S&P Global
Ratings

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Summary:

Arlington, Texas; Water/Sewer

Primary Credit Analyst:
John Schulz, Englewood + 1 (303) 721 4385; john.schulz@spglobal.com

Secondary Contact:
Jaime Blansit, Englewood (1) 303-218-0690; jaime.blansit@spglobal.com

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Credit Profile		
US$4.505 mil mun drainage util sys rev bnds ser 2023 dtd 06/01/2023 due 06/15/2043		
Long Term Rating	AAA/Stable	New
Arlington drainage		
Long Term Rating	AAA/Stable	Affirmed

Credit Highlights

- S&P Global Ratings assigned its 'AAA' long-term rating to Arlington, Texas' approximately $4.5 million series 2023 municipal drainage utility system revenue bonds.
- At the same time, S&P Global Ratings affirmed its 'AAA' rating on the city's existing municipal drainage utility system revenue debt.
- The outlook is stable.

Security

A first-lien pledge on the system's gross revenue secures the series 2023 bonds, which are on par with about $51 million in long-term debt outstanding. The bond proceeds will be used to finance projects in the city's capital plan. Although the security to bondholders is a gross pledge, we hypothetically assume a net revenue pledge in our analysis and in our financial metrics calculations to inform our opinion as to the viability of the system as a municipal enterprise.

Credit overview

The storm water system is characterized with healthy and consistent financial metrics. While the system's nominal cash was most recently at just $10.6 million (when including the rate stabilization fund), the nature of the storm water system's operations is that it provides 566 days' of operating expenses. Furthermore, all-in debt (DSC) has been robust, being maintained above 3.0x historically. While we expect DSC to be compressed due to the planned capital expenses but remain healthy and in line with its peers at the 'AAA' rating level.

Arlington provides drainage, flood control, and erosion prevention infrastructure to about 104,000 mainly residential accounts throughout the city. 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. With a nearly complete status of development and an abundance of newer infrastructure, the utility system's capital needs are relatively small, generally $19 million-$25 million per year, with the majority of the funding coming from 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; and

- Very affordable rates not tied to consumptive use, providing for high collections and reasonable flexibility to maintain its financial profile over time.

Environmental, social, and governance

The city's capital projects are all driven by Arlington's own priorities and not by its municipal separate storm sewer (MS4) permit requirements or environmental mandates. This has been the case since the stormwater enterprise fund was created. The city last updated its stormwater master plan in 2019 and has completed studies of the 10 key flood plains within the city, and management is confident that the scope of the capital plan is comprehensive and will lessen the influence of extreme wet weather events over time, especially to the most vulnerable neighborhoods.

The city has historically been deliberate in its fee adjustments, generally increasing the monthly charge by 50 cents per year. As of fiscal 2023, the charge is only $8.50 per month, assuming a single-family residential property of 2,800 square feet of impervious surface area. When combined with the average water and sewer bill for a typical residential customer of $65 per month, the total utility burden is only about 1.5% of Arlington's median household effective buying income of 98% that of the U.S. This is, in our view, indicative of the city's commitment to affordability, a key social consideration. We also consider the city's overall risk management and adherence to financial policies as generally better than that of its peers, and therefore that Arlington's management team has reasonably addressed its ESG-related risks.

Outlook

The stable outlook reflects S&P Global Ratings' expectation that the system's financial profile will remain consistent with historical trends. We believe strong management policies, including long-term planning and transparency regarding rate adjustments, will continue to allow Arlington to align sufficient financial resources to capital budget needs.

Downside scenario

Downward stress on the rating would most likely be associated with financial deterioration or MS4 violations, leading to unexpected costs and capital projects. While we currently deem them to be 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.

Credit Opinion

Arlington, with a population of more than 399,000, 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 local schools, General Motors Corp., which has a production facility in the city, 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 under 5.2% of fiscal 2022 operating revenues. The February 2023 unemployment rate was 4.2% after spiking as high as 12.5% in April 2020. The median household effective buying income is 98% of the U.S. level.

The system's financial position is its key strength, primarily because of its extremely low indebtedness. Including the series 2023 bonds, maximum annual debt service coverage (MADS) using fiscal 2022 net revenues of approximately $15.5 million was about 2.5x and in line with its historically robust performance. Even when we apply stress scenarios to the financial profile by assuming similarly sized borrowing each year throughout the long-term capital plan, it is likely that financial performance will still be as strong each year.

In addition to a liquidity position that exceeds the city's policy of reserves equivalent to at least 60 days of operating expenses, the municipal drainage fund has ($10.6 million as of fiscal 2022) cash balance designated for pay-as-you-go capital projects. Furthermore, Arlington's general government has a restricted reserve that as of fiscal year-end 2022 was almost $79 million. The reserve 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