Bulletin:

# Honolulu Board of Water Supply, HI's Coverage And Liquidity Position It To Withstand Near-Term Stress Of COVID-19

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CENTENNIAL (S&P Global Ratings) May 13, 2020--S&P Global Ratings has reviewed Honolulu Board of Water Supply (BWS), Hawaii's response to the COVID-19 pandemic, including performing an S&P Global Ratings stress test on projections, and currently does not expect the pandemic will materially affect the BWS' ability to maintain budgetary balance and pay debt service costs given BWS' significant coverage and liquidity position.

On Feb. 28, 2020, S&P Global Ratings assigned its 'AAA' long-term rating to the BWS' series 2020A and 2020B bonds. The outlook is stable.

In response to the potential impact to BWS of the economic recession, pandemic, and associated moratorium on shutoffs, we are stressing revenues by 10%-15%, consistent with the decline in billed water service consumption for the month of April, which is down by 11% compared to last year. In addition, the source production for April was about 126 million gallons per day (mgd)--based on a five-year monthly average of 134 mgd--down by 6.5% from last year. The drop in source production started in mid-March when the governor and mayor called for social distancing and travel restrictions. Based on our stress test, using a 15% decline in annual revenue, all-in coverage will decrease to about 1.85x in fiscal 2024, a figure we still consider extremely strong. This assumes preapproved rate increases are implemented. If approved rate increases are not implemented and revenues decline by 15%, we would expect coverage metrics to drop to about 1.34x by fiscal 2024, a figure we consider strong but weaker than that of peers at the current rating level. We expect a gradual recovery in the economy would occur by 2024 and the board would rebuild coverage to prior levels. BWS currently has a moratorium on shutoffs and disconnects; however, it will not write off these account balances and will continue collection efforts and make payment plans for affected customers. Unrestricted cash and investments as of April 15, 2020, was about $304 million, which we believe to be a sufficient cushion for short-term disruptions. Furthermore, about 50% of BWS' capital plan is cash funded, and if necessary, management has noted the ability to defer some capital projects and reallocate those funds to cover current operating expenses. Furthermore, BWS is working with the Hawaii Department of Health to leverage federal stimulus funding through the S.A.F.E Water Infrastructure Action Plan that utilizes the Clean Water and Drinking State Revolving funds.

The state of Hawaii and Honolulu's economy have exposure to the tourism industry, which we expected to result in an above-average degree of economic pressures stemming from the global

COVID-19 pandemic and subsequent recession. As an island economy, Honolulu is inherently vulnerable to negative effects of certain types of exogenous shock events. However, the Honolulu economy has a significantly greater diversity of employment than the peer counties and has proven relatively resilient to shocks such as the Sept. 11 terrorist attacks and the SARS epidemic. We believe that social distancing measures and the restriction of visitor arrivals to contain the COVID-19 pandemic present unique challenges but that the utility is positioned to withstand near-term stress. A longer-than-expected recovery could pressure the rating in the future.

While we continue to monitor events related to COVID-19, we believe BWS' significant coverage and liquidity position will allow it to maintain budgetary balance and pay debt service costs. For more information, see our articles "COVID-19's Potential Effects In U.S. Public Finance Vary By Sector" (published March 5, 2020, on RatingsDirect), "All U.S. Public Finance Sector Outlooks Are Now Negative" (published April 1, 2020), and "An Already Historic U.S. Downturn Now Looks Even Worse" (published April 16, 2020).

The enterprise risk profile reflects our view of BWS':

- Service area in the broad and diverse urban Honolulu service area economy with very strong income indicators;
- Affordable water system rates given the low county poverty rate and very strong income metrics; and
- Strong operational management assessment, reflected by a robust asset management program, sufficient high-quality groundwater supply, a focus on climate change, watershed management, and diversifying water supply to continue to meet customer demand.

The financial risk profile reflects our view of BWS':

- Extremely strong all-in coverage metrics during the past five years at 4.0x in fiscal 2019, which we expect to decline to about 2.4x, still considered extremely strong, as BWS issues additional debt annually to support 50% of its capital plan from bonds and loans;
- Extremely strong unrestricted cash and investments at about $411 million, equivalent to 950 days of operating expenses for fiscal 2019;
- Large but manageable capital plan at about $757 million during the next five years, with a low debt-to-capitalization ratio of about 22% that we expect to rise given future debt plans; and
- Strong financial management assessment, reflect by robust and transparent financial policies and long-range financial planning that incorporates sensitivity analyses for conservation, growth, natural disaster, water source contamination, climate change, and economic cycles.

In our opinion, environmental risks for the island are above the sector standard. Climate change risks include sea level rise, changes in precipitation, and a change in demand. However, we believe management has identified operational and financial risks through a recent climate change report and stress scenarios performed in the board's long-range financial plan. Importantly, we believe management has a prudent plan in place to address enterprise-specific risks and has financial cushion to implement the needed rate increases to prepare the system for contingencies. We view positively management's proactive stance in identifying these potential risks, diversifying long-term water supply, and performing vulnerability assessments to identify capital needs to ensure redundancy. For now, increased pressures on the service area economy due to higher public health and safety risks related to COVID-19 will increase the BWS' overall social risk factors.

This report does not constitute a rating action.