FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Harris County, TX's First-Lien Toll Road Revs Ser 2021 'AA'; Outlook Stable

Tue 08 Dec, 2020 - 4:40 PM ET

Fitch Ratings - San Francisco - 08 Dec 2020: Fitch Ratings assigns an 'AA' rating to Harris County, TX's approximately $437.7 million first-lien toll road revenue bonds series 2021 issued on behalf of Harris County Toll Road Authority (HCTRA). Fitch additionally affirms the 'AA' rating on $1.9 billion of outstanding senior toll road revenue bonds and $400 million of CP notes. 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 8.2x and 6.8x, respectively. Fitch-calculated senior leverage, measured as net debt/cash flow, is very low, averaging 0.2x 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.

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 steadily for decades, 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. Policymakers have shown a willingness to implement consistent annual toll rate hikes in most years since the rate policy's implementation in 2008.

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

HCTRA's five-year (2019-2023) capital improvement plan (CIP) totals $1.5 billion and is funded primarily by system operating revenues, with this debt financing funding approximately $100 million, focused predominantly on the Ship Channel Bridge replacement project and implementation of an all-electronic tolling (AET) 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, including a one-time $300 million transfer this year on top of the typical annual transfer. Transfer amounts can be increased on a discretionary basis and could potentially leave the authority more dependent on debt issuances for future projects.

Senior Debt Profile - Debt Structure: Stronger

This transaction closes the lien on the senior bonds 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 first 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 and have some interest rate exposure but represents only a small percentage of total debt and matures by FY 2021. Cash and surety-funded debt service reserve funds (DSRF) are maintained.

Financial Profile: The authority benefits from a strong balance sheet and high coverage ratios highlighted by sizeable cash balances and a robust rating case gross DSCR averaging 8.2x (first lien), 6.8x (second lien), and 6.0x (third lien) over the next 10 years. Rating case leverage metrics are minimal at a 10-year average of 0.2x (first lien), 0.8x (second lien), and 1.0x (third 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; AA-/Stable). Although ISTHA also benefits from a large and economically diverse catchment area, its lower rating reflects weaker financial metrics compared with 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 Positive Rating Action/Upgrade

-A senior-lien upgrade would be premised on substantially stronger financial metrics compared with the first lien, which is not anticipated over the outlook horizon.

-The first-lien rating is constrained by the authority's large and growing capital improvement plan, which requires future debt issuances.

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

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

-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.

-Substantial increases in county transfers that materially impair the authority's cash position and ability to fund a significant amount of capital with pay-as-you-go resources.

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 new junior lien bonds are being issued mainly to retire approximately $400 million of outstanding CP notes. The remainder of the issuance will be used to fund capital projects, key among them the Ship Channel Bridge and an AET system that will accelerate to 2021 from 2025 the move to system-wide AET.

This bond issuance is the first to be issued using the authority's junior lien, originally established under the 2015 indenture, and positioned between the outstanding senior and subordinate liens. A new junior indenture closes the senior lien and expands the junior lien into four sub liens to increase future debt structuring flexibility. Fitch now considers the first junior lien to be the operational senior lien for future debt issuances.

The series 2021 debt will include a cash-funded DSRA sized to 100% of average annual debt service. The debt will be structured as 30-year fixed rate with level debt service. Additional bonds tests under the junior lien will vary by sub-lien level, with the first lien equal to 1.25x net DSCR and 1.50x gross. In the unlikely event the authority issued down to the additional bonds test, the credit rating could drop by several notches.

The county previously signaled its intent for a debt structure that would have refunded all outstanding debt, to be taken out with debt under a new indenture that would have granted increased flexibility to transfer surplus funds to the county with no related requirement to use those funds for transportation purposes as is now required by the outstanding bond indenture. For the avoidance of doubt, that transaction was not ultimately executed so transferred funds continue to be governed by transportation use restrictions that are not expected to be changed moving forward.

Although not currently being pursued, Fitch would view the potential weakening of these use restrictions as a 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. Once a toll road authority's balance sheet is materially and systemically tapped for general governmental purposes, the system can become vulnerable to a slippery slope of increased political intervention and expanding cash transfers that can lead to credit quality degradation.

Although the authority is making a transfer of $300 million to the county this year on top of its more typical transfer in an amount of roughly $135 million, the transfer is one-time in nature and is being funded for transportation-related projects. After the transfer the authority will retain a solid available cash position of more than $500 million with very high debt service levels.

CREDIT UPDATE

Performance Update

FY 2020 traffic increased 3.8% from 2019 levels and there were no toll rate increases in FY 2020. Fiscal year to date traffic volumes through September 2020 declined 23.2% from the year prior. The steep reduction in traffic volumes was caused by the outbreak of coronavirus beginning in February of 2020, and then travel restrictions with the (-35.6%) trough occurring in April of 2020. Traffic volumes have gradually increased from April lows, with September 2020 volumes down 12.7% yoy. This level of rebound is quite strong in comparison to the toll road sector as a whole.

Prior to the pandemic revenue growth was moderate with a 3.6% gain to $896.8 million in FY 2020. However, similar to the authority's traffic losses, fiscal YTD revenues through September 2020 declined 39.0% yoy. These revenue losses are amplified due to the authority halting toll collections amid the pandemic in April 2020, with revenues down 94.4% when compared with April 2019.

In spite of the pandemic 2020 financial metrics remained strong, with gross senior DSCR at 5.7x (4.5x all-in). Senior net leverage continued to step down to just 0.3x net debt/CFADS (0.6x all-in), driven by lower outstanding debt balances.

FINANCIAL ANALYSIS

Fitch Cases

Under Fitch's rating case assumptions traffic is forecast to fall 21.1% in FY 2021. From there, volumes increase 38.4% and return to pre-coronavirus levels by FY 2022. Toll rate growth is held at 2.0% throughout the life of the debt. Operating expenses increase 5.0% annually from FY 2021 to FY 2023, and increase 4.0% throughout the remainder of our projection period. Under this scenario, 10-year gross DSCR averages 8.2x (senior lien), 6.8x (first junior lien), and 6.0x (subordinate lien). The 10-year leverage remains very low at 0.2x, 0.8x, and 1.0x, respectively.

Fitch's severe downside incorporates similar assumptions as the rating case, however traffic volumes return to pre-coronavirus levels at a slower pace before reverting back to prior rating case growth rates. Under these assumptions, 10-year DSCR still remains quite strong at 6.4x (senior lien), 5.3x (first junior lien), and 4.7x (subordinate lien). Similar to the rating case, 10-year leverage remains under 1.5x throughout all lien levels.

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 Environmental, Social and Corporate Governance (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	New Rating	
• 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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Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

Infrastructure and Project Finance Rating Criteria (pub. 24 Mar 2020) (including rating assumption sensitivity)

Toll Roads, Bridges and Tunnels Rating Criteria (pub. 26 Jun 2020) (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, v1.1.2 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Harris County (TX)	EU Endorsed

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Industrials and Transportation   US Public Finance   Infrastructure and Project Finance

North America   United States