CREDIT OPINION
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Harris County Hospital District, TX

Update to credit analysis

Summary

Harris County Hospital District ,TX(HCHD, Aa1 general obligation, A2 revenue bond, stable outlook) is a vital component of the healthcare delivery system in Harris County (Aaa stable), serving as both a trauma center and care provider for the indigent population. The district aligns with the boundaries of Harris County, benefiting from a large and diverse tax base that includes the City of Houston (Aa3 stable).

HCHD has initiated several significant construction projects aimed at replacing and upgrading most of its facilities. These projects, estimated to cost $3.2 billion through 2035, will be financed through $2.5 billion of voter-authorized general obligation bonds, HCHD's cash resources, and philanthropic contributions. Strong voter support (with a 70% approval rate for the bond resolution) highlights HCHD's crucial roles as a safety net hospital, Level I Trauma center, and teaching hospital for multiple medical schools in the Houston metropolitan area. Additionally, affiliated health insurance companies will continue to provide coverage for some of HCHD's patients, thereby broadening the organization's risk profile to include insurance exposure.

Credit strengths

» Component unit of Harris County, TX; property taxes provide 33% of operating revenue and fund major capital including an upcoming campus rebuild

» Large tax base that has experienced strong assessed value (AV) growth

» Property tax rate will remain below legal limit after new taxes levied to support upcoming bond issues, although political constraints may limit the practical ability to raise the tax rate

» Important role in the delivery of care in Houston as the primary safety net system, a Level I trauma center, and teaching hospital for several medical schools in Houston

» Effective management team that successfully operates within revenue constraints of tax revenue and supplemental funding structure

Credit challenges

» Majority of revenue comes from sources largely outside HCHD's control (property taxes, Medicaid, and other programs)

» Planned cash contribution to capital projects will reduce days cash to about 150 days

» Risk that affiliated insurance companies will require financial support will continue; although profitable, the companies' margins are modest and their business lines are concentrated in the Houston market and highly exposed to Medicaid, making them subject to unanticipated changes in state funding

Rating outlook

The stable outlook reflects our expectation that HCHD will continue receiving sufficient supplemental funding and tax revenue for operations to allow the organization to generate operating surpluses and sufficient cash flow to fund routine capital and operations. The stable outlook also reflects expectations that days cash will decline to about 150 days as cash is spent on master facility planning.

Factors that could lead to an upgrade

» Sustained trend of increased unrestricted liquidity along with a significant reduction in leverage

» Effective oversight and execution of HCHD's very substantial capital plan

» Expansion of programs, or increased funding which lead to higher margins and additional revenue

Factors that could lead to a downgrade

» Significant increase in the leverage profile, with a debt to revenue ratio in excess of 0.8x and debt to assessed value in excess of 0.5%

» Persistent operating losses combined with a significant reduction in federal, state, or tax revenues that do not align with inflation and HCHD's expense base

» Material capital transfers to affiliated insurance companies

Key indicators

Exhibit 1

Harris County Hospital District	2020	2021	2022	2023	2024
Economy/Tax Base					
Total Full Value ($000)	$461,641,802	$494,523,765	$508,749,755	$544,607,133	$590,883,077
Population	4,680,609	4,697,957	4,726,177	4,726,177	4,811,137
Full Value Per Capita	$98,629	$105,264	$107,645	$115,232	$122,816
Median Family Income (% of US Median)	91.5%	90.7%	89.5%	89.5%	89.5%
Finances					
Operating Revenue ($000)	$1,711,253	$2,115,047	$2,294,592	$2,521,876	$2,534,429
Fund Balance ($000)	$995,996	$1,327,602	$1,407,915	$1,562,754	$1,502,660
Cash Balance ($000)	$1,004,475	$1,198,950	$1,331,125	$1,140,817	$1,612,501
Fund Balance as a % of Revenues	58.2%	62.8%	61.4%	62.0%	59.3%
Cash Balance as a % of Revenues	58.7%	56.7%	58.0%	45.2%	63.6%
Debt/Pensions					
Net Direct Debt ($000)	$287,693	$307,708	$297,094	$327,155	$309,144
3-Year Average of Moody's ANPL ($000)	$624,712	$669,628	$670,414	$589,884	$472,259
Net Direct Debt / Full Value (%)	0.1%	0.1%	0.1%	0.1%	0.1%
Net Direct Debt / Operating Revenues (x)	0.2x	0.1x	0.1x	0.1x	0.1x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	0.1%	0.1%	0.1%	0.1%	0.1%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	0.4x	0.3x	0.3x	0.2x	0.2x

In 2022 the district changed the fiscal year end (FYE) to September 30; the September 30, 2023 audit is the first 12-month audit with the new September 30 FYE.
Source: Moody's Ratings

Exhibit 2
Harris County Hospital District, TX (revenue bond key indicators)

	2020	2021	2022	2023	2024	2023 A rated medians
Operating Revenue ($'000)	1,691,475	2,104,406	2,279,142	2,432,879	2,445,716	2,178,795
3 Year Operating Revenue CAGR (%)	7.8	14.0	16.3	12.9	5.1	8.0
Operating Cash Flow Margin (%)	9.5	18.8	13.1	8.6	4.4	5.5
PM: Medicare (%)	11.5	11.9	12.7	10.6	11.2	48.5
PM: Medicaid (%)	22.1	22.3	21.1	23.0	19.0	15.9
Days Cash on Hand	215	232	227	166	228	188
Unrestricted Cash and Investments to Total Debt (%)	374	464	539	463	693	164
Total Debt to Cash Flow (x)	1.2	0.5	0.6	0.8	1.1	3.6

In 2022 the district changed the fiscal year end (FYE) to September 30; the September 30, 2023 audit is the first 12-month audit with the new September 30 FYE.
Source: Moody's Ratings

Based on audits for Harris County Hospital District, d/b/a Harris Health, A Component Unit of Harris County, for fiscal years ended February 28 (2020 – 2022) and September 30, 2023-2024.

Profile

HCHD, d/b/a Harris Health, is the leading provider of medical care to the indigent and uninsured in Harris County, TX (Aaa stable), including the City of Houston (Aa3 stable). HCHD operates A level I Trauma center, serves as teaching hospitals for two medical schools and has numerous outpatient centers throughout its service area. The district is conterminous with Harris County and is a component unit of the county. The Harris County Commissioner's Court appoints the system's Board of Managers. The county's estimated population exceeds 4.8 million as of 2024.

Detailed credit considerations

Economy and tax base

Harris County Hospital District, which is conterminous with Harris County, stands to benefit from sustained commercial and residential demand throughout the county. This growth is driven by robust population trends, leading to continued assessed value (AV) increases over the forthcoming years and resulting in higher property tax revenue for the district's operations and debt servicing.

The local economy has consistently expanded, bolstered by strong demand for residential housing and ongoing employment growth. Over the past five years, assessed values have increased at an average annual rate of 5.7%, including a 3% increase from 2024, reaching to a large $608.07 billion in fiscal year 2025. Top taxpayers represent a modest 3.7% of the fiscal year 2025 AV.

Rising employment opportunities have contributed to steady population growth and an expansive labor force participation rate. From 2010 to 2024, the county's population grew by over 595,000 residents (a 16% increase), with an additional 52,000 residents added since 2020, bringing the estimated total population to over 4.8 million as of 2024. The resilient job market is reflected in the county's unemployment rate of 4.4% as of January 2025, slightly above the state rate (4.1%) and on par with the national rate (4.4%). The county's labor force has grown steadily by an average of 0.7% annually since 2014, reaching 2.5 million in 2024. Although resident income levels are below average, with median family income at 89% of the national level, the full value per capita remains solid at $126,390.

Market Position

HCHD will continue to serve an essential role in the City of Houston (Aa3 stable GO rating) and Harris County (Aaa stable GO rating) by providing healthcare services to a largely indigent population, operating one of the area's trauma centers and through its role as a teaching hospital for Baylor College of Medicine and University of Texas Medical School. These essential roles impart significant credit strength to HCHD, despite the financial challenges that its payor mix creates.

HCHD is a component unit of Harris County and receives significant property tax revenue to support operations and large capital projects. In 2023, voters overwhelmingly approved establishing new property tax levies to secure $2.5 billion in bonds that will be used to finance major capital projects including rebuilds of the system's major hospitals. The new taxes will be levied in addition to already existing levies for operations (M&O) and special capital projects. Tax support and strong voter support are key credit strengths of HCHD.

There are two health insurance companies whose financial results are presented alongside the health system's financial results in HCHD's audit. Though the insurance companies are legally separate from HCHD, they are strategically important and insure some of HCHD's patients. There is risk that the insurance companies will require financial support as they have once before; the companies are currently profitable though margins are modest and their business lines are concentrated in the Houston market and highly exposed to Medicaid, making them subject to unanticipated changes in state funding. Senior management at HCHD and the insurance companies meet regularly to advance the mission and strategic interests of both organizations. On balance, the close relationship is beneficial to HCHD, positively impacting insurance coverage and care coordination for patients insured by the insurance companies, however, the relationship also presents financial risk because of the likelihood that HCHD would provide financial support to the insurance companies if needed.

Operating performance, balance sheet and capital plans

HCHD is budgeting for weaker financial performance in 2025 with an operating cash flow margin of about 2.8% (with investment returns reclassified as non-operating). However, actual performance through five months, is significantly stronger at about 10% OCF margin. The positive variance is because of several factors including stronger than anticipated Medicaid supplemental payments, and good overall expense management by the district. Ultimately, the district's financial performance will continue to depend on management's ability to operate within revenue constraints set by the amount of supplemental funding and property taxes the organization receives. These funding sources are outside of management's control and have varied (sometimes substantially) from year to year. In fiscal 2024 (Sept. 30 year-end) property taxes accounted for 35% of operating revenue and supplemental funding accounted for 28%. The property tax levy has varied from year to year as the commissioners' court endeavors to balance tax allocations to maintain a generally stable tax burden for residents; property tax accounted for as much as 50% of operating revenue in 2018.

Potential changes to federal Medicaid policy, which are expected to be considered as part of the budget reconciliation process later this year, could have material impact on HCHD's Medicaid funding. Medicaid supplemental payments are a key source of revenue (28% in fiscal 2024) and cuts or reductions to the growth rate of payments would likely have a material negative impact to HCHD.

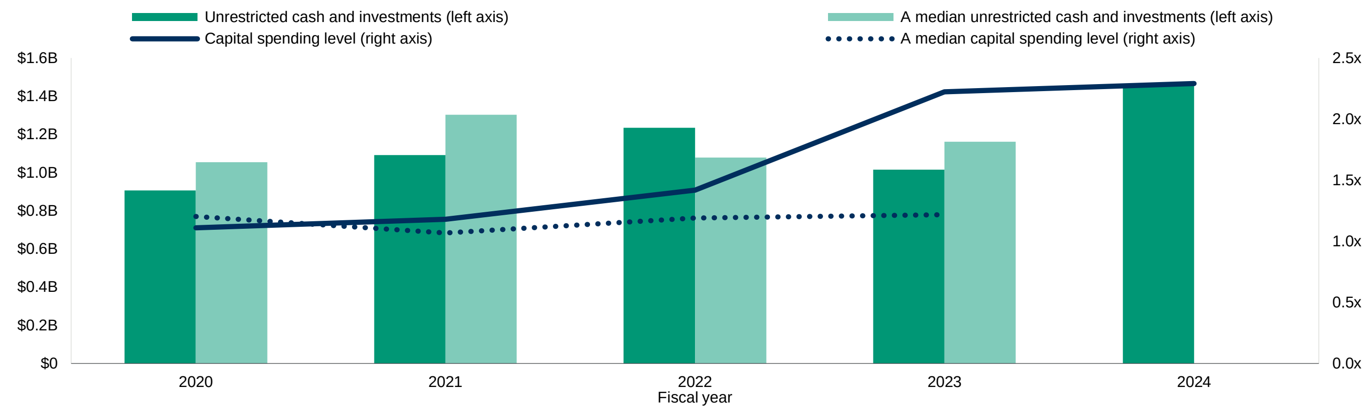
Liquidity

Cash and investment balances totaled about $1.8 billion at Feb. 28, 2025. HCHD will spend about $300 million of its own cash on the master facility plan, decreasing days cash to about 150 – 160 days over the next year or about $1.2 billion. Liquidity fluctuates throughout the year, peaking when property taxes are paid. At fiscal year-end 2024, the district had roughly $1.46 billion of unrestricted liquidity, representing 228 days cash on hand and 63% of operating revenue.

HCHD does not have access to lines of credit. As a governmental entity, Texas law prohibits it from establishing lines of credit; however, it may access the commercial paper market by using letters of credit or structuring borrowings from banks to comply with relevant laws.

Exhibit 3

Capex to rise significantly and be mostly debt financed; equity contributions of about $750 million will be financed from cash flow and reserves toward the end of the construction.



Source:Moody's Ratings

Debt structure and legal covenants

HCHD is modestly leveraged with revenue backed debt measuring under 8.6% debt to revenue. HCHD also has GOLT debt backed by a dedicated property tax levy. As fiscal 2024, GOLT debt consists of the Series 2016 (about $41.6 million) and Series 2020 (about $17.6 million).

Despite the anticipated increase in GOLT debt to complete the system's expansion, leverage is likely to remain manageable. Following the issuance of Series 2025 (approximately $850 million), total leverage is projected to rise to 0.19% of fiscal 2025 assessed value and 0.46x operating revenue. In November 2023, voters approved a $2.5 billion bond package, with a significant portion allocated for the construction of the new LBJ Hospital ($1.6 billion). The district plans to issue the bonds in phases, beginning with the current offering. The district has sufficient flexibility within the limited tax rate to meet the debt service requirements on the outstanding GOLT bonds. If the entire tax rate limit of $7.50 were utilized, it would generate a maximum levy of $4.8 billion, compared to the projected maximum annual debt service (MADS) of $62.7 million.

Legal security

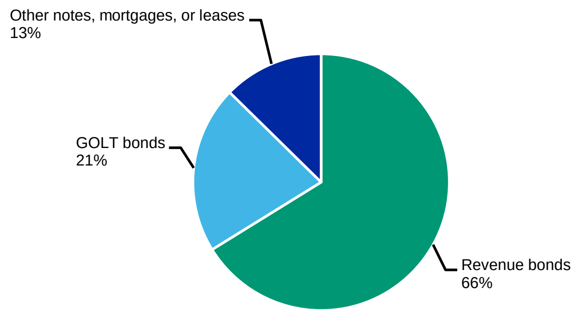
The district's outstanding general obligation limited tax (GOLT) bonds are payable from an ad valorem tax levied within the limits prescribed by law on all taxable property within the district. The district is limited to a total tax rate of $7.50 per $1,000 compared to a total tax rate of $1.64 for fiscal 2024, of which $0.01 was for debt service. The debt is also secured by state statute. The revenue bonds are secured by Pledged Revenues of HCHD. Pledged Revenues include revenue and income derived from the operation of the hospitals, exclusive of ad valorem taxes and certain other excluded items. The bonds are supported by debt service reserve funds so long as the Series 2010 bonds are outstanding.

Key covenants in the LOC include 60 days cash (measured semiannually) and coverage of maximum annual debt service by Pledged Revenues of at least 2.0x. Pledged Revenue includes most revenue, but excludes tax revenue. It is not a net revenue pledge. HCHD is also covenanted to prepare a balanced budget that includes ad valorem tax revenue as a revenue source. In tandem, these two covenants function similarly to net revenue pledge.

Debt structure

The GOLT debt is fixed rate and amortizes through maturity. The revenue backed debt structure is 65% amortizing fixed rate and short term borrowings, and 35% variable rate, backed by a letter of credit from JP Morgan. Key covenants in the LOC include 60 days cash (measured semiannually) and MADS coverage of 2.0x; we expect HCHD will maintain comfortable headroom to its financial covenants.

Exhibit 4



Data as of 9/30/2024.
Source: Moody's Ratings

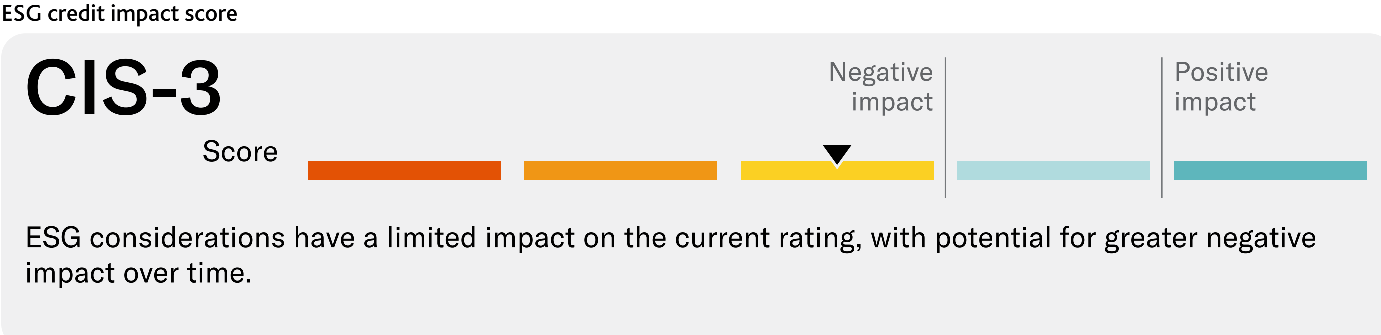
Debt-related derivatives
There are no debt-related derivatives.

Pensions and OPEB
HCHD maintains a defined benefit pension plan and sponsors OPEB benefits. The plan utilizes GASB accounting and was 80% funded at fiscal 2024 with an unfunded liability of $235 million. Because of recent increases in the discount rate, the funded status is similar to if the plan were valued using market discount rates. The plan is frozen to new entrants, although participants continue to accrue benefits. In fiscal 2019, HCHD adopted GASB 75, recognizing $444 million of OPEB liabilities. OPEB is paid on a pay-go basis and annual contributions are about $23 million.

ESG considerations

Harris County Hospital District, TX's ESG credit impact score is CIS-3

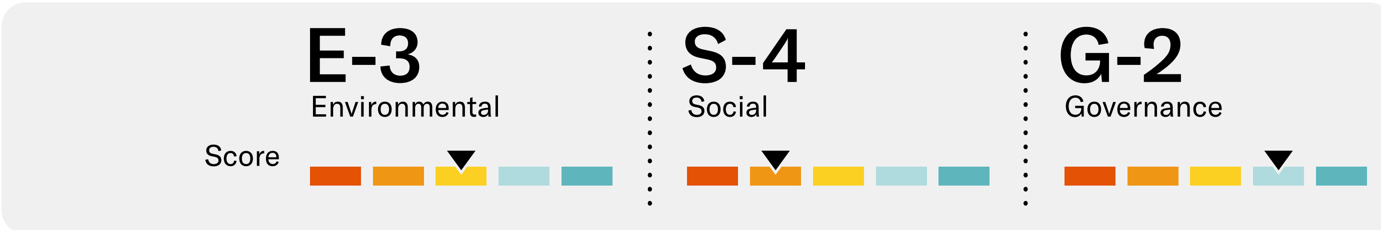
Exhibit 5
ESG credit impact score



Source: Moody's Ratings

Harris County Hospital District's (HCHD) ESG Credit Impact Score is moderately negative (3), reflecting moderately negative environmental risks, highly negative social risks related to its payor mix and revenue structure, and a neutral assessment of governance risks. These risks are offset by the essential role the organization plays in the region's healthcare delivery system and long track record of securing sufficient supplemental funding.

Exhibit 6
ESG issuer profile scores



Source: Moody's Ratings

Environmental

HCHD's E-IPS of moderately negative (**E-3**) higher than average flood risk in the Houston metro area where the system's facilities are located. All other environmental sub-factors are assessed as neutral

Social

HCHD's S-IPS of highly negative (**S-4**) balances highly negative exposure in societal and demographic trends against moderately negative exposure (3) to customer relations, human capital, and responsible production risks; these scores are broadly in line with national averages for the sector, though payor mix challenges and reliance on government related revenues is a notable challenge for HCHD. The customer relations score reflects HCHD's reputation for high quality care, provision of trauma and other essential services and its role as a teaching hospital for several medical schools, balanced against risks inherent to the sector including market and brand strength vis a vis commercial payors, and cyber-security. As a public safety net hospital receiving significant tax revenue and supplemental funding, the county commissioners and state agencies administering Medicaid and supplemental funding programs are key constituents for HCHD. Similarly, the affiliated insurance companies also have state insurance regulators and Medicaid policy makers as key constituents. HCHD and the insurance companies maintain normal working relationships with these various agencies and regulators. The highly negative (4) score assigned to societal and demographic trends reflects the organization's payor mix which is dominated by tax revenue and supplemental funding; though HCHD has normal working relationships with the entities determining these funding amounts, it does not have direct control over them, and as a result, a significant share of HCHD's cash flow will be subject to periodic updates with local and state officials.

Governance

HCHD's G-IPS is neutral-to-low (**G-2**) reflecting a neutral assessment of financial strategy and risk management and management credibility that offset challenges under board structure, which we assess as moderately negative (3) because it is appointed by an elected body and is not self-perpetuating. HCHD is governed by a nine member board whose members are appointed by the Harris County Commissioners, an elected body, which oversees the entire county including various other agencies. Risks of this governance model are evident in fiscal 2023: political disagreements among the county commissioners resulted in the county adopting a "no new revenue" tax rate, meaning that HCHD will not receive additional tax revenue in fiscal 2023 compared to the prior year. HCHD's organizational structure is also assessed as moderately negative (3) because of its relationship with affiliated insurance companies. HCHD appoints the Board of Directors of the insurance companies, which insure a similar patient population to that served by HCHD. HCHD does not manage the day-to-day operations of the insurance companies, but senior management of both are in regular contact. There are no regular financial transfers between HCHD and the insurance companies, though HCHD did make a significant transfer in 2018 and we believe both organizations have strategic and financial interests in the success of the other.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

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