07 JAN 2022

Fitch Rates Hawaii Airport Revenue Bonds 'A+'; Affirms Outstanding; Outlook Stable

Fitch Ratings - New York - 07 Jan 2022: Fitch Ratings has assigned an 'A+' rating to $272.1 million in airport system revenue and refunding bonds, series 2022A and 2022B issued by State of Hawaii, Department of Transportation (Airports Division). In addition, Fitch has affirmed the 'A+' rating on $1.5 billion of outstanding parity airport system revenue bonds and the 'A' rating on $123.3 million of outstanding subordinate lien lease revenue certificates of participation (COPs), series 2013.

The Rating Outlook for all of the bonds is Stable.

The Airports Division also has $52.5 million outstanding in parity COPs that are not rated by Fitch.

RATING RATIONALE

The ratings reflect the essentiality of air services to the state's island system of airports, which encompasses a high degree of tourism and leisure-focused traffic from long-haul domestic and international passengers. Given this demand profile, Fitch believes that Hawaii still has some downside risks to a longer recovery cycle relative to other U.S. airports.

The ratings also consider the ongoing capital program with a considerable budget, resulting in upward pressure to airline cost and leverage metrics, although the enterprise's overall financial position, aided by funds from multiple federal grant awards, as well as the existing strong liquidity profile, should remain intact. The rating distinction between the revenue bond liens reflects the subordinated nature of the obligation securing the COPs, and weaker coverage covenants when compared with those of the senior debt.

KEY RATING DRIVERS

Monopolistic Position; Leisure Exposure - Revenue Risk (Volume): Stronger

The necessity of air travel to, from and between Hawaii's various islands provides the airport system with a sizable base of enplaned passengers (approached almost 19 million prior to COVID-19), though these volumes have decreased substantially since the start of the coronavirus pandemic. The state has taken various pandemic mitigation measures since early 2020 that had initially resulted in dampened demand, but more recently supported better domestic recovery activity and near-term traffic levels will be linked to the virus conditions and a meaningful rebound to tourism.

Rolling Airline Agreement - Revenue Risk (Price): Stronger

The strong price risk assessment considers both the favorable residual rate setting approach to air carriers, albeit under short-term agreements with quarterly extensions, coupled with a diverse set of non-aeronautical revenues. Collectively, the airport system generates a strong cost recovery rate together with solid coverage levels and a moderate airline cost level under typical operating conditions.

Cost per enplanement (CPE) more than doubled to $23.80 in fiscal 2021 as volumes fell precipitously and forecasts show CPE trending toward the $17-$19 range through the projection period as enplanements recover, capital spending occurs and costs are charged to carriers. While the state has taken actions to alleviate the cost requirements to airlines, including debt payment structurings and application of federal award monies to offset operating revenue declines, the airline use and lease agreement mechanisms allow for surcharges to carriers to meet all of the airport's operating and financing obligations.

Partially Debt-Funded CIP - Infrastructure Development/Renewal: Midrange

The airport's current capital plan through 2026 totals $2.2 billion, down from $2.7 billion and reflecting a re-evaluation and prioritization of projects in response to the pandemic. The plan is anticipated to be approximately 50% debt funded, accounting for prior and planned debt issuances. About $712 million has been spent to date, with $1 billion of remaining CIP costs to be debt funded. Close oversight from the state government together with prudent management of capital spending and borrowings will be important to rating maintenance.

Conservative Debt Structure - Debt Structure: Stronger (Senior); Midrange (Subordinate)

The airport enterprise's senior revenue bond debt is 100% fixed rate with a generally declining debt service profile and final maturity in 2051. The rated subordinated certificates (COPs) are also fixed rate with final maturity in 2029 and have an increasing debt service profile that is structured to match the increase in the annual energy savings guarantee from Johnson Controls Inc. under the energy performance contract. 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.

Financial Profile

The airport system's overall financial profile remains in a solid position despite considerable revenue pressures led by the pandemic-led traffic decline. Debt coverage and liquidity metrics remain at robust levels while leverage has stayed steady at the 8x aided by management budgetary actions, debt payment restructurings, and prudent uses of federal funds, which will still carryover for several successive fiscal years. Debt service coverage from cashflows was a solid 2.7x in FY 2021 (3.4x including coverage accounts) while liquidity covered more than 600 days cash on hand. Fitch cases indicate forward leverage remaining around 8x, despite the continued borrowings for the capital program, while cashflow coverage metrics will moderate to under 2x in conjunction with the higher debt service obligations.

PEER GROUP

Hawaii's peers include Greater Orlando Aviation Authority (AA-/A+/Stable) and Las Vegas (Subordinate) (A+/Stable) given the similar relationship to leisure passenger traffic. Hawaii had the highest carrier concentration of the three prior to the pandemic, but had the lowest in FY 2020. Hawaii maintains a competitive liquidity position with Orlando and Las Vegas as measured by DCOH. Hawaii's aggregate leverage levels are higher than both Orlando and Las Vegas under the Fitch rating case, with future leverage of approximately 8x in 2025. All three airports have seen higher CPE in connection with lower enplanement levels induced by pandemic conditions and elevated leverage as their CIPs progress.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

A continued period of material traffic declines in line with the downside cases that result in leverage increasing to and remaining above 10x on a sustained basis.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Full traffic recovery along with successful completion of the capital program, which collectively drive leverage toward 5x.

Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

TRANSACTION SUMMARY

The 2022 bonds are senior secured, fixed rate, and fully amortizing. The bond proceeds will be used to fund $229 million in CIP as well as refund the remaining Series 2011 bonds for savings. The bonds are secured by the Airports' parity debt service reserve fund. The project fund will be AMT.

CREDIT UPDATE

Fitch continues to view Hawaii as an airport with an important role in the national aviation system, and the essentiality of air travel for this market partially mitigates risk as the air travel sector continues to recover. Prior to the pandemic, the 2.8% five-year CAGR through 2019 highlights the positive trends in underlying demand, as well as airline's support for increased services. Interisland travel remains a significant component of traffic, representing nearly 38% of total passengers.

Due to the various travel restrictions imposed as a result of the pandemic, enplanements remained depressed in FY 2021 (ended June 30), down 68% compared with FY 2019. Once travel restrictions were lifted to fully vaccinated U.S. mainland travelers in July 2021, enplanements have greatly improved in FY 2022, with enplanements through October recovering to 79% of FY 2019, in line with the national average.

Hawaii's two leading carriers, United and Hawaiian, account for 58% market share of total traffic, and Hawaiian maintains 77% of the interisland travel traffic. Both airlines continue to demonstrate a commitment to serving the Hawaii market. The stability of the airlines is important, as their presence and operations are influential in Hawaii's future capital investment and leveraging commitments.

Further, management views Hawaiian Airlines as an extension of the Hawaii brand of being a premier leisure destination. Southwest, who entered the market in March 2019, has grown to 12% market share in FY 2021. American Airlines and Mokulele Airlines have had the strongest passenger recovery, capturing additional market share, accounting for 11% and 6% respectively in FY 2021.

The remaining 2022-2026 CIP costs are estimated at $1.5 billion. Management expects that roughly 67% of the remaining $1.5 billion in capital projects will be debt funded. The Airports Division expects to issue approximately $543 million in 2023 and 2025 to fund its CIP, though these figures and timing remain preliminary.

The airports achieved strong senior DSCR of 3.4x in FY 2021 due in part to the strategic use of $125.6 million of federal relief grants. In an effort to offset the revenue declines, Hawaii also implemented a number of cost savings measures and deferred non-essential expenditures. The Airport has reserved $144.3 million ($15.5 million for concessionaires) in ARPA funds for use in FY 2022 and FY 2023.

Fitch expects coverage levels on overall airport debt to continue to exceed the required minimum of 1.25x through the projection period (inclusive of fund balances); however, given the airport's capital plans and volatility in enplanements in connection with the pandemic recovery, increases in airline rates and charges will be imperative to the airport's overall financial health. Leverage is expected to be elevated in future fiscal periods as gross debt levels are expected to rise with additional issuances over the next few years.

FINANCIAL ANALYSIS

The airports' base and low case forecasts developed for the series 2022 issuance, in Fitch's view, assume reasonably conservative traffic activity over the next five-year period and have been adopted as the Fitch rating and downside cases. Considering multiple recovery assumptions over three- and five-year time horizons, Hawaii could maintain a largely stable range of coverage levels while airline costs decrease from their pandemic highs and Fitch-calculated total leverage remains consistent with the rating over FY 2022-2026.

The Fitch rating case assumes, relative to FY 2019, a 24% enplanement decline in 2022 followed by recoveries reverting the losses to 16% and 4% in FY 2023 and FY 2024, respectively, and a full recovery by fiscal 2025. While non-aeronautical revenues are mostly fluctuating with passenger traffic, airline payments are driven by cost-recovery terms under the rate agreements and adjusted by CARES, CRSSA, and ARPA funding for costs through FY 2023.

Additionally, Fitch incorporated the planned debt issuances in FY 2023 and FY 2025 to support the airport's capital plan, causing additional fluctuation in airline payments. Results indicate a total Fitch-calculated debt service coverage ratio rising to 2.4x before decreasing to 1.4x by FY 2026. When excluding coverage accounts, coverage rises to 2.2x before decreasing to 1.3x by FY 2026. CPE increases slightly from about $17 in FY 2022 to $19 by FY 2026. Total leverage reaches 8.5x in FY 2023 before reaching 7.8x in FY 2026.

The Fitch downside case shows a traffic reduction of 36% in fiscal 2022, relative to FY 2019, followed by a slower pace of recovery in the following fiscal periods. In this case, the DSCR and leverage profiles are largely similar relative to the rating case due to the residual nature of the airport agreement. However, CPE levels would be modestly higher in each year to generate these results.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Hawaii, State of (HI) [Airports]					
• Hawaii, State of (HI) /Airport Revenues - Subordinate Lien/ 1 LT	LT	A	Affirmed		A
• Hawaii, State of (HI) /Airport Revenues/ 1 LT	LT	A+	Affirmed		A+

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Airports Rating Criteria (pub.22 Oct 2020) (including rating assumption sensitivity)

Infrastructure and Project Finance Rating Criteria (pub.23 Aug 2021) (including rating assumption sensitivity)

Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

GIG AST Model, v1.3.1 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

Hawaii, State of (HI)	EU Endorsed, UK Endorsed

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