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Sizing Up Dallas' Massive Pension Problem.

The short of it is this: Dallas' pension fund for police and firefighters is in big trouble. This week, the City Council heard from an outside auditor that the fund has $5 billion in commitments that it doesn't have assets to pay, based on the new way the Governmental Accounting Standards Board will begin calculating pension liabilities. Previously, those commitments were calculated to be $1 billion.

In light of the $4 billion reassessment, both the Moody's and Standard and Poor's ratings services downgraded the city's credit rating. Moody's downgraded the city's bond rating from its second highest level, Aa1, to its third highest Aa2. S&P did the same, using a slightly different lexicon — Dallas went from AA+ to just AA. The downgrades come less than a week after the city released $227 million in capital improvement bonds. Matt Fabian, a municipal finance analyst with Municipal Market Analytics, said that the credit downgrades in and of themselves shouldn't cause an immediate crunch for the city, thanks to a friendly bond market and the high perch from which Dallas' bond rating has only slightly dropped.

"Right now [municipal bond] yields are at or near an all-time low. That means that there aren't enough bonds available for all the investors that want to buy them. They're falling all over each other to buy bonds, to buy income for their municipal bond accounts, and so the penalty that Dallas is apt to pay is minimal," Fabian says. "[Dallas'] ratings are still very solid in the AA category. That's still an excellent rating. Typically, a city with a rating in the AA category or above receives minimal credit scrutiny from anyone."

The ratings themselves, as they stand, are not a big problem, but things could get worse, Fabian says, if the city doesn't show the political will to deal with the massively underfunded system.

"Investors are becoming a lot more sensitive to headline risks related to pensions, because pensions can create political instability. The debate about pensions can have a meaningful impact on how the city does business. Investors have been far more cautious on this topic than almost any other," he says. "If the city lets things fester and get worse, a penalty that it pays could easily become much larger and the rating downgrades could accelerate. [The ratings cut] is a clarion call to the city to take action."

Unfunded pension liabilities pile up, in part, because cities defer current costs (salaries) and take on future costs (pensions), Fabian says. Dallas pays its police officers some of the lowest salaries in North Texas but has one of the most generous pension systems. Given appropriate circumstances, it is possible for Dallas cops and firefighters to retire as millionaires, something Dallas police representatives have cited as one of the few things that can keep officers in the department. No matter how much retirees expect to get paid, it won't matter if the pension system goes broke, something Moody's warns could happen by 2038. Dallas can come out of the mess no worse for the wear, Fabian says, if it takes aggressive action to limit new liabilities and pay off old ones.

"Dallas could be a poster boy for fiscal management if it addresses this problem aggressively, but more likely than not, how these situations work out is that the large liabilities are very difficult to service," he says.

So far, Dallas has hired a new executive director, Kelly Gottschalk, for the pension fund and suspended enrollment in the lucrative "DROP" program, which allowed police officers and firefighters to collect and reinvest retirement benefits at high rates while they were still on the job. According to Fabian, one way or another, the only way to save the fund is to cut benefits, potentially through negotiations with the city's uniformed personnel, or increase income, which could happen through increased taxes or better performance from the funds investments.

THE DALLAS OBSERVER

BY STEPHEN YOUNG

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