Arlington, Texas

Water and Wastewater System Revenue Bonds

New Issue Report

Ratings

New Issue

Water and Wastewater System Revenue Bonds, Series 2016A	AAA

Outstanding Debt

Water and Wastewater System Revenue Bonds	AAA

Rating Outlook

Stable

Related Research

2016 Water and Sewer Medians (December 2015)
2016 Outlook: Water and Sewer Sector (December 2015)

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New Issue Details

Sale Information: Approximately $35,845,000 Water and Wastewater System Revenue Bonds, Series 2016A, selling competitively June 7.

Security: Special obligations of the city of Arlington, payable from and secured by a pledge of and first lien on the net revenues of the system.

Purpose: Bond proceeds: to improve and extend the system and pay issuance costs.

Final Maturity: June 1, 2036.

Key Rating Drivers

Consistently Strong DSC: System financial performance is strong, characterized by solid debt service coverage (DCS) in excess of 2.5x over the past five fiscal years.

Low Direct Debt: Direct system debt levels compare favorably to those of other 'AAA' rated credits. The system's capital improvement program (CIP) is manageable, and debt levels are projected to remain favorable due to the system's rapid principal amortization, combined with limited debt issuance plans.

Wholesale Cost Pressure: The system is susceptible to operating cost pressure from its wholesale water and wastewater providers. The system's overall debt burden grows significantly when the off-balance-sheet debt of Tarrant Regional Water District (TRWD; revenue bonds rated AA/Stable by Fitch) and Trinity River Authority (TRA; revenue bonds rated AA+/Stable) is taken into consideration, but remains acceptable for the rating category.

Affordable User Rates: User charges are competitive with those of other regional providers and, despite annual pass-through rate hikes, remain very affordable relative to area wealth levels.

Stable Economy: The mature service area benefits from its location in the center of the broad and diverse Dallas-Fort Worth metropolitan area.

Rating Sensitivities

Maintenance of Financial Performance: Continued maintenance of strong financial performance, characterized by high DSC, in light of increasing debt costs, will be key to maintaining the high rating on Arlington's water and sewer system.

Rating History

Rating	Action	Outlook/ Watch	Date
AAA	Affirmed	Stable	5/5/16
AAA	Affirmed	Stable	5/11/15
AAA	Affirmed	Stable	5/22/14
AAA	Affirmed	Stable	6/3/13
AAA	Affirmed	Stable	5/10/12
AAA	Affirmed	Stable	6/8/10
AAA	Revised	Stable	4/30/10
AA+	Affirmed	Stable	4/9/09
AA+	Affirmed	Stable	6/17/08
AA+	Affirmed	Stable	7/19/07
AA+	Assigned	Stable	3/4/05

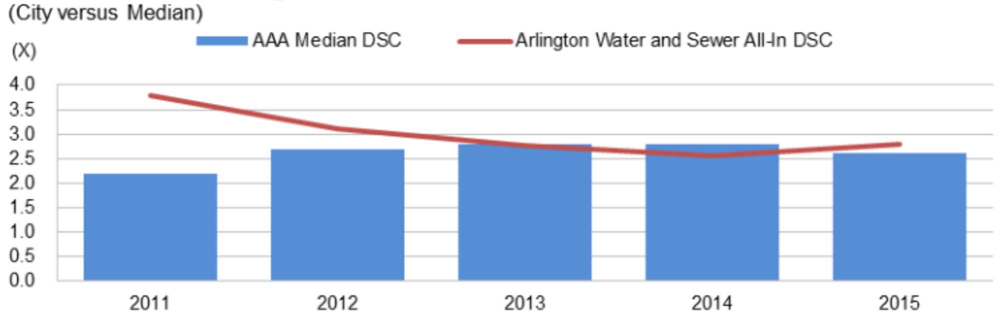
Credit Profile

The system provides retail water service to over 101,000 residential and commercial customers within the city. Arlington has its own water treatment facilities and purchases raw water supplies on a wholesale basis from TRWD. The sewer system serves approximately 100,000 connections with wastewater treatment service provided through a contract with TRA. Total costs for purchased water and sewer treatment from TRWD and TRA equaled 27% and 36% of operating expenses, respectively, in fiscal 2014 and are paid prior to debt service on the bonds.

History of Strong Debt Service Coverage

Financial performance and operating flexibility are solid. From 2004–2008, the city transitioned to an updated rate structure, increasing fixed charges while decreasing volumetric rates. This change led to increased reliability in fixed revenues relative to fixed expenditures, even during periods of low water sales. The stability in revenues allows Arlington to more accurately forecast revenues available not only for debt service, but also capital outlays, which is a key factor in limiting the city's need for additional leveraging.

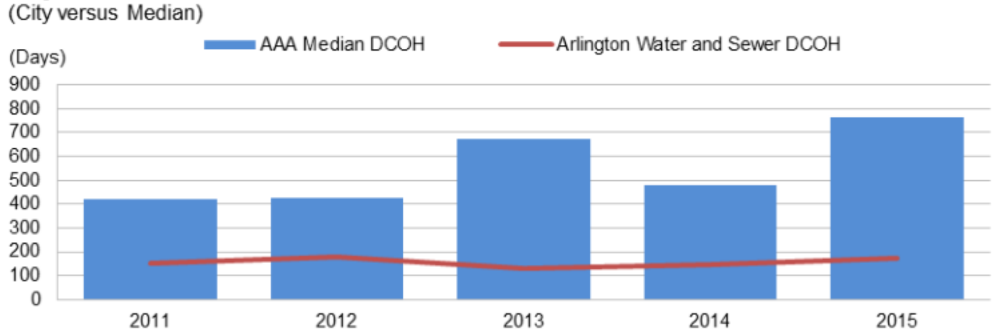
Debt Service Coverage
(City versus Median)



Sources: Fitch medians and City of Arlington CAFRs.

DSC based on a three-year historical average is a very strong 2.7x. Based on budget appropriations, management forecasts that DSC should remain healthy through 2020, not falling below 2.0x. Liquidity is considered somewhat weak for the rating level at just 172 days of operating expenses for fiscal 2015, taking into account operating and rate stabilization reserves. The system's consistent operating revenues, lack of growth pressure and practice of budgeting annual depreciation (over $14 million) all contribute to a very stable operating environment, thereby mitigating the need for higher fund balances.

Days Cash on Hand
(City versus Median)



Sources: Fitch medians and City of Arlington CAFRs.

Related Criteria
Revenue-Supported Rating Criteria (June 2014)
U.S. Water and Sewer Revenue Bond Rating Criteria (September 2015)

Manageable Capital Needs

Capital plans for fiscal years 2016–2018 total $188 million, up 24% from the prior plan. The plan will be largely debt financed. The direct debt burden is low, with debt per customer of $701, which compares very favorably to the 'AAA' median of $1,093. Planned debt issuances increase the system's debt ratios, but they remain comparable to similarly rated systems.

The low system leverage is partially a result of the city's purchase of wholesale service, in addition to limited growth pressures. Moreover, the city has proactive policies of debt amortization and funding annual depreciation from current revenues. As a result, amortization of debt is above average with 69% of all principal maturing within 10 years and 99% within 20 years.

Growing Debt of Wholesale Providers

Both TRA and TRWD are in capital-intensive phases and have notified contracting members that rates will increase approximately 10% annually for the next several years. Much of the expansion will be debt funded, adding to the system's annual requirement to both agencies. The increased debt will result in Arlington's off-balance sheet debt associated with TRA and TRWD to climb above $3,000 per customer.

Arlington is well positioned, with affordable rates and a low debt burden, to handle the increases in wholesale provider rates at the current rating. System user rates are affordable at approximately $60 a month (based on residential consumption of 7,500 gallons of water usage and 6,000 gallons of water for sewer usage), registering at 1.4% of median household income (MHI). This compares well to Fitch's affordability threshold of 2% of MHI and also provides the system flexibility for future rate adjustments.

The city anticipates raising rates between 3% and 9% through 2020 to partially offset the growing rates charged by its wholesale providers. While more significant increases in wholesale charges could pressure user charges, Fitch expects financial margins to remain consistent, given the city's policy of passing through provider charges.

Mature and Stable Service Area

Arlington (GO bonds rated AAA/Stable) is located in the center of the Dallas-Fort Worth metroplex and had an estimated 2014 population of just over 383,000. The city's proximity to the Dallas-Fort Worth International Airport and a well-developed highway transportation network make it a logical center for manufacturing, distribution and trade. Its central location in the metroplex has also led to the development of significant retail trade activity.

Tourism is another important economic component with Arlington serving as home to the Dallas Cowboys football franchise and the Texas Rangers baseball team. Professional sports and amusement parks are a major draw for residents from the area and around the state. The city's unemployment rate of 3.8% for March 2016 falls in line with that of the county, MSA and state, but is lower than the nation's 5.1% average. Wealth levels are on par with those of the state and nation.

Covenants

Security

The bonds are special obligations of the city, payable from and secured by a pledge of and first lien on net revenues of the system.

Rate Covenant

The city covenants that charges will be maintained and collected sufficient to pay operations and maintenance (O&M) expenditures, maintain reserve funds and produce net revenues of no less than 1.25x the average annual debt service (AADS) on outstanding bonds.

Additional Bonds Test

Additional bonds may be issued, provided the city is in compliance with all bond covenants and all funds contain the required deposits on hand. In addition, a public accountant must certify that net earnings of the system for either the preceding fiscal year or 12 consecutive months out of the past 15 months equal at least 1.25x AADS on all outstanding bonds.

Debt Service Reserve Fund

The requirement is an amount equal to no less than the AADS on outstanding bonds. Upon issuance of additional bonds, the city shall make additional deposits sufficient to meet the reserve requirement over a period of not more than 60 months from the date of issuance of the additional bonds.

Flow of Funds

From deposit of the system's gross revenues, moneys flow as follows:

- For payment of O&M expenses (includes annual requirement payments to TRA and TRWD).
- For payment of parity debt and funding a debt service reserve.
- For any lawful purpose of the city.

Financial Summary

($000, Audited Fiscal Years Ended Sept. 30)

	2011	2012	2013	2014	2015
Balance Sheet					
Unrestricted Cash and Investments	13,033	12,650	15,564	13,674	19,053
Other Unrestricted Current Assets	18,458	15,475	15,406	15,317	19,607
Available Restricted Cash and Investments	15,238	21,856	11,053	18,193	18,655
Current Liabilities Payable from Unrestricted Assets	(10,273)	(10,655)	(10,982)	(11,064)	(11,187)
Net Working Capital	**36,456**	**39,326**	**31,041**	**36,120**	**46,128**
Net Fixed Assets	558,815	582,724	603,111	616,977	632,577
Net Long-Term Debt Outstanding	116,500	124,053	123,641	133,306	141,411
Operating Statement					
Operating Revenues	123,442	114,719	114,234	116,145	123,870
Non-Operating Revenues Available for Debt Service	682	470	281	279	323
Total Revenues Available for Debt Service	**124,124**	**115,189**	**114,515**	**116,424**	**124,193**
Operating Expenditures (Excluding Depreciation)	67,924	70,300	72,941	78,672	79,933
Depreciation	13,825	14,209	14,658	15,178	15,715
Operating Income/(Loss)	**42,375**	**30,680**	**26,916**	**22,574**	**28,545**
Net Revenues Available for Debt Service	**56,200**	**44,889**	**41,574**	**37,752**	**44,260**
Senior Lien ADS	14,696	14,262	14,777	14,683	15,602
All-In ADS	14,760	14,326	14,841	14,747	15,666
Financial Statistics					
Senior ADS (x)	3.8	3.2	2.8	2.6	2.8
All-In ADS (x)	3.8	3.1	2.8	2.6	2.8
Days Cash on Hand	152	179	133	148	172
Days Working Capital	196	204	155	168	211
Debt/Net Plant (%)	21	21	21	22	22
Outstanding Long-Term Debt per Customer ($)	592	627	621	665	701
Outstanding Long-Term Debt per Capita ($)	314	330	326	348	368
Free Cash/Depreciation (%)	193	115	84	57	88

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

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