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Ratings

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Summary:

Brownsville Navigation District, Texas; Ports/Port Authorities

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Credit Profile		
Brownsville Navig Dist sr ln (AGM)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

Rationale

S&P Global Ratings has affirmed its 'A' long-term rating on the Brownsville Navigation District (BND), Texas' $27.5 million series 2016 senior-lien revenue bonds. The outlook is stable.

The rating reflects our view of Port of Brownsville's (PB) consistently strong debt service coverage (DSC), positive recent cargo growth, and limited capital needs.

More specifically, the rating reflects our assessment of the following factors:

- Stable financial performance, with strong DSC at no lower than 3.0x since fiscal 2009, which we expect to continue based on conservative budget assumptions
- A favorable competitive advantage as a designated foreign trade zone near the U.S.-Mexico border
- Steady recent growth in tonnage, which we expect to remain at least stable

We believe the following credit weaknesses partially offset these factors:

- BND's relatively small size and exposure to a limited number of products, particularly steel and petroleum, leaving the port susceptible to economic downturns and price fluctuations
- Some competition from larger regional and international ports

The district operates the port, and is governed by a five-member board of commissioners who are elected for four-year terms. The BND derives its revenues from charges for leases, rentals, wharfage, cargo storage, vessel dockage, and the sale of port services (such as utilities security, permits, and foreign trade zone tenancy). It levies an ad valorem tax that includes a portion to pay operations and maintenance expenses, as well; for the 2016 tax year, the district levied an ad valorem maintenance and operation tax of 0.03592 cents per $100 valuation, a decline from 2015.

PB is the southernmost port in the U.S., three miles north of the U.S.-Mexico border. It lies 17 miles inland by ship channel from the Gulf of Mexico. The port is also home to a local shrimp fleet. Rail lines and truck routes from both the Mexican and U.S. borders connect with PB for cargo transport. The port derives revenue from an even mix of waterborne vessel and cargo operations, as well as lease revenues. Lease revenues constituted approximately 48% of operating revenues in fiscal 2016, and approximately 63% of these revenues stem from the top 20 lessees in terms of annual rental rates. We view the lease tenant mix as diverse; the top tenants are on long-term leases (20 years or

longer), per management. Lease rates escalate annually based on CPI. More recently, there has been increased interest in port property due to access to the shale; there are three liquid natural gas export facilities that have secured options for lease in 2016, and are paying 10% of the full lease rate; if fully exercised, these leases would contribute an additional $13.3 million in revenue beginning in 2017.

Growth in tonnage has been strong over the past five years, fueled by the increases in the petroleum and coal product volume, as well as metals (largely steel) in just the most recent two fiscal years. Tonnage increased 17% and 13.2% in fiscals 2015 and 2014 before declining 1.6% to 6.9 million short tons for unaudited 2016. We view the commodity mix as very concentrated with petroleum and coal products, and primary metal products constituting 56.1% and 32.1% of total cargo in fiscal 2016, respectively. Somewhat offsetting this concentration are these industries' long-standing commitment to the port and the region, as well as the diverse customer mix. Dix Industries, which constitutes the largest amount of revenues, contributed about 16% of operating revenues in 2015.

We view the port's operating performance as strong and stable; based on flat-to-modest growth assumptions, we expect continued steady financial margins through 2017. Unaudited fiscal 2016 operating revenues decreased 0.6% in fiscal 2016 to $19.6 million, due to lower-than-anticipated vessel services revenues. Operating expenses excluding depreciation declined 9% over; DSC based on unaudited results was very strong ,at 3.6x, up from 3.4x and 2.3x in fiscal years 2015 and 2014, respectively. The port implemented wharfage charge increases on liquid cargo, as well as dockage and security fees on all vessels and cargo. The increases took effect Jan. 1, 2016, and will increase equally in 2017 and 2018. Lease rates increased on a five-year, phase-in basis beginning in 2011, as well.

In 2014, the port entered a 30-year agreement with OmniTrax Inc. and its parent company, the BROE Group, to develop an industrial park within the district and operate the railroad under a franchise agreement. As part of the agreement, the BND retired its 2003 junior-lien railroad revenue bonds; the component unit listed in prior audits was excluded as of 2015. The railroad has subsequently been renamed the Brownsville & Rio Grande Railway (BRG). Under the agreement, the railway prepaid five years of nonrefundable franchisee payments, which will be earned annually through 2020, and has boosted cash balances to levels we consider very strong.

PB's unrestricted cash and investments has been what we consider good historically, but they improved significantly in fiscal years 2014 and estimated 2015 to strong levels. We expect this to continue through the two-year outlook period. From fiscal years 2010-2013, unrestricted cash was no lower than 397 days'. Fiscal 2014 cash and investments increased to $23.1 million (29.2%) due to due to payments received as part of the BRG franchise agreement and increased volume. The port's fiscal 2015 estimated unrestricted cash and investments totaled $26.6 million, providing 995 days' cash on hand. In addition, the port ort's capital needs are limited, with no additional borrowings planned in the next three years.

PB's senior-lien net revenue pledge secures the bonds. Proceeds from the 2015 bonds financed the capital improvement plan, including a new oil dock, continued dredging, and a new administration building, and the port has no plans to issue an additional debt in the near term. The port has approximately $40.8 million in senior-lien parity debt, including $13.3 million in port revenue debt; it has an additional $8.3 million in general obligation debt as well, secured solely by ad valorem taxes. We view bond provisions as credit neutral. Rates and charges must be set such that net revenues provide 1.40x average annual debt service on senior obligations and 1.25x on all obligations

outstanding. Management may issue additional debt if the net revenues from the two previous years provide 1.40x maximum annual debt service (MADS) on senior obligations and 1.25x MADS on all obligations, which is only triggered when the senior obligations are no longer outstanding. Under the current indenture, rates and charges must be set to achieve 1.0x DSC. Management can issue new bonds if average annual net revenues provide 1.40x average annual debt service on senior obligations.

Outlook

The stable outlook reflects our expectation that PB's operations will continue to support coverage and liquidity near current levels. The outlook also reflects our expectation that management will prudently manage its capital plan and limit additional borrowing.

Upside scenario

We could raise the rating during the next two years if results exceeded forecast to levels we consider very strong and sustainable.

Downside scenario

We could lower the rating if demand for the port's facilities declined such that DSC or liquidity levels materially eroded.

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