FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Harris County, TX's First Lien Toll Revs Rfdg Bonds & CP Notes 'AA'; Outlook Stable

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Fitch Ratings - Austin - 24 May 2023: Fitch Ratings has assigned a 'AA' rating to Harris County, Texas' (the county) approximately $125 million ser 2023A junior first lien revenue refunding bonds and $150 million junior first lien revenue commercial paper (CP) notes series K-2 (bank bonds). Fitch has also affirmed $2.1 billion of outstanding county toll revenue bonds at 'AA'. The Rating Outlook is Stable.

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

RATING RATIONALE

The ratings reflect Harris County Toll Road Authority's (HCTRA) essential road network in a large and economically solid region with limited viable alternatives, which also drives strong traffic volume. The rating also reflects the authority's prudent financial management and history of strong and growing traffic and revenue performance. The authority shows 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 10.9x and 7.0x, respectively.

Fitch-calculated leverage (net debt to cash flow) is very low, averaging 0.3x for senior debt and 0.8x for senior and first lien debt over the next 10 years. These strengths are modestly offset by the authority's large capital plan, which will require additional debt issuances, and large annual subordinate transfers to the county.

KEY RATING DRIVERS

Revenue Risk - Volume - High Stronger

Proven Resilience and Traffic Demand: 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.

Revenue Risk - Price - Stronger

Demonstrated Ratemaking Flexibility: The authority's new toll rate policy reflects HCTRA's shift to a cashless system and will be effective in fiscal 2024. Toll rates will be based on payment method, with two-axle EZ Tag users receiving a 10% discount to encourage more EZ Tag transponder penetration in the region. Future toll rate increases may be systematically implemented reflecting the greater of 2% or annual CPI changes. The policy is expected to reduce leakage and collection costs and provides the authority with flexibility to maintain a strong financial profile.

Infrastructure Dev. & Renewal - Stronger

Manageable CIP with Prudent Policies: HCTRA's large five-year capital improvement plan (CIP) is funded primarily by a mix of system operating revenues and bond proceeds. The authority adheres to strong capital planning policies that do not allow deferred maintenance, limit 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.

Debt Structure - 1 - Stronger; Debt Structure - 2 - Stronger

Conservative Debt Structure: Fitch assesses the debt structure of both the senior and first lien bonds as stronger. The overall capital structure consists of fixed-rate, fully amortizing debt. Debt service declines in most years, and principal amortizes moderately with more than 50% of total debt retired over the next 10 years. Structural features are strong overall, and the authority maintains cash and surety-funded debt service reserve funds (DSRF). The Authority continues to shift debt from the senior lien to the first junior lien. Fitch considers the first junior lien to be the operational senior lien for future debt issuances.

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 10.9x (1st Lien), 7.0x (2nd Lien), and 6.3x (3rd Lien) over the next 10 years. Rating case leverage metrics are minimal at a 10-year average of 0.3x (1st Lien), 0.8x (2nd Lien), and 1.0x (3rd Lien). Future debt issuances may weaken financial metrics to some extent, but Fitch expects metrics to remain at levels consistent with the 'AA' rating category.

PEER GROUP

HCTRA's most comparable 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 2.0x and higher total leverage of 6.6x.

RATING SENSITIVITIES

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

--A material reduction in rating case DSCR to significantly below 2.5x for a prolonged period;

--Leveraging beyond the authority's historical targeted maximum 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

--Given the credit's already high rating level, a further upgrade is unlikely due to future investment together with sector-wide risks inherent to toll roads.

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 authority expects to issue approximately $125 million in toll road revenue first lien refunding bonds (series 2023A) for interest rate savings. The county expects to refund the senior lien series 2007B bonds and the related 2007B senior lien swap agreements under the 2015 indenture in connection with the expiration or termination of the LIBOR interest rate benchmark in June 2023. Upon the refunding and termination of such obligations, the county will close the 2015 indenture and no additional senior lien obligations will be issued thereunder. The series 2023A bonds are fixed rate and projected to lower debt service with a final maturity of 2035.

The bonds are on parity with the authority's outstanding first lien revenue bonds and CP notes and are secured by a junior lien on gross toll revenues. Fitch considers the first junior lien to be the operational senior lien for future debt issuances; however, senior lien debt remains outstanding. The junior lien consists of four sub-liens, with this issuance 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 are not currently used.

CREDIT UPDATE

Calendar year (CY) 2022 traffic increased approximately 7% from CY2021 levels and 8% compared to CY2019. 2023 year-to-date (YTD) traffic through February continues to show strong improvement, increasing 8% compared to the same prior year period. This level of performance reflects the overall increase in travel demand realized in Harris County, driven by strong population growth and recovery of the local economy following the pandemic.

Similarly, toll revenue performance has been solid, with a 12% increase in CY2022 from the prior year. Operating expense increased 7% in fiscal 2022 compared to the prior fiscal year. The combination of inflation and the transition to an all-electronic tolling (AET) system have been the primary drivers for the increase in expenses, and management expects costs to continue to rise until the transition to an all-electronic tolling system is complete and all facilities are converted to the AET system.

In January 2023, the Harris County Commissioners Court approved modifications to their existing toll policy, set to be effective in September 2023. The need to modify and update the toll policy was brought on by the authority's full elimination of cash collection for tolls during the pandemic, and to better capture the transition to all-electronic tolling. The new toll policy will establish new toll rates for the different methods of processing transactions, and will also provide a 10% toll rate discount to eligible EZ Tag users.

The authority anticipates the EZ Tag discount will encourage more EZ Tag penetration in the region, which will reduce leakage and collection costs. While the discount plan for EZ Tag users may reduce two-axle revenue in the near term, toll rate increases for other user groups and strong population growth in the region is expected to offset the discount. For this reasons Fitch views the modified toll policy as credit neutral.

The authority continues to make transfers of surplus revenues to the county to fund certain projects that are not part of the toll road system, as well as fund the recently established Flood Resilience Trust. Transfers out to the county amounted to $254 million in fiscal 2022, and an additional $123.9 million for the abbreviated seven-month fiscal 2022 transition period ending Sept. 30.

In April 2023, a new debt management policy was put in place by the authority which imposes additional restrictions regarding the use of surplus revenues. The use of surplus revenues now may only be considered if days cash on hand (DCOH) is targeted at 730 days or above, which Fitch views as a positive stipulation for the authority's ability to reserve cash.

Fitch will continue to monitor the subordinate transfers from the authority. 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' category rating.

FINANCIAL ANALYSIS

Financial metrics are extremely strong under Fitch's base and rating cases. Given the assets performance through the first five months of fiscal 2023, Fitch projected 2023 traffic to grow about 3% over the prior fiscal year and then used the sponsor's long-term traffic growth rate assumptions thereafter. Fitch assumed no inflationary toll rate increases in fiscal years 2023-2024, and then assumed 2% inflationary toll rate increases thereafter.

Initial O&M is derived from preliminary and budgetary figures, then later assumed to grow at above-inflationary rates beginning at 3.5%, reflecting increasing costs of the expanding system, and tapering down over time to 2% as system growth matures. Fitch assumes Interoperability Revenues remain at historical averages of 8% of total toll revenues. Under these assumptions, senior and first lien gross DSCR averages 11.0x (7.1x on a total debt basis) over the next 10 years, and senior and first lien net leverage averages 0.3x (.8x on a total debt basis).

Fitch adopts the same assumptions as the base case for fiscal 2023 and then applies a -4% traffic stress in fiscal 2024 (2/3rds of Great Recession drop). Toll rate growth is assumed same as the base case. Traffic recovers to base case levels in FY2026 and base case projections are used from 2025 to 2051. Base case O&M projections are used for 2022-2023, followed by a 50bps increase over base case projections through the life of the debt. Under these assumptions, senior and first lien gross DSCR averages 10.9x (7.0x on a total debt basis) over the next 10 years, and senior and first lien net leverage averages 0.3x (.8x on a total debt basis).

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.

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APPLICABLE CRITERIA

Transportation Infrastructure Rating Criteria (pub. 16 May 2022) (including rating assumption sensitivity)

Infrastructure & Project Finance Rating Criteria (pub. 17 May 2023) (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

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