Memorandum

CITY OF DALLAS

DATE October 29, 2021

TO Honorable Mayor and City Council

SUBJECT **Fitch Ratings Assigns 'AA' Rating and Stable Outlook for City of Dallas 2021 General Obligation Bonds – RATING ACTION**

On October 26, 2021, Fitch Ratings (Fitch) assigned its 'AA' credit rating and stable outlook to the anticipated General Obligation Refunding and Improvement Bonds, Series 2021, Combination Tax and Revenue Certificates of Obligation, Series 2021, and the Equipment Acquisition Contractual Obligations, Series 2021 (collectively, "the Bonds"), and affirmed the City's 'AA' credit rating and stable outlook on outstanding general obligation bonds. Fitch previously affirmed the City's rating on September 29, 2020.

According to the report, the City's 'AA' rating continues to reflect "strong revenue growth prospects, conservative budgeting practices, and solid reserve levels." Additionally, "reforms to both the city's civilian and public safety plans have had a positive effect on the city's long-term liability burden, and recent operating performance has been positive despite increased spending on both pensions and public safety salaries." In their analysis, Fitch again assigns 'aaa' grades to the Key Rating Drivers of Revenue Framework and Operating Performance, citing "strong post-pandemic revenue growth prospects," adding that the City's "healthy reserves position it to maintain the highest financial resilience through future cyclical downturns." The long-term liability burden is graded 'aa' as Fitch expects recent pension reforms "in conjunction with continued economic growth, to keep the long-term liability burden within the current range."

Fitch's current rating is again a credit positive for the City and supportive of market interest in the Bonds ahead of the planned November 2021 bond sale. Attached is the published rating report provided by Fitch for your review.

Please let me know if you need additional information.

for M. Elizabeth Reich
Chief Financial Officer

[Attachment]

c:
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Chris Caso, City Attorney
Mark Swann, City Auditor
Bilierae Johnson, City Secretary
Preston Robinson, Administrative Judge
Kimberly Bizor Tolbert, Chief of Staff to the City Manager
Majed A. Al-Ghafry, Assistant City Manager
Jon Fortune, Assistant City Manager
Joey Zapata, Assistant City Manager
Dr. Eric A. Johnson, Chief of Economic Development and Neighborhood Services
M. Elizabeth (Liz) Cedillo-Pereira, Chief of Equity and Inclusion
Directors and Assistant Directors

FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Dallas, TX $293MM LT Obligations 'AA'; Outlook Stable

Tue 26 Oct, 2021 - 5:20 PM ET

Fitch Ratings - Austin - 26 Oct 2021: Fitch Ratings has assigned a 'AA' rating to the following City of Dallas, TX obligations:

--$220.7 million general obligation (GO) refunding and improvement bonds, series 2021;

--$45.6 million combination tax and revenue certificates of obligation (COs), series 2021;

--$27.03 million equipment acquisition contractual obligations, series 2021.

All three series are scheduled for a competitive sale on Nov. 4. The series 2021 GO bond proceeds will finance infrastructure improvements and refund outstanding tax-supported debt; series 2021 CO proceeds will finance certain public works improvements; series 2021 contractual obligation proceeds will finance the acquisition of various departmental equipment.

Fitch also has affirmed the following Dallas ratings:

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

--$1.96 billion of outstanding limited tax (LT) debt at 'AA'.

The Rating Outlook is Stable.

SECURITY

GOs, COs and Contractual Obligations: 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 limited tax bond ratings reflect strong revenue growth prospects, conservative budgeting practices, and solid reserve levels. Reforms to both the city's civilian and public safety plans have had a positive effect on the city's long-term liability burden, and 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 rebuild police staffing levels and continues with increasing pension contributions. Fitch expects these pressures 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; it also ranks among the top visitor and leisure destinations in the state.

KEY RATING DRIVERS

Revenue Framework: 'aaa'

Strong post-pandemic revenue growth prospects are based on expectations for continued economic expansion. The assessment also reflects the city's diminished, though still high, independent legal ability to increase ad valorem revenues as a result of recently approved state legislation effective in fiscal 2021.

Expenditure Framework: 'a'

The city's pace of spending is expected to be generally in line with revenue growth given its mature residential base. Increased pension contributions will keep carrying costs at an elevated level. 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 13% of personal income. Recent pension reforms to both the civilian and uniform plans have reduced the combined total liability by roughly 40%. Fitch expects these reforms, in conjunction with continued economic growth, 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 cyclical downturns. Elevated debt and retiree benefit outlays will maintain some pressure on the city's budget management practices.

RATING SENSITIVITIES

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

--Continued positive operating performance and successful absorption of additional public safety-related spending.

--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.

--A sustained decline in the long-term liability burden to less than 10% of personal income.

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

--Failure to consistently fund annual pension contributions at the actuarially determined levels.

--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

City Budgetary Update

Fiscal 2020 (FYE Sept. 30) general fund results bettered earlier projections, with sales tax and property tax revenues both outperforming mid-year estimates. Expense growth was held below budget in anticipation of expected weaker revenue gains, and the resulting $47 million surplus after transfers easily exceeded earlier break-even expectations.

The fiscal 2021 general fund budget as adopted was balanced and anticipated revenue of $1.437 billion, unchanged from the fiscal 2020 budget (reimbursements and transfers added another $118 million to total resources). Sales tax receipts were budgeted at $296 million, or nearly 10% below the prior year budget (later amended to $305 million). Property tax revenues were budgeted at $825 million, up 5% from fiscal 2020 due to a comparable increase in TAV. General fund spending was slated to increase $28 million (1.8%) from fiscal 2020 to $1.56 billion. Management cited additional police hiring and increased public safety pension contributions as the primary spending drivers.

Current fiscal 2021 projections include sales tax revenues (22% of general fund revenues) of $336 million, up 8% from last year and 10% above the amended budget. Projected total general fund revenues of $1.478 billion are up 2% over amended budget and spending of $1.456 billion is up less than 1% over budget. Year-end fund balance is projected by management to increase more than $35 million. The fiscal 2022 general fund budget is balanced and includes revenues and spending both up 6% over the fiscal 2021 budget. Sales tax receipts are budgeted at $344 million, up 13% over the prior year amended budget

Dallas is slated to receive a total of $355.4 million from the American Rescue Plan Act. Management reports allocations of the assistance is targeted to these four areas: fiscal recovery/revenue loss at $131.5 million, infrastructure at $116.7 million, health and safety at $63.2 million, and economic development at $44 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, real estate, manufacturing, insurance and healthcare industries, and the tax base has no significant concentration. Fitch expects the underlying strength, size and diversity of Dallas' economy will support the city through periodic economic downturns.

Revenue Framework

General fund operations are supported by a diverse mix of revenues led by ad valorem tax revenues (55% of the fiscal 2020 total), sales tax revenues (24%), and franchise fees (9%).

The city's post-pandemic revenue growth prospects remain strong due to the current pace of economic activity.

The city's fiscal 2022 total tax rate of $0.7733 per $100 of TAV is down modestly from the prior year and is well below the constitutional and city charter caps of $2.50. However, the recently enacted Texas Senate Bill 2 (SB 2) makes a number of changes to local governments' property tax rate setting process. SB 2 will reduce the rollback tax rate (now the 'voter approval tax rate') from 8% to 3.5% for most local taxing units and require a ratification election (replacing the current petition process) if any local taxing unit exceeds its voter approval rate, effective fiscal 2021. The revenue cap does not apply to debt service tax levies.

The tax rate limitation in SB2 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 2020 general fund outlays), followed by general government (12%) 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 generally track what is projected to be a positive trajectory in revenues, 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.

Recent pension reforms have somewhat reduced required contribution amounts, but the city's annual carrying costs (debt service, actuarially determined pension contributions, actual OPEB outlays) remain elevated at 27% of fiscal 2020 governmental spending. Fitch expects actual carrying costs to remain high, the result of both increased pension contributions to the police and fire plan and debt service associated with a $1.05 billion GO bond authorization approved by voters in 2017. 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 reflect an above average 68% debt amortization rate over the next 10 years, which lessens both the concern regarding the relatively high costs and the burden associated with new debt (debt service was equivalent to nearly 14% of fiscal 2020 governmental spending). 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 13% of personal income, with about 45% of the total attributable to unfunded pension liabilities. The liability calculation is adjusted by Fitch to assume a more conservative 6% investment return. The overall burden is down from roughly 19% of personal income recently as a result of the various pension reforms. The city currently has roughly $2.2 billion in limited tax debt outstanding (including these offerings), about 20% of the total long-term liability burden. Overlapping debt of $4.0 billion comprises the remainder of the liability (35% 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.

Changes to the ERF benefit plan were approved by the ERF board, city council and voters in 2016. They apply to employees hired on or after Jan. 1, 2017 and include an increase in the normal retirement age from 60 to 65, an increase in service retirement from 30 to 40 years, elimination of the health benefit supplement, and a reduction in the benefit multiplier from 2.75% to 2.5%. These changes are expected to boost to the long-term viability of the plan.

Following a steady weakening of the DPFP plan, primarily due to issues associated with the deferred retirement option program (DROP) feature, the Texas Legislature in its 2017 regular session approved legislation that made a number of noteworthy changes to the DPFP plan. The modifications included increases in retirement ages for the various tiers of employees, a reduction in the benefit multiplier for most employees and elimination of the current COLA benefit.

The legislation also made changes to the troubled DROP, including a 10-year limitation on participation, elimination of interest on DROP accounts after Sept. 1, 2017, and modifications to DROP account distribution options. The legislation also called for increased plan contributions from both the city and employees. These reforms should stabilize the city's obligations to the plan and reduce the risks presented by the DROP feature of the retirement plan, and should enhance the plan's long-term viability.

The combined net pension liability (NPL) for all three plans as reported in the city's fiscal 2020 CAFR totaled $4.7 billion, with assets covering 55% of liabilities. The NPL increases to $5.2 billion and the ratio of assets to liabilities declines to 52% when a 6% investment return assumption is used.

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

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

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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

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US Public Finance   Infrastructure and Project Finance   North America   United States

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