

Arlington, Texas

Stormwater

New Issue Summary

Sale Date: June 6, 2023, via competitive bid

Series: Municipal Drainage Utility System Revenue Bonds, Series 2023

Purpose: Bond proceeds will be used to pay for improvements to Arlington's (the city) municipal drainage system (the system) and issuance costs.

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 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 system maintenance 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 Ratings expects will continue 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 2022 (FYE Sept. 30) leverage was 2.7x, 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 resilience to flooding.

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 Risk: '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. The liquidity profile is considered neutral to the assessment with coverage of full obligations (COFO) of 4.5x in fiscal 2022.

Rating Sensitivities

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

- The rating is at the highest level on Fitch's scale and cannot be upgraded.

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

- Sustained leverage that exceeds 5.0x 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 that weakens FADS.



Assessment

Stand-Alone Credit Profile aaa

New Issue

\$4,505,000 Municipal Drainage Utility System Revenue Bonds, Series 2023 AAA

Outstanding Debt

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

Rating Outlook

Stable

Applicable Criteria

[U.S. Water and Sewer Rating Criteria \(March 2023\)](#)

[Public Sector, Revenue-Supported Entities Rating Criteria \(April 2023\)](#)

Related Research

[Fitch Rates Arlington, TX Drainage Rev Bonds 'AAA'; Outlook Stable \(May 2023\)](#)

Analysts

Teri Wenck, CPA
 +1 512 215-3742
teri.wenck@fitchratings.com

Natalie Hughey
 +1 212 908-0614
natalie.hughey@fitchratings.com

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 104,000 accounts, which include residential, commercial and nonresidential 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 rating 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 the amount of impervious cover, in turn equating to an equivalent residential unit (ERU) 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 that displays modest customer growth and income and unemployment levels largely in line with the nation. All revenue is derived from a monopolistic business line.

Starting in fiscal 2014, rates have been adjusted annually to support planned capital spending. The monthly fee for one ERU, which is low in nominal terms and considered 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. Revenues from fees are collected almost equally between residential and commercial customers and revenue concentration among customers is limited at just 6%.

Operating Risk

Operating risk is assessed at 'aa' and reflects the system's moderate 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 516%. 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 and \$26 million. The fiscal 2023–2026 capital improvement plan (CIP) totals about \$98 million. The current offering provides about a quarter of the funding for planned fiscal 2023 capital spending of \$19 million.

Financial Profile

The financial profile is assessed at 'aaa'. 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 also increased by the reclassification of cash balances into restricted funds in fiscal 2018 to align accounting methodologies with the water and sewer utility system.

Fiscal 2022 leverage increased slightly to 2.7x from 2.2x the year prior as the city did not complete its typical practice of transferring surplus funds to restricted accounts in fiscal 2021. 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 COFO typically between 3.5x and 4.5x since fiscal 2018. Fitch calculated all-in debt service coverage is stronger at 5.1x, as it excludes net transfers. Fiscal 2022 current days cash on hand fell to 65 days from 1,050 days the year prior as the system continued its typical practice of transferring surplus funds to restricted accounts. Management expects this transfer to continue to occur, keeping cash low. 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.

Rating History

Rating	Action	Outlook/ Watch	Date
AAA	Affirmed	Stable	5/15/23
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 and CIP and included the current and planned debt issuances in formulating the FAST base case scenario. Fitch made additional reasonable assumptions surrounding expenditure growth at about 5.9% annually.

Factoring in these assumptions, leverage is expected to hover between 2.2x to 2.4x in the base case and 2.4x to 3.0x in the stress case, which is supportive of the assessment. The liquidity profile is expected to remain neutral to the assessment with COFO of at least 3.0x and sound cash levels.

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.

Financial Summary

(\$000, Audited Fiscal Years Ended Sept. 30)	2018	2019	2020	2021	2022
Revenue Defensibility					
% of Total Revenue from Monopolistic Services	100	100	100	100	100
Service Area Characteristics					
Service Area Population	397,903	398,930	394,266	392,786	N.A.
Total Customer Count	101,993	102,356	103,618	103,950	104,591
Five-Year Total Customer Count CAGR	0.5	0.5	0.6	0.6	0.6
Service Area Median Household Income (\$)	58,502	60,571	63,351	65,481	N.A.
Service Area MHI/U.S. Median Household Income (%)	97	96	97	95	N.A.
Service Area Unemployment Rate (%)	3.6	3.4	7.8	5.4	3.6
Service Area Unemployment Rate/US Unemployment Rate (%)	92	92	96	102	100
Rate Flexibility					
Total Monthly Bill (7,500 Gallons/6,000 Gallons)	6.25	6.75	7.25	7.50	8.00
% of Population with Unaffordable Bill	11	11	12	12	N.A.
Operating Risk					
Operating Cost Burden					
Operating Cost Burden (\$/mg)	—	—	—	—	—
Capital Planning and Management					
Life Cycle Ratio (%)	28	28	27	25	25
CapEx/Depreciation (%)	444	435	648	766	288
Five-Year Average Capex/Depreciation (%)	390	370	438	546	516
Financial Profile (\$000)					
Current Unrestricted Cash/Investments	1,335	2,142	2,702	12,286	822
Current Cash Available	1,335	2,142	2,702	12,286	822
Available Cash	1,335	2,142	2,702	12,286	822
Current Restricted Cash/Invest (Debt Service or Debt Service Reserve)	531	395	—	694	355
Noncurrent Restricted Cash/Invest (Debt Service or Debt Service Reserve)	532	839	1,038	919	1,558
Funds Restricted for Debt Service	1,063	1,234	1,038	1,613	1,913
Total Debt	31,797	36,970	45,481	52,000	57,867
Available Cash	1,335	2,142	2,702	12,286	822
Funds Restricted for Debt Service	1,063	1,234	1,038	1,613	1,913
Net Adjusted Debt	29,399	33,594	41,741	38,101	55,132
Total Operating Revs	16,384	18,014	19,650	20,526	22,072
Other Operating Expenses	3,903	3,597	4,290	4,273	4,593
EBITDA	12,481	14,417	15,360	16,253	17,479
Investment Income/(Loss)	250	365	—	121	339
Other Cash Revenues/(Expenses)	—	—	—	—	4,588
Funds Available for Debt Service	12,731	14,782	15,360	16,374	22,406
Net Transfers In/(Out)	-2,032	-904	-1,504	655	-2,281
Adjusted Funds Available for Debt Service	10,699	13,878	13,856	17,029	20,125
Net Adjusted Debt/Adjusted Funds Available for Debt Service (x)	2.8	2.4	3.0	2.2	2.7
Funds Available for Debt Service	12,731	14,782	15,360	16,374	22,406
Net Transfers In/(Out)	-2,032	-904	-1,504	655	-2,281
Adjusted FADS for Coverage of Full Obligations	10,699	13,878	13,856	17,029	20,125
Total Annual Debt Service	2,924	3,295	3,800	4,086	4,435
Adjusted Debt Service (Includes Fixed Services Expense)	2,924	3,295	3,800	4,086	4,435
Coverage of Full Obligations (x)	3.7	4.2	3.7	4.2	4.5
Coverage of Full Obligations Excluding Connection Fees (x)	3.7	4.2	3.7	4.2	4.5
Current Days Cash on Hand	125	217	230	1,050	65
Liquidity Cushion Ratio (Days)	125	217	230	1,050	65
All-In Debt Service Coverage (x)	4.4	4.5	4.0	4.0	5.1

N.A. - Not available. Note: Fitch may have reclassified certain financial statement items for analytical purposes.
Sources: Fitch Ratings, Fitch Solutions, Arlington

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.

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 © 2023 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.