

RatingsDirect®

Summary:

Hawaii

Hawaii Harbor Division; Ports/Port Authorities

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Table Of Contents

Rationale

Outlook

Related Criteria And Research

Summary:

Hawaii

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Credit Profile

Hawaii

Hawaii Harbor Div, Hawaii

Hawaii (Hawaii Harbor Division)

<i>Long Term Rating</i>	A+/Stable	Affirmed
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Hawaii (Hawaii Harbor Div)

<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Affirmed
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Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services affirmed its 'A+' long-term rating and underlying rating (SPUR) on Hawaii's \$350 million in bonds outstanding, issued for Hawaii Harbor Division. The outlook is stable.

The ratings are based on our view of the port system's dominant business position and importance to the state's economy, as well as recent tariff increases designed to address recent volume declines and to support the capital improvement program.

More specifically, the ratings reflect our view of:

- The system's monopolistic position as Hawaii's sole provider of maritime facilities and services;
- The importance of the system to the state, as approximately 80% of the total volume of goods consumed in Hawaii are imported and roughly 98% are processed through the system;
- The system's very strong liquidity, with 1,030 unrestricted days' cash on hand (UDCOH) in fiscal 2013; and
- Annual planned tariff increases effective beginning March 1, 2010 through July 1, 2015, with automatic annual adjustments thereafter.

The preceding credit strengths are offset in part, in our view, by recent declines in demand, and the system's significant capital needs to address the large port system's expansion and maintenance requirements. Management has stated that the capital plan is prioritized and that projects will be undertaken only once funding becomes available.

A senior lien on the system's net revenues secures the bonds. All revenue-secured debt outstanding is fixed rate, with a descending debt service that has a final maturity in 2041. In addition to the revenue-secured bonds, the division is obligated to pay from revenues on a subordinated basis annual debt service associated with approximately \$31 million in reimbursable state general obligation bonds outstanding it used to construct facilities for an interisland high-speed ferry (Hawaii Superferry Inc.) that filed for bankruptcy protection in 2009. The vessels were abandoned, ending all possibilities of a return to service. The Maritime Administration subsequently sold the vessels to the U.S. Navy.

Similar to many ports and port systems, Hawaii's harbor system experienced large declines in operating performance measures (tonnage, ship calls, and cruise passengers, for instance) due to the recent recession, resulting in lower revenues and eroded financial metrics; however, with the tariff increases and improved economy, revenues, metrics, and operating performance have improved. We view the division's monopoly position and essential role as a fundamental credit strength. We also view management's recent actions to adjust tariffs to compensate for volume declines and finance needed capital improvements as a positive credit factor.

The port system is extremely important to Hawaii, as the state imports 80% of its required goods, 98% of which are shipped via water. Despite the harbor division's near-monopoly (private operators largely handle oil), operating performance reflects statewide economic trends. The division oversees a system of 10 harbors on six islands throughout the state and is a landlord port operator with terminal operators directly hiring stevedoring firms. Unlike other large landlord container ports, the division is more exposed to revenue swings associated with volume fluctuations. The two harbor facilities supporting the most populous island of Oahu were responsible for 81% of operating revenues in fiscal 2013. Honolulu Harbor, the system's largest, was the 16th-largest port in North America by twenty-foot equivalent units (TEUs) in 2011, accounts for approximately 50% of system tonnage, and operates as the transshipment hub for cargo to all islands but Oahu from the U.S. mainland. It has a main harbor basin with a depth of 40 feet, five linear miles of berthing space, 27 acres of covered storage, and more than 200 acres of cargo handling area. Some facilities are owned by the federal government and private companies, and the state owns the majority of the land although both the U.S. Coast Guard and Chevron Corp. have significant holdings. Cargo volume tonnage has fluctuated during the past four years. TEUs declined by 10.2% in fiscal 2010, rose 6% in fiscal 2011, dropped 2.5% in fiscal 2012, and then increased by 3.5% in fiscal 2013 to 1.3 million.

Total operating revenues declined to \$73 million in fiscal 2010 (similar to fiscal 2003 results) from a peak of \$86 million in fiscal 2007. However, as a result of the tariff increases effective March 1, 2010, total operating revenue grew by 17% to \$86 million in fiscal 2011, greater than fiscal 2007, and then increased by an impressive 21% in fiscal 2012 to \$104 million, significantly higher than the originally expected 9% growth. In fiscal 2013 revenues increased again to a total of \$113 million, or an 8% gain. In addition to the scheduled tariff increases through 2015, a mechanism was created to increase the cargo tariffs annually by 3% or Consumer Price Index (CPI) from 2016 onward.

Effective March 1, 2010, management began implementing tariff increases (the most recent prior increase was 25% in 1997). The higher tariff will support new debt associated with the capital program and bolster financial performance. The rate structure simplifies and equalizes rates of some cargo types, with intraisland cargo still charged lower tariffs and no fees on empty containers. Most importantly, in our opinion, cargo rates increased annually, by 20% in fiscal 2011, 15% in fiscal 2012, 10% in fiscal 2013, and 7% in fiscal 2014, and are set to increase 5% in fiscal 2015, and 3% or a CPI escalator thereafter, whichever is higher. Cruise passengers fees increased to \$5.00 beginning in 2012 and are increasing 50 cents per year through 2017.

Debt service coverage (DSC) excluding eligible fund balances was strong in fiscal 2013, in our view, at 2.2x, up from 1.5x in fiscal 2010, and is projected at 1.8x in fiscal 2016. DSC including eligible fund balances was 2.6x in fiscal 2013, up from 2.1x in fiscal 2010, and is projected at 2.1x in fiscal 2016. Liquidity measures including just the unrestricted cash and investments increased to 1,030 UDCOH in fiscal 2013, which we consider very strong. We view the division's

recent tariff rate increases (preceded by an increase in 1997) and schedule of proposed increases favorably; we also consider the system's ability to tap federal grant sources of capital funding reduces debt levels as a positive credit factor.

In our view, the division's capital plan is large and could pressure debt levels in the long term; however, in our opinion, management operates the system with a prudent approach toward fiscal and capital issues. The division's priority new day work projects total \$571 million, the largest of which is a new \$450 million container terminal facility at Kapalama military reservation in Honolulu Harbor. While the system's expansive and essential nature provides for a strong business position, it also requires significant investment in facilities that individually sometimes do not have the commercial activity to fully support capital and operational costs. Also, the division occasionally participates in economic development projects (for instance, Hawaii Superferry) that can add to the overall debt burden without commensurate revenue growth. Management currently plans to issue \$200 million in additional bonds for the capital plan in 2015; we consider this additional debt burden to be manageable.

In our opinion, Hawaii's economy is very closely tied to traffic at the system's ports, more so than many other port credits, because of its location more than 2,000 miles from the nearest continent. It imports much of what it needs to support 1.4 million residents and 8.2 million annual visitors, so the state economy directly affects port volumes and overall financial performance. As the state continues to rebound from the recent recession, several positive trends are emerging and some economic metrics indicate that the state was relatively more resilient than the national economy during the recession. Labor force and employment were at historically high levels in March 2014. Unemployment was the sixth lowest in the nation during the first quarter of 2014 at 4.4% versus the national rate of 6.8%. Since 2003, Hawaii's unemployment rate has generally been 2% to 3% below the national rate.

Where Hawaii's economy historically has been most affected, is tourism, an industry that was weakened during the recent recession due to reduced consumer spending, job losses, the recent seismic and tsunami events in Japan, and competitive marketing campaigns from multiple tourism destinations (e.g., Las Vegas). However, visitor arrivals, visitor spending, and revenue per available room have all grown in 2010 through 2013 (and, as projected by management, in 2014). During the recession, visitor arrivals declined 10.9% in 2008 (versus 12.2% for the U.S.) and 4.5% in 2009 to 6.5 million, but increased in 2010 through 2013 to a total of 8.2 million. Visitor expenditures fell to \$10.0 billion in 2009 but rose to \$14.7 billion in 2013, and revenue per available room declined to \$115 in 2009 but grew to \$173 in 2013.

Outlook

The stable outlook reflects our anticipation that the capital program will not pressure the cost structure significantly more than forecast, that liquidity will remain at or near currently very strong levels, that DSC will be maintained at currently forecast levels, and that demand will not significantly deteriorate. We do not expect to raise the ratings during the next two years given the system's capital needs. At the same time, given the system's robust cash position and improving demand, we are unlikely to lower the ratings during the next two years.

Related Criteria And Research

Related Criteria

USPF Criteria: Port Facilities Revenue Bonds, June 13, 2007

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