

# Memorandum



CITY OF DALLAS

DATE November 25, 2015

TO The Honorable Mayor and Members of the City Council

SUBJECT Bond Ratings Overview

On Wednesday, December 2, 2015, the City Council will be briefed on a Bond Ratings Overview. The briefing is attached for your review.

Please let me know if you need additional information.

  
Jeanne Chipperfield  
Chief Financial Officer

## Attachment

c: A.C. Gonzalez, City Manager  
Warren M.S. Ernst, City Attorney  
Craig D. Kinton, City Auditor  
Rosa A. Rios, City Secretary  
Daniel F. Solis, Administrative Judge  
Ryan S. Evans, First Assistant City Manager

Jill A. Jordan, P.E., Assistant City Manager  
Joey Zapata, Assistant City Manager  
Mark McDaniel, Assistant City Manager  
Eric D. Campbell, Assistant City Manager  
Sana Syed, Public Information Officer  
Elsa Cantu, Assistant to the City Manager

# Bond Ratings Overview

Dallas City Council  
December 2, 2015



# Topics

- Bond ratings overview
- Current ratings for the City's general obligation bonds and moral obligation bonds
- Rating agency criteria
- Consideration given to the City's pension liabilities
- Summary

# Bond ratings overview

- Assessments of the **ability and willingness** of debt issuers to make full and timely payments expressed as a **grade**
- Opinions about the **future creditworthiness** of debt obligations in the form of rating agency **outlooks** characterized as positive, stable or negative

# Rating agencies

## ➤ Fitch Ratings

- Founded in 1914; Hearst Corporation, majority owner


## ➤ Moody's Investors Service

- Founded in 1909; Moody's Corporation, owner

## ➤ Standard and Poor's Rating Services

- Formed in 1941; McGraw Hill Financial, owner

# Rating agency scales

	Fitch Ratings	Moody's Investors Service	Standard & Poor's Ratings Services	
Highest  Lowest	AAA	Aaa	AAA	Highest Quality
	AA+	Aa1	AA+	High Quality
	AA	Aa2	AA	
	AA-	Aa3	AA-	Upper Medium Grade
	A+	A1	A+	
	A	A2	A	
	A-	A3	A-	Medium Grade
	BBB+	Baa1	BBB+	
	BBB	Baa2	BBB	
	BBB-	Baa3	BBB-	
<b>NON-INVESTMENT GRADE</b>				

# Current ratings of the ten largest cities

	Population	Fitch	Moody's	S&P
New York	• 8,491,079	AA	Aa2	AA
Los Angeles	• 3,928,864	AA-	Aa2	AA-
Chicago	• 2,722,389	A-	Ba1	A+
Houston	• 2,239,558	AA	Aa2	AA+
Philadelphia	• 1,560,297	A-	A2	A+
Phoenix	• 1,537,058	NR	Aa1	AA+
San Antonio	• 1,436,697	AAA	Aaa	AAA
San Diego	• 1,381,069	AA-	Aa2	AA
Dallas	• 1,281,047	AA+	Aa2	AA
San Jose	• 1,015,785	AA+	Aa1	AA+

Source: U.S. Census Bureau, FitchRatings, Moody's Investors Service, Standard & Poor's

# Dallas' current ratings

	Fitch	Moody's	S&P	S&P (DDDA)*	S&P (DCCHDC)*
Previous	• AA+	• Aa1	• AA+	• A+	• A+
Current	• AA+	• Aa2	• AA	• A	• A
Outlook	• Stable	• Stable	• Stable	• Stable	• Stable
				Moody's (DDDA)*	Moody's (DCCHDC)*
				• Aa2	• A1

\*The rating agencies consider the bonds issued by the Downtown Dallas Development Authority (DDDA) and the Dallas Convention Center Hotel Development Corporation (DCCHDC) to be moral obligations of the City. The Standard & Poor's General Obligation bond rating for the City is its benchmark rating, and any change made by S&P in the City's GO rating will be quickly followed by a change in the S&P rating of its moral obligations. Moody's will also change its current ratings of the City's moral obligation bonds at some point. The rating changes for DDDA and DCCHDC are not at this time indications of rating agency concerns about the credit of the outstanding bonds. More information about these issuers can be found in the Appendix.



# Credit criteria

- Combination of objective and subjective analysis, based on a variety of factors
- Comparing a set of predetermined standards with other similar issuers
- New criteria developed and implemented subsequent to passage of Dodd-Frank Act in 2010
  - Rating agencies required to disclose qualitative and quantitative methodologies and assumptions used in the rating process

# Fitch Ratings Factors

(no specific weighting)

## Economy

- Diversity, stability, and cyclical
- Evaluation of tax base diversity
- Regional income, poverty rate, education, and wealth
- Tax burden as an indication of competitiveness, and financial flexibility

## Finances

- Property, sales, and income taxes
- Flexibility in the use of taxes (legal ability to adjust property tax rate)
- Ability to implement timely spending cuts
- Fund balance, reserve, and liquidity levels

## Management

- Institutionalized policies
- Budget practices
- Financial reporting and accounting
- Political, taxpayer, and labor environments

## Debt/ Liabilities

- Legal pledge to support debt
- Future capital and debt needs
- Analysis of stability among pensions funded ratio, and sources of funding
- Moral obligations

Note: Fitch issued an exposure draft for the proposed adjustments to its tax-backed rating criteria. It plans to introduce the updated criteria early next year. Less than 10% of ratings are expected to change with an equal number of upgrades and downgrades. There are no specific weightings.

# Moody's Investors Service Factors

## Economy/Tax Base 30%

- Full Value (market value of taxable property)
- Full Value per Capita
- Median Family Income

## Finances 30%

- Fund Balance as % of Operating Revenue
- 5-Year Dollar Change in Fund Balance as % of Revenues
- Cash Balance as % of Revenues
- 5-Year Dollar Change in Cash Balance as % of Revenues

## Management 20%

- Institutional Framework
- Operating History: 5-Year Average of Operating Revenues / Operating Expenditures

## Debt/Pensions 20%

- Net Direct Debt/Full Value
- Net Direct Debt/Operating Revenue
- 3-Year Average of Moody's Adjusted Net Pension Liability/Full Value
- 3-Year Average of Moody's Adjusted Net Pension Liability/Operating Revenues

# Standard and Poor's Factors

## Institutional Framework

10%

- Predictability
- Revenue and Expenditure balance
- Transparency and Accountability
- System Support

## Economy

30%

- Projected per capita Effective Buying Income
- Total Market Value per capita

## Management

20%

- Accuracy of financial reports
- Plan to monitor and manage finances
- Auditor does not issue going concern opinion

## Financial Measures

30%

- Liquidity
- Budgetary Performance
- Budgetary Flexibility

## Debt/Contingent Liabilities

10%

- Net direct debt as a % of total gov't funds rev
- Total gov't funds debt service as a % of total gov't funds exp
- Pension and OPEB
- Future legal rulings, self-supporting enterprise debt likely to require support, etc.

# What could increase our ratings?

- Fitch – “Pension reforms and improvement in the City’s long-term liability burden could lead to positive rating action.”  
*(FitchRatings, 11-05-15)*
- Moody’s – “Material improvement to annual pension funding; reduction in the Moody’s adjusted net pension liability. Significant increase to operation reserves and liquidity.”  
*(Moody’s Report, 10-28-15)*
- S&P – “Should the debt and contingent liability profile improve and the City adopt a credible plan to overcome its very large and growing pension liabilities, we could raise the ratings.”  
*(Standard & Poor’s, 11-04-15)*

# What could reduce our ratings?

- Fitch – “Inability to improve the affordability and sustainability of pensions could pressure the current rating.”

*(FitchRatings, 11-05-15)*

- Moody's – “Reduction in operating reserves to a level inconsistent with the rating category. Protracted trend of significant tax base contraction without off-setting rate adjustments. Materially Increased net pension liabilities relative to operating revenues.”

*(Moody's Report, 10-28-15)*

- S&P – “Deterioration in the city’s budgetary flexibility, performance, or liquidity could result in a downgrade. Additionally, if the city’s debt service, pension and OPEB carrying charges rise to a level we view as very high or the city does not continue to pursue a plan to address the large pension liabilities, the rating could be lowered.”

*(Standard & Poor's, 11-04-15)*

# The pension factor

- The Governmental Accounting Standards Board issued new guidance for reporting the total net pension liability which the City of Dallas must implement beginning with fiscal year 2015.
  - Is a major factor considered by the rating agencies.
- Fitch: Pension liabilities assessed as a moderate burden on the tax base. Factor not weighted.
- Moody's: Pension liabilities assessed as large and growing. Sub factor weighted at 10%.
- Standard & Poor's: Pension liabilities assessed as large and lacking a plan to sufficiently address. This reduces the Debt and Contingent Liabilities score, which has a 10% weighting.

# Other considerations

- Rating agencies expressed concern about rising liabilities from pension funds which could negatively impact an improving reserve position and progress toward addressing infrastructure needs



# Keep in mind

- The City identified \$1 billion of available debt service for 2017 bond election
- Nationwide, governments are facing issues with rising infrastructure needs
  - “The nation’s backlog of infrastructure construction and repairs, which was last estimated at \$2.2 trillion, is a primary challenge for state and local governments.” (Gary Donaldson. "Prioritizing Capital Improvement Planning." Government Finance Review 1 Aug. 2015.)
- Pension boards are actively working to resolve issues
- The City’s current credit rating remains in the high quality range
  - The recent General Obligation bond sale attracted orders over three times the amount of bonds available
  - The true interest cost (TIC) was 3.041%, which was less than the 3.34% originally estimated when preparations for the sale began in October

# Next steps

- Pension information to follow
- Infrastructure/bond program to be discussed in January

# Appendix

# Financial Information: Downtown Dallas Development Authority (DDDA)

- Base value of TIF is \$565 million and grew to \$2.6 billion in 10 years
- Fiscal year 2016 projected increment revenue of \$17.2 million
- Fiscal year 2016 debt service \$6.4 million, approximately
- Maintains total bond reserve balance of \$17.9 million
- Fiscal year end 2014 coverage is 2.4 times the requirement (coverage = 3.03, required coverage = 1.25)
- Based on DDDA's strong financial performance to-date, it is unlikely in the near term that the City Council would need to consider a grant to support the DDDA

# Financial Information: Dallas Convention Center Hotel Development Corporation (DCCHDC)

- All reserves are fully funded at or above levels originally projected in the HVS study mentioned in the offering document
- Fiscal year end 2014 coverage is 1.79, which is 1.4 times higher than the original estimate of 1.29
- Based on DCCHDC's strong financial performance to-date, it is unlikely in the near term that the City Council would need to consider a grant to support the DCCHDC