Memorandum

CITY OF DALLAS

DATE August 16, 2022

TO Honorable Mayor and Members of the City Council

SUBJECT **Moody's Investors Service Releases Update to Credit Analysis of City's 'A1' (Stable) Rating - INFORMATION**

Yesterday, Moody's Investors Service (Moody's) released a credit opinion in an update to the credit analysis of the City's 'A1' rating. The outlook is stable. Moody's last affirmed the rating and outlook on July 29, 2021 in an update to the credit of the City. According to the current Moody's report, the credit profile of the City "benefits from a very strong and diverse economy that continues to grow despite the pandemic. Management's conservative budgeting and revenue growth have contributed to healthy operating reserves that have increased annually for the past several years. The growing tax base has allowed the debt burden to remain stable as the city continues to invest in infrastructure." The stable outlook "reflects the expectation that conservative financial management and growing operating revenue will lead to stable reserves, and that the tax base will continue to expand because of the strong economy."

Moody's also identifies certain credit challenges of the City, including "longer term budgetary pressures deriving from rising pension costs, coupled with maintenance of city services and continued infrastructure investment," and an "elevated pension burden expected to increase due to weak annual contributions and investment returns." However, Moody's reports that the City, "posted another strong general fund surplus in fiscal 2021 (Sept. 30 year-end) due largely to conservative budgeting and strong sales tax receipts." Additionally, "results seven months into fiscal 2022 show sales tax revenue is outperforming the budget and the city has savings in salaries from vacant positions," resulting in a projected "modest general fund surplus at fiscal year-end."

While Moody's update is not a rating action on the City, their report is a testament to the fiscal stewardship and leadership of the City and a positive reflection of the credit ahead of budget adoption and planned debt issuance. Attached is the published report for your review. Please let me know if you need additional information.

Jack Ireland
Chief Financial Officer

[Attachment]

c:
T.C. Broadnax, City Manager
Chris Caso, City Attorney
Mark Swann, City Auditor
Bilierae Johnson, City Secretary
Preston Robinson, Administrative Judge
Kimberly Bizor 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
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MOODY'S
INVESTORS SERVICE

CREDIT OPINION
15 August 2022

Send Your Feedback

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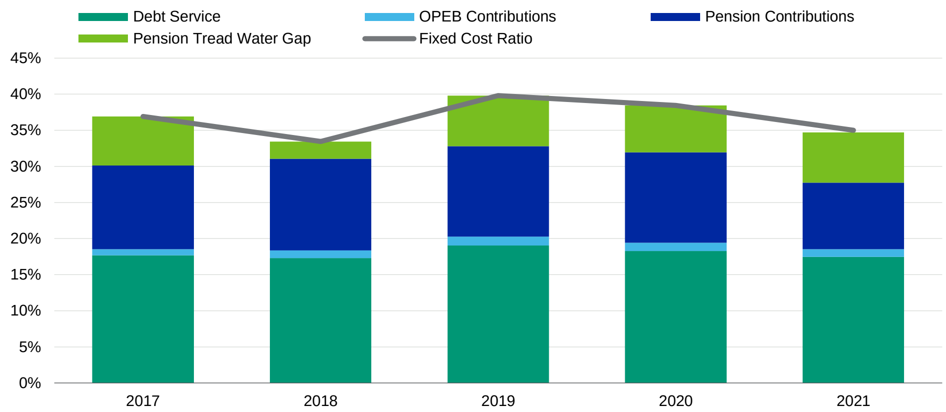
Dallas (City of) TX

Update to credit analysis

Summary

The City of Dallas, TX's (A1 stable) credit profile benefits from a very strong and diverse economy that continues to grow despite the pandemic. Management's conservative budgeting and revenue growth have contributed to healthy operating reserves that have increased annually for the past several years. The growing tax base has allowed the debt burden to remain stable as the city continues to invest in infrastructure. The primary and continuing challenge to the credit profile is the unfunded pension liability that will continue to grow because caps to contributions remain below a "tread water" level that would prevent the liability from growing, while investment returns lag plan targets.

Exhibit 1
Fixed costs remain high



Pension tread water gap is estimated for fiscal 2021
Source: Dallas (City of) TX's financial statements and Moody's Investors Service

Credit strengths

» Large, rapidly growing and diverse tax base that anchors the Dallas / Fort Worth (Aa3 stable) metroplex

» Continued annual surpluses have increased operating reserves to healthy levels

» Legal flexibility to further adjust pension benefits for current employees on a prospective basis

Credit challenges

» Longer term budgetary pressures deriving from rising pension costs, coupled with maintenance of city services and continued infrastructure investment

» Elevated pension burden expected to increase because of weak annual contributions and investment returns

Rating outlook

The stable outlook reflects the expectation that conservative financial management and growing operating revenue will lead to stable reserves, and that the tax base will continue to expand because of the strong economy. The outlook also considers pension contributions that should remain manageable in the near-term, but over the longer term the liability and annual costs are projected to grow.

Factors that could lead to an upgrade

» Material reduction in the Moody's Adjusted Net Pension Liability (ANPL) relative to operating revenue

» Demonstrated balanced operations inclusive of pension funding at actuarially determined levels

Factors that could lead to a downgrade

» Trend of declining operating reserves

» Trend of pension asset accumulation that lags targets; increases to the ANPL and weakened annual contributions

» Significant increase to the debt burden

Key indicators

Exhibit 2

Dallas (City of) TX

	2017	2018	2019	2020	2021
Economy/Tax Base					
Total Full Value ($000)	$110,387,629	$118,314,678	$130,080,986	$140,237,632	$147,443,518
Population	1,300,122	1,318,806	1,330,612	1,338,846	1,338,846
Full Value Per Capita	$84,906	$89,713	$97,760	$104,745	$110,127
Median Family Income (% of US Median)	72.3%	73.7%	74.9%	76.0%	76.0%
Finances					
Operating Revenue ($000)	$1,441,984	$1,506,713	$1,583,747	$1,606,195	$1,724,541
Fund Balance ($000)	$224,582	$263,690	$285,100	$367,076	$377,865
Cash Balance ($000)	$215,589	$245,393	$311,602	$373,966	$454,545
Fund Balance as a % of Revenues	15.6%	17.5%	18.0%	22.9%	21.9%
Cash Balance as a % of Revenues	15.0%	16.3%	19.7%	23.3%	26.4%
Debt/Pensions					
Net Direct Debt ($000)	$1,804,061	$2,057,083	$2,306,237	$2,403,401	$2,393,769
3-Year Average of Moody's ANPL ($000)	$8,047,975	$7,752,987	$7,191,402	$7,064,657	$8,044,710
Net Direct Debt / Full Value (%)	1.6%	1.7%	1.8%	1.7%	1.6%
Net Direct Debt / Operating Revenues (x)	1.3x	1.4x	1.5x	1.5x	1.4x
Moody's - ANPL (3-yr average) to Full Value (%)	7.3%	6.6%	5.5%	5.0%	5.5%
Moody's - ANPL (3-yr average) to Revenues (x)	5.6x	5.1x	4.5x	4.4x	4.7x

Sources: US Census Bureau, Dallas (City of) TX's financial statements and Moody's Investors Service

Profile

Dallas is the ninth largest city in the US and the third largest in Texas (Aaa stable) behind Houston (Aa3 stable) and San Antonio (Aaa stable). The city serves as the anchor to the Dallas-Fort Worth metroplex. The current population is approximately 1.3 million.

Detailed credit considerations

Economy and tax base

Dallas' robust economy is a strength of the credit profile and it will continue to expand as new businesses move into the area, leading to population growth and housing demand. Fiscal 2022 assessed value increased to $155.9 billion and preliminary fiscal 2023 values reflect further strong growth. Certified taxable values have increased an average of 7% annually for the past five years and while we expect the growth to continue, it could moderate over the near term if the housing market and property value appreciation cool down. Residential property comprises about 45.4% of taxable assessed value.

The unemployment rate has declined considerably since 2020 and was 3.4% in April, which is on par with the nation's 3.3% and below the state's 3.7%. Goldman Sachs Group, Inc. (A2) will expand its presence in the metro and open an office north of downtown. By 2028, the firm expects to add 5,000 high-paying jobs. The city approved tax abatements for this project.

Financial operations and reserves

The city budgets and manages its finances conservatively, posting general fund surpluses for the past several years that have driven healthy reserves. While we expect this trend will continue over the near term, the positive financial results are somewhat muted by persistent annual underfunding of pension plans, which is due to statutory and local ordinance caps on contributions. Longer term, the financial position will be challenged by balancing increasing pension and public safety expenses, as well as general costs of services.

The city posted another strong general fund surplus in fiscal 2021 (Sept. 30 year-end) due largely to conservative budgeting and strong sales tax receipts. Available general fund balance increased to $377.9 million or 25.9% of revenue. The city receives most of its general fund revenue from property taxes (54% in fiscal 2021) and sales taxes (25%). When including the debt service fund, available operating fund balance was 21.9% of combined revenue.

Results seven months into fiscal 2022 show sales tax revenue is outperforming the budget and the city has savings in salaries from vacant positions. This is helping to offset underperformance in fines and forfeitures and traffic fees as well as an overage in expenses for public safety overtime and temporary staffing. The city is projecting a modest general fund surplus at fiscal year-end.

Liquidity

Cash will remain healthy and in line with fund balance. The fiscal 2021 general fund cash position was $385.5 million or 26.4% of general fund revenue. When also including the debt service fund, the combined the operating fund cash position was $454.5 million or 26.4% of operating revenue.

Debt and pensions

Balance sheet leverage is high because of the pension burden; the debt burden remains stable and moderately-low and the unfunded OPEB liability is modest. The outstanding debt and unfunded retirement benefit liabilities (using our adjustments to pension and OPEB) total a significant 711% of operating revenue and 8.3% of full value as of fiscal 2021.

The debt burden has been stable despite annual bond issuances because of strong tax base growth and it is expected to remain around 2%. In November 2017, voters approved a $1.05 billion bond package to invest in city roads and other public infrastructure, which the city has been issuing in phases. Of this, $522.5 million remains unissued.

Fixed costs, which include debt service, pension and OPEB contributions, totaled a high 27.7% of fiscal 2021 operating revenue. If the city were to increase its pension contributions to prevent the unfunded liability from growing (pursuant to reported assumptions), fixed costs would increase to about 35% of operating revenue.

Legal security

The general obligation limited tax bonds constitute direct and general obligations of the city, payable from the levy and collection of a direct and continuing annual ad valorem tax, within the limits prescribed by law, on all taxable property located within the city.

Debt structure

All general obligation bonds are fixed rate and about 74% of the outstanding principal matures within 10 years.

Debt-related derivatives

The city is not a party to any derivative agreements.

Pensions and OPEB

The unfunded pension liability remains high and is a key constraining factor to the credit profile. Further, additional contributions and/or benefit reforms will likely be needed to the Dallas Police and Fire Plan (DPFP) and the Employees' Retirement Fund (ERF) plan to maintain their solvency. Year-to-date returns in 2022 are negative for both plans.

The ERF plan is projecting depletion in 2058. For the plan to remain solvent and amortize the unfunded liability, asset returns would need to exceed targets, absent increases to contributions or further benefit changes. The plan is governed by local ordinance and increases to contributions would need to be approved by voters.

The DPFP plan remains poorly funded and is not projected to reach full funding for several decades. The plan has negative noninvestment cash flow, which heightens the importance of the plan achieving its return targets in the near-term. But achieving targeted returns are challenged because the plan remains heavily invested in illiquid assets. The accumulation of assets is also dependent on higher near-term contributions tied to payroll targets. Deviation from these key targets will likely require further benefit changes and/or higher contributions.

DPFP recently lost its appeal for restitution against The Townsend Group, the plan's former real estate investment manager. The DPFP sued Townsend in 2017, accusing the advisory firm of poor investment management that cost the plan over $1 billion in losses. The suit also named DPFP's former attorney as a defendant.

The city's adjusted net pension liability (ANPL), reflective of all three of the city's single-employer plans[1] increased to $9.6 billion in fiscal 2021, which is equal to a high 5.6x operating revenue. The ANPL was based on a discount rate of 2.52%. The ANPL is likely to continue to increase because contributions are not sufficient to prevent the unfunded liability from growing, even if all reported assumptions are met, including the assumed rates of return for both plans.

Exhibit 3

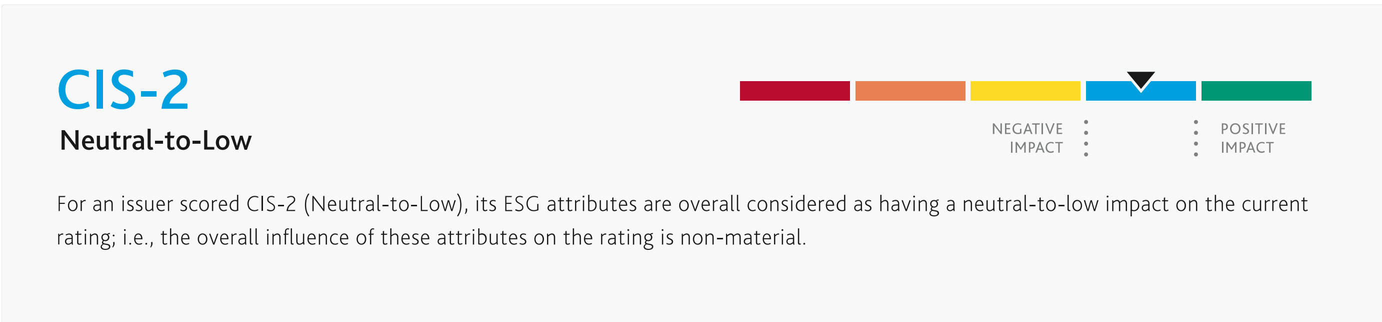
2021	$$$ (000)	% of Operating Revenues	Discount Rate
Operating Revenue	1,724,541	n/a	n/a
Reported Unfunded Pension Liability	4,861,147	282%	5.95%
Moody's Adjusted Net Pension Liability	9,619,243	558%	2.52%
Reported Net OPEB Liability	266,160	15%	2.19%
Moody's Adjusted Net OPEB Liability	252,736	15%	2.87%
Net Direct Debt	2,393,769	139%	n/a
Debt & unfunded retirement benefits (Moody's adjusted)	12,265,748	711.25%	
Pension Contribution	158,587	9.20%	n/a
OPEB Contribution	18,373	1.07%	n/a
Debt Service	301,222	17.47%	n/a
Total Fixed Costs	478,182	27.73%	n/a

The ANPL is an aggregate of DPFP and ERF; ERF is net of enterprise support. The discount rate for the reported unfunded liabilities is blended for the plans. DPFP assumes 6.5% and ERF assumes 7.25%. Given the ERF depletion projection, the single-equivalent discount rate as reported in the 2021 audit was 5.27%.
Source: Dallas (City of) TX's financial statements and Moody's Investors Service

ESG considerations

DALLAS (CITY OF) TX's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 4
ESG Credit Impact Score



Source: Moody's Investors Service

The City of Dallas' ESG Credit Impact Score is neutral-to-low (**CIS-2**), reflecting low exposure to environmental risks, low exposure to social risks, and good governance.

Exhibit 5
ESG Issuer Profile Scores

Source: Moody's Investors Service

Environmental

Dallas' E issuer profile score is neutral-to-low (**E-2**), reflecting relatively low exposure to environmental risks across all categories, including physical climate risk, carbon transition, natural resources management, and waste and pollution. Of the physical climate risks Moody's ESG Solutions evaluates, Dallas has medium exposure to heat stress, water stress and extreme rainfall. The city maintains robust water, wastewater and stormwater capital improvement, water sourcing and conservation plans to manage these risks, which are expected to materialize over the long term.

Social

We assess the S issuer profile score as neutral-to-low (**S-2**), reflecting relatively low exposure to social risks across all categories, including demographics, labor and income, education, housing, health and safety, and access to basic services. Demographic trends have been strong, though income levels are below the US median, similar to other large urban centers. Health and safety and access to basic services are positive in the area, and exposure to labor and income, education and housing risks are neutral to low.

Governance

Dallas' G issuer profile score is neutral-to-low (**G-2**), reflecting solid institutional structure and the city's strong commitment to transparency and disclosure reflected in monthly financial reporting and timely filing of audited financial statements and other disclosures. Budget management is sound as evidenced in outcomes that are favorable compared to expectations. The city also maintains long-term financial forecasting and capital planning, and has demonstrated policy credibility and effectiveness. Although management of the city's two defined benefit pension plans has led to very high unfunded liabilities, the city has the legal ability to enact additional reform to prevent further leveraging and rising fixed costs.

Rating methodology and scorecard factors

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 6

Scorecard Factors and Subfactors	Measure	Score
Economy/Tax Base (30%) [1]		
Tax Base Size: Full Value (in 000s)	$155,938,192	Aaa
Full Value Per Capita	$116,472	Aa
Median Family Income (% of US Median)	76.1%	A
Notching Factors:[2]		
Regional Economic Center		Up
Finances (30%)		
Fund Balance as a % of Revenues	21.9%	Aa
5-Year Dollar Change in Fund Balance as % of Revenues	11.5%	Aa
Cash Balance as a % of Revenues	26.4%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	15.5%	Aa
Notching Factors:[2]		
Other Scorecard Adjustment Related to Finances: treadwater gap		Down
Management (20%)		
Institutional Framework	Aa	Aa
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures	1.0x	Aa
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	1.5%	Aa
Net Direct Debt / Operating Revenues (x)	1.4x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	5.2%	Baa
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	4.7x	Baa
Notching Factors:[2]		
Unusually Strong or Weak Security Features		Up
Other Scorecard Adjustment Related to Debt/Pensions		Down
	Scorecard-Indicated Outcome	A1
	Assigned Rating	A1

[1] Economy measures are based on data from the most recent year available.
[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology.
[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs publication.
Source: US Census Bureau, Dallas (City of) TX's financial statements and Moody's Investors Service

Endnotes

1 The city participates in three single-employer systems: the Employees' Retirement Fund (ERF), Dallas Police and Fire Plan (DPFP), and the Supplemental Police and Fire Plan. Contribution rates for the systems are set by ordinance or statutes, and the ERF and DPFP are each managed by separate boards. In 2017 the city, DPFP, and the state were able to come to an agreement around pension reform; HB 3158 implemented sweeping changes to the DPFP plan, including reduced prospective pension benefits for current and future employees, significant reductions to DROP including time limits to participation, ceased lump-sum withdrawals and elimination of guaranteed interest, increased statutorily required contributions from the city and the membership, and governance changes. ERF also implemented changes in 2017, with the approval by the city council and voters in November 2016 to create a new tier of reduced pension benefits for new employees hired on or after Jan. 1, 2017. The new tier reduces the normal cost and the pace at which pension liabilities are accrued.

REPORT NUMBER 1337025

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

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