

Memorandum



CITY OF DALLAS

DATE August 16, 2024

TO Honorable Mayor and Members of the City Council

SUBJECT **Fitch Ratings Affirms 'AA' Rating for City of Dallas General Obligation Bonds and Upgrades Hotel Occupancy Tax Rating to 'AA' from 'A+' – RATING ACTION**

Today, Fitch Ratings (Fitch) affirmed the 'AA' credit rating on the City's outstanding long-term general obligation debt and upgraded the rating on the outstanding Hotel Occupancy Tax (HOT) bonds to 'AA' from 'A+.' The rating outlook for both is Stable. The HOT rating is a separate credit and does not apply to the Special Tax Revenue Bonds rating for the Kay Bailey Hutchison Convention Center Dallas (KBHCCD) Venue Projects.

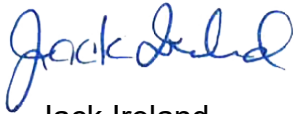
According to the Fitch report, the general obligation affirmed rating is derived from the City's specific metric profile and additional analytical factors which reflects the highest level of financial resilience, "based on an ample level of budgetary flexibility and assumes maintenance of unrestricted general fund reserves at least equal to 20 percent of spending, which the city significantly exceeds." Overall, the Fitch rating model finds Dallas' financial, demographic, and economic metrics to be in the "midrange" level, which are "balanced against Fitch's 'weakest' assessment for the long-term liability burden." In the report, Fitch explains that the City receives a "+1" for economic and institutional strength, which is offset by "-1" for pension funding assumptions reflective of the "City's history of weak returns in relation to the pension funds."

Fitch's upgrade of the HOT bond rating to 'AA' reflects "improved resilience of the structure due to no current plans to further leverage this lien," and "significant cash balance in available reserves." Additionally, Fitch expects "pledged revenue growth will maintain its historical pace above US GDP after a swift recovery from pandemic-related losses." However, the rating is sensitive to market changes and could face a negative rating action following a reduction in pledged revenues or maximum annual debt service coverage.

The rating action by Fitch is a testament to the financial strength of the City's general obligation and overall credit profile. This is an especially strong positive to the Hotel Occupancy Tax credit ahead of the related upcoming financings for the KBHCCD Master Plan and an optimistic indicator of what is to come. I look forward to continuing to share positive news. Attached is the published rating report provided for your review.

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Please let me or Jenny Kerzman, Assistant Director of Treasury, know if you need additional information.



Jack Ireland
Chief Financial Officer

[Attachment]

c: Kimberly Bizer Tolbert, City Manager (I)
Tammy Palomino, City Attorney
Mark Swann, City Auditor
Biliera Johnson, City Secretary
Preston Robinson, Administrative Judge
Dominique Artis, Chief of Public Safety (I)
Dev Rastogi, Assistant City Manager

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Alina Ciocan, Assistant City Manager
Donzell Gipson, Assistant City Manager (I)
Robin Bentley, Assistant City Manager (I)
Elizabeth Saab, Chief of Strategy, Engagement, and Alignment (I)
Directors and Assistant Directors

RATING ACTION COMMENTARY

Fitch Affirms Dallas, TX's IDR and GOs at 'AA'; Hotel Tax Upgraded to 'AA'; Outlook Stable

Thu 15 Aug, 2024 - 3:04 PM ET

Fitch Ratings - Austin - 15 Aug 2024: Fitch Ratings has affirmed the following Dallas, TX ratings at 'AA':

--Issuer Default Rating (IDR);

--Approximately \$2.43 billion in outstanding Fitch rated general obligation (GO) bonds and certificates of obligation (CO's).

Fitch has also upgraded the city's Hotel Occupancy Tax (HOT) bonds to 'AA' from 'A+'.

The Rating Outlooks are Stable.

RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕			PRIOR ↕
Dallas (TX) [General Government]	LT IDR	AA Rating Outlook Stable	Affirmed	AA Rating Outlook Stable

Dallas (TX) /General Obligation - Limited Tax/1 LT	LT	AA Rating Outlook Stable	Affirmed	AA Rating Outlook Stable
Dallas (TX) /Tourism Tax Revenues - Hotel Motel Tax/1 LT	LT	AA Rating Outlook Stable	Upgrade	A+ Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

The 'AA' IDR reflects a 'aaa' financial resilience assessment based on an ample level of budgetary flexibility and assumes maintenance of unrestricted general fund reserves at least equal to 20% of spending, which the city significantly exceeds.

The IDR also reflects Dallas' 'midrange' demographic and economic trend and level metrics, and a population and economy of sufficient size and diversification, balanced against Fitch's 'weakest' assessment for the long-term liability burden. The IDR incorporates a +1 notch additional analytical factor reflecting the economic and institutional strength of the city and a -1 notch additional analytical factor reflecting pension funding assumptions/contributions that have resulted in an amortization period above the industry norm.

The upgrade of the special tax revenue bond rating to 'AA' reflects improved resilience of the structure due to no current plans to further leverage this lien. Fitch's expects pledged revenue growth will maintain its historical pace above U.S. GDP after a swift recovery from pandemic-related losses. A significant cash balance in available reserves provide additional cushion to the structure.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

For the IDR

--A sustained approximate 10% increase in long-term liabilities and carrying costs metrics assuming current levels of personal income or governmental spending/resources;

--A decline in available general fund reserve levels sustained below 20% of spending, which would lower Fitch's assessment of financial resilience below 'aaa'.

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

For the HOT bonds:

--Diminished pledged revenue growth prospects to closer to the rate of inflation;

--A sustained reduction of maximum annual debt service (MADS) by the city's HOT pledged revenues to below 2.2x.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--A sustained approximate 10% decrease in long-term liabilities and carryings costs absent a commensurate decrease in personal income or governmental revenues if accompanied by a sustained reduction in the pension amortization period below 30 years;

--Sustained and meaningful improvement in the city's overall pension position;

--Material improvement in the city's economic level metrics including median household income as a percentage of Fitch's portfolio median, unemployment rate as a percentage of the national rate, and educational attainment levels.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

For the HOT bonds:

--An upgrade of the IDR and an increase in MADS coverage by the city's HOT revenues to 3.8x or higher.

SECURITY

General purpose bonds, tax notes, and certificates of obligations (COs) are payable from an annual property tax levy limited to \$2.50 per \$100 assessed valuation (AV) per state law. The COs are additionally payable from a subordinate lien on the surplus

revenues of the city's waterworks and sewer system.

FITCH'S LOCAL GOVERNMENT RATING MODEL

The Local Government Rating Model generates Model Implied Ratings which communicate the issuer's credit quality relative to Fitch's local government rating portfolio (the Model Implied Rating will be the IDR except in certain circumstances explained in the applicable criteria). The Model Implied Rating is expressed via a numerical value calibrated to Fitch's long-term rating scale that ranges from 10.0 or higher ('AAA'), 9.0 ('AA+'), 8.0 ('AA'), and so forth down to 1.0 ('BBB-' and below).

Model Implied Ratings reflect the combination of issuer-specific metrics and assessments to generate a Metric Profile, and a structured framework to account for Additional Analytical Factors not captured in the Metric Profile that can either mitigate or exacerbate credit risks. Additional Analytical Factors are reflected in notching from the Metric Profile and are capped at +/-3 notches.

RATINGS HEADROOM & POSITIONING

Dallas Model Implied Rating: 'AA' (Numerical Value: 8.20)

-- Metric Profile: 'AA' (Numerical Value: 8.20)

-- Net Additional Analytical Factor Notching: 0.0

Individual Additional Analytical Notching Factors:

-- Economic and Institutional Strength: +1.0

-- Pension Funding Assumptions: -1.0

Dallas' Model Implied Rating is 'AA'. The associated numerical value of 8.20 is at the lower end of the 8.0 to 9.0 range for its current 'AA' rating.

KEY RATING DRIVERS

FINANCIAL PROFILE

Financial Resilience - 'aaa'

Dallas' financial resilience is driven by the combination of its 'Midrange' revenue control assessment and 'Midrange' expenditure control assessment, culminating in a 'Midrange' budgetary flexibility assessment.

- Revenue control assessment: Midrange
- Expenditure control assessment: Midrange
- Budgetary flexibility assessment: Midrange
- Minimum fund balance for current financial resilience assessment: $\geq 15.0\%$
- Current year fund balance to expenditure ratio: 25.8% (2023)
- Five-year low fund balance to expenditure ratio: 18.5% (2023)

Revenue Volatility - 'Midrange'

Dallas' weakest historic three-year revenue performance has a modest negative impact on the Model Implied Rating.

The revenue volatility metric is an estimate of potential revenue volatility based on the issuer's historical experience relative to the median for the Fitch-rated local government portfolio. The metric helps to differentiate issuers by the scale of revenue loss that would have to be addressed through revenue raising, cost controls or utilization of reserves through economic cycles.

- Lowest three-year revenue performance (based on revenues dating back to 2005): 2.9% decrease for the three-year period ending fiscal 2010

-- Median issuer decline: -4.5% (2023)

A '+1' additional analytical assessment is applied for economic and institutional strength as Dallas is the Core economic and employment center of the Dallas-Ft. Worth-Arlington MSA which accounts for about 3% of the U.S. GDP.

DEMOGRAPHIC AND ECONOMIC STRENGTH

Population Trend - 'Midrange'

Based on the median of 10-year annual percentage change in population, Dallas' population trend is assessed as 'Midrange'.

Population trend: 1.0% 2022 median of 10-year annual percentage change in population (51st percentile)

Unemployment, Educational Attainment and MHI Level - 'Midrange'

The overall strength of Dallas' demographic and economic level indicators (unemployment rate, educational attainment, median household income [MHI]) in 2023 are assessed as 'Midrange' on a composite basis, performing at the 44th percentile of Fitch's local government rating portfolio. This is due to high education attainment levels offsetting low median-issuer indexed adjusted MHI and midrange unemployment rate.

-- Unemployment rate as a percentage of national rate: 102.8% 2023 (43rd percentile), relative to the national rate of 3.6%

-- Percent of population with a bachelor's degree or higher: 36.6% (2022) (68th percentile)

-- MHI as a percent of the portfolio median: 81.4% (2022) (21st percentile)

Economic Concentration and Population Size - 'Strongest'

Dallas' population in 2022 was of sufficient size and the economy was sufficiently diversified to qualify for Fitch's highest overall size/diversification category.

The composite metric acts asymmetrically, with most issuers (above the 15th percentile for each metric) sufficiently diversified to minimize risks associated with small population and economic concentration. Downward effects of the metric on the Metric Profile are most pronounced for the least economically diverse issuers (in the 5th percentile for the metric or lower). The economic concentration percentage shown below is defined as the sum of the absolute deviation of the percentage of personal income by major economic sectors relative to the U.S. distribution.

-- Population size: 1,297,358 (2022) (above the 15th percentile)

-- Economic concentration: 24.0% (2023) (above the 15th percentile)

Demographic and Economic Strength Additional Analytical Factors and Notching: +1.0 notch (for Economic and Institutional Strength)

LONG TERM LIABILITY BURDEN

Long-Term Liability Burden - 'Weakest'

Dallas' liabilities to personal income has deteriorated while carrying costs to governmental expenditures and liabilities to governmental revenue remain broadly weak. The long-term liability composite metric in 2023 is at the 12th percentile, indicating an elevated liability burden relative to the Fitch's local government rating portfolio.

-- Liabilities to personal income: 8.6% Analyst Input (26th percentile) (vs. 8.2% 2023 Actual)

-- Liabilities to governmental revenue: 351.6% Analyst Input (4th percentile) (vs. 338.3% 2023 Actual)

-- Carrying costs to governmental expenditures: 26.2% Analyst Input (5th percentile) (vs. 26.2% 2023 Actual)

Long-Term Liability Burden Additional Analytical Factors and Notching: -1.0 notch (for Pension Funding Assumptions)

A '-1' additional analytical assessment for pension funding assumptions reflects the city's history of weak returns in relation to the pension funds, especially the Police and Fire Pension, both the Dallas Police & Fire Pension Fund and Dallas Employees' Retirement Fund are underfunded at 39% and 73% funding ratios, respectively.

Long-term liability burden metrics include adjustment for amortized debt, credit given for self-supported bonds, pension and other post-employment benefit obligations of the enterprise fund and series 2024 bonds.

DEDICATED TAX SECURITY

Pledged revenues securing the bonds are 4.718% of the 7% Chapter 351 HOT of the net 9% hotel motel tax revenues collected within the city.

DEDICATED TAX KEY RATING DRIVERS

Fitch expects long-term pledged revenue growth to continue the historical trend and exceed U.S. GDP, fueled by the city's rapidly expanding hospitality sector that enabled a prompt recovery from pandemic-related declines. Continued growth at this level warrants an 'aaa' assessment for growth prospects.

The structure is expected to provide a solid MADS coverage cushion during typical economic cycles and an ability to absorb a larger decline consistent with the largest historical decline, consistent with an 'aa' assessment. Fitch's assessment discounts the large revenue decline posted during the coronavirus pandemic and uses the next largest revenue decline, 15.5%, posted in fiscal 2009 during the Global Fiscal Crisis.

The special tax revenue bond rating would not be capped at the city's IDR, as Fitch views the pledged city HOT revenues as special revenues under section 902(2)(B) of the U.S. Bankruptcy Code.

PROFILE

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

With a population of 1.3 million, Dallas ranks among the top 10 U.S. cities by population. The city serves as corporate headquarters for AT&T, Southwest Airlines, Texas Instruments, 7-Eleven, Inc., HollyFrontier Corp., Pizza Hut, Inc. and other large corporate concerns. Large employers in the education, government and health services sectors lend stability to the city's employment base. The city's role as a wholesale and retail trade center is enabled by a strong transportation network of airports, rail and interstate highways.

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 is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit <https://www.fitchratings.com/topics/esg/products#esg-relevance-scores>.

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APPLICABLE CRITERIA

[U.S. Public Finance Local Government Rating Criteria \(pub. 02 Apr 2024\) \(including rating assumption sensitivity\)](#)

APPLICABLE MODELS

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

FAST Econometric API - Fitch Analytical Stress Test Model, v3.1.0 (1)

U.S. Local Government Rating Model, v1.2.0 (1)

ADDITIONAL DISCLOSURES

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Dallas (TX)

EU Endorsed, UK Endorsed

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