

RatingsDirect®

Summary:

Arlington, Texas; Water/Sewer

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Credit Profile

US\$10.825 mil wtr and wastewtr sys rev rfdg bnds ser 2023B dtd 06/01/2023 due 06/01/2033

Long Term Rating AAA/Stable New

US\$6.92 mil wtr and wastewtr sys rev bnds ser 2023A dtd 06/01/2023 due 06/01/2043

Long Term Rating AAA/Stable New

Arlington wtr & swr

Long Term Rating AAA/Stable Affirmed

Credit Highlights

- S&P Global Ratings assigned its 'AAA' long-term rating to Arlington, Texas' approximately \$6.9 million series 2023A water and wastewater system revenue bonds and approximately \$10.8 million series 2023B water and wastewater system revenue refunding bonds.
- At the same time, S&P Global Ratings affirmed its 'AAA' rating on the city's outstanding water and wastewater system revenue debt.
- The outlook is stable.

Security

A first-lien pledge on the system's net revenue secures the 2023 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 2023A bond proceeds will be used to finance projects in the city's capital plan, primarily for underground infrastructure renewals and replacements. The series 2023B bonds will be used to refund the system's series 2012 and 2013A revenue bonds.

Credit overview

Arlington's water sewer fund credit strength is founded in:

- 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 during 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.

The above-mentioned strengths offset their all-in debt service metrics that remains weaker than most peers at the 'aaa' rating. While Annual debt service coverage (DSC) in fiscal 2022 on the city's own debt was healthy at about 2.6x and is in line with its historically robust performance, when adding certain fixed costs of Tarrant Regional Water District

(TRWD) and Trinity River Authority (TRA) onto Arlington's coverage metrics, all-in DSC in fiscal 2023 was significantly lower but still what we view as a very strong 1.7x. 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.

Arlington provides retail water and sanitary sewer services to approximately 113,000 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 2026 is \$209 million, 44% of which management intends to fund with internally generated revenues.

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.

Outlook

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

Downside scenario

Downward stress on the rating would most likely be associated with financial risk profile deterioration. In particular if the unrestricted cash within the utility fund is stressed for any reason, we would lower the rating despite the having potential access to "Arlington Tomorrow Fund". The utility's unrestricted cash is a weakness when compared to peers.

Credit Opinion

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 2022 operating revenues. The February 2023 unemployment rate was 4.2% after spiking as high as 12.5% in April 2020. The city's median household effective buying income (MHHEBI) is 98% 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 2023 is \$65--less than 1.4% 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.

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 \$7.5 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 2022 was almost \$79 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.

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.

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 May 11, 2023)		
Arlington wtr & swr		
Long Term Rating	AAA/Stable	Affirmed
Arlington wtr & swr		
Long Term Rating	AAA/Stable	Affirmed

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