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Dallas Area Rapid Transit, TX

DART Sales Tax Off Limits Until Debt Service is Paid

On April 13 the Police and Fire Pension System Board for employees of the City of Dallas, TX (A1 negative) approved a largely symbolic resolution to seek increased funding for its ailing pension fund. As a new revenue source, the board noted the option to divert a portion of the 1% sales taxes levied by Dallas Area Rapid Transit (DART; Aa2 stable). DART's sales taxes are not Dallas' to divert and cannot be used for Dallas' pensions under current state law.

» **Legal protections for DART bondholders are strong.** DART is a separate unit of government, distinct from the City of Dallas. The potential diversion of sales tax revenue to Dallas' pension would violate current state law, DART's pledge of the sales tax to its bondholders and its covenant not to reduce the tax.

» **A court in another state ruled against a similar attempt to reduce or divert transit revenues already pledged to bondholders.** Voters in the State of Washington (Aa1 stable) attempted to eliminate a vehicle tax pledged to bonds issued by the Central Puget Sound Regional Transit Authority (Aaa stable). The Washington Supreme Court struck down the elimination as a violation of contract law.

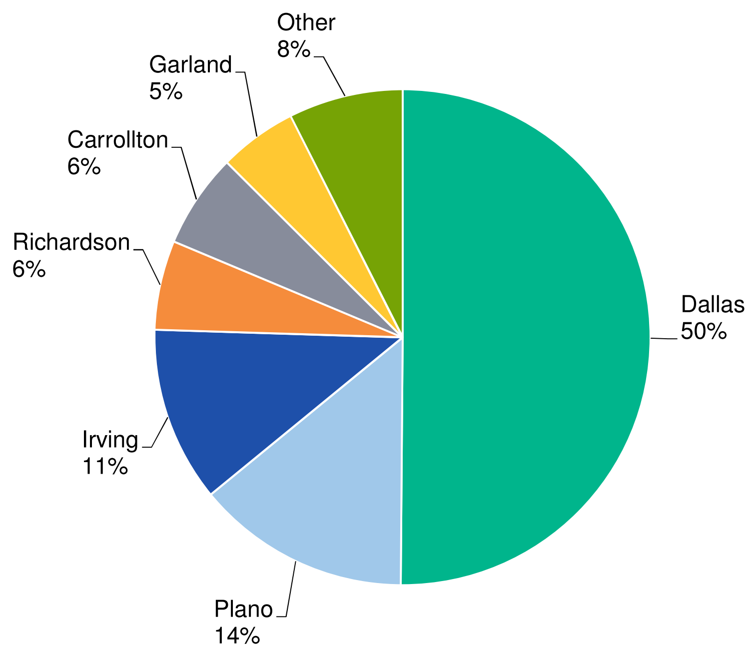
» **DART may not be completely insulated from Dallas' credit stress.** While bondholders benefit from strong legal protections, political and economic pressures cannot be ignored when evaluating credit quality. For example, a change in state law to redirect a portion of the sales tax after debt service is paid would weaken transit operations and DART's finances.

DART's Sales Tax Revenues Are Not Dallas' to Divert

The 1% gross sales tax revenues are pledged to pay debt service on DART's $3.3 billion of outstanding bonds. After bondholders are paid, the remainder is used to finance transit operations. State law restricts the usage of DART's pledged revenue: after debt service, the excess can only be used to fund operations, maintenance and reserves. Further, DART has covenanted in the Master Bond Resolution to protect the tax from reduction. Voters in the service area jurisdictions may choose to withdraw from DART, but there are significant disincentives from doing so: state law requires sales taxes to continue to be collected in the withdrawing entity, paying off a pro rata share of DART's outstanding debt and ending transit service in the jurisdiction.[1] Based on the statutorily-set calculation of liabilities, DART estimates sales taxes would need to be collected within Dallas for at least 13 years to pay off its financial obligation, if voters decided to leave the system.

DART was created in 1983 pursuant to state law, by a vote of residents of the service area jurisdictions. As a separate political entity and corporate body, the authority is governed by its own board, comprised of 15 members nominated by the 13 cities and towns in DART's service area. In another election in 1984, voters authorized a 1% sales tax to fund transit operations. Again in 2000, voters pledged that 1% sales tax on a gross basis to pay bonds issued to expand the system. Sales tax revenues are collected by the State of Texas (Aaa stable) and remitted by the state comptroller to the bond trustee to pay debt service; the remainder flows to DART for operations. Sales tax revenues were $545.9 million in fiscal 2016 and according to DART, collections in Dallas were half the total (see Exhibit 1).

Exhibit 1
Sales Taxes Collected in Dallas Represent Half of DART's Fiscal 2016 Collections



*Allocations based on DART estimates
Source: DART Fiscal 2016 CAFR

Voters Prevented From Eliminating Pledged Revenues for Other Transit System

According to public reports, the Dallas City Council has discussed asking voters to divert a portion of DART's sales tax collected in Dallas to the city. It is unlikely that, even if voters approved a diversion of DART's pledge revenue, this act would be permitted by the courts. In 2002 voters in the State of Washington approved an initiative to repeal motor vehicle excise taxes. The Central Puget Sound Regional Transit Authority had pledged this revenue stream to repay bondholders in 1999. The Washington Supreme Court ruled that the repeal of the tax impaired the constitutionally protected contractual relationship between bondholders and the transit organization. A Texas court would likely reach a similar conclusion regarding a reduction or diversion of revenues pledged to bondholders.

Political and Economic Considerations Cannot Be Ignored

While bondholders benefit from strong legal protections, broader political and economic pressures cannot be ignored when evaluating credit quality. Although we believe it is unlikely that DART will be dragged into Dallas' pension quagmire, the state government does possess strong power to change its tax laws and spending priorities if deemed necessary. State law could be changed, for example, to redirect a portion of DART's sales tax after payment of debt service. While possibly not a violation of DART's bond pledge, this would still be a credit negative action, with the potential to strain transit operations and DART's finances.

Moody's Related Research

Proposed Federal Budget Would Compound Mass Transit Capital Funding Shortfall (May 2017)

Endnotes

1 Withdrawal from DART has occurred twice since its inception: in 1988 the City of Coppell (Aaa) and Town of Flower Mound (Aa1) left the system.

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