



RATING ACTION COMMENTARY

Fitch Rates Harris County Flood Control District, TX's LT CP Notes, Series H-2 'AAA'; Outlook Stable

Wed 02 Feb, 2022 - 5:53 PM ET

Fitch Ratings - Austin - 02 Feb 2022: Fitch Ratings has assigned a 'AAA' rating to bank notes associated with Harris County Flood Control District, TX's \$200 million limited tax (LT) CP notes, series H-2.

The Rating Outlook is Stable.

The H-2 bank note rating is being assigned in connection with the execution of a liquidity agreement with PNC Bank, National Association, to be effective Feb. 24, 2022, which provides support for the series H-2 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.

SECURITY

The LT CP notes and associated bank bonds are payable from an annual property tax levy limited to \$0.30 per \$100 assessed valuation.

ANALYTICAL CONCLUSION

The county's 'AAA' Issuer Default Rating (IDR) reflects its ample gap-closing capacity and prospects for maintaining structural balance through economic cycles given superior inherent budget flexibility supplemented by large reserves, a moderate long-term liability burden, and robust economic base and growth prospects.

As the Harris County Flood Control District (the district) is a blended component unit of Harris County with limited operations, Fitch believes that operating risk exposure for the district's bonds is best reflected in the county's IDR.

Economic Resource Base

With a 2020 population totaling just over 4.7 million, 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. The energy exploration sector remains important, but the economy is fairly large and diversified with the health care, biomedical research, aerospace, port and petrochemical industries all expanding.

KEY RATING DRIVERS

Revenue Framework: 'aaa'

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 county's overall revenue-raising ability remains high relative to modest historical revenue volatility.

Expenditure Framework: 'aa'

The county's expenditure flexibility is aided by strong workforce controls with no collective bargaining agreements and pay-go capital spending. Fitch expects growth-related spending demands to be matched by revenue gains.

Long-Term Liability Burden: 'aa'

Fitch expects the county's long-term liability burden, comprised primarily of overlapping debt, to remain moderate given likely robust population and economic gains. 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 solid expenditure flexibility and ample revenue-raising authority, as well as its record of very large reserve funding, should enable maintenance of the highest level of financial flexibility through 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:

--Economic contraction that negatively affects key county revenues, particularly property tax upon which the county is heavily reliant, and materially erodes the county's gap-closing capacity;

--Although unlikely, a sustained increase in the long-term liability burden near or 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

The county has maintained its very strong financial position through the pandemic. The fiscal 2021 (YE Feb. 28) audit posted a net general fund surplus of approximately \$356 million (13.9% of spending) and an unrestricted fund balance of approximately \$1.4 billion or 55% of spending. Coronavirus-related expenditures incurred in fiscal 2021 were initially funded with \$153 million from the county's public improvement contingency (PIC) fund. Reported

as part of the general fund group, the PIC fund receives property tax revenues from a dedicated property tax levy. The county is seeking FEMA reimbursement to pay for these related recovery efforts.

Local property taxes, which accounted for 80% of general fund revenues in fiscal 2021, were not materially affected by the pandemic and continued to grow despite various coronavirus-related payment deadline extensions. The county saw its largest revenue loss in charges for services at \$21 million (an 8.4% yoy decline on total general fund revenues of \$2.3 billion). The county does not collect sales taxes. Overall stability in its primary revenue stream largely allowed county management to avoid implementing cost saving measures, such mid-year budget cuts or hiring freezes.

The county received \$426 million in federal CARES ACT funds in fiscal 2021, which were recorded outside the general fund. Harris County was allocated a total of \$914 million in American Rescue Plan Act (ARPA) aid, which will also be recorded outside of the general fund; roughly half (\$458 million) was received in May 2021, and the remainder is anticipated in 2022. The county's allocation of these funds is focused on the areas of health, housing and jobs.

Total operating tax revenue for fiscal 2022 is budgeted to be up by a sizable \$102 million (6.5%) from the prior year's adopted budget due in part to a modest increase in the nominal O&M tax rate. The year's taxable AV grew by a sluggish 1.8%, not unlike past downturns, to \$514 billion with a moderate decrease in industrial values offset in part by gains in residential valuations. Overall, budget assumptions remained largely flat in the county's roughly \$2 billion fiscal 2022 general fund operating budget and management currently expects break-even results.

CREDIT PROFILE

The Houston MSA is home to several thousand energy companies, ranging from large multi-national concerns to numerous mid-sized-to-smaller exploration, construction, engineering and service companies. The lingering effects of the oil price shock in the second quarter of 2020 to area employment may represent an additional challenge to the local economy post-pandemic. Widespread layoffs occurred in the manufacturing, construction/mining and leisure/hospitality sectors. However, a strong, ongoing recovery has led the county unemployment rate to trend downward to 5.1% in November 2021 from 8.0% a year prior.

Fitch expects economic growth will return to its strong pre-pandemic levels at full recovery. Professional and business services are likely to be one of the MSA's leading growth sectors.

Fitch expects the trade and transportation sector to benefit from additional activity at the Port of Houston due to the fast-growing export market for U.S. oil, natural gas and chemicals. The port is ranked first in the U.S. in foreign waterborne commerce and second in total tonnage.

Continued in-migration and natural population growth will serve to buoy the county's housing market and taxable values over the medium term. The county experienced a nearly 16% population gain in 2010-2020, the majority of which occurred in the unincorporated areas. Fitch expects the MSA's strong population growth trend to continue, aiding in the stabilization of the housing market during energy sector downturns. Per Zillow, the median home value totals \$256,048, an 18% increase over the 12-month period ending December 2021.

For more information, see "Fitch Rates Harris County, TX's Permanent Improvement Rfdg Bonds 'AAA'; Outlook Stable" (November 2021).

Revenue Framework

Revenue Framework Details: No text found.

DATE OF RELEVANT COMMITTEE

15 November 2021

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

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) [General Government]		
Harris County Flood Control District (TX) /General Obligation - Limited Tax/1 LT	LT AAA Rating Outlook Stable Affirmed	AAA Rating Outlook Stable

[VIEW ADDITIONAL RATING DETAILS](#)

FITCH RATINGS ANALYSTS

Jose Acosta

Senior Director

Primary Rating Analyst

+1 512 215 3726

jose.acosta@fitchratings.com

Fitch Ratings, Inc.

2600 Via Fortuna, Suite 330 Austin, TX 78746

Rebecca Moses

Director

Secondary Rating Analyst

+1 512 215 3739

rebecca.moses@fitchratings.com

Amy Laskey

Managing Director

Committee Chairperson

amy.laskey@fitchratings.com

MEDIA CONTACTS

Elizabeth Fogerty

New York

+1 212 908 0526

elizabeth.fogerty@thefitchgroup.com

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

[U.S. Public Finance Tax-Supported Rating Criteria \(pub. 04 May 2021\) \(including rating assumption sensitivity\)](#)

APPLICABLE MODELS

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

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

ADDITIONAL DISCLOSURES

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Harris County Flood Control District (TX)

EU Endorsed, UK Endorsed

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