



RATING ACTION COMMENTARY

Fitch Rates Arlington, Texas' Drainage Rev Bonds 'AAA'; Outlook Stable

Wed 27 Apr, 2022 - 12:20 PM ET

Fitch Ratings - Austin - 27 Apr 2022: Fitch Ratings has assigned a 'AAA' rating to the following city of Arlington, Texas (the city) bonds:

--Approximately \$8.96 million municipal drainage utility system revenue bonds series 2022.

The bonds will be sold via competitive bid on May 18. Series 2022A bond proceeds will be used to pay for improvements to the city's municipal drainage system (the system) and issuance costs. A debt service reserve will not be funded.

In addition, Fitch affirms the 'AAA' rating on the following bonds:

--\$45.5 million in outstanding municipal drainage utility system revenue bonds, series 2017, 2018, 2019 2020A, 2020B and 2021.

Fitch has assessed the system's standalone credit profile (SCP) at 'aaa'. The SCP represents the credit profile of the system on a standalone basis irrespective of its relationship with, and the credit quality of, the city of Arlington, TX (Issuer Default Rating AAA/Stable).

The Rating Outlook is Stable.

ANALYTICAL CONCLUSION

The 'AAA' bond rating and 'aaa' SCP reflect the system's exceptionally 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 strong operating risk assessments, both assessed at 'aa'. The low cost of maintenance of system assets provides it with a high degree of operating and financial flexibility. The revenue defensibility is supported by very stable revenue in the form of a fixed rate charge. The system has a long history of gradual rate adjustments that Fitch expects to continue through fiscal 2025 to support capital needs.

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 2021 leverage was 2.2x (based on draft audited results), and Fitch expects system leverage to remain stable, between 2.0x and 3.0x, over the coming five years as the system progresses through the CSP to increase the city's resilience to flooding.

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 103,000 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.

KEY RATING DRIVERS

Revenue Defensibility 'aa'

Very Strong Revenue Defensibility Supported by Fixed Rate Structure

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 charge 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 CSP.

Financial Profile 'aaa'

Exceptionally Strong Financial Profile; Very Low Leverage

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

Asymmetric Additive Risk Considerations

No asymmetric additive risk considerations affected this rating determination.

RATING SENSITIVITIES

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

--Not applicable due to the 'AAA' rating.

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.

Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical

performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit

<https://www.fitchratings.com/site/re/10111579>.

SECURITY

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

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. The monthly fee, which is low in nominal terms and which Fitch considers affordable for the vast majority of the population (around 90%), registered \$8.00 in fiscal 2022. The city expects to continue to gradually step up rates by \$0.50 annually through 2025. Revenues from fees are collected almost equally between residential and commercial customers and revenue concentration among customers is limited at just 4%.

Operating Risks

Operating risk is assessed at 'aa' and reflects the system's moderate life cycle investment needs, limited operations and lack of measured flows. The system's life cycle ratio is favorable at 25% with five-year average capex to depreciation of 546%. 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-\$26 million. The fiscal 2022-2026 capital improvement plan (CIP) totals \$100 million, up from about \$84 million identified in the prior plan. The current offering provides about half of the funding for the \$18 million of planned fiscal 2022 capital spending.

Financial Profile

The financial profile is assessed at 'aaa'. Fiscal 2021 financial results are unaudited due to delays related to implementation of a new software system, but management informed Fitch that results are largely final. The system's historically exceptionally low leverage ratio has grown over the last several years as investment in capital funded by debt continues. The leverage ratio was also boosted by the reclassification of cash balances into restricted funds in fiscal 2018 to align accounting methodologies with the water and sewer utility system.

Fiscal 2021 leverage decreased to 2.2x from 3.0x the year prior as the city did not complete its typical practice of transferring surplus funds to restricted accounts. Based on expected capital spending, combined with planned debt, Fitch expects leverage will be maintained at 2.0x to 3.0x over the next several years, consistent with the current assessment.

Liquidity is neutral to the assessment. Nevertheless, financial metrics are strong with fiscal 2021 coverage of full obligations of 4.0x and current days cash on hand (DCOH) of 1,050 days. The prior year's DCOH was 230 days due to the system's practice of transferring funds, which did not occur in 2021. Nevertheless, 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.

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 provided forecast, CIP and the current debt issuance in formulating the FAST base case scenario. Fitch made additional reasonable assumptions surrounding expenditure growth at about 4.5% annually.

Factoring in these assumptions, fiscal 2022 leverage in the FAST is expected to hover between 2.1x to 2.7x in the base case and 2.5x to 3.1x in the stress case, which is supportive of the assessment.

Sources of Information

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

ESG Relevance Scores for Waste and Hazardous Materials Management, Customer Welfare, and Exposure to Social Impacts for Arlington, TX - Municipal Drainage Utility System vary from water and sewer sector guidance as stormwater utilities are not exposed to the same extent to these Environmental and Social issues given there are no measured flows or product produced by the stormwater utility.

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

RATING ACTIONS

ENTITY / DEBT ⇅	RATING ⇅	PRIOR ⇅
Arlington (TX) [Stormwater]		
Arlington (TX) /Stormwater Revenues/1 LT	LT AAA Rating Outlook Stable Affirmed	AAA Rating Outlook Stable

[VIEW ADDITIONAL RATING DETAILS](#)

FITCH RATINGS ANALYSTS

Teri Wenck, CPA

Director

Primary Rating Analyst

+1 512 215 3742

teri.wenck@fitchratings.com

Fitch Ratings, Inc.

2600 Via Fortuna, Suite 330 Austin, TX 78746

Victor Valdez

Analyst

Secondary Rating Analyst

+1 512 813 5650

victor.valdez@fitchratings.com

Kristen Reifsnyder

Director

Committee Chairperson

+1 646 582 3448

kristen.reifsnyder@fitchratings.com

MEDIA CONTACTS

Sandro Scenga

New York

+1 212 908 0278

sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

[U.S. Water and Sewer Rating Criteria \(pub. 18 Mar 2021\) \(including rating assumption sensitivity\)](#)

[Public Sector, Revenue-Supported Entities Rating Criteria \(pub. 01 Sep 2021\) \(including rating assumption sensitivity\)](#)

ADDITIONAL DISCLOSURES

[Dodd-Frank Rating Information Disclosure Form](#)

[Solicitation Status](#)

[Endorsement Policy](#)

ENDORSEMENT STATUS

Arlington (TX)

EU Endorsed, UK Endorsed

DISCLAIMER & DISCLOSURES

All Fitch Ratings (Fitch) credit ratings are subject to certain limitations and disclaimers.

Please read these limitations and disclaimers by following this link:

<https://www.fitchratings.com/understandingcreditratings>. In addition, the following <https://www.fitchratings.com/rating-definitions-document> details Fitch's rating definitions for each rating scale and rating categories, including definitions relating to default.

Published ratings, criteria, and methodologies are available from this site at all times. Fitch's code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance, and other relevant policies and procedures are also available from the Code of Conduct section of this site. Directors and shareholders' relevant interests are available at

<https://www.fitchratings.com/site/regulatory>. Fitch may have provided another permissible or ancillary service to the rated entity or its related third parties. Details of permissible or ancillary service(s) for which the lead analyst is based in an ESMA- or FCA-registered Fitch Ratings company (or branch of such a company) can be found on the entity summary page for this issuer on the Fitch Ratings website.

In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and

complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided “as is” without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency

of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the “NRSRO”). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see <https://www.fitchratings.com/site/regulatory>), other credit rating subsidiaries are not listed on Form NRSRO (the “non-NRSROs”) and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

Copyright © 2022 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved.

[READ LESS](#)

SOLICITATION STATUS

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

ENDORSEMENT POLICY

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's [Regulatory Affairs](#) page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

US Public Finance

Infrastructure and Project Finance

North America

United States
