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Arlington, Texas

New Issue Summary

Sale Date: June 7, 2023, via competitive bid	
Series: $6,920,000 Water and Wastewater System Revenue Bonds, Series 2023A; and $10,825,000 Water and Wastewater System Revenue Refunding Bonds, Series 2023B	
Purpose: Proceeds will be used to make improvements and extensions to Arlington's (the city) water and sewer system (the system), refund portions of outstanding bonds and pay issuance costs.	
Security: The bonds are special obligations of the system, payable from and secured by a pledge of and first lien on net revenues of the system.	

The system's 'AAA' bond rating reflects exceptionally low leverage, measured as net adjusted debt to adjusted funds available for debt service (FADS), within the framework of very strong revenue defensibility and very low operating risk. The system has a high degree of rate affordability and the city retains legal autonomy to raise rates. The operating cost burden is very low but influenced by its dependence on wholesale service providers.

Leverage was 4.2x in fiscal year 2022 (ended Sept. 30), supported by strong FADS production and a modest decline in net adjusted debt for the year. Absent the most recent fiscal year, leverage from 2018 to 2021 has remained above 5.0x and is slightly elevated for the rating but does not consider significant restricted reserves available for capital construction; inclusive of those funds, leverage is materially lower. The city's practice is to transfer surplus funds each year into the restricted construction fund to address pay-as-you-go capital needs.

Fitch Ratings expects leverage to remain generally stable as the system continues to execute its capital improvement plan (CIP). The majority of bonds being used to fund upgrades at its water treatment facilities have been issued, and work on the projects continues to be completed. Additionally, stable leverage is supported by planned rate adjustments from fiscal years 2023 to 2026 that provide an offset to increasing costs paid to wholesale providers and annual debt service requirements.

Key Rating Drivers

Revenue Defensibility: 'aa': Very Strong Revenue Defensibility: System rates are among some of the lowest in the Dallas Metroplex and are affordable for the vast majority of the city population. The assessment is further supported by the monopolistic utility services and the city's legal independent ability to increase rates without external approval. Future rate adjustments are expected to keep pace with wholesaler rate increases yet system user charges should remain affordable for the vast majority of the population.

Operating Risk: 'aa': Very Low Operating Cost Burden: The system's operating risk is very strong, supported by a very low operating cost burden, low life cycle ratio and moderate investment needs. The system's $251 million CIP is up from the prior year with inflationary cost increases and because it remains in a capital-intensive period, yet remains manageable. It is expected to be about 50% debt funded.

Financial Profile: 'aaa': Leverage Expected to Gradually Decline: System leverage improved in fiscal 2022 to 4.2x, reflecting strong demand. Leverage will likely approach 5.0x in the next one to two years as the system executes its CIP but then begin a gradual decline thereafter. The liquidity profile is neutral to the assessment with coverage of full obligations (COFO) consistently above 1.3x.

FACT Tools

Assessment

Standalone Credit Profile	aaa

New Issues

$6,920,000 Water and Wastewater System Revenue Bonds, Series 2023A	AAA
$10,825,000 Water and Wastewater System Revenue Refunding Bonds, Series 2023B	AAA

Outstanding Debt

Water and Wastewater System Revenue and Refunding Bonds	AAA
Water and Wastewater System Revenue Bonds	AAA

Rating Outlook

Stable

Applicable Criteria

Public Sector, Revenue-Supported Entities Rating Criteria (April 2023)

U.S. Water and Sewer Rating Criteria (March 2023)

Related Research

Fitch Rates Arlington, TX Water and Sewer Revs 'AAA'; Outlook Stable (May 2023)

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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 above 5.0x, taking into consideration reserves for capital construction, particularly if near-term results do not point to declining leverage.
- A liquidity cushion that falls below 90 days could lead to an asymmetric risk and produce rating pressure.

Credit Profile

The system provides retail water and sewer service to over 104,000 residential and commercial customers within the city. The city has water rights in Lake Arlington and its own water treatment facilities but purchases raw water supplies on a wholesale basis from the Tarrant Regional Water District (TRWD; Issuer Default Rating: AA+/Stable) through a long-term contract. Sewer system treatment service is provided through a long-term contract with the Trinity River Authority (TRA; wastewater revenue bonds: AAA/Stable).

Fitch considers the system 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 city's credit quality does not currently constrain the bond rating. However, as a related entity, the issue rating could become constrained by a material decline in the city's general credit quality.

Revenue Defensibility

Revenue defensibility is very strong with all system revenue derived from services or business lines exhibiting monopolistic characteristics in a service area with favorable demographic trends. The city maintains independent rate-setting authority without external approval, and the monthly combined water and sewer bill is considered affordable for the vast majority of the city population (around 85%). Revenue concentration among customers is limited at just 5%.

The system has a history of annual rate adjustments to keep pace with necessary increases related to purchased water and sewer service from its wholesale providers (TRA and TWRD) and produces stable financial margins. Despite above average rate increases adopted from 2018 to 2019, rates are still considered among the lowest in the Dallas Metroplex. Rates were held flat for fiscal years 2020 and 2021; annual rate adjustments then resumed in fiscal 2022 at 4.5% and a 2% rate increase was adopted in 2023. Rates are anticipated to continue to see modest annual adjustments ranging from about 2% to 6.7% through fiscal 2027. Historically, the city council has voted to pass through rate adjustments related to wholesale services.

The city is located in the center of the Dallas-Fort Worth Metroplex with favorable demographic trends. The service area exhibits stable customer growth comprising a 0.7% five-year total CAGR, and area income levels and unemployment are on par with national averages. The close proximity to the Dallas-Fort Worth International Airport and a well-developed highway transportation network make the city a logical center for manufacturing, distribution and trade. Its central location in the Metroplex has also led to the development of sizable retail trade activity.

Operating Risk

The system's operating risk is very strong, reflecting a very low operating cost burden with modest investment needs. The system has been moving through an accelerated capital plan to address necessary upgrades and modernization at the system's water treatment facilities. The system has a favorable life cycle ratio of 34%. Capex routinely outpaces depreciation, which also supports the assessment, and favorable capex levels are expected to continue.

The system depends on wholesale providers for raw water purchases and wastewater treatment, which also influences annual operating costs. Both TRA and TRWD have been in capital-intensive phases and each agency has total debt outstanding of about $1 billion. Arlington's share of TRA's debt registers at about 25%, while the system's share of TRWD's debt is about 15%. Both TRA's and TRWD's capital costs are included within the system's

Rating History

Rating	Action	Outlook/ Watch	Date
AAA	Affirmed	Stable	5/12/23
AAA	Revised	Stable	4/30/10
AA+	Affirmed	Stable	2/19/04
AA+	Assigned	—	4/27/00

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purchased services, but these amounts have not resulted in elevated costs. In fact, the system's operating cost burden is very low, at $4,045 per million gallons (mg) in fiscal 2022, and allows for capacity to absorb continued moderate increases in expenses paid for wholesale services.

CIP spending for fiscal years 2023 to 2027 totals about $250 million and will be about 50% debt financed. The plan includes spending for upgrades to a city-owned water treatment plant, continued replacement of water and sewer mains and implementation of enhanced technology, including an advanced metering system.

Financial Profile

The financial profile is exceptionally strong. System leverage declined in fiscal 2022 to 4.2x, bolstered by a strong financial margin due to high demand during a hot, dry summer. This level of leverage reversed a trend of moderately increasing leverage over the past several fiscal years that reached 6.1x in fiscal 2021.

Cash balances are influenced by a city practice in which excess surplus revenues are transferred to the restricted capital construction fund to assist with pay-as-you-go funding of capital and reduce debt financing. This results in strong restricted reserves for capital construction of about $232 million. The restricted construction funds also include unspent bond proceeds that have been issued for appropriated capital projects. The liquidity profile is neutral to the assessment, with fiscal 2022 current days cash on hand of 95, down from the year prior, and COFO of 1.9x. Fitch-calculated all-in debt service coverage is much higher at 3.2x, as it excludes the fixed services expense and net transfers.

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 at 10% above expected levels and evaluate potential variability in projected key ratios. Fitch's inputs that inform the base case are based on expected annual rate adjustments, the adopted CIP, increasing wholesale provider costs, which results in total operating expenses increasing around 6% annually, and expected debt issuance. Further, the FAST assumes that funds restricted for capital construction will fund a portion of capital spending.

Factoring in these assumptions, leverage initially increases to 4.9x and 5.1x in the second year of the base and stress cases, respectively, but then gradually decreases thereafter, reaching 3.8x by fiscal 2027 of the base case and 4.0x in the stress case. In both cases, the leverage metric is supportive of the current assessment. Given the city's practice of transferring surplus revenues at the end of the fiscal year to restricted accounts to support pay-as-you-go spending, leverage that factors construction funds is consistently under 3.0x. The liquidity profile is expected to remain neutral to the assessment with COFO of at least 1.5x and sound liquidity 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, due to either 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.

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Financial Summary

($000, Audited Fiscal Years Ended Sept. 30)	2018	2019	2020	2021	2022
Revenue Defensibility					
% of Total Revenue from Monopolistic Services	100	100	100	100	100
Service Area Characteristics					
Service Area Population	397,903	398,930	394,266	392,786	N.A.
Total Customer Count	**204,796**	**206,406**	**208,508**	**209,912**	**211,107**
5-Year Total Customer Count CAGR	0.6	0.6	0.7	0.7	0.7
Service Area Median Household Income ($)	58,502	60,571	63,351	65,481	N.A.
Service Area Median Household Income/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/U.S. Unemployment Rate (%)	92	92	96	102	100
Rate Flexibility					
Total Monthly Bill (7,500 Gallons/6,000 Gallons)	**67.71**	**73.41**	**73.41**	**73.41**	**76.23**
% of Population with Unaffordable Bill	14	14	13	13	N.A.
Operating Risk					
Operating Cost Burden					
Operating Cost Burden ($/mg)	4,210	3,745	4,354	4,523	4,045
Capital Planning and Management					
Life Cycle Ratio (%)	33	33	34	35	34
Capex/Depreciation (%)	198	208	169	239	316
5-Year Average Capex/Depreciation (%)	183	194	193	202	226
Financial Profile ($000)					
Current Unrestricted Cash/Investments	25,453	32,062	33,823	31,862	24,432
Current Cash Available	25,453	32,062	33,823	31,862	24,432
Available Cash	25,453	32,062	33,823	31,862	24,432
Current Restricted Cash/Invest. (Debt Service or Debt Service Reserve)	16,023	14,504	12,498	17,002	12,852
Noncurrent Restricted Cash/Invest. (Debt Service or Debt Service Reserve)	7,021	13,855	16,083	12,728	17,444
Funds Restricted for Debt Service	23,044	28,359	28,581	29,730	30,296
Total Debt	**243,559**	**337,873**	**313,199**	**340,348**	**337,002**
Capitalized Fixed Charges	140,071	138,574	144,886	155,818	144,315
Adjusted Net Pension Liability	15,001	22,398	17,956	7,367	1,802
Available Cash	25,453	32,062	33,823	31,862	24,432
Funds Restricted for Debt Service	23,044	28,359	28,581	29,730	30,296
Net Adjusted Debt	**350,134**	**438,424**	**413,637**	**441,941**	**428,391**
Total Operating Revenues	**155,958**	**155,189**	**165,047**	**169,901**	**192,877**
Purchased Water/Sewer Services	57,172	56,561	59,137	63,599	58,904
Other Operating Expenses	28,032	31,192	30,873	36,085	35,058
EBITDA	70,754	67,436	75,037	70,217	98,915
Investment Income/(Loss)	1,600	2,649	1,466	667	3,009
Funds Available for Debt Service	72,354	70,085	76,503	70,884	101,924
Fixed Services Expense	20,010	19,796	20,698	22,260	20,616
Net Transfers In/(Out)	−32,579	−17,865	−27,810	−20,537	−20,796
Pension Expense	1,823	3,072	2,588	430	1,554
Adjusted Funds Available for Debt Service	61,608	75,088	71,979	73,036	103,298
Net Adjusted Debt/Adjusted Funds Available for Debt Service (x)	**5.7**	**5.8**	**5.8**	**6.1**	**4.2**
Funds Available for Debt Service	72,354	70,085	76,503	70,884	101,924
Fixed Services Expense	20,010	19,796	20,698	22,260	20,616
Net Transfers In/(Out)	−32,579	−17,865	−27,810	−20,537	−20,796
Adjusted FADS for Coverage of Full Obligations	59,785	72,016	69,391	72,607	101,744
Total Annual Debt Service	**24,078**	**28,528**	**31,467**	**30,050**	**31,915**

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Financial Summary

($000, Audited Fiscal Years Ended Sept. 30)	2018	2019	2020	2021	2022
Fixed Services Expense	20,010	19,796	20,698	22,260	20,616
Adjusted Debt Service (Includes Fixed Services Expense)	**44,088**	**48,324**	**52,165**	**52,310**	**52,531**
Coverage of Full Obligations (x)	1.4	1.5	1.3	1.4	1.9
Coverage of Full Obligations Excluding Connection Fees (x)	1.4	1.5	1.3	1.4	1.9
Current Days Cash on Hand	109	133	137	117	95
Liquidity Cushion Ratio (Days)	109	133	137	117	95
All-In Debt Service Coverage (x)	3.0	2.5	2.4	2.4	3.2

Notes: Fitch may have reclassified certain financial statement items for analytical purposes.
Sources: Fitch Ratings, Fitch Solutions, Arlington

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