Memorandum

CITY OF DALLAS

DATE April 7, 2020

TO Honorable Mayor and Council Members

SUBJECT **S&P Global Ratings Affirmed ‘AA-’ Rating and Stable Outlook for City of Dallas Outstanding General Obligation and ‘A’ Rating and Stable Outlook on Dallas Convention Center Hotel Development Corp. Bonds – RATING ACTION**

I am pleased to report that today, S&P Global Ratings (S&P) affirmed the City's ‘AA-’ credit rating and stable outlook for General Obligation debt and ‘A’ Rating and Stable Outlook on Dallas Convention Center Hotel Development Corp. Bonds. S&P also affirmed its 'A-1+' short-term rating on Dallas' GO commercial paper (CP) notes. With the advent of social distancing and shelter-in-place orders, S&P states that, “while the city’s stable financial performance, very strong reserve and liquidity position, and very strong fiscal management practices provide a cushion and counteract such disruptions, a prolonged restriction on residents' movement will likely have a significant negative impact on the city’s economy and finances.”

According to S&P, the General Obligation rating reflects the City’s strong economy, “fueled by solid population growth and job creation, development, and robust annual market value growth for a large metro area.” The rating agency also views the City’s management as “very strong”, with “strong financial policies and practices,” indicating “financial practices are strong, well embedded, and likely sustainable.” The report also states that S&P views the City’s liquidity and “budgetary flexibility” as “very strong,” stating, “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.”

In the analysis of the Dallas Convention Center Hotel Development Corp. Bonds, S&P states that the rating is based “on the strength of the city’s appropriation, 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,” noting that the City, “through appropriated grants if needed, supports the convention center hotel bonds (series 2009A and 2009B), Downtown Dallas Development Authority tax-increment financing (TIF) bonds (series 2006 and 2007), and civic center operational insufficiencies.”

The rating decision by S&P further reinforces the City's strong position during these uncertain times. Attached is the rating action report provided by S&P today. If you have any questions or need further information, please do not hesitate to contact me.

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
Dr. Eric A. Johnson, Chief of Economic Development and Neighborhood Services
Laila Alequresh, Chief Innovation Officer
M. Elizabeth (Liz) Cedillo-Pereira, Chief of Equity and Inclusion
Directors and Assistant Directors

S&P Global
Ratings

RatingsDirect®

Summary:

Dallas; CP; General Obligation; Moral Obligation

Primary Credit Analyst:
Andy A Hobbs, Farmers Branch + 1 (972) 367 3345; Andy.Hobbs@spglobal.com

Secondary Contact:
Kate Boatright, Farmers Branch (1) 214-871-1420; kate.boatright@spglobal.com

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Summary:

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Credit Profile		
US$233.195 mil GO rfdg and imp bnds ser 2020 due 02/15/2040		
Long Term Rating	AA-/Stable	New
US$29.045 mil equip acquis contractual obligs ser 2020 due 02/15/2030		
Long Term Rating	AA-/Stable	New
US$14.245 mil comb tax and rev certs of oblig ser 2020 due 02/15/2030		
Long Term Rating	AA-/Stable	New
Dallas GO		
Long Term Rating	AA-/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA-' rating to the City of Dallas' anticipated $233 million series 2020 general obligation (GO) refunding and improvement bonds, $14 million series 2020 combination tax and revenue certificates of obligation, and $29 million series 2020 equipment acquisition contractual obligations. At the same time, S&P Global Ratings affirmed its 'AA-' long-term and underlying ratings on Dallas' GO bonds outstanding. The outlook is stable.

The bonds, certificates, and contractual obligations, all 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 the city. The certificates are further secured by a limited pledge of surplus revenues of the city's municipal drainage utility system in an amount not to exceed $1,000. 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 sales will refund existing debt for a net present value savings and fund projects throughout the city, including public works updates, and fund equipment purchases.

S&P Global Ratings also 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 Nov. 20, 2019. The rating is based on the strength of the city's appropriation, 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. We had previously viewed the city's ability to make grant payments in the event of a deficiency as a moral obligation, which was an error. Yet this does not change our view of the city's support. Obligor involvement is considered weak, given the projects funded do not have a clear linkage with the city's basic functions. Although 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 strength of the city's ability to appropriate grants 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.

S&P Global Ratings also affirmed its 'A-1+' short-term rating on Dallas' GO commercial paper (CP) notes. The rating reflects our view of the city's strong general creditworthiness and liquidity. The CP notes are a GO of the city, secured by Dallas' unlimited ad valorem taxing power.

Credit overview

The long-term rating reflects the strength of the city's local economy and tax base, which is grounded in solid population growth and commercial and residential development in the past decade. The advent of social distancing and subsequent Dallas County order for all individuals currently living within the county to shelter at their place of residence will have a negative impact on the local economy and the city's revenues, in particular sales tax revenues. While the city's stable financial performance, very strong reserve and liquidity position, and very strong fiscal management practices provide a cushion and counteract such disruptions, a prolonged restriction on residents' movement will likely have a significant negative impact on the city's economy and finances. S&P Global Ratings recognizes that with almost 200 million Americans either under shelter-in-place orders or being urged to stay at home in a concerted effort to contain the spread of the new coronavirus, the longest economic expansion in U.S. history has come to an abrupt end. The toll on GDP will be far more severe than we once thought--with the contraction showing up in the first-quarter figure and worsening substantially in the April-June period. (see "It's Game Over For The Record U.S. Run; The Timing Of A Restart Remains Uncertain," published on March 27, 2020, on RatingsDirect). Future credit reviews will focus on what influence the current challenging environment presents to the city, as well as Dallas' ability to respond in a timely and appropriate fashion to ensure maintenance of stable key credit metrics.

The rating reflects our assessment 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;
- 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 178.9% of total governmental fund revenue, as well as a large pension and other postemployment benefit (OPEB) obligation; and

- Strong institutional framework score.

Stable One-Year Outlook

Downside scenario

We could lower the rating if the city fails to implement credible changes meant to curb growth in its large and rising pension obligation or if pension funding deteriorates materially tied to inadequate contributions or poor investment returns. We could also lower the rating if budgetary results were to weaken, as a result of the spread of COVID-19 or increased fixed costs, reducing available reserves to levels no longer comparable with those of similarly rated peers.

Upside scenario

All else being equal, we could raise the rating if Dallas were to implement credible changes to address its exposure to large pension obligations, reflected in a demonstrated trend of strong funding discipline and improved plan soundness coupled with continued economic growth and diversification that result in improved underlying economic metrics that are comparable with those of higher-rated peers.

Credit Opinion

Strong economy

We consider Dallas' economy strong. The city, with an estimated population of 1.3 million, is located in Collin, Dallas, and Denton counties in the Dallas-Fort Worth-Arlington, TX MSA, which we consider broad and diverse. The city has a projected per capita effective buying income of 98.3% of the national level and per capita market value of $104,597. Overall, the city's market value grew by 6.4% over the past year to $138.5 billion in 2020. The weighted-average unemployment rate of the counties was 3.7% in 2018.

Strength in the local economy is fueled by solid population growth and job creation, development, and robust annual market value growth for a large metro area. Although the fundamentals of the local economy remain strong, near-term challenges associated with the recent onset of COVID-19 and social distancing strategies used to thwart the spread of the virus will likely take their toll on what has been a positive trend. Given the greater metro area's population, development, and market value have been steadily growing, the depth and breadth of the risk to the city could be greatly influenced by the length of time the situation persists.

Dallas is the hub of business in North Texas. The region is home to 42 Fortune 1000 companies; 16 of which are located in Dallas, including two Fortune 500 companies. The city is centrally located in the U.S. and acts as a draw for tourism and conventions alike. It 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 Airlines and Southwest Airlines. 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 recent relocations of corporate headquarters to the area. The strong economic expansion is represented in robust annual market value growth since 2011.

Downtown revitalization draws residents to the urban core and new development thrives throughout the city. The downtown residential population is nearly 14,100. New construction permit activity in calendar year 2019 totaled more than $2.5 billion. Uber Technologies announced it is developing a major hub in the Deep Elum neighborhood north of downtown that will be provide at least 2,500 jobs. Kroger is partnering with Ocado Solutions to construct a 350,000-square-foot robotic grocery fulfillment center. Chime Solutions opened a 51,000-square-foot office center at the recently re-developed Red Bird Mall and plans to create over 1,000 full-time jobs. Despite near-term challenges to the tourism and hospitality sectors, the local economy is positioned well. However, the local economy will be negatively affected by the current events and it will likely be substantial if the situation is prolonged.

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. It 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 is conducted and presented to council. 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 and it currently adheres to this. 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 1.9% in fiscal 2018. General fund operating results have been stable over the past 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, 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. Dallas also benefits from a practice of producing a balanced budget for a two-year cycle and has historically benefitted from positive budget variances. Audited results of general fund revenues were primarily derived from property taxes (49% of total general fund revenues) and sales taxes (25%). Both revenue streams experienced solid growth in 2018, which aided stable performance. Before transfers, general fund revenues outpaced expenditures by $9.8 million. Also taken into consideration in the city's overall performance was the full cost of the city's actuarially determined contribution (ADC) for pension costs.

For fiscal 2019, the city anticipates solid results and an increase to year-end fund balance. Stable growth in property tax collections, charges for services, and in particular sales tax collection fueled positive performance. The adopted budget for 2020 is balanced and year-to-date trends remain strong. The 2020 budget invested heavily in public safety, including increasing annual contributions to the city's police and fire pension systems. Key revenue drivers for the year were positive property tax and sales tax assumptions, which before March remained strong. Sales tax revenues for 2020 were trending up 4.5%, although due to timing of collections and remittance to the city from the state, a significant downshift in sales tax collections would not be experienced until several months following the transactions. Given the current "Stay Home Stay Safe" order effective March 23, which is anticipated to be in place through April, we expect the restriction on residents' movement to directly affect sales tax collections of the city. While we do not expect a significant shift in the city's financial performance, a great deal of uncertainty remains regarding the breadth and depth of the risks that could arise if restrictions remain for a prolonged period.

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. The available reserve position continues to increase, which creates greater financial flexibility and is a credit strength. Based on expectations for fiscal 2019 performance, the city anticipates general fund balance to increase based on year-end projections.

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 available in less than a year and are in highly rated investment pools such as Logic and TexPool, and TexSTAR. The city, through appropriated grants if needed, supports the convention center hotel bonds (series 2009A and 2009B, Downtown Dallas Development Authority tax-increment financing (TIF) bonds (series 2006 and 2007), and civic center operational insufficiencies.

The intended payment source for the convention center hotel bonds 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 7% local HOT revenues collected at the hotel project and dedicated to debt service. In previous publications, we did not explicitly note that the intended payment source is from the 7% tax collected only on the hotel project. 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 HOT is pledged as a security for the life of the bonds. We acknowledge the challenging environment associated with the onset of COVID-19, and expect pledged revenues for Dallas Convention Center Hotel Development Corp. debt will be negatively affected by efforts associated with combating the spread of the virus. Despite the near-term challenges, 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 178.9% of total governmental fund revenue.

Dallas' fixed costs, including debt and pension costs, amounted to over 30% of expenditures, which affects our overall view of the debt and liability profile. We expect the city will continue to issue bonds for general infrastructure improvements should assessed value growth support such issuances. Incorporated into the debt profile are the city's contingent liabilities to make up any shortfalls in debt service coverage for both the Dallas Convention Center Hotel revenue bonds and the Downtown Dallas Development Authority tax increment revenue bonds. The city also maintains a commercial paper program through JP Morgan Chase Bank N.A. The notes have a total program authorization of $350 million. Liquidity support is provided by JPMorgan Chase Bank through a revolving credit agreement, which extends to Nov. 27, 2020.

Pension and other postemployment benefit highlights

In our opinion, a credit weakness is Dallas' large pension and other postemployment benefits (OPEB) obligation. Dallas' combined total pension and OPEB contributions for fiscal 2018 were 14.4% of governmental expenditures.

Despite significant structural changes to the pension plans, we anticipate the city's pension obligations will remain a source of pressure for Dallas, as funding has yet to meet minimum funding progress or 100% of our static funding calculation.

Dallas provides pension benefits to its employees via three separate retirement plans:

- Employees Retirement System, 83% funded for fiscal 2018 and the city contributed $60.5 million, or 65.8%, of its ADC;
- Dallas Police and Fire Pension System, 47% funded for fiscal 2018, which we consider weak, and the city contributed $151.8 million, or 96% of the statutorily required contribution amount; and
- Supplemental Police and Fire Pension Plan of the City of Dallas, 53% funded and the city contributed 100% of its ADC in 2018, this was $2.2 million, which we consider relatively low.

The relatively recent changes to the city's pension plans have stabilized it for the medium term, but we expect it will be several years until funding progress improves to a position we deem adequate. Uncertainty exists in the near term around plan investment return assumptions and the ability for market returns to match assumptions.

Aside from its pension benefits, Dallas provides certain OPEB for retired employees. As of Sept. 30, 2018, the plan was not funded. It discontinued offering subsidized retiree health care for employees hired after Jan. 1, 2010. At Sept. 30, 2018 the city's OPEB liability was $511.1 million, down from $518.8 million the previous year. OPEB costs equaled

0.8% of the city's expenditures. Given the closed nature of the plan, we expect the city's OPEB liability will slowly decline on an annual basis.

Strong institutional framework

The institutional framework score for Texas municipalities is strong.

Ratings Detail (As Of April 7, 2020)		
Dallas taxable GO (AGM) (SEC MKT)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Dallas CP GO		
Short Term Rating	A-1+	Affirmed
Dallas CP GO 2010A		
Short Term Rating	A-1+	Affirmed
Dallas CP GO 2010C		
Short Term Rating	A-1+	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
Dallas GO (BAM) (SECMKT)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Dallas GO (BAM) (SEC MKT)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
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
Downtown Dallas Dev Auth, Texas		
Dallas, Texas		
Downtown Dallas Dev Auth (Dallas) (MBIA) (National		

Ratings Detail (As Of April 7, 2020) (cont.)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.