MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns Aa2 to Honolulu Board of Water Supply (HI) Water System Revenue Bonds, 2014

Global Credit Research - 10 Nov 2014

Approximately $262 million of debt affected

HONOLULU BOARD OF WATER SUPPLY, HI
Water Enterprise
HI

Moody's Rating

ISSUE		RATING
Water System Revenue Bonds Series 2014A (Tax-Exempt)		Aa2
Sale Amount	$94,870,000	
Expected Sale Date	11/20/14	
Rating Description	Revenue: Government Enterprise	
Water System Revenue Bonds Series 2014B Bonds (Taxable)		Aa2
Sale Amount	$43,450,000	
Expected Sale Date	11/20/14	
Rating Description	Revenue: Government Enterprise	

Moody's Outlook STA

Opinion

NEW YORK, November 10, 2014 --Moody's Investors Service has assigned a Aa2 rating to the Honolulu Board of Water Supply's Water System Revenue Bonds, Series 2014A and Water System Revenue Bonds, Series 2014B. At this time, Moody's affirms the Aa2 rating on the Board's previously issued $262 million, pre- refunding. The current offering is secured by a senior lien on net revenues of Honolulu's water system. Proceeds of the current offering will be used to refund a portion of the Board's previously issued revenue bonds for annual debt service savings. The long term rating carries a stable outlook.

SUMMARY RATING RATIONALE

The Aa2 rating primarily reflects the system's sound service area which includes the City and County of Honolulu (G.O. rated Aa1 with stable outlook), strong and improving operating results, an ample supply of high quality ground water and no plans for additional borrowing.

The stable rating outlook reflects Moody's expectation that system financial operations will continue to benefit from sound management practices, recently implemented multi-year rate increases and minimal additional borrowing plans.

STRENGTHS

-Large service area; local economy continues to recover

-Recent multi-year rate increases improve financial metrics

-Conservative financial management

CHALLENGES

-Debt service reserve requirement will be reduced to 50% of MADS, per springing amendment to resolution

-Economy concentrated in tourism

DETAILED CREDIT DISCUSSION

SYSTEM SERVES MOST OF OAHU; AMPLE SUPPLY OF HIGH QUALITY GROUND WATER

The system benefits from a mature, though tourism-dependent service area that encompasses the island of Oahu and is coterminous with the City and County of Honolulu (Aa1/stable). The water utility provides service to a population of 983,429 supplying an average of 138 million gallons per day (mgd) to nearly 168,000 accounts. Nearly all water system accounts are residential (92.8%) with a small amount comprised of commercial and industrial (6.7%) and agricultural (0.5%) accounts. Residential accounts comprised 60% of FY 2014 water sales, followed by commercial (36%) with a small amount derived from industrial (3%) and agricultural (1%) accounts.

Water supply is ample and of high quality, sourced from a vast underground aquifer which is recharged by tropical rains, filtered through lava, and requires only minimal treatment. The system's pump capacity is a substantial 398 mgd which far exceeds the board's authorized use by the State Commission on Water Resource Management of 182 mgd and above the system's average daily production of 138 mgd. The system's storage capacity is also more than sufficient at 196 mg. The system's ten largest customers comprised 18.4% of FY 2014 water sales. However, the three largest customers (military, state and local government) are considered very stable in nature and provide predictability to the system's revenues. Moody's notes water loss for the system has improved in recent years, declining from 12.5% in fiscal year 2010 to 8% in fiscal 2012. Similarly, the number of water breaks annually has declined from 401 in 2010 to 294 in 2014. The system is reportedly in compliance with all state and federal regulations. Prudently, management continually reviews and adjusts its capital plan to identify source, storage, transmission needs. Over the next five years, management has identified an estimated $370 million in capital needs comprised of primarily transmission (55%), general (25%) and source (17%) projects, which are expected to be funded from a combination of system net revenues, state loans, and facility charges with no additional parity borrowing expected in this forecast period.

STRONG DEBT SERVICE COVERAGE; MULTI-YEAR RATE INCREASES APPROVED BY BOARD

System financial performance has been strong, aided by regular rate increases and manageable capital needs. The system's operating ratio improved slightly in fiscal 2014 to 68.6%, but remained slightly above the Aa2 national median. Given continued pay-go financing for a majority of the system's capital needs, the 18.9% debt ratio remains very low. Between fiscal 2010 and fiscal 2013 annual debt service coverage averaged a healthy 2.4 times, well above the Board's 1.6 times target level. Coverage increased for a third consecutive year to 3.2 times in fiscal 2014 and projections show coverage continuing to improve to nearly 4.3 times by fiscal 2016 and supported in part by the current refunding but importantly also supported by multi-year rate increases of 9.65% annually between FY 2012 and FY 2016. Projections are conservative and assume annual revenue and expenditure growth at about 3%, compared to somewhat higher but nearly average growth of about 6% from fiscal 2010 to fiscal 2014.

Average residential bills of $44.50 (based on average consumption of 10,000 gallons per month) are relatively low compared to systems of comparable size nationally as well as other Hawaii counties. Further, the Board's approval of annual increases of 9.65% through 2016 is expected to adequately provide for ongoing system needs and debt service coverage while maintaining monthly bills in-line with other Hawaii counties.

Importantly, the Board has improved its balance sheet metrics and as of fiscal 2014 unrestricted cash and investments were in a healthy position and projections indicate this trend will continue. The Board's unrestricted cash equaled a healthy 553 days in fiscal 2014. This solid liquidity position provides for sound flexibility to mitigate any unanticipated operating and capital costs while also allowing ample cushion to provide for pay-go financing for the system's five-year CIP. The system is projected to generate between $46 million and $60 million in excess revenues annually from FY 2015 to FY 2019, after O&M and debt service which should generate sufficient resources to support the Board's capital improvement plan.

SATISFACTORY LEGAL PROVISIONS, THOUGH DEBT SERVICE RESERVE REQUIREMENT WILL BE 50% OF MADS BY 2016

Moody's notes the Board enacted a springing amendment in conjunction with the 2012A financing, reducing the Common Debt Service Reserve (DSR) Account to 50% of maximum annual debt service, upon bondholder consent; full bondholder consent is expected sometime in 2016. Legal provisions also include covenants to maintain rates and charges sufficient to generate net revenues at least equal to 1.20 times MADS; a similar covenant is provided for the issuance of additional parity bonds. Although we view the springing amendment as an eventual credit weakness, this is somewhat mitigated by the board's debt and reserve planning targets that provide additional financial cushion. Planning targets include debt service coverage of at least 1.60 times, a debt to net asset ratio of 40% and a working capital reserve of at least 60 days.

WHAT COULD MAKE THE RATING GO UP

-Substantial local economic diversification

-Improved and sustained financial performance, including higher debt service coverage levels consistent with projections and higher rated entities

WHAT COULD MAKE THE RATING GO DOWN

-Trend of significantly weakened coverage of annual debt service coverage

-Substantial increase in borrowing and debt ratio

KEY STATISTICS:

2014 service area resident population: 983,429

Water system accounts, FY 2014: 167,931

Annual debt service coverage, FY 2014: 3.19 times

Operating ratio, FY 2014: 68.6%

Debt ratio, FY 2014: 18.9%

Unrestricted reserves as % of O&M, FY 2014: 155.3%

The principal methodology used in this rating was Analytical Framework For Water And Sewer System Ratings published in August 1999. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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