



RATING ACTION COMMENTARY

Fitch Rates Harris County, TX LT Bank Notes 'AAA'; Outlook Stable

Mon 20 Jul, 2020 - 3:02 PM ET

Fitch Ratings - Austin - 20 Jul 2020: Fitch Ratings assigns a 'AAA' rating to bank notes associated with the following Harris County, TX obligations:

--\$375 million General Obligation Disaster Recovery Commercial Paper Notes, Series J-1.

The J-1 bank note rating is being assigned in connection with the execution of a liquidity agreement with Bank of America, N.A., effective July 1, 2020, which provides support for the series J-1 notes. Based on a review of the terms governing bank bonds specified in the agreement, it is Fitch's opinion that the incremental risk associated with bank bonds does not have a material impact on the long-term credit quality of the county.

In addition, Fitch affirms the 'AAA' on the following county obligations:

-- Issuer Default Rating (IDR);

-- Approximately \$834 million limited tax bonds;

- Approximately \$655 million unlimited tax bonds;
- Approximately \$83 million Harris County Flood Control District limited tax bonds;
- Approximately \$4065 million Harris County Flood Control District contract tax revenue bonds.

The Rating Outlook is Stable.

The note proceeds will be used to facilitate disaster recovery, restoration, and economic revitalization in areas affected by Hurricane Harvey.

SECURITY

The notes and limited tax bonds are payable from an annual property tax levy limited to \$0.80 per \$100 assessed valuation (AV) for operations and debt service. The unlimited tax bonds are payable from an unlimited annual property tax levy. The Harris County Flood Control District (the district) limited tax bonds are payable from an annual property tax levy limited to \$0.30 per \$100 AV for operations and debt service. The district's contract tax revenue bonds are payable from payments received from the county pursuant to a flood control projects contract. The county's obligation to make the payments is backed by a pledge of its tax levy, limited to \$0.80 per \$100 AV.

ANALYTICAL CONCLUSION

The county's 'AAA' IDR reflects its strong gap-closing capacity in the form of budget controls supplemented by ample reserve funding, a moderate long-term liability burden, and robust economic base and growth prospects. Management's prudent budgeting of its expansive resource base benefits the county's prospects for maintaining structural balance through economic cycles.

Fitch rates the Harris County Flood Control District's (the district) long-term debt 'AAA' based on the tax base's strong revenue growth prospects as well as ample

revenue-raising flexibility within the annual property tax revenue limitation, which provide a significant cushion against potential tax base declines and offsets any concern about tax base volatility. As the district is a blended component unit of Harris County with limited operations, Fitch believes that operating risk exposure for the bonds is best reflected in the county's IDR of 'AAA'.

ECONOMIC RESOURCE BASE

Harris County is the largest county in Texas and the third largest in the nation, encompassing all but a small portion of the city of Houston, with a population totaling nearly 4.7 million. The county features a large, diverse economy. Expansion of the healthcare, biomedical research, aerospace, port, and petrochemical industries over the past several decades has reduced the historically strong reliance on the energy exploration sector.

KEY RATING DRIVERS

Revenue Framework: 'aaa'

Although the pandemic-induced shutdown and the oil price shock is likely to result in sluggish or negative AV growth in near-term budget cycles, a long-term healthy pace of revenue growth is likely to continue as cyclical contraction within the energy sector is balanced against continued expansion of the county's diverse economy. The impact of recent statewide property tax revenue limitations is mitigated by flexibility in other locally controlled revenues.

Expenditure Framework: 'aa'

The county's expenditure flexibility is aided by prudent budgeting, pay-go capital spending, and lack of collective bargaining agreements with any of its personnel. Fitch expects growth-related spending demands to be matched by revenue gains, keeping their trajectories in line with one another.

Long-Term Liability Burden: 'aa'

The long-term liability burden is moderate relative to personal income and driven primarily by overlapping debt. The county consistently funds its pension at actuarially determined levels and the net pension liability is modest relative to the resource base.

Operating Performance: 'aaa'

The combination of the county's expenditure flexibility and revenue-raising authority, as well as its record of very large reserve funding, should enable maintenance of a high level of financial flexibility during the current downturn and future economic cycles.

RATING SENSITIVITIES

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

--Not applicable given the current 'AAA' rating.

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

--An economic contraction extending well into the second half of 2020 or beyond, consistent with Fitch's coronavirus downside scenario, which triggers sustained and deeper than expected revenue declines and materially erodes the county's gap-closing capacity.

--Although unlikely, a sustained increase in the long-term liability burden above 20% of personal income due to substantially larger debt issuance than expected or large declines in the county's resource base.

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>].

CURRENT DEVELOPMENTS

Sector-Wide Coronavirus Implications

The ongoing outbreak of coronavirus and related government containment measures worldwide create an uncertain global environment for U.S. state and local governments and related entities in the near term. While the district's most recently available fiscal and economic data may not fully reflect impairment, material changes in revenues and expenditures are occurring across the country and likely to worsen in the coming weeks and months as economic activity suffers and public health spending increases. Fitch's ratings are forward-looking in nature, and Fitch will monitor developments in state and local governments as a result of the virus outbreak as it relates to severity and duration and incorporate revised expectations for future performance and assessment of key risks.

In its baseline scenario, Fitch assumes sharp economic contractions to hit major economies in 1H20 at a speed and depth that is unprecedented since World War II. Sequential recovery is projected to begin from 3Q20 onward as the health crisis subsides after a short but severe global recession. GDP is projected to remain below its 4Q19 level until mid-2022. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the report entitled, [Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases - Update](#), published April 29, 2020 on www.fitchratings.com.

As is the case with other counties, Harris County has experienced the effects from the spread of the coronavirus. The governor declared a state of disaster for all counties in Texas on March 13, 2020. Subsequently, the governor's executive order,

effective March 31 through April 30, directed all Texans to stay at home unless participating in essential services or activities. Large meetings and sporting events were cancelled; elective and/or non-critical hospital surgeries were postponed; essential businesses remain closed or are operating with a remote workforce, and all area K-12 school districts switched to remote learning.

Beginning on May 5, the governor has allowed for phased-in partial restarting of economic activity in the state. However, Fitch believes the reopening of Harris County may be stalled due to the surging number of coronavirus cases in the county. The county currently leads the state in the number of coronavirus cases, leading county management to elevate its assessment of risk to 'Level 1: Severe-Stay Home Work Safe' on (date); however, a county-wide stay at home order has not been issued.

The county entered the pandemic-induced shutdown with a very strong financial position. Unaudited fiscal 2020 results point to further expansion of its fiscal 2019 unrestricted fund balance of \$1.3 billion, equal to nearly 59% of spending. The budget for fiscal 2021, which began on March 1, was adopted as balanced; however, but greater than budgeted AV gains are expected to result in additional property tax revenues (which accounted for 81% of general fund revenues in fiscal 2019). Because the county doesn't expect a material near-term impact to property taxes and it does not collect sales taxes, management projects a modest revenue loss of less than 1% for the general fund in fiscal 2021.

COVID-related expenditures totaled \$75 million through June and were funded from the county's public improvement contingency (PIC) fund (unaudited fiscal 2020 unrestricted fund balance of \$247 million). Reported as part of the general fund group, the PIC fund receives property tax revenues from a dedicated property tax levy. The county expects to utilize its entire \$426 million allocation of Coronavirus Recovery and Economic Stabilization (CARES) Act funds to reimburse the PIC fund and pay for related recovery efforts, allowing the fiscal 2021 general operating budget to remain balanced.

The recent oil price shock represents an additional challenge to the local economy. The combined economic setback of the coronavirus and the oil price shock has led to widespread layoffs in the manufacturing, construction/mining, and leisure/hospitality sectors. The larger layoffs include Haliburton Energy Services (3,500), Texas Steel Conversion (491), Four Season Hotel (344), Zachary Industrial (288), UTLX Manufacturing (278), and Baker Hughes (184).

Recovery from these combined economic setbacks may last longer than previous downturns, but Fitch expects economic growth will return to strong pre-pandemic levels. IHS Markit expects a slower than typical recovery in 2021 for the MSA, followed by gradual recovery of the energy sector that will boost overall economic growth in 2022. Compared to the forecast price of \$35 per barrel for 2020, Fitch projects the price will increase to \$45 and \$53 in 2021 and 2022, respectively. During the recovery period, Fitch expects AV will turn sluggish or decline modestly as in past downturns. Continued in-migration and natural population growth will serve to buoy the county's housing market and taxable values over the medium term.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

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

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

RATING ACTIONS

ENTITY/DEBT	RATING		
Harris County (TX) [General Government]	LT IDR	AAA Rating Outlook Stable	Affirmed

ENTITY/DEBT	RATING		
<ul style="list-style-type: none"> Harris County (TX) /General Obligation - Limited Tax/1 LT 	LT	AAA Rating Outlook Stable	Affirmed
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[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[U.S. Public Finance Tax-Supported Rating Criteria \(pub. 27 Mar 2020\) \(including rating assumption sensitivity\)](#)

APPLICABLE MODELS

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

FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

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Harris County Flood Control District (TX)	EU Endorsed

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