	3.7	5.3	-0.4
Debt Outstanding ($'000)	1,011,255	1,227,847	1,237,285	1,192,004	1,558,603
Debt to Operating Revenues (x)	3.0	3.5	3.1	2.8	3.5
Adjusted Debt Per O&D Enplaned Passenger ($)	82.61	97.90	106.17	99.14	122.10
Days Cash on Hand ('000)	938	955	940	871	858
Total Coverage by Net Revenues (x)	1.09	1.26	1.45	1.54	1.45

Source: Moody's Investors Service

Profile

The Hawaii Department of Transportation (DOT) operates and maintains 15 airports at various locations within the state serving 18.7 million enplaned passengers in fiscal 2019. The DOT is one of 18 principal executive departments of the state and is empowered to establish, maintain and operate the transportation facilities of the state, including highways, airports, harbors and other transportation facilities. The DOT is headed by the director, who is appointed by the governor and confirmed by the state senate. The governor also appoints four deputy directors of transportation. The director and deputy directors of transportation serve four-year terms conterminous with the governor's term. Through the Airports Division all state airports are operated as a single integrated system for management and financial purposes.

Virtually all non-military passenger traffic throughout Hawaii passes through the airport system, which includes five primary airports and ten secondary airports. The primary airports are Honolulu (on the Island of Oahu, HNL), Kahului (on the Island of Maui, OGG), Hilo International and Kona International (both on the Island of Hawaii), and Lihue (on the Island of Kauai).

Detailed credit considerations

Revenue Generating Base - Despite experiencing severe enplanement declines due to coronavirus, monopoly position on air travel to an established tourism destination supports strong rate-recovery prospectus

The system's strong ability to recover costs as needed during the major disruptions caused by COVID-19 will be governed by this airline use and lease agreement's residual provisions that allow the system to raise fees on airlines to cover all operating expense and debt service. We also think that there will be strong demand for travel to Hawaii for leisure travel once mandatory quarantine requirements are weakened.

Unique features of the agreement and the carrier base/traveller profile of the system provides solid rationale for the agreement to continue to be rolled on a quarterly basis. The agreement contains a coverage protection clause that causes the agreement to act like a residual agreement when volumes are low, despite being compensatory for some cost centers. Airlines could seek to exit the agreement by not rolling, but all airlines would need to do so. If any airline remains, those that exit move to non-signatory status and pay higher rates. Hawaiian Airlines (Hawaiian Holdings, Inc., B1 negative) and Southwest Airlines Co. (Baa1 negative) achieve lower landing fees for inter island flights in the current agreement than would be available if the system went to rates by ordinance. The airlines combined account for a majority of passengers and landed weight, so the terms of the agreement would continue to roll if they chose to maintain the advantageous fee structure.

Economic conditions in the State of Hawaii (GO, Aa2 stable) have continued to decelerate, mostly due to weaker tourism from areas outside of the US. Hawaii's average state unemployment rate in 2019 was 2.7%, well below the 2019 US average of 3.7%. However, although becoming more diversified, the state economy is dominated by tourism. The leisure/hospitality sector in particular employs nearly one in five of Hawaii's nonfarm workers, the highest share of any state outside of Nevada.

The state's population of 1.42 million, provides a large economy for an island and a captive air travel market. The defense industry is a critical anchor in Hawaii's economy, employing over 8% of the state employment base as of the first quarter of 2020. The five largest employers in Hawaii are military bases, making the share of jobs in the military higher than any other state. The military recently increased military pay raises by 3% which helps support growth in incomes and spending. The proposed fiscal 2021 federal spending is expected to include over $300 million for major military construction projects in Hawaii, promising more jobs and consequently translating into more consumer spending by military families, providing a much-needed lift to retail and leisure/hospitality.

Financial Operations and Position - Financial metrics will suffer during the outbreak but will return to pre-outbreak levels as leisure travel returns

The system estimates that fiscal 2020 enplanements declined by approximately 23% due to the impact of coronavirus on travel from March through their fiscal year end in June. Through the airport consultant's six year recovery model, the system forecasts that enplanements will continue to substantially decline by additional 45% of 2020 estimates and then increase substantially by 74% in 2022 before slowly returning to 2019 actual enplanements in 2025. While we do anticipate a notable jump in enplanements, this substantial 74% increase in 2022 and stronger recovery thereafter is above our expectations for the sector.

In normal operating conditions, the enterprise achieves robust net revenue DSCR for an airport that has residual protection to the downside. Net revenue DSCR of bonds decreased moderately to 1.68x in fiscal 2019 from 1.80x in fiscal 2018 and net revenue DSCRs for both revenue bonds and COPs declined to 1.45x from 1.54x in the same period. Net revenue DSCRs will decrease 1.2x in fiscal 2021 and 2022 because of lower non-airline revenue, but aided by the substantially lower annual debt service requirements achieved through the Series 2020B and 2020C refunding bond issuances and expense management.

DSCR and required airline costs increases will be mitigated in the coming years by operating expense savings and the application of CARES Act funds. The system closed facilities, including 35 of the 87 gates at five airports, in April 2020 and instituted a systemwide hiring freeze to reduce operating expenses. The airport consultant projects that the system will be able to reduce 2021 operating expenditures to just under $300 million, an approximate 4.7% decrease from the unaudited 2020 totals. The system applied $50 million of CARES Act funds to expenses in fiscal 2020 and the systems expects to apply the remaining CARES Act allocation of $83.3 million in fiscal 2021 to reduce airline rates and charges and preserve liquidity.

Airline costs will increase in the near term under the residual rate recovery but a higher airline cost per enplanement (CPE) will not play a meaningful roll in airlines' decisions to restore service to Hawaii. Airlines will be able to achieve sufficient yield to cover the expected higher costs because of the relatively strong demand for leisure travel. The system's airline CPE remained reasonable at $9.75 in fiscal 2019, but the airport consultant expects CPE will more than double to a peak of around $20 in fiscal 2021.

Liquidity

The system's strong liquidity is the biggest mitigant to slower than expected growth in fiscal 2021 and 2022. We calculate current liquidity to be 729 days on hand as of June 30, 2020, based on operating expenses of $314 million in fiscal 2020 (all unaudited). Available liquidity would be sufficient to cover over 20 months of projected 2021 operating expenses and debt service without any other incoming cash flow. For our liquidity calculations, we use available account balances of $627.3 million from the following accounts:

» Unrestricted cash - $495 million

» Operations and Maintenance Reserve - $104.7 million

» Funded Coverage Account - $27.6 million

In addition to the funds above that could be used for operating expenses, if needed, the system had $195.1 million of restricted PFC balances which could be used for up to $16 million of debt service in fiscal 2021, and the amount of eligible debt service that can be paid with PFCs increases moderately after fiscal 2022.

Although not factored into our DCOH calculation, the enterprise also maintains a debt service reserve that is fully cash funded ($102.5 million)

Debt and Other Liabilities - Leverage will increase as Hawaii Airport Enterprise proceeds with its ongoing capital improvement plant and begins planning for their 2022-2026 CIP.

The system continues work on components of its $1.62 billion capital plan that are under construction, but seeks to delay those projects that can be delayed without significantly adding costs. The system also plans to allocate resources towards its $1.1 billion 2022-2026 capital improvement plan (CIP). Both plans will focus on the development and improvement of facilities across the system and will call for the issuance of sizable debt financing to fund the projects. The ongoing capital plan specifically calls for the issuance of approximately $635 million of debt funding over the next two years while the subsequent 2022-2026 CIP will require just under $800 million of issuances over the subsequent 4 years. The CIPs include projects at all airports, though the majority of the plan is focused on the largest airport, with HNL accounting for $1.1 billion or 70% of the ongoing capital program and $432 million or 38% of the 2022-2026 CIP. Although the ongoing capital plan is significantly larger and more complex than the airport has previously managed, as of June 2020, about 41% of the CIP funds have been expended and more than 67% is in construction or closeout phases.

Remaining costs on the most intensive project, the Mauka Concourse, are estimated to be approximately $193 million and although much delayed from the initially anticipated opening date, construction of the project is advancing with foundations complete and structural steel currently rising with completion anticipated for August 2021. Other large remaining projects include $581 million for other terminal improvements at HNL ($154 million of which is already incurred) and $92 million for terminal improvements at Kahului (Maui) to expand passenger holdrooms to accommodate the larger class of airplanes that increasingly call on the airport.

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 100% total debt service 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 lesser of the 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 has assigned 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 airport's system.

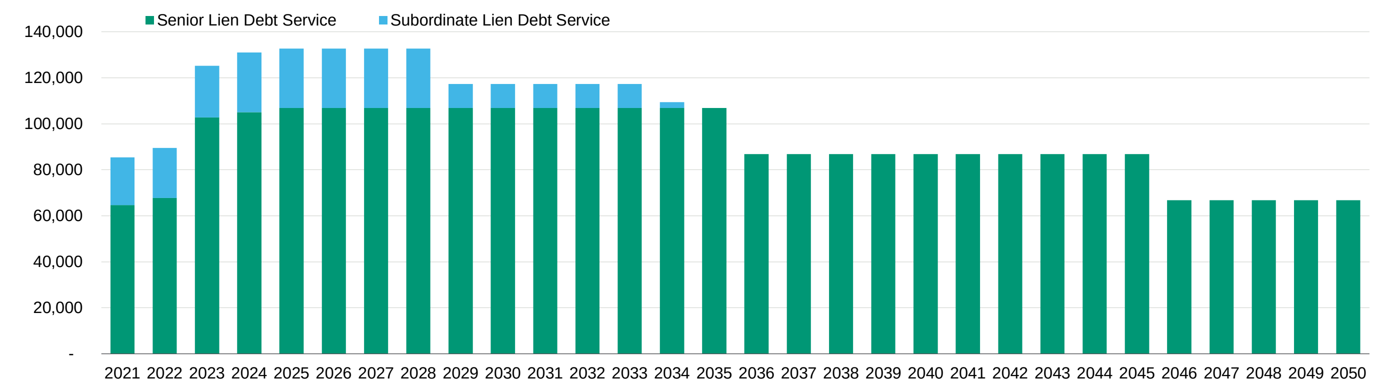
If the state fails to appropriate the lease payment, the contract can be terminated at the end of the fiscal year for which money has been appropriated and the holders of the certificates would gain recourse to the equipment. We believe this equipment would have little to no value outside of its use with the airport system, but its removal would be significantly detrimental to the operations of the airport system.

Debt structure

All of the airport's debt is fixed-rate and amortizing. Following the issuance of the Series 2020D and 2020E revenue refunding bonds, gross debt service will decrease noticeably in 2021 and 2022 as the system shifts near-term amortization requirements to mitigate the risk of a slower post-coronavirus traffic recovery (see Exhibit 3). Debt service on the subordinate lien was approximately $15 million in fiscal 2019 and will increase each until 2025-2028 where it will remain constant before declining through maturation in 2034. It is anticipated that with the issuance of new money debt to fund the capital improvement plan, the debt service profile will increase. The risk of increased debt service requirements is mitigated as the bulk of the ongoing and upcoming capital plans are for airfield or terminal projects which would be able to be recovered from airline revenue, even in the event that an airline lease agreement expired and the airport had to go to rates by ordinance.

Exhibit 3

Series 2020 refunding bonds reduced 2021 and 2022 annual debt service, providing flexibility to navigate the pandemic
Post refunding gross debt service schedule



Source: Hawaii Airport Enterprise

Debt-related derivatives

None.

Pensions and OPEB

For fiscal 2019, the airport's reported net pension liability (NPL) was $166.6 million and its funding contribution was $14.2 million. Our adjusted net pension liability (ANPL) calculation for fiscal 2019 was $332.36 million, or about $22 per O&D enplanement. While the

ANPL is large in relation to the outstanding leverage of around $101 per O&D enplanement, the level is around the middle of our range of airports.

The airport also reported a net other post-employment benefit liability (OPEB) of $180.8 million in fiscal 2019. On our adjusted net OPEB liability basis, Hawaii Airport Enterprise had a $292.5 million liability in fiscal 2019 or approximately $19 per O&D enplanement.

ESG considerations

Environmental

The primary risk is a reduction in passengers if more stringent air emission and carbon regulations on airlines significantly increase airfares. This would have the greatest impact on airports that have increased leverage to expand capacity. Airports may face more regulation regarding air quality, including noise pollution, in and around airports. Disasters (SARS, Icelandic volcanoes, hurricanes) can temporarily reduce volumes. Airports encounter a manageable level of soil pollution exposure, through fuel leaks, de-icing fluids, and by-products from fire-fighting activities. New airports in expanding markets may also face environmental issues depending on the environmental sensitivity of the proposed sites. The sector is generally able to pass along added costs stemming from these exposures. Growth in demand for air travel, particularly long-haul routes, which are most exposed to costs of carbon legislation, will likely remain steady, leading to increasing carbon costs with growing passenger volumes. Airports have typically maintained stable credit even during periods of financial stress at airlines.

Social

Airports can be at risk of social factors such as labor agreements and noise issues with communities. However, the most pressing social concern is in regard to the COVID-19 outbreak which has disrupted global airport passenger traffic volume reducing passenger numbers and causing flight cancellations which has hindered commercial revenue and airport charges.

Governance

The DOT is one of 18 principal executive departments of the state and is empowered to establish, maintain and operate the transportation facilities of the state, including highways, airports, harbors and other transportation facilities. The department is headed by the director, who is appointed by the governor and confirmed by the state senate. The Airports Division is managed by a deputy director and the airports administrator. 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.

Rating methodology and scorecard factors

The principal methodology used in this rating was Publicly Managed Airports and Related Issuers published on March 6, 2019. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

The assigned A1 rating on the senior lien airport revenue bonds is equivalent to the Scorecard Indicated Outcome.

Exhibit 4

Hawaii (State of) Airport Enterprise

Publicly Managed Airports and Related Issuers Scorecard

Regional Position:	**Compensatory**		
Rate Making Framework:	**Regional**		
Factor	**Subfactor**	**Score**	**Metric**
1. Market Position	a) Size of Service Area (millions)	A	1.42
	b) Economic Strength and Diversity of Service Area	A	
	c) Competition for Travel	Aaa	
2. Service Offering	a) Total Enplanements (millions)	Aaa	18.72
	b) Stability of Traffic Performance	A	
	c) Stability of Costs	Baa	
	d) Carrier base (Primary Carrier as % of Total Enplanements)	Baa	50.30%
3. Leverage and Coverage	a) Debt Service Coverage by Net Revenues	A	1.45x
	b) Adjusted Debt in USD per O&D Enplaned Passenger	Ba	$122.10
		Notch	**Metric**
4. Liquidity	Days Cash on Hand	+1.0	858
5. Connecting Traffic	O&D Traffic	0.0	82.7%
6. Potential for Increased Leverage		-0.5	
7. Debt Service Reserves		0.0	
Scorecard Indicated Outcome:		**A1**	

Source: Moody's Investors Service

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