

21 FEB 2024

Fitch Rates Honolulu Board of Water Supply, HI Water Revs 'AAA'; Outlook Stable

Fitch Ratings - San Francisco - 21 Feb 2024: Fitch Ratings has assigned a 'AAA' rating to the following obligations issued by the Honolulu Board of Water Supply, HI (BWS):

--\$73.7 million water system revenue bonds, series 2024A (sustainability bonds).

Bond proceeds will be used to fund or reimburse the BWS for certain improvements to the water system (the system), refund certain outstanding water system revenue bonds, and pay costs of issuance of the bonds. The bonds are expected to sell via negotiation the week of March 11.

In addition, Fitch has affirmed the 'AAA' ratings on the following:

--Approximately \$363 million water system revenue bonds;

--Issuer Default Rating (IDR) of the BWS.

The Rating Outlook is Stable.

The 'AAA' water revenue bond rating along with the 'AAA' IDR reflect the board's 'Exceptionally Strong' financial profile within the framework of 'Very Strong' revenue defensibility and 'Very Strong' operating risk profile, both assessed at 'aa'. The board's leverage, measured as net adjusted debt to adjusted funds available for debt service (FADS), was extremely low at 2.0x in fiscal 2023 and is expected to increase to a peak of 3.3x in fiscal 2025 in Fitch's Analytical Stress Test (FAST) stress case as the BWS addresses projects consistent with its 30-year water master plan (WMP), but retain comfortable headroom for the rating.

U.S. Navy Fuel Leak

Impacts from the fuel leak at the Navy's Red Hill Bulk Fuel Storage Facility (RHBFSF) are still being evaluated, but BWS has not detected any contamination in its well stations to date and is taking appropriate steps to monitor and mitigate damage. BWS planned in advance for a potential Red Hill contamination event and has been actively monitoring its wells in that area since a 2014 leak. According to BWS, it has the technical, managerial, and financial expertise to respond to the recent leak and it has thus far not experienced any material adverse financial impacts.

BWS shut down its Halawa Shaft and certain Aiea and Halawa drinking water wells to prevent fuel contamination from entering the BWS's own water distribution system. In addition, BWS implemented enhanced water quality testing and protocols, installed additional groundwater monitoring wells,

temporarily increased reliance upon other water sources to replace the lost water production, developed alternative water supply wells to make up for the lost water production and evaluated drinking water treatment technology.

In October 2023, BWS filed a \$1.2 billion claim with the U.S. Navy under the Federal Tort Claims Act (FTCA) to recover related costs. The claim encompasses \$25 million for costs already incurred to adjust BWS' operations and \$1.183 billion to construct new water wells to replace BWS Halawa Shaft, Halawa Wells and Aiea Wells (this work is not yet underway). According to BWS, if the Navy has not responded within six months the BWS will decide its legal options and next steps.

The Navy completed the gravity defueling of 104.6 million gallons of fuel from the Red Hill facility on Dec. 15, 2023. It reported 64,000 gallons of residual fuel still remain in low points and difficult to reach places within the piping system of the facility and 28,000 gallons of sludge remain at the bottom of the tanks. The Navy plans to remove most of residual fuel from low points of the pipeline and valves by March 2024, and plans to remove the remaining residual fuel and the 28,000 gallons of sludge by November 2027.

The federal government has appropriated over \$2 billion over the last two years to the Navy for related clean-up costs. Given actions taken to date and expected future actions of the BWS and federal government, the contamination does not affect BWS' rating or ESG relevance score at this time.

SECURITY

The bonds are special obligations of BWS payable solely from water system net revenues.

KEY RATING DRIVERS

Revenue Defensibility - 'aa'

Very Favorable Service Area, Affordable Rates for the Vast Majority of the Population: The board retains the legal authority to adjust rates as needed without external oversight. Fitch considers the monthly residential water bill affordable for around 87% of the service area population based on standard monthly usage of 7,500 gallons. However, rate flexibility is slightly lower when considering wastewater charges for which BWS provides billing service. The very favorable service area is characterized by stronger income levels, a moderate unemployment rate relative to the nation and midrange customer growth. Customer growth registered a five-year compound annual growth rate of 0.2% as of fiscal 2023. Income levels are about 33% above the national median as of 2022. The unemployment rate has decreased from the high seen in 2020, and was 97% of the national average in 2022.

Operating Risk - 'aa'

Very Low Operating Cost Burden, Elevated Investment Needs, Supported by Adequate Capital Investment: In fiscal 2023, the system's operating cost burden was considered very low at \$4,400 per million gallons (mg), consistent with the operating risk assessment. The life cycle ratio is elevated at 48% in fiscal 2023. Capex to depreciation has been strong, reflected in the five-year average of around 165% from fiscal 2019 to fiscal 2023. Planned capital spending for the next five years should generally

outpace historical depreciation, resulting in a stable to improving life cycle ratio.

BWS's projected capital spending for fiscal years 2024-2028 totals \$957 million and includes \$299 million of pipeline projects and \$508 million in facilities projects as well as about \$150 million in construction cost index adjustments and contract adjustments. About half of the spending is expected to be funded with debt, 6% with grants, and the remainder with cash.

Financial Profile - 'aaa'

Exceptionally Low Leverage: The board had exceptionally low leverage of 2.0x as of fiscal 2023. This is the highest leverage over the past five years as it measured 0.1x in fiscal 2019. While FADS has generally increased over this period, BWS has also taken on additional debt as it has begun undertaking WMP projects, yet leverage still remains supportive of the current rating. The liquidity profile is neutral to the overall assessment with current days cash on hand of 534 and coverage of full obligations (COFO) of 3.0x. Fitch-calculated total debt service coverage was 3.0x in fiscal 2023.

The FAST considers the potential trend of key ratios in a base case and stress case over a five-year period. The stress case is designed to impose capital costs 10% above expected base case levels and evaluate potential variability in projected key ratios. The FAST reflects Fitch's view of a reasonable scenario, which is generally informed by publicly available and/or management-provided information with respect to capital expenditures, user charges and rate of revenue and expenditure growth.

In the base case scenario, the leverage ratio is expected to increase to 3.0x in fiscal 2025, then decrease to 2.6x through fiscal 2028. In the stress case, the leverage ratio is projected to increase to 3.3x in fiscal 2025, then decline to 3.1x through fiscal 2028. In consideration of the significant construction funds that would likely be available in most years given the cyclical nature of issuing and spending down that the system demonstrates, leverage is less than 2.0x in each year of the stress case. Liquidity is expected to remain neutral to the assessment over the five-year horizon.

Asymmetric Additional Risk Considerations

No asymmetric additive risk considerations affect this rating determination.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

--Sustained leverage in Fitch's base and stress case that exceeds 5.0x provided stability in the revenue defensibility and operating risk assessments;

--While not expected, material unanticipated impacts from the Red Hill facility fuel leak that affect the BWS operating risk and/or financial profile assessments.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--The ratings are at the highest level on Fitch's scale and cannot be upgraded.

PROFILE

BWS provides water service to the entire island of Oahu (City and County of Honolulu). With an estimated residential population of around 1 million, BWS serves approximately 172,000 accounts, over 90% of which are residential, lending stability to the customer base. BWS does not serve the large military installations on the island, since those sites have their own well systems and have permitted pumping amounts from the state.

BWS' water supply is provided by high-quality groundwater aquifers located under the island that require limited treatment. Currently, there is a sustainable yield of 393.5 million gallons per day (mgd) of available water supply on the island, of which 284.6 mgd is permitted. BWS' authorized use is 182.6 mgd, which was more than sufficient to meet system production of 133.8 mgd in fiscal 2023. Water use has been largely flat for the past 10 years given conservation efforts and lower agricultural use, and while the WMP estimates an increase in demand of between 5% and 15% through 2040, it also notes that supplies should be sufficient through at least that period.

Sources of Information

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

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

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit <https://www.fitchratings.com/topics/esg/products#esg-relevance-scores>.

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Rating Actions

ENTITY/DEBT	RATING		RECOVERY	PRIOR
Honolulu Board of Water Supply (HI)	LT IDR	AAA	Affirmed	AAA

- Honolulu
Board
of
Water
Supply LT
(HI)
/Water
Revenues/
1 LT

RATINGS KEY OUTLOOK WATCH

POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

[U.S. Public Sector, Revenue-Supported Entities Rating Criteria \(pub.12 Jan 2024\) \(including rating assumption sensitivity\)](#)

[U.S. Water and Sewer Rating Criteria \(pub.03 Mar 2023\) \(including rating assumption sensitivity\)](#)

Additional Disclosures

[Solicitation Status](#)

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Honolulu Board of Water Supply (HI) EU Endorsed, UK Endorsed

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