FitchRatings

Public Finance
Water & Sewer
U.S.A.

Arlington, Texas - Drainage System

Ratings

Stand-Alone Credit Profile	aaa

New Issue

$8,290,000 Municipal Drainage Utility System Revenue Bonds, Series 2021	AAA

Outstanding Debt

Municipal Drainage Utility System Revenue Bonds	AAA
Municipal Drainage Utility System Revenue Refunding Bonds (Taxable)	AAA

Rating Outlook

Stable

Applicable Criteria

Public Sector, Revenue-Supported Entities Rating Criteria (February 2021)

U.S. Water and Sewer Rating Criteria (March 2021)

Related Research

Fitch Rates Arlington, Texas' Drainage Rev Bonds 'AAA'; Outlook Stable (May 2021)

New Issue Summary

Sale Date: June 16, 2021 via competitive bid

Series: Municipal Drainage Utility System Revenue Bonds, Series 2021

Purpose: Proceeds will be used to pay for drainage improvements and costs of issuance.

Security: The bonds are secured by a first lien on the gross revenues of the system.

The 'AAA' bond rating and 'aaa' SCP reflect the system's very low leverage, as measured by net adjusted debt to adjusted funds available for debt service (FADS), within the framework of very strong revenue defensibility and very low operating cost burden assessments, both assessed at 'aa'. The low cost of maintenance of utility assets provides the system with a high degree of operating and financial flexibility. The revenue defensibility is supported by the very stable revenue in the form of a fixed rate charge. The final year of a seven-year stepped fee increase was implemented in fiscal 2021 and rates are currently expected to remain stable.

The most recent city Comprehensive Stormwater Plan (CSP) was completed in April 2021 and spending over the coming five-year period will be higher than the past five years. Fiscal 2020 leverage was 3x and Fitch expects system leverage to remain stable over the coming five years as the system progresses through the CSP to increase the city's resilience to flooding.

Key Rating Drivers

Revenue Defensibility 'aa'

Very Strong Revenue Defensibility

Revenue defensibility is very strong, supported by the city's favorable service area characteristics, very affordable rates and 100% monopolistic business service. The drainage fee, which in nominal dollars is very low, is a fixed cost and provides a very stable revenue stream.

Operating Risks 'aa'

Low Operating Risk

The system generally has limited operations and lacks measured flows. Consequently, Fitch has assessed operating risk at 'aa'. Annual capital spending on stormwater projects has gradually increased as the city has been addressing priority projects outlined in the system's master plan.

Financial Profile 'aaa'

Strong Financial Profile; Low Leverage

Despite recent and planned debt issuances, system leverage is very favorable and is expected to remain stable.

Rating Sensitivities

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Not applicable due to the 'AAA' rating.

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Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Sustained increase in leverage that exceeds 5x in Fitch's base and stress cases, assuming no change in revenue defensibility and operating risk assessments;
- Further escalation in capital spending without offsetting increases in revenues could weaken FADS.

Credit Profile

The city established the system in 1990 to address damage to property caused by surface water overflows and surface water stagnation. The system serves over 100,000 accounts, which include residential, commercial and non-residential property within the city.

Fitch considers the system to be a related entity to the city for rating purposes given the city's oversight of the system, including the authority to establish rates and direct operations. The credit quality of the city does not currently constrain the bond rating. However, as a result of being a related entity, the issue ratings could become constrained by a material decline in the general credit quality of the city.

Revenue Defensibility

The system has a very stable and predictable revenue stream, with the system fee determined by equivalent residential unit and charged on the monthly combined utility bill. Nonpayment of any portion of the utility fees results in termination of water service. The assessment is also supported by a favorable service area with all revenue derived from a monopolistic business line.

Starting in fiscal 2014, rates have been adjusted annually to support planned capital spending. Rates, which are low in nominal terms and which Fitch considers affordable for the vast majority of the population (around 90%), peak in 2021 at $7.50. Revenues from fees are collected almost equally between residential and commercial customers and revenue concentration among customers is limited at just 4%.

No asymmetric rating factor considerations affect the revenue defensibility assessment.

Operating Risk

As a stormwater system, the operating risk is assessed at 'aa' due to the limited operations and lack of measured flows. The system's CSP was most recently updated in April 2021 and projects focus on making the city more resilient to flooding. Since fiscal 2016, capital spending has seen steady increases to address flood and erosion mitigation but needs are considered manageable. The CSP points to annual capital spending of between $15 million-$18 million. The fiscal 2021-2025 capital improvement plan (CIP) totals $84 million, up from about $60 million identified in the prior plan. The current offering provides about half of the funding for the $19.8 million of planned fiscal 2021 capital spending.

No asymmetric rating factor considerations affect the operating risks assessment.

Financial Profile

The system's historically very low leverage ratio has grown over the last several years as investment in capital funded by debt continues. Also impacting the increase to the leverage ratio was the reclassification of cash balances into restricted funds in fiscal 2018 to align accounting methodologies with the water and sewer utility system. Fiscal 2020 leverage increased to 3.0x from 2.4x the year prior. Based on expected capital spending, combined with planned debt, leverage will remain just above 3x over the next couple of years.

Liquidity is neutral to the assessment. Nevertheless, financial metrics are strong with fiscal 2020 coverage of full obligations of 3.7x and current days cash on hand of 230 days. Financial ratios and margins are very healthy as the fixed revenue stream and low maintenance cost of this type of utility provide the system with high degree of operational and financial flexibility. Continued financial strength is expected as management forecasts point to increasing revenues through fiscal 2021 from adopted rate increases to support fixed debt carrying costs and to address capital needs on a pay-go basis.

Rating History (IDR)

Rating	Action	Outlook/ Watch	Date
AAA	Affirmed	Stable	5/25/21
AAA	Assigned	Stable	5/2/17

Fitch Analytical Stress Test (FAST)

The FAST considers the potential trend of key ratios in a base case and a stress case, with the stress case designed to impose capital costs 10% above expected levels and evaluate potential variability in projected key ratios. Fitch used management's provided forecast, CIP and expected debt issuance in formulating the FAST base case scenario. Fitch made additional reasonable assumptions surrounding expenditure growth at about 3% annually.

Factoring in these assumptions, fiscal 2021 leverage in the FAST base and stress cases is expected to grow to 3.3x and 3.5x, respectively. Thereafter, leverage is expected to gradually decline to 2.6x in the base case and 3.2x in the stress case by fiscal 2025, which is supportive of the assessment.

Asymmetric Additional Risk Considerations

No asymmetric additive risk considerations affected this rating determination.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Issuer Summary

($000, Audited Years Ended Sept. 30)	2016	2017	2018	2019	2020
Revenue Defensibility					
% of Total Revs from Monopolistic Services	**100**	**100**	**100**	**100**	**100**
Service Area Characteristics					
Service Area Population	394,384	397,173	398,123	398,854	n.a
Total Customer Count	100,939	101,329	101,993	102,356	103,618
Five-Year Total Customer Count CAGR	—	**0.5**	**0.5**	**0.5**	**0.6**
Three-Year Total Customer Count CAGR	**0.4**	—	—	—	—
Service Area MHI ($)	53,574	55,562	58,502	60,571	n.a
Service Area MHI/US MHI (%)	**97**	**96**	**97**	**96**	—
Service Area Unemployment Rate (%)	3.9	3..8	3.6	3.4	7.7
Service Area Unemployment Rate/US Unemployment Rate (%)	**80**	**86**	**92**	**92**	**95**
Rate Flexibility					
Total Monthly Bill (7,500 gallons/6,000 gallons)	5.25	5.75	6.25	6.75	7.25
% of Population w/Unaffordable bill	10	11	11	11	n.a
Operating Risks					
Operating Cost Burden					
Operating Cost Burden ($/mg)[a]	—	—	—	—	—
Capital Planning and Management					
Life Cycle Ratio (%)	**28**	**28**	**28**	**28**	**27**
CapEx/Depreciation (%)	226	437	444	435	648
Five-Year Avg Capital Expenditures/Depreciation (%)	**382**	**390**	**390**	**370**	**438**

Financial Profile ($000)					
Current Unrestricted Cash/Investments	18,231	26,483	1,335	2,142	2,702
Current Cash Available	**18,231**	**26,483**	**1,335**	**2,142**	**2,702**
Available Cash	**18,231**	**26,483**	**1,335**	**2,142**	**2,702**
Current Restricted Cash/Invest (Debt Service or Debt Service Reserve)	718	—	531	395	—
Noncurrent Restricted Cash/Invest (Debt Service or Debt Service Reserve)	—	692	532	839	1,038
Funds Restricted for Debt Service	**718**	**692**	**1,063**	**1,234**	**1,038**
Total Debt	19,860	27,910	31,797	36,970	45,481
Available Cash	18,231	26,483	1,335	2,142	2,702
Funds Restricted for Debt Service	718	692	1,063	1,234	1,038
Net Adjusted Debt	**911**	**735**	**29,399**	**33,594**	**41,741**
Total Operating Revs	13,575	15,011	16,384	18,014	19,650
Other Operating Expenses	3,430	3,441	3,903	3,597	4,290
EBITDA	**10,145**	**11,570**	**12,481**	**14,417**	**15,360**
Investment Income/(Loss)	116	175	250	365	—
FADS	**10,261**	**11,745**	**12,731**	**14,782**	**15,360**
Net Transfers In/(Out)	(1,106)	(1,164)	(2,032)	(904)	(1,504)
Adjusted FADS	**9,155**	**10,581**	**10,699**	**13,878**	**13,856**
Net Adjusted Debt to Adjusted FADS (x)	**0.1**	**0.1**	**2.8**	**2.4**	**3.0**
FADS	10,261	11,745	12,731	14,782	15,360
Net Transfers In/(Out)	(1,106)	(1,164)	(2,032)	(904)	(1,504)
Adjusted FADS for COFO	**9,155**	**10,581**	**10,699**	**13,878**	**13,856**
Total Annual Debt Service (automatic calculation)	2,243	2,434	2,924	3,295	3,800

Issuer Summary

($000, Audited Years Ended Sept. 30)	2016	2017	2018	2019	2020
Adjusted Debt Service (Including fixed services expense)	**2,243**	**2,434**	**2,924**	**3,295**	**3,800**
Coverage of Full Obligations (COFO) (x)	**4.08**	**4.35**	**3.66**	**4.21**	**3.65**
COFO exc. connection Fees (x)	**4.08**	**4.35**	**3.66**	**4.21**	**3.65**
Current Days Cash on Hand	**1,940**	**2,809**	**125**	**217**	**230**
Liquidity Cushion Ratio (days)	**1,940**	**2,809**	**125**	**217**	**230**
All-in DSC (x)	4.57	4.83	4.35	4.49	4.04

[a]Metric not calculated due to lack of measured flows

Note: Fitch may have reclassified certain financial statement items for analytical purposes. N.A. - Not Available.
Source: Fitch Ratings, Fitch Solutions, Arlington (TX).

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.