

Memorandum



CITY OF DALLAS

DATE January 22, 2021

TO Honorable Mayor and Council Members

SUBJECT **S&P Global Ratings Assigns 'AAA' Rating, Stable Outlook for Tarrant Regional Water District Dallas Water Revenue Bonds**

Today, S&P Global Ratings (S&P) assigned their 'AAA' credit rating to the Tarrant Regional Water District (TRWD) Water Transmission Facilities Contract Revenue Bonds (City of Dallas Project), Series 2021A and Water Transmission Facilities Contract Revenue Refunding Bonds (City of Dallas Project), Taxable Series 2021B for the joint integrated pipeline (IPL) project. The outlook is stable. S&P also affirmed the rating on outstanding IPL-related contract revenue debt issued for Dallas and the 'AAA' long-term underlying rating on the City's waterworks and sewer system bonds. S&P notes that Dallas Water Utilities (DWU) "is the only participant and obligor for TRWD's IPL contract revenue bonds," therefore the rating is based on "the general creditworthiness of the city's water and sewer system."

S&P explains the district intends to use the proceeds of the series 2021A bonds to "fund the initial projects associated with phase 3 of the IPL, including additional sections of the pipeline and a pump station." The series 2021B bonds will advance refund its series 2012 and 2014 contract revenue bonds for savings purposes, with no adjustments to any final maturities. Additionally, "the bonds are secured by a first-lien pledge on the revenues derived from payments to TRWD from DWU." Details of the IPL project were included in a briefing to Council on November 17, 2020.

According to the report, the 'AAA' reflects S&P's view of DWU's, "long-term planning, locking in a 25-year water supply with planning ongoing for a 50-year supply; affordable rates, with a willingness to regularly adjust them; very strong all-in coverage typically at or close to 1.6x, boosted by the wholesale relationships that provide cash flow certainty to overall operating revenues even if weather patterns affect retail sales; very strong liquidity; and, financial 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."

S&P continues, detailing "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." In regard to the City's use of financial management performance criteria (FMPC), S&P states, "the FMPC speaks to desired debt service coverage (DSC), minimum required reserves, and other guidelines that we typically associate with a financial management assessment we would characterize as strong."

DATE January 22, 2021

SUBJECT S&P Global Ratings Assigns 'AAA' Rating, Stable Outlook for Tarrant Regional Water District Dallas Water Revenue Bonds

S&P's rating of the TRWD IPL project bonds and outstanding Dallas Water Utilities debt speaks to the effective management and prudent leadership of the City and DWU System and supports continued partnerships and planning with regional agencies to provide essential services to the region. Attached is the published S&P Report for further details.

Please let me know if you need additional information.


M. Elizabeth Reich
Chief Financial Officer

Attachment

c: T.C. Broadnax, City Manager
Chris Caso, City Attorney
Mark Swann, City Auditor
Biliera Johnson, City Secretary
Preston Robinson, Administrative Judge
Kimberly Bizzor 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 and Neighborhood Services
M. Elizabeth (Liz) Cedillo-Pereira, Chief of Equity and Inclusion
Directors and Assistant Directors

RatingsDirect®

Summary:

Tarrant Regional Water District, Texas Dallas; Water/Sewer

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Tarrant Regional Water District, Texas Dallas; Water/Sewer

Credit Profile

US\$298.565 mil wtr transmission facs contract rev rfdg bnds (Dallas) ser 2021B dtd 02/01/2021 due 09/01/2044

<i>Long Term Rating</i>	AAA/Stable	New
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US\$218.195 mil wtr transmission facs contract rev bnds (Dallas) ser 2021A dtd 02/01/2021 due 09/01/2051

<i>Long Term Rating</i>	AAA/Stable	New
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Dallas WS

<i>Long Term Rating</i>	AAA/Stable	Affirmed
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Rating Action

S&P Global Ratings assigned its 'AAA' rating to Tarrant Regional Water District (TRWD), Texas' \$218.195 million series 2021A contract revenue bonds and the district's \$298.565 million taxable series 2021B contract revenue refunding bonds, issued for the City of Dallas for the joint integrated pipeline (IPL) project. In addition, we affirmed our 'AAA' underlying rating on the district's \$415.67 million existing IPL-related contract revenue debt, also issued for Dallas, including a 2015 Texas Water Development Board loan. The bonds issued for Dallas' share of the IPL are separately secured from TRWD's own bonds. As the city is the only participant and obligor for TRWD's IPL contract revenue bonds, we base the rating on the general creditworthiness of the city's water and sewer system, doing business as Dallas Water Utilities (DWU). The outlook is stable.

We also affirmed our 'AAA' long-term and underlying ratings on Dallas' waterworks and sanitary sewer bonds. We note that even with economic headwinds that Dallas' operating revenues are further stabilized by its wholesale sales to municipalities with similarly strong credit fundamentals, which in our view provides uplift to the rating versus comparable peers. Both the TRWD and DWU systems have 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 the district's debt above the U.S. sovereign rating.

The series 2021A bonds will fund the initial projects associated with phase 3 of the IPL, including additional sections of the pipeline and a pump station. The district intends to use the proceeds of the series 2021B bonds to advance refund its series 2012 and 2014 contract revenue bonds for savings purposes, with no adjustments to any final maturities. The bonds are secured by a first-lien pledge on the revenues derived from payments to TRWD from DWU; those obligations are treated as unconditional operating expenses by DWU, senior to any of the city's own debt.

Credit overview

The IPL is a joint venture between TRWD and DWU to build a 150-mile-long, 84-inch to 108-inch-diameter pipe that interconnects their respective systems to three key reservoirs--Richland-Chambers Lake, Lake Palestine, and Cedar

Creek Lake--southeast of the Dallas-Fort Worth metropolitan statistical area (MSA). The first two phases are complete; phase 2 will be fully operational by spring 2021. Phase 3 is expected to be complete by 2027. The IPL will eventually be able to deliver as much as 350 million gallons per day (mgd) of water to TRWD and DWU from reservoirs that generally have been more drought-resilient than those in the MSA. In fiscal 2019, TRWD provided about 300 mgd to its 30 wholesale customers across 11 counties, and Dallas 369 mgd to its diverse mix of retail city customers and wholesale customers in almost all of Dallas County plus portions of five surrounding counties.

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

- Long-term planning, locking in a 25-year water supply with planning ongoing for a 50-year supply;
- Affordable rates, with a willingness to regularly adjust them;
- Very strong all-in coverage typically at or close to 1.6x, boosted by the wholesale relationships that provide cash flow certainty to overall operating revenues even if weather patterns affect retail sales;
- Very strong liquidity; and
- Financial 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 addition, DWU has no responsibility for or exposure to the city's most underfunded fiduciary obligations for its uniformed civil service. These pension and postemployment benefit liabilities have been among the factors most pressuring our general obligation rating on the city. Although the city did not pay 100% of its actuarially defined contribution in the most recent fiscal year, the plan in which DWU participates--the Employees Retirement System--is adequately funded at 83%. We also understand that 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. The city has also represented that it continues to receive full and timely payments from all its wholesale customers, and that it began fiscal 2021 with \$118 million in available working capital, equivalent to four months of operating expenses.

Environmental, social, and governance 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 capital plan. Because of the

complexity--and massive capital investments--required for bringing a new reservoir into commercial operations, we view this as especially favorable environmental stewardship relative to that of peers.

The city also is sensitive to affordability concerns, even as city council has a long history of as-necessary rate adjustments. As a health and safety measure, a suspension of shutoffs and disconnections remains in place. DWU does not have a formal bill pay customer assistance program, but 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. It does expect to use some federal money from the December 2020 stimulus package related to rental and bill pay assistance.

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 debt service coverage (DSC), minimum required reserves, and other guidelines that we typically associate with a financial management assessment 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. As vaccine rollouts continue, S&P Global Ratings believes there remains a high degree of uncertainty about the evolution of the coronavirus pandemic and its economic effects. Widespread immunization, which the U.S. might achieve by midyear, will help pave the way for a return to more normal levels of social and economic activity. We use this assumption about vaccine timing in assessing the economic and credit implications associated with the pandemic. As the situation evolves, we will update our assumptions and estimates accordingly but that it remains a possibility that unfavorable variances to budget could occur. 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 that beyond that revenues will generally be supportive of financial performance 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 January 22, 2021)

Dallas WS		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Dallas WS (AGM)		
<i>Unenhanced Rating</i>	AAA(SPUR)/Stable	Affirmed

Ratings Detail (As Of January 22, 2021) (cont.)

Tarrant Regl Wtr Dist, Texas

Dallas, Texas

Tarrant Regl Wtr Dist (Dallas) wtr

<i>Long Term Rating</i>	AAA/Stable	Affirmed
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Tarrant Regl Wtr Dist (Dallas) wtr

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