Memorandum

CITY OF DALLAS

DATE April 7, 2023

TO Honorable Mayor and Members of the City Council

SUBJECT **Fitch Ratings Affirmed 'AA' Rating and Stable Outlook for City of Dallas General Obligation Bonds – RATING ACTION**

On April 4, 2023, Fitch Ratings (Fitch) assigned its 'AA' credit rating and stable outlook to the anticipated General Obligation Refunding and Improvement Bonds, Series 2023A and Combination Tax and Revenue Certificates of Obligation, Series 2023, and affirmed the City's 'AA' credit rating and stable outlook on outstanding general obligation bonds. Fitch previously affirmed the City's rating on October 26, 2021.

According to the Fitch report, the City's affirmed rating continues to reflect, "strong revenue growth prospects, conservative budgeting practices, and solid reserve levels." In their analysis, Fitch notes that "the fiscal 2022 general fund results were positive as both revenues and expenditures outperformed budget," while "elevated debt and retiree benefit outlays will maintain a certain amount of pressure on the city's budget management practices." However, the City's 'aaa' resilience assessment reflects "Fitch's expectation that the city will make spending cuts and maintain a strong reserve cushion, maintaining the highest level of financial resilience through future business cycles." In the long-term, "Fitch expects the underlying strength, size and diversity of Dallas' economy will support strong operating performances through periodic futures economic downturns."

Fitch's affirmed rating reinforces the City's ability to navigate challenges and changes in the economy with prudent fiscal management and sound leadership. The rating is yet another credit positive for the City and supportive of market interest in the City ahead of the planned May 2023 bond issuance. Attached is the published rating report provided for your review.

Please let me know if you need additional information.

Jack Ireland
Chief Financial Officer

c:
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Chris Caso, City Attorney
Mark Swann, City Auditor
Bilierae Johnson, City Secretary
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Robert Perez, Assistant City Manager
Carl Simpson, Assistant City Manager
Genesis D. Gavino, Chief of Staff to the City Manager
Directors and Assistant Directors

FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Dallas, TX $429MM Limited Tax Obligations 'AA'; Outlook Stable

Tue 04 Apr, 2023 - 4:14 PM ET

Fitch Ratings - Austin - 04 Apr 2023: Fitch Ratings has assigned a 'AA' rating to the following City of Dallas, TX limited tax (LT) obligations:

--$373.87 million GO refunding and improvement bonds, series 2023A; and

--$55.265 million combination tax and revenue certificates of obligation (COs), series 2023.

Both series are scheduled for a negotiated sale the week of May 1. The series 2023 GO bond proceeds will finance various infrastructure improvements and refund outstanding tax-supported debt and CP; series 2023 CO proceeds will finance certain transportation-related improvements.

Fitch also has affirmed the following ratings:

--Issuer Default Rating (IDR) at 'AA';

--$2.3 billion of outstanding LT debt at 'AA'.

The Rating Outlook is Stable.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Dallas (TX) [General Government]	LT IDR	AA Rating Outlook Stable	Affirmed	AA Rating Outlook Stable
Dallas (TX) /General Obligation - Limited Tax/1 LT	LT	AA Rating Outlook Stable	Affirmed	AA Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

SECURITY

The GO bonds and COs are payable from a limited ad valorem tax levied against all taxable property in the city. The COs are further backed by a limited pledge (not to exceed $1,000) of the city's drainage utility system.

ANALYTICAL CONCLUSION

The city's 'AA' IDR and LT bond ratings reflect strong revenue growth prospects, conservative budgeting practices, and solid reserve levels. Recent operating performance has been positive despite increased spending on both pensions and public safety salaries. Budgeting pressure is likely to continue as the city attempts to build up police staffing levels and continues with increasing pension contributions; these pressures are expected to be manageable given the city's high degree of inherent budget flexibility.

Economic Resource Base

Dallas is the anchor of the large and diverse Dallas-Fort Worth regional economy. The city is a center for technology, trade, finance and healthcare and it also ranks among the top visitor and leisure destinations in the state.

KEY RATING DRIVERS

Revenue Framework: 'aaa'

Strong revenue growth prospects are based on expectations for continued economic expansion. The assessment also reflects the city's high independent legal ability to increase operating revenues.

Expenditure Framework: 'a'

The city's pace of spending is expected to be marginally above revenue growth given ongoing service demands and inflationary pressures. Increased pension contributions will keep carrying costs at an elevated level; a rapid debt amortization rate also contributes to the elevated carrying costs.

Long-Term Liability Burden: 'aa'

The long-term liability burden currently represents a moderate 12% of personal income. Recent pension reforms to both the civilian and uniform plans have reduced the combined total liability and, in conjunction with continued economic growth, are expected to keep the long-term liability burden within the current range.

Operating Performance: 'aaa'

The city of Dallas' gap-closing capabilities and healthy reserves position it to maintain the highest financial resilience through future business downturns. Elevated debt and retiree benefit outlays will maintain a certain amount of pressure on the city's budget management practices.

RATING SENSITIVITIES

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

--A sustained reduction in the long-term liability burden below 10% of personal income.

--An improvement in Fitch's assessment of the city's expenditure flexibility, due to moderation in fixed debt service and retiree benefit costs as a percentage of spending.

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

--Failure to close the gap between annual pension contributions and the actuarially determined contribution amounts.

--Longer term, poor operating performance and resulting material decline in operating reserves.

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.

CURRENT DEVELOPMENTS

The fiscal 2022 general fund results were positive as both revenues and expenditures outperformed budget. Sales tax receipts totaled $407 million versus the budgeted $394 million and were up roughly 15% from the fiscal 2021 total. Property tax revenues totaled $804 million versus $775.5 million in fiscal 2021, a 3.7% increase aided by a nearly 5% increase in taxable assessed value (TAV). The general fund recorded a $41.8 million surplus, increasing the unrestricted fund balance to nearly $418 million or 27.6% of spending and transfers out.

The biennial fiscal 2023-2024 budget is balanced and highlights include a $0.0275 reduction in the fiscal 2023 total property tax rate, an increase in the over 65/disabled property tax exemption to $115,500 from $107,000, an increase in the minimum hourly wage to $18 and the hiring of 250 police officers. Management reports fiscal 2023 general fund revenues are trending positively compared to budget, led by an increase in sales tax receipts; the current fiscal year-end projection is for sales tax revenues to outperform budget by roughly $11.7 million or nearly 3%. Total general fund revenues and outlays are expected to outpace the original budget totals, and the fiscal 2023 ending fund balance is projected to increase by roughly $3.5 million.

CREDIT PROFILE

Dallas is located in north central Texas and with a population of 1.3 million ranks among the top 10 U.S. cities by population. The city serves as corporate headquarters for AT&T,

Southwest Airlines, Texas Instruments, 7-Eleven, Inc., HollyFrontier Corp., Pizza Hut, Inc. and other large corporate concerns. Large employers in the education, government and health services sectors lend stability to the city's employment base.

The city's role as a wholesale and retail trade center is enabled by a strong transportation network of airports, rail and interstate highways. Dallas Area Rapid Transit (DART) provides major employers easy access to a highly skilled work force to support growing technology, finance, business and medical service sectors. Top taxpayers represent utility, air transportation, developers, real estate, manufacturing and retail industries, and the tax base has no significant concentration. Fitch expects the underlying strength, size and diversity of Dallas' economy will support strong operating performances through periodic futures economic downturns.

Revenue Framework

General fund operations are supported by a diverse mix of revenues led by ad valorem tax revenues (53% of the fiscal 2022 total), sales tax revenues (27%), and franchise fees (9%).

The city's revenue growth prospects remain strong due to current and planned economic activity.

The city's fiscal 2023 total tax rate of $0.7458 per $100 of TAV is down $0.0275 from the prior year and is well below the constitutional and city charter cap of $2.50. Any increase in the operating tax rate which produces an annual operating levy increase of more than 3.5% (the voter approval tax rate) requires a ratification election. The revenue cap does not apply to debt service tax levies; the city's fiscal 2023 debt service tax rate is $0.2055 out of the total rate.

The tax levy limitation excludes new additions to tax rolls and allows for banking of unused margin for up to three years. Dallas' remaining control over property taxes and other local revenues such as fines, fees and charges for services is still sufficient to maintain high revenue-raising flexibility.

Expenditure Framework

As is typical with U.S. cities, public safety is Dallas' largest operating spending category (62% of fiscal 2022 general fund outlays), followed by general government (13%) and culture and recreation (10%). General fund spending growth has generally kept pace with revenue gains in recent years.

Fitch expects the pace of spending growth to trend marginally above what is projected to be a strong revenue growth trend, as future service demands from a relatively mature residential base and increasing public safety and pension outlays should align with increasing operating receipts over the near to medium term.

Fitch expects actual carrying costs to remain elevated (25% to 27% of governmental spending), the result of both increased pension contributions to the police and fire plan and debt service associated with issuances from a 2017 $1.05 billion GO bond authorization. Fitch's supplemental pension metric, which estimates the annual pension cost based on a level dollar payment for 20 years with a 5% interest rate, indicates that carrying costs are vulnerable to future increases.

The current carrying costs also reflect a rapid 73% debt amortization rate over the next 10 years; the city's ability to control headcount and salary costs is strong, providing additional operational flexibility.

Long-Term Liability Burden

Dallas' long-term liability burden is moderate at roughly 12% of personal income, with about 42% of the total attributable to unfunded pension liabilities. The liability calculation is adjusted by Fitch to assume a more conservative 6% investment return. The city currently has roughly $2.3 billion in GO debt outstanding (including these offerings), about 20% of the total long-term liability burden. Overlapping debt of $4.8 billion comprises the remainder of the liability (38% of the total).

Dallas participates in three single employer defined benefit pension plans. The ERF covers non-uniformed employees. The DPFP (combined plan) and the smaller Supplemental Police and Fire Pension Plan of the city of Dallas (supplemental plan) cover police and firefighters. Recent plan changes to both the ERF and DPFP addressed retirement age and service retirement age, benefit multipliers and -- for the DPFP-- changes to the deferred retirement option program, elimination of the COLA benefit, and increases in both city and employee contributions. The reforms are expected to boost the long-term viability of both plans.

The combined net pension liability (NPL) for all three plans as reported in the city's fiscal 2022 audit totaled $4.03 billion, with assets covering 61% of liabilities. The NPL increases to $5.09 billion and the ratio of assets to liabilities declines to 55% when the 6% investment return assumption is used. The city's other post-employment benefit liability was recently reduced by more than one-half (to $221.6 million) through the elimination of the subsidy for retirees' Medicare Advantage plans.

Operating Performance

The Fitch Analytical Stress Test (FAST) scenario analysis tool relates historical tax revenue volatility to GDP to support the assessment of operating performance under Fitch's criteria. FAST is not a forecast, but it represents Fitch's estimate of possible revenue behavior in a downturn, based on historical revenue performance. Hence, actual revenue will vary from FAST results, and Fitch expects the city will implement necessary corrective actions to offset them. FAST does provide a relative sense of the risk exposure of a particular local government compared to other U.S. local governments. FAST results indicate minimal pressure on the city's financial resilience in the medium term, even absent policy interventions.

The 'aaa' resilience assessment reflects Fitch's expectation that the city will make spending cuts and maintain a strong reserve cushion, maintaining the highest level of financial resilience through future business cycles.

The city has demonstrated positive budget management practices historically, and the recent positive operating results (that included steadily increasing pension contribution amounts) have continued that trend and enabled the city to maintain a strong financial cushion. However, increased annual pension contributions and public safety salary outlays will maintain a degree of pressure on the city's budget management practices for the foreseeable future.

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.

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 04 May 2021) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Dallas (TX)	EU Endorsed, UK Endorsed

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