

TESTIMONY BY GEORGINA K. KAWAMURA  
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE  
STATE OF HAWAII  
TO THE SENATE COMMITTEE ON WAYS AND MEANS  
ON  
HOUSE BILL NO. 509, H.D. 2, S.D. 1, PROPOSED S.D. 2

April 1, 2008

RELATING TO TRANSPORTATION.

House Bill No. 509, H.D. 2, S.D.1, Proposed S.D. 2, authorizes the Department of Business, Economic Development, and Tourism (DBEDT), through its Director, to guarantee loans from private lending institutions.

The Department has technical comments on the bill.

Pursuant to Article VII, section 13 of the State Constitution, the State must establish and maintain a reserve in an amount in reasonable proportion to the outstanding loans guaranteed by the State. This reserve needs to be established and funded by the legislature. (Historically, the reserve funding levels have been in the 15% to 25% range, depending on the degree of risk.) Accordingly, the Department recommends that the bill be amended to include the following new sections:

SECTION \_\_\_\_\_. There is created a trust fund in the state treasury to be known as the Hawaii interisland air carrier loan guarantee trust fund which shall serve as the reserve for all loans guaranteed under this Act.

SECTION \_\_\_\_\_. There is appropriated out of the \_\_\_\_\_ of the State of Hawaii the sum of \$ \_\_\_\_\_, or so much thereof as may be necessary for fiscal year 2008-2009, to be deposited into the Hawaii interisland air carrier loan guarantee trust

fund. This sum shall, if and when necessary, be expended by the department of business, economic development, and tourism, for the purposes of this Act.

Honorable Rosalyn Baker, Chair  
Committee on Ways and Means  
Hawaii State Senate  
State Capitol Building  
State of Hawaii

Hearing: April 1, 2008 at 10:00 a.m. in Room 211

Re: HB 509, Proposed SD2 --- Relating to Transportation

Dear Chair Baker and Honorable Committee Members:

My name is Aaron Media and I am a Vice President with Catrala-Hawaii. Catrala's membership consists of the major u-drive companies in Hawaii and the many businesses which support our industry. A majority of the u-drive/car rental members on Catrala's Board supports this bill. Such Board members are: Avis Rent A Car, Budget Rent A Car, Dollar Rent A Car, Thrifty Rent A Car and Hertz Rent A Car.

While Catrala supports competitive inter-island air travel and lowest possible airfares, it has grave concerns about proposed SD2 in that it deletes all of the prior provisions of SD1 relating to the planning and construction of common facilities as set forth in SD1 of the bill. Catrala would have no concerns about proposed SD2 if the language in SD1 was also retained as part of the bill.

The deleted language in SD1 is very important and Catrala believes such language is in the public's best interest. SD1 will generate additional revenues for our State's airport system. It will allow much needed improvements to u-drive facilities and operations so that Hawaii is on par with major airports across the United States. Why is there opposition to SD1 given DOT's support of SD1 based on recent past discussions between Catrala and the DOT's Airport Division?

SD1 incorporated various changes to a bill (SB 2916) previously considered by this Committee. The changes incorporated are the result of many discussions with the DOT and members of the industry. While all members of the industry do not support the bill, changes to a prior version of the bill were made to address some of their concerns. Please discuss matters with the DOT-Airport Division which has participated in these recent past and continuing discussions.

While SD1 is a significant improvement over the prior version of the bill, further clarifying language is being discussed with the DOT and members of the industry including those opposing SD1. We respectfully urge you to include and pass SD1 which will allow those discussions to take place. As the DOT proceeds with airport planning and improvements, it is important and vital to the u-drive industry that it be considered in those discussions. The passage of SD1 will provide the necessary funding that will allow the industry to be a part of such discussions.

No Cost to State; Better Facilities and Services: Catrala supports SD1 and believes it is a very important measure that will result in better u-drive services and facilities to local residents and the millions of tourists who visit Hawaii each year. Many of you have experienced the major CFC projects at mainland airports which include common bussing and a large u-drive structure with multiple companies. Such facilities and services are typically funded by CFC fees charged to customers renting a vehicle at the airport. Thus, such improved facilities and services are provided at no cost to the State.

U-drives Left Out of Airport Planning; CFC Funding Would Allow Planning, Projects and Services.

As you know various airport improvements are being planned and available space is becoming scarce. Better u-drive facilities and services for u-drives are not being planned due to other priority needs for funding in spite of payments in excess of \$40 million a year being paid by u-drives as concession fees to the State. When will things get better?

To address the needs for better facilities and services and so Hawaii's airports can be like many other public airports across the U.S., the concepts in SD1 were introduced by Catrala following discussions with DOT's Airport Division which supports SD1. Please talk with them. This bill will provide DOT with the necessary additional funds to plan and provide better u-drive services and facilities to local residents and millions of visitors similar to what other airports are providing across the U.S.

In addition to immediate collection of funds for necessary planning, SD1 also seeks to appropriate some monies for immediate and necessary improvements at the Kahalui Airport. U-drive vehicles have been flooded, under carriage of vehicles damaged and workers injured at a common storage facility at this airport. This has now continued on for many years and something needs to be done. These critical improvements to the facility are long overdue and the temporary fixes by the DOT do not last long resulting in renewed and continued problems and difficulties.

Closing. In closing we urge you to pass this bill with SD1 and keep this important measure alive. We understand there may be some clarification and fine tuning to the bill that will likely occur. As we have stated in the past, we urge opponents of SD1 to submit proposed amendments to the DOT and to Catrala for consideration.

Thank you for allowing us to testify. Please pass this important bill so discussion may continue to take place.



99 Kapalulu Place | Honolulu, Hawaii 96819-1843

TESTIMONY BEFORE THE SENATE COMMITTEE ON  
WAYS AND MEANS

April 1, 2008

RE: HB 509, HD2, SD2 – RELATING TO TRANSPORTATION

Chair Baker and Members of the Committee on Ways and Means:

My name is Charles Willis, IV, and I am the owner of Hawaii Island Air, Inc., dba Island Air. Island Air supports HB 509, HD2, SD2.

As stated in this bill, the recent inter-island fare wars, the conduct of which is currently subject to litigation has resulted in a dramatic and severe loss of revenues by inter-island airlines (see attached graph).

The results of the fare wars have caused great hardship, not only to Island Air, but to all of Hawaii's residents and visitors. Since the fare wars began in 2006, Island Air has:

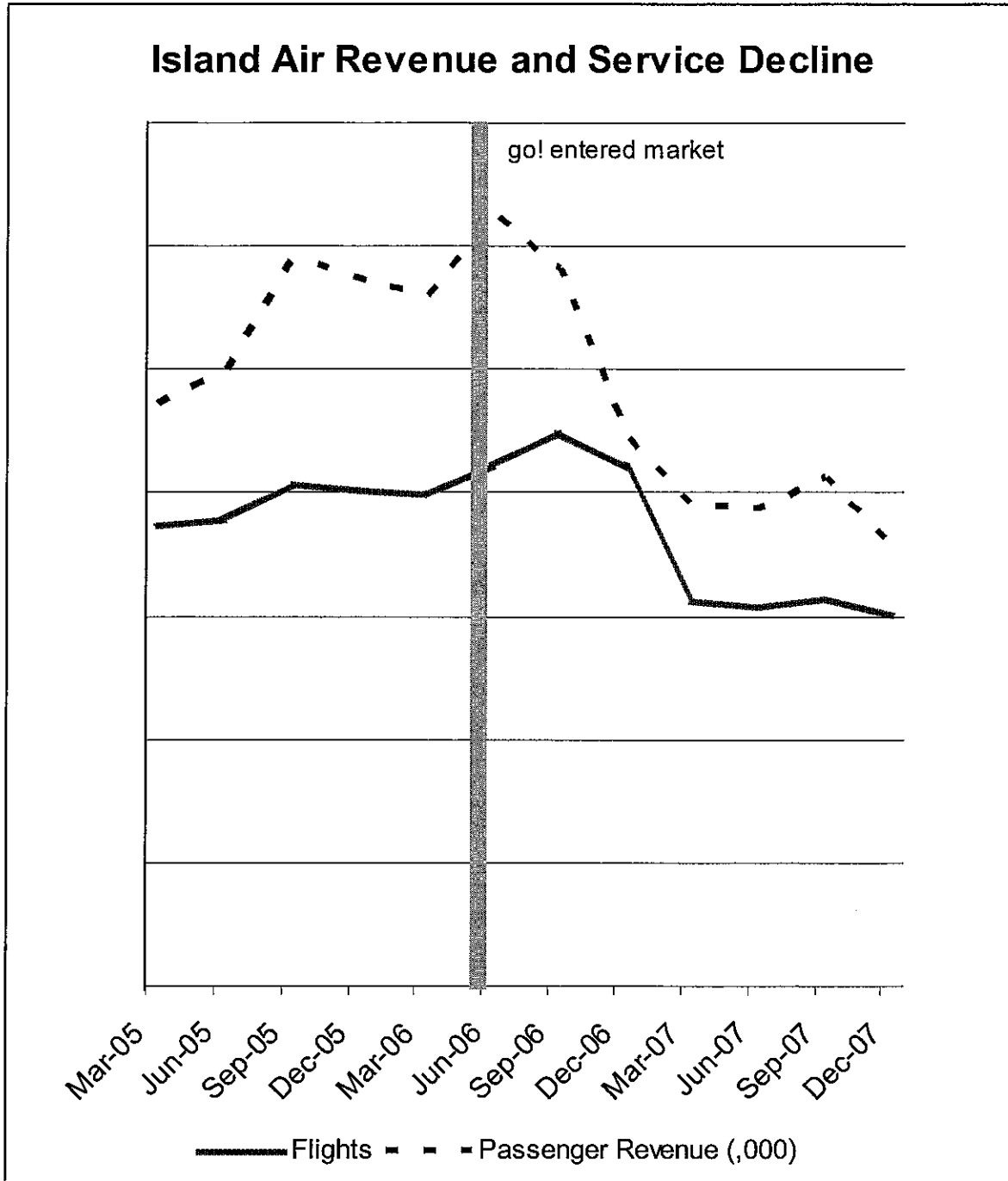
- Ceased non-stop services in eight Neighbor Island markets and has been unable to reinstate service to those markets;
- Reduced total scheduled flights by 38%;
- Closed freight service to and from Lihue, Kona, Maui, and Hilo;
- Reduced our work force by over 150 employees statewide (40%);
- Reduced revenues by 30%.

We humbly petition the Committee to define "Hawaii Air Carriers" as existing Federal Aviation Regulation (FAR) 121 certified air carriers currently servicing Hawaii's inter-island market.

The inter-island fare wars have caused financial instabilities in the marketplace resulting in the reduction of services that Island Air can offer.

We recommend the passage of HB 509, HD2, SD2, which affords Island Air the ability to grow and better serve Hawaii's communities.

Thank you for the opportunity to testify.



LATE

Testimony of Thomas J. Smyth, CECD  
Before the  
Senate Committee on Ways And Means  
Tuesday, April 1, 2008  
10:00 am Room 211  
on  
HB 509 HD 2 SD1, Proposed SD 2  
Relating to Transportation

Chair Baker, Vice Chair Tsutsui, and Members of the Committee:

**I support the intent and purpose of HB 509, Proposed SD 2, providing for a Loan Guarantee to a Hawaii air carrier.** This is an important step, one of several perhaps, needed to ensure that we have a vibrant competitive inter-island air transportation system. I have concerns with specific language proposed in SD 2 that I will comment on.

I recently retired from the Department of Business, Economic Development & Tourism. My testimony today as an individual is based on over 20 years experience in administering five direct loan programs and specifically in managing the Hawaiian Loan Guarantee project created by Act 322, Session Laws of Hawaii 1993.

As some may recall we were not able to complete the loan guarantee for Hawaiian Airlines that was authorized in Act 322. There were several major reasons for this situation that I will enumerate.

A. **Loan Guarantee background.**

First let me review the most common form of commercial loans and loan guarantees:

1. A company applies for a loan from a lender, usually a commercial bank.
2. A formal application is underwritten by the lender as to ability to repay, previous credit history, value of collateral and the overall spending proposal outlined in a business plan.
3. If the loan is riskier than the lender prefers, they may seek a government-sponsored loan guarantee. The most widely used guarantee is the Small Business Administration "7(a)" program which makes hundreds of loan guarantees a year on behalf of banks routinely using this form of risk reduction.
4. The SBA charges a fee of up to 3.75% for loans over \$1,000,000, less for smaller loans. They may also charge a "servicing fee" of 0.494%. These fees may be passed on to the borrower. The guarantee is usually for 75-90% of the amount borrowed based on the size of the loan.

5. Commercial airlines, often larger than a federally defined “small business,” can obtain a loan guarantee from the Air Transportation Stabilization Board, Office of Management and Budget. This agency, created after the terrorist attacks of September 11, 2001 has made more than a dozen loans.
6. One was made to Aloha Airlines in November 2002. That loan, guaranteed for \$40.5 million was paid off in April 2005 for \$24.7 million.

Usually, when there is loan “default,” the lender liquidates the collateral, often real property or major equipment and asks the guarantor for the unpaid balance. For larger, publically traded companies, collateral may also include stock warranties which have fixed stock share value but not corporate share voting rights or “ownership.” Airlines may have collateral value in airport gates or arrival time slots previously purchased.

**B. 1993 Hawaiian Airline Loan guarantee.**

1. Act 322, Relating to Transportation, was enacted June 28<sup>th</sup>, as part of a larger bill including provisions to “re-regulate” local airlines, subject to federal DOT approval. That portion of the bill was never put in place.
2. Section 4 had specific terms and conditions for the loan itself and for the guarantee. The seven-year guarantee could not exceed \$12.6 million, based on a 90% guarantee of a loan of up to \$14 million, the expected value of Hawaiian’s collateral equipment and parts. All aircraft and engines were leased and not counted as collateral.
3. The process included a “cash security deposit” of 20% of the loan value or \$2.8 million. This amount was deposited into the Hawaii Interisland Loan Guarantee Trust Fund, managed by B&F.
4. The law required that DBEDT conduct due diligence as to Hawaiian’s ability to pay, the value of the offered collateral and the consequences if the airline shut down. We did this quickly through a \$20,000 sole source contract with a nationally-known aviation analysis company, using previously appropriated DBEDT general funds. Based on their positive report we continued to try and develop a workable loan guarantee.
5. After extensive review by DBEDT and several formal opinions from the Attorney General, the law was found to have several serious flaws including no procedure for liquidation of collateral in the event of default. The banks wanted the State to liquidate after paying them the defaulted loan balance and interest and the State felt the banks should first liquidate and then come to the State for the balance.
6. The banks also expected the state to appropriate the entire loan amount and hold it in reserve to be claimed quickly if there was a default. We pointed that only 90% of the loan principle was guaranteed and there was a \$2.8 million case reserve, so no more than \$9.8 million would ever be in default. No appropriation was made.



7. There was also considerable consternation by the airline over language that seemed to freeze salaries for the duration of the loan, require them to raise new equity equal to the value of the loan, and set conditions on purchase of new parts and equipment.
8. Hawaiian did not enter bankruptcy until October 1993 so at the time of the negotiations over the loan guarantee, it required agreement by all of its principal creditors. After entering bankruptcy, agreement from only 50% of the major creditors was needed.

After much discussion and serious but cooperative negotiations, the differences between the State and the potential lender consortium could not be resolved. The loan was never made and the guarantee never put in place.

C. **Conclusions and Recommendations.**

1. Based on our unsuccessful efforts to fully implement Act 322, I feel that much of our difficulty was in the detailed conditions imposed on the loan itself and the lack of specificity in defining the guarantee.
2. **I strongly recommend that the procedures and forms used by the Air Transportation Stabilization Board be adopted by reference or in the final committee report.** This procedure is well understood by the funders and the airlines. Aloha Airlines has successfully used this process so they are specifically aware of its information and reporting requirements. The forms and background information are available on the OMB website.
2. Use of this relatively accepted (some will disagree that loan guarantees are even a solution to airline financial problems) procedure will help ensure a rapid, timely and thorough review by the State and the lenders, so if a loan guarantee is determined, as a matter of policy, as the best vehicle in this situation, it can be completed in a timely manner.

Thank you for the opportunity to provide testimony.