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Hawaii's strong operating performance brings an upgrade

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Hawaii’s ability to maintain a strong operating performance as it ramps up efforts to pay down pension and retiree medical liabilities brought a one-notch Fitch Ratings upgrade to AA-plus Tuesday.

The new issuer default rating affects $7.7 billion in general obligation bonds. Fitch also upgraded $4 million in certificates of participation to AA from AA-minus and affirmed the rating on $408 million in outstanding highway revenue bonds at AA.

The Hawaii State Capitol. Fitch Ratings upgraded the state's issuer default rating to AA-plus Tuesday. **Bloomberg News**

The upgrade came the same day that Fitch released a report naming Hawaii as one of six states that has elevated long-term liability burdens in excess of 20% of personal income, driven by the pension liability component of the ratio. The other five states are Illinois, Connecticut, Kentucky, New Jersey and Alaska.

“We see Hawaii doing what they said what they were going to do in terms of adhering to long term commitments,” said Alan Gibson, a Fitch director. “We also see it happening in the context of ongoing strong financial operations, supported by a strong, increasingly diversified economy.”

Fitch also noted in the pension report that the magnitude of a pension burden often, but not always, corresponds with whether a state's pension situation is sustainable. Some states with relatively higher pension burdens have been active in addressing sustainability challenges, Fitch analysts wrote, raising the likelihood of funding progress over time, while others with low burdens have taken few steps or have only belatedly sought to address the need for change.

Fitch had revised Hawaii’s outlook to positive in April 2017. It holds a stable outlook at the newly upgraded rating.

“We had the state on positive outlook for some time,” Gibson said. “We wanted to see how the state was able to absorb the increased contributions to pension and other-post employment benefits within the context of its operating performance.”

The state set a course in May 2011 to gradually move toward full actuarial funding of both pension and OPEB.

Pension reform efforts began with the passage of legislation that reduced employee benefits by limiting spiking, partly through the exclusion of overtime in estimating employee annual pension payouts based on current salary. Employee contributions were also increased. Hawaii began prefunding OPEB liabilities in 2013 with the aim of reaching 100% of its actuarially required prefunding level.

The state reduced its assumed rate of return from 7% to 7.5% in 2017.

Hawaii’s total pension liability is $16.2 billion and its net pension liability is $7.3 billion, Gibson said. The state reports its actuarial funded ratio at 54.8% using a 7% discount rate, but Fitch calculates the rate at 51% as it uses a 6% discount rate for all of the credits it rates, Gibson said. Total OPEB liability is $10.7 billion and net OPEB liability is $9.1 billion.

In addition, to committing to paying down pension and OPEB liabilities, the state also mandated that it undertake an annual stress test on its pension assumptions, which Fitch views favorably, Gibson said.

The state also benefits from increasing economic diversity shifting away from its historic dependence on tourism. In addition, to growth of R&D at its universities, the state has experienced growth in construction with a boom in private and public building, he said.

Fitch's upgrade brings it to parity with Moody's Investors Service, which rates Hawaii Aa1, and S&P Global Ratings, which rates the state AA-plus.