

# Memorandum



CITY OF DALLAS

DATE June 26, 2020

TO Honorable Mayor and Council Members

SUBJECT **Fitch Ratings Affirms 'AA' Rating and Stable Outlook in Updated Report for City of Dallas General Obligation Debt - INFORMATION**

On Monday, Fitch Ratings (Fitch) affirmed the City's 'AA' credit rating and stable outlook in an updated report of upcoming general obligation debt. Fitch previously reviewed the City's upcoming general obligation debt including bonds, certificates of obligation, and equipment acquisition contractual obligations, that were previously approved by City Council and scheduled to sell in early April. The certificates and contractual obligations completed a scheduled competitive sale on Wednesday, June 23. The certificates of obligation proceeds will finance the construction of two new fire stations damaged in storms and the contractual obligation proceeds will finance the acquisition of various departmental equipment.

According to the report, the City's 'AA' rating is reflective of "strong post-pandemic revenue growth prospects, conservative budgeting practices, and solid reserve levels." Fitch also states that "reforms to both the city's civilian and public safety plans have had a positive effect on the city's long-term liability burden, and recent operating performance has been positive despite increased spending on both pensions and public safety salaries."

In the analysis, Fitch again assigns 'aaa' grades to two Key Rating Drivers following updated budget information, Revenue Framework and Operating Performance, citing "expectations for continued economic expansion once normal business activity resumes," and noting that the City's "healthy reserves position it to maintain financial resilience through the current crisis and future economic cycles." The report today is a positive note for the City of Dallas and an indicator of the challenging yet appropriate steps forward in the right direction.

Please let me know if you need additional information.

A handwritten signature in blue ink that reads "M. Elizabeth Reich".

M. Elizabeth Reich  
Chief Financial Officer

#### Attachment

c: T.C. Broadnax, City Manager  
Chris Caso, City Attorney  
Mark Swann, City Auditor  
Billierae Johnson, City Secretary  
Preston Robinson, Administrative Judge  
Kimberly Bizzor 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 & Neighborhood Services  
Laila Alequresh, Chief Innovation Officer  
M. Elizabeth (Liz) Cedillo-Pereira, Chief of Equity and Inclusion  
Directors and Assistant Directors



## RATING ACTION COMMENTARY

# Fitch Affirms Dallas, TX \$46MM COs at 'AA'; Outlook Stable

Mon 22 Jun, 2020 - 4:44 PM ET

Fitch Ratings - Austin - 22 Jun 2020: Fitch Ratings - Austin: Fitch Ratings has affirmed the 'AA' rating on the following City of Dallas, Texas obligations:

--\$15,525,000 Combination Tax and Revenue Certificates of Obligation, Series 2020;

--\$30,090,000 Equipment Acquisition Contractual Obligations, Series 2020.

The certificates and contractual obligations were originally scheduled to sell in early April but are now scheduled for a competitive sale on June 23. Certificate proceeds will finance the construction of two new fire stations; contractual obligation proceeds will finance the acquisition of various departmental equipment.

Fitch also has affirmed the following ratings:

--Issuer Default Rating (IDR) at 'AA';

--\$1.6 billion of outstanding limited tax debt at 'AA'.

The Rating Outlook is Stable.

## **SECURITY**

The certificates and contractual obligations are payable from a limited ad valorem tax levied against all taxable property in the city. The certificates are further backed by a limited pledge (not to exceed \$1,000) of the city's drainage utility system.

## **ANALYTICAL CONCLUSION**

The city's 'AA' IDR and LT bond rating reflect strong post-pandemic revenue growth prospects, conservative budgeting practices, and solid reserve levels. Reforms to both the city's civilian and public safety plans have had a positive effect on the city's long-term liability burden, and recent operating performance has been positive despite increased spending on both pensions and public safety salaries. Budgeting pressure over the near to medium term is likely to continue as the city attempts to build up police staffing levels and continues with increasing pension contributions; these pressures will be exacerbated by the pandemic-induced economic contraction but are expected to be manageable given the city's high degree of inherent budget flexibility.

## **ECONOMIC RESOURCE BASE**

Dallas is the anchor of the large and diverse Dallas-Fort Worth regional economy. The city is a center for technology, trade, finance and healthcare; it also ranks among the top visitor and leisure destinations in the state.

## **KEY RATING DRIVERS**

### **Revenue Framework: 'aaa'**

Strong revenue growth prospects are based on expectations for continued economic expansion once normal business activity resumes. The assessment also reflects the city's diminished, though still high, independent legal ability to increase ad valorem revenues as a result of recently approved state legislation effective in fiscal 2021.

### **Expenditure Framework: 'a'**

The city's pace of spending is expected to be generally in line with revenue growth given its mature residential base. Increased pension contributions will keep carrying costs at an elevated level; a rapid debt amortization rate also contributes to the elevated carrying costs.

### **Long-Term Liability Burden: 'aa'**

The long-term liability burden currently represents a moderate 12% of personal income. Recent pension reforms to both the civilian and uniform plans have reduced the combined total liability by roughly 40%. These reforms, in conjunction with continued economic growth, are expected to keep the long-term liability burden within the current range.

### **Operating Performance: 'aaa'**

The city of Dallas' gap-closing capabilities and healthy reserves position it to maintain financial resilience through the current crisis and future economic cycles. Elevated debt and retiree benefit outlays will maintain a certain amount of pressure on future budget management practices.

## **RATING SENSITIVITIES**

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Continued positive operating performance and successful absorption of additional public safety-related spending.

--An improvement in Fitch's assessment of the city's expenditure flexibility, due to moderation in fixed debt service and retiree benefit costs as a percentage of spending.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--An economic contraction extending well into the second half of 2020 or beyond, consistent with Fitch's coronavirus downside scenario, which triggers sustained and deeper than expected revenue declines and materially erodes the city's gap-closing capacity.

--Failure to consistently fund annual pension contributions at the actuarially determined levels.

## **BEST/WORST CASE RATING SCENARIO**

International scale credit ratings of Public Finance issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

## **CURRENT DEVELOPMENTS**

### Sectorwide Coronavirus Implications

The ongoing outbreak of coronavirus and related government containment measures worldwide creates an uncertain global environment for U.S. state and local governments and related entities in the near term. While the city's most recently available fiscal and economic data may not fully reflect impairment, material changes in revenues and expenditures are occurring across the country and likely to worsen in the coming weeks and months as economic activity suffers and public health spending increases. Fitch's ratings are forward-looking in nature, and Fitch will monitor developments in state and local governments as a result of the virus

outbreak as it relates to severity and duration, and incorporate revised expectations for future performance and assessment of key risks.

In its baseline scenario, Fitch assumes sharp economic contractions to hit major economies in 1H20 at a speed and depth that is unprecedented since World War II. Sequential recovery is projected to begin from 3Q20 onward as the health crisis subsides after a short but severe global recession. GDP is projected to remain below its 4Q19 level until mid-2022. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the report entitled, "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases - Update" (<https://www.fitchratings.com/site/re/10120570>), published April 29, 2020 on [www.fitchratings.com](http://www.fitchratings.com).

The city's most recent projection for fiscal 2020 (FYE 9/30) financial performance include sales tax revenues of \$300 million, roughly 8% below budget; strong pre-pandemic economic performance offset a sharp decline beginning in March. Sales tax receipts typically comprise roughly 25% of annual general fund revenues. Management reports total general fund revenues are tracking roughly \$50 million below budget (a 3.5% decline from \$1.44 billion budgeted) while expenses have been trimmed by nearly \$40 million. Administrators plan to eliminate the remaining \$10 million gap through a combination of measures, including application of federal assistance for coronavirus-related expenses. The city received a \$234.4 million allocation from the CARES Act Coronavirus Relief Fund, which comes with certain restrictions regarding how the money is used. The city also reports receipt of various other grant funding for specific pandemic-response purposes. Preliminary projections for the first year of the city's fiscal 2021-2022 biennial budget suggest a \$60 million to \$100 million gap, which management plans to close prior to adoption of the budget in September.

## **CREDIT PROFILE**

Certificate proceeds will finance the designing, constructing, improving, equipping and furnishing fire station facilities for stations #41 and #19; contractual obligation proceeds will finance the acquisition of various departmental equipment.

For additional information on Dallas, please see 'Fitch Rates Dallas TX \$276MM GOs, COs 'AA'; Outlook Stable' published April 2, 2020 and available on [fitchratings.com](http://fitchratings.com).

## CRITERIA VARIATION

None

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

## REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

## ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg).

## RATING ACTIONS

ENTITY/DEBT	RATING		
Dallas (TX) [General Government]	LT IDR	AA Rating Outlook Stable	Affirmed
● Dallas (TX) /General Obligation - Limited Tax/1 LT	LT	AA Rating Outlook Stable	Affirmed

[VIEW ADDITIONAL RATING DETAILS](#)

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Additional information is available on [www.fitchratings.com](http://www.fitchratings.com)**APPLICABLE CRITERIA**

[U.S. Public Finance Tax-Supported Rating Criteria \(pub. 27 Mar 2020\) \(including rating assumption sensitivity\)](#)

**APPLICABLE MODELS**

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

**ADDITIONAL DISCLOSURES**



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Dallas (TX)

EU Endorsed

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