S&P Global
Ratings

RatingsDirect®

Summary:

Honolulu Board of Water Supply, Hawaii; Water/Sewer

Primary Credit Analyst:
Jaime Blansit, Englewood (1) 303-218-0690; jaime.blansit@spglobal.com

Secondary Contacts:
Scott D Garrigan, New York + 1 (312) 233 7014; scott.garrigan@spglobal.com
Jenny Poree, San Francisco + 1 (415) 371 5044; jenny.poree@spglobal.com

Table Of Contents

Summary:

Honolulu Board of Water Supply, Hawaii; Water/Sewer

Credit Profile		
US$73.725 mil wtr sys rev bnds ser 2024 due 07/01/2053		
Long Term Rating	AAA/Stable	New
Honolulu Brd of Wtr Supp wtr sys rev bnds		
Long Term Rating	AAA/Stable	Affirmed
Honolulu Brd of Wtr Supp wtr sys rev bnds (taxable)		
Long Term Rating	AAA/Stable	Affirmed

Credit Highlights

- S&P Global Ratings assigned its 'AAA' rating to Honolulu Board of Water Supply (BWS), Hawaii's anticipated $74 million water system revenue bonds, series 2024.
- At the same time, S&P Global Ratings affirmed its 'AAA' rating on the board's $365 million in outstanding bonds.
- The outlook is stable.

Security

The security is credit-neutral and includes a senior lien net revenue pledge, a 1.2x rate covenant, and a parallel additional bonds test. This series does not have a debt reserve fund but other outstanding issues benefit from a common reserve. The lack of a formal debt service reserve fund does not affect our view of the credit given the substantial liquidity in the system.

Credit overview

The 'AAA' rating reflects the board's robust financial metrics and best-in-class management policies and practices. Management continues to successfully manage the Red Hill fuel spill from a position of strength. The board swiftly addressed health and safety concerns and has been advocating on behalf of the rate base to reduce future risks associated with the presence of the fuel tanks. Last October, the board filed a $1.2 billion claim with the U.S. Navy for remediation costs and construction of new wells. Management informed us that due to the complexity and associated risks of addressing the contamination, the board will not use the affected wells going forward. Rather, the incident has shifted the board's focus to augmenting supply and furthering source protection, including building a desalination plant. Although the desalination plant may increase operating complexity and cost, it will improve supply diversification and resiliency. We expect the relatively complex capital plan to increase debt and thus utility rates, which may pressure affordability, but the board's highly strategic One Water policy addresses many of the associated risks through strong communication, planning, and environmental stewardship, which supports credit quality. Further, substantial strength is demonstrated within the financial profile, providing ample cushion to absorb additional debt and capital costs.

The rating further reflects:

- Broad and diverse service area serving the majority of Oahu's residential population;
- Affordable utility rates that may become pressured in the longer term taking into account planned 8% to 10% annual increases through 2029;
- Strong coverage and liquidity metrics, which we forecast to remain healthy despite a large capital improvement plan; and
- Management practices that are best in class, in our view.

Environmental, social, and governance

Environmental risk is elevated but credit-neutral within our analysis, while social and governance risk are credit-neutral. The island has exposure to physical risks, including severe storms and sea-level rise. Governance, specifically risk management, is extremely robust, mitigating some of this risk. The board conducted a vulnerability assessment that concluded that most essential water utility infrastructure will not be exposed to sea-level rise until mid-century. However, if the sea level rises faster than projected the impact on infrastructure would be far greater. The board has partnered with the city on climate change adaptation legislation, which was adopted in December 2020 and addresses programs related to energy, coastal and water, climate resilience and equity, food security and sustainability, zero waste, pre-disaster multi-hazard mitigation, long-term disaster recovery, climate action, and climate change adaptation. The One Water philosophy is embedded in the water resources planning, including institutionalizing collaboration among city agencies and others to, for example, prioritize coastal infrastructure and elevate streets and private developments to adapt to forecasted sea-level rise. Given the uncertainties associated with climate resiliency, we expect this effort to be ongoing and important to credit stability, given the costs associated with potential hardening or emergency response.

In addition to its adaptation and mitigation efforts, the board completed a risk-and-vulnerability assessment and emergency response plan in accordance with the American Water Infrastructure Act of 2018. Although the assessment concluded that existing infrastructure has significant resilience components already built in, management has identified additional enhancement that is included in the capital plan. The board is also partnering with FEMA to continually improve emergency response. These efforts are expected to mitigate and adapt to higher incidence of hurricanes and severe storms.

Outlook

The underlying economy in Honolulu has proven resilient under several real-life economic stress scenarios. Further, current financial metrics are healthy and, given the board's internal policies related to coverage and liquidity, we believe metrics will remain at or above 'AAA' medians. We expect that margins may soften somewhat given the economic environment and the costs associated with the Red Hill fuel spill, especially as the board balances necessary capital investment with customer affordability. Stability in senior management also supports the current outlook given the complexities of operations and capital planning.

Downside scenario

If capital, operating, or deferred maintenance costs result in affordability pressures for the customer base, hindering rate-setting flexibility, it could affect credit stability. If metrics fall below policy levels for consecutive years, it could also pressure the rating. A divergence from the strategic plan or instability in management would also increase downside risks.

Credit Opinion

The utility provides water to approximately one million resident and visitors, and the service area's underlying economy is large and diverse. The visitor industry has demonstrated the ability to rebound following significant disruptions such as 9/11, COVID-19, SARS, and periods of economic contraction. The utility benefits from strong median household income and low unemployment, which contributes to rate-setting flexibility and low delinquencies. The military presence is a stabilizing factor and we expect that it will result in continued investment and development given the strategic military importance of Oahu. Currently, the primary economic pressures are a lack of affordable housing and continued weakness in the international travel market, which has been slow to recover given COVID-19 policies abroad.

The board has ample groundwater supply for the residential customer base as well as recycled water for commercial and industrial use. Management plans to expand supply through the Kalaeloa Seawater Desalination Facility Project, which will add 1.7 million gallons a day of surface water capacity. Given the recent Red Hill fuel spill as well as the potential presence of emerging contaminants such as PFAS, the board has heightened its focus on source protection and procuring additional supply. The U.S. Navy confirmed two fuel spills in November and December of 2021 at the Red Hill Bulk Fuel Storage Facility. In response, the board has shut down the Halawa Shaft (which delivers 20% of Honolulu's water). In the interim, the board has sufficient supply available from pumping at higher rates from other well stations and expects to augment this supply with new wells and a desalination plant (the Kalaeloa plant). Fuel operations have been suspended by the Navy and a consent order to safely defuel Red Hill is in place. The Navy anticipates that the storage facility will be closed by July 2028. BWS has determined that treating the contaminated water is neither feasible nor cost-effective given the different fuel types and quantity present, in addition to the risk of spreading the contamination to downstream water sources.

The island's topography is varied and the climate is challenging for optimizing asset life. The board has an integrated approach to infrastructure and financial stewardship that is demonstrated by the planning documents that guide decision-making. Its Strategic Plan and Water Master Plan (WMP) address current and emerging risks such as climate change, watershed management, and population growth. A condition assessment and hydraulic modeling has also been performed. These documents inform prioritization of preventative maintenance and capital planning. The output is then incorporated into the board's long-range financial plan (LRFP), which assesses the impact of potential risks to the system and whether the board has the financial capacity to respond. Of the total $957 million capital plan through 2028, 31% is dedicated to renewal and replacement of the transmission system. Pipes are also being replaced with higher-grade materials that management expects to be more resilient. Given the above-average exposure to climate risk, we view preventative maintenance and detailed climate planning through the WMP and One Water project positively and see it as improving both asset and financial resiliency.

The organization is highly effective, with comprehensive policies that address cyber security, emergency planning, and succession planning. Like utilities throughout the country, labor is a challenge for the board due to both retirements and recruiting. This has primarily affected hiring for operations, in particular engineering. Management is addressing these challenges through adjustments to benefits and policies as well as through successful apprenticeship and internship programs that have resulted in relatively low turnover rates of just over 6%. However, the vacancy rate remains high at 27%. Given the complexity of the system and the risks, strong management is critical to credit quality, in our view. We will continue to monitor the status of the labor strategy.

The policies and practices associated with rate-setting include all the elements that are deemed strong in our methodology. There are two stakeholder boards, residential and commercial, which promote transparency. There are cost adjusters for energy and regulatory expenses, in our opinion the two biggest drivers of cost escalations given the nature of the system. Finally, management adopts multi-year rate increases that are supported by a third-party cost-of-service study. The planning documents discussed above are integrated into the rate-setting and budgetary process. The board's recently adopted rate package shows higher increases than previously anticipated to support the rising debt requirements and capital needs of the county. While increases are somewhat elevated at 8% to 10% annually through 2029, management is engaged in extensive community outreach, which eases customer adoption and delinquencies. In our view, future rates will remain affordable due to conservation efforts, paired with tiered, primarily volumetric charges that build equity across rate classes and those in weaker demographics.

Rate-setting practices contribute to the board's very healthy financial performance. Coverage over the past three years has averaged 3.0x, well above the board's 1.7x policy, demonstrating financial resilience even during the pandemic period. Liquidity is also high, with $460 million in unrestricted cash and over two years of total cash, and an additional $262 million that is restricted. We expect projected coverage and cash to weaken but will stay well above policy targets. Debt levels are relatively moderate, but the capital plan is substantial. Taking into account the almost $1 billion capital plan and the $99 million Water Infrastructure Finance and Innovation (WIFIA) Act loan, leverage will more than double. While this will require future rate increases, we believe the capital projects are necessary to maintain the integrity of the system and mitigate future risks, which we view favorably. Balancing capital needs with rate affordability may require all-in coverage to dip to levels closer to policy targets in the future but such levels are still expected to be commensurate with the current rating level.

Honolulu Board of Water Supply, Hawaii--Economic and financial data

		Fiscal year-end			
	Most recent	**2023**	**2022**	**2021**	**Median (AAA)**
Economic data					
Water customers	159,151				82,450
Sewer customers	--				66,870
MHHEBI of the service area as % of the U.S.	111.0				114.0
Unemployment rate (%)	2.5				3.4
Poverty rate (%)	10.0				10.2
Water rate (6,000 gallons or actual) ($)	47.3				33.0
Sewer rate (6,000 gallons or actual) ($)	0.0				37.0
Annual utility bill as % of MHHEBI	0.8				1.0

Honolulu Board of Water Supply, Hawaii--Economic and financial data (cont.)					
		Fiscal year-end			
	Most recent	**2023**	**2022**	**2021**	**Median (AAA)**
Operational Management Assessment	Strong				Good
Financial data					
Gross revenues ($000s)		244,712	248,263	238,003	77,481
Total operating expenses less depreciation ($000s)		161,582	157,603	176,958	50,331
Net revenues available for debt service ($000s)		94,502	98,656	69,199	--
Debt service ($000s)		36,549	31,920	27,622	--
S&P Global Ratings-adjusted all-in DSC (x)		2.6	3.1	2.5	2.6
Unrestricted cash ($000s)		461,051	429,558	424,800	78,493
Days' cash of operating expenses		1,041	995	876	610
Total on-balance-sheet debt ($000s)		546,783	530,623	448,652	139,496
Debt-to-capitalization ratio (%)		28.9	29.0	26.1	22.5
Financial Management Assessment	Strong	--	--	--	Strong

Note: Most recent economic data available from our vendors. MHHEBI--Median household effective buying income. DSC--Debt service coverage.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022