

Memorandum



DATE July 30, 2021

CITY OF DALLAS

TO Honorable Mayor and Members of the City Council

SUBJECT **S&P Global Ratings Affirms 'AAA' Rating, Stable Outlook on Waterworks and Sewer System Revenue Refunding Bonds – INFORMATION**

On July 29, S&P Global Ratings (S&P) affirmed its 'AAA' rating and stable outlook on the upcoming Waterworks and Sewer System Revenue Refunding Bonds, Series 2021C ("Series 2021C") and outstanding City of Dallas Waterworks and Sewer System ("System") bonds. S&P also affirmed the 'A-1+' short-term rating on Dallas Water Utilities' (DWU) Series F and Series G commercial paper programs. The Series 2021C bonds are scheduled to be sold on August 24, 2021.

In their report, S&P notes that the rating is reflective of the System's "proactive long-term planning," "affordable rates, with a demonstrated willingness to regularly adjust them," "all-in debt service coverage" that is "boosted by the wholesale relationships that provide cash flow certainty to overall operating revenues even if weather patterns affect retail sales," "total available reserves typically equivalent to four-to-six months of operating expenses," and strong management practices "which indicate best practices across the utility and the city are well embedded, and financial and operational goals are highly aligned." S&P also rates the System's environmental, social, and governance (ESG) factors as having "comparably strong environmental stewardship relative to that of 'AAA' peers," "sensitive to affordability concerns," and "good overall governance." The report also presents a downside scenario wherein, "although unlikely," S&P "could lower the rating should there be sustained deterioration in the credit fundamentals, primarily measured by total financial capacity."

In anticipation of the upcoming bond sale, the affirmed rating is another positive reflection of the diligent stewardship of the DWU System as a regional provider and a testament to the System's strong credit profile. Attached is the publish S&P report. Please let me know if you need additional information.

A handwritten signature in blue ink that reads "M. Elizabeth Reich".

M. Elizabeth Reich
Chief Financial Officer

c: T.C. Broadnax, City Manager
Chris Caso, City Attorney
Mark Swann, City Auditor
Biliera Johnson, City Secretary
Preston Robinson, Administrative Judge
Kimberly Bizer Tolbert, Chief of Staff to the City Manager

Majed A. Al-Ghafry, Assistant City Manager
Jon Fortune, Assistant City Manager
Joey Zapata, Assistant City Manager
Dr. Eric A. Johnson, Chief of Economic Development & Neighborhood Services
M. Elizabeth (Liz) Cedillo-Pereira, Chief of Equity and Inclusion
Directors and Assistant Directors

RatingsDirect®

Summary:
Dallas; CP; Water/Sewer

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Summary:

Dallas; CP; Water/Sewer

Credit Profile			
US\$135.87 mil wtrwks & swr sys rev rfdg bnd ser 2021C due 10/01/2050			
<i>Long Term Rating</i>	AAA/Stable	New	
Dallas WS			
<i>Long Term Rating</i>	AAA/Stable	Affirmed	

Rating Action

S&P Global Ratings assigned its 'AAA' long-term rating to the City of Dallas, Texas' \$135.87 million series 2021C waterworks and sewer system revenue refunding bonds. At the same time, S&P Global Ratings affirmed its 'AAA' long-term and underlying (SPUR) ratings on the city's previously issued revenue bonds, of which about \$2.5 billion is outstanding. The city's water and sewer system, doing business as Dallas Water Utilities (DWU), also supports approximately \$688 million in debt, issued by Tarrant Regional Water District (TRWD), for the city's share of a joint water supply and transmission project. The outlook on all ratings is stable.

We are also affirming our 'A-1+' short-term rating on DWU's series F and series G commercial paper (CP) programs. The short-term rating is based on the 'AAA' rating using the application of our "Methodology For Linking Long-Term And Short-Term Ratings," published April 7, 2017.

The bonds are secured by a first lien pledge on the net revenues of the city's water and sewer system. Proceeds will be used to convert \$146 million of existing CP notes to long-term debt. A reserve fund in the amount of average annual debt service provides additional liquidity.

The DWU system has a predominantly locally derived revenue base. Local service charges, derived through an autonomous rate-setting process, represent virtually all of both entities' revenue. This, coupled with operating-expense flexibility, limits the system's exposure to federal revenue and allows us to rate Dallas' debt above the U.S. sovereign rating.

Credit overview

The 'AAA' rating reflects our view of the city's:

- Proactive long-term planning, locking in what will be, when an ongoing project is finished, a 50-year supply;
- Affordable rates, with a demonstrated willingness to regularly adjust them;
- All-in debt service coverage (DSC) typically at or close to 1.4x, boosted by the wholesale relationships that provide cash flow certainty to overall operating revenues even if weather patterns affect retail sales. All-in DSC is S&P Global Ratings adjusted DSC metric that includes all use of operating revenues regardless of lien or accounting treatment. DWU is projecting senior lien DSC of better than 1.7x in fiscal 2021;
- Total available reserves typically equivalent to four-to-six months of operating expenses; and

- Management practices that we consider strong, which indicate best practices across the utility and the city are well embedded, and financial and operational goals are highly aligned.

The DWU system supplies retail water and wastewater service to Dallas, which has a population of about 1.3 million, as well as treated and raw water services to almost all the cities in Dallas County on a wholesale basis, and to the Dallas-Fort Worth International Airport. Because the customer base is sufficiently large and diverse, in our view, DWU has no dependence on any of its principal retail customers for its operating revenues.

In the early days of COVID-19, the city revised its 2020 budget with far more conservative assumptions for both revenues and expenses than the 4% variance that actually played out. The city had always planned to make use of a rate-stabilization reserve through at least fiscal 2022; therefore, the stable base rates are unrelated to the pandemic's impact on the customer base, and adjustments to retail and wholesale rates are considered whenever necessary. The city has also represented that it received full and timely payments from all its wholesale customers throughout the worst of the recent recession, and that it began the fourth quarter of fiscal 2021 with \$99.5 million in available cash, equivalent to five months of operating expenses on a budgetary basis. DWU reported no material effects from the February 2021 winter storm.

The city's capital improvement plan (CIP), beyond the joint-venture project with TRWD, contains no major programs beyond traditional renewals and replacements and largely did not need to be reprioritized due to the pandemic. Management identified about \$1 billion in capital commitments from fiscal years 2021-2023, with a target of equal balance between debt financing internally generated revenues. In addition, DWU has no responsibility for or exposure to the city's most underfunded fiduciary obligations for its uniformed civil service. Those pension and postemployment benefit liabilities have been among the factors most pressuring our general obligation rating on the city. The plan in which DWU participates--the Employees Retirement System--is however only 65% funded, assuming a relatively conservative 5.93% discount rate. DWU's share as of fiscal 2020 of the \$2 billion liability is \$438 million.

Environmental, social, and governance (ESG) factors

In addition to enhancing the long-term water supply with the joint project with TRWD, Dallas has proactively engaged in preserving its existing supplies by way of aggressive water-conservation measures--most recently revised in 2019--including public education and a number of supporting ordinances and practices aimed primarily at curbing outdoor watering. Based on consumption use patterns in 2001 across all customer classes, DWU management estimates that the water-conservation measures have extended the life of existing reservoirs by two-three years, as well as reducing per capita per day consumption by 30% even as the population has increased by 10%. The city reports no regulatory mandates or environmental enforcement actions among its well-prioritized CIP. Because of the complexity--and massive capital investments--required for bringing a new reservoir into commercial operations, we view this as comparably strong environmental stewardship relative to that of 'AAA' peers.

The city is also sensitive to affordability concerns, even as city council has a long history of as-necessary rate adjustments; we understand that a low single-digit adjustment could be proposed for consideration for fiscal 2022. As a health and safety measure, a suspension of shutoffs and disconnections that began in March 2020 remains in place. DWU does not have a formal bill-pay-customer-assistance program, but it does have payment plans and other ancillary services such as in-home leak detection and free repairs of certain fixtures to qualified customers to help

them reduce water use and, therefore, lower their monthly bill. Dallas did receive some federal assistance from the December 2020 stimulus package related to rental and bill pay assistance. Dallas will also receive \$377 million from the federal American Rescue Plan Act, although it is not yet fully defined as to if DWU will benefit from the first tranche as initial indications reflect rental and housing assistance as priorities. Similarly, neither timing nor eligibility for federal low-income-household water assistance has been fully defined by the federal government, but it could eventually be another source of assistance for qualifying DWU customers.

It is our view that the good overall governance, in which immediate- and long-term operational needs are aligned with intended financial resources, also lend to our stable outlook. The city has for years used its financial management performance criteria (FMPC) to establish required financial metrics for all of its major operating funds, including DWU. The FMPC speaks to desired DSC, minimum required reserves, and other guidelines that we typically observe in our Financial Management Assessment that we would characterize as strong.

Stable Outlook

Downside scenario

Although unlikely, we could lower the rating should there be sustained deterioration in the credit fundamentals, primarily measured by total financial capacity. General examples could include costly regulatory mandates or a collapse in operating revenues, neither of which is currently the case for Dallas. The stable outlook is also predicated on the city's representation that any near-term weakness in DSC is attributable to the purposeful drawdown of designated cash reserves and recessionary effects, and that beyond that revenues will generally be supportive of financial performance that is more in line with historical levels.

Related Research

Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of July 29, 2021)

Dallas Wtrwks and Swr Sys Commercial Paper Nts ser G due 07/08/2024		
<i>Short Term Rating</i>	A-1+	Affirmed
Dallas Wtrwks and Swr Sys Commercial Paper Nts ser 2021F-1 due 07/07/2024		
<i>Short Term Rating</i>	A-1+	Affirmed
Dallas Wtrwks and Swr Sys Commercial Paper Nts ser 2021F-2 due 07/08/2024		
<i>Short Term Rating</i>	A-1+	Affirmed
Dallas WS		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Dallas WS (AGM)		
<i>Unenhanced Rating</i>	AAA(SPUR)/Stable	Affirmed

Tarrant Regl Wtr Dist, Texas

Dallas, Texas

Tarrant Regl Wtr Dist (Dallas) wtr

Ratings Detail (As Of July 29, 2021) (cont.)

<i>Long Term Rating</i>	AAA/Stable	Affirmed
Tarrant Regl Wtr Dist (Dallas) wtr		
<i>Long Term Rating</i>	AAA/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 for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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