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Fitch: Meaningful Pension Reform Critical To Dallas Credit Quality.

Fitch Ratings-Austin-09 January 2017: Maintenance of the City of Dallas' current 'AA' Issuer Default Rating (IDR) and limited tax bond rating, hinges upon the ability of city and Dallas Police and Fire Pension (DPFP) staff and leadership to craft meaningful pension reform legislation that is acceptable to both groups as well as state lawmakers in the upcoming Texas legislative session, according to Fitch Ratings.

Fitch believes that such legislation has reasonable prospects for success and keeps Fitch's assessment of carrying costs and operating performance from deteriorating further at present.

The Rating Outlook on the city's IDR and bond rating is currently Negative, indicating the likelihood of further negative rating action if one or more key rating factors weaken from current levels. Fitch would view additional credit deterioration as a likely outcome if current efforts result in ineffectual or no pension reform in the 2017 legislative session. The session begins January 10.

(Please see 'Fitch Downgrades City of Dallas, TX GOs to 'AA' on Pensions; Outlook Negative' dated Oct. 6, 2016 at www.fitchratings.com for more information related to Fitch's most recent rating action.)

The Rating Sensitivity in Fitch's Oct. 6, 2016 Dallas rating action commentary states 'Maintenance of the current rating will require successful pension reform efforts that stabilize the level of the city's obligations and reduce the risks presented by the deferred retirement option plan.' The city's 'AA' rating continues to reflect strong operating performance enabled by robust economic and revenue growth prospects, strong control over revenues, conservative budgeting , and solid reserve funding.

The city's fiscal 2015 carrying costs (for debt service and retiree benefit outlays) were elevated at 25% of governmental spending, contributing to the 'a' category assessment for expenditure flexibility. The city and DPFP are reportedly seeking consensus on a package of pension reforms to lower benefits and stabilize the system, although implementation requires legislative approval. Fitch believes a reform proposal endorsed by both groups will receive a better reception at the legislature and improve odds for approval. Lack of meaningful DPFP pension reform would put additional upward pressure on pension contributions, which have been driven higher by the magnitude of the DPFP net pension liability, now at nearly \$7 billion. Further increases in carrying costs would reduce expenditure flexibility, weaken the city's budget management capabilities, and reduce overall financial resilience. Deterioration of these key rating factors would weaken the city's credit profile and may result in a multi-notch downgrade.

Fitch will monitor closely the Texas 2017 session and track the progress of DPFP pension reform legislation as it winds through the legislative process.

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