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CREDIT OPINION
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New Issue

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City of Arlington, TX Water and Sewer Enterprise

New Issue: Moody's assigns Aa2 to the City of Arlington, TX's Water and Wastewater Revenue Bonds; Outlook Stable

Summary Rating Rationale

Moody's Investors Service assigns a Aa2 rating to the City of Arlington, TX's $37.9 million Water and Wastewater System Revenue Bonds, Series 2017A. Concurrently, Moody's affirms the Aa2 rating on the system's parity debt outstanding, which will total approximately $206 million post-sale.

The Aa2 rating reflects the system's large and diverse service area, satisfactory financial operations which consistently yields strong debt service coverage, a low direct debt profile. Also considered is the narrow, though improving, unreserved system liquidity relative to peers that is tempered by ample restricted balances and liquidity outside of the water and sewer fund.

Credit Strengths

» Large and diverse service area

» Cash-funding of capital improvements reflected by low direct debt profile

» Historically strong debt service coverage ratios

» Ample access to liquidity outside of unrestricted reserve balance

Credit Challenges

» Narrow unrestricted cash position relative to rated peers

Rating Outlook

The stable outlook reflects the anticipation of satisfactory operations over the near term. While the city will continue to issue debt in order to partially fund their capital improvement plan, annual rate increases are expected to support additional debt issuance and maintain coverage.

Factors that Could Lead to an Upgrade

» Continued improvement in unrestricted liquidity combined with continued practice of maintaining liquidity for capital improvements

» Material and sustained large increases in debt service coverage

Factors that Could Lead to a Downgrade

» Trend of narrowed debt service coverage inconsistent with the rating

» Decreased unrestricted liquidity

» Substantial increase to the ratio of debt to revenues

Key Indicators (Fix Rate Covenant)

Exhibit 1

Arlington (City of) Water and Sewer Enterprise, TX					
System Characteristics					
Asset Condition (Net Fixed Assets / Annual Depreciation)	39 years				
System Size - O&M (in $000s)	78,067				
Service Area Wealth: MFI % of US median	95.00%				
Legal Provisions					
Rate Covenant (x)	1.25x				
Debt Service Reserve Requirement	DSRF funded a less than 3 prong test or springing DSRF				
Financial Strength					
	2012	2013	2014	2015	2016
Operating Revenue ($000)	114,719	114,234	116,145	123,870	131,086
System Size - O&M (in $000s)	70,300	72,941	78,672	80,233	78,067
Net Funded Debt ($000)	110,613	110,983	119,871	127,315	151,457
Annual Debt Service Coverage (x)	3.15x	2.81x	2.57x	2.82x	3.55x
Cash on Hand	66 days	78 days	63 days	87 days	111 days
Debt to Operating Revenues (x)	1.0x	1.0x	1.0x	1.0x	1.2x

Days cash on hand includes unrestricted cash only.
Source: Moody's Investors Service, bond legal documents and city audited financial reports

Detailed Rating Considerations

Service Area and Customer Base: Large and Diverse Service Area in Dallas/Fort Worth Metroplex; Ample Water Supply and Treatment Capacity

Arlington's Water and Sewer Enterprise benefits from a stable customer base. Located in Tarrant County (Aaa stable), the city of Arlington (Aa1 stable) has a large and diverse tax base characterized by residential development (nearly two thirds of the base) as well as significant industrial and commercial development, including ATT Stadium, the Dallas Cowboys and Texas Rangers sports franchises, UT Arlington, and major amusement parks, General Motors Company (Baa3 stable - manufacturing and finance), and healthcare establishments. The city serves as a regional employment center located equidistant from Fort Worth (Aa2 stable) and Dallas (A1 negative). New development and redevelopment in the city has bolstered growth over the past five years, bringing the city's fiscal 2017 tax base to $20.4 billion, with an expectation of continued growth for fiscal 2018. The city is mature although experiencing modest growth in population, which currently stands at approximately 383,000. Residential water utility customers account for 96% of the customer base by count of units served, and 71% of average daily water consumption. The system's historical number of customers has been relatively stable over the past five years, and at present is equal to 148,694 units. Given the largely residential customer base, the top ten water customers accounted for a small 9% of 2016 water sales.

The city contracts for raw water and wastewater treatment from large and stable entities. The city obtains the majority of its untreated water from the Tarrant Regional Water District's (TRWD) surface reservoirs. TRWD estimates sufficient supply through 2030 to meet the needs of the city of Arlington and other municipal participants, although is currently in a planning stage extend that estimation

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through 2070. The treatment of raw water is provided by two city owned treatment facilities that presently have a capacity for 172.5 million gallons per day (MGD), which well exceeds the peak flow during the drier fiscal 2011 of 115 MGD. The system is well-poised to provide for projected build-out peak demand of 130 MGD. Wastewater is treated by the Trinity River Authority (TRA) at its central regional facility. City officials believe that TRA has sufficient treatment capacity to serve the city's present and foreseeable future needs.

Debt Service Coverage and Net Working Capital: Healthy Debt Service Coverage Expected to Continue Supported by Annual Rate Increases

The system has posted strong debt service coverage over the past five years, and will continue to do so given the practice of annual rate increases to support capital plans and cost increases. The city's demonstrated willingness to raise rates as necessary to cover increasing operating costs and maintain a healthy level of debt service coverage, all while continuing to implement robust conservation and efficiency efforts, is a credit positive. Based on fiscal 2016 net revenues of $53.6 million, debt service coverage was a strong 3.6 times. The city has historically posted strong coverage ratios between 2.6 times to 3.8 times over the past five years. Looking to fiscal 2017, debt service coverage will remain strong based on expected results for the fiscal year. Revenues are trending down a modest 1.2% largely due to lower than expected water and sewer demand. However, the system will realize cost savings through conservative budgeting as well as unfilled vacant positions.

To note, this coverage calculation does not specifically segregate the city's share of debt issued by TRWD and TRA related to infrastructure improvements to access to raw water supply and wastewater treatment, respectively. While the debt is not a debt of the city, a portion of the debt service is passed to the city as an operating expenses under the city's contract with the water district and the authority, and is combined with their respective bills for purchase of untreated water and wastewater treatment. Being an operating expense, which is paid before any direct revenue bonds debt service, any cost increases related to either the additional cost of raw water or further infrastructure spending, is passed onto to customers and built into the rate setting models of the city.

LIQUIDITY

The system's unrestricted liquidity is improving but still narrow relative to rated peers. However, the liquidity position is greatly increased when considering the portion of cash and investments restricted for construction that is available to shift back to operations if needed. Unrestricted liquidity of the system includes the operating reserve, the rate stabilization fund and working capital. The city has a policy of maintaining unrestricted reserves equal to 60 days of operating expenses, and a target rate stabilization fund of approximately 18 days of expenses (5%); for a combined targeted unrestricted reserve of 78 days of expenses. Over the past few years, the city has been building up reserves in excess of policy levels and now stands at 111 days of cash on hand - a level it expects to maintain. The practice of maintaining narrower unrestricted liquidity is partially tempered by the system's annual use of excess cash to fund capital needs, and keeping debt levels low relative to revenues. As of fiscal 2016, the portion of restricted cash and investments earmarked for capital construction that could be shifted to general operations if needed totaled $33 million. Inclusive of restricted amounts for construction, total available liquidity increases to a stronger 265 days of expenses.

The city continues to maintain significant additional resources outside of the system, most notably through the Arlington Tomorrow Fund, which held a cash position of $61 million as of fiscal 2016. Derived from natural gas bonus payments and royalties received by the city, the Foundation is controlled by a board, made up of the city council and an executive director that is an employee of the city. The Arlington Tomorrow Fund provides substantial operating flexibility given a super-majority vote of city council could enable it to be used for any lawful purpose of the city.

Debt and Legal Covenants: Partial Cash Funding of CIP Reflects in Low Debt Profile; Adequate Legal Structure

DEBT STRUCTURE

The system's debt profile is a strength of the credit. Given the system's historically conservative debt issuance practices, rapid rate of principal amortization and proactive rate adjustments, we believe the debt profile will remain manageable over the long term. The system's debt to operating revenues is low, and below average compared to rated peers at 1.2x as of fiscal 2016. Amortization is also favorable, with 64% of principal retired within ten years.

Following the current fiscal year, the system's capital improvement plan from 2018 to 2021 includes $200 million in planned capital expenditures, of which approximately 64% will be debt funded and the remaining portion will be funded with cash. To note, historically management has opted to forgo debt issuance in the event revenues significantly exceeded the budget, therefore the funding mechanism for the capital improvement plan could shift.

DEBT-RELATED DERIVATIVES

The utility system is not a party to any derivative agreements.

LEGAL COVENANTS

Legal provisions provide adequate bondholder security. The rate covenant requires net revenues to produce 1.25 times average annual debt service. The debt service reserve fund is equal to average annual debt service funded over 24 months, and was fully funded with cash as of fiscal 2016. The additional bonds test requires 1.25 times average annual debt service. Finally, excess revenues may be used for any lawful purpose.

Management and Governance: System Managed by Strategic and Forward-Looking Team

Management of the city of Arlington water and sewer department provide departmental administration within the framework of the city's council-manager form of government. Management of the system has been characterized by prudent fiscal practices and forward-looking planning to create greater efficiencies and conservation within the water and sewer system.

Legal Security

The Series 2017A Bonds are secured by a first lien on the net revenues of the system.

Use of Proceeds

Proceeds from the sale of the 2017A bonds will be used to fund a portion of the system's annual capital improvement plan including water treatment improvements and meter infrastructure.

Obligor Profile

The city of Arlington, TX is located in the center of the Dallas/Fort Worth Metroplex. The city encompasses 99.5 square miles and has a current population of approximately 383,000. The city operates its water and sewer system as a self-supporting enterprise fund.

Methodology

The principal methodology used in this rating was US Municipal Utility Revenue Debt published in December 2014. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Ratings

Exhibit 2

Arlington (City of) TX Water & Sewer Ent.

Issue	Rating
Water and Wastewater System Revenue Bonds, Series 2017A	Aa2
Rating Type	Underlying LT
Sale Amount	$37,920,000
Expected Sale Date	06/15/2017
Rating Description	Revenue: Government Enterprise

Source: Moody's Investors Service

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