

RatingsDirect®

Summary:

Arlington, Texas; Water/Sewer

Primary Credit Analyst:

Theodore A Chapman, Farmers Branch + 1 (214) 871 1401; theodore.chapman@spglobal.com

Secondary Contact:

Edward R McGlade, New York + 1 (212) 438 2061; edward.mcglade@spglobal.com

Table Of Contents

Rating Action

Stable Outlook

Related Research

Summary:

Arlington, Texas; Water/Sewer

Credit Profile

US\$8.29 mil mun drainage util sys rev bnds ser 2021 due 06/01/2041

Long Term Rating AAA/Stable New

Arlington drainage

Long Term Rating AAA/Stable Affirmed

Rating Action

S&P Global Ratings assigned its 'AAA' rating to Arlington, Texas' \$8.29 million series 2021 municipal drainage utility system revenue bonds. At the same time, S&P Global Ratings affirmed its 'AAA' rating on the city's existing municipal drainage utility system revenue debt. The outlook is stable.

A first-lien pledge on the system's gross revenue secures the 2021 bonds, which are on par with about \$40.7 million in long-term debt outstanding. The bond proceeds will be used to finance projects in the city's capital plan. Although the security to bondholders is a gross pledge, we hypothetically assume a net revenue pledge in our analysis and in our financial metrics calculations to inform our opinion as to the viability of the system as a municipal enterprise.

We rate Arlington's debt above the U.S. because the system has a predominantly locally derived revenue base. Local service charges from an autonomous rate-setting process represent virtually all of the utility's revenue. This, coupled with operating expense flexibility, precludes exposure to federal revenue.

Credit overview

Arlington provides drainage, flood control, and erosion prevention infrastructure to about 104,000 mainly residential accounts throughout the city. While the city is still realizing some residential growth--primarily higher-end single-family homes--via infill, its service area is largely built out. Growth in the number of accounts, therefore, has been very small in recent years. With a nearly complete status of development and an abundance of newer infrastructure, the utility system's capital needs are relatively small, generally \$15 million-\$20 million per year, almost entirely from internally generated revenues.

Key credit factors that support our opinion include the city's:

- Role as one of the anchor and namesake cities in the broad and diverse Dallas-Fort Worth-Arlington metropolitan statistical area (MSA), with a regional economy that has been resilient through and beyond the pandemic; and
- Very affordable rates not tied to consumptive use, providing for high collections and reasonable flexibility to maintain its financial profile over time.

Arlington, with a population of more than 390,000, is the third-largest city after Dallas and Fort Worth in an MSA that bears its name. Beside its central location, the city has a strong employment base anchored by K-12, General Motors

Corp., which has a production facility in the city, and a variety of technology and health care employers. The city is not reliant on any of its key customers, as the top 10 accounted for just under 9% of fiscal 2020 operating revenues.

Although COVID-19 had an outsized impact on the city's disproportionately large number of employers that emphasize an in-person presence, such as the University of Texas-Arlington (about 34,000 students), Six Flags Over Texas, and Hurricane Harbor amusement parks, as well as Major League Baseball's Texas Rangers and the National Football League's Dallas Cowboys teams, the city's direct employment base has shown resilience. The March 2021 unemployment rate was 6.5% after spiking as high as 12.5% in April 2020, The median household effective buying income is 101% of the U.S. level.

The system's financial position is its key strength, primarily because of its extremely low indebtedness. Including the series 2021 bonds, maximum annual debt service coverage (DSC) using fiscal 2020 net revenues of approximately \$15.3 million was about 3.1x and in line with its historically robust performance. Even when we apply stress scenarios to the financial profile by assuming similarly sized borrowing each year throughout the long-term capital plan, it is likely that financial performance will still be as strong each year.

In addition to a liquidity position well in excess of the city's policy of reserves equivalent to at least 60 days of operating expenses, the municipal drainage fund has a sizable (\$31 million as of fiscal 2020) cash balance designated for pay-as-you-go capital projects. Furthermore, Arlington's general government has a restricted reserve that as of fiscal year-end 2020 was almost \$71.4 million. The reserve was originally funded from natural gas and oil drilling royalties and exists for the benefit of general city operational emergencies, unplanned budgetary variances, and designated capital investments for all major operating funds. Draws on that reserve have been very uncommon, and elected officials by policy only appropriate the investment earnings for nonrecurring items. Because management made rapid and worst-case assumptions to its mid-year 2020 budget revision and implemented a variety of governmental-wide cost-containment measures, the city did not have to draw upon that reserve even during the worst months of the pandemic-related recession in order to shore up any of its major operating funds.

The stable outlook reflects S&P Global Ratings' expectation that the system's financial profile will remain commensurate with the rating over our two-year horizon. We believe strong management, including long-term planning and transparency regarding rate adjustments, will continue to allow Arlington to align sufficient financial resources to capital budget needs.

Environmental, social, and governance (ESG) factors

The city's capital projects are all driven by Arlington's own priorities and not by its municipal separate storm sewer (MS4) permit requirements or environmental mandates. This has been the case since the stormwater enterprise fund was created. The city last updated its stormwater master plan in 2019 and has also completed studies of each of the 10 key flood plains within the city, and as such management is confident that the scope of the capital plan is comprehensive and will lessen the impacts of extreme wet weather events over time, especially to the most vulnerable neighborhoods.

The city has historically been deliberate in its fee adjustments, generally increasing the monthly charge by 50 cents per year in recent years. As of fiscal 2021, the charge is only \$7.50 per month, assuming a single-family residential property of 2,800 square feet of impervious surface area. When combined with the average water and sewer bill for a

typical residential customer of \$62 per month, the total utility burden is only about 1.5% of Arlington's median household effective buying income of 101% that of the U.S. This is, in our view, indicative of the city's commitment to affordability, a key social consideration. We also consider the city's overall risk management and adherence to financial policies as generally better than that of peers, and therefore that Arlington's management team has reasonably addressed ESG-related risks.

Stable Outlook

Downside scenario

Downward stress on the rating would most likely be associated with financial risk profile deterioration, possibly associated with remote events such as negative extraordinary intervention, aggressive use of more risky debt instruments, or an unfunded mandate from environmental regulators that could cause a sharp deviation in financial performance from a rapid increase in debt. Downward stress on the rating would most likely be associated with financial risk profile deterioration, possibly associated with remote events such as negative extraordinary intervention by way of the general fund stripping cash from the utility; aggressive use of more risky debt instruments; or an unfunded mandate from environmental regulators that could cause a sharp deviation in financial performance from a rapid increase in debt.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

Copyright © 2021 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.