FitchRatings

Fitch Affirms Port of Houston, TX IDR and Unlimited Tax Bonds at 'AA'; Outlook Stable

Fitch Ratings-New York-25 May 2018: Fitch Ratings has affirmed approximately $639 million of outstanding Port of Houston Authority, TX (Port Houston) unlimited tax bonds at 'AA'. Fitch has also affirmed Port Houston's Issuer Default Rating (IDR) at 'AA'. The Rating Outlook is Stable.

KEY RATING DRIVERS

The rating reflects the pledge of an unlimited property tax levied on all taxable property within the authority's taxing boundaries coterminous with Harris County, TX, supporting project costs. 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 an '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
Operating revenues are 93% derived from vessel and cargo services, with the remaining 7% coming from leases and other sources. In the breakbulk portion of the business, the port operates as a landlord with long-term contracts for the use of dock facilities. With regards to the container side, the port runs the Barbours Cut and Bayport terminals as operator.

Sizable Capital Program - Infrastructure Development/Renewal: Stronger
While existing facilities are in good repair, the port's sizable but manageable capital improvement plan (CIP) calls for approximately $999 million in funding for projects through 2022, and approximately $1 billion every five years thereafter. The current capital budget focuses on expansion and ongoing maintenance needs, including retrofitting for Barbours Cut; continued expansion of the Bayport terminal; dredging the channel depth at Barbours Cut and Bayport to 46.5 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 (expires September 2018); 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 $639 million in rated unlimited tax bonds outstanding, all fixed rate, with final maturity in 2039. Debt service is fully funded from voter-approved ad valorem taxes in Harris County, with no support from port revenues. The flexible-rate revolving notes program, which expires in September 2018, consists of the ability to draw up to $300 million in senior lien revenue-backed debt, to be replaced either with a comparable note or with longer-term obligations. To date, no draws have been made on the facility, and no revenue debt is outstanding or planned.

Financial Profile

Financial metrics appear very strong. Leverage is initially 1.7x when considering the capacity of the existing notes program, on which no draws have been made. Under a full-draw scenario in 2018 and continuation of the program through 2022, coverage remains at 23x or better, and leverage remains below 1.2x. In the more conservative rating case which assumes a recessionary downturn in revenues, coupled with full implementation of the CIP, amortization of a $200 million note program, and $300 million in additional revenue-backed borrowing in 2020, coverage remains above 3.8x. By 2022, leverage still remains moderate at under 3.2x in the rating case.

PEER GROUP

While there are no direct comparables to Port Houston on a metrics basis given Houston's lack of revenue debt outstanding, closest comparable ports on an operational basis 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; however, 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 'AA'), with lower throughput volumes but greater diversification and balance of trade in cargos.

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 4x 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.

CREDIT UPDATE

Performance Update
The only debt currently outstanding for Port Houston consists of tax-backed debt, secured by an unlimited property tax levied on all taxable property within the authority's taxing boundaries. 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 2010-2016. Fitch expects county assessed value (AV), currently at nearly $426 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. Property values within the port's taxable district may be temporarily impacted following flood damage from Hurricane Harvey, though affected homes are expected to return to approximately pre-storm values once repaired. Furthermore, the authority does not expect storm impacts to have a material adverse effect on its ability to pay debt service on its outstanding ad valorem tax bonds.

From the operational side, container traffic as measured in twenty foot equivalent units (TEUs) rose by nearly 13% in fiscal 2017, following more tepid growth of 2% in 2016. Looking forward, container volumes are anticipated to increase in 2018 as containerized polyethylene exports ramp up due to recent manufacturing investments by the local petrochemical industry. For 2018, the port expects limited positive growth overall but continued strength in container units (budget 8% increase over 2017). Auto volumes fell by nearly 15% in 2017 following a 11% loss in 2016. Steel cargo volumes increased sharply in 2017, rising 56%, following comparable decreases in 2016 and 2015; year to date 2018 steel volumes are up a further 17% over a year prior. Steel currently accounts for only $12-$14 million in revenues for wharfage and dockage annually (3-4% of operating revenues). As a result, direct impacts of steel tariffs on the port are not expected to be material.

Port Houston's operating revenues increased by approximately 15%, following a 1% decline in 2016. Container revenues increased by 19% as volumes rose, though this increase was offset slightly by a decline in Other revenues of 17.1%. With operating expenses increasing by nearly 8%, the increase in operating revenues lead to higher net cash flow at $146.8 million versus $113.7 million in fiscal 2016. Operating margins remain strong and given the lack of revenue bond debt service, the net cash flow provides sound funding for pay-go capital.

Port Houston was affected by Hurricane Harvey in 2017. The authority closed its terminals on Aug. 25, 2017, in advance of the storm's arrival, and reopened for normal operations on Sept. 1. Damage to port facilities from wind or surge was minimal, falling below the authority's self-insured retention. The U.S. Army Corps of Engineers (USACE) performed emergency dredging along most of the Houston Ship Channel (expected completion in May 2018), with many berths draft restricted and requiring dredging as well. Portions of the upper Channel area, including the authority's Turning Basin Terminal berths, are expected to remain severely draft restricted for another six to nine months. However, management notes that these draft restrictions have not had a material adverse impact on revenues, as there are sufficient alternate berths to accommodate vessels. Despite operational restrictions following the storm, operating revenues have not been materially impacted by Hurricane Harvey. The authority has applied for Federal Emergency Management Agency funding to partially offset dredging costs.

Fitch Cases
The port provided Fitch with its detailed CIP budget and liquidity analysis through 2022, 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 5.2% growth in container revenues from, and assumes no growth in lease and bulk revenues from 2019 onwards. Overall revenues grow at 4.8% through 2022 (vs. 5.9% in the port's five-year plan) while expenses are assumed to be growing at a 3.0% CAGR. Fitch has assumed the current notes program is renewed at $200 million, is drawn in full in 2018 and remains outstanding through the forecast period, paying interest only at 3%. Roughly $30 million in short term CIP borrowing is required under this scenario. Debt service coverage remains high (23x-27x as the notes are interest-only). Leverage is low, never rising above 1.2x.

The Fitch Rating Case assumes a downturn in 2018, resulting in 8% decline across all revenue categories, followed by 5% recovery in 2019, then a return to 3% growth thereafter for cargo-related revenues except bulk, which is held flat to reflect potential tariff impacts. Overall revenues grow 0.9% through 2022. Total expenses decrease by 4% in the recession year, then grow at a steady 4% per year through 2022, for a 2.3% CAGR. Fitch has assumed the notes program is refinanced with $200 million of 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 under a recessionary scenario, coverage remains strong for the rating level (3.8x or better). Leverage as measured by net debt to CFADS is low, never rising above 3.6x 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 benefits from flexibility provided by its 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 'Rating Criteria for Infrastructure and Project Finance'. Enhanced analysis under the variation relates to the evaluation of the strength of the tax revenue and legal framework to support operations. This evaluation is supported by Fitch's 'U.S. Tax-Supported Rating Criteria' dated April 3, 2018.

Contact:

Primary Analyst
Emma Griffith
Senior Director
+1-212-908-9124
Fitch Ratings Inc.
33 Whitehall St
New York NY 10004

Secondary Analyst
Seth Lehman
Senior Director
+1-212-908-0755

Committee Chairperson
Scott Zuchorski
Senior Director
+1-212-908-0659

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com

Additional information is available on www.fitchratings.com

Applicable Criteria

Ports Rating Criteria (pub. 23 Feb 2018) (https://www.fitchratings.com/site/re/10021628)
Rating Criteria for Infrastructure and Project Finance (pub. 24 Aug 2017) (https://www.fitchratings.com/site/re/902689)
U.S. Public Finance Short-Term Debt Rating Criteria (pub. 01 Nov 2017) (https://www.fitchratings.com/site/re/905637)
U.S. Public Finance Tax-Supported Rating Criteria (pub. 03 Apr 2018) (https://www.fitchratings.com/site/re/10024656)

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