Memorandum

CITY OF DALLAS

DATE July 2, 2018

TO Honorable Mayor and Council Members

SUBJECT **Standard and Poor's Global Ratings Affirmed Rating and Outlook for City of Dallas Outstanding General Obligation and Raised Convention Center Hotel Development Corporation Debt Rating and Downtown Dallas Development Authority Rating - INFORMATION**

I am pleased to report that today, Standard and Poor's Global Ratings (S&P) affirmed the City's AA- credit rating and stable outlook for General Obligation debt. At the same time, S&P upgraded both the Dallas Convention Center Hotel Development Corporation's rating to 'A' from 'A-' and the Downtown Dallas Development Authority (DDDA) to 'A+' from 'A.' Both outlooks are stable. These are positive actions that continue to contribute to investor confidence in the City of Dallas.

S&P states the affirmed rating and outlook for the General Obligation debt reflects the agency's view of the City's "very strong management, with 'strong' financial policies and practices," and a "strong economy, with access to a broad and diverse metropolitan statistical area." As a major economic hub, the City continues to benefit from new developments, solid growth trends, and a prudently forecast growth assumption.

S&P also raised the Dallas Convention Center Hotel Development Corporation's moral obligation rating, "based on the strength of the moral obligation of the City of Dallas, given Dallas' city council-adopted grant program resolution, in which council will consider making grants or loans from the city's general fund to the issuer, should the pledged revenues be insufficient to service the corporation's debt," and the DDDA's moral obligation rating based on "continued positive growth and strength within the reinvestment zone and tax increments collected within," as well as "improved debt service coverage by pledged revenues as well as a declining volatility ratio."

The City of Dallas is economically strong, fiscally stable, and a good investment. I look forward to continuing to work with all ratings agencies on future ratings actions, and am confident that we have a positive story to share.

DATE July 2, 2018

SUBJECT Standard and Poor's Global Ratings Affirmed Rating and Outlook for City of Dallas Outstanding General Obligation and Raised Convention Center Hotel Development Corp. Debt Rating and Downtown Dallas Development Authority Rating - INFORMATION

Please let me know if you need additional information.

M. Elizabeth Reich

M. Elizabeth Reich
Chief Financial Officer

[Attachment]

c: T.C. Broadnax, City Manager
Larry Casto, City Attorney
Craig D. Kinton, City Auditor
Bilierae Johnson, City Secretary
Daniel F. Solis, 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
Nadia Chandler Hardy, Chief of Community Services
Raquel Favela, Chief of Economic Development & Neighborhood Services
Theresa O'Donnell, Chief of Resilience
Directors and Assistant Directors

S&P Global
Ratings

RatingsDirect®

Summary:

Dallas, Texas; General Obligation

Primary Credit Analyst:
Andy A Hobbs, Dallas + 1 (972) 367 3345; Andy.Hobbs@spglobal.com

Secondary Contact:
Kristin Button, Dallas (1) 214-765-5862; kristin.button@spglobal.com

Table Of Contents

Summary:

Dallas, Texas; General Obligation

Credit Profile		
US$55.275 mil GO rfdg bnds ser 2018 due 02/15/2038		
Long Term Rating	AA-/Stable	New
Dallas GO		
Long Term Rating	AA-/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA-' rating to the City of Dallas' series 2018 general obligation (GO) refunding bonds. At the same time, S&P Global Ratings affirmed its 'AA-' long-term and underlying ratings on Dallas' GO bonds. The outlook is stable.

The series 2018 bonds are secured by a direct and continuing ad valorem tax, within the limits prescribed by law, on all taxable property within the city in an amount sufficient to provide for payment of principal and interest on the bonds. Dallas' ad valorem tax pledge, within the limits prescribed by law, secures the GO bonds. The Texas maximum for city tax rates is $2.50 per $100 of assessed value (AV); the city is currently levying 78.04 cents per $100 of AV, which is well under the state cap. Given the remaining tax flexibility coupled with the city's rating level, we are rating the limited-tax GO debt on par with our rating on the city's GO debt.

Proceeds from the series 2018 bonds will finance payments to plaintiffs under the terms of a written settlement agreement as incorporated in judgments entered by the 199th Judicial District Court in Collin County.

The 'AA-' ratings reflect our view of the city's:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with "strong" financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Weak budgetary performance, with an operating surplus in the general fund but an operating deficit at the total governmental fund level in fiscal 2017 that was heavily influenced by underfunding of the actuarially determined contribution for pensions;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2017 of 18% of operating expenditures;
- Very strong liquidity, with total government available cash at 48.4% of total governmental fund expenditures and 3.2x governmental debt service, and access to external liquidity we consider exceptional;
- Very weak debt and contingent liability profile, with debt service carrying charges at 15.1% of expenditures and net direct debt that is 174.5% of total governmental fund revenue, as well as a large pension and other postemployment benefit (OPEB) obligation; and
- Strong institutional framework score.

Strong economy

We consider Dallas' economy strong. The city, with an estimated population of 1.3 million, is located in Collin, Dallas, Denton, and Rockwall counties in the Dallas-Fort Worth-Arlington, MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 97.2% of the national level and per capita market value of $89,673. Overall, the city's market value grew by 6.6% over the past year to $117.9 billion in 2018. The weight-averaged unemployment rate of the counties was 3.8% in 2017.

Dallas is a major economic hub in the southern and central part of the country. The city benefits from its status as the center of the Dallas-Fort Worth MSA and the broad and diverse economy that surrounds it. Dallas and the greater metropolitan area continue to be a desirable location for new business as well as recent relocations of corporate headquarters. The strong economy is represented in solid annual growth in market value since 2011. Dallas is home to 22 Fortune 500 companies, 3,489 company headquarters, and 242 Class A office buildings. Twenty-seven percent of all hotel rooms in the metroplex are in the city, as it is one of the nation's top convention destinations. It also benefits from two major airports (Dallas-Fort Worth International Airport and Dallas Love Field) that are home to two large carriers, American Airlines and Southwest Airlines.

Recent new developments in the city include a $50 million investment from Vistaprint, which will build a logistics facility in southern Dallas with an estimated 600 new jobs. Smoothie King and JetSuite recently moved their headquarters to Dallas. Also, RedBird Mall, a largely vacant shopping mall in southern Dallas, is being renovated into a mixed-use facility with hotel, apartment, office, entertainment, retail, and park uses.

Despite solid growth trends, the city prudently forecast a growth assumption of 7.22% for fiscal 2019 in the second year of the biennial budget. The city estimates market value growth of about 9% for fiscal 2019. It updated its growth projections for use in the next budget recommendation to the city council. Dallas conservatively plans to use a modestly declining annual market value growth assumption over the next five years. New development and solid market value growth should help sustain financial stability in the near term, which contributes to the outlook.

Very strong management

We view the city's management as very strong, with "strong" financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Dallas uses multi-year trends of certified property tax values, historical sales tax revenue trends, and other revenue stream data, as well as outside sources to formulate the budget. Management provides monthly reports to city council and produces a year-end report that reflects expenditures concurrently with publishing a comprehensive annual financial report. City council can amend the budget at any time. City staff prepares and presents long-range financial forecasts for both the general and debt service funds, and presents them to council during the budget development process or during bond program development. Council does not formally adopt these forecasts, but uses them as a financial planning tool in policy deliberations. The city maintains an inventory of capital needs that is updated annually. A formal facility condition assessment was conducted and presented to council in 2016. The assessment is being used to better plan for long-term maintenance and replacement needs. Dallas has historically used a multi-year capital bond program to fund infrastructure improvements. Management also reports investment results quarterly to council, and it reviews the investment policy annually. The city's financial management performance criteria (FMPC) establishes guidelines and targets for operating programs and cash-and-debt management, including minimum reserves, debt ratios, and restrictions on debt use and issuance. The FMPC is part of the budget development process, at year-end, and is part of GO bond program development. The city has also developed Dallas 365, which is composed of 35 performance measures organized by six key strategic priorities.

Weak budgetary performance

Dallas' budgetary performance is weak, in our opinion. The city had surplus operating results in the general fund of 3.3% of expenditures, but a deficit result across all governmental funds of 2.6% in fiscal 2017. Our weakening view of Dallas' budgetary performance is significantly impacted by the analytical adjustment related to the city's underfunding of the actuarially determined contribution (ADC) for its pension plans (roughly $112 million in 2017). Net of the adjustment the city's budgetary performance would significantly improve. Given the recent changes to the city's pension plans and contributions to the plans, we anticipate that contributions will improve and the underfunding of the ADC will not have as negative of an impact on the budgetary performance going forward.

Stable budgetary performance in 2017 was aided by growing general fund revenues, including property taxes at $578 million (or 48% of total general fund revenues) and sales taxes at $295 million (25%). General fund expenditures at $1.16 billion included $712 million for public safety. At fiscal year-end (Sept. 30), general fund revenues exceeded budget by $1.5 million while general fund expenditures fell below budget by $14.6 million, resulting in a net excess of revenues over expenditures of $16.1 million prior to our adjustments for transfers.

Budgetary performance in 2018 has remained relatively stable. Year-to-date revenues are trending $8.4 million above budget while expenditures are favorably trending $3 million below budget. Property and sales tax collections are both expected to exceed budget modestly. In February, Dallas Fire Rescue expenditures were forecast to be $4.2 million over budget, primarily caused by increased overtime because of higher-than-expected attrition. The fiscal 2018 budget was amended by city council ordinance on April 25, 2018 by $3.7 million from excess revenue to account for the increase in expenditures. Taken into consideration in the city's performance was the full cost of its actuarially determined contribution (ADC) for pension costs. Historically the city has not contributed 100% of the ADC to the employee retirement plan as well as the police and fire plan. As a result, to better reflect ongoing budgetary performance, we added back the deferred amount of the ADC to the total governmental fund expenditures, which was $30.5 million and $81.8 million, respectively, for fiscal 2017. We anticipate with recent plan changes and increases in contributions that the city will move significantly closer to the ADC with regard to contributions for the fiscal 2018 year.

Dallas' total tax rate was reduced slightly when compared with previous years. The current rate of 78.04 cents per $100 of AV is a modest decline from fiscal 2016. The city's total tax rate is well below the state maximum for cities of more than 5,000, at $2.50 per $100 of AV. City council could elect to reduce the city's total tax rate in the near term based on solid market value growth. If a reduction is realized, we expect that it will be modest. Stable market value growth and forecast growth in revenues will support the city's 2019 budget, which is expected to be adopted Sept. 19. There are no significant one-time expenditures expected in the budget or draw-down of reserves. Given historical modest positive budget variances, we anticipate stable budgetary performance in the near term.

Very strong budgetary flexibility

Dallas' budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2017 of 18% of operating expenditures, or $210.7 million.

The city's fiscal 2017 year-end available reserve balance exceeds its financial policy requirement of 40 days of general fund operating expenditures. Dallas' available reserve position continues to grow, which is a credit positive. Based on current financial trends, we anticipate the city's available reserve will remain stable in the near term.

Very strong liquidity

In our opinion, Dallas' liquidity is very strong, with total government available cash at 48.4% of total governmental fund expenditures and 3.2x governmental debt service in 2017. In our view, the city has exceptional access to external liquidity if necessary.

The city's liquid and non-restricted investments are available in less than a year and are in highly rated investment pools such as the Local Government Investment Cooperative and Texas Local Government Investment Pool, and TexSTAR. While the city has pledged moral obligation support for the convention center hotel bonds (series 2009A, 2009B, and 2009C), Downtown Dallas Development Authority tax-increment financing bonds (series 2006 and 2007), and civic center operational insufficiencies, we do not view it as likely that it will need to support these in the near-to-medium term. The fiscal 2017 debt service costs of these obligations amount to about 2.5% of Dallas' operating revenues for fiscal 2017. Supporting our view is the city's exceptional access to external liquidity based on frequent bond issuances, secured by various revenue streams, over the past 15 years.

Very weak debt and contingent liability profile

In our view, Dallas' debt and contingent liability profile is very weak. Total governmental fund debt service is 15.1% of total governmental fund expenditures, and net direct debt is 174.5% of total governmental fund revenue.

The current debt issue is to address settlements of four lawsuits by former police officers and firefighters in Collin County over the language of a 1979 pay referendum. In addition, on June 27, the City Council approved $173.3 million to settle two class-action lawsuits in Rockwall County related to the same 1979 pay referendum. . These settlements, while not finalized, will end a dispute that has been ongoing for more than 20 years. It is anticipated the city's payments will likely be addressed through a long-term obligation.

We expect Dallas will continue to issue bonds for general infrastructure improvements should AV growth support such issuances. In November 2017, voters approved a $1.05 billion bond authorization package that included 10 different propositions for various projects and upgrades throughout the city, including over $500 million for streets and transportation, over $260 million for parks and recreation, and the remainder for Fair Park, flood control, public safety facilities, city facilities, and cultural arts.

The city has a contingent liability to make up any shortfalls in debt service coverage for both the Dallas Convention Center Hotel revenue bonds and the Downtown Dallas tax increment revenue bonds. However, based on revenue trends and coverage for both bonds, general fund support is not expected in the near term. Management does not foresee a need to support the operations for the convention center in the near term. The city also maintains a commercial paper program through JPMorgan Chase Bank N.A. The notes have a total program authorization of $350 million. Liquidity support is provided by JPMorgan Chase Bank N.A. through a revolving credit agreement, which extends to Dec. 2, 2020. The term of the notes shall not exceed 270 days after issuance, with a maximum maturity date of Dec. 2, 2020. The city has no commercial paper outstanding.

In our opinion, a credit weakness is Dallas' large pension and OPEB obligation. We also note a significant amount of positive changes have taken place in the recent past with regards to the funding of the city's pension plans. Dallas' combined required pension and actual OPEB contributions totaled 17.9% of total governmental fund expenditures in 2017. Of that amount, 17.0% represented required contributions to pension obligations, and 0.9% represented OPEB payments. The city made 62% of its annual required pension contribution in 2017. The funded ratio of the largest pension plan is 25.5%.

Dallas provides pension benefits to its employees via three separate retirement plans: the Employees Retirement System , the Dallas Police and Fire Pension System (DPFP), and the Supplemental Police and Fire Pension Plan of the City of Dallas. The ERF is for all eligible employees, excluding firefighters and police officers. For fiscal 2017, the ERF was 78% funded and the city contributed $58 million, or 65.5%, of its ADC. The plan's funded status improved in 2017 when compared with a 60% funded status in fiscal 2016. The DPFP was 25% funded for fiscal 2017 and the city paid $120.3 million or 100% of the statutorily required contribution amount. Weakness in the plan's affordability between 2015 and 2016 was caused by continued negative investment returns as well as actuarial assumption and methodology changes following a five-year experience study. Most recently in late 2016, the plan's assets fell sharply because of more than $500 million in deferred retirement funds that were withdrawn through a deferred retirement option plan (DROP), exacerbating the plan's weakness. The supplemental plan in 2017 was 43% funded and the city paid 100% of its ADC, which was a relatively small $2 million.

In the summer of 2017, the state legislature passed House Bill (HB) 3158, which fundamentally changed the contribution to and benefits provided by the DPFP.

Key features of HB 3158 include:

- A change in the benefit multiplier to 2.5% for service accrued after the effective date;
- Modification of normal retirement age, early retirement age, and early retirement reduction;
- Vesting after five years of service;
- Cost of living adjustments may be provided but only after certain financial benchmarks are met, prospective elimination of supplemental benefits, modifications around the DROP program;
- Employee contribution rate of 13.5% of computation pay for all active participants; and
- Employer contribution rate of 34.5% of computation pay with a floor for seven years, plus $13 million per year until 2024.

According to the city's actuary, Deloitte, HB 3158 raised the funded status of the plan to 50.3% upon passage. While we expect the plan's funded status will likely not improve further in the near term, the recent changes have stabilized it for the long term. In addition, part of the plan's revisions is that an actuarial study will be conducted in seven years and if certain key funding benchmarks are not being met, additional changes will be made.

Aside from its pension benefits, Dallas provides certain OPEB for retired employees. As of Sept. 30, 2017, the plan was not funded. The city contributed 56% of the annual OPEB cost, which amounted to $15.4 million. The city discontinued offering subsidized retiree health care for employees hired after Jan. 1, 2010.

Dallas' combined total pension and OPEB contributions were $193.8 million, or 17.9% of fiscal 2017 governmental expenditures.

Strong institutional framework

The institutional framework score for Texas municipalities is strong.

Outlook

The stable outlook reflects strength in Dallas' local economy that we anticipate will continue to grow in the near term, stable financial metrics, as well as recent changes to the city's pension plans that counteract any further deterioration in funded status.

Upside scenario

Should the debt and contingent liabilities profile improve significantly, and the large and growing pension liabilities moderate, we could raise the rating.

Downside scenario

Any deterioration over the next two years in the city's budgetary flexibility, performance, or liquidity could result in a downgrade. Additionally, if the city's debt service, pension, and OPEB carrying charges rise to a level we view as very high and large pension liabilities continue to grow and funded status of the plans deteriorate further, we could lower the rating multiple notches.

Related Research

- 2017 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of July 2, 2018)		
Dallas GO (AGM)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Dallas GO (BAM) (SECMKT)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Dallas GO (BAM) (SECMKT)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Dallas GO (BAM) (SECMKT)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Dallas GO (BAM) (SECMKT)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed

Ratings Detail (As Of July 2, 2018) (cont.)		
Dallas GO (BAM) (SECMKT)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Dallas GO (BAM) (SECMKT)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Dallas GO (BAM) (SEC MKT)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

S&P Global
Ratings

RatingsDirect®

Summary:

Dallas Convention Center Hotel Development Corp., Texas; Moral Obligation

Primary Credit Analyst:
Andy A Hobbs, Dallas + 1 (972) 367 3345; Andy.Hobbs@spglobal.com

Secondary Contact:
Kristin Button, Dallas (1) 214-765-5862; kristin.button@spglobal.com

Table Of Contents

Summary:

Dallas Convention Center Hotel Development Corp., Texas; Moral Obligation

Credit Profile		
Dallas Convention Center Hotel Development Corp, Texas		
Dallas, Texas		
Dallas Convtn Ctr Hotel Dev Corp (Dallas)		
Long Term Rating	A/Stable	Upgraded
Dallas Convtn Ctr Hotel Dev Corp (Dallas)		
Long Term Rating	A/Stable	Upgraded

Rationale

S&P Global Ratings has raised its rating on the Dallas Convention Center Hotel Development Corp., Texas' series 2009A and B hotel revenue bonds, issued on behalf of the City of Dallas, to 'A' from 'A-'. The outlook is stable.

The rating is based on the application of our criteria, titled "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness" ("ratings linked criteria"; published Jan. 22, 2018, on RatingsDirect). The upgrade is based on the strength of the moral obligation of the City of Dallas, given Dallas' city council-adopted grant program resolution, in which council will consider making grants or loans from the city's general fund to the issuer, should the pledged revenues be insufficient to service the corporation's debt. The strength of the city's moral obligation outweighs the strength of the pledged revenue base. This resolution is a revision to the public-private partnership program and guidelines that allow for a local government grant program and general fund appropriations of Chapter 380 grants to the corporation. Loans or grants are subject to annual appropriation by city council.

Obligor involvement is considered weak given the nature of the projects funded do not have a clear linkage with the basic functions of the city. While intended payment source (the hotel taxes) is a narrow and reliable revenue stream, the source of payment ultimately supporting the issue is from the making grants or loans from the city's general fund to the issuer, should the pledged revenues be insufficient to service the corporation's debt. Finally, there has been no evidence of political or community resistance to the city's support of the debt, nor are there any unusual administrative risks that could disrupt timely debt service payments.

The intended payment source is the hotel project's net operating income, 6% state hotel occupancy tax (HOT) revenue collected on the qualified hotel project (limited to the initial 10 years of operation), 6.25% state sales and use tax collected on the qualified hotel project (limited to the initial 10 years of operation), and the citywide 7% local HOT revenues collected and dedicated to debt service. The state hotel occupancy and sales-use tax pledge is limited to 10 years subsequent to the initial opening of the hotel, but the local citywide HOT is pledged as a security for the life of the bonds.

The corporation issued the series 2009B hotel revenue bonds as federally taxable Build America Bonds (BABs), in which the corporation receives a subsidy from the U.S. Treasury equal to 35% of the stated interest paid. The U.S. Treasury subsidy for BABs, if issued, is paid directly to the corporation, and does not constitute security for the payment of principal or interest on the series 2009B revenue bonds.

The 1,016-room Omni hotel, which opened in 2011, has at least 80,000 square feet of meeting-room and function space, and 720 structured parking spots. During the past five years, HOT revenues have continued to rise, with relatively stable trends from year to year. In addition, the hotel occupancy rate has steadily increased.

The debt service schedule indicates principal repayment on the series 2009A bonds beginning in 2018, and principal repayment of the series 2009B bonds beginning in 2026. The debt service requirement steadily increases to about $40.9 million in 2026. Should hotel tax revenues be insufficient to cover the annual debt service requirement, the trustee will be able to access a debt service reserve fund, funded at the maximum annual debt service (MADS) payment (about $41 million). Fiscal 2017 pledged collections of $38.8 million provided 1x coverage of annual debt service, but did not incorporate BAB direct payments. When calculating direct payments, debt service coverage increases. Fiscal 2017 pledged revenues still provided weak 0.95x MADS coverage (when not taking into consideration direct payment subsidies).

The primary credit factor, however, remains the city council-adopted resolution, in which general fund appropriations will be considered to cover any deficiencies. The repayment of any loans made to the corporation by Dallas is subordinate to the corporation's annual debt service requirement.

Outlook

The stable outlook reflects the moral obligation of the City of Dallas. The outlook also takes into consideration the strength in the local economy that we anticipate will continue to grow in the near term, and stable financial metrics.

Upside scenario

Should the corporation's debt and contingent liabilities profile decline significantly and the large and growing pension liabilities of the city moderate, we could raise the rating.

Downside scenario

Any deterioration over the next two years in Dallas' budgetary flexibility, performance, or liquidity could result in a downgrade. In addition, we could lower the rating multiple notches if the city's debt service, pension, and other postemployment benefits carrying charges elevate to levels that we consider very high, large pension liabilities continue to grow, and the plans' funded status further deteriorates.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

S&P Global
Ratings

RatingsDirect®

Summary:

Downtown Dallas Development Authority, Texas; Moral Obligation

Primary Credit Analyst:
Andy A Hobbs, Dallas + 1 (972) 367 3345; Andy.Hobbs@spglobal.com

Secondary Contact:
Kristin Button, Dallas (1) 214-765-5862; kristin.button@spglobal.com

Table Of Contents

Summary:

Downtown Dallas Development Authority, Texas; Moral Obligation

Credit Profile		
Downtown Dallas Dev Auth, Texas		
Dallas, Texas		
Downtown Dallas Dev Auth (Dallas) (MBIA) (National		
Unenhanced Rating	A+(SPUR)/Stable	Upgraded
Many issues are enhanced by bond insurance.		

Rationale

S&P Global Ratings has raised its ratings on the Downtown Dallas Development Authority's (DDDA) tax increment contract revenue bonds, issued on behalf of the City of Dallas to 'A+' from 'A'. The outlook is stable.

The upgrade reflects continued positive growth and strength within the reinvestment zone and tax increments collected within. The upgrade also reflects improved debt service coverage by pledged revenues as well as a declining volatility ratio.

The bonds are secured by tax increments collected within the boundaries of the authority. The amount of a participant's tax increment for a year is calculated based on the amount of property taxes levied by the participant for that year on the captured appraised value of real property in Reinvestment Zone No. 11 taxable by the participant. The captured appraised value equals: the total appraised value of the real property in Reinvestment Zone No. 11 taxable by the participant for a year less the tax increment base, which is the adjusted total appraised value as of Jan. 1, 2005, of all real property located within the boundaries of the zone. No additional debt issuance is expected in the near-to-medium term. Also incorporated in the review is the strength of the moral obligation of the City of Dallas, given Dallas' city council-adopted grant program resolution, in which council will consider making grants or loans from the city's general fund to the issuer, should the pledged revenues be insufficient to service the corporation's debt.

The strength of the tax increments collected within the boundaries of the authority, legal provisions for the bonds, and general creditworthiness outweigh the city's moral obligation. The rating is based on the application of our criteria, titled "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness" ("ratings linked criteria"; published Jan. 22, 2018, on RatingsDirect).

Obligor involvement is considered moderate given the obligation provides funding of projects serving an auxiliary function of the city. While the intended payment source (tax increment revenues) is a narrow and reliable revenue stream, the source of payment ultimately supporting the issue is from the making of grants or loans from the city's general fund to the issuer, should the pledged revenues be insufficient to service the corporation's debt. Finally, there has been no evidence of political or community resistance to the city's support of the debt, nor are there any unusual administrative risks that could disrupt timely debt service payments.

The rating reflects our view of the DDDA's:

- Historically strong growth in property values;
- Low volatility ratio at 0.18%; and
- Strong legal provisions for bonds.

Partly offsetting the above strengths, in our opinion, are the authority's:

- Moderately concentrated tax base; and
- Steady increases in debt service requirements to 2036.

Dallas created Reinvestment Zone No. 11, which spans a significant portion of its central business district, to improve the physical connection between its uptown and downtown areas. The base value was set in 2006 at $562 million and then revised to $564.9 million during fiscal 2009 to reflect the addition of acreage within the zone. The current taxable value in the zone is $2.99 billion (city portion), reflecting continued growth in the zone. Both Dallas and Dallas County are participants in the zone and have agreed to transfer incremental tax revenues to the project fund. The city will be participating through 2035 at a 90% participation level, while the county will be participating through 2025 at a 55% participation level. The debt service requirement steadily increases from $6.3 million in 2016 to about $9.9 million in 2036. The fiscal 2017 incremental tax revenues of about $20.9 million provide maximum annual debt service ($9.9 million in 2034) coverage of 2.12x, based on the most recent year's pledged revenues, which is a modest improvement from the previous year. The volatility ratio (which incorporates the participation levels of 90% and 55% of the city and county, respectively) given current pledged revenues is a low 0.18%, indicating that total assessed value (AV) would need to fall by 82% before there would be no more tax increment revenues.

We consider Dallas' economy strong. The city, with an estimated population of 1.3 million, is located in Collin, Dallas, and Denton counties in the Dallas-Fort Worth-Arlington metropolitan statistical area (MSA), which we consider to be broad and diverse. The city has a projected per capita effective buying income of 97.2% of the national level and per capita market value of $89,673. Overall, the city's market value grew by 6.6% over the past year to $117.9 billion in 2018. The weight-averaged unemployment rate of the counties was 3.8% in 2017.

Dallas is a major economic hub in the southern and central part of the country. The city benefits from its status as the center of the Dallas-Fort Worth MSA and the broad and diverse economy that surrounds it. Dallas and the greater metro area continue to be a desirable location for new business as well as recent relocations of corporate headquarters to the area. The strong economic growth is represented in solid annual growth in market value growth since 2011. Dallas is home to 22 Fortune 500 companies, 3,489 company headquarters, and 242 Class A office buildings. Twenty-seven percent of all hotel rooms in the metroplex are in the city, as it is one of the nation's top convention destinations. It also benefits from two major airports (Dallas-Fort Worth International Airport and Dallas Love Field) in the area that are home to two large carriers in American Airlines and Southwest Airlines.

Recent new develops in the city include a $50 million investment from Vistaprint, which will build a logistics facility in southern Dallas with an estimated 600 new jobs. Smoothie King and JetSuite recently moved their headquarters to Dallas. Also, RedBird Mall, a largely vacant shopping mall in southern Dallas, is being renovated into a mixed-use facility with hotel, apartment, office, entertainment, retail, and park uses. New development and solid market value growth should help sustain the city's financial stability in the near term, which contributes to the outlook.

Legal provisions for the bonds are strong, in our opinion. Should tax increments be insufficient to cover the annual debt service requirement, two reserve funds are accessible by the trustee. The first is the typical debt service reserve fund, funded at the lesser of the standard three-prong test. The second reserve fund available to the trustee is a fund with an ultimate deposit of $10 million, which has been funded with excess increment revenues. Ideally, any shortfalls are drawn from this reserve first. A debt service reserve is established at the lesser of the standard three-prong test. An additional bonds test is also established at 150% of the maximum annual requirements, after giving effect of the additional bonds.

Outlook

The stable outlook reflects our expectation AV will remain stable and experience modest growth in the near term, and that debt service coverage will remain stable with no near-term debt plans in the next two years. We do not expect the rating to change over the two-year outlook.

Upside scenario

We could raise the rating if coverage increases substantially and diversification among the top 10 taxpayers improves to a level comparable with that of higher rated peers. Additional strengthening of legal provisions for the bonds could also have a positive effect on the rating. We could also raise the rating if the city's credit profile improves and if Dallas' large and growing pension liabilities moderate.

Downside scenario

We could lower the rating if debt service coverage were to materially weaken or there were significant deterioration in AV.