Fitch Downgrades Port of Houston, TX Ultd Tax Bonds to 'AA'

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Fitch Ratings-New York-04 August 2017: Fitch Ratings has downgraded approximately $658 million of outstanding Port of Houston Authority, TX (Port Houston) unlimited tax bonds to 'AA' from 'AAA'. The action follows a 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 Issuer Default Rating (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. Port Houston's IDR is currently 'AA' with a Stable Outlook.

Although an opinion supporting special revenue bond status can reasonably be given, Fitch criteria sets a high bar for rating bonds without regard to an issuer's operating risk when based on the provision of Section 902(2)(E). In addition to a legal opinion, the criteria looks for elements that altogether lead to a judgment by Fitch that there is negligible incentive to challenge the special revenue status in bankruptcy. In this case, the law does not directly limit the authority to levy a specific tax to the financing of specific capital projects. Fitch believes it could be argued that the law is more general in nature. Further the county treasurer is also the treasurer of the Port Authority, which Fitch believes could incentivize a challenge to the status of the funds under 902(2)(E). Therefore, Fitch is constraining the rating of the unlimited tax bonds to the issuer's IDR.

KEY RATING DRIVERS

Rating Rationale: The 'AA' IDR reflects 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 GO debt and Miami-Dade County's County and Sunshine State debt).

RATING SENSITIVITIES

Future Developments that May, Individually or Collectively, Lead to Negative Rating Action:

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

Future Developments that May, Individually or Collectively, Lead to Positive Rating Action:

--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.

For detailed analysis on the port's operational and financial performance, please see 'Fitch Assigns 'AA' IDR to Port Houston, TX' dated May 12, 2017.

VARIATION FROM PUBLISHED CRITERIA

Fitch's analysis includes a variation from the 'Rating Criteria for Infrastructure and Project Finance'. Enhanced analysis under the variation relates to the evaluation of the strength of the tax revenue framework available to the port as an economic enterprise. This evaluation is supported by Fitch's 'U.S. Tax-Supported Rating Criteria' dated May 31, 2017.

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Applicable Criteria
Rating Criteria for Infrastructure and Project Finance (pub. 08 Jul 2016)
Rating Criteria for Ports (pub. 17 Oct 2016)
U.S. Public Finance Tax-Supported Rating Criteria (pub. 31 May 2017)

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Port of Houston Authority, TX	06 Jul 15
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