FitchRatings

Fitch Affirms Hawaii DOT's $332MM Harbor System Revs at 'A+'; Outlook Stable

Ratings Endorsement Policy
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Fitch Ratings-New York-14 February 2014: Fitch Ratings affirms the 'A+' rating of on the Hawaii Department of Transportation's (HI) $332 million in outstanding harbor system revenue bonds.

The Rating Outlook on all bonds is Stable.

KEY RATING DRIVERS

Stable Volume Supported by Natural Monopoly: Port volumes are stabilized by the essentiality of the port to the State's economy. The port system provides essential maritime services and serves a state without an efficient alternative means of transporting goods to and throughout it. This partially mitigates the system's exposure to fluctuations in the tourism industry. Revenue Risk: Volume - Stronger

Approved Tariff Increases: The harbor system has adopted scheduled tariff increases for cruise, cargo, and pipelines. Escalations have been underway since 2010 and are scheduled to continue through 2015. The increases include a mechanism to increase cargo tariffs annually by the greater of 3% or CPI from 2016 onwards. Revenue Risk: Price - Midrange

Considerable Capital Plan: The port system's sizable and evolving capital improvement plan (CIP), currently sized at $618 million, is progressing on schedule. It is expected that the plan will necessitate additional leverage, with $200 million in revenue bonds expected in late fiscal 2015. Infrastructure Development & Renewal - Midrange

Conservative Debt Structure: The harbor system has relatively low leverage consisting of all fixed rate bonds with a rapid amortization schedule on existing debt, somewhat mitigating the limited protection provided by the 1.25x rate covenant and additional bonds test (1.0x excluding contingency account and other allowable funds). Debt Structure - Stronger

Strong Financial Profile: Stable operating margins with a sizable liquidity cushion, with unrestricted liquidity providing more than 1000 days cash on hand in 2013. Coverage is relatively strong at over 2.0x historically and is expected to remain at these levels through the forecast period. Leverage was moderate at 2.86 times (x) net debt to CFADS (cash flow available for debt service) in 2013 but could rise modestly with future debt issuances.

RATING SENSITIVITIES

Stagnant growth or increased volatility in throughput volumes may erode pricing flexibility .Limitations to the ability to manage continued price increases may affect ratings.

Credit quality may be adversely affected to the extent increasing debt service requirements from the harbor system's capital program outpace revenue generation.

Should coverage fall meaningfully below 2x for an extended period, or should leverage climb above levels anticipated in the current plan, ratings may be affected.

SECURITY

The revenue bonds are special limited obligations of the State of Hawaii, payable from and secured solely by net revenue generated by the harbor system.

CREDIT SUMMARY

After remaining steady over the past decade and a half, overall cargo volume for the harbor system (measured in short tons) declined in the 2008 to 2010 period as the recession took hold. Throughput recovery has been seen in fiscal 2011, 2012 and 2013 (0.1%, 6.8% and 4.1% respectively), rising to 19.7 million short tons from a low of 17.7 million in 2010. This reflects a moderate recovery in cargo levels as tourism activity rebounds in Hawaii.

While operating revenues likewise declined in the 2008-2010 period due to the recession, multi-year tariff increases starting in 2010 have led to a healthy rebound in operating revenues. Fiscal 2011 revenues grew 17.2%, and 2012 and 2013 saw further increases of 20.9% and 8.5% ($104 million and $113 million respectively).

The scheduled tariff increases, developed with concurrence from primary harbor system users, were the first increases to have been implemented since 1997. Cargo rates have increased incrementally each year starting in 2010, initially increasing 20% and stepping down on an annual basis to 5% in 2014. The plan also includes 3% or CPI increases from 2016 onwards. Likewise, passenger fees have increased $0.50 annually since 2011, and will continue to do so through 2016. These prescribed increases have provided considerable revenue flexibility to the harbor division, and are intended to support the division's sizable modernization plan.

Operating expenses were $47 million in 2013, growing 9.3% over the year prior and reflecting a continued normalization of costs following furloughs and cost reductions during the downturn.

Going forward, Fitch expects more normalized increases in the system's operating expense profile as harbor operations return to pre-recession levels. Deferred maintenance funding and labor costs covered under collective bargaining agreements will also drive future operating costs.

The harbor division has historically recorded strong cash levels and healthy debt service coverage ratios. The division's unrestricted cash as of fiscal 2013 is $133.2 million. This represents 1030 days cash on hand. Unrestricted cash balances have increased 22% since 2011, and liquidity levels are supportive to the current rating level. Fitch believes cash balances will remain adequate, although they may decline some as management executes the harbor modernization plan over the next several years.

Debt service coverage in fiscal 2011 and 2012 was largely in line with historical levels at 2.7x in both years. Fiscal 2013 figures show coverage at 2.6x. When including the system's general obligation payment requirements of roughly $3.3 million per year for obligations taken on in the context of the Superferry project, all-in coverage is slightly lower at 2.5x. With the implementation of scheduled tariff increases through 2016, the harbor division projects coverage of 2.1x or higher with net revenue increases of on average 4% per year (2x including general obligation debt).

Under Fitch's rating case scenario, including a combination of throughput reductions in 2014, no revenue growth above the scheduled tariff increases and a 100-basis point increase in annual operating expense growth, debt coverage would still remain robust at 1.5x or higher (1.4x including general obligation debt). This scenario includes the anticipated additional borrowing of $200 million in fiscal 2015 in the context of the harbor system's CIP, increasing annual debt service obligations by approximately $15 million by fiscal 2019. With this issuance, leverage levels are expected to increase from currently moderate levels (3x net debt to CFADS for 2013) to around 7x in 2015, but should fall to the 3 - 4x range by 2019. However, Fitch anticipates that the harbor division will manage the timing and sizing of borrowing for its capital program in order to maintain sufficient levels of coverage and liquidity.

The current capital program focuses largely on the harbors modernization plan, known as the New Day Work Projects (NDWP). The plan consists of various projects to enhance the system's efficiency and capacity by addressing long-term capital needs. The plan is expected to cost $618 million, and funding is expected to come largely from revenue bond proceeds, though grant and port funds are also being used.

The State of Hawaii Department of Transportation harbors division consists of 10 commercial harbors on six islands, with Honolulu serving as the state's principal port and trans-shipment station for cargo that is bound for the other islands. As a monopoly, the harbor system benefits from the lack of alternative means of transporting cargo to and throughout the state, as well as the state's limited commodity and manufacturing base, which results in an inelastic demand for imported goods.

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Additional information is available at 'www.fitchratings.com'.

Applicable Criteria and Related Research:
--'Rating Criteria for Infrastructure and Project Finance' (Jul. 12, 2012);
--'Rating Criteria for Ports' (Oct. 3, 2013).

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Additional Disclosure
Solicitation Status