

Moody's

INVESTORS SERVICE

New Issue: MOODY'S ASSIGNS INITIAL Aa2 RATING TO CITY OF ARLINGTON MUNICIPAL DRAINAGE UTILITY SYSTEM'S (TX) \$25.6 MILLION REVENUE BONDS, SERIES 2011

Global Credit Research - 08 Apr 2011

Aa2 RATING AFFECTS CURRENT SALE ONLY

Water/Sewer
TX

Moody's Rating

ISSUE	RATING
Municipal Drainage Utility System Revenue Bonds, Series 2011	Aa2
Sale Amount	\$25,600,000
Expected Sale Date	04/26/11
Rating Description	Revenue

Opinion

NEW YORK, Apr 8, 2011 – Moody's Investors Service has assigned an initial Aa2 underlying rating to the City of Arlington Municipal Drainage Utility System's (TX) \$25.6 million Revenue Bonds, Series 2011. Proceeds from the current sale will finance general storm water drainage improvements throughout the city.

RATING RATIONALE

The bonds are secured by a first lien on the gross revenues of the system. The Aa2 rating reflects the system's large and diverse service air, stable revenue source projected to provide healthy debt service coverage, and somewhat weak legal provisions.

STRENGTHS

*Gross revenue pledge

*Stable revenue source

CHALLENGES

*Springing debt service reserve

*Significant additional capital needs

DETAILED CREDIT DISCUSSION

MATURE SERVICE AREA IN DFW METROPLEX

Located in Tarrant County (Aaa general obligation rating), the City of Arlington (Aa1) has a significant base in single-family residential developments but has also diversified with large commercial and industrial developments, establishing Arlington as a regional employment center located equidistance from Ft. Worth and Dallas. Officials anticipate that the residential component of the tax base is approaching full build-out while the commercial and retail sectors have some modest expansion and redevelopment opportunities. Inclusive of a 5.9% decline in the most recent year, the tax base has experienced a 1.3% average annual rate of growth over the past years, reaching \$17.2 billion in fiscal 2011.

The city's population has grown approximately 10.8% since the 2000 U.S. Census to an estimated 368,854 residents in 2011. Wealth levels are slightly above average as measured by per capita income and median family income (from 2000 U.S. Census) at 114.4% and 122.3% of the state averages, respectively. The city's December 2010 unemployment rate was 7.4%, below the state (8.0%) and nation (9.1%) for the same time period.

STORM WATER FEE STRUCTURE

The City of Arlington (Aa1 general obligation rating) established the Municipal Drainage Utility System in August of 1990 to protect the public health and safety from loss of life and property caused by surface water overflows and surface water stagnation. Drainage improvements were historically funded by the General Fund until storm water fees were implemented in fiscal 1990. Residential and commercial rates are billed monthly through the city's utility billing system. Residential properties are charged a flat monthly fee while commercial properties are charged based on the amount of impervious area square footage. In 2007, the city implemented a \$4.25 fee and was phased in over a period of four years with annual increases. Officials report there are currently no plans to further increase the storm water fee. Collection of fees is strong because failure to pay may result in discontinuance of any utility services provided by the city.

HEALTHY DEBT SERVICE COVERAGE PROJECTED

Although the security pledge is gross revenues, Moody's also assesses debt service coverage based on net revenues given the operating costs of the system are expected to continue. Fiscal 2010 gross revenues provide a strong 3.52 maximum annual debt service (MADS) coverage while net revenues provide a solid 2.58 times MADS coverage based on the amortization schedule of the current sale. When factoring

in additional debt issuances planned for fiscal years 2012 and 2013, fiscal 2010 gross revenues provide a still-healthy 2.31 times MADS coverage (net revenues provide 1.69 times MADS coverage). The most recent rate increase is expected to result in a 17.4% increase in gross revenues for fiscal 2011; management reports year-to-date collections are on track to meet the projection. As such, projected fiscal 2011 gross revenues provide 4.04 times MADS coverage for the current sale and 2.70 times pro-forma MADS coverage (projected fiscal 2011 net revenues provide 2.85 times and 1.87 times MADS coverage for current and pro forma debt, respectively). Moody's believes the system's revenues will remain stable to fiscal 2011 projected levels thus producing healthy debt service coverage over the life of the bonds (current sale and planned parity obligations).

DESPITE STRONG SECURITY, LEGAL PROVISIONS SOMEWHAT WEAK

The bonds are secured by first lien on gross revenues of the system; therefore, debt service payments are the highest priority in the flow of funds. Under the bond indenture, the city covenants to set rates sufficient to yield net revenues that provide 1.10 times MADS coverage. To issue additional parity debt, gross revenues must provide 1.25 times MADS coverage of current and proposed debt. The system is not required to maintain a debt service reserve unless gross revenues provide less than 2.0 times MADS coverage. In the event MADS coverage falls below 2.0 times, the system must fund the debt service reserve requirement (equal to MADS) over 60 months.

WHAT COULD CHANGE THE RATING-UP:

*Trend of better-than-projected debt service coverage

WHAT COULD CHANGE THE RATING-DOWN:

*Leveraging pledged revenues for debt service further than currently planned

KEY STATISTICS

Security: first lien on gross revenues of the system

Rate Structure: flat monthly fee

2011 Estimated Population: 368,854

FY 2010 Unrestricted Reserves as % of Operating Expenses: 454.0%

MADS coverage (FY 2010 gross revenues): 3.52 times

MADS coverage (FY 2010 net revenues): 2.58 times

Payout of Principal (10 years): 58.6%

Post-sale Parity Debt Outstanding: \$23.3 million

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was Analytical Framework For Water And Sewer System Ratings published in August 1999.

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