

Memorandum



CITY OF DALLAS

DATE March 29, 2024

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 Refunding and Improvement Bonds, Series 2024B and Certificates of Obligation, Series 2024B – RATING ACTION**

On March 25, 2024, S&P Global Ratings (S&P) assigned its 'AA-' credit rating and stable outlook to the anticipated General Obligation Refunding and Improvement Bonds, Series 2024B and Certificates of Obligation, Series 2024B, affirming the credit rating on the City's long-term general obligation debt.

The rating by S&P continues to reflect the City's "strong economy with an anchoring broad, diverse Metropolitan Statistical Area [MSA];" as well as "very strong management with strong practices, policies focused on long-term planning, reserve maintenance," and a "strong institutional framework." In their report, S&P also includes 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," noting, "however, reserves and liquidity have improved recently due to strong operating revenue growth."

In the current active bond season and oversupplied market, S&P's affirmed rating further bolsters the City's credit profile ahead of the issuance of the General Obligation Refunding Bonds, Series 2024B and Certificates of Obligation, Series 2024B. The bonds are currently scheduled for pricing on April 4, 2024. Attached is the published rating report provided for your review. 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
Tammy Palomino, City Attorney
Mark Swann, City Auditor
Biliera 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
Dr. Robert Perez, Assistant City Manager
Genesis D. Gavino, Chief of Staff to the City Manager
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RatingsDirect®

Summary:

Dallas; General Obligation

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Dallas; General Obligation

Credit Profile

US\$379.54 mil GO rfdg & imp bnds ser 2024B due 02/15/2043

<i>Long Term Rating</i>	AA-/Stable	New
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US\$199.065 mil combination tax and rev certs of obig ser 2024B due 02/15/2033

<i>Long Term Rating</i>	AA-/Stable	New
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Credit Highlights

- S&P Global Ratings assigned its 'AA-' rating to Dallas' roughly \$380 million series 2024B general obligation (GO) refunding and improvement bonds and roughly \$200 million series 2024B combination tax and revenue certificates of obligation.
- The outlook is stable.

Security

The GO bonds and certificates of obligation are a direct obligation of Dallas, 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 city's existing 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 2024B bond proceeds to fund various capital projects and refund certain debt for interest-rate savings. Officials also intend to use series 2024B certificate proceeds to fund street, park, drainage, and other improvements.

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 \$6 billion as of Dec. 31, 2022, continue to grow, leading to further weakened plan-funding status 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 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) factors relative to Dallas' economy, financial management, fiscal performance, and debt-and-contingent-liability profile. In our opinion, Dallas has elevated long-term governance factors 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 factors 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 factors as outsized for the region.

On May 3, 2023, Dallas experienced a ransomware cyberattack. While federal investigations remain underway, affected city systems are nearly fully recovered or restored. Officials report that the city quickly contained the attack and that any financial implications were manageable within the city's budget framework. The city had an established reserve for cyber incidents, and it has taken numerous steps to prepare for a situation such as this event. Officials do not expect any material financial effect on the city. The city maintains cyber insurance. Its cybersecurity program oversees and addresses cyber risks and ensures compliance with regulations. The city is continuously allocating resources to enhance cybersecurity readiness.

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, 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 Dallas were to reduce unfunded pension liabilities meaningfully in a way that we view them as sustainable and that improve funding.

Credit Opinion

A strong and growing economy with a sizable, diverse tax base in a broad and 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 12 consecutive years of tax base growth. Most recently, for fiscal 2024, the tax base increased by 10% to slightly less than \$200 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. In the coming months, Dallas will begin construction of a new convention center downtown, which should support a continued trend of sales and hotel tax revenue growth in its core business district. We think ongoing development and population growth regionwide will likely continue to support positive economic trends for Dallas, supporting overall credit strength.

Very strong management with strong 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 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.

Consistently weak budgetary performance when incorporating pension underfunding, but 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 2023, combined contributions toward the Employees' Retirement Fund of the City of Dallas (ERF) and Dallas Police & Fire Pension (DPFP) plans were below ADCs. However, outside of contribution shortfalls, finances have been balanced or positive with consistent increases in available reserves. Prior to the adjustment to operating expenditures and discounting lease-funded capital outlay funded by lease proceeds recorded below the line, Dallas reported a general fund surplus in fiscal 2023. Budgetary performance benefits from growing operating revenue and strong financial-management practices. We think projected revenue growth will largely support growing expenditures, not including pension contribution shortfalls.

Available reserves have increased during 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 2024, the city's latest projects reflect positive revenue and expenditure variances compared with the budget. Dallas balanced the adopted fiscal 2024 general fund budget, including funding for priorities related to economic development, park improvements, increased staffing, increased compensation, housing and homelessness solutions, public safety, and transportation and infrastructure. Key expenditure growth factors for the general fund include police and firefighter pay with overtime and increased fire staffing. The city projects key revenue factors as property tax and sales tax revenue, in-line with recent history.

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. However, it does not consistently meet the ADC, which we view as a credit weakness. Combined pension and OPEB contributions, as of fiscal 2023, are 14% of total governmental funds expenditures. Dallas provides benefits to employees primarily through two defined-benefit retirement plans: ERF, which is 54% funded, and DPFP, which is 34% funded. Combined unfunded pension liabilities total slightly more than \$6 billion as of Dec. 31, 2022.

Pension contribution rates are fixed by statute and are insufficient based on ADC rates. In fiscal 2023, the city paid 66% and 68% of the ADCs for ERF 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 \$208 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 come in many different forms, they will likely require additional city contributions, which could pressure budgetary performance or require offsetting expenditure reductions.

	Most recent	--Historical information--		
		2023	2022	2021
Strong economy				
Projected per capita effective buying income (EBI) (%) of U.S.	95.4			
Market value per capita (\$)	146,305	132,404		
Population			1,355,194	1,359,296
County unemployment rate(%)			3.7	
Market value (\$000)	198,272,091	179,433,592	155,938,192	
10 leading taxpayers as a % of taxable value	3.9			
Weak budgetary performance				
Operating fund result as a % of expenditures		(5.1)	(3.5)	(2.5)
Total governmental fund result as a % of expenditures		(1.2)	(6.1)	(3.8)
Very strong budgetary flexibility				
Available reserves as a % of operating expenditures		25.2	26.1	25.1
Total available reserves (\$000)		441,196	414,935	375,865
Very strong liquidity				
Total government cash % of governmental fund expenditures		79.0	77.7	65.9
Total government cash % of governmental fund debt service		540.0	393.6	329.8
Very strong management				
Financial Management Assessment	Strong			
Very weak debt and long-term liabilities				
Debt service as a % of governmental fund expenditures		14.8	19.7	20.0
Net direct debt as a % of governmental fund revenue	148.0			
Overall net debt as a % of market value	4.1			
Direct debt 10-year amortization (%)	57.0			
Required pension contribution as a % of governmental fund expenditures		13.9	13.7	
Other postemployment benefits actual contribution as a % of governmental fund expenditures			--	

Dallas--key credit metrics (cont.)

	<u>Most recent</u>	<u>--Historical information--</u>		
		2023	2022	2021
Strong Institutional Framework				

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
- 2023 Update Of Institutional Framework For U.S. Local Governments, Nov. 28, 2023
- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

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