Memorandum

CITY OF DALLAS

DATE October 28, 2022

TO Honorable Mayor and Members of the City Council

SUBJECT **Kroll Bond Rating Agency Affirms ‘AA+’ Rating and Revises Outlook to Positive on City of Dallas General Obligation Bonds - Information**

On October 25, 2022, Kroll Bond Rating Agency (KBRA) affirmed the ‘AA+’ credit rating on the City of Dallas General Obligation Bonds as part of a statutorily required annual review. Notably, the outlook was revised to Positive from Stable. KBRA’s surveillance report states that the rating affirmation reflects “the City’s sound financial profile, disciplined, forward-looking financial management practices, healthy reserves, and ample liquidity,” while the Positive outlook reflects the “continued favorable growth trends across the City’s resource base and financial operations coupled with the return of a more stable operating environment.”

In the report, KBRA notes key credit considerations for the rating, including “fiscally conservative financial management practices,” a “growing tax and resource base, and unemployment rates which have trended below the state average,” and the “ability to achieve budgetary balance through operating expense reductions and without the use of reserves,” as credit positives. The report also details KBRA’s view of credit challenges to the City, including elevated pension costs and a “partial reliance on sales tax receipts for operations.” KBRA further explains that “the City’s sizable tax-base and strong financial position help to mitigate the burden posed by elevated pension liabilities,” and “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 City’s General Obligation rating is currently one notch below the highest rating for KBRA. The affirmed rating and revised outlook is a credit positive and bolsters the City’s credit profile to stakeholders and investors during a challenging time of market uncertainty.

Attached is the published report for your review. Please let me know if you need additional information.

Jack Ireland
Chief Financial Officer

c:
T.C. Broadnax, City Manager
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Bilierae Johnson, City Secretary
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Robert Perez, Assistant City Manager
Carl Simpson, Assistant City Manager
Genesis D. Gavino, Chief of Staff to the City Manager
Directors and Assistant Directors

City of Dallas, Texas

Issuer: City of Dallas, Texas		
Affirmed	**Ratings**	**Outlook**
General Obligation Bonds	AA+	Positive *(from Stable)*
Equipment Acquisition Notes	AA+	Positive *(from Stable)*
Certificates of Obligation	AA+	Positive *(from Stable)*

Methodology

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

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Rating Summary: The Outlook revision on the City of Dallas (the "City")'s General Obligation (GO) obligations reflects continued favorable growth trends across the City's resource base and financial operations coupled with the return of a more stable operating environment. Additionally, property tax revenues have demonstrated resiliency during the COVID-19 pandemic. The Positive Outlook also reflects KBRA's expectation that the City's debt and continuing obligations will remain well supported by its growing assessment and resource base. Should favorable growth trends in overall assessment values continue, and the City's debt burden remain manageable, upward rating momentum over the near term may be possible.

The rating affirmation 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 City's GO obligations include the GO Bonds, Equipment Acquisition Notes, and Certificates of Obligation. The GO Bonds and Equipment Acquisition Notes are secured by a pledge of an annual ad valorem tax levied on all taxable property within the City. Certificates of Obligation are additionally secured by a limited pledge of surplus revenues generated by the City's Municipal Drainage Utility System in an amount not to exceed $1,000. KBRA does not make an analytical rating distinction between the G.O. Bonds/Equipment Acquisition Notes and the Certificates of Obligation.

The State Constitution and the City Charter limit the ad valorem tax rate to $2.50 per $100 of taxable assessed valuation (TAV) 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, 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. The City's FY 2021-2022 tax rate was $0.7733 per $100 of TAV with further reduction to $0.7458 for FY 2022-2023.

Dallas 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 New York, Los Angeles, and Chicago. The City is the 3rd largest city in the State of Texas (the "State"; KBRA rated AAA/Stable) and 9th largest in the nation with a population of 1.3 million. The City's growing employment base has fueled both domestic and international migration. The City's tax base remains diverse with no dominant taxpayers. Full market value (FMV) per capita is approximately $137,876, which KBRA views as favorable.

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.

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 (GF) balance, which includes Emergency and Contingency Reserves, of at least 50 days and not more than 70 days of GF operating expenditures less debt service. The FY 2021 unassigned GF fund balance of $324.3 million, equated to 88 days of GF operating expenses less debt service. In addition, the City has maintained ample liquidity as evidenced by consistent growth in year-end fund balance. The City ended FY 2021 with 123 days cash on hand (DCOH), which strengthened year over year (YoY).

KBRA views the City's current and historical financial performance as very strong, reflecting a trend of healthy operating surpluses and strong reserve levels with minimal pandemic impacts. FY 2021 GF balance increased by a healthy 16.2%, to $400.5 million. Primary GF revenue sources are property taxes and sales taxes, accounting for 54% and 25% of FY 2021 revenues, respectively.

Forecast (unaudited) FY 2022 GF revenues are 2.3% above budget, due primarily to stronger than anticipated property tax and sales tax receipts. The City forecasts FY 2022 GF expenditures largely in line with budgetary expectations, and projects an ending FY 2022 GF balance of $314.9 million. The City's proposed biennial FY 2023 and FY 2024 budget continues to project unassigned fund balance greater than 60 days. However, due to rapidly growing pension and overtime costs, the unassigned fund balance is projected to decline to 14.5 days in FY 2027 (budgetary basis). Nonetheless, 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.

Key Credit Considerations

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

Credit Positives

- Strong financial profile reflecting fiscally conservative financial management practices, solid reserves, and healthy liquidity.
- Robust economic growth, evidenced by a diverse, growing tax and resource base, and unemployment rates which have trended below the state average.
- Ability to achieve budgetary balance through operating expense reductions and without the use of reserves.

Credit Challenges

- Partial reliance on sales tax receipts for operations exposes revenue base to economic fluctuation.
- Pension costs are expected to remain elevated.

Rating Sensitivities

▪ Sustained, robust financial operating performance across the near-term supported by continued strong growth in the City's resource and assessment base. ▪ Ability to absorb increasing pension contributions while maintaining robust financial strength. ▪ 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 CAGR Growth 2011 to 2021	
City	0.5%
State	1.4%
United States	0.6%
Top 10 Taxpayers as a % of Total Assessed Value	3.9%
Assessed Property Value 5-Yr CAGR Through FY 2022	7.2%
Unassigned General Fund Balance as % of Expenditures at FYE 2021	23.5%
Direct and Overlapping Debt as a % of Full Market Value in FY 2021	3.3%
Direct Debt Amortized Within 10 Years	75%
Fixed Costs as a % of Governmental Expenditures in FY 2021	19.7%

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 except for RD 2 and 3. For a detailed discussion on RD 1, 4, and ESG Management, please refer to KBRA's surveillance report published on October 4, 2021.

Bankruptcy Assessment

KBRA has consulted outside counsel on bankruptcy matters and the following represents our understanding of the material bankruptcy issues relevant to the City. To be a debtor under the municipal bankruptcy provisions of the U.S. Bankruptcy Code (Chapter 9), a local governmental entity must, among other things, qualify under the definition of "municipality" in the Bankruptcy Code, and must also be specifically authorized to file a bankruptcy petition by the State in which it is located. The City is a political subdivision and municipal corporation of the State of Texas organized and existing under state law, and thus is a "municipality" as defined under the Bankruptcy Code. As to authorization, Texas state law specifically authorizes any municipality in the state that has the power to incur indebtedness through the action of the municipality's governing body to file a Chapter 9 petition. Thus, the City has the authority under Texas state law to incur indebtedness and, hence, it is specifically authorized under Texas state law to file a Chapter 9 petition, subject of course to the further threshold requirements in Federal law (the Bankruptcy Code) for commencement of a Chapter 9 case.

The principal of and interest on the Obligations are payable from a direct and continuing ad valorem tax levied by the City, within the limits prescribed by law, upon all taxable property in the City.

Chapter 9 provides for post-petition recognition of (i) a security interest represented by a pledge of specific special tax revenues or municipal enterprise revenues (each "special revenues") and also (ii) a statutory lien on revenues pledged for municipal obligations. In contrast, the pledge of general ad valorem property taxes for a general purposes obligation of a municipality, such as the pledge of City ad valorem property taxes to pay the Obligations, is not recognized as a security interest or lien that survives the filing of a petition under Chapter 9. Accordingly, because (a) the funds pledged to pay the Obligations are not from a separate, dedicated source of revenues that meets the definition of "special revenues" under Chapter 9, and (b) there is no statutory lien imposed on the pledged ad valorem tax revenues levied to pay the Obligations, if the City were to file a petition commencing a Chapter 9 proceeding holders of the Obligations would likely be treated as unsecured creditors of the City.

RD 2 Update: 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. The City's FY 2021 fixed cost burden inclusive of pension contributions ($229.3 million), OPEB benefit payments ($18.4 million) and annual debt service ($272.4 million), though somewhat improved from prior years, equated to 19.7% of governmental fund expenditures, which KBRA considers somewhat elevated, but remains affordable.

Local Government Pension Obligation

The City participates in three single employer defined benefit pension plans. The Employees' Retirement Fund (ERF), Dallas Police and Fire System Combined Plan (DPFS Combined Plan) and the Dallas Police and Fire System Supplemental Plan (DPFS Supplemental Plan). 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. Nonetheless, the funding progress of the three plans continued to weaken throughout FY 2021. Fiduciary net position as a percentage of the total pension liability was a low 59.7% for ERF, 37.9% for the DPFS Combined Plan, and 43.7% for the small DPFS Supplemental Plan as of the December 31, 2020 measurement date (Figure 1). The combined NPL of $5.7 billion equates to 3.1% of FMV and $4,320 per capita. It thus represents a manageable burden on the tax base, but a relatively high per capita burden.

The $229 million pension contribution remains manageable at 8.7% of FY 2021 governmental fund expenditures (Figure 2).

Figure 1

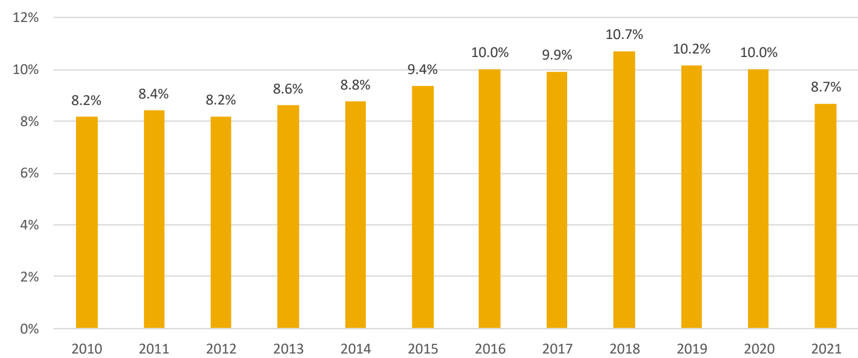
($ in MMs)	As of December 31, 2020 Measurement Date[1]				FY 2021		
	Total Pension Liability	Fiduciary Net Position	Net Pension Liability (NPL)	Fiduciary Net Position as a % of Total Pension Liability	Actual Contribution	Actuarially Determined Contribution (ADC)	Actual Contribution as a % of ADC
Employees' Retirement Fund (ERF)	6,210	3,707	2,503	59.7%	62	97	64.1%
Dallas Police and Fire System Combined Plan (Combined Plan)	5,122	1,944	3,179	37.9%	165	223	74.1%
Dallas Police and Fire System Supplemental Plan (Supplemental Plan)	37	16	21	43.7%	2	2	100.0%
Total	**$11,370**	**$5,667**	**$5,703**		**$229**	**$322**	**71.3%**

Source: City of Dallas ACFR

[1]As presented in FY 2021 ACFR.

Figure 2

Actual Pension Contribution as a % of Governmental Expenditures



Source: ACFRs

RD 3 Update: Financial Performance and Liquidity Position

The primary GF revenue sources are property taxes and sales taxes, which account for 56% and 24% of forecast FY 2022 revenues, respectively. In addition to the GF, other sizable components of governmental operations are the Debt Service Fund, Internal Service Funds, and the Water Utilities Fund.

FY 2021 Audited Financial Results

Financial operations reflect a trend of healthy operating surpluses and strong GF reserves with minimal pandemic impacts during FY 2020. GF revenues growth of 7.5% YoY exceeded 7.2% expenditure growth, thus increasing the operating surplus from the prior year.

The City continues to maintain a trend of exceptional growth in reserves (11.2% CAGR in ending GF balance from FY 2017 through FY 2021). Moreover, unassigned GF balance levels have consistently met or exceeded the City's policy. As of FYE 2021, unassigned GF balance grew to a very strong $324.3 million, or 88 days of GF operating expenses less debt service, exceeding the FMPC's 50-day minimum in FY 2021.

Liquidity

The City maintains ample liquidity as evidenced by consistent growth in year-end fund balance. The FY 2021 governmental funds cash position was $886.8 million, equating to a very strong 123 DCOH, with an additional $144.9 million of pooled cash and cash equivalents held in Internal Service Funds.

Figure 3

General Fund Summary Statement of Income and Balance Sheet FYE September 30 (Audited GAAP Basis) (dollars in thousands)	2017	2018	2019	2020	2021
Statement of Income					
Revenues					
Ad Valorem Tax	578,032	611,133	677,607	728,339	775,518
Sales Tax	295,361	307,149	320,413	314,385	354,288
Franchise Fees	138,998	146,209	135,697	120,944	120,445
Services to Others	126,498	122,924	109,491	102,021	118,897
Other	53,972	58,063	67,600	61,586	10,805
Total Revenues	1,192,861	1,245,478	1,310,808	1,327,275	1,426,948
Expenditures					
Public Safety	712,990	736,879	774,182	792,917	849,288
General Government	121,279	144,161	167,958	150,372	173,809
Culture and Recreation	136,984	143,813	141,594	132,749	134,021
Other	188,791	210,790	196,919	209,401	221,193
Total Expenditures	1,160,044	1,235,643	1,280,653	1,285,439	1,378,311
Excess (Deficiency) of Revenues Over (Under) Expenditures	32,817	9,835	30,155	41,836	48,637
Other Financing Sources (Uses)	11,316	11,255	10,745	5,641	7,230
Net Change in Fund Balance	**44,133**	**21,090**	**40,900**	**47,477**	**55,867**
Beginning Fund Balance	191,031	235,164	256,254	297,154	344,631
Ending Fund Balance	**235,164**	**256,254**	**297,154**	**344,631**	**400,498**
Balance Sheet					
Assets					
Cash and Cash Equivalents	203,452	216,346	277,654	328,272	385,525
Receivables	142,490	142,466	119,530	128,026	153,927
Other	15,514	16,384	30,643	32,930	31,309
Total Assets	361,456	375,196	427,827	489,228	570,761
Liabilities					
Accrued Payroll	21,273	23,633	28,339	8,569	11,916
Accounts Payable	35,339	32,985	35,684	35,215	53,387
Other	20,648	12,680	13,416	44,083	45,187
Total Liabilities	77,260	69,298	77,439	87,867	110,490
Deferred Inflows of Resources (Unavailable Revenue)	49,032	49,644	53,234	56,730	59,773
Fund Balance					
Nonspendable	11,143	11,227	13,385	15,385	16,006
Restricted	12,061	10,244	11,185	8,724	6,627
Committed	1,250	1,250	1,250	2,000	2,000
Assigned	38,963	20,727	37,109	41,071	51,565
Unassigned	171,747	212,806	234,225	277,451	324,300
Total Fund Balance	**235,164**	**256,254**	**297,154**	**344,631**	**400,498**
Unassigned Fund Balance as a % of Expenditures	14.8%	17.2%	18.3%	21.6%	23.5%

Source: City of Dallas ACFRs

FY 2023 and FY 2024 Budget Overview

The adopted $1.7 billion FY 2023 General Fund budget, up 9.4% from the FY 2022 amended budget, contemplates a $132.2 million or 11% increase in property tax revenues while plan for a seventh consecutive annual decrease in the tax rate (reduced by $2.75 cents to $0.7458 per $100 AV). Of this increment, approximately 18.8% is tax revenue to be raised from new property additions to the tax roll in FY 2022. The budget also projects a 14.5% increase in sales tax revenues over the amended FY 2022 budget (up 6% versus FY 2022 forecast).

The FY 2023 and FY 2024 budgets anticipate maintenance of the unassigned General Fund balance at $308.4 million, or between 64 and 66 days. While the budget continues to project outyear structural imbalance starting in FY 2025 with a decline in the General Fund balance to $82.5 million (14.5 days) by FY 2027 primarily as a result of increasing personnel costs, 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 proposed FY 2023 and FY 2024 biennial budget continue to prioritize the advancement of economic development, environment and sustainability, housing and homelessness solutions, public safety, culture and quality of life, transportation, infrastructure, and workforce, education and equity initiatives.