To the Mayor and Members of the City Council

May 17, 2022

SUBJECT: FINAL RESULTS OF CREDIT RATINGS ON BONDS WITHIN THE 2022 DEBT PLAN

Executive Summary

Prior to offering the bonds for sale, the City sought credit rating opinions from Kroll Bond Rating Agency (“Kroll”) (General Obligation only), Fitch Ratings (“Fitch”), and Moody’s Investors Service (“Moody’s”).

We are proud to report all of the City’s credit ratings were affirmed at current levels. Additionally, Kroll revised its outlook to ‘Positive’ from stable, citing “continued favorable growth trends across the City’s resource base and financial operations, coupled with the return of a more stable operating environment characterized by reduced economic uncertainty and revenue volatility as the worst of the Covid-19 pandemic (“the pandemic”) continues to wane”. Overall, the rating actions and levels are encouraging and a testament to the resilience and strength of Fort Worth.

The rating agencies’ affirmations of the City’s existing GO ratings are as follows:

- Kroll – AA+/Positive (outlook revised from stable);
- Fitch – AA/Stable; and
- Moody’s – Aa3/Stable.

In addition, the rating agencies’ affirmations of the City’s existing W&S ratings are as follows:

- Fitch – AA/Stable; and
- Moody’s – Aa1/Stable.

Consensus credit strengths of the City’s property tax secured general obligation (“GO”) debt include strong financial management, very strong financial flexibility as evidenced by general fund reserves, and strong liquidity. Similarly, credit strengths of the City’s Water and Sewer (“W&S”) secured debt include strong management, a solid operating track record, and strong liquidity.

For context, below is the investment grade rating scale.

	FORT WORTH								
AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-
Prime	*High Investment Grade*			*Medium Investment Grade*			*Low Investment Grade*		

The City also maintains GO and W&S ratings from S&P of AA/Stable and AA+/Stable, respectively. The City chose not engage with S&P this year stemming from the rotational schedule that was implemented in 2020.

As a final update, Moody’s and Fitch both maintain credit ratings on the City’s Special Tax Revenue Bonds, issued in 2017 for the Dickies Arena venue project. At this time, both rating agencies are

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undergoing a surveillance review of the special tax rating. The results of these rating reviews will be shared in another forthcoming informal report in several weeks.

Overview of Credit Rating Outcomes

This year's discussion with the rating agencies focused on growth in the City and projections for the future. Similar to prior rating meetings, the analysts revisited the City's pension and OPEB obligations, noting an ongoing credit weakness and discussing the impact of risk sharing pension reforms and recent plan assumption changes.

The rating agencies noted improvement in the funding status of the pension fund in the past few years driven by the increased City and employee contributions and various benefit changes. This has been somewhat tempered by assumption changes to the plans which brought the assumptions more in line with actual experience. While the rating agencies recognize this improvement, they continue to view the liability as a credit concern.

The rating reviews of the water and sewer credit echoed favorable sentiment of credit strengths including the growing resource base, strong management, a solid operating track record, and strong liquidity. Highlights of each rating commentary are shared below.

Moody's

GO Rating – Affirmed rating of Aa3 with a 'stable' outlook (no change)

"The City of Fort Worth, TX's credit profile reflects the balance between its robust, diverse economy and demographic trends with rising pension liabilities despite repeated benefit reforms. The city's conservative budget management has supported a stable financial profile with ample reserves despite the budget constraint stemming from high fixed costs. The city has the legal ability and political will to implement pension reforms and has done so successfully three times during the last decade. Despite these efforts, the city's unfunded pension liability will still loom large (see Exhibit 1) even considering that next year's reporting will include better asset performance. Rapid amortization of existing general obligation debt is a credit positive, but additional debt to fund needs associated with population growth will likely keep the outstanding net direct debt at current levels."

Credit strengths:
- Growing tax and population base, currently the fifth largest city in Texas
- Stable financial trend supporting healthy reserves
- Legal flexibility to reform pension benefits prospectively

Credit challenges:
- Large unfunded pension liability despite the implementation of multiple benefit reforms
- High fixed costs that are expected to continue as the city issues new money to fund infrastructure improvements and expansions

Factors that could lead to an upgrade
- Material decreases in unfunded pension liabilities
- Moderation of fixed cost burden and improved pension contribution practices
- Considerable corporate investment and job creation within the city limits which strengthen income levels

Factors that could lead to a downgrade
- Increase to total leverage or fixed costs
- Poor financial performance leading to a significant decline in reserves
- Trend of declining assessed values

Water/Sewer Rating – Rating affirmed at Aa1, with a 'stable' outlook. (no change)

"The City of Fort Worth Water and Sewer Enterprise, TX's (Aa1 stable) credit profile is anchored by its role as a regional treated water and wastewater service provider that benefits from its large and economically vibrant service area in the western Dallas-Fort Worth metroplex. The system exhibits strong management practices including multi-year capital planning and periodic rate increases, ample debt service coverage levels, and a low debt profile. The system's revenue bonds are in part constrained by relatively weak legal provisions and below-median though improving system liquidity. The system has a manageable level of exposure to the city's unfunded pension liability."

Credit strengths
- Large service area that extends well beyond city limits; growing customer base
- Strong fiscal management and capital planning
- Ample debt service coverage and low direct debt profile

Credit weaknesses
- Below median liquidity for the rating category
- Weak legal provisions

Factors that could lead to an upgrade
- Sustained trend of building and maintaining liquidity at high levels
- Strengthened legal provisions for bond holder protection
- Upgrade of the city's general obligation bond rating

Factors that could lead to a downgrade
- Substantial decline in liquidity or trend of weak liquidity
- Weak financial performance leading to a reduction in debt service coverage
- Significant increase in leverage
- Downgrade of the city's general obligation bond rating

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Fitch

GO Rating – Rating affirmed at AA, with a 'stable' outlook. (no change)

"The 'AA' Issuer Default Rating (IDR) and limited tax bond rating reflect the city's strong operating profile as well as sold economic and revenue growth prospects. The rating also incorporates elevated pressure on the expenditure flexibility assessment. Increasing pension contributions are driving carrying costs higher. The rating also reflects Fitch Ratings' expectation that management will continue to make budgetary adjustments to maintain a strong operating profile."

Factors that could, individually or collectively, lead to positive rating action/upgrade:
- A closing of the current gap between actual and actuarially determined pension contributions (ADCs) and a reduction in the current projected 42-year amortization period to one closer to the 30-year industry standard.
- A sustained reduction in the long-term liability burden to below 10% of personal income
- Marked improvement to the city's expenditure flexibility, including carrying costs that are trending upward due to pension pressures.

Factors that could, individually or collectively, lead to negative rating action/downgrade:
- While not expected, an erosion of post-pandemic economic prospects that weakens the recently strong revenue growth trend.
- A reversal of the recent positive operating performance and resulting decline in resilience cushion below a level consistent with the 'AA' rating.
- An increase in the long-term liability burden that weakens the current assessment.

Water Rating – Affirmed rating of AA with a 'stable' outlook (no change)

"The system's 'AA' bond rating and 'aa' SCP assessment reflect a very strong leverage profile within the business framework of very strong revenue defensibility and very low operating risk. Leverage, defined as net adjusted debt to adjusted funds available for debt service, is very low at 4.7x in fiscal 2021. Contributing to the very favorable leverage metric, the city adopted a minimum cash balance policy in fiscal 2015, which resulted in fiscal 2021 finishing with a five-year high cash balance of over $180 million."

Factors that could, individually or collectively, lead to positive rating action/upgrade:
- Sustained trend of leverage that approximates 5.0x to 6.0x in Fitch's base and stress scenarios, assuming stability in the revenue defensibility and operating risk assessments.

Factors that could, individually or collectively, lead to negative rating action/downgrade:
- An increase in leverage that consistently exceeds 9.0x in Fitch's base and stress case scenarios, assuming stability in the revenue defensibility and operating risk assessments.

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Kroll

GO Rating – Affirmed rating of AA+ with a revised 'positive' outlook (changed from stable)

"The City's G.O. rating reflects strong financial management policies and practices, experienced leadership, and very strong financial performance and liquidity measures. Economic growth remains robust, fostering improvements in resident wealth base and the assessment base of the City. While overall debt levels have increased, they remain moderate and continue to benefit from a rapid amortization profile. Fixed costs remain manageable.

The Outlook revision on the City of Fort Worth's ("the City's") General Obligation (G.O.) Bonds and Notes reflects the continued favorable growth trends across the City's resource base and financial operations, coupled with the return of a more stable operating environment characterized by reduced economic uncertainty and revenue volatility as the worst of the Covid-19 pandemic ("the pandemic") continues to wane. Further, the Positive Outlook reflects KBRA's expectation that the City's debt and continuing obligations will remain well supported by its growing assessment and resource base. Should favorable growth trends in overall assessment values continue, and the financial operating performance continues to be at a level such that the City's financial burden remains manageable, upward rating momentum over the near term may be possible."

Key Credit Strengths:

- Strong financial management policies and an experienced, effective management team.
- Robust economic growth, evidenced by a diverse, growing tax and resource base, and unemployment rates which have historically trended below the State average.
- Strong financial reserves and liquidity, bolstered by conservative budgeting practices and formal fiscal policies and monitoring practices.

Key Rating Concerns:

- Ability to absorb increasing pension contributions while maintaining financial strength.
- Reliance on sales taxes exposes the City's revenue base to economic fluctuations; deviation from conservative budgeting practices would also increase risk.

Drivers for Rating Change:

- Sustained, strong financial performance despite any economic downturns. (+)
- Continuing progress in transitioning to a new pension funding model, with minimal impact to the City's financial position from new risk sharing mechanism. (+)
- Management's ability to adapt to new property tax levy limitation without significant operational impact. (+)
- Economic decline or tax base growth stagnation causing a significant reduction in tax revenues (-)

The rating reports are accessible online at: https://www.fortworthtexasbonds.com/fort-worth-investor-relations-tx/bonds/i1639#anchor-bond-ratings

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Next Steps

We are pleased to share excellent rating outcomes. Special thanks to city staff, the City's financial advisors, and outside counsel for their hard work and dedication to the ratings process. The City will continue the 2022 debt plan and related bond sales with the sale of the bonds scheduled to occur on May 17th (GO) and May 24th (Water). If you have any questions, please contact Reginald Zeno, Interim Asst. City Manager/Chief Financial Officer, at 817-392-8500.

David Cooke
City Manager