



RATING ACTION COMMENTARY

Fitch Affirms Tarrant Regional Water District, Texas' Water Revs at 'AA+'; Outlook Stable

Thu 07 Oct, 2021 - 2:52 PM ET

Fitch Ratings - Austin - 07 Oct 2021: Fitch Ratings takes the following rating actions with respect to the following Tarrant Regional Water District, Texas (TRWD or the district) bonds:

--Approximately \$789.7 million outstanding water revenue bonds affirmed at 'AA+';

--Up to \$150 million in authorized extendable commercial paper (ECP) bonds, series A affirmed at 'F1+'; and

--Up to \$150 million in aggregate in tax exempt and taxable ECP bonds, series B affirmed at 'F1+'.

In addition, Fitch affirms a 'AA+' Issuer Default Rating (IDR) on the district.

The Rating Outlook is Stable.

ANALYTICAL CONCLUSION

The 'AA+' IDR and issue rating on the water revenue bonds primarily reflect the purchaser credit quality (PCQ) and demonstrated credit strength of the district's largest contracting parties coupled with the district's own very strong operating profile. The ratings also consider the district's relatively stable leverage (net adjusted debt to adjusted funds

available for debt service) of 9.5x, but the district's financial profile is less of a consideration in the rating.

Strong contract provisions for repayment of the water revenue bonds among the cities of Fort Worth, Arlington, Mansfield and the Trinity River Authority (TRA; combined the contractors) create an implied step-up feature, which minimizes bondholder exposure to individual contractors. Collectively, the contractors constitute about 90% of total payments in fiscal 2020.

The IDR considers the consolidated operations including water and drainage, as well as management of recreational assets. The water enterprise fund comprises most of the consolidated district's operating risk. The general fund, where all other activities are accounted for, maintains very large reserves and collects from diverse revenue sources including stable property tax revenues, oil and gas royalties, and contributions from Fort Worth's tax increment financing district, but currently maintains no outstanding debt. While water revenue bonds are only secured by a pledge of net water revenues and not by property taxes, Fitch believes solvency risks are best reflected in the overall entity's combined financial profile.

The 'F1+' on the ECP bonds reflects the Long-Term IDR rating and the terms of the program that allow repayment of outstanding extendable ECP bonds to be delayed at a higher interest rate in the event of a failed remarketing, providing flexibility for a fixed-rate debt refinancing in the event of a short-term market disruption. In that event, the maximum interest rate is the lesser of 10% or the maximum allowable by current law (which is 15%).

CREDIT PROFILE

TRWD is a water control and improvement district charged with the responsibilities for water supply and flood control, as well as management of recreational facilities related to the two functions. The district's water system provides raw water supply to about 50 municipal and non-municipal entities located both within and outside of Tarrant County. Overall, the district provides water either directly or indirectly to about 95% of Tarrant County's more than two million population. The district also operates and maintains a floodway system consisting of levees and river channel improvements and recreational assets related to its other functions.

The district water revenue bonds are payable from contract payments made by the contractors pursuant to the Tarrant County Regional Supply Facilities Amendatory Contract (the contract) between TRWD and the contractors. Payments from the four aforementioned

contractors generally approximate 90% of the district's total water revenues or over 60% of total district program revenues.

Coronavirus Considerations

The outbreak of coronavirus has not shown impairment in the district's revenue or cost profiles.

KEY RATING DRIVERS

Revenue Defensibility 'aa'

Unconditional Contracts, Pass Through Operations, Very Strong Purchaser Credit Quality

The TRWD provides water supplies to a strong service area through contractors with very strong credit quality. The strong contract provisions provide unconditional repayment obligations and step-up provisions for full reallocation of costs.

Operating Risks 'aa'

Very Low Cost Burden, Moderating Capital Needs

The contractual operating structure as a pass-through agency to a very broad service area results in a very low-cost burden. Recent completion of Phase Two of the Integrated Pipeline (IPL) project results in a gradual decline in capital improvement plan (CIP) spending.

Financial Profile 'aa'

High Leverage

The system's leverage position is considered high, although this is somewhat mitigated by both the strong contractual framework by which the district passes through all costs to contractors with very strong credit profiles as well as the district's low operating risk profile.

Asymmetric Additive Risk Considerations

No asymmetric additive risk considerations affected this rating determination.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Improvement in the credit quality of the contractors.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Severe deterioration of the credit quality of one or more of the contractors;

--A significant rise in planned capital spending;

--A weakening in the district's operating risk profile assessment.

Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

SECURITY

The water revenue bonds are payable from a first lien on pledged revenues from the district's water enterprise fund, which consist mainly of payments made by the contractors pursuant to the contract between TRWD and the contractors. The series A ECP bonds have a subordinate lien on pledged water revenues and are further secured from proceeds of ECP bonds issued to refinance maturing ECP bonds as well as from proceeds of any first lien bonds issued to refund the ECP bonds.

The series B ECP bonds are secured by proceeds of ECP bonds and unlimited tax general obligation (ULTGO) refunding bonds that will be issued periodically by the district. The ULTGO bonds will be secured by and payable from the levy of a continuing, direct annual ad valorem tax, without legal limitation as to rate or amount, upon all taxable property within the district. Monies collected to repay the series B ECP bonds are accounted for within the district's governmental fund. The district does not currently have any ULTGO bonds outstanding.

Revenue Defensibility

Revenue defensibility is assessed at 'aa' taking into consideration revenue source characteristics from unconditional wholesale contracts that provide full cost recovery. The contractors agree to make monthly payments to TRWD equal to the annual requirement of the district's operating and maintenance expenses, debt service requirements (including debt service on the bonds), and any other requirement under the district's bond resolution (including replenishment of any draws on the debt service reserve fund) related to the water system.

If there is a deficiency in the district's revenues required to fund such items, the contractors are required to make up this difference proportionally to their level of consumption relative to all non-delinquent customers and prior to the next debt service payment date. To date, the contractors have never failed to make timely payments to the district required under the contract. The contract is in effect until all outstanding debt obligations of the district related to the water system are paid in full.

Fitch uses individual purchaser evaluations to calculate a purchaser credit index (PCI) which numerically reflects the weighted average credit quality of at least 40% of TRWD's revenue. TRWD's PCQ is assessed below '1.5', consistent with an 'aa' PCQ subfactor assessment based on the ratings Fitch has assigned to the four contractors that comprise 90% of water revenues. Fitch rates the water and wastewater revenue bonds of the cities of Arlington, Fort Worth, Mansfield and TRA (all rated at AA category or higher). The top member accounting for 59% of total revenues in fiscal 2020 was Fort Worth.

The district has independent legal ability and flexibility to collect revenues sufficient to cover all costs through increases in contractor charges. Contractors also have independent legal ability to increase rates and charges without external approval. Moreover, each of the contractors whose credit quality was evaluated had ample rate flexibility with rates deemed affordable to the vast majority of their respective customers.

Operating Risks

The system's operating risk is assessed at 'aa' which takes into consideration a very low operating cost burden and moderate life cycle needs. The system's life cycle ratio indicates low capital needs. Capital spending as a percent of depreciation has been very high over the last five fiscal years.

In April 2020 the district completed the second phase of the IPL project and began taking water supply from East Texas via the 150-mile pipeline as scheduled. The IPL project, which commenced construction in 2010, was designed to be completed in three phases to accommodate future growth. Long-term plans for the third phase of the IPL project are likely

to be deferred beyond the original plans due to water conservation efforts and will be implemented in accordance with water demand growth.

Other water related capital needs, relate primarily to the Kennedale Balancing Reservoir improvements, Cedar Creek Wetlands, and rehab of existing infrastructure. The water system's entirely debt funded five-year capital spending estimates for fiscal years 2021-2025 totals an estimated \$356 million, down considerably from the \$838 million in spending during the last five years (fiscal years 2016-2020), which was largely related to the IPL. Debt levels are projected to rise more modestly as projected debt only slightly exceeds scheduled debt maturities over the next few years.

Other district capital projects stem from flood protection needs and include the Trinity Vision Project which is a large drainage project with diverse funding sources. TRWD is managing a \$1.17 billion project to expand the existing drainage infrastructure that protects the growing population of Fort Worth. The project is being funded by a number of entities including both local and nonlocal sources. Approximately 49% of project funds are provided by the city of Fort Worth, Tarrant County, and the district. To date the local sources have already funded more than half of their project share.

The district will fund the remaining local requirements with pay-go sources and with the proceeds of series B ECP bonds that will ultimately be refunded with periodic issuances of ULTGO bonds authorized by voters for up to \$250 million; timing for these issuances is currently not determined. The nonlocal funds will be provided from the federal government via the U.S. Army Corps of Engineers and the U.S. Department of Housing and Urban Development, as well as state funds via the Texas Department of Transportation.

Financial Profile

The financial profile is assessed at 'aa' and primarily reflects a focus on the PCQ rating factor assessment in consideration of the full effect of the district's operating risk. Fitch's calculated leverage has generally been around 10.0x each of the last five years, closing out fiscal 2020 at 9.5x. The leverage ratio is expected to decline very gradually, due to debt issuance approximating debt amortization.

The liquidity profile is assessed as neutral. Since the contractual framework between the district and its contractors provides for essentially sum sufficient coverage, coverage of full obligations would typically be expected to average about 1.0x for the water system. Consolidated results are typically better, benefitting from property taxes and additional revenues from operations. At the close of fiscal 2020, the district's cash days on hand totaled 743 days.

Fitch's Analytical Stress Test (FAST)

The FAST base case utilized the district's water system financial plan which Fitch deems reasonable and is based on the contractual pass-through structure between the district and its contractors. The base case incorporates the water system's CIP for fiscal years 2021 to 2025 which is entirely debt funded. In the context of the government wide operations, which includes the flood protection and recreational management activities, Fitch made certain assumptions based on the previous five fiscal years. Fitch expects leverage to approximate current levels over the ensuing five years.

Asymmetric Additive Risk Considerations

No asymmetric additive risk considerations affected this rating determination.

Sources of Information

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING	PRIOR
Tarrant Regional Water District (TX) [General Government]	LT AA+ Rating Outlook Stable IDR	Affirmed AA+ Rating Outlook Stable

ENTITY/DEBT	RATING			PRIOR
<ul style="list-style-type: none"> Tarrant Regional Water District (TX) /Issuer Default Rating - General Government/1 	LT	AA+ Rating Outlook Stable	Affirmed	AA+ Rating Outlook Stable

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[U.S. Water and Sewer Rating Criteria \(pub. 18 Mar 2021\) \(including rating assumption sensitivity\)](#)

[Public Sector, Revenue-Supported Entities Rating Criteria \(pub. 01 Sep 2021\) \(including rating assumption sensitivity\)](#)

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Tarrant Regional Water District (TX)

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