Memorandum

CITY OF DALLAS

DATE October 15, 2021

TO Honorable Mayor and Members of the City Council

SUBJECT **S&P Global Ratings Assigns New 'A' Rating and Stable Outlook for City of Dallas Hotel Occupancy Tax Revenue Refunding Bonds – RATING ACTION**

On October 7, 2021, S&P Global Ratings (S&P) assigned its 'A' credit rating and stable outlook to the anticipated Hotel Occupancy Tax (HOT) Revenue Refunding Bonds, Series 2021, and affirmed the 'A' rating on the City of Dallas' 2009 civic center convention complex revenue refunding and improvement bonds with a revised outlook to stable from negative. The anticipated bonds are currently scheduled for a negotiated sale on October 19 to refund the outstanding Series 2009 Convention Center bonds for savings. The pledged revenues securing the bonds are 4.718 percent of the net 7 percent hotel occupancy tax collected within the City, excluding HOT generated at the convention center hotel.

According to the S&P report, the City's "'A' rating on the bonds reflects Dallas' "very strong and robust economy," "a return to positive month-over-month growth in pledged revenue collections following historical lows in 2020 and 2021," adequate debt service coverage "with anticipation of improvement in the near term," "a debt service reserve fund that will be funded with cash at average annual debt service", and "an additional bonds test of 1.25x average annual debt service." Additionally, S&P "analyzed social, environmental, and governance risks relative to Dallas' economy, management, financial measures, and debt and liability profile, and determined that none of these present unusual risk."

The rating decision by S&P on the bonds is yet another positive reinforcement to the City's credit profile, fueled by prudent financial management and strategic efforts to support our vibrant local economy. Attached is the rating report provided by S&P.

Please let me know if you need additional information.

M. Elizabeth Reich

M. Elizabeth Reich
Chief Financial Officer

[Attachment]

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S&P Global Ratings

RatingsDirect®

Summary:

Dallas; General Obligation; Miscellaneous Tax

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Summary:

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Credit Profile		
US$236.595 mil hotel occup tax rev rfdg bnds ser 2021 due 08/15/2038		
Long Term Rating	A/Stable	New
Dallas misc tax (Civic Ctr Convtn Complex) (ASSURED GTY)		
Unenhanced Rating	A(SPUR)/Stable	Outlook Revised
Many issues are enhanced by bond insurance.		

Rating Action

S&P Global Ratings has revised the outlook to stable from negative and affirmed the 'A' rating on the City of Dallas' 2009 civic center convention complex revenue refunding and improvement bonds. At the same time, we have assigned an 'A' rating to Dallas' $236.5 million hotel occupancy tax revenue refunding bonds series 2021, which will refund the existing 2009 bonds. The outlook is stable.

We have applied our priority-lien tax revenue debt criteria (published Oct. 22, 2018), which factors in the strength and stability of pledged revenues and the general credit quality of the municipality where taxes are distributed or collected, known as the obligor's creditworthiness (OC). Our view of the OC does not currently limit the priority-lien rating.

The bonds constitute special obligations of the city, payable from and secured by a lien on and pledge of 4.718% of a 7% hotel occupancy tax. The current provisions of Chapter 351 authorize the city to levy and collect a tax at any rate not to exceed 7% of the price paid for hotel rooms located within the corporate limits of the city. The city currently levies the Chapter 351 Hotel Tax at the maximum rate of 7%. Proceeds from the sale of the bonds will be used to refund the city's 2009 civic center convention complex bonds for a projected net present value savings. The existing 2009 bonds are secured by the same 4.718% portion of the 7% hotel tax, as well as gross revenues and income received by the city as a result of renting, leasing, or otherwise operating the business affairs of the civic center.

Credit overview

The city is wholly refunding its existing 2009 civic center issuance with the new bonds. Despite a significant and material drop in pledged hotel tax revenues caused by disruptions due to the COVID-19 pandemic, revenues are returning to more traditional norms as hotel stays are rebounding from historical lows, which is reflected in the rating and change to stable outlook. While 2020 annual pledged revenue collections indicate maximum annual debt service (MADS) coverage of 1.36 times, more recent trends show significant improvement. If improved trends continue at approximately 72% of 2019 collections based on 2021 collections from May 2021, pledged revenue collections for 2022 would show 1.6x coverage. If more recent months of collections are taken into consideration, projected MADS coverage improves to 1.89x. A steady growth trend without material decline or return to stress scenario which was experienced in April and May 2020, coverage of MADS could improve to above 2x in the outlook horizon.

The local economy in Dallas remains vibrant and robust, fueled by population growth. In 2021, 852 new hotel rooms have either opened or are under construction, which should support near-term growth in pledged revenues. While the city has discussed potential future renovation or expansion projects associated with the civic center, no definitive plans for future debt have been established. The city has not issued new money bonds, which would leverage the existing hotel tax revenue stream, since 2009. Given an upward trajectory of pledged hotel taxes, we expect adequate debt service coverage will improve to strong debt service coverage, commensurate with pledged revenue growth.

The rating reflects our view of:

- Dallas' favorable location in the region and greater Dallas Fort Worth MSA;
- A return to positive month-over-month growth in pledged revenue collections following historical lows in 2020 and 2021;
- Adequate coverage of MADS of 1.36x, based on 2020 annual collections;
- A debt service reserve fund that will be funded with cash at average annual debt service; and
- An additional bonds test of 1.25x average annual debt service.

Environmental, social, and governance factors

We analyzed social, environmental, and governance risks relative to Dallas' economy, management, financial measures, and debt and liability profile, and determined that none of these present unusual risk in our analysis.

Stable Outlook

Downside scenario

We could consider a lower rating if significant decreases in pledged revenues result in materially weaker debt service coverage or if our view of the Dallas economy weakens. Additional leveraging of the pledged hotel taxes through additional borrowing could also dilute coverage and put negative pressure on the rating. We could also lower the rating if Dallas' general creditworthiness deteriorates.

Upside scenario

Although unlikely in the near term, we could consider a higher rating if revenue growth produces a sustained trend of consistently stronger debt service coverage.

Credit Opinion

Economic fundamentals: Very strong and robust economy

We consider Dallas' economy very strong. The city, with an estimated population of 1.3 million, is in Collin, Dallas, and Denton counties in the Dallas-Fort Worth-Arlington, TX MSA, which we consider broad and diverse. Despite the ongoing pandemic and disruptions in the local economy, steady growth in market value and population should support near-term stability. Dallas is the hub of business in North Texas. The region is home to 42 Fortune 1000 companies, 16 of which are in Dallas, including nine Fortune 500 companies. The city is centrally located in the U.S. and is a draw for tourism and conventions alike. 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 remain a desirable location for new business as well as for relocations of corporate headquarters. The strong economic expansion is represented in robust annual market value growth since 2011.

The pandemic has affected economic metrics, most notably unemployment. However, data indicate travel, tourism, and hotel stays are returning to more traditional patterns following historical lows in 2020 and 2021. Hotels with 300 and greater rooms represent a significant part of the Dallas hotel inventory of hotels. Many of these hotels generate a significant portion of their room night demand from meeting and group activity. While group activity is slower to return, demand at hotels concentrating on commercial and leisure has already significantly returned to more positive operations. In the past five years, 47 hotels with a total of 5,138 rooms opened in the city, boosting the supply of hotel rooms by 15.7%. Two additional hotels have opened in 2021, the 255-room Marriott Dallas Uptown and the 91-room Fairfield Inn. In 2021, hotels have added or are building 852 new rooms. We expect the breadth and depth of Dallas' robust economy will remain a credit strength.

Coverage and liquidity: Adequate with anticipation of improvement in the near term

We assess 1.36x coverage of MADS, as provided by 2020 pledged hotel tax collections, as adequate. In the past several years, pledged hotel taxes (4.718% of the city's 7% hotel tax) have fluctuated significantly, with a steady growth trend followed by 2020's 38% year-over-year decline from the previous year. For fiscal 2021, year-to-date revenue collections have been steadily rising since March. March 2021 was the first month of significant recovery from the pandemic for the hotel market in Dallas, with the number of occupied room nights divided by the number of available room nights rising over 50% for the first time since February 2020. However, weak collections in October year 2021 through February 2021 when compared with the previous year will influence annual pledged revenue collections. For fiscal 2021, year-to-date expectations are for pledged revenues to total $25.5 million, which represents only a modest decline from 2020 and provides 1.30x MADS coverage. Yet, coverage continues to improve on a month-to-month basis in 2021. If improved trends continue at approximately 72% of 2019 collections based on 2021 collections from May of 2021, pledged revenue collections for 2022 would show 1.6x coverage. If more recent months of collections are taken into consideration, projected MADS coverage improves to 1.89x. A steady trend of improving collections and subsequent debt service coverage is incorporated in our rating and stable outlook.

Bond provisions include an additional bonds test of 1.25x average annual debt service. Additional liquidity for debt service on the bonds is provided by a debt service reserve equal to average annual debt service, which is expected to be cash funded. Despite pledged revenue collections below historical norms, if they continue to rise, they could exceed fiscal 2019 collections as early as 2023.

Volatility: Moderate

We assess the volatility of pledged revenues to determine the likelihood of the availability of revenues during different economic cycles. We have two levels of volatility assessment: macro and micro.

Our macro volatility assessment begins with an assessment of the historical volatility of the economic activity being taxed, and includes an analysis of societal, demographic, political, and other factors that could affect these activities. Based on the variance of national economic activity that we believe most closely represents the taxing base over multiple economic cycles, we use historical volatility to inform our opinion on expectations of future volatility as it relates to hotel taxes.

On a micro level, considering stable collections, coupled with a broad base, we see no internal or external influences that we believe improve or weaken the macro assessment of volatility as moderate. Although fluctuations could occur relative to economic cycles, historical trends inform our view of pledged hotel tax collections that we believe have been relatively stable. We note the material decline in collections during the 2020 and 2021 period as a direct result of the pandemic and restrictions on travel and leisure industries. However, we also note that through calendar 2021, pledged hotel tax collections have returned to month-over-month gains.

Obligor linkage: Close

In our view, the issuer does not benefit from limited operations or extraordinary expenditure flexibility, and we believe pledged revenues have some exposure to operating risk, leading to a one-notch upward limitation compared with the city's general creditworthiness. Although pledged revenues will support debt service first, the flow of funds for the pledged revenues allows management to use excess revenue for qualifying expenditures, and we consider the hotel tax and use of revenue within Dallas' direct control and exposed to operating risk. Therefore, under our priority-lien criteria, we believe there is a close relationship between the priority-lien pledge and the obligor's pledge.

Rating linkage to Dallas

We assess the city's general operations because we view overall creditworthiness as a key determinant of an obligor's ability to pay all its obligations, including bonds secured by a special tax.

The strength of Dallas' local economy and tax base is grounded in solid population growth and commercial and residential development that has occurred in the past decade. In fiscal 2020, the city recorded a stable fiscal performance through cost-saving measures and cuts in discretionary spending to maintain budget stability in the face of a difficult revenue environment. Dallas faces hurdles in fiscal 2021 as the COVID-19 pandemic remains a negative influence on the economy and some revenue streams. Although its stable financial performance, very strong reserve and liquidity position, and very strong fiscal management practices provide a cushion and counteract the negative effects of the pandemic, the city faces high fixed costs and weak funded status of its pension plans.

For more information on the city's general creditworthiness, see the summary analysis published Sept. 25, 2020, on RatingsDirect.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020