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Port Freeport, Texas; Ports/Port Authorities

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Credit Profile		
US$43.135 mil sr lien rev bnds (AMT) ser 2019A due 06/01/2049		
Long Term Rating	A/Stable	New
US$25.42 mil sr lien rev bnds (non-AMT) ser 2019B due 06/01/2049		
Long Term Rating	A/Stable	New
Port Freeport sr lien rev bnds		
Long Term Rating	A/Stable	Affirmed
Port Freeport Senior Lein Rev and Rfdg Bnds ser 2015A dtd 09/15/2015 due 06/01/2045		
Long Term Rating	A/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'A' long-term rating to Port Freeport, Texas' estimated $68.6 million series 2019A&B senior-lien revenue bonds. At the same time, S&P Global Ratings affirmed its 'A' rating on the port's senior-lien revenue bonds outstanding. The outlook is stable.

The ratings reflects our opinion of the port's strong enterprise risk and financial risk profiles.

The enterprise risk profile reflects an adequate market position, reflective of the port's importance to the regional economy as an import/export hub and competitive position with relatively deep waterways. Furthermore, the port's capital improvement projects will enhance its competitive position through harbor deepening and the Velasco Terminal expansion. Tempering our assessment is the port's high customer concentration, with Freeport LNG providing approximately 38% of operating revenues in fiscal 2018, and competition from other Gulf ports.

The financial risk profile reflects our expectation that the port will maintain strong debt service coverage (DSC) and very strong debt and liabilities capacity as it funds its large-but-manageable $385 million five-year capital improvement plan (CIP), despite escalating debt service requirements and debt burden along with plans to draw down a portion of its unrestricted reserves to fund the CIP. Our financial profile assessment also considered surplus ad valorem tax revenues available for the port's operations and maintenance (O&M) expenses. We have incorporated the effects of the port's proposed series 2019A&B bonds, other additional borrowing plans for its CIP, and plans to draw down a portion of its unrestricted reserves by considering pro forma metrics. As a result of the port's plans to draw down a portion of its unrestricted reserves to fund a portion of its CIP, we expect liquidity and financial flexibility to decline to a level we consider adequate based on pro forma metrics.

The strong enterprise risk profile reflects our view of the port's:

- Adequate market position, reflecting the port's importance to the regional economy as an import/export hub, albeit for a niche market of goods, and competitive position with relatively deep waterways. Tempering our assessment is competition from other Gulf ports, including the ports of Houston; New Orleans; Gulfport, Mo.; and Galveston and Corpus Christi, Texas and high customer concentration;

- Extremely strong service area economic fundamentals, which include favorable GDP per capita, low unemployment, and a large and rapidly growing population;
- Low industry risk relative to that of other industries and sectors; and
- Strong management and governance that, in our view, has established a track record of successfully operating its major lines of business and managing risk.

The strong financial risk profile reflects our view of the port's:

- DSC (S&P Global Ratings calculated) that we expect will remain at levels we consider strong as revenue growth partially offsets the significant increase in annual debt service from the proposed series 2019A&B bonds, additional revenue bonds in 2021, and $130 million in anticipated tax-supported general obligation (GO) debt;
- Very strong debt and liabilities capacity, with debt-to-net revenues that we expect will remain within a range of 5x-10x, including the effects of the proposed series 2019A&B bonds, additional revenue bonds, and tax-supported debt to fund the CIP, although we note a portion of the CIP is devoted to revenue-producing assets, which partially offsets the significant amount of additional debt; and
- Adequate liquidity and financial flexibility, reflecting our expectation that management will maintain unrestricted reserves of at least $10 million and in excess of 250 days' cash on hand as it uses a modest portion of its unrestricted reserves to fund some of its CIP needs.

Bond proceeds will fund various capital improvement projects including the expansion and development of the Velasco Terminal, a levee stabilization project in the harbor, and development of a rail served multi-modal industrial site. In addition, the series 2019A&B bond proceeds will be used to fund a debt service reserve funded at 50% of maximum annual debt service and pay issuance costs.

A first-lien pledge of net revenues secures the bonds. We view bond provisions as credit neutral. The revenue bond rate covenant requires net revenues to provide at least 1.25x DSC on senior-lien bonds and 1.10x DSC on senior- and junior-lien obligations. In the calculation of net revenues, the port can include ad valorem tax revenue associated with O&M expenses. The additional bonds test requires that net revenues for a 12-month period in the past 18 months provide at least 1.25x coverage of average annual debt service on all senior-lien bonds and 1.1x coverage on all senior- and junior-lien obligations, including the proposed bonds. The port may adjust net revenues to give effect to any rate increases at least 60 days before, and can include ad valorem tax revenues associated with O&M.

Located 60 miles south of Houston in Brazoria County, Port Freeport is a harbor district governed by a six-member port commission whose members are elected to six-year staggered terms. The port district, as defined for tax-assessment purposes, encompasses approximately 85% of the county. Port Freeport is a landlord port, and owns and operates public wharves, transit sheds, open storage facilities, freight-handling facilities, and related equipment for the use of stevedoring companies to load and unload vessels. In addition, the port leases land, buildings, and improvements to others and provides areas for depositing dredging materials for port waterway construction and maintenance. Its facilities are on the Brazos River Channel, between the mouth of the Brazos River and the Gulf of Mexico. In fiscal 2018, the port had total operating revenues of $26.3 million.

Outlook

The stable outlook reflects our expectation that the port will maintain strong coverage (S&P Global Ratings calculated) as it funds its CIP while experiencing some fluctuations in tonnage levels.

Upside scenario

We do not expect to raise the rating, given the large-but-manageable CIP and additional borrowing plans, which we believe will likely preclude material improvement in the port's financial profile.

Downside scenario

Although unlikely, we could lower the rating if the port experiences material fluctuations in financial performance or tonnage levels.

Enterprise Risk

Our assessment of the port's enterprise risk profile as strong reflects its extremely strong economic fundamentals, low industry risk, adequate market position, and strong management and governance.

Economic fundamentals

In our view the port's primary service area (the state of Texas) maintains extremely strong economic fundamentals. This is exemplified by the state's estimated GDP per capita of approximately $61,245, its 2018 unemployment rate of 3.9% in line with the national rate of 3.9%, and a projected three-year growth rate for its population that, at 4.2%, is above the U.S. rate of 2.2%.

Market position

We consider the port's overall market position as adequate, reflective of its importance to the regional economy as an import/export hub, albeit for a niche market of goods; and competitive position with relatively deep waterways in its harbors for large ships, as well as its proximity to the open ocean. Furthermore, we note the port's capital improvement projects will enhance its competitive position through harbor deepening and the Velasco Terminal expansion. Tempering our assessment is competition from other Gulf ports and a high customer concentration base.

The port's cargo traffic consists of a variety of imported and exported goods, including aggregate, chemicals, crude, bananas, other green fruits, paper goods, resins, autos, clothing, and rice. The port has historically maintained a niche market particularly in fruits, rice, and liquid bulk, which, in our view, exposes it to fluctuations and competition with other Gulf ports--particularly Houston, New Orleans, Gulfport, Galveston, and Corpus Christi. However, the port generally structures its leases with minimum annual guarantees (MAGs), mitigating some risk of a downturn in cargo activity. The customer base is somewhat concentrated, in our opinion, with the top five tenants representing 70% of total revenues in fiscal 2018, and 74% for unaudited fiscal 2019.

Although cargo volume has varied year over year, tonnage has generally trended positively since fiscal 2009, partially due to reinvestment in port facilities and the addition of new tenants. Tonnage increased 9.4% to 2.3 million short tons in fiscal 2018 from 2.1 million short tons in fiscal 2017, following a decline of 30.5% in fiscal 2017 from 3.1 million short tons in fiscal 2016. The decline in fiscal 2017 was largely driven by a reduction in dry bulk goods, although we note tonnage remains up from a low of 1.7 million in 2012. The port's top five products by short ton cargo traffic in fiscal 2018 include dry bulk (37%), miscellaneous/general cargo (17%), bananas/fruit (14%), steel products (13%), and roll-on roll-off cargo (10%). The increase in short tons since fiscal 2012 largely came from dry bulk (specifically limestone), steel products, and roll-on roll-off cargo. Overall, average annual growth in short tonnage is 5.1% since fiscal 2013, and the port expects moderate growth as the oil and gas industry continues to invest in the south and central Texas regions.

Revenue diversity among tenants is somewhat concentrated, with the top customer, Freeport LNG, contributing 38% of operating revenues and the top three customers contributing 57% in fiscal 2018. This is likely to increase in the near term as the port's two largest customers--Freeport LNG and Horizon Terminal Services--expand operations under their lease terms and incur increased payments to the port. Leases vary in range from short to long term and make up a significant revenue source at 53% of operating revenues for fiscal 2018.

Deep waterways are important because they enable ports to handle the increasingly large vessels used by shipping companies. The port is beginning the planning and construction process for the Freeport Harbor Channel improvement project, which will deepen and widen the channel, making the port more accessible to a wider range of vessels, and further enhancing its competitive position. Harbor depth will increase to depths ranging from 51-56 feet from 46 feet, making the port the deepest in Texas upon completion, which is estimated in about five years.

Management and governance

The port's management and governance, in our view, is strong. This reflects our view of the port's strategic positioning; risk management and financial management; and organizational effectiveness. The port commission, the governing body, is made up of six local residents who are elected to a six-year term, with one of the nonpartisan positions up for election every two years. The port has statutory authority to levy property taxes in the county for general operating purposes; to pay voted GO debt; to finance certain industrial development activities; and to fund special projects, including dredging and canal construction. Property taxes are available for marine and other nonaviation operations per port policy, but may not legally be used to pay revenue bond debt service.

We consider management practices and internal controls to be credit neutral. Although the port has no formal or informal policies to maintain financial metrics, management has established a track record of successfully operating its major lines of business, as demonstrated by the maintenance of a strong financial profile with revenue growth supportive of capital funding. Most of the port's top tenants have MAGs, and all of these tenants exceeded them in fiscal 2018. The port publishes a five-year CIP as part of the annual budgeting process in addition to long-term planning conducted in association with debt issuances.

Financial Risk

Our assessment of the port's financial risk profile considers its financial performance, debt and liabilities capacity, and liquidity and financial flexibility. Our financial risk profile assessment considers the port's historical performance and pro forma figures that reflect the effects of the series 2019A&B bonds, an additional estimated $73.1 million revenue bond issuance in 2021, up to $130 million in tax-supported debt, and plans to draw down a portion of unrestricted reserves to fund its CIP.

The pro forma figures we evaluated are based on a financial forecast that was prepared in connection with the series 2019A&B bonds. We consider the forecast assumptions reasonable given revenue growth is supported by expanding operations from existing and expected new customers and a history of exceeding budgeted figures. The pro forma figures assume rising debt service requirements and debt burden from the proposed series 2019A&B bonds and an additional revenue bond issuance in 2021, and steady, although modest, increases in demand and related net revenue growth. Our financial profile assessment also considers the port's financial policies, which we consider credit neutral, and the financial support to pay a portion of O&M expenses from the collection of ad valorem tax revenue within the district.

Financial performance

The strong financial performance assessment reflects our expectation that DSC, per our calculations, will decline, but remain at or above 1.6x, a level we consider strong, as revenue growth partially offsets the significant increase in annual debt service from the proposed series 2019A&B bonds and additional GO and revenue bond issuances to fund the CIP. The port's DSC, per our calculations, was 2.9x in fiscal 2018, and has steadily improved from 2.2x in fiscal 2016. However, we expect DSC, per our calculations, to decline following the issuance of the series 2019A&B bonds and additional debt to fund the CIP. The port expects to issue all tax-supported GO debt by fiscal 2023; $31.8 million was issued in July 2019. The tax-supported bonds will help fund the port's portion of the Freeport Harbor Channel improvement project. Ad valorem tax revenue is not pledged toward debt service, but can pay O&M expenses, which are senior to debt service. We view the O&M support from the ad valorem tax as an important credit strength. This support has remained steady historically at about $4.7 million-$5.1 million from fiscal years 2016 to 2018, and is expected to increase due to significant development within the port district's tax base in Brazoria County.

Debt and liabilities

We assess the port's debt and liabilities capacity as very strong, with debt-to-net revenues expected to remain within a range of 5x-10x, per our calculations, including the effects of the proposed series 2019A&B bonds and additional debt to fund the CIP--although we note the additional debt is somewhat offset by anticipated revenue growth. Net revenues include the port's operating revenues plus interest income and support from ad valorem tax revenue. The port had about $124.7 million in debt outstanding at unaudited fiscal year-end 2019, with debt-to-net revenues of 5.6x; however, we expect the debt burden to peak at about $343 million by fiscal 2023 (including revenue bonds and GO debt), with debt-to-net revenues increasing to about 9.2x.

We consider the port's 2020-2024 CIP to be large but manageable for the size of the facilities. The CIP totals $384.9 million, of which up to $130 million will be funded by GO debt and $143.2 million will be funded by revenue bonds (including the series 2019A&B bonds). The two largest projects are the Freeport Harbor Channel improvement project ($194.0 million) and the expansion of the Velasco Terminal ($163.5 million).

Liquidity and financial flexibility

We assess the port's liquidity and financial flexibility as very strong, based on unrestricted cash and investments of $25 million in fiscal 2018, or 979 days' cash on hand and 23.8% of total debt. Unrestricted cash and investments increased to $45.2 million or 1,528 days' cash on hand based on fiscal 2019 unaudited results. However, management anticipates applying a portion of its unrestricted reserves to fund a portion of its CIP, and we expect the port to maintain at least $10 million in unrestricted reserves, in excess of 250 days' cash on hand and 3% of total debt, within a range we consider adequate in the near term.