FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Harris County, TX's Permanent Improvement Rfdg Bonds 'AAA'; Outlook Stable

Tue 16 Nov, 2021 - 1:30 PM ET

Fitch Ratings - Austin - 16 Nov 2021: Fitch Ratings has assigned a 'AAA' rating to Harris County, TX's $120 million Permanent Improvement Refunding Bonds, Series 2021A.

In addition, Fitch has affirmed the 'AAA' rating on the following:

--Issuer Default Rating (IDR);

--Approximately $706 million limited tax bonds;

--Approximately $531 million unlimited tax bonds;

--Approximately $585 million Harris County Flood Control District limited tax bonds;

--Approximately $348 million Harris County Flood Control District contract tax bonds.

The Rating Outlook is Stable.

Bond proceeds will be used to refund certain outstanding commercial paper notes. The bonds are expected to price during the week of Nov. 29 via negotiated sale.

SECURITY

The permanent improvement refunding 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 road refunding bonds are payable from an unlimited annual property tax levy. The Harris County Flood Control District (the district) improvement refunding 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 ample gap-closing capacity in the form of superior inherent budget flexibility supplemented by large reserve funding, a moderate long-term liability burden, and robust economic base and growth prospects. Management's conservative budgeting of its expansive resource base benefits the county's prospects for maintaining structural balance through economic cycles.

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 county features a large, diverse economy that retains exposure to the energy sector. 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'

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, 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'

At an estimated 12% of resident personal income, the county's long-term liability burden is moderate and Fitch expects it to remain so, driven primarily by overlapping debt. Future growth-related debt and capital needs should stay aligned with likely further 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 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 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). 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. County management has begun initial discussions on the use of these funds with a broad focus 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 were realized in the manufacturing, construction/mining and leisure/hospitality sectors. However, a strong, ongoing recovery has led the county unemployment rate to trend downward to 6.1% in August 2021 from 8.5% a year prior.

Fitch expects economic growth will return to its strong pre-pandemic levels at full recovery. Professional and business services are expected to be one of the MSA's leading growth sectors. The trade and transportation sector is projected 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.

The current price of West Texas Intermediate (WTI) oil per barrel ($80) bodes well for the county's energy sector and is well above Fitch's projection of $55 and $50 in 2021 and 2022, respectively. Additional details are described in the report entitled, "What Investors Want to Know: North American Energy (Oil & Gas) and Natural Resources (One Year Post Coronavirus - Recovery, End-Market Demand Improves)," published June 2, 2021 on www.fitchratings.com.

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 $247,453, a 17.6% increase over the 12-month period ending September 2021.

Revenue Framework

Property taxes accounted for over 82% of general fund revenues in fiscal 2021. Favorable revenue trends have been aided by steady tax base gains and the county's practice to maintain a level O&M tax rate even during periods of AV growth. A modest reduction in the nominal tax rate was levied in fiscal 2021 before being partially restored in fiscal 2022.

Historical revenue growth has exceeded the level of inflation and U.S. GDP growth, which Fitch expects to continue over time as cyclical contraction within the energy sector is balanced against continued expansion of the county's increasingly diverse economy. The county's AV grew by a 10-year CAGR of 6.3% through fiscal 2021 and slowed to a modest 1.8% gain in fiscal 2022 as pandemic-related losses on the commercial sector materialized as expected.

Harris County's fiscal 2022 tax rate of approximately $0.377 per $100 of AV provides ample capacity below the statutory cap of $0.80. However, in 2019, the Texas legislature approved and the governor signed into law Senate Bill 2, which made a number of changes to local governments' property tax rate setting process starting in fiscal 2021.

Most notably, SB 2 reduces the voter approval tax rate (previously the 'rollback rate') to 3.5% from 8.0% for most local taxing units and requires a ratification election (replacing the previous petition process) if any local taxing unit exceeds its voter approval rate. The tax rate limitation in SB2 excludes new additions to tax rolls and allows for banking of unused margin for up to three years. Remaining control over other local revenues such as fines, fees and charges for services is sufficient to generate still ample revenue-raising flexibility relative to Fitch's assessment of expected modest revenue volatility in a typical downturn. The revenue cap does not apply to debt service tax levies.

Expenditure Framework

Typical of municipalities, public safety is the largest expenditure, accounting for approximately 48% of general fund spending in fiscal 2021.

The pace of spending growth absent policy actions is likely to be generally in line with revenue growth. Fitch expects that the rising operating costs associated with an expanding population and growing service delivery needs in the unincorporated portions of the county will be funded with revenue gains from its expanding resource base.

Fitch assesses the county's expenditure flexibility to be solid, aided by the county's strong control over employee headcount, lack of collective bargaining agreements with any of its personnel, and use of pay-go capital funding, which can be delayed, reduced or eliminated. The county's fixed cost burden is moderate with carrying costs for debt, pension and OPEB equaling approximately 15% of governmental spending in fiscal 2021. Debt service alone accounts for approximately 9% of governmental spending as it includes toll road-supported tax bonds and flood control district contract tax bonds.

Long-Term Liability Burden

The long-term liability burden, including direct and overlapping debt and unfunded pension liabilities, is moderate at approximately 12% of personal income. About 86% of the total liability burden is in the form of overlapping debt. Overall debt levels have risen mostly from substantial debt issuances by the county's approximately 350 overlapping jurisdictions. Continued overlapping debt issuance is likely to be accompanied by steady gains in personal income, leading Fitch to expect the county's long-term liability burden to remain moderate relative to the resource base.

Including a $784 million GO authorization approved by voters in 2015, the county's remaining bond authorization totals approximately $800 million. This amount is equal to approximately one-half of outstanding net direct debt, including the Harris County Flood Control District's contract revenue bonds, which are paid by the county's limited tax. The county plans to issue its remaining authorization over a seven to 10-year period. Capital needs, while extensive, appear to be manageable given the county's history of a measured pace of debt issuance and reliance on existing taxable resources using flat or declining tax rates.

To address the damage caused by Hurricane Harvey in 2017, voters approved a $2.5 billion GO bond authorization for the flood control district to finance major flood control improvements. As in past and current projects, Fitch expects planning and capital costs to be shared with the U.S. Army Corp of Engineers. Specifically, $1 billion of the authorization will be used to leverage an estimated $3 billion in federal funds.

The balance of the authorization will be used for flood control projects to be prioritized using a "social vulnerability index" that takes into account residents' ability to readily recover from flood events. The flood control district plans to issue its bond authorization over a 10-15 year period and require a modest debt service tax rate increase of $0.03 per $100 AV. Fitch expects the impact of the district's large authorization on the county's long term liability burden will be manageable given the expansive size of the district's tax base and the extended issuance schedule. The district's remaining $2.28 billion authorization is equal to approximately 1% of personal income.

County employees participate in the Texas County and District Retirement System, a cost-sharing multiple-employer plan. The county consistently funds its pension at the actuarially determined level and the net pension liability totals approximately $2.4 billion, equal to about 1% of personal income based on Fitch's adjusted 6% rate of return.

Operating Performance

Fitch believes the county's ample revenue-raising capacity, solid expenditure control and large reserves make it well-positioned to manage through an economic downturn. The FAST (Fitch Analytical Stress Tool) model, which relates the district's general fund revenues to U.S. GDP, is used to support the assessment of operating performance under Fitch's criteria. FAST is not a forecast (actual revenue declines will vary from FAST), but it provides a relative sense of revenue risk exposure across Fitch's local government portfolio. The district's FAST revenue volatility of -1% is moderate relative to Fitch's U.S. local government sector. Based on the county's ample revenue-raising ability and solid expenditure flexibility, the inherent budget flexibility is assessed as superior.

During previous economic downturns, the county demonstrated swift budgetary action to mitigate revenue pressures, with no deferrals of annual pension contributions or reliance on non-recurring revenue, leading to steady and sustainable additions to financial reserves. Moderate annual pay-go funding provided additional expenditure flexibility. The accumulation of substantial reserves allowed the county to forego its annual tax anticipation notes (TAN) borrowing for interim cash-flow purposes since fiscal 2017.

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]	LT IDR	AAA Rating Outlook Stable Affirmed	AAA Rating Outlook Stable
Harris County (TX) /General Obligation - Limited Tax/1 LT	LT	AAA Rating Outlook Stable Affirmed	AAA Rating Outlook Stable
Harris County (TX) /General Obligation - Unlimited Tax/1 LT	LT	AAA Rating Outlook Stable Affirmed	AAA Rating Outlook Stable
Harris County Flood Control District (TX) /General Obligation - Limited Tax/1 LT	LT	AAA Rating Outlook Stable Affirmed	AAA Rating Outlook Stable
Harris County Flood Control District (TX) /Limited Ad Valorem Tax Revenues/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
+1 212 908 0568
amy.laskey@fitchratings.com

MEDIA CONTACTS

Sandro Scenga
New York
+1 212 908 0278
sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

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

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Harris County (TX)	EU Endorsed, UK Endorsed

DISCLAIMER

READ LESS

COPYRIGHT

party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

READ LESS

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained by Fitch at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's Regulatory Affairs page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

US Public Finance Infrastructure and Project Finance North America United States