



RATING ACTION COMMENTARY

Fitch Affirms Evanston, IL's IDR at 'AA+', Rates \$27.6MM GOs 'AA+'; Outlook Stable

Thu 23 Jul, 2020 - 3:30 PM ET

Fitch Ratings - New York - 23 Jul 2020: Fitch Ratings has assigned a 'AA+' rating to the following Evanston, IL general obligation (GO) bonds:

--\$27.6 million GO corporate purpose bonds, series 2020.

Proceeds of the series 2020 bonds will be used to finance various capital projects outlined in the city's capital improvements plan and to refund certain other bonds.

The bonds will be sold competitively on Aug. 10, 2020.

In addition, Fitch has affirmed the following ratings at 'AA+':

--Issuer Default Rating (IDR);

-- \$190 million of GO bonds outstanding.

The Rating Outlook is Stable.

SECURITY

The bonds are backed by the city's full faith and credit pledge. Debt service will be paid from an ad valorem tax on all taxable property within the city, without limit as to rate or amount.

ANALYTICAL CONCLUSION

Evanston's 'AA+' IDR and GO ratings incorporate the city's strong independent revenue-raising ability, moderate long-term liability burden, and adequate spending flexibility. Available reserves have declined as a percentage of spending in recent years but remain relatively healthy. The city has sustained capital spending levels since the Great Recession and has increased its annual pension contributions.

ECONOMIC RESOURCE BASE

The city is contiguous with Chicago and is approximately 13 miles from downtown. The strong local economy is anchored by Northwestern University. Northshore University Healthcare and St. Francis Hospital provide additional employment and economic stability to the city. The city's large downtown retail corridor draws in shoppers from neighboring municipalities in northern Illinois. Evanston's 2018 population was estimated at about 73,400.

KEY RATING DRIVERS

Revenue Framework: 'aa'

Fitch expects that the city's revenue growth pattern will continue to be slow, roughly even with inflation. The city's independent legal ability to raise revenue is exceptionally strong given its status as an Illinois home rule municipality.

Expenditure Framework: 'a'

Fitch anticipates that the city's natural rate of expenditure growth will be above its revenue growth rate. The city retains adequate spending flexibility pertaining to service delivery, head count and capital spending. Fixed carrying costs for debt service and retiree benefits are elevated, totaling over 20% of governmental expenditures in 2019.

Long-Term Liability Burden: 'aa'

Evanston's long-term liability burden, inclusive of its net overall debt and net pension liabilities, is moderate compared to its economic resource base, equaling approximately 10% of personal income.

Operating Performance: 'aaa'

The city retains the highest level of gap-closing capacity and could manage successfully through a moderate cyclical downturn while maintaining a high level of financial flexibility. Available reserves, including unrestricted deposits held outside the general fund, equaled 22% of spending in 2019 - a solid fiscal cushion.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Improvements in growth prospects for revenue growth independent of policy action to a rate higher than inflation;

--Sustained decline in the long-term liability burden as a percentage of personal income.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Lack of success in using new and augmented revenue sources and managing spending to maintain operating performance stability and increase reserves to levels

in line with policy over the long term;

--Sustained significant increase in the long-term liability burden as a percentage of personal income;

--Economic contraction consistent with Fitch's coronavirus downside scenario that triggers sustained and deep revenue declines and materially erodes the city's gap-closing capacity.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [<https://www.fitchratings.com/site/re/10111579>].

CURRENT DEVELOPMENTS

The ongoing outbreak of coronavirus and related government containment measures worldwide creates an uncertain global environment for U.S. state and local governments and related entities in the near term. While the Village's most recently available fiscal and economic data may not fully reflect impairment, material changes in revenues and expenditures are occurring across the country and likely to worsen in the coming weeks and months as economic activity suffers and public health spending increases. Fitch's ratings are forward-looking in nature, and Fitch will monitor developments in state and local governments as a result of the virus outbreak as it relates to severity and duration, and incorporate revised expectations for future performance and assessment of key risks.

In its baseline scenario, Fitch assumes sharp economic contractions to hit major economies in 1H20 at a speed and depth that is unprecedented since World War II. Sequential recovery is projected to begin from 3Q20 onward as the health crisis subsides after a short but severe global recession. GDP is projected to remain below its 4Q19 level until mid-2022. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the report "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases - Update" published on April 29, 2020 and available on [fitchratings.com](https://www.fitchratings.com).

City management expects a revenue decline of \$8 million to \$12 million due to the coronavirus pandemic and resulting shutdown measures, at the higher end of the range if Northwestern University opts to go to fully remote learning in the fall 2020 semester. In response, the city has made expenditure reductions through furloughs, reducing seasonal positions, attrition, and reducing pay-go capex for a large portion of those potential revenue shortfalls, although there may also be a small draw on reserves if revenue declines are at the higher end of the city's projected range.

CREDIT PROFILE

The primarily residential city has a strong socioeconomic profile, as evidenced by high resident wealth and employment levels. Proximity to Chicago and Evanston's own diverse economy provides abundant employment opportunities. Residents are highly educated, with 66% of the population attaining at least a bachelor's degree versus around 30% nationally. The city's unemployment rate has historically been below those of the state and U.S. The city also had a large increase in estimated assessed value (EAV) in 2020 (2021 tax year) during its triennial reassessment of over 26% to \$3.4 billion.

REVENUE FRAMEWORK

Fitch expects future revenue growth to be in line with U.S. inflation based on expectations for improving economic conditions in the long term and the city's ability to capture growth due to its status as an Illinois home rule municipality. General fund operations are funded by a mix of property taxes, local and state-shared sales, liquor and cigarette taxes, intergovernmental transfers, other taxes,

and license and permit fees. Property taxes are the largest general fund revenue source at 27% of the 2019 total, followed by intergovernmental transfers at 17%.

Fitch believes the natural rate of revenue growth will stay consistent with recent history, during which time revenues have expanded at close to the rate of inflation. EAV rose over 26% in 2020 tax year following the triennial assessment. Growth in EAV reflects improving economic activity, including new construction, and the three-year time lag included in Cook County's property revaluation procedures, which affects all municipalities within the county. Before a period of new growth commenced in 2014, Evanston's EAV endured four years of steep declines that had reduced the tax base by 33%.

The city has a significant legal and practical ability to raise revenues given its status as an Illinois home rule municipality. There are no tax rate limits or requirements to conduct voter referenda to raise taxes or other sources of local revenue, which the mayor and city council may do via a simple majority vote. The absence of legal restrictions means that elected officials in Illinois home rule municipalities have broad revenue-raising authority.

EXPENDITURE FRAMEWORK

General fund spending is concentrated heavily in public safety, which accounted for 55% of spending in 2019. Other notable expenditure items include general government (15%), public works (11%), and culture & recreation (11%).

Fitch believes spending is likely to grow more quickly than revenues in the near term given the modest expected pace of revenue gains and rising salary and employee pension costs. The bulk of spending is related to contractual salaries and benefits, which consume nearly two-thirds of budget. Ongoing policy actions will likely be needed to align revenues and expenditures.

Expenditure flexibility is adequate, as the city retains a solid degree of control over service delivery and headcount. The city has also reduced pay-go capital from the budgeted \$12 million to \$7 million this fiscal year. Fixed carrying costs related to annual pension contributions, debt service, and retiree healthcare consumed over 20% of governmental spending in 2019.

A portion of GO debt service is paid from sources outside of the property tax levy, including special assessments, sales taxes, water & sewer fees, and others. The portion of abated debt service is commonly in the range of 20% of debt service per annum. Non-property tax sources provide the city a degree of added spending flexibility.

The administration's ability to control personnel costs is constrained by labor contracts that largely determine workplace rules, work hours and employee salaries. Most of Evanston's contracts with its four bargaining units (two police, one fire, and one general) are subject to binding arbitration. The city cut its workforce by 10% during the last recession, but had since restored some positions, providing management options during the current economic decline.

LONG-TERM LIABILITY BURDEN

The long-term liability burden is moderate compared to the economic resource base. Combined debt and net pension liabilities equal approximately 10% of resident personal income, which is at the lower end of Fitch's 'aa' assessment range for municipal long-term liabilities. Direct debt accounts for 26% of the liability, overlapping debt accounts for 31%, and net pension liabilities account for 43% of the total. Direct debt will grow only modestly in 2020 as a result of the current issue. Amortization is average, with 58% of principal scheduled to mature within 10 years.

The city participates in three public defined benefit pension plans: two single employer plans for the city's police and fire safety officers and a state-sponsored plan for most other employees. The police and fire plans are both single employer plans, but with benefits and employee and employer contribution rates established by state statute. As of Dec. 31, 2019, the police and firefighters' pension plans were underfunded with reported assets-to-liabilities ratios of 49% and 45%, respectively, assuming a 6.5% discount rate. As of Dec. 31, 2019, the state-sponsored plan, the Illinois Municipal Retirement Fund, had a much stronger assets-to-liabilities ratio of 90.0% assuming a 7.5% rate of return. Taken as a whole, the city's Fitch-adjusted net

pension liability for all three plans totaled \$215 million and was 68% funded when adjusted to a 6% discount rate.

Management has been pro-active about addressing pension liabilities. It has consistently exceeded required contribution amounts and, in consultation with its pension boards, has steadily lowered discount rate assumptions to better align them with historical investment returns. Fitch expects annual ADC increases will be manageable in light of the plans' already-low discount rate assumptions.

Evanston's other-post employment benefits (OPEB) liability is modest at \$18 million, equal to 0.3% of personal income.

OPERATING PERFORMANCE

Evanston retains a high degree of financial flexibility due to healthy available reserves, strong revenue-raising ability, and adequate control over spending. The city added over \$2 million to reserves in 2019, bringing available reserves inclusive of unrestricted balances in the enterprise funds to around 22% of expenditures. The city expects a general fund revenue shortfall of \$8 million to \$12 million in 2020, with the range depending on whether Northwestern University has in-person learning in the fall semester. The city has identified expenditure reductions to balance the budget, including furloughs and the reduction of some positions - mostly seasonal workers and through attrition, in addition to delaying pay-go capital spending. While the city may have a small draw on reserves if the revenue decline is at the upper range of expectations, Fitch expects that the city's strong inherent budget flexibility will enable it to keep draws to a minimum. Larger than expected reliance on reserves to balance the financial operations would introduce negative pressure on the rating.

The city's general fund balance policy requires a minimum balance equal to two months (16.6%) of general fund spending. If reserves fall below that level, then the city may budget a surplus. If the total fund balance increases to above 20%, then the city may budget a deficit. Fitch notes that the city has been below its own policy target since 2015 due to a one-time draw on reserves in that year, despite adopting

the target that same year. The city has made progress in increasing reserves since then. The city has also been conservative in other financial management policies, including lowering its pension rate of return assumptions for its police and fire plans to 6.5%. While the city anticipates a small draw on reserves in 2020, management believes it will be able to replenish that amount in 2021 due to the large increase in EAV affecting the property tax levy in that year. Additionally, the city has the ability to generate some one-time revenue, if needed.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

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, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING		
Evanston (IL) [General Government]	LT IDR	AA+ Rating Outlook Stable	Affirmed

ENTITY/DEBT	RATING		
● Evanston (IL) /General Obligation - Unlimited Tax/1 LT	LT	AA+ Rating Outlook Stable	Affirmed

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APPLICABLE CRITERIA

[U.S. Public Finance Tax-Supported Rating Criteria \(pub. 27 Mar 2020\) \(including rating assumption sensitivity\)](#)

APPLICABLE MODELS

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

FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

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