

Memorandum



CITY OF DALLAS

DATE April 7, 2023

TO Honorable Mayor and Members of the City Council

SUBJECT **S&P Global Ratings Affirmed 'AA-' Rating and Stable Outlook for City of Dallas General Obligation Bonds – RATING ACTION**

On April 3, 2023, S&P Global Ratings (S&P) 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. At the same time, S&P affirmed the City's 'AA-' (stable) rating on outstanding general obligation bonds and 'A' (stable) rating on outstanding Convention Center Hotel Development Corporation debt. S&P previously affirmed the City's rating on October 21, 2021.

S&P affirmed the rating based on the City's "strong economy with an anchoring broad, diverse Metropolitan Statistical Area [MSA]," as well as "very strong management with practices, policies focused on long-term planning, reserve maintenance," and a "strong institutional framework." In their report, S&P also details their assessment of the City's credit weaknesses, including budgetary performance and debt and pension liabilities. As S&P explains, "our view of budgetary performance incorporates pension plan contribution deficiencies, which we include as operating expenditures in budgetary-performance calculations," while noting, "however, reserves and liquidity have improved recently due to strong operating revenue growth." With an eye on the upcoming legislative pension funding deadline in 2025, S&P will be looking at the City's proposed plans for pension reform in their determination to raise or lower the rating.

The affirmed rating decision by S&P is a testament to the City's continued stability and credit strength in a volatile market, and a positive indicator ahead of the negotiated bond sale scheduled in May. Attached is the published report for your review.

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 Bizer 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; Appropriations; General Obligation

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Summary:

Dallas; Appropriations; General Obligation

Credit Profile

US\$373.87 mil GO rfdg and imp bnds ser 2023A dtd 05/17/2023 due 02/15/2043

| | | |
|-------------------------|------------|-----|
| <i>Long Term Rating</i> | AA-/Stable | New |
|-------------------------|------------|-----|

US\$55.265 mil comb tax and rev certs of oblig ser 2023 dtd 05/17/2023 due 02/15/2033

| | | |
|-------------------------|------------|-----|
| <i>Long Term Rating</i> | AA-/Stable | New |
|-------------------------|------------|-----|

Dallas Convention Center Hotel Development Corp, Texas

Dallas, Texas

Dallas Convtn Ctr Hotel Dev Corp (Dallas)

| | | |
|-------------------------|----------|----------|
| <i>Long Term Rating</i> | A/Stable | Affirmed |
|-------------------------|----------|----------|

Dallas Convtn Ctr Hotel Dev Corp (Dallas)

| | | |
|-------------------------|----------|----------|
| <i>Long Term Rating</i> | A/Stable | Affirmed |
|-------------------------|----------|----------|

Credit Highlights

- S&P Global Ratings assigned its 'AA-' rating to Dallas, Texas' roughly \$373.8 million series 2023A general obligation (GO) and improvement bonds and roughly \$55.26 million series 2023 combination tax and revenue certificates of obligation.
- At the same time, S&P Global Ratings affirmed its 'AA-' rating on the city's existing GO debt and certificates of obligation and 'A' rating on Dallas Convention Center Hotel Development Corp., Texas' series 2009A and 2009B hotel revenue bonds, issued for Dallas.
- The outlook is stable.

Security

The bonds and certificates are a direct obligation of the city, payable from, and secured by, a pledge of a direct and continuing ad valorem tax, within the limits prescribed by the law, on all taxable property within the city. The certificates are also payable from, and secured by, a limited pledge of the city's municipal drainage utility system in an amount not to exceed \$1,000; due to the pledge's limited nature, we rate the certificates to the strength of the ad valorem-tax pledge.

The maximum allowable ad valorem tax rate in Texas is \$2.50 per \$100 of assessed value with the portion dedicated to debt service limited to \$1.50. We view the limited-tax GO debt pledge on par with the city's general creditworthiness because ad valorem taxes are not levied on a narrower or distinctly different property tax base and there are no limitations on the fungibility of resources for debt-service payment.

Officials intend to use series 2023A bond proceeds to refund a portion of the city's debt outstanding and fund various capital projects, including street, park, library, city hall, and public-safety improvements and homeless facilities. Officials intend to use series 2023 certificate proceeds to fund various street-and-road-related projects.

We rate the 2009A and 2009B hotel revenue bonds based on the city's appropriation pledge, according to a city-council-adopted grant resolution, where the council will consider making grants or loans from the city's general fund to the issuer should pledged revenue be insufficient to service the corporation's debt.

Credit overview

Dallas is the anchor of the Dallas-Fort Worth-Arlington metropolitan statistical area (MSA), one of the nation's fastest-growing metropolitan areas. This growth supports a recent trend of increasing taxable value, improving income, and growing property tax and sales tax revenue. However, a very weak debt-and-contingent-liability profile, particularly large unfunded pension liabilities, somewhat offsets these positive trends and credit strengths. Although economic and financial metrics are generally improving, if pension liabilities, which currently total more than \$4 billion as of Dec. 31, 2021, continue to grow, leading to further weakened plan funding statuses and increasing contribution costs that pressure the budget, we could lower the rating. City contributions have historically not met the actuarially determined contribution (ADC). According to state law, the city must present a funding-soundness-and-restoration plan to the Texas Pension Review Board by Sept. 1, 2025, showing an ability to fund pension liabilities within a 30-year period.

The rating reflects our assessment of the city's:

- Strong economy with an anchoring broad, diverse MSA;
- Very strong management with a strong Financial Management Assessment (FMA) methodology, with formal long-term planning and several council-approved policies guiding finances, and a strong Institutional Framework score;
- Weak budgetary performance that incorporates pension ADC shortfalls--However, reserves and liquidity have improved recently due to strong operating revenue growth; and
- Elevated debt and pension burden, not expected to decrease during the next few years due to additional debt plans and pension contributions below the ADC and our static- and minimum-funding-progress calculations.

Environmental, social, and governance

We have assessed environmental, social, and governance (ESG) risks relative to Dallas' economy, financial management, fiscal performance, and debt-and-contingent-liability profile. In our opinion, Dallas has elevated long-term governance risk associated with high pension and other postemployment benefit (OPEB) expenditures and large unfunded liabilities because we think costs will likely increase over time and the city has a history of funding its plans below actuarially determined amounts.

We view environmental and social risks as neutral in our analysis. Despite the city's susceptibility to some significant weather events--such as heavy storms, tornados, high winds, and drought--we do not view these risks as outsized for the region.

The city is working with the G20 Global Smart Cities Alliance to develop and implement G20 policies for technology and cybersecurity. The city is also participating in development and construction of a Cyber Fusion Center, unifying security functions such as threat intelligence, security automation, threat response, security orchestration, and incident response across the Dallas-Fort Worth regional area.

Outlook

The stable outlook reflects S&P Global Ratings' expectation that Dallas will likely maintain very strong reserves and liquidity, supported by a growing economy and strong financial-management practices and policies.

Downside scenario

We could lower the rating if changes to pensions do not successfully address growing unfunded liabilities or if debt service, pension, and OPEB carrying charges were to increase to levels that negatively affect budgetary flexibility or further weaken performance.

Upside scenario

Assuming all other credit factors remain stable or improve, we could raise the rating if unfunded pension liabilities were meaningfully reduced in a way that we view them as sustainable and that improve funding.

Credit Opinion

A strong, growing economy with a sizable, diverse tax base in a broad, diverse MSA

Dallas and the Dallas-Fort Worth-Arlington MSA benefit from consistent regional population and job growth. The local economy's diversity and depth remain a credit strength. Continued economic development citywide has contributed to 11 consecutive years of tax base growth. Most recently, for fiscal 2023, the tax base increased by more than 15% to more than \$179 billion, supported by rising property values and economic development. Newly announced economic developments, supported by the city, include a mixed-use development downtown, an expansion of a large corporate office downtown, and a housing development in north Dallas. Recent openings include two mixed-use developments downtown and two fulfillment-and-distribution centers in the city's inland port area southeast of downtown. We think ongoing development and population growth regionwide will likely continue to support positive economic trends for Dallas and provide credit strength.

Very strong management with practices, policies focused on long-term planning, reserve maintenance

Dallas uses multiyear trends of certified property tax values, historical sales tax revenue trends, other economic and revenue data, and outside sources to formulate the budget. Management provides monthly reports to the city council and produces a year-end report that reflects expenditures, concurrent with publishing a comprehensive annual financial report. City staff prepares and presents long-range financial forecasts for the general and debt-service funds, presented to the council during the budget-development process or bond-program development.

Dallas maintains an inventory of capital needs that it updates annually. It has historically used a multiyear capital-bond program to fund infrastructure improvements. Management also reports investment-management results quarterly to the council, and it reviews the investment-management policy annually. Financial-management-performance criteria (FMPC) establish guidelines and targets for operating programs and cash and debt management, including minimum reserves, debt ratios, and debt use-and-issuance restrictions. The FMPC is part of the budget-development process at fiscal year-end and GO-bond-program development. The city adheres to a reserve policy of maintaining no less than 50 days' expenditures.

The Institutional Framework score for Texas municipalities is strong.

A consistently weak budgetary performance when incorporating pension underfunding, though reserves are increasing

Dallas' budgetary performance is weak, in our opinion. Our view of budgetary performance incorporates pension plan contribution deficiencies, which we include as operating expenditures in budgetary-performance calculations. If the city cannot address contribution deficiencies and operating performance remains negative after adjustments, we could lower the rating.

For fiscal years 2021 and 2022, combined contributions toward the Employees' Retirement Fund of the City of Dallas (ERF) and Dallas Police & Fire Pension (DPFP) plans were \$97.4 million below ADCs. However, outside of contribution shortfalls, finances have been consistently positive with consistent increases in available reserves. Prior to the adjustment to operating expenditures, Dallas reported a more than \$40 million general fund surplus in fiscal 2022. Budgetary performance benefits from growing operating revenue and strong financial-management practices. Available reserves have increased in each of the past three fiscal years, maintaining levels we consider very strong during this period. The city adheres to its formal fund-balance policy that calls for maintaining, at least, 50 days' operations in reserve.

For fiscal 2023, Dallas expects reserves will likely remain stable; however, due to positive revenue variances to date, a general fund surplus and additions to reserves are possible depending on final expenditures. The fiscal 2023 budget includes funding for several prioritized initiatives, including its economic development, environmental-and-sustainability outreach and projects, racial equity, technological improvements for certain city services, homeless-and-housing solutions, public safety, and transportation. Preliminary budget planning for fiscal 2024 shows a balanced budget with continued property and sales tax growth supporting growing personnel costs and ongoing budget priorities.

Very weak debt with ongoing debt needs

We expect Dallas will likely continue to issue bonds for general infrastructure improvements, according to its capital plan. The debt profile incorporates contingent liabilities, making up any shortfalls in debt service coverage for both Dallas Convention Center hotel revenue bonds and Downtown Dallas Development Authority tax-increment revenue bonds. The city also has a commercial paper program through JPMorgan Chase Bank N.A.: The notes have a total program authorization of \$350 million. JPMorgan Chase Bank provides liquidity support through a revolving-credit agreement.

Pension, OPEB liabilities remain a significant credit weakness

Dallas continues to underfund single-employer pension plans and does not consistently meet the ADC, which we view as a credit weakness. Combined pension and OPEB contributions, as of fiscal 2022, are 14.1% of total governmental funds expenditures with 13.7% from pensions alone. Dallas provides benefits to employees primarily through two defined-benefit retirement plans: ERF, which is 80% funded, and DPFP, which is 41% funded. Combined unfunded pension liabilities total slightly more than \$4 billion as of Dec. 31, 2021.

Pension contribution rates are fixed by statute and are insufficient based on ADC rates. In 2022, the city paid 63% and 74% of the ADCs for TERF and DPFP. These contributions were not only well below our minimum-funding-progress

metric but also below static funding, indicating increasing unfunded liabilities if all assumptions are met. Furthermore, the combined DPFP's supplemental contributions should expire by fiscal 2025; however, this could change as the city proposes reforms during the next two years. We view the city's funding discipline as weak, which is likely to lead to funding deterioration during the next few years unless it enacts effective reforms.

Dallas closed OPEB to new participants as of Jan. 1, 2010, representing a comparatively smaller liability of just \$221 million with pay-as-you-go funding. We expect the overall liability to continue to decrease slowly over time.

Dallas made significant changes to pension plans in 2017 to reduce benefits; however, unfunded liabilities remain substantial. The city has until 2025 to submit a plan to the state that demonstrates an ability to fully fund pension liabilities within 30 years. City management expects to present an outline of this plan in 2024. While reforms or changes could be come in many different forms, they will likely require additional city contributions, which could pressure budgetary performance or require offsetting expenditure reductions.

| Dallas--Key Credit Metrics | | | | |
|---|-------------|------------------------|-------------|---------|
| | Most recent | Historical information | | |
| | | 2022 | 2021 | 2020 |
| Strong economy | | | | |
| Projected per capita EBI % of U.S. | 99 | | | |
| Market value per capita (\$) | 131,998 | | | |
| Population | | 1,359,296 | 1,365,075 | |
| County unemployment rate(%) | | 5.5 | | |
| Market value (\$000) | 179,424,000 | 155,938,192 | 147,443,517 | |
| Ten largest taxpayers % of taxable value | 3.7 | | | |
| Weak budgetary performance | | | | |
| Operating fund result % of expenditures | | (3.5) | (2.5) | (1.1) |
| Total governmental fund result % of expenditures | | (6.1) | (3.8) | 0.9 |
| Very strong budgetary flexibility | | | | |
| Available reserves % of operating expenditures | | 26.1 | 25.1 | 23.1 |
| Total available reserves (\$000) | | 414,935 | 375,865 | 318,522 |
| Very strong liquidity | | | | |
| Total government cash % of governmental fund expenditures | | 78 | 66 | 65 |
| Total government cash % of governmental fund debt service | | 394 | 330 | 436 |
| Very strong management | | | | |
| Financial Management Assessment | Strong | | | |
| Very weak debt & long-term liabilities | | | | |
| Debt service % of governmental fund expenditures | | 19.7 | 20.0 | 15.0 |
| Net direct debt % of governmental fund revenue | 140 | | | |
| Overall net debt % of market value | 4.3 | | | |
| Direct debt 10-year amortization (%) | 52 | | | |
| Required pension contribution % of governmental fund expenditures | | 13.7 | | |
| OPEB actual contribution % of governmental fund expenditures | | 0.4 | | |

Dallas--Key Credit Metrics (cont.)

| | Most recent | Historical information | | |
|--|-------------|------------------------|------|------|
| | | 2022 | 2021 | 2020 |

Strong institutional framework

EBI--Effective buying income. OPEB--Other postemployment benefits.
Data points and ratios may reflect analytical adjustments.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- 2022 Update Of Institutional Framework For U.S. Local Governments
- 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 March 31, 2023)

| | | |
|---------------------------|------------------|----------|
| Dallas GO | | |
| <i>Long Term Rating</i> | AA-/Stable | Affirmed |
| Dallas GO | | |
| <i>Long Term Rating</i> | AA-/Stable | Affirmed |
| Dallas GO | | |
| <i>Long Term Rating</i> | AA-/Stable | Affirmed |
| Dallas GO | | |
| <i>Long Term Rating</i> | AA-/Stable | Affirmed |
| Dallas GO (AGM) | | |
| <i>Unenhanced Rating</i> | AA-(SPUR)/Stable | Affirmed |
| Dallas GO (AGM) | | |
| <i>Unenhanced Rating</i> | AA-(SPUR)/Stable | Affirmed |
| Dallas GO (AGM) | | |
| <i>Unenhanced Rating</i> | AA-(SPUR)/Stable | Affirmed |
| Dallas GO (AGM) (SEC MKT) | | |
| <i>Unenhanced Rating</i> | AA-(SPUR)/Stable | Affirmed |
| Dallas GO (BAM) (SECMKT) | | |
| <i>Unenhanced Rating</i> | AA-(SPUR)/Stable | Affirmed |
| Dallas GO (BAM) (SECMKT) | | |
| <i>Unenhanced Rating</i> | AA-(SPUR)/Stable | Affirmed |

Ratings Detail (As Of March 31, 2023) (cont.)

| | | |
|---------------------------|------------------|----------|
| Dallas GO (BAM) (SECMKT) | | |
| <i>Unenhanced Rating</i> | AA-(SPUR)/Stable | Affirmed |
| Dallas GO (BAM) (SECMKT) | | |
| <i>Unenhanced Rating</i> | AA-(SPUR)/Stable | Affirmed |
| Dallas GO (BAM) (SECMKT) | | |
| <i>Unenhanced Rating</i> | AA-(SPUR)/Stable | Affirmed |
| Dallas GO (BAM) (SEC MKT) | | |
| <i>Unenhanced Rating</i> | AA-(SPUR)/Stable | Affirmed |

Many issues are enhanced by bond insurance.

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