

# RatingsDirect®

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## Summary:

# Evanston, Illinois; General Obligation

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## Summary:

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### Credit Profile

US\$27.61 mil GO corp purp bnds ser 2020 due 12/01/2040

*Long Term Rating*

AA/Stable

New

## Rating Action

S&P Global Ratings assigned its 'AA' long-term rating to Evanston, Ill.'s \$27.6 million series 2020 general obligation (GO) bonds. The outlook is stable.

The city's unlimited tax, full faith and credit GO ad valorem tax pledge secures the series 2020 bonds. The bond proceeds will be used to finance capital projects in the city's 2020 capital improvement plan and refund a portion of the series 2010A and 2011A bonds for interest savings.

### Credit overview

Although the scope of economic and financial challenges posed by COVID-19 remains to be seen, due to the city's strong reserve levels and strong management team, we believe Evanston is well positioned to navigate the possible impact of the pandemic in the short-to-medium term. Evanston embodies many characteristics that will be helpful in weathering this time of uncertainty, including a diverse economy that is independently very strong, but also part of a broad and diverse metropolitan statistical area (MSA); consistently stable financial operating results, as the city relies on a large and diverse tax base; and a sophisticated and knowledgeable management team. Generally, our rating outlook timeframe is up to two years. Given the current uncertainty around the pandemic, our view of the credit risks to the city are centered on the more immediate budget effects in 2020. (For additional information, see "The U.S. Faces A Longer and Slower Climb From The Bottom," published June 25, 2020, on RatingsDirect.) We view Evanston's growing pension payments as the greatest financial pressure in the medium-to-long term, as the city's plans are poorly funded and we expect costs will increase.

The ratings reflect our assessment of Evanston's:

- Very strong economy, with access to a broad and diverse MSA and a local stabilizing institutional influence;
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with an operating surplus in the general fund and break-even operating results at the total governmental fund level in fiscal 2019;
- Strong budgetary flexibility, with an available fund balance in fiscal 2019 of 13.4% of operating expenditures;
- Very strong liquidity, with total government available cash at 42.9% of total governmental fund expenditures and 3.8x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability profile, with debt service carrying charges at 11.4% of expenditures and net

direct debt that is 122.1% of total governmental fund revenue, as well as a large pension and other postemployment benefit (OPEB) obligation and the lack of a plan to sufficiently address the obligation; and

- Strong institutional framework score.

### **Environmental, social, and governance factors**

The rating also incorporates our view of health and safety risks posed by COVID-19, which we consider social risk factors. Although the scope of economic and financial challenges posed by COVID-19 remains unknown, we imagine a prolonged disruption could weaken the local economy. Absent COVID-19 implications, we consider the city's social risks in line with the sector standard. We also consider governance and environmental risks in line with our view of the sector as a whole.

## **Stable Outlook**

### **Downside scenario**

If the city experiences a large drop in revenue and fails to make budgetary adjustments, causing a significant deterioration in general fund reserves, we could lower the rating. In addition, we could lower the rating if increasing pension contributions were to further pressure the budget.

### **Upside scenario**

We could raise the rating if the city demonstrates the ability to manage its finances through this period of uncertainty and maintains reserves at the current level.

## **Credit Opinion**

### **Very strong economy**

We consider Evanston's economy very strong. The city, with an estimated population of 75,590, is located in Cook County in the Chicago-Naperville-Elgin, IL-IN-WI MSA, which we consider to be broad and diverse. The city also benefits, in our view, from a stabilizing institutional influence. The city has a projected per capita effective buying income of 160% of the national level and per capita market value of \$136,605. Overall, the city's market value grew by 26.5% over the past year to \$10.3 billion in 2020. The county unemployment rate was 3.8% in 2019.

Evanston is just north of Chicago and is home to Northwestern University, a prestigious private institution. The university is the city's largest employer (5,700 employees) and we believe is a stabilizing institution (with over 20,000 students); Evanston relies on the student population and university visitors for much of its economic activity. With the school using distancing learning for the spring session and uncertainty regarding this fall because of the COVID-19 pandemic, Northwestern's normal contributions to the economy will be dampened. Adding additional uncertainty to Evanston's economy is the city's second-largest employer, Northshore University Health System (4,641 employees), which if it follows the national trend, will likely have less revenue because elective procedures and routine doctor appointments have declined during this pandemic. Even with this uncertainty, we believe that Evanston's economy will remain, what we view, as very strong over the next year. We believe that following the pandemic's resolution, Evanston's economy will recover quicker than most cities given it is a desirable place to live with diverse employment

opportunities and access to the Chicago MSA.

### **Strong management**

We view the city's management as strong, with good financial policies and practices under our FMA methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Management has a comprehensive budgeting process that uses historical data and outside information to project budgeted revenues and expenditures. The city council adopts a detailed two-year budget, and maintains a five-year capital improvement plan that is updated every two years and identifies sources and uses of funds. The council reviews monthly budget-to-actual results, and reviews investment holdings quarterly. Evanston adopted a fund balance policy to work toward a general fund balance of 16.6% of general fund expenditures; it's currently not meeting that goal. The city also has its own debt management policy and investment policy.

### **Adequate budgetary performance**

Evanston's budgetary performance is adequate, in our opinion. The city had surplus operating results in the general fund of 1.8% of expenditures, and balanced results across all governmental funds of 0.2% in fiscal 2019. General fund operating results of the city have been stable over the past three years, with a result of 0.4% in 2018 and a result of 1.3% in 2017.

Although property taxes make up the largest revenue source, at 27%, our view of Evanston's adequate budgetary performance is driven by its general fund reliance (24%) on economically sensitive revenue, primarily sales and use taxes, but also a variety of small revenues like athletic contest tax, parking tax, and municipal hotel tax. The remaining 50% of the city's revenue comes from a wide variety of sources; officials report that building permits and the liquor tax are faring well during the COVID-19 pandemic. For fiscal 2020 (year-end Dec. 31), the city budgeted for a \$1.62 million general fund surplus. After the onset of the pandemic, the city began to reduce expenditures with mandatory unpaid furloughs, \$5 million in capital expenditure cuts, and exploring some one-time revenue sources from the sale of assets. The sales tax collections have a three-month lag, so it's difficult to gain a clear picture of the current status, but officials are estimating a \$2.4 million deficit (2% of expenditures) based on current conditions and expenditure cuts already completed. The council has a meeting scheduled for August, where it will have updated revenue collections. Officials indicate the council is preparing for a variety of scenarios and would prefer to minimize the use of reserves to balance the budget.

The fiscal 2019 results in the general fund were typical of most years, with strong revenue growth. We removed bond proceeds expenditures from the total governmental expenditures.

### **Strong budgetary flexibility**

Evanston's budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2019 of 13.4% of operating expenditures, or \$15.5 million.

Based on our expectations that Evanston could have a deficit in fiscal 2020, we expect reserves to remain, what we consider, adequate to strong, over the next year.

### **Very strong liquidity**

In our opinion, Evanston's liquidity is very strong, with total government available cash at 42.9% of total governmental fund expenditures and 3.8x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary.

Evanston has \$60.7 million of cash and investments in money markets with maturities of less than one year. The city opened a \$15 million line of credit in case of emergencies, but does not plan to draw on it. The agreement has what we consider permissive covenants, and although it does not outline accelerations, given Evanston's high cash position, we do not consider this a contingent liability risk. The city has accessed the capital markets annually and we view its access to external liquidity as strong.

### **Very weak debt and contingent liability profile**

In our view, Evanston's debt and contingent liability profile is very weak. Total governmental fund debt service is 11.4% of total governmental fund expenditures, and net direct debt is 122.1% of total governmental fund revenue.

Considering the COVID-19 pandemic, Evanston is evaluating debt needs for the next two year, and it does not have definitive plans to issue additional debt yet. Evanston reduced this current issuance by \$5 million for the same reason..

### **Pension and other postemployment benefit highlights**

In our opinion, a credit weakness is Evanston's large pension and OPEB obligation, without a plan in place that we think will sufficiently address the obligation. Evanston's combined required pension and actual OPEB contributions totaled 15.5% of total governmental fund expenditures in 2019. Of that amount, 14.9% represented required contributions to pension obligations, and 0.6% represented OPEB payments. The city made its full annual required pension contribution in 2019. The funded ratio of the largest pension plan is 56.3%.

- Based on low-to-moderate funding for the police and fire pension plans and the magnitude of the city's net liability, we think pension costs will likely remain elevated and increase during the coming years.

Evanston contributes to the following defined-benefit pension plans:

- A single-employer police pension plan: 56.3% funded, with an employer net pension liability (NPL) of \$109.6 million as of Dec. 31, 2019;
- A single-employer firefighters pension plan: 48% funded, with an employer NPL of \$97 million as of Dec. 31, 2019;
- Illinois Municipal Retirement Fund (IMRF), an agent multiple-employer plan: 90.7% funded, with an employer NPL of \$23 million as of Dec. 31, 2019; and
- Illinois Post-Employment Health Care Benefit Plan, a single-employer OPEB plan: 0% funded, with an employer net liability of \$21.7 million as of Dec. 31, 2019.

The police plan uses a 6.5% discount rate, which is above our 6.0% guideline and, along with the static mortality assumption, could lead to contribution volatility for the city. The city's actuarially determined contribution (ADC) is at the statutory level, reflecting a 90% funding goal by 2040, which we view as weak funding discipline that defers costs into the future. However, we view positively the assumption of level dollar amortization. In fiscal 2019, police pension plan contributions were 83% of our minimum funding progress metric and 114% of static funding, which we view

positively, as contributions were almost adequate to make progress on paying down unfunded liabilities.

IMRF uses a 7.25% statewide discount rate, which is above our 6.5% guideline and could lead to contribution volatility for the city. Evanston pays its full ADC annually to IMRF, although it includes annual increases of 3.4%. In fiscal 2019, IMRF contributions were 104% of our minimum funding progress metric.

Evanston funds its OPEB on a pay-as-you-go basis, which we view negatively, but liabilities are currently considered manageable.

### **Strong institutional framework**

The institutional framework score for Illinois home-rule cities and villages is strong.

## **Related Research**

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 2019 Update Of Institutional Framework For U.S. Local Governments

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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