

Memorandum



CITY OF DALLAS

DATE December 8, 2023

TO Honorable Mayor and Members of the City Council

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

Yesterday, Fitch Ratings (Fitch) assigned its 'AA' credit rating and stable outlook to the anticipated Combination Tax and Revenue Certificates of Obligation, Series 2024A, and affirmed the City's 'AA' credit rating and stable outlook on outstanding general obligation bonds. Fitch previously affirmed the City's rating on April 4, 2023.

According to the Fitch report, the City's affirmed rating continues to reflect, "strong revenue growth prospects, moderate long-term liability burden, and solid reserve levels." In their analysis, Fitch notes that "the fiscal 2022 general fund results were positive as both revenues and expenditures outperformed budget." The report also notes that "elevated debt and retiree benefit outlays will maintain a certain amount of pressure on the city's budget management practices," however, the City's "gap-closing capabilities and healthy reserves position it to maintain the highest financial resilience through future business downturns."

Fitch's affirmed rating is a positive reflection of the City's credit ahead of the issuance of the Combination Tax and Revenue Certificates of Obligation, Series 2024A. The bonds are currently scheduled for pricing on January 11, 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
Billerae 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
Carl Simpson, Assistant City Manager
Genesis D. Gavino, Chief of Staff to the City Manager
Directors and Assistant Directors



RATING ACTION COMMENTARY

Fitch Rates Dallas, TX \$224MM Limited Tax Obligations 'AA'; Outlook Stable

Thu 07 Dec, 2023 - 5:19 PM ET

Fitch Ratings - Austin - 07 Dec 2023: Fitch Ratings has assigned a 'AA' rating to the following city of Dallas, TX limited tax (LT) obligations:

--\$223.6 million combination tax and revenue certificates of obligation (COs), series 2024A.

Fitch also has affirmed the following ratings:

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

--\$2.5 billion of outstanding LT debt at 'AA'.

The Rating Outlook is Stable.

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](#)

The series 2024A CO proceeds will finance certain street and transportation-related improvements. The bonds are scheduled for a competitive sale the week of January 11.

SECURITY

The COs and limited tax bonds are payable from an annual property tax levy limited to \$2.50 per \$100 assessed valuation (AV) for operations and debt service. 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,LT bond, and CO ratings reflect strong revenue growth prospects, moderate long-term liability burden, and solid reserve levels. 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 build up police staffing levels and continues with increasing pension contributions; these pressures are expected 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 health care and it also ranks among the top visitor and leisure destinations in the state.

KEY RATING DRIVERS

Revenue Framework: 'aaa'

Strong revenue growth prospects are based on expectations for continued economic expansion. The assessment also reflects the city's high independent legal ability to increase operating revenues.

Expenditure Framework: 'a'

The city's pace of spending is expected to be marginally above revenue growth given ongoing service demands and inflationary pressures. Increased pension contributions will keep carrying costs at an elevated level; a 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 12% of personal income. Recent pension reforms to both the civilian and uniform plans have reduced the combined total liability and, in conjunction with continued economic growth, are expected 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 business downturns. Elevated debt and retiree benefit outlays will maintain a certain amount of pressure on the city's budget management practices.

RATING SENSITIVITIES

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

--A sustained reduction in the long-term liability burden below 10% of personal income;

--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.

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

--Failure to close the gap between annual pension contributions and the actuarially determined contribution amounts;

--Longer term, poor operating performance and resulting material decline in operating reserves.

CURRENT DEVELOPMENTS

The fiscal 2022 general fund results were positive as both revenues and expenditures outperformed budget. Sales tax receipts totaled \$407 million versus the budgeted \$394 million and were up roughly 15% from the fiscal 2021 total. Property tax revenues totaled \$804 million versus \$775.5 million in fiscal 2021, a 3.7% increase aided by a nearly 5% increase in taxable assessed value (TAV). The general fund recorded a \$41.8 million surplus, increasing the unrestricted fund balance to nearly \$418 million or 27.6% of spending and transfers out.

The biennial fiscal 2023-2024 budget is balanced and highlights include a \$0.0275 reduction in the fiscal 2023 total property tax rate, an increase in the over 65/disabled property tax exemption to \$115,500 from \$107,000, an increase in the minimum hourly wage to \$18 and the hiring of 250 police officers. Management reports fiscal 2023 general fund revenues are trending positively compared to budget, led by an increase in sales tax receipts; the current FYE projection is for sales tax revenues to outperform budget by roughly \$8.3 million or nearly 2%. Total general fund revenues and outlays are expected to outpace the original budget totals, and the fiscal 2023 ending fund balance is projected to increase by roughly \$3.5 million.

The city's roughly \$1.8 billion fiscal 2024 budget projections are balanced with a forecasted ending fund balance of nearly \$320 million, approximately 17% of budgeted general fund spending. The major cost drivers are expected to be public safety spending demands including the police and fire salary increases that were negotiated under the meet and confer agreement. The city plans to increase staffing levels across the police and fire departments to reduce public safety overtime demands.

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 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, developers, real estate, manufacturing and retail industries, and the tax base has no significant concentration. Fitch expects the underlying strength, size and diversity of Dallas' economy will support strong operating performances through periodic futures economic downturns.

Revenue Framework

General fund operations are supported by a diverse mix of revenues led by ad valorem tax revenues (53% of the fiscal 2022 total), sales tax revenues (27%), and franchise fees (9%).

The city's revenue growth prospects remain strong due to current and planned economic activity.

The city's fiscal 2024 total tax rate of \$0.7357 per \$100 of TAV is down \$0.0101 from the prior year and is well below the constitutional and city charter cap of \$2.50. Any increase in the operating tax rate which produces an annual operating levy increase of more than 3.5% of reappraised value (the voter approval tax rate) requires a ratification election. The revenue cap does not apply to debt service tax levies; the city's fiscal 2024 debt service tax rate is \$0.204 out of the total rate.

The tax levy limitation 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 2022 general fund outlays), followed by general government (13%) 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 trend marginally above what the city's strong revenue growth prospects as future service demands from a relatively mature residential base and increasing public safety and pension outlays should align with increasing operating revenues over the near to medium term.

Fitch expects actual carrying costs to remain elevated (25% to 27% of governmental spending), the result of both increased pension contributions to the police and fire plan and debt service associated with issuances from a 2017 \$1.05 billion GO bond authorization of which \$134.8 million remains. 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 also reflect a rapid 72% debt amortization rate over the next 10 years. The city's use of meet and confer agreements for both police and fire provides strong control over headcount and salary costs and expenditure flexibility.

Long-Term Liability Burden

Dallas' long-term liability burden is moderate at roughly 13% of personal income. The city currently has roughly \$2.5 billion in GO debt outstanding (including the current offerings), which accounts for about 20% of the total long-term liability burden. The city will seek voter authorization for an additional \$1 billion in 2024 to be issued over two years. Overlapping debt of \$4.8 billion comprises the remainder of the liability (38% of the total).

Dallas participates in three single employer defined benefit pension plans. The Employee Retirement Plan (ERF) covers non-uniformed employees and the Dallas Police & Fire Pension Plan (DPFP), combined plan, and the smaller Supplemental Police and Fire Pension Plan of the city of Dallas (supplemental plan) cover police and firefighters.

The combined net pension liability (NPL) for all three plans as reported in the city's fiscal 2022 audit totaled \$4.03 billion, with assets covering 61% of liabilities. The NPL increases to \$5.09 billion and the ratio of assets to liabilities declines to 55% when the 6% investment return assumption is used

Recent plan changes to both the ERF and DPFP addressed retirement age and service retirement age, and reduced benefit multipliers. The DPFP plan changes deferred the retirement option program, restricted the COLA benefit to a minimum funding threshold, and increased both city and employee contributions. The reforms are expected to boost the long-term viability of both plans. However, additional reforms will be needed to comply with the Texas Pension Review Board's (TPRB) target of full-funding within 30 years for all three pension plans. The ERF and the DPFPS amortization periods currently exceed this target. An ad hoc committee is exploring potential changes to both benefits and contribution policy and submission of a plan to the TPRB is required by Sept. 1, 2025.

The city's other post-employment benefit liability was recently reduced by more than one-half (to \$221.6 million) through the elimination of the subsidy for retirees' Medicare Advantage plans.

Operating Performance

The 'aaa' resilience assessment reflects Fitch's expectation that the city will make spending cuts and utilize its strong reserve cushion to maintain 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

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit <https://www.fitchratings.com/topics/esg/products#esg-relevance-scores>.

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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)

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Dallas (TX)

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