

RatingsDirect®

Summary:

Arlington, Texas; Water/Sewer

Primary Credit Analyst:

John Schulz, Centennial + 1 (303) 721 4385; john.schulz@spglobal.com

Secondary Contact:

James M Breeding, New York + 1 (214) 871 1407; james.breeding@spglobal.com

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Credit Profile

US\$18.94 mil wtr and wastewtr sys rev bnds ser 2022A dtd 05/15/2022 due 06/01/2042		
<i>Long Term Rating</i>	AAA/Stable	New
US\$7.31 mil wtr and wastewtr sys rev rfdg bnds ser 2022B dtd 05/15/2022 due 06/01/2032		
<i>Long Term Rating</i>	AAA/Stable	New
Arlington wtr & swr		
<i>Long Term Rating</i>	AAA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AAA' rating to Arlington, Texas' approximately \$19 million series 2022A water and wastewater system revenue bonds and approximately \$7.3 million series 2022B water and wastewater system revenue refunding bonds. At the same time, S&P Global Ratings affirmed its 'AAA' rating on the city's existing water and wastewater system revenue debt. The outlook is stable.

A first-lien pledge on the system's net revenue secures the 2022 bonds, which are on par with about \$318 million in long-term debt currently outstanding. A fully funded debt service reserve in the amount of average annual debt service provides additional liquidity. The series 2022A bond proceeds will be used to finance projects in the city's capital plan, primarily for underground infrastructure renewals and replacements. The series 2022B bonds will be used to refund the system's series 2012 revenue bonds.

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 retail water and sanitary sewer services to approximately 111,000 metered accounts. 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. The peak growth period was primarily between 1990 and 2010, as evidenced by the average age of the city's underground infrastructure of only about 26 years. With a nearly complete status of development and an abundance of relatively newer infrastructure, the utility system's capital needs are small. The five-year capital improvement plan through 2025 is \$178 million, 55% of which management intends to fund with 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;

- Wholesale arrangements with highly rated counterparties for raw-water supply and wastewater treatment, greatly limiting operating and financial risk to the city; and
- Very affordable rates, providing reasonable flexibility as costs rise and the ability to maintain its financial profile over time.

Arlington, with a population of about 387,000, 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 the local school district 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 more than 8% of fiscal 2021 operating revenues.

Although COVID-19 had an outsize impact on the city's disproportionately large number of employers that emphasize an in-person presence, such as a General Motors production facility, 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, Arlington's direct employment base has shown resilience. The March 2022 unemployment rate was 3.8% after spiking as high as 12.5% in April 2020. The city's median household effective buying income (MHHEBI) is 96% of the U.S. level.

Raw water is supplied to Arlington via Tarrant Regional Water District (TRWD), and wastewater treatment by Trinity River Authority (TRA). These relationships have helped keep rates and rate adjustments low. The average residential monthly bill in fiscal 2021 is \$63--less than 1.5% of MHHEBI--with only low single-digit base rate adjustments planned in each of the next five years. The city also fully passes through any cost increases from its wholesale providers.

The system's financial position is another identified strength. Annual debt service coverage (DSC) in fiscal 2021 was about 2.4x and is in line with its historically robust performance. Even when adding certain fixed costs of TRWD and TRA onto Arlington's coverage metrics, all-in DSC in fiscal 2020 was still what we view as a very strong 1.6x. All-in coverage is S&P Global Ratings' internally adjusted coverage metric, which treats certain recurring costs--such as those related to water purchase contracts--as if they were debt service payments, and net transfers of surplus net revenues out of the utility as if they were operating expenses. Management is conservatively forecasting similarly strong DSC for the five years through fiscal 2025.

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 utility fund's discretionary rate stabilization reserve balance stands at \$7.1 million. Management budgets substantial money each year for pay-as-you-go projects that can be redirected or revised, depending on priorities. Furthermore, Arlington's general government has a restricted reserve that as of fiscal year-end 2021 was almost \$71 million. The "Arlington Tomorrow Fund" 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.

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 with its capital budget needs.

Environmental, social, and governance

The city's relationships with the TRWD as the long-term raw water supplier as well as TRA not only creates financial predictability and scale, it also goes far to address key operational risks regarding water scarcity and environmental stewardship. As of April 26, 2022, all of TRWD's reservoirs were at or near full, which is favorable versus historical levels heading into the peak summer months. TRWD is the raw water provider to most of the immediate area's suburbs, many of which are fast growing. The district, however, has enough supply to serve the current and existing population through at least the middle of this century. Still, the city was one of the first in the region to implement year-round water conservation measures, especially toward outdoor irrigation. We view the low rates as a key social consideration. We also consider the city's overall risk management and adherence to financial policies as generally better than peers, and therefore that Arlington's management team has made reasonable efforts to mitigate ESG-related risks, including cybersecurity threats and natural disasters. Lastly long-range planning is strong and well-integrated with operations, financial planning and wholesalers. This is most evident with ample water and sewer treatment capacity for city build out.

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 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 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

Ratings Detail (As Of April 28, 2022)		
Arlington wtr & swr		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Arlington wtr & swr		
<i>Long Term Rating</i>	AAA/Stable	Affirmed

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