FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Harris County, TX's Toll Road First Lien CP Notes (Bank Bonds) 'AA'; Outlook Stable

Fri 15 Apr, 2022 - 1:37 PM ET

Fitch Ratings - Austin - 15 Apr 2022: Fitch Ratings has assigned a 'AA' underlying rating to Harris County, TX's (the county) $200 million junior first lien revenue commercial paper (CP) notes series K (bank bonds). Fitch has also affirmed $2.0 billion of outstanding toll revenue bonds at 'AA'. The Rating Outlook is Stable.

RATING RATIONALE

The ratings reflect the authority's essential road network in a large and economically solid region with limited viable alternatives, which also drives strong traffic volume. Years of consistent toll rate increases demonstrate a willingness and ability to raise tolls to maintain a healthy financial profile. The ratings further reflect the authority's robust financial metrics in Fitch's rating case, with a very high Fitch-calculated average 10-year gross senior and first lien debt service coverage ratio (DSCR) of 8.6x and 6.7x, respectively.

Fitch-calculated leverage (net debt to cash flow) is very low, averaging 0.2x for senior debt and 0.9x for senior and first lien debt over the next 10 years. These strengths are modestly offset by the authority's large capital plan that is expected to require additional debt issuances, and large annual subordinate transfers to the county.

KEY RATING DRIVERS

Proven Resilience and Traffic Demand - Revenue Risk (Volume): Stronger

HCTRA's toll road facilities provide vital transportation links with a strong monopolistic position in the Houston metropolitan area and an established and stable traffic demand profile. System traffic has increased nearly every year since fiscal 1998, supported by its continuing expansion in a large and rapidly growing metropolitan region. Toll rates are moderate and historical elasticity of demand is low.

Demonstrated Ratemaking Flexibility - Revenue (Price): Stronger

The authority's toll rate policy allows for annual increases at the greater of 2% or inflation, which has provided sufficient flexibility to maintain a strong financial profile. Since the rate policy's implementation in 2007, policymakers have shown a willingness to implement toll rate hikes with rate increases every year from 2008 to 2016.

Manageable CIP with Prudent Policies - Infrastructure Development & Renewal: Stronger

HCTRA's five-year (2022-2026) capital improvement plan (CIP) totals $2.3 billion and is funded primarily by system operating revenues. HCTRA is making investments focused predominantly on the Ship Channel Bridge replacement project and implementation of an all-electronic tolling system. The authority adheres to strong capital planning policies that do not allow deferred maintenance, limits leverage to four to five times toll revenues, and makes use of significant pay-as-you-go funding resources. These strengths are offset by large annual subordinate transfers to the county that could be increased and would leave the authority more dependent on debt issuances for future projects.

New Working Lien - Debt Structure: Stronger

This transaction closes the lien on the senior commercial paper, with the senior lien bonds closed as of 2021, and creates what is effectively a new working lien at the junior level. The junior lien itself will consist of four sub liens, though this issuance is entirely positioned at the 1st junior lien level. Additional sub-lien levels provide the authority with added flexibility in relation to future debt issuances but they are not currently used. A portion of the authority's debt is structured as variable rate, with some exposure to interest rate fluctuation, but represents only a small percentage of total debt. A mix of cash and surety-funded debt service reserve funds (DSRF) are maintained.

Financial Profile

The authority benefits from strong balance sheet liquidity and high coverage ratios highlighted by growing cash balances and a robust rating case gross DSCR averaging 8.6x (1st Lien), 6.7x (2nd Lien), and 6.0x (3rd Lien) over the next 10 years. Rating case leverage metrics are minimal at a 10-year average of 0.2x (1st Lien), 0.9x (2nd Lien), and 1.0x (3rd Lien). Although future debt issuances may weaken financial metrics to some extent, Fitch expects metrics to remain at levels consistent with the 'AA' rating category.

PEER GROUP

HCTRA's closest large expressway network peer is the Illinois State Toll Highway Authority (ISTHA; rated AA-/Stable). Although ISTHA also benefits from a large and economically diverse catchment area, its lower rating reflects weaker financial metrics as compared to HCTRA, including lower total debt service coverage of 1.9x and higher total leverage of 6.1x.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A material reduction in the authority's debt service coverage profile that leaves rating case DSCR projections significantly below 2.5x for a prolonged period;

--Excessive and sustained leveraging beyond the authority's historical targeted maximums of 5.0x senior gross debt to cash flow available for debt service (CFADS);

--A substantial increase in subordinate transfers from the system leading to reduced liquidity and higher dependence on debt to finance future CIP needs.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--At the current rating level, a further upgrade is unlikely due to future investment and political risks inherent to toll systems.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

TRANSACTION SUMMARY

The notes are being issued by the county on behalf of the Harris County Toll Road Authority. The authority is issuing $200 million of CP notes series K backed by a direct pay letter of credit from PNC Bank, National Association (rated F1/A+/Stable). The notes are on parity with the authority's first lien revenue bonds and are secured by a first (junior) lien on gross toll revenues. Fitch considers the first junior lien to be the operational senior lien for future debt issuances. The proceeds of the Series K notes will be used for capital projects, including toll system upgrades and toll plaza conversions and improvements.

CREDIT UPDATE

Calendar year (CY) 2021 traffic increased approximately 21% from CY2020 levels and 2% compared to CY2019. Traffic volumes began to exceed 2019 levels in March 2021, and 2022 year-to-date (YTD) traffic is up 18% yoy. This level of performance coming out of the pandemic is strong in comparison to the toll road sector as a whole.

Similarly, toll revenue performance has been solid, with a 35% increase in CY2021 from the prior year. In spite of disruptions caused by the omicron variant in January and ice storms in February, YTD toll revenues are in line with 2019 numbers.

In June 2021 the Harris County Commissioners Court approved the creation of the Flood Resilience Trust and allocated HCTRA surplus revenue to fund specific county road and bridge improvements designed to improve subdivision drainage. The use of HCTRA revenue is subject to statutory restrictions, and the county is drafting a set of policy and liquidity guidelines reportedly designed to limit the size of transfers out to fiscally sustainable levels. Total subordinate transfers to the county amounted to $545 million in fiscal 2021, and an additional transfer of $123.9 million has been approved for abbreviated fiscal 2022 ending September 30.

Fitch will continue to monitor the subordinate transfers from the authority and awaits details on the authority's cash policy on the transfer of funds. Fitch would view the potential weakening of liquidity resulting in an increased reliance on debt issuances to fund the CIP as credit negative. The county's fiscal prudence and restraint to date created the positive conditions under which the authority now benefits from robust debt service coverage, solid liquidity, low leverage, low toll rates, and a well-maintained system, all supporting the very high 'AA' rating.

FINANCIAL ANALYSIS

Financial performance is extremely strong under Fitch's base and rating cases. Fitch's base case adopts the sponsor's traffic and toll revenue growth projections, and results in a compound annual growth rate (CAGR) of 4.9% for pledged revenues and 2.6% for expenditures over the life of the debt. Under these assumptions, senior and first lien gross DSCR averages 6.8x (6.0x on a total debt basis) over the next 10 years, and senior and first lien net leverage averages 0.9x (1.0x on a total debt basis).

Fitch's rating case assumes recessionary conditions leading to a traffic decline of 4% in fiscal 2023, followed by a two-year recovery of 4% and a return to base case growth projections for the remainder of the period. The case also assumes fixed 2% toll rate increases beginning in fiscal 2023. Under this scenario, senior and first lien DSCR is still high at an average of 6.7x (6.0x on a total debt basis) over the first 10 years and average net leverage is essentially unchanged at 0.9x (1.0x on a total debt basis). For purposes of calculating DSCR, both cases assume the CP notes are refunded with 30-year amortizing debt.

SECURITY

Asset Description

The authority manages a large and growing toll road system with a long operating history that serves the Houston metropolitan region in Texas. The authority operates as a department of the county and coordinates with outside agencies including the Texas Department of Transportation (TxDOT).

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Harris County (TX) [Toll Roads]				
Harris County (TX) /Toll Revenues - 1st Lien/1 LT	LT	AA Rating Outlook Stable	Affirmed	AA Rating Outlook Stable
Harris County (TX) /Toll Revenues/1 LT	LT	AA Rating Outlook Stable	Affirmed	AA Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Toll Roads, Bridges and Tunnels Rating Criteria (pub. 26 Jun 2020) (including rating assumption sensitivity)

Infrastructure and Project Finance Rating Criteria (pub. 23 Aug 2021) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

GIG AST Model, v1.3.1 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Harris County (TX)	EU Endorsed, UK Endorsed

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