Fitch Assigns 'AA' IDR to Port Houston, TX; Affirms Unltd Tax Bonds at 'AAA' Pending Legal Opinion

Fitch Ratings-New York-12 May 2017: Fitch Ratings has assigned an Issuer Default Rating (IDR) of 'AA' to Port of Houston Authority, TX (Port Houston or the port) and affirms the 'AAA' rating on approximately $658 million of the port's outstanding unlimited tax bonds, pending legal review of the special revenue status of pledged taxes supporting the bonds. The Rating Outlook is Stable.

The rating action reflects application of Fitch's 'Rating Criteria for Infrastructure and Project Finance' and 'Rating Criteria for Seaports' to tax-supported transportation infrastructure enterprises. Under Fitch's 'U.S. Tax-Supported Rating Criteria,' the agency caps property tax-supported bonds at the IDR unless there is a reasonable basis to consider the pledged revenues to be 'special revenues' under Section 902(2)(E) of the U.S. Bankruptcy Code.

Fitch has identified a number of elements it considers sufficient to reduce the incentive to challenge the special revenue status given the definitions outlined in the bankruptcy code. These include clear restrictions on the use of pledged revenues for identified projects and clear separation from the entity's operations.

Fitch expects the issuer to provide a legal opinion within the next 60 days that would form the basis of Fitch's analysis of the pledged revenues' special revenue status. If Fitch determines that there is a reasonable basis to consider the bonds to be secured by special revenues, the unlimited tax bond rating would not be constrained by the issuer's IDR.

KEY RATING DRIVERS

Rating Rationale: The 'AA' IDR reflects the Port Houston's position as a major maritime gateway for both Texas and the U.S., ranking first in the country in petroleum, steel and project cargo, and sixth in 20-foot equivalent unit (TEU) throughput. The rating also reflects the port's long-term positive growth trends and historically stable cargo revenues through economic cycles. The port currently has no revenue-backed debt, with its capital improvements thus far being funded via ad-valorem taxes and excess cash flows from operations. The forward capital program is expected to total slightly under $1 billion and may require future borrowing, with expectations that additional unlimited tax bonds would be a primary source. The rating reflects the port's expected ability to service anticipated future debt under various sensitivity scenarios at strong coverage levels and low leverage levels that are commensurate with a 'AA' rating.

Strong Port Franchise [Revenue Risk - Volume: Stronger]: Port Houston is one of the nation's largest maritime ports with numerous terminals and facilities along the Houston Ship Channel. The overall port complex ranks second in the U.S. in total tonnage and includes eight public terminals, which handle breakbulk, general, and containerized cargo, plus over 150 privately owned docks and facilities. The port benefits from proximity to Houston, TX, the fourth largest city in the U.S. and an area which has shown resilience through economic downturns.

Diverse Revenues [Revenue Risk - Price: Stronger]: Revenues are 90% derived from cargo operations, with the remaining 10% coming from leases and other sources. On the breakbulk side of the business, the port operates as a landlord with long-term contracts for the use of dock facilities. On the container side, it runs the Barbours Cut and Bayport terminals as operator.

Sizable Capital Program [Infrastructure Development/Renewal: Stronger]: The port's capital improvement plan (CIP) calls for approximately $920 million in funding for projects through 2021 and approximately $1 billion every five years thereafter. The current capital budget includes retrofitting for Barbours Cut; continued expansion of the Bayport terminal; dredging the channel depth at Barbours Cut and Bayport to 45 feet; and various turning basin, breakbulk, and general cargo facility improvements. While a large portion of the plan is funded with net cash flow from operations, the port anticipates additional funding may be needed and entail drawing on the existing flexible rate note program, funding via unlimited tax bonds and/or funding via equipment leases. If additional funds are not available, the port can issue revenue bonds or revise the amounts and timing of its CIP to match cash resources.

No Revenue Debt Outstanding [Debt Structure: Stronger]: The port has $658 million in rated unlimited tax bonds outstanding, all fixed rate, with final maturity in 2039. Debt service is funded from voter-approved ad valorem taxes in Harris County. The flexible-rate revolving notes program consists of the ability to draw up to $300 million in senior lien revenue-backed debt maturing in three years, to be replaced either with a comparable note or with longer-term obligations. Currently no draws have been made on the facility, and no revenue debt is outstanding or planned.

Strong Financial Profile: Financial metrics appear very strong. Leverage is initially 1.1x even when considering the undrawn $300

million program. Under a full-draw scenario in 2017 and continuation of the program through 2020, coverage remains at 14x or better, and leverage remains below 1.3x. In the more conservative rating case which assumes amortization of the note program and $300 million in additional borrowing in 2020, coverage remains above 2.7x. By 2020, leverage still remains moderate at under 3.8x in the rating case. Liquidity metrics are favorable, with nearly $400 million in cash/liquidity translating to days cash on hand of almost 700 days.

Peer Group: Comparable ports include Port Miami (rated 'A'), which serves the east coast/gulf and competes with Houston to some degree. Miami has considerably higher leverage than Houston, but Houston has a larger, cash-funded, forward capital program than Miami. Both ports benefit from alternate debt financing sources for their capital plans (via Houston's general obligation (GO) debt and Miami-Dade County's County and Sunshine State debt). Houston also compares favorably to the Ports of Los Angeles and Long Beach (both rated 'A'), with lower throughput volumes but greater diversification in cargos, and comparably strong leverage and coverage metrics.

RATING SENSITIVITIES

Negative: Nature of Special Revenue Legal Opinion: Without a satisfactory special revenue opinion, Fitch expects to receive and review within the next 60 days the rating on the unlimited tax bonds, which may be may be lowered to the IDR.

Negative: Increased Leverage: Future borrowing for the CIP that increases revenue-backed leverage materially above 2x without corresponding increases to net revenues.

Positive: Improved Ratios: Longer term, successful execution of the capital plan with higher than expected net revenue generation or a larger portion of unlimited tax-backed debt than anticipated, reducing leveraging on the revenue-backed lien

Performance Update

The port's tax base is coterminous with Harris County, the largest county in Texas and third largest in the nation. The county, whose population totals 4.6 million, features a large, diverse economy that remains exposed to the energy sector. The county's population grew at a substantial rate of 12% from 2010-2015. Fitch expects county assessed value (AV), currently at nearly $377 billion, to continue to grow, albeit at a more moderate rate going forward following posting double-digit growth in recent years. Property taxes are levied only to pay debt service on voter-authorized unlimited tax bonds.

From the operational side, fiscal 2016 had seen continued strength in container volumes offset by measurable reductions in throughput in the steel and auto business lines. Container units rose by 2.1% in fiscal 2016, following a stronger 9.1% growth rate in 2015. New services and impacts from the west coast work stoppages supported the recent positive trends. Steel cargo volumes are not a very large segment of port business, but volumes fell by over 50% in fiscal 2016 based on weakness in steel pricing and its use in the oil sector. Auto volumes fell by 10.6% in 2016 but this loss follows a strong 27% uptick in volume in the prior year. For 2017, the port expects limited positive growth overall but continued strength in container units (budget 8.8% increase over 2016).

Fiscal 2016 figures indicate operating revenues declining by approximately 1.0%, which is the weakest year-over-year change since the fiscal 2009 recession. Container revenues increased by 6% but were more than offset by revenue reductions in bulk segments. Total expenses increased by 11.6% leading to lower net cash flow at $113.7 million versus $126.6 million in fiscal 2015. Still, operating margins remain strong and given the lack of revenue bond debt service, the net cash flow provides sound funding for pay-go capital.

Fitch Cases

The port provided Fitch with its detailed CIP budget and liquidity analysis through 2021, and Fitch used this forecast as a basis for its cash flow models. Fitch views the five-year plan as conservative, as it does not factor in any inflation of expenses or increases in revenues due to increases in tariffs.

The Fitch Base Case assumes modest 4% growth in all cargo related revenues from 2017, in line with historical cargo trends, and assumes no growth in leases and other operating revenues from 2017 onwards. Overall revenues grow at 3.2% through 2021 (vs. 5.0% in the port's five-year plan) while expenses are assumed to be growing at a 3.0% CAGR. Fitch has assumed the $300 million notes are drawn in full in 2017, and remain outstanding for a further three years as the notes program is extended, paying interest only at 3%. No additional CIP borrowing is required under this scenario. Debt service coverage remains high (14x-15x as the notes are interest-only). Leverage is low, never rising above 1.4x.

The Fitch Rating Case assumes a downturn in 2017, resulting in 8% decline across all revenue categories, followed by 5% recovery in 2018, then a return to 3% growth thereafter for cargo-related revenues. Overall revenues grow 0.9% through 2021. Total expenses decrease by 4% in the recession year, then grow at a steady 4% per year through 2021, for a 2.3% CAGR. Fitch has assumed the $300 million notes are drawn in full in 2017 (paying interest only at 3%), and then in 2018 the notes are assumed to be refinanced with 30-year long-term fixed-rate debt at 5%. An additional $300 million debt issuance is also assumed to be issued in 2020 to further support the CIP. Despite this borrowing, coverage remains strong for the rating level (2.7x or better).

Leverage as measured by net debt to CFADS is low, never rising above 3.8x even when considering the additional borrowing.

Fitch views the port's credit profile as extremely robust, with strong coverage levels and low leverage levels that are commensurate with a 'AA' rating. In addition to resilient credit metrics, the port's benefits from flexibility provided by its considerable liquidity position, its stable historical performance, and its ability to potentially fund future CIP needs using both the GO and revenue liens.

Asset Description
The port owns a diverse group of facilities designed to accommodate a variety of cargo, including general cargo, containers, grain, coal, pet coke, dry and liquid bulk and project and heavy lift cargo. In operation since 1914 as a deep draft port, the port is ranked first in the nation for foreign waterborne tonnage, and second in terms of total tonnage. The Houston Ship Channel extends 52 miles inland and links the City of Houston with the Gulf of Mexico. The channel serves some of the largest petrochemical terminals and refineries in the world. Generally the port acts as a landlord port for breakbulk cargos, while acting as an operator for the container terminal yards, with a few exceptions.

VARIATION FROM PUBLISHED CRITERIA

Fitch's analysis supporting the 'AA' IDR on the port includes a variation from the 'Global Infrastructure Seaport Rating Criteria'. Enhanced analysis under the variation relates to the evaluation of the strength of the tax revenues available to support operations. This evaluation is supported by Fitch's revised 'U.S. Tax-Supported Rating Criteria' dated April 18, 2016.

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Applicable Criteria
Rating Criteria for Infrastructure and Project Finance (pub. 08 Jul 2016) (https://www.fitchratings.com/site/re/882594)
Rating Criteria for Ports (pub. 17 Oct 2016) (https://www.fitchratings.com/site/re/889015)

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