Memorandum

CITY OF DALLAS

DATE April 19, 2019

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 Convention Center Hotel Development Corp. Debt Rating - INFORMATION**

As previously communicated, on April 18, Standard and Poor's Global Ratings (S&P) affirmed the City's 'AA-' credit rating and stable outlook for General Obligation debt and the Dallas Convention Center Hotel Development Corporation 'A' rating and stable outlook. The S&P rating report echoes the Fitch Ratings report released on Tuesday, highlighting Dallas' economy, fiscal management, and robust City reserves.

In addition to the agency's analysis of the City as an organization with "very strong management, with strong financial policies and practices," bolstered by a "strong economy," S&P states that the affirmed rating and outlook for the General Obligation debt reflects "very strong budgetary flexibility," "very strong liquidity," and a "strong institutional framework score." According to the report, "Dallas' available reserve position continues to grow, which creates greater financial flexibility for the city and is a credit strength," Additionally, S&P states, "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."

S&P also affirmed the Dallas Convention Center Hotel Development Corp. 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." The rating also reflects, "strength in Dallas' local economy," "stable financial metrics, and stabilization of the funded status of the city's pension plans."

Overall, the City of Dallas continues to be economically strong, fiscally stable, and a good investment. I look forward to continuing to work with all ratings agencies on future ratings actions and working towards an enhanced credit profile of the City.

DATE April 19, 2019

SUBJECT Standard and Poor's Global Ratings Affirmed Rating and Outlook for City of Dallas Outstanding General Obligation and Convention Center Hotel Development Corp. Debt 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
Chris Caso, City Attorney (Interim)
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
Nadia Chandler Hardy, Assistant City Manager and Chief Resilience Officer
Michael Mendoza, Chief of Economic Development and Neighborhood Services
Laila Alequresh, Chief Innovation Officer
Directors and Assistant Directors

S&P Global
Ratings

RatingsDirect®

Summary:

Dallas, Texas; General Obligation

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Summary:

Dallas, Texas; General Obligation

Credit Profile		
US$267.5 mil GO rfdg & imp bnds ser 2019A dtd 05/22/2019 due 02/15/2039		
Long Term Rating	AA-/Stable	New
US$174.705 mil GO rfdg bnds ser 2019B dtd 05/22/2019 due 02/15/2039		
Long Term Rating	AA-/Stable	New

Rationale

S&P Global Ratings assigned its 'AA-' rating to the City of Dallas' series 2019A and 2019B general obligation (GO) 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 bonds constitute direct obligations of the city, payable from the proceeds of a continuing, direct annual ad valorem tax, within the limits prescribed by law, on all taxable property within its borders. The maximum allowable rate in Texas is $2.50 per $100 of assessed value (AV) for all purposes, with the portion dedicated to debt service limited to $1.50. The city's total tax rate is well below the maximum, at 77.67 cents, 21.00 cents of which is dedicated to debt service. Based on the application of our criteria, "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness," published Jan. 22, 2018, we view the limited-tax GO debt pledge on par with the city's general creditworthiness. The ad valorem taxes are not levied on a narrower or distinctly different tax base, and there are no limitations on the fungibility of resources available for the payment of debt service.

Proceeds from the sale of series 2019A bonds will be used to refund GO commercial paper notes series A, as well as to fund various improvements throughout the city. Proceeds from the sale of series 2019B bonds will be used to refund special and general obligations of the city in conjunction with final judgments in two longstanding lawsuits relating to city ordinance number 16084. On June 27, 2018, the city council approved a settlement agreement of the two Rockwall County lawsuits not to exceed $173,312,500. The city and the plaintiffs agreed on the terms of a written settlement agreement and received court approval of the settlement on Feb. 8, 2019.

The 'AA-' rating reflects 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 2018, which incorporates underfunding of the city's total pension actuarially determined contribution (ADC);
- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 19% of operating expenditures;

- Very strong liquidity, with total government available cash at 52.7% of total governmental fund expenditures and 3.3x governmental debt service, and access to external liquidity we consider exceptional;
- Very weak debt and contingent liability profile, with debt service carrying charges at 15.9% of expenditures and net direct debt that is 180.4% of total governmental fund revenue, as well as a large pension and other postemployment benefit (OPEB) obligation; and an evolving plan to sufficiently address the 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, Rockwall, and Denton counties in the Dallas-Fort Worth-Arlington, TX 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 $100,486. Overall, the city's market value grew by 5.7% over the past year to $129.3 billion in 2019. The weight-averaged unemployment rate of the counties was 3.8% in 2017.

New development and solid market value, as well as population growth, should help sustain the city's local economy and financial stability in the near term, which contributes to the outlook.

Sustained annual increases in market value, population growth and in-migration, and positive employment metrics continue to bolster Dallas' local economy and further ground the city as a major economic hub in the country. 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 has almost 76,000 businesses and over 1.15 million jobs, 3,489 company headquarters, and 242 Class A office buildings. The city's top 10 taxpayers are diverse and represent a modest 3.6% of the total tax base, which is favorably composed of a healthy mix of residential and commercial properties.

The value of new construction has increased by an average of 23% in the last four years. Between 2015 and 2018, the city's public-private partnership program secured approvals by council for 54 business development projects that are expected to generate or retain 16,276 jobs and leverage $1.4 billion in new private investment. The city 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 and Southwest Airlines.

Recent new developments in the city include Nokia, which is moving its North American headquarters with 2,300 employees to the city. Amazon Services, Inc. began construction on a new 855,000-square-foot e-commerce facility with a total project cost over $100 million and is expected to bring 1,200 jobs to the city. Construction is also underway on a 1.5 million-square-foot facility for Home Depot with a second large project planned. The total investment of the two phases is approximately $136 million. The housing market for the city and greater MSA continues to indicate some of the fastest increases in housing prices for large cities nationwide. Dallas is drawing more residents into the central business district (CBD). New construction of residential units downtown has allowed for an estimated population of 13,850 in the city's CBD.

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 multiyear 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. The city uses a third party for sales tax projections and other economic forecasts to further inform budget preparation and planning. Management provides monthly reports to city council and produce 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 a long-range financial forecast for both the general and debt service funds, which are presented 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 multiyear 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) establish 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 maintains a reserve policy of 40 days of expenditures, to which it currently adheres. It has also developed Dallas 365, which comprises 35 performance measures organized by six key strategic priorities that it tracks and reports on to better inform decision-making throughout the year.

Weak budgetary performance

Dallas' budgetary performance is weak in our opinion. The city had surplus operating results in the general fund of 1.7% of expenditures, but a deficit result across all governmental funds of 2.7% in fiscal 2018. General fund operating results have been stable over the last three years, with a result of 3.3% in 2017 and 0.4% in 2016. Weakening our view of Dallas' budgetary performance is the city's deferral of significant expenditures (pension obligation costs in association with the ADC), which we think inflates the budgetary result ratios.

Continued stable financial performance is the result of close monitoring of expenditures, positive budget variances, and generally increasing revenue streams. General fund revenues were primarily derived from property taxes (49% of total general fund revenues) and sales taxes (25%). In 2018, both revenue streams experienced solid growth, which aided stable performance. Before transfers, general fund revenues outpaced expenditures by $9.8 million (audited figures). In comparison to the budget for fiscal 2018, general fund revenues were $11.7 million better than budget and expenses were $21.5 million less than budget. Yet, also taken into consideration in the city's overall performance was the full cost of Dallas' ADC for pension obligations. Despite recent positive changes to plan benefits and contributions, the city did not contribute 100% of the ADC for the combined plans in fiscal 2018. 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 about $37.5 million in fiscal 2018. We anticipate with recent plan changes and increases in contributions that the city will continue to move closer to the ADC with regard to contributions for fiscal 2019.

Budgetary performance in 2019 has remained relatively stable. Year-to-date revenues are trending above budget while expenditures are favorably trending on target. Sales tax revenue is projected to increase 2.7% in fiscal 2019 to $311.6 million up from actual collections of $305.4 million in 2018. Property tax values rose 9.94%, which equates to annual growth in property tax revenues. In fiscal 2019, Dallas has committed at least $157 million to the Police and Fire Pension Fund. Future city financial projections also indicate increases in pension funding in line with changes recently implemented. To improve more than 569 street lane miles, the city will use $125 million, including $64 million through pay-as-you-go funding.

Dallas' total tax rate was reduced slightly when compared with previous years. The current rate of 77.67 cents per $100 of AV is a modest decline from fiscal 2017 and for a third consecutive year, the city has modestly reduced its overall tax rate when combining both maintenance and operations and debt service levies. Officials are anticipating mid-to-high single-digit increases in market value in the near term. Officials note a 2.5% rollback rate cap would have resulted in a loss of nearly $32 million from the adopted budget for fiscal 2019. Given a history of modest positive budget variances, increases in pension contributions, and growing major revenue streams, we anticipate stable budgetary performance in the near term that could favorably affect our overall view of the city's budgetary performance. Future rating reviews will examine any changes in state statutes that might negative affect budget formation.

Very strong budgetary flexibility

Dallas' budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 19% of operating expenditures, or $233.5 million.

The fiscal 2018 year-end available reserve balance exceeds the city's financial policy requirement of 40 days of general fund operating expenditures, and marks a third consecutive year of growth in available reserves on a dollar basis as well as on a percentage of the city's expenditures. Dallas' available reserve position continues to grow, which creates greater financial flexibility for the city and is a credit strength. Based on current financial trends and performance in fiscal 2019, we anticipate the city's available reserve will remain stable in the near term, if not grow modestly.

Very strong liquidity

In our opinion, Dallas' liquidity is very strong, with total government available cash at 52.7% of total governmental fund expenditures and 3.3x governmental debt service in 2018. In our view, the city has exceptional access to external liquidity if necessary.

The city's liquid and non-restricted investments are short term and are in highly rated investment pools such as Logic and TexPool, and TexSTAR. While the city has pledged moral obligation support for the convention center hotel bonds (series 2009A and 2009B), 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 2018 debt service costs of these obligations amount to about 2% of Dallas' operating revenues. 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 15.9% of total governmental fund expenditures, and net direct debt is 180.4% of total governmental fund revenue.

Combined with debt service requirements, the city's fixed costs amounted to 30.3% of expenditures, which affects our overall view of the debt and liability profile.

We anticipate the city 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 parks and recreation, flood control, police and fire, city hall, homeless, economic development, streets, library, and cultural arts facility.

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 anticipated 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 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. Upon closing of the 2017 commercial paper program on Nov. 28, 2017, the city issued $3,500,000 in series B notes that were purchased by JPMorgan pursuant to the note purchase agreement, and at least $3,500,000 aggregate principal amount of series B notes must remain outstanding for the duration of the term of the agreement. In April 2019, the city also issued $31.6 million in association with the commercial paper note program.

In our opinion, a credit weakness is Dallas' large pension and OPEB obligation. Dallas' combined required pension and actual OPEB contributions totaled 14.4% of total governmental fund expenditures in 2018. Of that amount, 13.6% represented required contributions to pension obligations, and 0.8% represented OPEB payments. The city made 85% of its annual required pension contribution in 2018. The funded ratio of the largest pension plan is 46.8%.

Dallas provides pension benefits to its employees via three separate retirement plans: the Employees Retirement System (ERF), 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 2018, the ERF was 83% funded and the city contributed $60.5 million, or 65.8%, of its ADC. The plan's funded status improved in 2018 when compared with a 78% funded status in fiscal 2016 and 60% funded status in 2016. The DPFP was a weak 47% funded for fiscal 2018 and the city contributed $151.8 million or 96% of the statutorily required contribution amount. The plan's funded status improved in 2018 when compared with a 25% funded status in 2017. Weakness in the plan's affordability between 2015 and 2017 was caused by continued negative investment returns as well as actuarial assumption and methodology changes following a five-year experience study. The supplemental plan in 2018 was 53% funded and the city contributed 100% of its ADC, which was a relatively small $2.2 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. While we anticipate the plan's funded status will likely not improve in the near term to levels we feel are adequate, 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, 2018, the plan was not funded. The city discontinued offering subsidized retiree health care for employees hired after Jan. 1, 2010. At Sept. 30, 2018, the OPEB liability was $511.1 million, down from $518.8 million in the previous year. OPEB costs equaled 0.8% of the city's expenditures. Dallas' combined total pension and OPEB contributions for fiscal 2018 were 14.4% of 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 expand in the near term, stable financial metrics, as well as leveling-off of the funded status of the city's pension plans, despite a remaining large liability. We do not anticipate changing the rating over the two-year outlook horizon.

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

Weakening in the city's budgetary flexibility, performance, or liquidity could result in a downgrade. Furthermore, if the city's debt service, pension, and OPEB carrying charge elevate to a level we view as unsustainable and negatively affect the city's financial metrics or performance, we could lower the rating.

Ratings Detail (As Of April 18, 2019)		
Dallas GO		
Long Term Rating	AA-/Stable	Affirmed
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
Dallas GO (BAM) (SECMKT)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Dallas GO (BAM) (SECMKT)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed

Ratings Detail (As Of April 18, 2019) (cont.)		
Dallas GO (BAM) (SEC MKT)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

Summary:

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

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Summary:

Dallas Convention Center Hotel Development Corp. Dallas, 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	Affirmed
Dallas Convtn Ctr Hotel Dev Corp (Dallas)		
Long Term Rating	A/Stable	Affirmed

Rationale

S&P Global Ratings has affirmed its 'A' 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. 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," published Jan. 22, 2018. The rating 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 projects funded do not have a clear linkage with the city's basic functions. While the intended payment source (the hotel taxes) is a narrow and reliable revenue stream, the source of payment ultimately supporting the issue is the 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.

For additional information regarding the city, see our summary published April 18, 2019, on RatingsDirect.

Outlook

The stable outlook reflects the moral obligation of the city, strength in Dallas' local economy that we anticipate will continue to expand in the near term, stable financial metrics, and stabilization of the funded status of the city's pension plans, despite a remaining large liability. We do not anticipate changing the rating over the two-year outlook horizon.

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

Weakening in the city's budgetary flexibility, performance, or liquidity could result in a downgrade. Furthermore, if the city's debt service, pension, and other postemployment benefits carrying charge elevate to a level we view as unsustainable and negatively affect the city's financial metrics or performance, we could lower the rating.