

Memorandum



CITY OF DALLAS

DATE January 20, 2023

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, Series 2023A – INFORMATION**

Today, S&P Global Ratings (S&P) affirmed its 'AAA' rating and stable outlook on the upcoming Waterworks and Sewer System Revenue Refunding Bonds, Series 2023A ("Series 2023A") 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 2023A bonds are scheduled to be sold on February 14, 2023.

In their report, S&P notes that the System's autonomous rate-setting process, 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." As before, 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. Additionally, the System's environmental, social, and governance (ESG) score highlights Dallas' water conservation efforts, long-term planning and supportive City Council, demonstrating "comparably strong environmental stewardship relative to that of 'AAA' peers." The report also presents an "unlikely" downside scenario wherein "costly regulatory mandates or a collapse in operating revenues" could lower the rating, though "neither of which is currently the case for Dallas."

In anticipation of the upcoming bond sale, the affirmed rating is a positive indicator of DWU's continued stability and credit worthiness to the market. Attached is the published S&P report. Please let me know if you need additional information.

A handwritten signature in blue ink that reads "Jack Ireland".

Jack Ireland
Chief Financial Officer

c: T.C. Broadnax, City Manager
Chris Caso, City Attorney
Mark Swann, City Auditor
Billierae Johnson, City Secretary
Preston Robinson, Administrative Judge
Kimberly Bizzor Tolbert, Deputy City Manager
Jon Fortune, Deputy City Manager

Majed A. Al-Ghafry, Assistant City Manager
M. Elizabeth (Liz) Cedillo-Pereira, Assistant City Manager
Robert Perez, Assistant City Manager
Carl Simpson, Assistant City Manager
Genesis D. Gavino, Chief of Staff to the City Manager
Directors and Assistant Directors

RatingsDirect®

Summary:

Dallas; CP; Water/Sewer

Primary Credit Analyst:

Edward R McGlade, New York + 1 (212) 438 2061; edward.mcglade@spglobal.com

Secondary Contact:

James M Breeding, New York + 1 (214) 871 1407; james.breeding@spglobal.com

Table Of Contents

Credit Highlights

Outlook

Related Research

Summary:

Dallas; CP; Water/Sewer

Credit Profile

US\$172.46 mil wtrwks and swr sys rev rfdg bnds ser 2023A due 10/01/2053

<i>Long Term Rating</i>	AAA/Stable	New
-------------------------	------------	-----

Dallas WS

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

Credit Highlights

- S&P Global Ratings assigned its 'AAA' long-term rating to Dallas, Texas' \$172.46 million series 2023A waterworks and sewer system revenue refunding bonds;
- S&P Global Ratings affirmed its 'AAA' long-term rating and underlying rating (SPUR) on the city's previously issued revenue bonds;
- Total debt outstanding is about \$2.6 billion.
- The city's water and sewer system, doing business as Dallas Water Utilities (DWU), also supports approximately \$1 billion 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 also affirmed our 'A-1+' short-term rating on DWU's \$600 million series F and 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, on RatingsDirect.

Security

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 \$190 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 1.8x in fiscal 2023;
- 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.

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 \$1.6 billion in capital commitments from fiscal years 2023-2027, with a target of equal balance between debt financing internally generated revenues.

Environmental, social, and governance

Giving a culture of long term planning and a supportive city council our view of Dallas' environmental, social and governance risks are credit neutral. 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--an update to address the next five years was awarded in November 2022 as part of the long-range water supply plan update--to date, the program includes 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 through 2022 have reduce gallons per capita per day by more than 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 the city council has a long history of as-necessary rate adjustments; DWU raised retail rates 1% in 2021, 1.5% in 2022, and most recently 5% in 2023. We understand that a low-single-digit adjustment could be proposed for consideration for fiscal 2024. 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, thereby lower their monthly bill.

Outlook

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.

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 reflect 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 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

Ratings Detail (As Of January 20, 2023)		
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		
<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.

Copyright © 2023 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.