

# RatingsDirect®

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## Summary:

# Arlington, Texas; Water/Sewer

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## Table Of Contents

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Rationale

Outlook

Related Criteria And Research

## Summary:

# Arlington, Texas; Water/Sewer

### Credit Profile

US\$35.845 mil wtr and wastewater sys rev bnds ser 2016A dtd 06/01/2016 due 06/01/2036

<i>Long Term Rating</i>	AAA/Stable	New
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#### **Arlington wastewtr**

<i>Long Term Rating</i>	AAA/Stable	Affirmed
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## Rationale

Standard & Poor's Ratings Services assigned its 'AAA' rating and stable outlook to Arlington, Texas' series 2016A water and wastewater system revenue bonds. In addition, Standard & Poor's affirmed its 'AAA' long-term and underlying ratings (SPUR) on the system's existing water and wastewater system revenue debt.

The ratings reflect our opinion of the system's general creditworthiness, including its extremely strong enterprise and financial risk profiles.

Factors that support the enterprise risk profile include the city's:

- Broad and diverse service area economy, stabilized by some unique aspects in its employment base such as professional sports franchises and destination entertainment facilities, as well as its central location in the Arlington-Dallas-Fort Worth metropolitan statistical area (MSA);
- Wholesale arrangements with highly rated counterparts for raw-water supply and wastewater treatment, greatly limiting operating and financial risk to the city; and
- Very affordable rates, providing reasonable flexibility as its costs rise over time.

Factors which support the financial risk profile include:

- Very strong all-in debt service coverage (DSC) and relatively low system indebtedness, which when combined with a modest capital improvement plan and rapid roll-off of existing debt makes it likely that such financial performance is sustainable well into the future;
- Good total system liquidity when including available designated reserves; and
- A "strong" Financial Management Assessment, reflective of the city's well-embedded financial controls and best practices.

The series 2016A bonds are secured by a first-lien pledge on the system's net revenues and are on parity with about \$128 million in long-term debt, including \$36.3 million in subordinate-lien Texas Water Development Board (TWDB) loans; the city is expected to sign an additional \$2 million TWDB loan later in 2016. A fully funded debt service reserve in the amount of average annual debt service provides additional liquidity. We understand that bond proceeds will be used to fund rehabilitation and line extension projects in the city's capital improvement program (CIP).

Arlington's debt is rated above the U.S. as the system has a predominantly locally derived revenue base. Local service

charges, derived through an autonomous rate-setting process, represent virtually all of the entity's revenues. This, coupled with operating expense flexibility, precludes exposure to federal revenues.

### **Enterprise Risk Profile**

Arlington, with a population of about 379,300, is the third-largest city after Dallas and Fort Worth in an MSA that bears its name. Besides its central location, the city also has a strong employment base of its own, anchored by Arlington Independent School District, General Motors Corp., which manufactures pickup trucks and SUVs, and a variety of technology and health care employers. In addition, the city has a very strong tourist and entertainment sector, including Six Flags Over Texas and Hurricane Harbor amusement parks. Additional stabilizing factors are the facilities for Major League Baseball's Texas Rangers and the National Football League's Dallas Cowboys teams as well as the Arlington campus of the University of Texas system (about 31,000 students). Although the sports franchises introduce a small level of seasonality to the employment base, the city's 4.2% unemployment rate as of March 2016 is below that of the state and nation. The median household effective buying income is 99% of the U.S. level.

Arlington provides retail water and sanitary sewer services to nearly 148,000 metered accounts. 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 over the last five years, lessening pressure on the CIP.

Also helping the city's operating profile is its relationship with its wholesale service providers. The city purchases nearly all of its water from the Tarrant Regional Water District (TRWD) under a take-or-pay contract in effect at least until all of TRWD's bonds are repaid. The district has a diverse system of seven reservoirs and ongoing projects to further enhance its long-term supply. The purchased water is treated at two plants that, combined, have ample capacity even through projected build-out. The city sends the entirety of its sewer flows to the Trinity River Authority's (TRA) central regional plant for treatment, also under a long-term commitment. Obligations to both TRWD and TRA are treated as operating expenses of Arlington's system. Even with no reliance on any single TRWD reservoir and with all reservoirs near or at full levels as of April 2016, the city by ordinance continues to maintain year-round water conservation measures, especially toward outdoor irrigation. Management does not anticipate this reduction will impede its ability to meet its revenue requirements.

Based on our Operational Management Assessment (OMA), we view Arlington to be a '2' on a scale of 1-6, with '1' being the strongest. This indicates, in our view, that operational and organizational goals are generally quite well-aligned, even if some challenges exist. The OMA of "good" includes a raw-water supply that while already sufficient for decades to come is being enhanced further by the TRWD's integrated pipeline project. While the age of the infrastructure is relatively new and nonrevenue water is not problematic, the focus remains on underground infrastructure integrity. The city also remains a regional leader in water conservation and demand-side management practices. Rates are reviewed at least with every budget, even if it has been several years since base rates last needed to be adjusted.

### **Financial Risk Profile**

The system's financial position is another identified strength. Annual debt service coverage (DSC) in fiscal 2015 was nearly 3x and in line with its historically robust performance. Even when imputing certain fixed costs of TRWD and

TRA onto Arlington's coverage metrics, fixed-charge coverage in fiscal 2015 was still what we view as a very strong 1.57x and consistently at similar levels. All-in coverage is Standard & Poor's internally adjusted coverage metric which treats certain recurring costs--such as those related to water purchase contracts--as if they were debt. Management is conservatively forecasting similarly strong DSC for the five years through fiscal 2020. The system also remains well above its minimum working capital reserve policy of at least 60 days of operating expenses, not including its rate stabilization reserve of almost \$3 million, after a modest draw during fiscal 2015. The city also has designated reserves of over \$50 million, funded from natural gas and oil drilling royalties, which exist for the benefit of general city operational emergencies, unplanned budgetary variances, and designated capital investments. Draws on that reserve have been very uncommon, and elected officials by policy only appropriate the investment earnings for nonrecurring items.

Management in its fiscal 2016 budget identified approximately \$188 million in capital projects through fiscal 2018. It continually updates the utility master plan to determine future projects. Given the strong surplus net revenues and a declining overall debt service schedule, the multiyear forecast indicates an aggressive use of pay-as-you-go funding, including about 40% funding from internally generated revenues. The strong system equity has allowed the city to keep its user rates relatively low; a monthly residential water and sewer bill, based on Standard & Poor's universal assumption of 6,000 gallons of service, is \$56, or an affordable 1.6% of median household effective buying income. The city reviews its rates regularly and relies on regularly updated rate studies for recommendations on future adjustments, but has not needed to make rate adjustments for the past several years.

We view financial management of the system as strong, meaning policies are embedded and likely sustainable. Interim financial results are produced and shared throughout the year and management updates its multiyear financial projections and capital improvement plan throughout the fiscal year. There are formal policies regarding liquidity and investments, and independently audited financial statements are produced annually, with ongoing transparency and disclosure also at a very high level.

## **Outlook**

The stable outlook reflects Standard & Poor's expectation that the system's financial profile will remain commensurate with the ratings over our two-year horizon. The large CIP simply reflects the current regulatory environment and a large system that serves roughly 9 million people. We believe the strong management, including long-term planning and transparency regarding future rate adjustments, will continue to allow the authority to fund identified needs despite expected inflationary rises in operating costs and sizable amounts of additional debt.

While highly unlikely, downward pressure on the rating would most likely be associated with a precipitous collapse of the financial risk profile, possible associated with remote events such as negative extraordinary intervention, aggressive use of more risky debt instruments, or an unfunded mandate from environmental regulators that could cause a sharp deviation in financial performance due to rapid escalation of debt.

## Related Criteria And Research

### Related Criteria

- USPF Criteria: Rating Methodology And Assumptions For U.S. Municipal Waterworks And Sanitary Sewer Utility Revenue Bonds, Jan. 19, 2016
- USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011
- Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions, Nov. 19, 2013
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

### Related Research

- U.S. State And Local Government Credit Conditions Forecast, Jan. 11, 2016

### Ratings Detail (As Of April 28, 2016)

Arlington wtr & swr		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Arlington WTRSWR		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
<b>Arlington wastewtr</b>		
<i>Unenhanced Rating</i>	AAA(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.globalcreditportal.com](http://www.globalcreditportal.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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