# Memorandum

CITY OF DALLAS

DATE October 29, 2021

TO Honorable Mayor and Members of the City Council

SUBJECT **Kroll Bond Rating Agency Assigns 'AA+' Rating and Stable Outlook for City of Dallas 2021 General Obligation Bonds – RATING ACTION**

On October 27, 2021, Kroll Bond Rating Agency (KBRA) assigned its 'AA+' credit rating and stable outlook for the General Obligation Refunding and Improvement Bonds, Series 2021, Combination Tax and Revenue Certificates of Obligation, Series 2021, and the Equipment Acquisition Contractual Obligations, Series 2021 (collectively, "the Bonds"). KBRA affirmed the City's outstanding General Obligation debt in an annual surveillance review on October 4, 2021. Once more, the KBRA report states that the assigned rating reflects "the City's sound financial profile, disciplined, forward-looking financial management practices, healthy reserves, and ample liquidity," while the stable outlook reflects "the City's considerable budgetary flexibility and long-term favorable outlook for economic and revenue growth."

The KBRA report notes that there have been no updates to the rating determinants since the recent surveillance review, but continues to view the City's "strong financial profile reflecting fiscally conservative financial management practices, solid reserves, and healthy liquidity," and the "growing economic base, robust employment expansion and declining poverty levels," as credit positives. Additionally, KBRA's view of credit challenges to the City include elevated pension costs, "property tax levy limitation" that could have an impact on expenditures, and a "partial reliance on sales tax receipts". The report also expanded on the City's Environmental, Social, and Governance (ESG) factors, including efforts toward air quality monitoring and drainage relief, public safety and the City's first Racial Equity Resolution, and the City's leadership in developing a regional Cyber Fusion Center to unify technology security functions.

KBRA's rating on the upcoming General Obligation debt issuances further enhances the credit profile of the City and supports the marketability of the Bonds ahead of the planned November 2021 bond sale. Attached is the published report for your review.

Please let me know if you need additional information.

for ~~M. Elizabeth Reich~~
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
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Jon Fortune, Assistant City Manager
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Dr. Eric A. Johnson, Chief of Economic Development and Neighborhood Services
M. Elizabeth (Liz) Cedillo-Pereira, Chief of Equity and Inclusion
Directors and Assistant Directors

# City of Dallas, Texas

| **Issuer:** City of Dallas, Texas | | |
|---|---|---|
| **Assigned** | **Ratings** | **Outlook** |
| General Obligation Refunding and Improvement Bonds, Series 2021 | AA+ | Stable |
| Combination Tax and Revenue Certificates of Obligation, Series 2021 | AA+ | Stable |
| Equipment Acquisition Contractual Obligations, Series 2021 | AA+ | Stable |
| **Affirmed** | **Ratings** | **Outlook** |
| General Obligation Refunding and Improvement Bonds, Series 2020A | AA+ | Stable |
| General Obligation Refunding Bonds, Taxable Series 2020B | AA+ | Stable |
| Equipment Acquisition Contractual Obligations, Series 2020B | AA+ | Stable |

**Methodology**

- U.S. Local Government GO Methodology
- ESG Global Rating Methodology

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**Rating Summary:** The rating on the City's General Obligation Refunding and Improvement Bonds, Series 2021 ("the Bonds"), Combination Tax and Revenue Certificates of Obligation, Series 2021 ("the Certificates of Obligation") and the Equipment Acquisition Contractual Obligations, Series 2021, ("the Contractual Obligations"), *(collectively, "the Series 2021 Obligations")*, reflects the City's sound financial profile, disciplined, forward-looking financial management practices, healthy reserves, and ample liquidity. As a regional hub for technology, healthcare, finance and tourism, Dallas is among the nation's top-ranked cities for economic growth, with robust employment expansion and declining poverty levels.

The Bonds and the Contractual Obligations are secured by a pledge of an annual ad valorem tax levied on all taxable property within the City.

The Certificates of Obligation are secured by a pledge of a combination of the ad valorem tax and a limited pledge of the surplus revenues of the City's Municipal Drainage Utility System in an amount not to exceed $1,000.

The State Constitution and the City Charter limit the ad valorem tax rate to $2.50 per $100 of taxable assessed valuation for all purposes, including payment of debt service. The State Attorney General will not approve debt if, based on then current taxable property values, more than $1.50 of the maximum $2.50 is required for aggregate general obligation debt service, inclusive of the bonds being proposed.

In addition, effective January 1, 2020, the Texas Property Tax Reform and Transparency Act of 2019 (SB2) caps the City's ability to grow property tax revenue (without voter approval) at 3.5% per year. Revenue to pay voter approved debt is excluded from the SB2 cap, as is revenue growth from new construction. In KBRA's view, the combination of conservative forecasting and disciplined expenditure controls support the City's ability to maintain structurally balanced operations within the more constrained property tax revenue framework imposed by SB2. While the ultimate trajectory of recovery from the COVID-19 pandemic remains uncertain, KBRA views continued growth in property values, together with a strong recovery in FY 2021 sales tax receipts, as indicative of the City's economic resilience.

The City cites the positive impact of Federal stimulus on disposable personal income and unemployment levels, both of which have almost fully rebounded from sharp pandemic-related declines, as contributing to a recovery in General Fund revenues for the fiscal year ending September 30, 2021. The City was allocated COVID-19 federal funding totaling approximately $627.3 million.

Detailed Financial Management Performance Criteria (FMPC) originally adopted by City Council in 1978, as periodically revised, provide a policy framework for fiscal decision making and are an important contributor to the City's strong governance profile. Pursuant to the FMPC, the City maintains an unassigned General Fund balance, which includes Emergency and Contingency Reserves, of at least 50 days and not more than 70 days of General Fund operating expenditures less debt service. The FY 2020 unassigned fund balance in the General Fund of $250.4 million after interfund transfers, equated to 68 days of General Fund operating expenses less debt service. The City has maintained ample liquidity as evidenced by consistent growth in year-end fund balance.

Forecast (unaudited) FY 2021 General Fund revenues are 2.2% above budget, due primarily to stronger than anticipated property tax and sales tax receipts. The City forecasts FY 2021 General Fund expenditures in line with budgetary expectations, and projects an ending FY 2021 General Fund balance of $272.1 million. However, due to rapidly growing pension and overtime costs, the City's proposed biennial FY 2022 and FY 2023 budget projects the unassigned fund balance to decline to 40 days in FY 2024 and to only 8.4 days by FY 2026 (budgetary basis). The City states that it will not allow a budget imbalance to occur, and will maintain structural balance by corrective actions, including budget reductions and/or revenue increases.

The City's sizable tax-base and strong financial position help to mitigate the burden posed by elevated pension liabilities, in KBRA's view. Pension reforms enacted in 2017 have eliminated the prospect of the Police and Fire pension plan's insolvency, increased contributions, and reduced the net pension liability. While pension costs are expected to remain elevated, overall fixed costs are affordable, especially given the City's practice of rapid direct debt amortization. In the context of its otherwise conservative fiscal controls, KBRA does not view the City's plan for pension funding, which projects a long ramp-up to full funding, as reflective of credit weakness.

The Stable Outlook reflects the City's considerable budgetary flexibility and long-term favorable outlook for economic and revenue growth. The City has proven its ability to achieve budgetary balance through operating expense reductions and without the use of reserves. Fixed costs are expected to remain moderately elevated but affordable, given recent pension reforms.

## Key Credit Considerations

The rating was assigned because of the following key credit considerations:

Credit Positives

- Strong financial profile reflecting fiscally conservative financial management practices, solid reserves, and healthy liquidity.
- Growing economic base, robust employment expansion and declining poverty levels.

Credit Challenges

- Property tax levy limitation could adversely impact expenditure flexibility.
- Partial reliance on sales tax receipts for operations exposes revenue base to economic fluctuation.

Pension costs are expected to remain elevated.

## Rating Sensitivities

| | |
|---|---|
| ▪ Ability to adapt to the new property tax limitation without significant impact on operations would be viewed positively. | + |
| ▪ Deviation from the City's practice of conservative budgeting would increase credit risk. | - |

| Key Ratios | |
|---|---|
| Population Growth 2010 to 2019 | |
| City | 11.7% |
| State | 14.8% |
| United States | 6.1% |
| | |
| Top 10 Taxpayers as a % of Total Assessed Value | 4.06% |
| Assessed Property Value 5-Yr CAGR Through FY 2021 | 9.2% |
| Unassigned General Fund Balance as % of Expenditures at FYE 2020 | 21.6% |
| | |
| Direct and Overlapping Debt as a % of Full Market Value in FY 2020 | 3.6% |
| Direct Debt Amortized Within 10 Years | 75% |
| Fixed Costs as a % of Governmental Expenditures in FY 2020 | 24.2% |

| Rating Determinants (RD) | |
|---|---|
| 1. Management Structure and Policies | AAA |
| 2. Debt and Additional Continuing Obligations | AA |
| 3. Financial Performance and Liquidity Position | AAA |
| 4. Municipal Resource Base | AA+ |

**There have been no updates to the above-mentioned rating determinants since KBRA's recent surveillance report published October 4, 2021. The surveillance report incorporates a detailed discussion of each rating determinant and includes a link to the Bankruptcy Assessment.**

## RD 1: Management Structure and Policies

The City's strong management practices include a comprehensive budget process, a two-year balanced budget requirement, active financial monitoring, defined reserve policies, and five-year revenue and expenditure projections for the General Fund and each of the enterprise funds. Detailed Financial Management Performance Criteria (FMPC) establish a targeted unassigned General Fund balance, including Emergency and Contingency Reserves, of not less than 50 days and not more than 70 days of General Fund expenditures, less debt service. The City's fiscal year begins October 1 and ends on September 30. The FY 2021 Emergency Reserve was budgeted at $35 million which is unchanged since at least FY 2019 and is sized, in part, to withstand a 5% decline in property values. Use of the Emergency Reserve requires a super majority of City Council.

## ESG Management

KBRA typically analyzes Environmental, Social, and Governance (ESG) factors through the lens of how issuers plan for and manage relevant ESG risks and opportunities. More information on KBRA's approach to ESG risk management in public finance ratings can be found here. Over the medium-term, public finance issuers will need to prioritize ESG risk management and disclosure with the likelihood of expansions in ESG-related regulation and rising investor focus on ESG issues.

### Environmental Factors

Matters relating to climate risk are under the purview of the Chief of Equity and Inclusion, who supervises the City's Office of Environmental Quality and Sustainability (OEQS). OEQS completed development of a Comprehensive Environmental and Climate Action Plan (CECAP) which was unanimously adopted by City Council in May 2021. The CECAP identifies objectives, actions and targets in the areas of air quality, emissions reductions, transportation sustainability, water resources protection, ecosystems/green spaces, and food access. It also incorporates detailed ESG factors in procurement. The inaugural CECAP was presented to a committee of OEQS on October 4, 2021. The CECAP will be updated annually, and a year-end report of sustainable procurement activities will be presented to City Council. A task force has been convened to advise on implementation of the CECAP.

In keeping with the CECAP plan, the City's adopted FY 2022 Budget includes a total of $3 million in investments in additional air quality monitors throughout the City, testing of solar panels on City facilities, and a solar/energy storage initiative.

Other environmental and sustainability priorities in the FY 2022 budget include improving trash and recycling service delivery, implementation of a comprehensive food and urban agriculture plan, and the relaunch of a plan to provide 2,500 native trees to City residents to reduce heat island effect and stormwater runoff.

The City Council also adopted a Green Energy Policy in 2019 and already uses 100% renewable energy for all municipal operations. The City's Energy Program Manager is responsible for the implementation of an energy management system to monitor energy use and opportunities for energy reduction.

To ensure the adequacy of future water supply, the City is finalizing components of the 150-mile Integrated Pipeline Project, which will connect the City's water supply system to Lake Palestine, providing an additional 102 million gallons per day to the system, sufficient to meet projected demand through 2050. The City is also completing a regional water supply project with the Tarrant Regional Water District, which is expected to improve reliability of supply.

The Mill Creek/Peaks Branch/State-Thomas (MCPBST) drainage relief tunnel on the east side of the City will provide enhanced flood protection in East Dallas and Uptown Dallas, and improve stormwater management. Completion of the $320 million, five-mile tunnel is expected in the fall of 2023.

### Social Factors

The City intends to invest in strategic initiatives that it believes are responsible, equitable, accountable and legitimate. The proposed FY 2022 budget includes investments in streets and infrastructure, neighborhood cleanliness, air quality and arts programming, economic development (including infrastructure subsidies to incentivize developers to construct additional affordable housing, and to extend water, sewer and digital infrastructure into historically underserved areas of the city). Public safety investments, including mobile crisis response, enhanced lighting, blight and nuisance remediation, and the hiring of 250 additional police officers in each of FY 2022 and FY 2023 are also prioritized. An additional 95 non-uniform employees, of whom 56 had already been hired as of July 2021, will assume public safety support functions formerly undertaken by uniformed officers.

The proposed budget also includes investments to promote equity, including addressing the digital divide, developing a comprehensive racial equity plan and prioritizing language access, rental assistance and rapid rehousing to address homelessness.

The City plans to continue to provide over $100 million in rental assistance for pandemic victims using dedicated ARPA funding, and to make a $25 million contribution to leverage public and private investment in a program to reduce and prevent homelessness, in partnership with the County and other local stakeholders. Additionally, the budget includes an increase in the minimum wage for full-time City employees from $14.00 to $15.50 per hour in FY 2022 and to $16.00 per hour in FY 2023, reinstatement of market-based pay increases for uniformed employees and merit pay for non-uniformed employees, as well as a new parental leave benefit. A tiered health benefits contribution plan designed to provide all employees with affordable health benefits is in place.

The City's Chief of Equity and Inclusion is appointed by the City Manager and is a member of the City's executive leadership team. City Council approved the City's first Racial Equity Resolution on March 24, 2021. The City's adopted FY 2022 budget funds various policy initiatives in line with the Racial Equity Resolution, including a small business center. Additionally, the Budgeting for Equity initiative of the City's bond and construction management program prioritizes projects located in underserved communities.

### Governance Factors

The City is leading the coordination of municipalities in the Dallas-Fort Worth area and the Dallas Police Department in the development of a regional Cyber Fusion Center to unify security functions including threat intelligence and response, security automation and orchestration, and incident response.

In addition to data center operational control improvements, authentication enhancements, and other proactive steps to protect and secure its information, including moving from the .com domain to the .gov domain, the City is also working with the G20 Global Smart Cities Alliance to develop a G20 Policy for Technology and Cybersecurity, which will be brought to City Council for review and adoption.

The City self-funds employee health insurance, most tort liability exposures, and certain workers' compensation claims, and uses commercial insurance where required and to insure city property (subject to a $750 thousand deductible per loss occurrence), as well as for workers compensation losses in excess of $1.5 million per occurrence.

## RD 2: Debt and Additional Continuing Obligations

While the City has successfully relied upon pay-go financing, rapid debt amortization and the careful management of other continuing obligations to maintain a moderate pace of growth in total long-term liabilities, the adequacy of pension funding remains an area of credit focus.

## RD 3: Financial Performance and Liquidity Position

Financial operations reflect a trend of healthy operating surpluses and strong General Fund reserves with only modest sensitivity to recessionary impacts. The primary General Fund revenue sources, property taxes and sales taxes, account for 57% and 23% of forecast FY 2021 revenues, respectively. In addition to the General Fund, other sizable components of governmental operations are the debt service fund, internal service fund and the water utilities fund.

The City maintains ample liquidity as evidenced by consistent growth in year-end fund balance. The FY 2020 governmental funds cash position was $733 million, equating to a very strong 117 days cash on hand, with an additional $130 million of pooled cash and cash equivalents held in Internal Service Funds.

## RD 4: Municipal Resource Base

Incorporated in 1856, Dallas is approximately 378 square miles in area and is the county seat of the County of Dallas. The City, which is spread across four counties (Dallas, Collin, Denton and Rockwall) is the primary economic driver in the Dallas-Fort Worth-Arlington metropolitan statistical area (MSA), which is the fourth largest MSA in the nation behind the New York, Los Angeles, and Chicago. The City is the 3rd largest city in the State of Texas (AAA/Stable) and 9th largest in the nation with a population of 1.3 million. Population growth in Dallas (11.7% since 2010) has significantly outpaced the nation but modestly lags the State. The City's growing employment base has fueled both domestic and international migration with foreign-born residents making up 24.8% of the City's population in 2019.