FitchRatings

# Fitch Assigns 'AA-' Dallas Area Rapid Transit (TX) IDR; Downgrades Sr Lien Sales Tax Revs to 'AA-'

Fitch Ratings-Austin-09 January 2018: Fitch Ratings has downgraded the rating on the following Dallas Area Rapid Transit, Texas' (DART or the authority) outstanding debt to 'AA-' from 'AA':

--Approximately $118.4 million senior lien sales tax revenue refunding bonds series 2007;
--Approximately $9.4 million senior lien sales tax revenue bonds series 2008.

Fitch also has assigned the authority an Issuer Default Rating (IDR) of 'AA-'.

The Rating Outlook is Stable.

SECURITY

The outstanding bonds are payable from a senior lien on pledged revenues, which consist of gross receipts from the levy and collection of the 1% sales tax within the system's service area, farebox revenues, and investment income from the debt service account.

ANALYTICAL CONCLUSION

The assignment of a 'AA-' IDR and downgrade to 'AA-' from 'AA' of the DART's sales tax revenue bonds reflects both the currently elevated liability burden, particularly when measured by net debt to cash flow, and the likely future increase anticipated in DART's liability burden and carrying costs from additional debt planned for various capital projects. .

The 'AA-' rating is underpinned by DART's very strong gap-closing capacity in economic downturns, solid expenditure flexibility, and strong revenue growth prospects. These credit strengths are balanced against a relatively constrained revenue-raising environment and the aforementioned elevated and increasing liability burden .

Fitch's analysis of the 'AA-' sales tax revenue bond rating focuses on the strong growth prospects and sound resiliency of the pledged sales taxes, which are the dominant pledged revenue source. The rating is capped at the authority's 'AA-' IDR. Fitch believes that bondholders' claim on pledged revenues would not be protected in the event of a bankruptcy filing by the authority.

Economic Resource Base
DART is a sub-regional transportation authority that was created in 1983 and provides bus, light rail, commuter rail, paratransit and general mobility services within the broad and growing Dallas-Fort Worth metropolitan statistical area (MSA) economy and population base. The service area incorporates about 2.5 million residents in 11 cities and two towns, all of which are voter-approved participating municipalities and remit 1% of locally collected sales tax to DART. The member cities include Carrollton, Cockrell Hill, Dallas, Farmers Branch, Garland, Glenn Heights, Irving, Plano, Richardson, Rowlett, University Park, and the towns of Addison and Highland Park.

KEY RATING DRIVERS

Revenue Framework: 'a'
DART's revenue framework is dominated by sales taxes. Revenue growth has been consistently strong, exceeding inflation and U.S. GDP, and brief downturns are followed by rapid recovery. However, the authority has very limited revenue raising flexibility with no independent taxing authority and limited practical ability to adjust fares.

Expenditure Framework: 'aa'
Expenditure growth is expected to remain at or below the authority's strong revenue growth. Expenditure flexibility is presently adequate to maintain balanced operations across business cycles, although further growth in already moderately high fixed costs from near-term debt plans likely will erode this flexibility in the future. DART benefits from a flexible labor framework that allows strong control of labor costs and the ability to adjust service levels as needed.

Long-Term Liability Burden: 'a'
The long-term liability burden, driven largely by direct and overlapping debt levels, is currently elevated relative to DART's annual cash flows, and it is expected to grow further given additional debt planned. However, Fitch expects the liability burden will remain relatively moderate when compared to resident personal income.

Operating Performance: 'aaa'
Fitch expects DART will maintain strong financial flexibility throughout the business cycle based on high reserve levels relative to potential revenue declines anticipated in a typical recession.

Sales Tax Revenue Bonds
The sales tax that backs the revenue bonds is economically sensitive, and revenues are expected to increase over time given healthy economic prospects for the area economy. In addition, the pledged sales tax revenues would be expected to demonstrate strong resilience through a typical economic downturn.

RATING SENSITIVITIES

Finances and Leverage Drive Rating: The IDR and sales tax revenue bond rating could come under downward pressure if DART leverages its sales tax revenues significantly more than currently expected or fails to align ongoing spending with available revenues.

Sales Tax Performance: The 'AA-' rating on the sales tax bonds is sensitive to both declines in economic activity and sales tax revenues greater than those expected. Typical cyclical fluctuations should not pressure the rating.

CREDIT PROFILE

Dallas is the anchor of the large and diverse Dallas-Fort Worth regional economy, and the largest of DART's participating municipalities. The city is a center for technology, trade, finance and healthcare; it also ranks among the top visitor and leisure destinations in the state. Large employers in the education, government and health services sectors lend stability to the employment base. The strength of the area's economy is reflected in historically robust sales tax growth and expanding employment.

Strong regional growth has prompted increasing investments in public transit infrastructure with DART completing major investments in light rail over the past decade. DART's light rail system more than doubled in size from 45 miles in 2009 to 93 miles in 2017. Management has a strong track record with such construction projects and a history of delivering capital projects on schedule and within budget. Rail developments have also spurred transit-oriented projects and further economic development in cities and towns across the region with higher density mixed-used projects being built or planned near many rail stops.

Revenue Framework
DART is highly dependent on sales taxes, which provide about 75% of operating revenues (excluding capital grants). Sales tax revenue grew by a healthy 4% in fiscal 2017. Fares are a relatively small portion of the revenue mix, comparable to most U.S. transit agencies, providing roughly 10% of revenues. Public funding allows policymakers to incentivize transit use and maintain affordability while spreading the cost of broader public policy benefits such as reductions in road congestion and air pollution, across a larger population base.

Operating revenue performance (before consideration of capital grants) has been strong in recent years, increasing at an average annual rate of nearly 4% over the past 10 years (fiscal 2006-2016), which outpaced inflation and U.S. GDP. Fitch expects future revenue growth will continue at a similarly strong pace due to current and prospective economic activity underway.

DART's independent legal ability to raise revenues is limited largely to fare box collections, which comprise a relatively small portion of total revenues. For instance, a 10% increase in fares would raise less than half of the amount of revenue that the Fitch Analytical Sensitivity Tool (FAST) suggests the authority could lose in a moderate recession with a 1% decline in U.S. GDP. The FAST estimate is based on an analysis of the authority's historical revenue performance across economic cycles. DART can increase fares without outside approval, but such increases have practical and political limitations. DART's financial plan assumes an increase to the average fare of approximately 17% every five years. The current 1% sales tax rate levied is at the maximum approved by voters in the participating municipalities.

Expenditure Framework
About 70% of DART's operational spending is directed towards labor costs for employee salaries and benefits.

Fitch expects that natural spending growth will remain in line with to marginally above revenue growth based on current spending patterns. Labor costs tend to track inflation well. Fixed debt service costs are expected to increase, but are unlikely to rise faster than revenues given management's current borrowing plans that are measured and somewhat constrained by the reliance on residual sales tax revenues for operations.

Fitch believes that the authority has a solid degree of control over operating expenses and capital spending. DART maintains full legal ability to adjust service, staffing and compensation levels, which is balanced against an elevated fixed cost burden as a leveraged, capital-intensive enterprise. In downturns, it can reduce hours and/or frequency of service on bus and train lines, decreasing both labor and fuel costs. The authority has a strong track record of making cuts in a disciplined manner, having managed prior recessionary revenue losses largely through spending adjustments.

DART made and retained significant service reductions during and after the Great Recession to maintain solid financial performance. Management indicates the average reduction to DART's operating budget over fiscal 2009-2017 was 8% and the total of these reductions in this period was $352 million. Nonetheless, DART's already elevated carrying costs (approximately 27% of fiscal 2016 expenditures and including debt service and retiree benefit contributions) are expected to grow further given DART's sizeable, near-term debt plans. Fitch believes this additional debt may constrain DART's expenditure flexibility.

Long-Term Liability Burden
DART's long-term liability burden is elevated in terms of annual system cash flows, but moderate relative to 2015 resident personal income. The DART pension obligation constitutes a very small portion of the total liability burden. Net debt to cash flow available for debt service (CFADS) was high at about 14.4x in 2016, and was consistent with prior fiscal years' performance. The overall liability burden is estimated at a fairly moderate 11% of 2015 resident personal income, inclusive of overlapping debt from the participating municipalities.

The analysis supporting the 'AA-' IDR is based upon the application of a variation from Fitch's "U.S. Public Finance Tax-Supported Rating Criteria". Enhanced analysis under the variation relates to the evaluation of the transit agency's debt profile. This evaluation is supported by Fitch's new "Rating Criteria for Public Sector Revenue-Supported Debt" dated June 5, 2017.

Fitch expects debt ratios to increase over the next five years given the authority's large, 5-year capital plan over 2018-2022 of approximately $2.7 billion. The plan includes resources for maintaining current assets in a state of good repair as well as for capital expansion/enhancement. The plan anticipates about $1.6 billion of borrowing over the next five years, in addition to pay-go and grant/external funding sources. DART currently has about $3.3 billion of senior lien sales tax revenue bonds outstanding and amortization is slow with about 20% of principal repaid in ten years. Maximum annual debt service (MADS) occurs in fiscal 2018 at $220.5 million. Fitch notes the additional debt issuance currently planned (estimated at an average of $405 million/year starting in fiscal 2019) would outstrip the current pace of amortization and push debt levels up further

Much of the 5-year CIP (about 60% of the total) is oriented toward a large, recently prioritized capital project--the Cotton Belt single-track commuter rail expansion in the northern part of DART's service area (Plano, Richardson, Addison). This line will be designed to link up with the TEX Rail project currently under construction by the Fort Worth Transportation Authority (FWTA), which runs from downtown Fort Worth to DFW Airport. Revenue service for the Cotton Belt is currently expected by management in 2021. Management anticipates increased system-wide ridership after completing this major capital project, which Fitch believes is a reasonable assumption that could boost associated operating revenues in the intermediate term.

Operating Performance
DART's operating reserves as measured by unrestricted cash and investments are sizable relative to revenue declines anticipated in a moderate recession, contributing to strong anticipated financial resilience and exceptional gap-closing ability. Liquidity levels are consistently high and Fitch expects that the authority would address a revenue shortfall through a combination of expenditure reductions and use of reserves. Fitch expects the authority to adjust service levels, fares and capital spending to maintain a healthy financial cushion and cash balances through a downturn.

Budget management in times of recovery is strong with no meaningful deferrals of necessary spending. Planning is comprehensive, and includes annually adopted updates to the district's long-term financial and capital forecasts. The district ended the last recession with substantial reserves and has added to them in subsequent years.

Unrestricted cash and investments equaled $616 million (a very strong 122% of operating expenses) or 444 days cash at the end of fiscal 2016. The authority has posted positive margins in recent years, and net revenues after payment of operating and maintenance expenses (excluding depreciation and capital grants), provided adequate all-in debt service coverage of slightly more than 1x in fiscal 2016.

Management anticipates roughly break-even performance at fiscal 2017 year-end as higher than budgeted sales tax revenues ($3 million or less than 1% of spending) and some expenditure savings largely offset the budgeted revenue loss associated with ridership decline.

The structurally balanced $523 million fiscal 2018 operating budget grew by about 6% from the prior year, offset by a similarly-sized decline in the capital/non-operating budget. Sales taxes are budgeted to grow by about 4% in fiscal 2018, which will in part support increased healthcare costs, new staff, and a modest salary increase. Further cost savings in fiscal 2018 which should provide additional savings over the near-term include adjustments to bus service and restructured medical coverage for DART employees. Year-to-date performance is running in line with budget according to management.

Revenue Stream Sensitivity
Dedicated Tax Analysis
Pledged revenues consist primarily of a 1% sales tax levy, collected by the Texas Comptroller from the 13 participating municipalities, and are remitted to DART on a monthly basis. Revenues are initially deposited into the gross sales tax revenue fund account. Upon receipt, the bond trustee withdraws and deposits to the respective debt service funds' account the amounts equal to the aggregate debt service for bond obligations of each lien ranking, held in trust for bondholders. Bondholders have a first claim on amounts held in the bond account, with surplus balances after bondholder payment becoming available to DART for any lawful purpose. If amounts on deposit are not enough, the trustee is also required to deposit all the pledged farebox revenues to the debt service funds in the same order of priority.

Additional senior lien bonds may be issued if gross sales taxes during 12 out of the most recent 18 months are equal to at least either 2x annual debt service for the next 3 fiscal years on outstanding and proposed bonds, or 2x MADS. Fitch does not expect the authority to leverage pledged revenues to the additional bonds test (ABT) level since surplus revenues support operations and capital spending.

Management reports no plans to utilize a new junior/subordinate lien on the pledged revenues or issue additional short-term commercial paper (CP). The currently outstanding $140 million in CP carries a subordinate lien on the pledged revenues, but the full amount is expected to be paid off over the next 5 years in cash rather than fixed out in long-term debt.

Pledged revenue coverage is strong (2.5x solely from sales taxes in fiscal 2016) and it is expected to remain strong throughout a typical, moderate U.S. recession. MADS coverage using audited fiscal 2016 pledged sales tax revenue is comparable at 2.5x.

Revenue Stream Sensitivity
To evaluate the sensitivity of the dedicated tax revenue stream to cyclical decline, Fitch considers both a revenue sensitivity scenario (using the 1% decline in national GDP scenario) and the largest decline in revenues over the period covered by the revenue sensitivity analysis. Based on the authority's sales tax revenue history, FAST generates a 4.5% decline in pledged revenues during the first year of a moderate recession. The largest cumulative revenue decline historically was 17.3% over the recessionary period of fiscal years 2000-2003.

Conservatively assuming pledged revenues were leveraged to the 2x ABT, a revenue decline of 50% would still allow for payment of debt service. This cushion is solid at 11.1x the recessionary decline scenario produced by the FAST model and 2.9x of the largest cumulative revenue drop, which Fitch views as consistent with an 'aaa' resilience assessment. The sales tax bond rating is capped at the authority's 'AA-' IDR. Fitch believes that bondholders' claim on pledged revenues would not be protected in the event of a bankruptcy filing by the authority.

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**Applicable Criteria**
Rating Criteria for Public Sector Revenue-Supported Debt (pub. 05 Jun 2017) (https://www.fitchratings.com/site/re/898969)
U.S. Public Finance Tax-Supported Rating Criteria (pub. 31 May 2017) (https://www.fitchratings.com/site/re/898466)

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