



Harbors Division
Department of Transportation
State of Hawaii
(An Enterprise Fund of the State of Hawaii)

Financial Statements and Supplementary Information
(With Independent Auditors' Report Thereon)

June 30, 2020 and 2019

Submitted by
THE AUDITOR
STATE OF HAWAII

**Harbors Division
Department of Transportation
State of Hawaii
(An Enterprise Fund of the State of Hawaii)**

Financial Statements and Supplementary Information

June 30, 2020 and 2019

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PART I

INTRODUCTION SECTION

November 30, 2020

The Auditor
State of Hawaii:

We have completed our audits of the financial statements of the Harbors Division, Department of Transportation, State of Hawaii (the Harbors Division), an enterprise fund of the State of Hawaii, as of and for the years ended June 30, 2020 and 2019. We transmit herewith our independent auditors' report containing our opinion on those financial statements and our independent auditors' report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with *Government Auditing Standards*.

Audit Objectives

The objectives of the audits were as follows:

1. To provide an opinion on the fair presentation of the Harbors Division's financial statements in accordance with accounting principles generally accepted in the United States of America.
2. To consider the Harbors Division's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements.
3. To perform tests of the Harbors Division's compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts.

Scope of Audit

We performed our audits of the Harbors Division's financial statements as of and for the years ended June 30, 2020 and 2019, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

As part of the audits of the Harbors Division's financial statements, we considered the Harbors Division's internal control over financial reporting to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We also performed tests of the Harbors Division's compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts.

Organization of Report

This report has been organized into three parts as follows:

1. The Introduction Section describes briefly the objectives and scope of our audits and the organization and contents of this report.
2. The Financial Section includes management's discussion and analysis, the Harbors Division's financial statements and the related notes, and other supplementary information as of and for the years ended June 30, 2020 and 2019, and our independent auditors' report thereon.
3. The Internal Control and Compliance Section contains our independent auditors' report on the Harbors Division's internal control over financial reporting and on compliance and other matters based on an audit of the financial statements performed in accordance with *Government Auditing Standards*.

* * * * *

We would like to take this opportunity to express our appreciation for the courtesy and assistance extended to us by the personnel of the Harbors Division during the course of our engagement. Should you wish to discuss any of the matters contained herein, we will be pleased to meet with you at your convenience.

Very truly yours,

KKDLY LLC

PART II

FINANCIAL SECTION

Independent Auditors' Report

The Auditor
State of Hawaii:

Report on the Financial Statements

We have audited the accompanying financial statements of the Harbors Division, Department of Transportation, State of Hawaii (the Harbors Division), an enterprise fund of the State of Hawaii, which comprise the statements of net position as of June 30, 2020 and 2019, and the related statements of revenues, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Harbors Division as of June 30, 2020 and 2019, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

Relationship to the State of Hawaii

As discussed in Note 1, the financial statements of the Harbors Division are intended to present the financial position, the changes in financial position and, where applicable, cash flows of only that portion of the business-type activities and proprietary fund type of the State of Hawaii that is attributable to the transactions of the Harbors Division. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2020 and 2019, and the changes in its financial position, or, where applicable, its cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Harbors Division's basic financial statements. The supplementary information included in Schedules 1 through 4 is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated November 30, 2020, on our consideration of the Harbors Division's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Harbors Division's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Harbors Division's internal control over financial reporting and compliance.

KKDL Y LLC

Honolulu, Hawaii
November 30, 2020

Harbors Division
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Management's Discussion and Analysis

June 30, 2020 and 2019

The following Management's Discussion and Analysis of the Harbors Division, Department of Transportation, State of Hawaii (the Harbors Division), an enterprise fund of the State of Hawaii, presents the reader with an introduction and overview of the Harbors Division's financial performance for the fiscal years ended June 30, 2020 and 2019. This discussion has been prepared by management and should be read in conjunction with the financial statements, and the notes thereto, which follow this section.

The commercial harbors are owned by the State of Hawaii (the State) and are operated as a single statewide system for management and financial purposes on behalf of the State by the Department of Transportation (the Department) through the Harbors Division.

The statewide system of commercial harbors consists of 10 harbors on six islands. The harbors system includes the harbors, harbor and waterfront improvements, ports, docks, wharves, quays, bulkheads, landings, and other related facilities and properties belonging to or controlled by the State and under the administration, jurisdiction, control, and management of the Harbors Division. The system plays a vital role in Hawaii's economy as the ports serve as the primary means for goods to enter and exit the State. A 1994 Department of Business and Economic Development and Tourism (DBED&T) study revealed that about 80% of all goods used in Hawaii are imported (Size and Growth Potential of Hawaii's Maritime Industry, Lee & Olive, 1994). Of this amount, 98.6% of the goods are brought in through the State's commercial harbors system.

The Harbors Division is self-sustaining. The Department is obligated by the Hawaii Revised Statutes to impose and collect rates and charges for the use of the harbors system and its properties to generate revenues to pay the costs of operations, maintenance, and repair of the commercial harbors, and to pay debt service on the harbors system revenue bonds and certain other outstanding obligations of the Harbors Division. The Capital Improvements Program (CIP) is also funded by the Harbors Division's revenues and proceeds from the issuance of harbors system revenue bonds.

Using the Financial Statements

The Harbors Division is accounted for as a proprietary fund and utilizes the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. The proprietary fund includes the enterprise fund type, which is used to account for the acquisition, operation, and maintenance of government facilities and services that are entirely or predominantly supported by user charges.

The Harbors Division's financial report includes three financial statements; the statements of net position, the statements of revenues, expenses, and changes in net position, and the statements of cash flows. The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) as promulgated by the Governmental Accounting Standards Board (the GASB).

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Management's Discussion and Analysis

June 30, 2020 and 2019

Financial Highlights

- The Harbors Division's net position at June 30, 2020 and 2019 amounted to \$1,073.1 million and \$995.8 million, respectively. Net position increased by \$77.3 million in fiscal year 2020, an increase of 7.8%. Net position increased by \$105.7 million or 11.9% in fiscal year 2019.
- Operating income of \$87.6 million in fiscal year 2020 decreased by \$19.5 million as compared to 2019 as a result of Governor David Y. Ige's (the Governor) March 4, 2020 emergency declaration to contain the spread of the SARS-CoV-2 novel coronavirus disease, commonly referred to as COVID-19, as named by the World Health Organization. The Governor issued stay-at-home orders to residents, closed non-essential businesses, and asked visitors to postpone their trips to Hawaii. Additional supplemental proclamations were issued mandating self-quarantine for a fourteen (14) day period for all persons entering the State. Operating income amounted to \$107.1 million in fiscal year 2019, an increase of \$28.6 million or 36.4% as compared to 2018.

A summary of operations and changes in net position for the fiscal years ended June 30, 2020, 2019, and 2018 follows:

Table 1
Condensed Statements of Revenues,
Expenses, and Changes in Net Position
(In Thousands)

	Year Ended June 30			2020-2019		2019-2018	
	2020	2019	2018	Increase (decrease)	% Change	Increase (decrease)	% Change
Operating revenues	\$ 176,132	\$ 190,717	\$ 165,111	\$ (14,585)	(7.6%)	\$ 25,606	15.5%
Nonoperating revenues	7,490	7,888	5,488	(398)	(5.0)	2,400	43.7
Total revenues	183,622	198,605	170,599	(14,983)	(7.5)	28,006	16.4
Depreciation expense	32,453	28,994	27,019	3,459	11.9	1,975	7.3
Other operating expenses	56,061	54,661	59,601	1,400	2.6	(4,940)	(8.3)
Nonoperating expenses	17,975	9,239	11,845	8,736	94.6	(2,606)	(22.0)
Total expenses	106,489	92,894	98,465	13,595	14.6	(5,571)	(5.7)
Income before capital contributions	77,133	105,711	72,134	(28,578)	(27.0)	33,577	46.5
Capital contributions	163	-	153	163	100.0	(153)	(100.0)
Change in net position	77,296	105,711	72,287	(28,415)	(26.9)	33,424	46.2
Net position, beginning of year	995,845	890,134	817,847	105,711	11.9	72,287	8.8
Net position, end of year	\$ 1,073,141	\$ 995,845	\$ 890,134	\$ 77,296	7.8	\$ 105,711	11.9

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Management's Discussion and Analysis

June 30, 2020 and 2019

Operating Revenues

Total operating revenues for fiscal year 2020 were \$176.1 million compared to \$190.7 million for fiscal year 2019. In fiscal year 2020, operating revenues consist primarily of service revenues and rental revenues, which accounted for 84.0% and 15.4%, respectively, of the Harbors Division's total operating revenues.

The Governor's March 4, 2020 emergency declaration in response to contain the COVID-19 disease and supplemental proclamations mandated a fourteen (14) day self-quarantine for all persons entering the State resulting in a sudden stoppage in tourism. The emergency and supplemental proclamations also affected primary, secondary, and higher education schools, which required social distancing through the implementation of various learning methods, hybrid schedules, or remote learning. Cargo demand declined due to the reduced demand for food and other goods by schools, restaurants, retail businesses, and the hospitality industry.

The U.S. Centers for Disease Control and Prevention (CDC) issued a No Sail Order and Suspension of Further Embarkation on March 14, 2020 for all cruise ships that did not voluntarily suspend operations. On June 19, 2020, the Cruise Lines International Association (CLIA) announced that the association's ocean-going cruise line members would voluntarily extend the suspension of cruise operations from U.S. ports until September 15, 2020. The CLIA extended the voluntary suspension on August 5, 2020 to at least October 31, 2020, and again on November 3, 2020 to maintain the ongoing voluntary suspension of cruise operations in the U.S. through December 31, 2020. The CLIA stated that its members would use the remainder of the year to prepare for the implementation of extensive measures to address COVID-19 safety with the guidance of the CDC.

Cargo continued to flow through the harbor system to support essential needs of the State's population. The construction industry, an essential business, was not affected by emergency proclamations. DBED&T forecasts the construction industry to remain strong with ongoing large public and private sector capital projects.

Total operating revenues for fiscal year 2019 were \$190.7 million compared to \$165.1 million for fiscal year 2018. In fiscal year 2019, operating revenues consisted primarily of service revenues and rental revenues, which accounted for 83.5% and 15.7%, respectively, of the Harbors Division's total operating revenues.

Service Revenues

Service revenues are directly related to cargo and ship operations. Service revenues include wharfage, passenger fees, and other ship related fees. Service revenues in fiscal years 2020 and 2019 were \$147.9 million and \$159.2 million, respectively. Although tourism slowed significantly during March 2020 to June 2020, essential cargo, as stated in the above section, continued to flow through the harbor system with the construction industry, an essential business, continuing to operate.

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June 30, 2020 and 2019

Service revenues for fiscal year 2020 decreased \$11.3 million or 7.1% as compared to fiscal year 2019. Wharfage revenues from cargo movements decreased by \$9.8 million from \$140.9 million in fiscal year 2019 to \$131.1 million in fiscal year 2020 due primarily to the effects of the emergency proclamations to contain the spread of the COVID-19 pandemic.

Service revenues for fiscal year 2019 increased \$23.2 million or 17.0% as compared to fiscal year 2018. Increase in service revenues were bolstered with a 15% cargo and pipeline tariff increase. Wharfage revenues from cargo movements increased by \$22.7 million from \$118.2 million in fiscal year 2018 to \$140.9 million in fiscal year 2019 due primarily to the tariff increase that took effect on July 1, 2018. This increase was applied to the rates that were increased by 15% effective July 1, 2017.

Passenger fee revenue decreased by \$2.7 million or 30.4% from \$9.0 million in fiscal year 2019 to \$6.3 million in fiscal year 2020, as cruise ship travel was suspended by the CDC and voluntarily by the CLIA and its member cruise lines from March 2020 due to the COVID-19 pandemic. The fiscal year 2020 passenger count represents eight months of passenger revenue. Passenger fee revenue increased by \$0.8 million or 10.8% from \$8.2 million in fiscal year 2018 to \$9.0 million in fiscal year 2019. The suspension of cruise ship travel caused passenger volumes (inbound and outbound) for fiscal year 2020 to drop to approximately 813,000 passengers, a decrease of approximately 387,000 passengers from the 1.2 million passengers in fiscal year 2019. During fiscal years ended June 30, 2020 and 2019, a flat fee for embark and debark fee was at \$15.00 per passenger for Honolulu Harbor, Oahu; and \$8.00 per passenger at Hilo and Kawaihae Harbors, Hawaii; Kahului Harbor, Maui; Kaunakakai Harbor, Molokai; Kaunapali Harbor, Lanai; and Nawiliwili and Port Allen Harbors, Kauai.

Rental Revenues

Rental revenues for fiscal year 2020 were \$27.1 million, a decrease from fiscal year 2019 of approximately \$2.8 million, due primarily to an administrative change in storage fee charges. Revenues from revocable permit were re-assigned to charges pursuant to the Hawaii Administrative Rules for storage charges at 50% of the stated rates for the use of land to store stevedoring equipment, mobile equipment, and shipping devices. Wharf space and land rental income decreased by approximately \$815,000 due to revocable permit cancellations, and storage fee revenues decreased by approximately \$996,000 due to reduced cargo storage. On July 2, 2019, tariff rates for pipeline fees were increased by 3%, however, revenues from pipeline fees decreased by approximately \$635,000 due to reduced volumes of imported jet fuel attributed to reduced airline and passenger arrivals, and diesel and gasoline volume because of the 14-day stay-at-home order and the closure of non-essential businesses.

Rental revenues for fiscal year 2019 were \$29.9 million, an increase from fiscal year 2018 of approximately \$2.2 million, due primarily to a 15% pipeline tariff rate increase, effective July 1, 2018.

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Operating Expenses

The increase in operating expenses for fiscal year 2020 as compared to fiscal year 2019 of \$1.4 million is primarily due to the increase in personnel services costs of \$1.4 million, attributed to the success in staffing key positions and the increase in other postemployment benefit (OPEB) and pension expense plus the increase in harbors operations expense of \$1.8 million, offset by decreases in general administration expenses of \$1.1 million and Department of Transportation general administration expenses of \$0.6 million.

Operating expenses, excluding depreciation expense, for fiscal years 2019 and 2018 amounted to \$54.7 million and \$59.6, respectively. The decrease in operating expenses for fiscal year 2019 in comparison to fiscal year 2018 of \$4.9 million or 8.3% was due primarily to decreases in harbor operations costs of \$6.4 million and maintenance costs of \$2.2 million, offset by increases in State of Hawaii surcharge for central service expenses of \$1.4 million and general administration expenses of \$1.1 million.

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Management's Discussion and Analysis

June 30, 2020 and 2019

A summary of the Harbors Division's net position at June 30, 2020, 2019, and 2018 are shown below:

Table 2
Condensed Statements of Net Position
(In Thousands)

	As of June 30			2020-2019		2019-2018	
	2020	2019	2018	Increase (decrease)	% Change	Increase (decrease)	% Change
Assets:							
Current and other assets	\$ 440,265	\$ 446,902	\$ 427,433	\$ (6,637)	(1.5%)	\$ 19,469	4.6%
Capital assets, net	1,037,834	987,702	921,367	50,132	5.1	66,335	7.2
Total assets	1,478,099	1,434,604	1,348,800	43,495	3.0	85,804	6.4
Deferred outflows of resources	10,994	12,574	13,381	(1,580)	(12.6)	(807)	(6.0)
Liabilities:							
Current liabilities	54,268	71,036	72,976	(16,768)	(23.6)	(1,940)	(2.7)
Long-term liabilities	360,783	378,922	398,460	(18,139)	(4.8)	(19,538)	(4.9)
Total liabilities	415,051	449,958	471,436	(34,907)	(7.8)	(21,478)	(4.6)
Deferred inflows of resources	901	1,375	611	(474)	(34.5)	764	125.0
Net position:							
Net investment in capital assets	736,647	666,526	580,855	70,121	10.5	85,671	14.7
Restricted	209,525	177,801	204,790	31,724	17.8	(26,989)	(13.2)
Unrestricted	126,969	151,518	104,489	(24,549)	(16.2)	47,029	45.0
Total net position	\$ 1,073,141	\$ 995,845	\$ 890,134	\$ 77,296	7.8	\$ 105,711	11.9

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June 30, 2020 and 2019

Net Position

The largest portion of the Harbors Division's net position (68.7% and 66.9% at June 30, 2020 and 2019, respectively), net investment in capital assets, represents its investment in capital assets (e.g., land, wharves, buildings, improvements, and equipment), less related indebtedness outstanding to acquire those capital assets. The Harbors Division uses these capital assets to provide services to its users of the harbors system; consequently, these assets are not available for future spending. Although the Harbors Division's net investment in its capital assets is reported net of related debt, the resources required to repay this debt must be provided annually from operations, since it is unlikely the capital assets will be liquidated to pay for such liabilities.

The restricted portion of the Harbors Division's net position (19.5% and 17.9% at June 30, 2020 and 2019, respectively) represents bond revenue reserve and other funds that are subject to external restrictions on how funds may be used.

The unrestricted portion of the Harbors Division's net position (11.8% and 15.2% at June 30, 2020 and 2019, respectively) may be used to meet any of the Harbors Division's ongoing operations or to fund capital improvement projects.

The change in net position is an indicator of whether the overall fiscal condition of the Harbors Division improved or worsened during the fiscal year. The change in net position may serve over time as a useful indicator of the Harbors Division's financial position. Net position or the amount of total assets and deferred outflows of resources that exceed liabilities and deferred inflows of resources amounted to \$1,073.1 million at June 30, 2020, an increase in net position of \$77.3 million or 7.8% from 2019. Net position or the amount of total assets and deferred outflows of resources that exceed liabilities and deferred inflows of resources amounted to \$995.8 million at June 30, 2019, an increase in net position of \$105.7 million or 11.9% from 2018.

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Capital Assets and Debt Administration

Capital Assets

As of June 30, 2020 and 2019, the Harbors Division had \$1,037.8 million and \$987.7 million, respectively invested in capital assets as shown in Table 3. There was a net increase (additions, deductions, and depreciation) of \$50.1 million in 2020 from the prior year, and a net increase in 2019 of \$66.3 million from 2018.

Table 3
Capital Assets
(In Thousands)

	As of June 30			2020-2019		2019-2018	
	2020	2019	2018	Increase (decrease)	% Change	Increase (decrease)	% Change
Land and land improvements	\$ 630,572	\$ 626,053	\$ 600,035	\$ 4,519	0.7%	\$ 26,018	4.3%
Wharves	345,034	338,807	328,693	6,227	1.8	10,114	3.1
Other improvements	146,404	115,773	116,094	30,631	26.5	(321)	(0.3)
Buildings	125,754	125,782	116,912	(28)	0.0	8,870	7.6
Equipment	28,156	28,686	26,526	(530)	(1.8)	2,160	8.1
Total at cost	1,275,920	1,235,101	1,188,260	40,819	3.3	46,841	3.9
Less accumulated depreciation	(472,448)	(440,439)	(412,532)	(32,009)	7.3	(27,907)	6.8
	803,472	794,662	775,728	8,810	1.1	18,934	2.4
Construction in progress	234,362	193,040	145,639	41,322	21.4	47,401	32.5
Total capital assets, net	\$ 1,037,834	\$ 987,702	\$ 921,367	\$ 50,132	5.1	\$ 66,335	7.2

Depreciation expense amounted to \$32.5 million and \$29.0 million for the fiscal years 2020 and 2019, respectively, an increase of \$3.5 million.

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Major capital asset additions to the statewide harbors system for the fiscal year ended June 30, 2020, included the following:

- \$29.0 million Energy Savings Performance Contract, Statewide
- \$233,400 Install Air Curtains at Pier 2 Terminal, Honolulu Harbor, Oahu Island
- \$340,000 Repair Light Poles at Pier 1, Kahului Harbor, Maui Island
- \$377,800 Repair Roll-Up Doors at Pier 2 Shed Nawiliwili Harbor, Kauai Island
- \$411,400 Repair Concrete Pavement at Pier 39 Honolulu Harbor, Oahu Island
- \$429,900 Repair Fender Systems at Piers 1 & 3 Nawiliwili Harbor, Kauai Island
- \$374,200 Substructure Repairs at Piers 24-26 Honolulu Harbor, Oahu Island
- \$619,600 Substructure Repairs at Piers 8-10 Honolulu Harbor, Oahu Island
- \$498,500 Repair Concrete Bridge at Kawaihae Harbor, Hawaii Island
- \$1,697,600 Substructure and Waterline Repairs at Piers 33-34 Honolulu Harbor, Oahu Island
- \$742,500 Repair Tile Roof at Pier 11 Honolulu Harbor, Oahu Island
- \$301,000 Substructure Repair at Kaunakakai Harbor, Molokai Island
- \$484,200 Repair Fenders at Pier 2 Hilo Harbor, Hawaii Island
- \$224,800 Repair Fence, Kalaeloa Barbers Point Harbor, Oahu Island
- \$871,400 Substructure and Fender Repairs at Piers 9-10, Honolulu Harbor, Oahu Island
- \$275,300 Repair Pavement at Kaumalapau Harbor, Lanai Island
- \$283,600 Substructure Repairs at Kaunakakai Harbor, Molokai Island
- \$242,800 Repair Siding at Pier 2 Shed, Nawiliwili Harbor, Kauai Island
- \$311,700 Replace Roll-Up Doors at Pier 2 Shed, Nawiliwili Harbor, Kauai Island

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Management's Discussion and Analysis

June 30, 2020 and 2019

In addition to those capital asset additions, the Harbors Division is currently in the process of constructing the following projects statewide:

- \$164.0 million Construction of Kapalama Container Terminal Yard, Honolulu, Harbor, Oahu Island
- \$4.0 million Tower Demolition and Water System Improvements, Hilo Harbor, Hawaii Island
- \$3.5 million New DOT Harbor Personnel Office, Kaunakakai Harbor, Molokai Island
- \$2.0 million Drain, Roadway and Pedestrian Walkway Improvements at Piers 2 & 3, Nawiliwili Harbor, Kauai Island

Major capital asset additions to the statewide harbors system for the fiscal year ended June 30, 2019, included the following:

- \$334,500 Pavement Repairs at Horizon Lines Container Yard, Honolulu Harbor, Oahu Island
- \$497,700 Concrete Pavement & Waterline Repairs at Piers 5-6, Kalaeloa Barbers Pt, Oahu Island
- \$540,000 Pavement Repairs at Piers 51C, 52 & 53 Container Yard, Honolulu Harbor, Oahu Island
- \$276,600 Dredging at Pier 20, Honolulu Harbor, Oahu Island
- \$283,900 Substructure and Bulkhead Repairs at Pier 33, Honolulu Harbor, Oahu Island
- \$563,400 Repair Air Conditioning System Administration Building, Honolulu Harbor, Oahu Island
- \$536,900 Renovate Pier 2 Passenger Terminal, Oahu Island
- \$397,700 Repair Pier 11 Rooftop Air Conditioning, Honolulu Harbor, Oahu Island
- \$883,000 Substructure Repairs at Pier 19-20, Honolulu Harbor, Oahu Island
- \$1,021,900 Substructure Repairs to Pier 1, Hilo Harbor, Hawaii Island
- \$3,784,200 Substructure Repairs at Pier 52-53, Honolulu Harbor, Oahu Island
- \$3,777,300 Pier 19 Ferry Terminal Building, Honolulu Harbor, Oahu Island

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- \$25,460,800 Inter-Island Cargo Terminal Facility, Hilo Harbor, Hawaii Island
- \$443,000 Repair Waterline at Pier 2, Kawaihae Harbor, Hawaii Island
- \$312,800 Repairs at Pier 1 Shed, Kahului Harbor, Maui Island
- \$267,000 Repair Maintenance Shop, Hilo Harbor, Hawaii Island
- \$474,600 Installation of Lift Station and Force Main, Port Allen Harbor, Kauai Island

The Harbors Division is committed under contracts awarded for capital improvement projects totaling \$118.3 million as of June 30, 2020.

Additional information regarding the Harbors Division's capital assets can be found in Note 4 to the financial statements.

Indebtedness

Harbors System Revenue Bonds and Reimbursable General Obligation Bonds

Harbor system revenue bonds have been issued pursuant to the *Certificate of the Director of Transportation Providing for the Issuance of 1997 State of Hawaii Harbor Revenue Bonds* (the 1997 Certificate) and are collateralized by a charge and lien on the Harbors Division's revenues. The proceeds from these bonds are used for harbor and waterfront improvements. As of June 30, 2020 and 2019, outstanding harbor system revenue bonds amounted to \$259.5 million and \$276.9 million, respectively.

The Harbors Division executed a contract with BofA Securities, Inc. on November 19, 2020 to underwrite a total of \$266,550,000 of Hawaii Harbors System Revenue Bonds (Revenue Bonds). This transaction allows for a public sale of \$147,520,000 Series A of 2020 Revenue Bonds (AMT), \$15,685,000 Series B of 2020 Revenue Bonds (Taxable), and \$103,345,000 Series C of 2020 Revenue Bonds (Non-AMT), all these Series are the 2020 Revenue Bonds. On December 2, 2020, the closing date for this public sale of the 2020 Revenue Bonds, proceeds in the amount of \$145,090,000 from the Series A of 2020 Revenue Bonds (AMT) and proceeds of \$9,770,000 from the Series B of 2020 Revenue Bonds (Taxable) will be used to provide funding for the Harbors Division Capital Improvement Program, primarily for the Kapalama Container Terminal Phase I and Phase II projects.

The remaining proceeds obtained from the Series A of 2020 and the Series B of 2020 Revenue Bonds will be used to partially refund existing Series A of 2010 and Series B of 2010 Revenue Bonds balances outstanding as of June 30, 2020. The Series C of 2020 Revenue Bonds (Non-AMT) will refund the remaining portion of the existing Series A of 2010 Revenue Bonds (Non-AMT) balances outstanding as of June 30, 2020.

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Reimbursable general obligation bonds are general obligations of the State, but since the proceeds were used to finance the harbor and waterfront improvements, the Harbors Division is required to reimburse the State's general fund for the payment of principal and interest on such bonds. As of June 30, 2020 and 2019, outstanding reimbursable general obligation bonds amounted to \$18.7 million and \$21.0 million, respectively. There have been no issuances of reimbursable general obligation bonds to finance the harbor and waterfront improvements during fiscal years 2020 and 2019.

Additional information regarding the Harbors Division's indebtedness can be found in Notes 5, 6, 7, 8, and 20 to the financial statements.

Credit Rating and Bond Insurance

All harbor system revenue bonds issued since 1997 through June 30, 2010 have been issued with bond insurance. A new reserve policy replaced all previously issued surety bonds and the portion of the reserve requirement allocable to the Series B of 2010 Revenue Bonds. The surety policy was amended effective August 2, 2013 to include the reserve requirement allocable to the Series A of 2013 Revenue Refunding Bonds. The Series A of 2010 Revenue Bonds are secured by a cash deposit of \$11.5 million.

As of June 30, 2020, the underlying ratings for harbor system revenue bonds were as follows:

- Standard and Poor's AA-
- Moody's Investors Service Aa3
- Fitch IBCA, Inc. AA-

Ratings made by Standard and Poor's, Moody's Investors Service, and Fitch IBCA, Inc. may be changed, suspended, or withdrawn as a result of changes in, or unavailability of, information. Ratings provided by these rating companies are not "market ratings," as the ratings are not a recommendation to buy, hold, or sell any security.

Bond Covenants

Bond covenants allow the issuance of additional debt, on parity, as to a lien on the net revenues of the Harbors Division provided certain net revenue ratios are met. Net revenues of the Harbors Division must be at least 1.25 times the debt service requirements under the 1997 Certificate.

The Harbors Division coverage ratio as of June 30, 2020 was 5.06 under the 1997 Certificate as compared to the ratio of 5.61 as of June 30, 2019.

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Request for Information

The financial report is designed to provide a general overview of the Harbors Division's finances for all interested parties. Questions concerning any of the information provided in this report or requests for additional information should be addressed in writing to the Harbors Administrator, State of Hawaii, Department of Transportation, Harbors Division, 79 S. Nimitz Highway, Honolulu, Hawaii, 96813, or by e-mail to *davis.k.yogi@hawaii.gov*.

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Statements of Net Position
June 30, 2020 and 2019

Assets:	2020	2019	Liabilities:	2020	2019
Current assets:			Current liabilities (payable from current assets):		
Cash and cash equivalents	\$ 199,315,946	\$ 226,978,777	Accounts payable	\$ 6,924,874	\$ 8,720,912
Receivables, less allowance for doubtful accounts of \$10,602,702 in 2020 and \$4,631,849 in 2019	15,922,147	16,926,233	Contracts payable, including retainages	680,526	786,120
Notes receivable, less allowance for doubtful accounts of \$2,179,610 in 2020 and \$2,589,088 in 2019	409,478	387,500	Capital lease obligation	1,023,605	914,562
Interest receivable	772,351	8,027,586	Accrued interest payable - capital lease obligation	506,711	525,505
Due from other State agencies	800,618	711,913	Accrued workers' compensation	276,241	184,398
Other current assets	7,049	1,287,535	Accrued vacation	626,993	773,986
	<u>217,227,589</u>	<u>254,319,544</u>	Due to other State agencies	7,080,644	4,634,989
				<u>17,119,594</u>	<u>16,540,472</u>
Restricted assets:			Current liabilities (payable from restricted assets):		
Cash and cash equivalents-restricted for debt service payments and reserve requirements	34,357,460	34,727,745	Contracts payable, including retainages	8,964,065	26,368,076
Total current assets	<u>251,585,049</u>	<u>289,047,289</u>	Revenue bonds payable, current maturities	17,298,935	17,380,263
			General obligation bonds payable, current maturities	2,450,903	2,336,771
Noncurrent assets:			Accrued interest payable - revenue bonds	5,612,427	5,907,710
Cash and cash equivalents-restricted for:			Security deposits	2,821,646	2,503,127
Capital improvement projects	175,167,453	143,073,277		<u>37,147,976</u>	<u>54,495,947</u>
Other	13,512,317	14,781,842	Total current liabilities	<u>54,267,570</u>	<u>71,036,419</u>
	<u>188,679,770</u>	<u>157,855,119</u>			
Capital assets:			Long-term liabilities:		
Nondepreciable assets	311,862,647	311,813,847	Accrued workers' compensation	1,103,460	890,668
Depreciable assets, net	491,608,949	482,847,571	Net pension liability	37,288,062	35,113,859
Construction in progress	234,362,174	193,040,322	Net other postretirement benefits liability	38,397,222	38,353,266
Total capital assets, net	<u>1,037,833,770</u>	<u>987,701,740</u>	Long-term debt, less current maturities:		
			Revenue bonds payable, net	242,138,216	259,437,151
Total noncurrent assets	<u>1,226,513,540</u>	<u>1,145,556,859</u>	General obligation bonds payable	16,239,042	18,689,945
Total assets	<u>1,478,098,589</u>	<u>1,434,604,148</u>	Capital lease obligation	23,525,362	24,548,967
			Accrued vacation	2,091,972	1,888,223
			Total long-term liabilities	<u>360,783,336</u>	<u>378,922,079</u>
			Total liabilities	<u>415,050,906</u>	<u>449,958,498</u>
Deferred Outflows of Resources:			Deferred Inflows of Resources:		
Related to pension	5,930,636	6,968,844	Related to pension	373,327	682,350
Related to other postemployment benefits	3,574,238	3,473,181	Related to other postemployment benefits	527,199	692,238
Deferred charge on refunding, net	1,488,720	2,131,466	Total deferred inflows of resources	<u>900,526</u>	<u>1,374,588</u>
Total deferred outflows of resources	<u>10,993,594</u>	<u>12,573,491</u>			
			Net Position:		
			Net investment in capital assets	736,646,427	666,525,546
			Restricted - revenue bond requirements	34,357,460	34,727,745
			Restricted - for capital improvement projects	175,167,453	143,073,277
			Unrestricted	126,969,411	151,517,985
			Total net position	<u>\$ 1,073,140,751</u>	<u>\$ 995,844,553</u>

See accompanying notes to financial statements.

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Statements of Revenues, Expenses, and Changes in Net Position

Years Ended June 30, 2020 and 2019

	<u>2020</u>	<u>2019</u>
Operating revenues, net:		
Services	\$ 147,896,202	\$ 159,189,339
Rentals	27,120,024	29,865,857
Others	1,116,059	1,661,974
	<u>176,132,285</u>	<u>190,717,170</u>
Operating expenses:		
Depreciation	32,453,079	28,993,799
Personnel services	23,692,386	22,302,235
Harbor operations	18,848,548	17,097,769
State of Hawaii surcharge for central service expenses	7,851,763	7,475,000
General administration	2,674,851	3,815,054
Maintenance	1,550,229	1,924,959
Department of Transportation general administration expenses	1,443,588	2,046,113
	<u>88,514,444</u>	<u>83,654,929</u>
Operating income	<u>87,617,841</u>	<u>107,062,241</u>
Nonoperating revenues (expenses):		
Interest expense	(12,970,269)	(8,505,943)
Interest income	7,490,378	7,887,537
Loss on disposal of capital assets	(4,377,494)	(275,032)
Amortization of bond premium, discount, and deferred charge on refunding	(627,483)	(458,688)
	<u>(10,484,868)</u>	<u>(1,352,126)</u>
Income before capital contributions	77,132,973	105,710,115
Capital contributions	163,225	-
Change in net position	<u>77,296,198</u>	<u>105,710,115</u>
Net position, beginning of year	<u>995,844,553</u>	<u>890,134,438</u>
Net position, end of year	<u><u>\$ 1,073,140,751</u></u>	<u><u>\$ 995,844,553</u></u>

See accompanying notes to financial statements.

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Statements of Cash Flows

Years Ended June 30, 2020 and 2019

	2020	2019
Cash flows from operating activities:		
Cash received from customers	\$ 179,789,862	\$ 164,650,455
Cash paid to suppliers	(34,004,534)	(31,861,665)
Cash paid to employees	(20,922,873)	(19,913,885)
Net cash provided by operating activities	124,862,455	112,874,905
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(102,915,854)	(69,337,253)
Principal paid on bonds	(19,701,771)	(18,982,919)
Interest paid on bonds and capital lease obligation	(13,284,346)	(14,023,445)
Principal paid on capital lease obligation	(914,562)	(812,396)
Net cash used in capital and related financing activities	(136,816,533)	(103,156,013)
Cash flows provided by investing activities:		
Interest received	14,745,613	3,256,587
Net increase in cash and cash equivalents	2,791,535	12,975,479
Cash and cash equivalents at beginning of year	419,561,641	406,586,162
Cash and cash equivalents at end of year	\$ 422,353,176	\$ 419,561,641

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Statements of Cash Flows (Continued)

Years Ended June 30, 2020 and 2019

	2020	2019
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 87,617,841	\$ 107,062,241
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	32,453,079	28,993,799
Provision for doubtful accounts	5,970,853	997,887
Changes in assets, deferred outflows, liabilities, and deferred inflows:		
Receivables	(5,077,450)	(2,891,068)
Other current assets	(7,049)	-
Deferred outflows of resources	937,151	324,431
Payables	(1,901,632)	590,667
Accrued workers' compensation	304,635	157,276
Accrued vacation	56,756	557
Due to other State agencies	2,445,655	(24,197,209)
Security deposits	318,519	23,675
Net pension liability	2,174,203	700,901
Net other postretirement benefits liability	43,956	348,457
Deferred inflows of resources	(474,062)	763,291
Net cash provided by operating activities	\$ 124,862,455	\$ 112,874,905

Supplemental disclosure of noncash capital and related financing activities:

Amounts included in contracts payable for the acquisition of capital assets	\$ 8,964,065	\$ 26,368,076
Interest capitalized in capital assets	\$ -	\$ 5,217,909
Other assets utilized for the acquisition of capital assets	\$ 1,287,535	\$ 30,000
Amortization of bond premium, discount, and deferred charge on refunding	\$ (627,483)	\$ (458,688)
Capital contributions	\$ 163,225	\$ -

See accompanying notes to financial statements.

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1. Financial Reporting Entity

In 1959, the Harbors Division was established within the Department of Transportation of the State of Hawaii (the DOT) effective July 1, 1961. All functions and powers to administer, control, and supervise all State of Hawaii (the State) harbors and water navigational facilities were assigned to the Director of the DOT on that date.

The Harbors Division is part of the DOT, which is part of the executive branch of the State. The State Comptroller maintains the central accounts for all State funds and publishes financial statements for the State annually, which include the Harbors Division's financial activities. The accompanying financial statements present only the activities of the Harbors Division and are not intended to present fairly the financial position of the State and the changes in its financial position and cash flows of its business-type activities.

The "Certificate of the Director of Transportation Providing for the Issuance of 1997 State of Hawaii Harbor Revenue Bonds," dated March 1, 1997 (1997 Certificate), defines the "Undertaking" as all of the harbor and waterfront improvements and other properties under the jurisdiction, control, and management of the Harbors Division, except those principally used for recreation and the landing of fish.

2. Summary of Significant Accounting Policies

The financial statements of the Harbors Division have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). The Governmental Accounting Standards Board (the GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The Harbors Division's significant accounting policies are described below.

Measurement Focus and Basis of Accounting

An enterprise fund is used to account for the acquisition, operation, and maintenance of government facilities and services that are entirely or predominantly supported by user charges. The Harbors Division's operations are accounted for using the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Cash and Cash Equivalents

Cash and cash equivalents include all cash and investments with original maturities of three months or less and amounts held in State Treasury.

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Amounts Held in State Treasury

The State's investments held in the State Treasury are reported at fair value within the fair value hierarchy established by GAAP. Investment earnings are allocated to the pool participants, including the Harbors Division, based upon their equity interest in the pooled monies.

Fair Value Measurements

The Harbors Division measures the fair value of assets and liabilities as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants at the measurement date. The fair value hierarchy distinguishes between independent observable inputs and unobservable inputs used to measure fair value, as follows:

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - Inputs other than quoted market prices included in Level 1 that are observable for an asset or liability, either directly or indirectly.

Level 3 - Unobservable inputs for an asset or liability reflecting the reporting entity's own assumptions. Level 3 inputs are used to measure fair value to the extent that observable Level 1 or 2 inputs are not available.

Restricted Assets

Restricted assets consist primarily of amounts for the principal and interest accumulated to make debt service payments, amounts restricted for capital improvement projects including unspent bond proceeds, amounts restricted for bond reserve requirements, security deposits, and customer advances.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are reported at their gross value when earned, reduced by an allowance for doubtful accounts.

Accounts are written-off upon the approval of the State Department of the Attorney General, when it believes, after considering economic conditions, business conditions, and collection efforts, that the accounts are uncollectible.

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The allowance for doubtful accounts is increased by charges to operating income and decreased by charge-offs (net of recoveries). Management’s periodic evaluation of the adequacy of the allowance is based on the adverse situations that may affect the customer’s ability to repay, historical experience, and current economic conditions. Past due status is determined based on contractual terms.

Risk Management

The Harbors Division is exposed to various risks for loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and workers’ compensation. A liability for a claim for a risk of loss is established if information indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. The estimated reserve for losses and loss adjustment costs includes the accumulation of estimates for losses and claims reported prior to fiscal year-end, nonincremental estimates (based on projections of historical developments) of claims incurred but not reported, and nonincremental estimates of costs for investigating and adjusting all incurred and unadjusted claims. Amounts reported are subject to the impact of future changes in economic and social conditions. The Harbors Division believes that, given the inherent variability in any such estimates, the reserves are within a reasonable and acceptable range of adequacy. Reserves are continually monitored and reviewed and, as settlements are made and reserves adjusted, the differences are reported in current operations.

Capital Assets and Depreciation

Capital assets are stated at cost. Depreciation of capital assets is computed using the straight-line method over the estimated useful lives of the assets. Disposals of assets are recorded by removing the cost and related accumulated depreciation from the accounts with the resulting gain or loss reflected in nonoperating revenues (expenses).

Capital assets and their related estimated useful lives used to compute depreciation are as follows:

	<u>Useful Lives</u>	<u>Capitalization Threshold</u>
Land improvements	10 – 100 years	\$ 100,000
Wharves	10 – 100 years	100,000
Buildings	5 – 50 years	100,000
Other improvements	5 – 50 years	100,000
Equipment	5 – 20 years	5,000

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Maintenance and repairs, as well as minor replacements, renewals, and betterments, are charged to operations. Major renewals, replacements, and betterments which extend the service lives of the related assets are capitalized in the year incurred. Interest cost is capitalized during the period of construction for capital improvement projects, except those projects funded by grants from the State or the Federal government.

Unamortized Debt Premium (Discount)

Debt premium (discount) is amortized using the effective interest rate method over the term of the related debt, and the unamortized balance is reflected as an addition or deduction to the related liabilities in the statements of net position.

Refunding of Debt

The difference between the reacquisition price and the net carrying amount of the old debt is deferred and amortized as a component of interest expense in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter. The deferred charge on refunding amounted to \$1,488,720 and \$2,131,466 at June 30, 2020 and 2019, respectively, and are reported as deferred outflows of resources in the statements of net position.

Deferred Outflows of Resources and Deferred Inflows of Resources

Deferred outflows (inflows) of resources represent a consumption of (benefit to) net position that applies to a future period. The Harbors Division defers recognition of the charge on refunding related to issuance of its revenue bonds and amortizes these costs over the life of the bonds using the effective interest rate method. The deferred outflow of resources related to pensions and other postemployment benefits (OPEB) resulted from changes in assumptions, differences between expected and actual experience, changes in proportion and differences between contributions and proportionate share of contributions, and the net difference between projected and actual earnings on OPEB plan investments, which will be amortized over five years, and the Harbors Division's contributions to the pension and OPEB plans subsequent to the measurement date of the actuarial valuations for the pension and OPEB plans, which will be recognized as a reduction of the net pension liability and net OPEB liability in the subsequent fiscal year.

The deferred inflows of resources related to pension and OPEB resulted from differences between expected and actual experience, changes in assumptions, changes in proportion and differences between contributions and proportionate share of contributions, and the net difference between projected and actual earnings on pension and OPEB plan investments, which will be amortized over five years.

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Accrued Vacation

The Harbors Division accrues all vacation and compensatory pay at current salary rates, including additional amounts for certain salary-related expenses associated with the payment of compensated absences. Vacation is earned at the rate of 168 hours per calendar year, depending on an employee's date of hire. Accumulation of such vacation credits is limited to 720 hours at calendar year-end and is convertible to pay upon termination of employment.

Net Position

Net position is reported in three categories as follows:

Net investment in capital assets - represents the Harbors Division's investment in capital assets, less related indebtedness outstanding to acquire those capital assets.

Restricted - represents revenue bond reserves and capital improvement funds that are subject to external restrictions on how they may be used.

Unrestricted - may be used to meet any of the Harbors Division's ongoing operations or fund capital improvement projects.

Operating Revenues

Operating revenues are those that result from providing goods and services and are reported net of bad debt. The provision for bad debts for the years ended June 30, 2020 and 2019 was approximately \$5,971,000 and \$998,000, respectively. Operating revenues also exclude revenues related to capital and related financing activities, noncapital financing activities, and investing activities.

As of June 30, 2020, the Harbors Division has pledged its future operating revenues, net of certain operating expenses, to repay \$259,490,000 in Harbor Revenue Bonds. Proceeds from the bonds provided financing for the construction of new facilities and the improvement of existing facilities related to the State's commercial harbors. The bonds are payable solely from the Harbors Division's operating revenues and are payable through July 2040.

The total principal and interest remaining to be paid on the bonds is approximately \$375,001,000 as of June 30, 2020. Principal and interest paid (as defined by the Harbor revenue bond debt service requirements under the 1997 certificate) and total operating revenues, net of certain operating expenses, were approximately \$23,940,000 and \$132,041,000 respectively, for the year ended June 30, 2020, and approximately \$28,936,000 and \$149,392,000 respectively, for the year ended June 30, 2019.

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Operating Expenses

All expenses related to operating the Harbors Division are reported as operating expenses. Interest income, interest expense, loss on disposal of capital assets, and the amortization of bond premium, discount, and deferred charge on refunding are reported as nonoperating revenues (expenses).

When an expense is incurred for which unrestricted and restricted resources are available to pay the expense, it is the Harbors Division's policy to apply the expense to unrestricted resources first, then to restricted resources.

Capital Contributions

The Harbors Division receives federal grants restricted for capital asset acquisition and facility development. Grants are considered earned as the related allowable expenditures are incurred, and are reported in the statements of revenues, expenses, and changes in net position, after nonoperating revenues (expenses) as capital contributions.

Pension

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pension, and pension expense, information about the fiduciary net position of the Harbors Division's participation in the Employees' Retirement System of the State of Hawaii (the ERS) and additions to/deductions from the ERS's fiduciary net position have been determined on the same basis as they are reported by the ERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with benefit terms. The ERS's investments are reported at fair value.

Other Postemployment Benefits

For purposes of measuring the net OPEB liability, deferred outflows of resources and deferred inflows of resources related to OPEB, and OPEB expense, information about the fiduciary net position of the Harbors Division's participation in the Hawaii Employer-Union Health Benefits Trust Fund (the EUTF), and additions to/deductions from the EUTF's fiduciary net position have been determined on the same basis as they are reported by the EUTF. For this purpose, benefit payments are recognized when due and payable in accordance with the benefit terms. The EUTF's investments are reported at fair value.

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Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Change in Accounting Principle

GASB Statement No. 89

Effective July 1, 2019, the Harbors Division adopted the provisions of GASB Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*. This statement replaces Paragraph 5-22 of GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. This statement requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus.

Recently Issued Accounting Pronouncements

GASB Statement No. 95

The Harbors Division adopted GASB Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance* in the current year. The objective of this statement is to provide temporary relief to governments and other stakeholders in light of the SARS-CoV-2 novel coronavirus disease (COVID-19) pandemic. That objective is accomplished by postponing the effective dates of certain provisions in statements and implementation guides that first became effective or are scheduled to become effective for periods beginning after June 15, 2018, and later.

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GASB Statement No. 87

The GASB issued Statement No. 87, *Leases*. The objective of this statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This statement requires recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the provisions of the contract. The requirements of this statement are effective for reporting periods beginning after June 15, 2021. The Harbors Division is currently evaluating the impact that this statement will have on its financial statements.

GASB Statement No.92

The GASB issued Statement No. 92, *Omnibus 2020*. The objectives of this statement are to enhance comparability in accounting and financial reporting and to improve the consistency of authoritative literature by addressing practice issues that have been identified during implementation and application of certain GASB statements. The requirements of this statement are effective at multiple periods depending on when certain statements are implemented. The Harbors Division is currently evaluating the impact that this statement will have on its financial statements.

GASB Statement No. 96

The GASB issued Statement No. 96, *Subscription-Based Information Technology Arrangements*. This statement provides guidance on the accounting and financial reporting for subscription-based information technology arrangements for government end users. The requirements of this statement are effective for reporting periods beginning after June 15, 2022. The Harbors Division is currently evaluating the impact that this statement will have on its financial statements.

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3. Cash and Cash Equivalents

Cash and cash equivalents at June 30, 2020 and 2019 consisted of the following:

	<u>2020</u>	<u>2019</u>
Amounts held in State Treasury	\$ 422,254,862	\$ 415,996,872
Petty cash and other	98,314	3,564,769
	<u>\$ 422,353,176</u>	<u>\$ 419,561,641</u>

Such amounts are reflected in the statements of net position at June 30, 2020 and 2019 as follows:

	<u>2020</u>	<u>2019</u>
Current assets:		
Unrestricted	\$ 199,315,946	\$ 226,978,777
Restricted:		
Revenue bond debt service payments	22,902,427	23,272,712
Revenue bond cash reserve requirements	11,455,033	11,455,033
Noncurrent assets:		
Restricted:		
Capital improvement projects -		
Construction - special purpose funds	175,167,453	143,073,277
Other-bond reserve requirements		
and security deposits	13,512,317	14,781,842
	<u>\$ 422,353,176</u>	<u>\$ 419,561,641</u>

Amounts Held in State Treasury

The Director of Finance of the Department of Budget and Finance, State of Hawaii (B&F), is responsible for the safekeeping of all monies paid into the State Treasury. The Director of Finance pools and invests any monies of the State, which in the Director of Finance's judgment, are in excess of the amounts necessary for meeting the specific requirements of the State. Investment earnings are allocated to the pool participants based upon their equity interest in the pooled monies.

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Legally authorized investments include obligations of or guaranteed by the U.S. government, obligations of the State, federally-insured savings and checking accounts, time certificates of deposit, and repurchase agreements with federally-insured financial institutions.

At June 30, 2020 and 2019, amounts held in State Treasury by the Harbors Division totaled \$422,254,862 and \$415,996,872, respectively. The amounts held in State Treasury reported in the accompanying statements of net position reflects the Harbors Division's relative position in the State's investment pool based upon the average monthly investment balance of each participant in the investment pool.

Information relating to the cash and investments in State Treasury is determined on a statewide basis and not for individual departments or agencies. Information regarding the carrying amount and corresponding bank balances of the investment pool and collateralization of the investment pool balances is included in the comprehensive annual financial report (CAFR) of the State.

Cash and Cash Equivalents

The State maintains bank accounts for various purposes at locations throughout the State and the nation. Bank deposits for the State Treasury are under the custody of the Director of Finance. Cash and cash equivalents consist of cash, time certificates of deposit, and money market accounts. Cash and cash equivalents also include repurchase agreements and U.S. government securities with original maturities of three months or less.

Investments

The State holds investments both for its own benefit and as an agent for other parties. Further, the State pools all excess funds into an investment pool that is administered by B&F. The pool's investment options are limited to investments listed in the Hawaii Revised Statutes (HRS).

At the end of each year, B&F allocates the investment pool amount to each of the participants. The allocation is based on the average monthly investment balance of each participant in the investment pool.

The EUTF maintains a separate investment pool. The EUTF board is responsible for safekeeping these monies and has appointed an investment committee responsible for investing EUTF assets in compliance with HRS Sections 87A-24(2) and 88-119. Money is invested in accordance with the EUTF's investment policy.

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The following table presents the fair value of the State's investments by level of input at June 30, 2019 (amounts expressed in thousands):

	<u>Reported Value</u>	<u>Fair Value Measurements Using</u>		
		<u>Quoted Prices in Active Markets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Primary government:				
Investments measured by fair value level:				
U.S. government securities	\$ 2,749,621	\$ 1,112,238	\$ 1,637,383	\$ -
Mutual funds	33,472	33,472	-	-
Commingled funds				
Domestic equity	8,845	8,845	-	-
International equity	7,102	7,102	-	-
Total investments by fair value level	2,799,040	<u>\$ 1,161,657</u>	<u>\$ 1,637,383</u>	<u>\$ -</u>
Investments measured at amortized cost:				
Certificates of deposit	964,234			
Investments at net asset value (NAV)				
Alternative investments	6,598			
Total investments	<u>\$ 3,769,872</u>			
Fiduciary funds:				
Investments measured by fair value level:				
Equity securities	\$ 458,650	\$ 458,650	\$ -	\$ -
U.S. government securities	502,119	105,896	396,223	-
Mutual funds	96,493	96,493	-	-
Derivatives	(298)	-	(298)	-
Total investments	1,056,964	<u>\$ 661,039</u>	<u>\$ 395,925</u>	<u>\$ -</u>
Investments measured by NAV:				
Commingled funds:				
Domestic equity	688,146			
International equity	606,617			
Domestic core fixed income	90,368			
Domestic inflation-linked fixed income	240,801			
Real estate	313,905			
Alternative investments	297,517			
Total investments	3,294,318			
Investments measured at amortized cost:				
Certificates of deposit	91,806			
Total investments	<u>\$ 3,386,124</u>			
Invested securities lending collateral at NAV:				
Money market fund	<u>\$ 25,872</u>			

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Information relating to the fair value of investments in the State's investment pool at June 30, 2020 will be included in the State's CAFR when issued.

Cash and Cash Equivalents, Certificates of Deposit, and Repurchase Agreements

The State considers all cash and investments with original maturities of three months or less to be cash equivalents. The carrying amounts for cash equivalents, certificates of deposit, and repurchase agreements are measured at amortized cost.

Debt Securities, Mutual Funds, Equity Securities, Commingled Funds, Real Estate, and Alternative Investments, and Money Market Fund

The following methods and assumptions were used by the State in estimating the fair value of its financial instruments:

Debt securities – Debt securities held by the State consist of U.S. government obligations including U.S. Treasury bills and U.S. Treasury notes and bonds. The fair value of these investments are based on quoted prices in active markets or other observable inputs, including pricing matrices. These investments are categorized in either Level 1 or 2 of the fair value hierarchy.

Mutual funds and equity securities – The mutual funds held by the State are open-ended mutual funds that are registered with the Securities Exchange Commission (SEC). These funds are required to publish their daily NAV and to transact at that price. The fair value of mutual funds and equity securities are valued at the daily closing price as reported by the fund. These investments are categorized in Level 1 of the fair value hierarchy.

Commingled funds, real estate, and alternative investments – Investments in commingled funds are valued at the NAV. In addition, real estate and alternative investments held in limited partnerships and limited liability companies are measured at their respected NAV. The NAV is based on the fair value of the underlying assets held by the fund less its liabilities.

Money market fund – Investment in a money market fund is valued at the NAV of the custodian bank liquid asset portfolio. NAV is based on the fair value of the underlying assets held by the fund less its liabilities.

The preceding measurements described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. The market volatility of equity-based investments is expected to substantially impact the value of such investments at any given time. It is likely that the State's investments have fluctuated since June 30, 2019.

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The following table presents the investments by maturity period at June 30, 2019 (amounts expressed in thousands):

	Reported Value	Maturity (in years)		
		Less than 1	1-5	>5
Primary government:				
Certificates of deposit	\$ 964,234	\$ 926,936	\$ 37,298	\$ -
U.S. government securities	2,749,621	1,494,928	1,254,693	-
	<u>3,713,855</u>	<u>\$ 2,421,864</u>	<u>\$ 1,291,991</u>	<u>\$ -</u>
Mutual funds	33,472			
Commingled funds	15,947			
Alternative investments	<u>6,598</u>			
Total investments	<u>\$ 3,769,872</u>			
Fiduciary funds:				
Certificates of deposit	\$ 91,806	\$ 88,255	\$ 3,551	\$ -
U.S. government securities	502,119	142,332	359,787	-
Derivatives	<u>(298)</u>	<u>-</u>	<u>(298)</u>	<u>-</u>
	<u>593,627</u>	<u>\$ 230,587</u>	<u>\$ 363,040</u>	<u>\$ -</u>
Equity securities	458,650			
Mutual funds	96,493			
Commingled funds	1,625,932			
Real estate	313,905			
Alternative investments	<u>297,517</u>			
Total investments	<u>\$ 3,386,124</u>			

Information relating to the State's investments by maturity period at June 30, 2020 will be included in the State's CAFR when issued.

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Interest Rate Risk

As a means of limiting its exposure to fair value losses arising from rising interest rates, the State's investment policy generally limits maturities on investments to not more than five years from the date of investment.

Credit Risk

The State's investment policy limits its investments in state and U.S. treasury securities, time certificates of deposit, U.S. government or agency obligations, repurchase agreements, commercial paper, banker's acceptances, and money market funds maintaining a Triple-A rating.

Custodial Risk

For an investment, custodial risk is the risk that, in the event of the failure of the counterparty, the State will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The State's investments are held at broker/dealer firms, which are protected by the Securities Investor Protection Corporation (SIPC) up to a maximum amount. Excess-SIPC coverage is provided by the firms' insurance policies. In addition, the State requires the institutions to set aside in safekeeping certain types of securities to collateralize repurchase agreements. The State monitors the market value of these securities and obtains additional collateral when appropriate.

Concentration of Credit Risk

The State's policy provides guidelines for portfolio diversification by placing limits on the amount the State may invest in any one issuer, types of investment instruments, and position limits per issue of an investment instrument.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. The EUTF's asset allocation and investment policy allows for active and passive investments in international securities. The foreign currency risk exposure to the State arises from the international equity investment holdings, including commingled funds, common stocks, and exchange traded funds.

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4. Capital Assets

Capital asset activity for the years ended June 30, 2020 and 2019 were as follows:

	Balance July 1, 2019	Additions	Deductions	Balance June 30, 2020
Nondepreciable assets:				
Land and land improvements	\$ 311,813,847	\$ 48,800	\$ -	\$ 311,862,647
Depreciable assets:				
Land improvements	314,239,355	4,469,028	-	318,708,383
Wharves	338,806,639	6,346,712	(118,942)	345,034,409
Other improvements	115,772,962	30,630,502	-	146,403,464
Buildings	125,782,124	3,869,233	(3,897,237)	125,754,120
Equipment	28,686,030	458,154	(987,918)	28,156,266
Total at cost	<u>1,235,100,957</u>	<u>45,822,429</u>	<u>(5,004,097)</u>	<u>1,275,919,289</u>
Less accumulated depreciation for:				
Land improvements	127,534,670	11,041,281	-	138,575,951
Wharves	175,282,479	8,899,890	-	184,182,369
Other improvements	64,542,278	9,693,226	-	74,235,504
Buildings	54,764,750	976,302	(119,957)	55,621,095
Equipment	18,315,362	1,842,380	(324,968)	19,832,774
Total accumulated depreciation	<u>440,439,539</u>	<u>32,453,079</u>	<u>(444,925)</u>	<u>472,447,693</u>
Construction in progress	<u>193,040,322</u>	<u>86,668,927</u>	<u>(45,347,075)</u>	<u>234,362,174</u>
Total capital assets, net	<u>\$ 987,701,740</u>	<u>\$ 100,038,277</u>	<u>\$ (49,906,247)</u>	<u>\$ 1,037,833,770</u>

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	Balance July 1, 2018	Additions	Deductions	Balance June 30, 2019
Nondepreciable assets:				
Land and land improvements	\$ 311,813,847	\$ -	\$ -	\$ 311,813,847
Depreciable assets:				
Land improvements	288,221,236	26,018,119	-	314,239,355
Wharves	328,693,350	10,113,289	-	338,806,639
Other improvements	116,093,936	1,707,685	(2,028,659)	115,772,962
Buildings	116,912,184	8,869,940	-	125,782,124
Equipment	26,526,470	3,310,458	(1,150,898)	28,686,030
Total at cost	<u>1,188,261,023</u>	<u>50,019,491</u>	<u>(3,179,557)</u>	<u>1,235,100,957</u>
Less accumulated depreciation for:				
Land improvements	118,121,100	9,413,570	-	127,534,670
Wharves	166,358,693	8,923,786	-	175,282,479
Other improvements	61,396,002	3,146,276	-	64,542,278
Buildings	49,082,707	5,682,043	-	54,764,750
Equipment	17,573,985	1,828,124	(1,086,747)	18,315,362
Total accumulated depreciation	<u>412,532,487</u>	<u>28,993,799</u>	<u>(1,086,747)</u>	<u>440,439,539</u>
Construction in progress	<u>145,638,900</u>	<u>88,579,204</u>	<u>(41,177,782)</u>	<u>193,040,322</u>
Total capital assets, net	<u>\$ 921,367,436</u>	<u>\$ 109,604,896</u>	<u>\$ (43,270,592)</u>	<u>\$ 987,701,740</u>

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5. Long-Term Liabilities

The changes in long-term liabilities were as follows:

	Balance July 1, 2019	Additions	Deductions	Balance June 30, 2020	Current	Noncurrent
Accrued workers' compensation (Note 13)	\$ 1,075,066	\$ 580,876	\$ 276,241	\$ 1,379,701	\$ 276,241	\$ 1,103,460
Accrued vacation	2,662,209	1,028,881	972,125	2,718,965	626,993	2,091,972
Capital lease obligation (Note 9)	25,463,529	-	914,562	24,548,967	1,023,605	23,525,362
Net pension liability (Note 12)	35,113,859	4,588,435	2,414,232	37,288,062	-	37,288,062
Net other postretirement benefits liability (Note 12)	38,353,266	3,127,945	3,083,989	38,397,222	-	38,397,222
General obligation bonds (Note 8)	21,026,716	-	2,336,771	18,689,945	2,450,903	16,239,042
Revenue bonds (Note 6)	276,855,000	-	17,365,000	259,490,000	17,290,000	242,200,000
Unamortized premium (discount), net	(37,586)	-	15,263	(52,849)	8,935	(61,784)
Revenue bonds, net	276,817,414	-	17,380,263	259,437,151	17,298,935	242,138,216
	<u>\$ 400,512,059</u>	<u>\$ 9,326,137</u>	<u>\$ 27,378,183</u>	<u>\$ 382,460,013</u>	<u>\$ 21,676,677</u>	<u>\$ 360,783,336</u>

	Balance July 1, 2018	Additions	Deductions	Balance June 30, 2019	Current	Noncurrent
Accrued workers' compensation (Note 13)	\$ 917,790	\$ 341,674	\$ 184,398	\$ 1,075,066	\$ 184,398	\$ 890,668
Accrued vacation	2,661,652	1,139,011	1,138,454	2,662,209	773,986	1,888,223
Capital lease obligation (Note 9)	26,275,925	-	812,396	25,463,529	914,562	24,548,967
Net pension liability (Note 12)	34,412,958	2,927,918	2,227,017	35,113,859	-	35,113,859
Other postretirement benefits payable (Note 12)	38,004,809	2,855,938	2,507,481	38,353,266	-	38,353,266
General obligation bonds (Note 8)	23,254,635	-	2,227,919	21,026,716	2,336,771	18,689,945
Revenue bonds (Note 6)	293,610,000	-	16,755,000	276,855,000	17,365,000	259,490,000
Unamortized premium, net	(13,162)	-	24,424	(37,586)	15,263	(52,849)
Revenue bonds, net	293,596,838	-	16,779,424	276,817,414	17,380,263	259,437,151
	<u>\$ 419,124,607</u>	<u>\$ 7,264,541</u>	<u>\$ 25,877,089</u>	<u>\$ 400,512,059</u>	<u>\$ 21,589,980</u>	<u>\$ 378,922,079</u>

6. Revenue Bonds Payable

Pursuant to authorization from the State Legislature, the Director of DOT issued the 1997 Certificate, which provides for the issuance of bonds at any time and from time-to-time upon compliance with certain conditions of the 1997 Certificate.

The Harbor Revenue Bonds (Revenue Bonds) are collateralized by a charge and lien on the revenues of the Public Undertaking as defined in the 1997 Certificate.

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The Revenue Bonds are subject to redemption at the option of the Director of DOT and the State during specific years at prices ranging from 102% to 100% of face value.

The following is a summary of the Revenue Bonds issued and outstanding at June 30, 2020:

Year of Issue	Final Redemption Date	Interest Rate	Original Amount of Issue	Current		Total Current	Noncurrent
				Principal Due July 1, 2020	Principal Due January 1, 2021		
2010	July 1, 2040	3.00 - 5.75%	\$ 201,390,000	\$ 9,340,000	\$ -	\$ 9,340,000	\$ 145,180,000
2013	July 1, 2029	3.25%	23,615,000	60,000	-	60,000	13,345,000
2016	January 1, 2031	1.99 - 3.09%	113,660,000	3,625,000	4,265,000	7,890,000	83,675,000
			<u>\$ 338,665,000</u>	<u>\$ 13,025,000</u>	<u>\$ 4,265,000</u>	17,290,000	242,200,000
						Unamortized premium (discount), net	
						8,935	(61,784)
						<u>\$ 17,298,935</u>	<u>\$ 242,138,216</u>

The following is a summary of the Revenue Bonds issued and outstanding at June 30, 2019:

Year of Issue	Final Redemption Date	Interest Rate	Original Amount of Issue	Current		Total Current	Noncurrent
				Principal Due July 1, 2019	Principal Due January 1, 2020		
2010	July 1, 2040	3.00 - 5.75%	\$ 201,390,000	\$ 5,755,000	\$ -	\$ 5,755,000	\$ 154,520,000
2013	July 1, 2029	3.25%	23,615,000	3,210,000	-	3,210,000	13,405,000
2016	January 1, 2031	1.99 - 3.09%	113,660,000	3,550,000	4,850,000	8,400,000	91,565,000
			<u>\$ 338,665,000</u>	<u>\$ 12,515,000</u>	<u>\$ 4,850,000</u>	17,365,000	259,490,000
						Unamortized premium (discount), net	
						15,263	(52,849)
						<u>\$ 17,380,263</u>	<u>\$ 259,437,151</u>

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Debt service requirements to maturity for the Revenue Bonds are as follows:

<u>Fiscal Year Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2021	\$ 17,290,000	\$ 10,956,248	\$ 28,246,248
2022	17,950,000	10,305,832	28,255,832
2023	18,595,000	9,648,188	28,243,188
2024	15,025,000	9,103,587	24,128,587
2025	14,855,000	8,594,221	23,449,221
2026-2030	74,990,000	34,709,073	109,699,073
2031-2035	42,440,000	21,811,529	64,251,529
2036-2040	47,205,000	10,069,366	57,274,366
2041	11,140,000	313,313	11,453,313
	<u>\$ 259,490,000</u>	<u>\$ 115,511,357</u>	<u>\$ 375,001,357</u>

The debt service requirements reflect the sum of the amounts to be paid in accordance with the repayment schedules of the bonds issued. Principal and interest payments are required to be funded in the 12-month and 6-month periods, respectively, preceding the date on which the payments are due. Accordingly, the debt service requirements include reserves of \$22,902,427 as of June 30, 2020, for principal payments of \$13,025,000 and \$4,265,000 due on July 1, 2020 and January 1, 2021, respectively, and for interest payments of \$5,612,427 due on July 1, 2020.

7. Harbor Revenue Bond Requirements

1997 Certificate – Minimum Net Revenue Requirement

Pursuant to Section 6.03 of the 1997 Certificate, the Harbors Division covenants and agrees that so long as any of the Revenue Bonds remain outstanding, it will enforce and collect fees, rates, rents, and charges for the Public Undertaking that will yield net revenue, as defined by the 1997 Certificate, for the immediately ensuing 12 months, in an amount at least sufficient to:

- (1) Together with funds legally available, therefore including any amounts on deposit in the harbor reserve and contingency account; an aggregate sum equal to at least 1.25 times the total amount of: (i) the interest payments for such 12 months on all the Revenue Bonds outstanding under the 1997 Certificate, (ii) the principal amount of the Revenue Bonds maturing by their terms during such 12 months, and (iii) the minimum sinking fund payments for all Revenue Bonds required to be made during such 12 months; and

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- (2) Without consideration of other funds, shall be at least equal to 1.00 times the bond service for such 12 months.

The Harbor Revenue Bond debt service requirements, including minimum sinking fund payments during the current fiscal year, computed in accordance with Section 6.03 of the 1997 Certificate totaled \$28,939,998. Net revenues of the Public Undertaking, as defined by the 1997 Certificate amounted to \$146,310,719 or 5.06 times the minimum net revenue requirement for the fiscal year ended June 30, 2020, and \$162,316,235 or 5.61 times the minimum net revenue requirement for the fiscal year ended June 30, 2019.

Harbor Special Fund

All revenues are deposited into this fund and applied in the order of priority set forth under the 1997 Certificate. Section 5.01 of the 1997 Certificate requires that the following accounts be established:

- (1) *Harbor Interest Account*

Equal monthly installments sufficient to pay for the interest next becoming due on the Revenue Bonds are required to be paid into this account. This requirement was met as of June 30, 2020 and 2019.

- (2) *Harbor Principal Account*

Commencing with the first business day of each fiscal year, equal monthly payments are required to be made to this account sufficient to redeem the Revenue Bonds scheduled for redemption on the following July 1 and January 1. This requirement was met as of June 30, 2020 and 2019.

- (3) *Harbor Debt Service Reserve Account*

In order to provide a reserve for the payment of the principal and interest on the Revenue Bonds, the Harbors Division is required to deposit in the harbor revenue special fund an amount equal to the lesser of: (a) the average annual bond service on such series and (b) the amount permitted by the Internal Revenue Code of 1986 in order that the interest on such series is excluded from gross income for federal income tax purposes.

Furthermore, the Harbors Division is required to satisfy the reserve requirement of maximum aggregate bond service by no later than the first date on which a principal installment is payable on July 1 or January 1 of each fiscal year.

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In lieu of the credit of monies to the harbor debt service reserve account, the Harbors Division may cause to be so credited a surety bond or an insurance policy payable to the Harbors Division for the benefit of the holders of the Revenue Bonds of a series or a letter of credit in an amount equal to the difference between the reserve requirement and the amounts then on credit to the harbor debt service reserve account. In the event a surety bond, insurance policy, or letter of credit is secured to satisfy that portion of the reserve requirement allocable to a series of Revenue Bonds, so long as such surety bond, insurance policy, or letter of credit is in effect, the owners of such series of Revenue Bonds shall not be entitled to payment from or a lien on the funds on deposit in the harbor revenue special fund credited to the harbor debt service reserve account to satisfy that portion of the reserve requirement allocable to other series of Revenue Bonds, nor shall the owners of Revenue Bonds of such other series be entitled to any payment from such surety bond, insurance policy, or letter of credit. The surety bond, insurance policy, or letter of credit shall be payable (upon the giving of notice as required thereunder) on any date on which monies will be required to be applied from the harbor debt service reserve account to the payment of the principal or interest on any Revenue Bonds of such series and such withdrawals may not be made from amounts credited to the harbor debt service reserve account for such series of Revenue Bonds.

Prior to the use of a surety bond, insurance policy, or letter of credit pursuant to the provisions of this paragraph (other than any such use at the time of issuance of the 1997 Series Revenue Bonds), DOT shall receive written confirmation from the rating agency that the rating on the Revenue Bonds outstanding as then in effect shall not be reduced as a result of such use. If a disbursement is made pursuant to a surety bond, an insurance policy, or a letter of credit provided pursuant to this paragraph, the Harbors Division shall be obligated either: (a) to reinstate the maximum limits of such surety bond, insurance policy, or letter of credit or (b) to credit the harbor debt service reserve account, funds in the amount of the disbursement made under such surety bond, insurance policy, or letter of credit, or a combination of such alternatives, as shall provide that the amount credited to the harbor debt service reserve account allocable to a series of Revenue Bonds equals that portion of the reserve requirement allocable to such series; provided, however, a failure to immediately restore such reserve requirement shall not constitute an event of default if the reserve requirement is restored within the time period permitted by Section 11.01(c) (90 days following the required notice). Notwithstanding the provisions of Section 11.01(c), the Harbors Division shall not permit any surety bond, insurance policy, or letter of credit which has been established in lieu of a deposit into the harbor revenue special fund for credit to the harbor debt service reserve account to terminate or expire prior to depositing to such fund for credit to such account the amount satisfied previously by the surety bond, insurance policy, or letter of credit.

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(4) *Harbor Reserve and Contingency Account*

Monies on credit to the harbor reserve and contingency account may be used to make up any deficiency with respect to any series of Revenue Bonds in the harbor interest account, the harbor principal account and the harbor debt service reserve account. To the extent not used to make up any such deficiencies, monies on credit to the harbor reserve and contingency account may be used for any other purpose within the jurisdiction, powers, duties, and functions of the Harbors Division.

8. General Obligation Bonds

In fiscal 2006, the State issued \$350,000,000 of General Obligation bonds, Series DI, dated March 23, 2006; in fiscal 2007, the State issued \$350,000,000 of General Obligation bonds, Series DJ, dated March 28, 2007; and in fiscal 2008, the State issued \$375,000,000 of General Obligation bonds, Series DK, dated May 1, 2008. Interest rates on outstanding Series DI, Series DJ, and Series DK General Obligation bonds range from 4.00% to 5.00%.

Reimbursable general obligation bonds are general obligations of the State, but since the proceeds were used to finance the harbor and waterfront improvements, the Harbors Division is required to reimburse the State's general fund for the payment of principal and interest on such bonds. As of June 30, 2020 and 2019, outstanding reimbursable general obligation bonds amounted to approximately \$18,690,000 and \$21,027,000, respectively.

Debt service requirements to maturity for the reimbursable general obligation bonds are as follows:

Fiscal Year Ending June 30	Principal	Interest	Total
2021	\$ 2,450,903	\$ 929,861	\$ 3,380,764
2022	2,572,554	808,084	3,380,638
2023	2,700,654	680,024	3,380,678
2024	2,835,218	545,735	3,380,953
2025	2,976,657	404,299	3,380,956
2026-2028	5,153,959	399,935	5,553,894
	<u>\$ 18,689,945</u>	<u>\$ 3,767,938</u>	<u>\$ 22,457,883</u>

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9. Capital Lease Obligation

The Harbors Division entered into an equipment lease purchase agreement to fund the installation and acquisition of energy conservation measures at selected Harbors Division locations. Proceeds of \$26,245,564 were deposited into an acquisition fund held in trust by an acquisition fund custodian to provide for future payments as requested by the Harbors Division. The agreement also provided for the financing of interest expense through October 1, 2016 amounting to \$747,095, which was applied toward the principal of the capital lease obligation. The capital lease obligation amounted to \$24,548,967 and \$25,463,529 at June 30, 2020 and 2019, respectively. Annual lease payments commenced on October 1, 2017 and will continue through October 1, 2032 at an interest rate of 2.74%. Costs incurred for the installation and acquisition of energy conservation measures through June 30, 2020 are included in capital assets as other improvements and amounted to \$28,952,281, net of related expense of \$23,213, which includes additional capitalized interest of \$1,982,835 for the period October 2, 2016 through June 30, 2019. Unused proceeds in the acquisition fund at June 30, 2020 and 2019, amounted to nil and \$1,287,535, respectively, and are reported as other current assets in the accompanying statements of financial position.

Future minimum lease commitments are as follows:

<u>Fiscal Year Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2021	\$ 1,023,606	\$ 672,642	\$ 1,696,248
2022	1,139,923	644,595	1,784,518
2023	1,263,929	613,361	1,877,290
2024	1,396,064	578,729	1,974,793
2025	1,536,788	540,477	2,077,265
2026-2030	10,131,002	1,984,645	12,115,647
2031-2033	8,057,655	443,467	8,501,122
	<u>\$ 24,548,967</u>	<u>\$ 5,477,916</u>	<u>\$ 30,026,883</u>

10. Interest Cost

Total combined interest cost incurred related to Revenue Bonds and reimbursable general obligation bonds for the fiscal years ended June 30, 2020 and 2019 amounted to approximately \$12,291,000 and \$13,021,000, respectively. As a result of the adoption of Statement No. 89 effective July 1, 2019, none of the interest costs were capitalized during the fiscal year ended June 30, 2020 as part of the construction cost of harbor facilities. During the fiscal year ended June 30, 2019, approximately \$4,515,000 was capitalized as part of the construction cost of harbor facilities.

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Approximately \$679,000 and \$703,000 of additional interest costs were incurred related to the capital lease obligation (see Note 9), of which, nil and approximately \$703,000 were capitalized during the fiscal years ended June 30, 2020 and 2019, respectively.

11. Leasing Operations

The Harbors Division's leasing operations consist principally of the leasing of land, wharf, and building space under revocable permits and long-term leases. The revocable permits provide for tenancy on a month-to-month basis and are renewable annually at the option of the State. The long-term leases, which are classified as operating leases, expire in various years through August 2087. These leases generally call for rental increases every five to 10 years based on a step-up or independent appraisals of the fair rental value of the leased property.

The following is a schedule of approximate future minimum lease rentals on noncancelable operating leases as of June 30, 2020:

<u>Fiscal Year Ending June 30</u>	<u>Amount</u>
2021	\$ 7,677,000
2022	8,005,000
2023	8,024,000
2024	7,880,000
2025	7,752,000
2026-2030	38,692,000
2031-2035	34,288,000
2036-2040	27,483,000
2041-2045	20,722,000
2046-2050	8,727,000
2051-2055	7,737,000
2056-2060	6,583,000
2061-2065	5,137,000
2066-2070	5,137,000
2071-2075	5,137,000
2076-2080	5,137,000
2081-2085	5,137,000
2086-2088	2,187,000
	<u>\$ 211,442,000</u>

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The above schedule does not include estimated future rental revenue for certain leases beyond their first 15 years. An estimate could not be made due to rental reopenings after the 15th year in which rental rates will be based upon the prevailing fair value.

12. Retirement Benefits

Pension Plan

Plan Description

Generally, all full-time employees of the State and counties, which includes the Harbors Division, are required to be members of the ERS, a cost-sharing multiple-employer defined benefit pension plan that administers the State's pension benefits program. Benefits, eligibility, and contribution requirements are governed by HRS Chapter 88 and can be amended through legislation.

Benefits Provided

The ERS Pension Trust is comprised of three pension classes for membership purposes and considered to be a single plan for accounting purposes since all assets of the ERS may legally be used to pay the benefits of any of the ERS members or beneficiaries. The ERS provides retirement, disability, and death benefits with three membership classes known as the noncontributory, contributory, and hybrid retirement classes. The three classes provide a monthly retirement allowance equal to the benefit multiplier (generally 1.25% to 2.25%) multiplied by the average final compensation multiplied by years of credited service. Average final compensation for members hired prior to July 1, 2012 is an average of the highest salaries during any three years of credited service, excluding any salary paid in lieu of vacation for members hired January 1, 1971 or later and the average of the highest salaries during any five years of credited service including any salary paid in lieu of vacation for members hired prior to January 1, 1971. For members hired after June 30, 2012, average final compensation is an average of the highest salaries during any five years of credited service excluding any salary paid in lieu of vacation.

Each retiree's original retirement allowance is increased on each July 1 beginning the calendar year after retirement. Retirees first hired as members prior to July 1, 2012 receive a 2.5% increase each year of their original retirement allowance without a ceiling. Retirees first hired as members after June 30, 2012 receive a 1.5% increase each year of their original retirement allowance without a ceiling. The annual increase is not compounded.

The following summarizes the provisions relevant to the largest employee groups of the respective membership class. Retirement benefits for certain groups, such as police officers, firefighters, some investigators, sewer workers, judges, and elected officials, vary from general employees.

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Noncontributory Class

Retirement Benefits

General employees' retirement benefits are determined as 1.25% of average final compensation multiplied by the years of credited service. Employees with 10 years of credited service are eligible to retire at age 62. Employees with 30 years of credited service are eligible to retire at age 55.

Disability Benefits

Members are eligible for service-related disability benefits regardless of length of service and receive a lifetime pension of 35% of their average final compensation. Ten years of credited service is required for ordinary disability. Ordinary disability benefits are determined in the same manner as retirement benefits but are payable immediately, without an actuarial reduction, and at a minimum of 12.5% of average final compensation.

Death Benefits

For service-connected deaths, the surviving spouse/reciprocal beneficiary receives a monthly benefit of 30% of the average final compensation until remarriage or re-entry into a new reciprocal beneficiary relationship. Additional benefits are payable to surviving dependent children up to age 18. If there is no spouse/reciprocal beneficiary or surviving dependent children, no benefit is payable.

Ordinary death benefits are available to employees who were active at the time of death with at least 10 years of credited service. The surviving spouse/reciprocal beneficiary (until remarriage/re-entry into a new reciprocal beneficiary relationship) and surviving dependent children (up to age 18) receive a benefit equal to a percentage of member's accrued maximum allowance unreduced for age or, if the member was eligible for retirement at the time of death, the surviving spouse/reciprocal beneficiary receives 100% joint and survivor lifetime pension and the surviving dependent children receive a percentage of the member's accrued maximum allowance unreduced for age.

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Contributory Class for Members Hired Prior to July 1, 2012

Retirement Benefits

General employees' retirement benefits are determined as 2% of average final compensation multiplied by the years of credited service. General employees with five years of credited service are eligible to retire at age 55.

Police officers and firefighters' retirement benefits are determined using the benefit multiplier of 2.5% for qualified service, up to a maximum of 80% of average final compensation. Police officers and firefighters with five years of credited service are eligible to retire at age 55. Police officers and firefighters with 25 years of credited service are eligible to retire at any age, provided the last five years is service credited in these occupations.

Disability Benefits

Members are eligible for service-related disability benefits regardless of length of service and receive a one-time payment of the member's contributions and accrued interest plus a lifetime pension of 50% of their average final compensation. Ten years of credited service is required for ordinary disability. Ordinary disability benefits are determined as 1.75% of average final compensation multiplied by the years of credited service but are payable immediately, without an actuarial reduction, and at a minimum of 30% of average final compensation.

Death Benefits

For service-connected deaths, the surviving spouse/reciprocal beneficiary receives a lump sum payment of the member's contributions and accrued interest plus a monthly benefit of 50% of the average final compensation until remarriage or re-entry into a new reciprocal beneficiary relationship. If there is no surviving spouse/reciprocal beneficiary, surviving dependent children (up to age 18) or dependent parents are eligible for the monthly benefit. If there is no spouse/reciprocal beneficiary or surviving dependent children/parents, the ordinary death benefit is payable to the designated beneficiary.

Ordinary death benefits are available to employees who were active at time of death with at least one year of service. Ordinary death benefits consist of a lump sum payment of the member's contributions and accrued interest plus a percentage of the salary earned in the 12 months preceding death, or 50% joint and survivor lifetime pension if the member was not eligible for retirement at the time of death but was credited with at least 10 years of service and designated one beneficiary, or 100% joint and survivor lifetime pension if the member was eligible for retirement at the time of death and designated one beneficiary.

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Contributory Class for Members Hired After June 30, 2012

Retirement Benefits

General employees' retirement benefits are determined as 1.75% of average final compensation multiplied by the years of credited service. General employees with 10 years of credited service are eligible to retire at age 60.

Police officers and firefighters' retirement benefits are determined using the benefit multiplier of 2.25% for qualified service, up to a maximum of 80% of average final compensation. Police officers and firefighters with 10 years of credited service are eligible to retire at age 60. Police officers and firefighters with 25 years of credited service are eligible to retire at age 55, provided the last five years is service credited in these occupations.

Disability and Death Benefits

Members are eligible for service-related disability benefits regardless of length of service and receive a lifetime pension of 50% of their average final compensation plus refund of contributions and accrued interest. 10 years of credited service is required for ordinary disability.

For police officers and firefighters, ordinary disability benefits are 1.75% of average final compensation for each year of service and are payable immediately, without an actuarial reduction, at a minimum of 30% of average final compensation.

Death benefits for contributory members hired after June 30, 2012 are generally the same as those for contributory members hired June 30, 2012 and prior.

Hybrid Class for Members Hired Prior to July 1, 2012

Retirement Benefits

General employees' retirement benefits are determined as 2% of average final compensation multiplied by the years of credited service. General employees with five years of credited service are eligible to retire at age 62. General employees with 30 years of credited service are eligible to retire at age 55.

Disability Benefits

Members are eligible for service-related disability benefits regardless of length of service and receive a lifetime pension of 35% of their average final compensation plus refund of their contributions and accrued interest. Ten years of credited service is required for ordinary disability.

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Ordinary disability benefits are determined in the same manner as retirement benefits but are payable immediately, without an actuarial reduction, and at a minimum of 25% of average final compensation.

Death Benefits

For service-connected deaths, the designated surviving spouse/reciprocal beneficiary receives a lump sum payment of the member's contributions and accrued interest plus a monthly benefit of 50% of the average final compensation until remarriage or re-entry into a new reciprocal beneficiary relationship. If there is no surviving spouse/reciprocal beneficiary, surviving dependent children (up to age 18) or dependent parents are eligible for the monthly benefit. If there is no spouse/reciprocal beneficiary or surviving dependent children/parents, the ordinary death benefit is payable to the designated beneficiary.

Ordinary death benefits are available to employees who were active at time of death with at least five years of service. Ordinary death benefits consist of a lump sum payment of the member's contributions and accrued interest plus a percentage multiplied by 150%, or 50% joint and survivor lifetime pension if the member was not eligible for retirement at the time of death but was credited with at least 10 years of service and designated one beneficiary, or 100% joint and survivor lifetime pension if the member was eligible for retirement at the time of death and designated one beneficiary.

Hybrid Class for Members Hired After June 30, 2012

Retirement Benefits

General employees' retirement benefits are determined as 1.75% of average final compensation multiplied by the years of credited service. General employees with 10 years of credited service are eligible to retire at age 65. Employees with 30 years of credited service are eligible to retire at age 60. Sewer workers, water safety officers, and emergency medical technicians may retire with 25 years of credited service at age 55.

Disability and Death Benefits

Provisions for disability and death benefits generally remain the same except for ordinary death benefits. Ordinary death benefits are available to employees who were active at time of death with at least 10 years of service. Ordinary death benefits consist of a lump sum payment of the member's contributions and accrued interest, or 50% joint and survivor lifetime pension if the member was not eligible for retirement at the time of death but was credited with at least 10 years of service and designated one beneficiary, or 100% joint and survivor lifetime pension if the member was eligible for retirement at the time of death and designated one beneficiary.

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Contributions

Contributions are governed by HRS Chapter 88 and may be amended through legislation. The employer rate is set by statute based on the recommendations of the ERS actuary resulting from an experience study conducted every five years. Since July 1, 2005, the employer contribution rate is a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liabilities. The contribution rates for fiscal years 2020 and 2019 were 36% and 31.0%, respectively, for police officers and firefighters, and 22.0% and 19.0%, respectively, for all other employees. Contributions to the ERS from the Harbors Division were \$2,690,753 and \$2,414,232 for the fiscal years ended June 30, 2020 and 2019, respectively.

Pursuant to Act 17, SLH 2017, employer contributions from the State and counties are expected to increase over four years beginning July 1, 2017. The rate for police officers and firefighters increased to 36.0% on July 1, 2019, and increases to 41.0% on July 1, 2020. The rate for all other employees increased to 22.0% on July 1, 2019, and increases to 24.0% on July 1, 2020.

The employer is required to make all contributions for noncontributory members. Contributory members hired prior to July 1, 2012 are required to contribute 7.8% of their salary, except for police officers and firefighters who are required to contribute 12.2% of their salary. Contributory members hired after June 30, 2012, are required to contribute 9.8% of their salary, except for police officers and firefighters who are required to contribute 14.2% of their salary. Hybrid members hired prior to July 1, 2012 are required to contribute 6.0% of their salary. Hybrid members hired after June 30, 2012 are required to contribute 8.0% of their salary.

Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pension

Measurement of the actuarial valuation of the pension liability, pension expense, and deferred outflows of resources and deferred inflows of resources related to pension is made for the State as a whole and is not separately computed for the individual state departments and agencies such as the Harbors Division. The State allocates the pension liability, pension expense, and deferred outflows of resources and deferred inflows of resources related to pension to the various departments and agencies based upon a systematic methodology. Additional disclosures and required supplementary information stipulated by Statement Nos. 68 and 71 pertaining to the State's net pension liability, pension expense, and deferred outflows of resources and deferred inflows of resources related to pension can be found in the State's CAFR.

At June 30, 2020 and 2019, the Harbors Division reported a net pension liability of \$37,288,062 and \$35,113,859, respectively, for its proportionate share of the State's net pension liability. The net pension liability was measured as of June 30, 2019 and 2018, and the total pension liability used to calculate the net pension liability was determined by actuarial valuations as of those dates.

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At June 30, 2020 and 2019, the Harbors Division's proportionate share of the State's net pension liability was 0.47%.

There were no changes between the measurement date, June 30, 2019, and the reporting date, June 30, 2020, that are expected to have a significant effect on the Harbors Division's proportionate share of the State's net pension liability.

For the years ended June 30, 2020 and 2019, the Harbors Division recognized pension expense of \$5,594,140 and \$4,525,173, respectively. At June 30, 2020 and 2019, the Harbors Division reported deferred outflows of resources and deferred inflows of resources related to pension from the following sources:

	Deferred Outflows of Resources	
	2020	2019
Contributions subsequent to the measurement date	\$ 2,690,753	\$ 2,414,232
Changes in assumptions	2,482,977	3,800,141
Differences between expected and actual experience	671,567	643,685
Changes in proportion and differences between contributions and proportionate share of contributions	85,339	110,786
	<u>\$ 5,930,636</u>	<u>\$ 6,968,844</u>
	Deferred Inflows of Resources	
	2020	2019
Differences between expected and actual experience	\$ 51,626	\$ 202,708
Changes in assumptions	621	-
Changes in proportion and differences between contributions and proportionate share of contributions	193,411	268,353
Net difference between projected and actual earnings on pension plan investments	127,669	211,289
	<u>\$ 373,327</u>	<u>\$ 682,350</u>

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The \$2,690,753 reported as deferred outflows of resources related to pension at June 30, 2020 resulting from the Harbors Division’s contributions subsequent to the measurement date will be recognized as a reduction of net pension liability in the year ended June 30, 2021. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pension at June 30, 2020 will be recognized in pension expense as follows:

Fiscal Year Ended June 30:

2021	\$ 1,711,465
2022	758,924
2023	156,454
2024	209,524
2025	30,189
	<u> </u>
	<u>\$ 2,866,556</u>

Actuarial Assumptions

The total pension liability in the June 30, 2019 actuarial valuation was determined using the following actuarial assumptions adopted by the ERS Board of Trustees on August 12, 2019, based on the 2018 Experience Study for the five year period from July 1, 2013 through June 30, 2018:

Inflation	2.50%
Payroll growth rate	3.50%
Investment rate of return	7.00% per year, compounded annually including inflation

There were no changes to ad hoc postemployment benefits including cost of living allowances.

Post-retirement mortality rates are based on the 2016 Public Retirees of Hawaii mortality table, with adjustments based on generational projections of the BB projection table for 2016 and full generational projections in future years. Pre-retirement mortality rates are based on multiples of the RP-2014 mortality table based on the occupation of the member.

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The long-term expected rate of return on pension plan investments was determined using a "top down approach" of the Client-Constrained Simulation-based Optimization Model (a statistical technique known as "re-sampling with a replacement" that directly keys in on specific plan-level risk factors as stipulated by the ERS Board of Trustees) in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future nominal rates of return (real returns and inflation) by the target asset allocation percentage.

The target allocation and best estimates of geometric real rates of return for each major asset class are summarized in the following table:

Strategic Allocation (Risk-Based Classes)	Target Allocation	Long-Term Expected Real Rate of Return
Broad growth	63.00%	7.10%
Principal protection	7.00%	2.50%
Real return	10.00%	4.10%
Crisis risk offset	20.00%	4.60%
	<u>100.00%</u>	

Discount Rate

The discount rate used to measure the total pension liability was 7.00%, consistent with the rate used at the prior measurement date. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current contribution rate and that contributions from the State, which includes the Harbors Division, will be made at statutorily required rates, actuarially determined. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

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Sensitivity of the Harbors Division's Proportionate Share of the State's Net Pension Liability to Changes in the Discount Rate

The following presents the Harbors Division's proportionate share of the State's net pension liability calculated using the discount rate of 7.00%, as well as what the Harbors Division's proportionate share of the State's net pension liability would be if it were calculated using a discount rate that is one percentage point lower (6.00%) or one percentage point higher (8.00%) than the current rate:

	1% Decrease (6.00%)	Discount Rate (7.00%)	1% Increase (8.00%)
Harbors Division's proportionate share of the State's net pension liability	\$ 48,390,727	\$ 37,288,062	\$ 29,294,349

Assumption Changes

The following changes were made to the actuarial assumptions as of June 30, 2018 to June 30, 2019:

- The assumed salary increase schedules include an ultimate component for general wage inflation that may add on additional increases for individual merit and then an additional component for step rates based on service.
- Mortality rates generally decreased due to the continued improvements in using a fully generational approach and Scale BB.
- The rates of disability of active employees increased for all general employees and teachers, and for police officers and firefighters from duty-related reasons.
- There were minor increases in the retirement rates for members in certain groups based on age, employment group and/or membership class.

Pension Plan Fiduciary Net Position

The pension plan's fiduciary net position is determined on the same basis used by the pension plan. The ERS's financial statements are prepared using the accrual basis of accounting under which expenses are recorded when the liability is incurred, and revenues are recorded in the accounting period in which they are earned and become measurable. Employer and member contributions are

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recognized in the period in which the contributions are due. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan. Investment purchases and sales are recorded as of their trade date. Administrative expenses are financed exclusively with investment income.

There were no significant changes after the report measurement date. Detailed information about the pension plan's fiduciary net position is available in the separately issued ERS financial report. The ERS's complete financial statements are available at <http://ers.ehawaii.gov/resources/financials>.

Payables to the Pension Plan

The State's employer contributions payable to the ERS was paid by June 30, 2020. Excess payments will be applied to amounts due in fiscal year 2021.

Postemployment Health Care and Life Insurance Benefits

Plan Description

The State provides certain health care and life insurance benefits to all qualified employees. Pursuant to Act 88, SLH 2001, the State contributes to the EUTF, an agent multiple-employer defined benefit plan that replaced the Hawaii Public Employees Health Fund effective July 1, 2003. The EUTF was established to provide a single delivery system of health benefits for state and county workers, retirees, and their dependents.

For employees hired before July 1, 1996, the State pays the entire base monthly contribution for employees retiring with 10 years or more of credited service, and 50% of the base monthly contribution for employees retiring with fewer than 10 years of credited service. A retiree can elect a family plan to cover dependents.

For employees hired after June 30, 1996, but before July 1, 2001, and who retire with less than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State pays 50% of the base monthly contribution. For employees retiring with at least 15 years but fewer than 25 years of service, the State pays 75% of the base monthly contribution. For employees retiring with at least 25 years of service, the State pays 100% of the base monthly contribution. Retirees in this category can elect a family plan to cover dependents.

For employees hired on or after July 1, 2001, and who retire with less than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State pays 50% of the base monthly contribution. For those retiring with at least 15

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years but fewer than 25 years of service, the State pays 75% of the base monthly contribution. For those employees retiring with at least 25 years of service, the State pays 100% of the base monthly contribution. Only single plan coverage is provided for retirees in this category. Retirees can elect family coverage but must pay the difference.

Members Covered by Benefit Terms

At July 1, 2019, the State’s plan members covered by benefit terms consisted of the following:

Inactive plan members or beneficiaries currently receiving benefits	36,993
Inactive plan members entitled to but not yet receiving benefits	7,678
Active plan members	50,591
Total plan members	95,262

Contributions

Contributions are governed by HRS Chapter 87A and may be amended through legislation. Contributions to the EUTF from the Harbors Division were \$2,993,381 and \$3,083,989 for the years ended June 30, 2020 and 2019, respectively. The Harbors Division is required to make all contributions for members.

OPEB Liabilities, OPEB Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB

Measurement of the actuarial valuation of the OPEB liability, OPEB expense, and deferred outflows of resources and deferred inflows of resources related to OPEB is made for the State as a whole and is not separately computed for the individual state departments and agencies such as the Harbors Division. The State allocates the OPEB liability, OPEB expense, and deferred outflows of resources and deferred inflows of resources related to OPEB to the various departments and agencies based upon a systematic methodology. Additional disclosures and required supplementary information stipulated by Statement No. 75 pertaining to the State’s net OPEB liability, OPEB expense, and deferred outflows of resources and deferred inflows of resources related to OPEB can be found in the State’s CAFR.

At June 30, 2020 and 2019, the Harbors Division reported a net OPEB liability of \$38,397,222 and \$38,353,266, respectively, for its proportionate share of the State’s net OPEB liability. The net OPEB liability was measured as of July 1, 2019 and 2018, and the total OPEB liability used to calculate the net OPEB liability was determined by actuarial valuations as of those dates.

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At June 30, 2020 and 2019, the Harbors Division's proportionate share of the State's net OPEB liability was 0.41%.

There were no changes between the measurement date, July 1, 2019, and the reporting date, June 30, 2020, that are expected to have a significant effect on the Harbors Division's proportionate share of the State's net OPEB liability.

For the years ended June 30, 2020 and 2019, the Harbors Division recognized OPEB expense of \$2,771,242 and \$3,110,127, respectively. At June 30, 2020 and 2019, the Harbors Division reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources:

	Deferred Outflows of Resources	
	2020	2019
Contributions subsequent to the measurement date	\$ 2,993,381	\$ 3,083,989
Changes in assumptions	502,680	389,192
Net difference between projected and actual earnings on OPEB plan investments	78,177	-
	<u>\$ 3,574,238</u>	<u>\$ 3,473,181</u>
	Deferred Inflows of Resources	
	2020	2019
Differences between expected and actual experience	\$ 527,199	\$ 643,049
Net difference between projected and actual earnings on OPEB plan investments	-	49,189
	<u>\$ 527,199</u>	<u>\$ 692,238</u>

The \$2,993,381 reported as deferred outflows of resources related to OPEB resulting from the Harbors Division's contributions subsequent to the measurement date will be recognized as a reduction of the net OPEB liability in the year ending June 30, 2021.

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Other amounts reported as deferred outflows of resources and deferred inflows of resources related to OPEB will be recognized in OPEB expense as follows:

Fiscal Year Ended June 30:

2021	\$	(32,820)
2022		(32,820)
2023		9,333
2024		20,103
2025		89,862
		89,862
	\$	53,658

Actuarial Assumptions

The total OPEB liability in the July 1, 2019 actuarial valuation was determined using the following actuarial assumptions adopted by the EUTF Board of Trustees, on January 13, 2020, based on the experience study covering the five-year period ended June 30, 2018:

Inflation	2.50%
Salary increases	3.50% to 7.00%, including inflation
Investment rate of return	7.00%, net of investment expenses, including inflation

Healthcare cost trend rates:

PPO*	Initial rate of 8.00%; declining to a rate of 4.86% after 12 years
HMO*	Initial rate of 8.00%; declining to a rate of 4.86% after 12 years
Part B & Base Monthly Contribution (BMC)	Initial rates of 5.00%; declining to a rate of 4.70% after 11 years
Dental	4.00%
Vision	2.50%
Life insurance	0.00%

* Blended rates for medical and prescription drugs.

Mortality rates are based on system-specific mortality tables utilizing scale BB to project generational mortality improvement.

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The long-term expected rate of return on the EUTF's investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of the EUTF's investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Non-U.S. equity	17.00%	6.90%
U.S. equity	15.00%	5.35%
Private equity	10.00%	8.80%
Core real estate	10.00%	3.90%
Trend following	9.00%	3.25%
U.S. microcap	7.00%	7.30%
Global options	7.00%	4.75%
Private credit	6.00%	5.60%
Long treasuries	6.00%	2.00%
Alternative risk premia	5.00%	2.75%
TIPS	5.00%	1.20%
Core bonds	3.00%	1.50%
	<u>100.00%</u>	

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Single Discount Rate

The discount rate used to measure the total OPEB liability was 7.00%, based on the expected rate of return on the EUTF's investments of 7.00%. Beginning with the fiscal year 2019 contribution, the State's funding policy is to pay the recommended actuarially determined contribution, which is based on layered, closed amortization periods. Based on those assumptions, the EUTF's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive plan members. Therefore, the long-term expected rate of return on the EUTF's investments was applied to all periods of projected benefit payments to determine the total OPEB liability.

Assumption Changes

Assumption changes during the current measurement period include updating (1) the demographic and salary-related assumptions based on an experience study which covered the five-year period ended June 30, 2018, and (2) the dependent coverage assumptions to better reflect anticipated experience.

OPEB Plan Fiduciary Net Position

The OPEB plan's fiduciary net position has been determined on the same basis used by the EUTF. The EUTF's financial statements are prepared using the accrual basis of accounting under which revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of the timing of the cash flows. Employer contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan. Investment purchases and sales are recorded on a trade-date basis. Administrative expenses are financed exclusively with investment income.

There were no significant changes after the report measurement date. Detailed information about the OPEB plan's fiduciary net position is available in the separately issued EUTF financial report. EUTF's complete financial statements are available at <http://eutf.hawaii.gov/reports>.

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Changes in the Harbors Division's Proportionate Share of the State's Net OPEB Liability

The following table represents a schedule of changes in the Harbors Division's proportionate share of the State's net OPEB liability. The ending balances are as of the measurement date, July 1, 2019.

	Total OPEB Liability	Plan Fiduciary Net Position	Net OPEB Liability
Beginning balance	\$ 43,026,319	\$ 4,673,053	\$ 38,353,266
Service cost	926,180	-	926,180
Interest on the total OPEB liability	2,919,405	-	2,919,405
Differences between expected and actual experience	(24,308)	-	(24,308)
Changes in assumptions	234,639	-	234,639
Employer contributions	-	3,083,989	(3,083,989)
Net investment income	-	280,390	(280,390)
Benefit payments	(1,398,092)	(1,398,092)	-
Administrative expense	-	(1,926)	1,926
Other	-	649,507	(649,507)
Net changes	2,657,824	2,613,868	43,956
Ending balance	\$ 45,684,143	\$ 7,286,921	\$ 38,397,222

Sensitivity of the Harbors Division's Proportionate Share of the State's Net OPEB Liability to Changes in the Discount Rate and Healthcare Cost Trend Rates

The following table represents the Harbors Division's proportionate share of the State's net OPEB liability calculated using the discount rate of 7.00%, as well as what the Harbors Division's proportionate share of the State's net OPEB liability would be if it were calculated using a discount rate that is one percentage point lower (6.00%) or one percentage point higher (8.00%) than the current discount rate:

	1% Decrease (6.00%)	Discount Rate (7.00%)	1% Increase (8.00%)
Harbors Division's proportionate share of the State's net OPEB liability	\$ 45,749,603	\$ 38,397,222	\$ 32,595,836

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The following table represents the Harbors Division’s proportionate share of the State’s net OPEB liability calculated using the assumed healthcare cost trend rate, as well as what the Harbors Division’s proportionate share of the State’s net OPEB liability would be if it were calculated using a trend rate that is one percentage point lower or one percentage point higher than the current healthcare cost trend rate:

	1% Decrease	Healthcare Cost Trend Rate	1% Increase
Harbors Division’s proportionate share of the State’s net OPEB liability	\$ 32,331,555	\$ 38,397,222	\$ 46,233,978

Payables to the OPEB Plan

The State’s employer contributions payable to the EUTF was paid by June 30, 2020.

Deferred Compensation

The State offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, which is available to all State employees (excluding part-time, temporary, and casual/seasonal), permits employees to defer a portion of their compensation until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

All plan assets are held in a trust fund to protect them from claims of general creditors. The State has no responsibility for loss due to the investment or failure of investment of funds and assets in the plan, but does have the duty of due care that would be required of an ordinary prudent investor. Accordingly, the assets and liabilities of the State’s deferred compensation plan are not reported in the State’s nor the Harbors Division’s financial statements.

13. Risk Management

The State purchases policies to provide coverage for all state entities, including the Harbors Division. The State generally retains the first \$1,000,000 per occurrence of property losses such as fires, and 3% of a property replacement cost value for catastrophic losses such as hurricanes, earthquakes, and floods, the first \$5,000,000 with respect to general liability claims, and the first \$500,000 of losses due to crime and cyber liability. Losses in excess of those retention amounts are insured with commercial insurance carriers. The limit per occurrence for property losses is

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\$200,000,000, except for terrorism, which is \$100,000,000 per occurrence. The annual aggregate limit for general liability losses is \$9,000,000 per occurrence, \$50,000,000 for cyber liability losses, and for crime losses, the limit per occurrence is \$10,000,000 with no aggregate limit.

The Harbors Division obtained coverage for certain strategic piers and wharves infrastructure to mitigate its exposure to natural disasters from hurricane, earthquake, and flood (including a tsunami) events. The amount of insurance provided by this difference in conditions policy is \$30,000,000 on an annual aggregate basis on a shared perils basis, subject to a \$5,000,000 deductible per occurrence.

The State generally self-insures for its automobile no-fault and workers' compensation losses. A liability for workers' compensation and general liability claims is established if information indicates that a loss has been incurred as of June 30, 2020, and the amount of the loss can be reasonably estimated. The liability also includes an estimate for amounts incurred but not reported. Accrued workers' compensation amounted to approximately \$1,380,000 and \$1,075,000 at June 30, 2020 and 2019, respectively.

14. Ceded Lands

In 2006, the Legislature enacted Act 178, SLH 2006 (Act 178), to re-establish a mechanism for OHA to receive a portion of the income and proceeds from the Ceded Lands, for native Hawaiians, under Article XII, Sections 4 and 6 of the Hawaii Constitution. Among other things, Act 178 directs state agencies that collect receipts from the Ceded Lands to annually transfer a total of \$15,100,000 in four equal quarterly installments to OHA, and directs the Governor to issue an executive order to establish procedures for this purpose. The Governor issued Executive Order No. 06-06 on September 20, 2006.

The Harbors Division transferred \$10,000,000 to B&F in four equal quarterly installments pursuant to Governor Executive Order No. 06-06 during the fiscal years ended June 30, 2020 and 2019. The transfers are included in harbor operations costs in the accompanying statements of revenues, expenses, and changes in net position for the fiscal years ended June 30, 2020 and 2019.

15. Transactions with Other Government Agencies

The State assesses a surcharge of 5% for central service expenses on all receipts of the Harbors Division, after deducting any amounts pledged, charged, or encumbered for the payment of bonds and interest during the fiscal year. The assessments amounted to approximately \$7,852,000 and \$7,475,000 for the fiscal years ended June 30, 2020 and 2019, respectively.

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The Harbors Division is assessed a percentage of DOT's general administration expenses. The assessments amounted to approximately \$1,444,000 and \$2,046,000 for the fiscal years ended June 30, 2020 and 2019, respectively.

Act 200, SLH 2008, was enacted to authorize a statewide Harbors Modernization Plan (HMP) to address harbor infrastructure improvements to Kahului Harbor on Maui, Nawiliwili Harbor on Kauai, Hilo and Kawaihae Harbors on Hawaii, and Honolulu and Kalaeloa Harbors on Oahu. In addition to the six commercial harbors included in the plan, the law placed Hana Harbor on Maui under the jurisdiction of the Harbors System and included appropriations for its upgrade. The Act authorizes the DOT to issue harbor revenue bonds to finance the improvements. The cost of the Harbors Modernization Plan, originally estimated at \$842 million, was revised to \$618 million in 2008. Act 200 also designated the Aloha Tower Development Corporation (the ATDC) as the entity responsible for the management and implementation of the HMP under the direction of the DOT.

The State Legislature in its 2009 legislative session questioned ATDC's role and effectiveness and provided operational funding for only FY2010 of the FY2009-2011 biennium. In its 2010 legislative session, the Legislature did not restore operating funds to ATDC for FY2011, effectively terminating its operations on June 30, 2010. Contracts executed by ATDC for HMP projects were assigned to the Harbors Division, which assumed management and implementation responsibilities for the HMP. The modernization projects have been integrated into the administration's Harbors Modernization Program, a capital improvements program comprised of priority public works projects critical to create jobs and jumpstart the economy.

In the 2011 legislative session, Act 152, SLH 2011 was enacted to remove ATDC from DBEDT and place the agency under the Department of Transportation for administrative purposes, redefine the boundaries of the Aloha Tower complex and repealed references to the HMP, effectively July 1, 2011. Act 152 provides that ATDC is headed by a three-member board comprised of the Directors of Transportation and DBEDT and the Deputy Director of Harbors. The Director of DBEDT chairs the board and the Deputy Director of Harbors serves as the acting Chief Executive Officer for the ATDC. Act 152 also provided that the unencumbered and unexpended fund balance in the Aloha Tower Fund shall lapse to the credit of the Harbor Special Fund to be used for operating expenses for the ATDC. DBEDT transferred the balance of approximately \$2.8 million to the Harbor Special Fund pursuant to Act 152. The \$2.8 million offset a portion of the \$7.8 million balance owed by the ATDC to the Harbors Division for losses in revenue, obligations which were operating expenses for ATDC.

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16. Aloha Tower Complex Development

The ATDC is a state agency established under HRS Chapter 206J, primarily to redevelop the Aloha Tower complex. The complex originally encompassed Piers 5 to 23 of Honolulu Harbor, but its boundaries were redefined by Act 152, SLH 2011. In September 1993, the Harbors Division entered into a ground master lease and a capital improvements, maintenance, operations, and security agreement with the ATDC for certain portions of the Aloha Tower complex. The ATDC is required annually to reimburse the Harbors Division for any losses in revenues during the term of the lease caused by any action of the ATDC or the developer and to provide replacement facilities for maritime activities at no cost to the Harbors Division.

On January 18, 2006, an agreement amending the Aloha Tower Project Memorandum of Understanding and Aloha Tower Ground Lease was executed, effective as of June 30, 2005, and retroactive to July 1, 2004 (the Amendment). The Amendment required the ATDC to pay \$225,000 as a minimum annual base payment for losses in revenues owing in the fiscal year beginning July 1, 2004. From July 1, 2005, subject to the approval of the Deputy Director for the Harbors Division, the base payment of \$225,000 was to be reduced by expenses incurred by the ATDC for the Hawaii Harbors Project Office. The Amendment also required an equity participation payment to be made in an amount of 50% of the difference between the total revenues and total operating expenses of the ATDC for a fiscal year (the equity payment), provided that if the equity payment exceeds two and one-half times the actual operating expenses of the ATDC. These payments were to be applied to reduce the amount owed to the Harbors Division for losses in revenues by the ATDC prior to July 1, 2004. The balance owed to the Harbors Division by the ATDC under this Amendment as of June 30, 2020 and 2019 was approximately \$2,589,000 and \$2,977,000, respectively, and is included in notes receivable, net of allowance for doubtful accounts for approximately \$2,180,000 and \$2,589,000 as of June 30, 2020 and 2019, respectively, in the accompanying statements of net position.

At its meeting on July 13, 2011, the ATDC Board approved the transfer of the leasehold interest of the Marketplace to a new operator, Hawaii Lifestyle Retail Properties, (HLRP). HLRP is a limited liability company that consisted at that time of two legal entities, Lifestyle Retail Properties LLC (LRP) and Hawaii Downtown Holdings LLC (HDH); HDH being solely owned by Hawaii Pacific University (HPU). After the transfer of the lease to HLRP in mid 2011, the ATDC discussed various development proposals with HLRP culminating in a memorandum of understanding (MOU) dated December 15, 2011. In the 2012 Hawaii Legislative Session, HPU received legislative support for the issuance of special purpose revenue bonds for improvements to their facilities. In mid 2012, a dispute arose among the owners of HLRP which ultimately resulted in HDH buying out LRP's interest in HLRP and HDH taking control of the leasehold interest in late 2012. The terms of the ATDC's MOU with HLRP, which were performance-based and had not been met, terminated on January 1, 2014. Since the resolution of the owners' dispute within HLRP, HLRP has been reformulating its plans for improvements to the Marketplace leasehold property.

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Subsequent to the year ended June 30, 2014, the State, by its Interim Director of the DOT, entered into a successor MOU with the ATDC and HLRP whereby the ATDC agreed to abate rent under the lease between the ATDC and HLRP for the period retroactive to July 1, 2014 to June 30, 2015 in consideration for the construction of HLRP improvements to create student and faculty residences and various university spaces for Hawaii Pacific University and to memorialize the understanding of the parties with respect to various aspects of its agreement.

The successor memorandum of understanding also amended the punchlist obligations owed to the Harbors Division which had a total value of \$3.5 million, depending upon when actual payments are made by the operator within a six year timeframe ending June 2017. The amendment provided that in consideration of the ATDC's issuance of any renewed leases, HLRP shall pay the Harbors Division the sum of \$1,750,000 on or before December 31, 2021.

17. Kapalama Land Development

Plans for the development of the Kapalama Military Reservation (KMR) site involve the creation of a new cargo container yard and vessel berthing piers, a key priority under the Harbor's Modernization Plan. During the fiscal year ended June 30, 2017, the Airports Division and Harbors Division continued discussions to resolve the use of approximately 11.344 acres of ceded lands under management and control of the Airports Division that are located near the KMR site of which a portion is planned for inclusion into the KMR container yard development.

On December 12, 2017, an agreement was executed between the Airports Division and the Harbors Division, which effectively conveyed the control and management of the subject 11.344 acres to the Harbors Division for an appraised value of \$32,820,000. In accordance with the agreement, the Harbors Division made the payments of \$16,410,000 to the Airports Division in June 2018 and 2019. The total release price of \$32,820,000 is included in nondepreciable capital assets as of June 30, 2020 and 2019 in the accompanying statements of net position. The agreement also provided for the payment of \$4,159,350 from the Harbors Division to the Airports Division for rental income collected by the Harbors Division. This amount was paid on August 7, 2018.

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18. Arbitrage

The Harbors Division is required to annually calculate rebates to the U.S. Treasury on the Revenue Bonds issued from 1986. In accordance with the requirements of Section 148 of Internal Revenue Code of 1986, as amended, rebates are calculated by bond series based on the amount by which the cumulative amount of investment income exceeds the amount that would have been earned had funds been invested at the bond yield. In the opinion of management, rebates payable as of June 30, 2020 and 2019, if any, are not material to the financial statements. Accordingly, no rebates payable have been recorded in the accompanying financial statements.

19. Commitments and Contingencies

Construction and Other Contracts

The Harbors Division is committed under contracts awarded for construction and other services. These commitments amounted to approximately \$139,243,000 and \$180,808,000 at June 30, 2020 and 2019, respectively.

Accumulated Sick Leave Pay

Employees earn sick leave credits at the rate of 14 hours for each month of service depending on the employee's hire date. Unused sick leave may be accumulated without limitation and is not convertible to pay upon termination of employment. Accordingly, no liability for sick pay is recorded. However, for public employees who retire or leave government service in good standing with sixty days or more of unused sick leave, the unused sick leave is converted to additional retirement service credit at the rate of one additional month of service for each 20 days of unused sick leave. The accumulated sick leave liabilities as of June 30, 2020 and 2019 were approximately \$6,027,000 and \$6,248,000, respectively.

Environmental Issues

Iwilei District Participating Parties

The Harbors Division is subject to laws and regulations relating to the protection of the environment. The Harbors Division has been identified by the State Department of Health as a potentially responsible party for petroleum contamination in the Honolulu Harbor/Iwilei area. Pursuant thereto, the Harbors Division entered into a voluntary agreement with the Department of Health and other third parties to share in the responsibility for the investigation and potential remediation of petroleum contamination in the Iwilei District. This group of potentially responsible parties, known as the Iwilei District Participating Parties (IDPP), has conducted various

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investigations to determine potential contamination in the Iwilei area from 1997 to present, which investigations have determined the existence of petroleum contamination at various locations. The remediation alternative selected involves the management of the contamination in-place with limited extraction, plume monitoring, active institutional controls including education/awareness and outreach of landowners, potential developers and utility operators, and reimbursement of future incremental project costs attributable to the contamination. However, the project has not yet advanced to the stage where total costs to the IDPP can reasonably be estimated due to: (1) the extent of the environmental impact, (2) the undetermined allocation among the potentially responsible parties, and (3) the continued discussion with the regulatory authorities. Although it is not possible to reasonably estimate the Harbors Division cost liability until these items have been resolved, the Harbors Division, in accordance with GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations* (GASB 49), accrued only for the estimated cost of the studies and investigations allocated to the Harbors Division of approximately \$1,681,000 as of June 30, 2020.

Environmental Protection Agency

During December 2008, the United States Environmental Protection Agency (EPA) conducted an audit to determine Harbors Division's compliance with its Storm Water Environmental Permits (SWMP). As a follow up to this audit, on June 18, 2009, the EPA issued an Administrative Order directing the Harbors Division to revise its Storm Water Management Plan, upgrade environmental inspections and procedures, improve documentation of environmental inspections and follow up actions, establish "Best Management Practices" (BMPs) standards, and include the use of permanent BMPs in any construction projects that are undertaken on Harbors Division premises.

In July 2012, the EPA and the U.S. Department of Justice provided a Compliance Measures draft for the Harbors Division's review and comment. The Compliance Measures draft is intended to be the Injunctive Relief portion of the comprehensive Consent Decree between the United States, the State of Hawaii Department of Health and the Department of Transportation.

On September 18, 2014, the U.S. Department of Justice lodged a proposed Consent Decree with the United States District Court for the District of Hawaii in the lawsuit entitled United States et al. v. Hawaii Department of Transportation, Civil Case No. 14-00408. The Department agreed to correct federal Clean Water Act violations at Honolulu and Kalaeloa Barbers Point Harbors on Oahu, modify departmental administrative and operational procedures and pay a civil penalty of \$600,000 plus interest to the U.S. Department of Justice and \$600,000 plus interest to the Hawaii Department of Health. Under the conditions of the Consent Decree, the Department is required to implement structural changes to management and a comprehensive stormwater management plan over the life of the Consent Decree. The Consent Decree was entered on November 5, 2014 and payments of \$600,160 were remitted accordingly to each party.

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The Harbors Division entered into an agreement with Weston Solutions, Inc., an international environmental consulting firm, to assist in negotiating the Compliance Measures for a cost of approximately \$600,000, which was amended during fiscal year 2015 to \$900,000, of which has been fully paid as of June 30, 2017. In fiscal year 2020, the Harbors Division paid EnviroServices and Training Center LLC, a Hawaii environmental consulting firm, \$926,500 for their assistance in implementing the compliance measures.

Litigation

The Harbors Division is subject to a number of lawsuits arising in the ordinary course of its operations. While the ultimate liabilities, if any, in the disposition of these matters are presently difficult to estimate, it is management's belief that the outcomes are not likely to have a material adverse effect on the Harbors Division's financial position. Accordingly, no provisions for any liabilities that might result have been made in the accompanying financial statements.

20. Subsequent Events

COVID-19 Pandemic

On March 4, 2020, Governor David Y. Ige (the Governor) issued an emergency proclamation in response to the COVID-19 pandemic outbreak. The emergency proclamation and following supplementary proclamations ordered residents and non-essential businesses to self-quarantine to contain the spread of the respiratory disease, except as necessary to maintain the continuity of operations of critical federal infrastructure and essential businesses. There have been a total of 16 supplementary proclamations extending the emergency through November 30, 2020.

Economic activity in the State slowed significantly due to the closure of non-essential businesses, traveler quarantine requirements, and the substantial reduction in visitors to Hawaii. Airlines have suspended nearly all flights to and from the State and the U. S. mainland and Asia. Visitor arrivals to the State dropped from an average of 30,000 to 35,000 people a day to 200 people a day in March 2020, and the rate of arrivals has risen only incrementally thereafter.

The U.S. Centers for Disease Control and Prevention (CDC) issued a No Sail Order and Suspension of Further Embarkation on March 14, 2020 for all cruise ships that did not voluntarily suspend operations. On June 19, 2020, the Cruise Lines International Association (CLIA) announced that the association's ocean-going cruise line members would voluntarily extend the suspension of cruise operations from U.S. ports until September 15, 2020. The CLIA extended the voluntary suspension on August 5, 2020 to at least October 31, 2020, and again on November 3, 2020 to maintain the ongoing voluntary suspension of cruise operations in the

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U.S. through December 31, 2020, and that its members would use the remainder of the year to prepare for the implementation of extensive measures to address COVID-19 safety with the guidance of the CDC.

The 14th supplementary proclamation, issued on October 13, 2020, suspended specific provisions of law. Included were Sections 87A-42(b) – (f), HRS, other post-employment benefits trust, 87A-43, HRS, payment of public employer contributions to the other post-employment benefits trust, and 237-31(3), HRS, remittances, related to the requirement for public employers to pay the annual required contribution to the EUTF in the fiscal year 2020-2021.

On October 15, 2020, the State launched a pre-travel testing program, allowing passengers arriving from out-of-state and traveling inter-county to bypass the 14-day quarantine with a valid negative COVID-19 test result from a trusted testing and travel partner. As a result, slightly more travelers arrived in Hawaii than in previous months, when testing was not an option to bypass the trans-Pacific quarantine requirement. During October 2020, a total of 76,613 visitors traveled to Hawaii by air service, compared to 796,191 visitors who came by air service and cruise ships in October 2019. Total visitor days declined 81.7% compared to October of last year.

On November 23, 2020, the Governor signed a 16th supplementary proclamation that required all trans-pacific travelers to have a negative test result from a trusted testing partner before their departure for the State of Hawaii, in order to bypass the 14-day quarantine. Travelers who did not have a negative test result prior to departing for Hawaii must self-quarantine for 14 days or the length of their stay, whichever is shorter, without exception.

While the Harbors Division expects that the COVID-19 pandemic will continue to negatively impact its operating results, the related financial impact and duration cannot be reasonably estimated at this time.

Bond Issuance

The Harbors Division executed a contract with BofA Securities, Inc. on November 19, 2020 to underwrite a total of \$266,550,000 of Hawaii Harbors System Revenue Bonds (Revenue Bonds). This contract allows for a public sale of \$147,520,000 Series A of 2020 Revenue Bonds (AMT), \$15,685,000 Series B of 2020 Revenue Bonds (Taxable), and \$103,345,000 Series C of 2020 Revenue Bonds (Non-AMT), all of these Series are the 2020 Revenue Bonds. On December 2, 2020, the closing date for this public sale of the 2020 Revenue Bonds, proceeds in the amount of \$145,090,000 from the Series A of 2020 Revenue Bonds (AMT) and proceeds of \$9,770,000 from the Series B of 2020 Revenue Bonds (Taxable) will be used to provide funding for the Harbors Division Capital Improvement Program, primarily for the Kapalama Container Terminal Phase I and Phase II projects.

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Notes to Financial Statements

June 30, 2020 and 2019

The remaining proceeds obtained from the Series A and the Series B of 2020 Revenue Bonds will be used to partially refund existing Series A and Series B of 2010 Revenue Bonds balances outstanding as of June 30, 2020. The Series C of 2020 Revenue Bonds (Non-AMT) will refund the remaining portion of the existing Series A of 2010 Revenue Bonds (Non-AMT) balances outstanding as of June 30, 2020.

The Harbors Division has evaluated subsequent events from the statements of net position date through November 30, 2020, the date at which the financial statements were available to be issued, and determined that there are no other items to disclose.

SUPPLEMENTARY INFORMATION

Harbors Division
Department of Transportation
State of Hawaii
(An Enterprise Fund of the State of Hawaii)

Cash and Cash Equivalents of the Public Undertaking

June 30, 2020

Unrestricted cash and cash equivalents	<u>\$ 199,315,946</u>
Restricted cash and cash equivalents:	
For construction—special purpose funds	175,167,453
For revenue bond debt service payments	22,902,427
For cash reserve requirement for Series A of 2010 revenue bonds	11,455,033
For revenue bond harbors reserve and contingency account	10,897,658
For risk management and other	<u>2,614,659</u>
	<u>223,037,230</u>
	<u><u>\$ 422,353,176</u></u>
With Director of Finance, State of Hawaii	\$ 422,254,862
On hand	<u>98,314</u>
	<u><u>\$ 422,353,176</u></u>

See accompanying independent auditors' report.

Harbors Division
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Revenue Bonds of the Public Undertaking

June 30, 2020

	Final Redemption Date	Interest Rate	Original Amount of Issue	Balance at June 30, 2020		
				Current	Noncurrent	Total
Issue of 2010	July 1, 2040	3.00 - 5.75%	\$ 201,390,000	\$ 9,340,000	\$ 145,180,000	\$ 154,520,000
Issue of 2013	July 1, 2029	3.25%	23,615,000	60,000	13,345,000	13,405,000
Issue of 2016 Series A	January 1, 2024	1.99%	14,565,000	2,080,000	6,510,000	8,590,000
Issue of 2016 Series B	January 1, 2031	2.46 - 2.89%	68,535,000	2,185,000	54,795,000	56,980,000
Issue of 2016 Series C	July 1, 2020	2.34%	8,135,000	3,605,000	-	3,605,000
Issue of 2016 Series D	July 1, 2027	3.09%	22,425,000	20,000	22,370,000	22,390,000
			<u>\$ 338,665,000</u>	<u>\$ 17,290,000</u>	<u>\$ 242,200,000</u>	<u>\$ 259,490,000</u>

See accompanying independent auditors' report.

Harbors Division
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Income from Operations Before Depreciation

Year Ended June 30, 2020

	District										Total
	Statewide	Oahu		Hawaii		Maui		Kauai		Port Allen	
		Honolulu	Kalaheo	Hilo	Kawaihae	Kahului	Kaunakakai	Kaunapau	Nawiliwili		
Operating revenues, net:											
Services:											
Wharfage	\$ -	\$ 100,895,603	\$ 4,614,342	\$ 4,317,300	\$ 6,105,186	\$ 9,592,719	\$ 374,233	\$ 814,199	\$ 4,372,640	\$ -	\$ 131,086,222
Dockage	-	4,603,459	898,742	244,471	65,691	269,461	16,491	8,412	213,631	2,441	6,322,799
Pax debark/embark	-	2,937,413	-	1,341,154	3,624	844,333	4,296	-	1,166,905	-	6,297,725
Demurrage	-	1,439,272	-	138,584	47,082	223,115	-	-	71,293	-	1,919,346
Port Entry	-	715,435	140,706	79,635	39,600	95,666	12,194	7,466	67,385	2,426	1,160,513
Mooring charges	-	258,351	1,832	18,812	31,217	116	1,931	-	-	604,690	916,949
Cleaning charges	-	116,518	-	-	-	-	-	-	147	413	117,078
Other services	-	54,545	-	3,084	3,255	908	166	-	696	12,916	75,570
Total services	-	111,020,596	5,655,622	6,143,040	6,295,655	11,026,318	409,311	830,077	5,892,697	622,886	147,896,202
Rentals:											
Wharf space and land	-	9,738,595	2,352,517	77,445	405,105	200,050	14,246	4,541	355,398	251,386	13,399,283
Storage	-	3,701,745	131,581	193,203	474,256	83,922	-	-	338,697	17,950	4,941,354
Automobile parking	-	788,748	7,089	45,917	10,933	108,992	762	-	63,875	8,367	1,034,683
Pipeline water	-	96,067	9,944	69,254	1,467	81,939	981	-	79,329	-	338,981
Other pipeline	-	1,872,129	2,445,478	1,111,688	192,018	1,256,019	25,564	-	303,105	199,722	7,405,723
Total rentals	-	16,197,284	4,946,609	1,497,507	1,083,779	1,730,922	41,553	4,541	1,140,404	477,425	27,120,024
Others:											
Sale of utilities	-	225,362	160,331	43,966	1,074	81,120	355	-	68,128	6,156	586,492
Miscellaneous	-	375,821	61,380	9,181	14,217	48,789	1,929	14,250	3,694	306	529,567
Total others	-	601,183	221,711	53,147	15,291	129,909	2,284	14,250	71,822	6,462	1,116,059
Total operating revenues	-	127,819,063	10,823,942	7,693,694	7,394,725	12,887,149	453,148	848,868	7,104,923	1,106,773	176,132,285
Operating expenses before depreciation expenses:											
Personal services	9,491,018	9,525,563	299,161	1,218,487	86,466	1,482,729	64,855	2,587	1,456,320	65,200	23,692,386
Harbor operations	10,019,000	5,629,181	757,381	624,594	444,116	727,500	12,830	976	603,050	29,920	18,848,548
State of Hawaii surcharge for central service expenses	7,851,763	-	-	-	-	-	-	-	-	-	7,851,763
General administration	2,346,665	234,746	695	39,577	5,736	19,885	1,019	99	24,846	1,583	2,674,851
Maintenance	645,732	547,174	22,516	117,699	69,912	58,149	17,269	2,550	59,647	9,581	1,550,229
Department of Transportation general administration expenses	1,443,588	-	-	-	-	-	-	-	-	-	1,443,588
Subtotal	31,797,766	15,936,664	1,079,753	2,000,357	606,230	2,288,263	95,973	6,212	2,143,863	106,284	56,061,365
Allocation of statewide expenses (1)	(31,797,766)	23,075,615	1,954,083	1,388,969	1,334,995	2,326,561	81,808	153,249	1,282,676	199,810	-
Total operating expenses before depreciation expense	-	39,012,279	3,033,836	3,389,326	1,941,225	4,614,824	177,781	159,461	3,426,539	306,094	56,061,365
Income from operations before depreciation expense	\$ -	\$ 88,806,784	\$ 7,790,106	\$ 4,304,368	\$ 5,453,500	\$ 8,272,325	\$ 275,367	\$ 689,407	\$ 3,678,384	\$ 800,679	\$ 120,070,920

Note (1): Statewide expenses are allocated to the Harbors Division based upon their respective current year operating revenues to total current year operating revenues for all Harbors.

See accompanying independent auditors' report.

Harbors Division
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Harbor Revenue Bonds 1997 Certificate – Minimum Net Revenue
Requirement of the Public Undertaking

Year Ended June 30, 2020

Net revenues, as defined by the 1997 Certificate:

Operating income before depreciation expense	\$ 120,070,920
Add:	
Interest income	7,490,378
State of Hawaii, surcharge for central service expenses	7,851,763
Cash available in the harbor reserve and contingency account	10,897,658
	\$ 146,310,719

Harbor revenue bond debt service requirements under the 1997 Certificate, including minimum sinking fund payments	\$ 28,939,998
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Ratio of net revenues to harbor revenue bond debt service requirements	5.06
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See accompanying independent auditors' report.

PART III

INTERNAL CONTROL AND COMPLIANCE SECTION

Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

The Auditor
State of Hawaii:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the statements of net position of the Harbors Division, Department of Transportation, State of Hawaii (the Harbors Division), as of June 30, 2020 and 2019, and the related statements of revenues, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to financial statements, which collectively comprise the Harbors Division's basic financial statements, and have issued our report thereon dated November 30, 2020.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Harbors Division's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Harbors Division's internal control. Accordingly, we do not express an opinion on the effectiveness of the Harbors Division's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Harbors Division's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KKDL LLC

Honolulu, Hawaii
November 30, 2020