

FITCH RATES EVANSTON, IL'S \$47MM SER. 2018 GOS 'AA+'; RATING OUTLOOK STABLE

Fitch Ratings-New York-11 July 2018: Fitch Ratings has assigned a 'AA+' rating to the following Evanston, IL general obligation (GO) bonds:

- \$20.3 million GO corporate purpose bonds, series 2018A;
- \$15.3 million GO refunding bonds, series 2018B;
- \$7.9 million GO refunding bonds, series 2018C;
- \$3.6 million taxable GO corporate purpose bonds, Series 2018D.

Fitch has also affirmed the following ratings at 'AA+':

- the city's Issuer Default Rating (IDR);
- the city's \$146.5 million of GO bonds outstanding.

The Rating Outlook is Stable.

Proceeds of the series 2018A bonds will be used to finance a portion of the costs of building the new Robert Crown Community Center, the proceeds of series 2018B will be used to finance capital projects outlined in the city's capital improvements plan, the proceeds of series 2018C are being used to currently refund the city's series 2008 GO bonds, and proceeds of series 2018D will be used to provide long-term financing for infrastructure improvements in one of the city's TIF districts.

The bonds will be sold competitively on July 24, 2018.

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 solid financial flexibility. The ratings also incorporate Evanston's uneven general fund operating performance since the last recession, which reflects management's desire to preserve services and increase annual pension funding while avoiding major tax increases. The city has sustained capital spending since the recession and has improved funding of annual pension contributions; available reserves have declined, but remain relatively healthy.

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, which employs over 6,500 people and educates approximately 21,000 students at its Evanston campus. 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 2017 population was estimated at about 74,800.

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, but fixed carrying costs for debt service and retiree benefits are presently elevated, totaling approximately 32% of governmental expenditures in 2017.

Long-Term Liability Burden: 'aa'

Evanston's long-term liability burden, inclusive of its net overall debt and unfunded pension liabilities, is moderate compared to its economic resource base, equaling nearly 12% of personal income.

Operating Performance: 'aaa'

The city retains robust 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 15.4% of spending in 2017 - a solid fiscal cushion, albeit one that has steadily declined from more than 30% of spending as recently as in 2014.

RATING SENSITIVITIES

FINANCIAL FLEXIBILITY: Failure to maintain the current high level of financial flexibility as the result of further declines in available reserves could lead to negative action on the rating. Management's ability to use new and augmented revenue sources to stabilize general fund operating performance and eliminate the recent dependence on fund balance for operations will determine the future direction of the rating and outlook.

PERSISTENTLY HIGHER FIXED COSTS: Sustained high carrying costs for debt service and annual pension contributions as a percent of governmental spending could also place negative pressure on the rating.

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 30% nationally. The city's unemployment rate has historically been below those of the state and U.S.

Revenue Framework

Fitch expects future revenue growth to be in line with U.S. inflation based on improving economic conditions 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%, 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. Equalized assessed values

(EAV) rose 2.6% in 2017 after rebounding by 22% the prior year. Recent 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 residing 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 expects sales taxes to rise 1% to 2% annually given new retail developments in the city center.

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 home rule municipalities have broad revenue-raising authority.

Expenditure Framework

General fund spending is concentrated heavily in the area of public safety (i.e. police and fire), which accounted for 57% of spending in 2017. Other notable expenditure items include general government (15%), public works (12%), and culture & recreation (11%).

Growth in spending has tracked the rate of revenue expansion since 2010 due to policy actions by management to control costs. Fitch expects this trend to persist as continuous policy actions will likely be needed to align revenues and expenditures. Budget management in recent years has required frequent mid-year actions to close budget gaps and thereby limit or prevent draws on reserves. 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.

The city's expenditure flexibility is adequate, in Fitch's view, as it retains a high degree of control over service delivery and employee headcount and can scale back pay-go capital spending, which accounts for approximately 4% of the 2018 budget. However, fixed carrying costs related to annual pension contributions, debt service, and retiree healthcare consumed over 32% of governmental spending in 2017. Elevated fixed costs hinder spending flexibility, which could be materially weakened if carrying costs stay elevated. Debt service accounted for 17% of spending in 2017, while annual pension contributions were 15% of expenditures. Spending on retiree healthcare benefits is negligible.

A portion of the GO debt service is typically paid from sources outside of the property tax levy, including special assessments, sales taxes, water & sewer charges, 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 has 807 full-time employees, down slightly from 860 employees in 2008. The city cut its workforce by 10% during the recession, but has since restored some positions, providing management with options should it need to cut costs to balance the budget. The city budgets a contingency each year for revenues. The city raised its contingency level to 4% of spending for 2017 to factor in the possibility that part of its share of state income taxes could be delayed due to state fiscal pressures; this delay actually occurred. Fitch views the city's annual spending reduction contingencies as achievable.

Long-Term Liability Burden

The long-term liability burden is moderate compared to the economic resource base. Combined debt and unfunded pension liabilities equaled approximately 12% of resident personal income in 2017, which is at the lower end of Fitch's 'aa' assessment range for municipal long-term liabilities. The direct GO debt burden shrank 28% in the decade from 2006 to 2016 as the administration imposed tighter issuance guidelines. Direct debt is expected to grow modestly in the near term, as the city plans to issue amounts slightly greater than annual maturities in the next two years to finance a new community center. Amortization is fairly rapid with more than 60% of outstanding principal maturing in 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 benefits and employee and employer contribution rates are established by state statute. As of Dec. 31, 2017, the police and firefighters' pension plans were badly underfunded with reported assets-to-liabilities ratios of 52% and 46%, respectively, assuming a 6.5% discount rate. Using Fitch's slightly more conservative 6% discount rate assumption, the asset-to-liability ratios for the plans were slightly weaker at 51% and 44%, respectively.

As of Dec. 31, 2016, the state-sponsored plan, the Illinois Municipal Retirement Fund, had a much stronger assets-to-liabilities ratio of 93% assuming a 7.5% rate of return; Fitch estimates an 80% assets-to-liabilities ratio using its more conservative 6% discount rate assumption. Taken as a whole, the city's Fitch-adjusted net pension liability for all three plans totaled \$273 million for fiscal 2017 and equaled close to 5% of personal income.

Management has been pro-active about addressing unfunded 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 \$15 million, equal to 0.3% of personal income.

Operating Performance

Evanston retains a high degree of financial flexibility due to still-healthy available reserves despite some recent drawdowns, strong revenue-raising ability, and adequate control over spending. Unrestricted general fund reserves constituted just over 11% of spending at year-end 2017. The city maintains additional fund balances in its parking fund, bringing available reserves to 15.4% of spending for 2017. While it is possible that the city could maintain reserves near current levels under a moderate stress scenario, Fitch believes it is equally likely that the city would continue to draw on reserves until they are no longer consistent with Fitch's 'aaa' operating performance assessment.

Fitch would regard continued pressure on available reserves negatively, particularly since available reserves are already close to Fitch's 12.3% of spending threshold needed to maintain a 'aaa' operating assessment, and general fund reserves have been below the city's own policy target since 2015.

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, despite adopting the target that same year.

The city budgeted for a surplus for 2017 to increase reserves closer to the policy target, and ultimately added \$1.7 million to general fund balance. The city achieved its surplus through the combination of a mid-year hiring freeze, cuts in discretionary spending, elimination of a \$1.7 million transfer out to fund pay-go capital, and increased transfers into the general fund, particularly from the economic development fund, the fund balances of which were consolidated with general fund reserves in 2017. Capital projects in 2017 were funded using sources already on deposit in the capital fund.

The 2018 all-funds budget grew by \$11.7 million, or 3.6%, over 2017, with general fund spending rising by 3.5% year-over-year due to salary increases under the employee contracts, health care premium growth and continued pay-go capital spending. Revenues are tracking above budget for 2018 due to higher-than-anticipated permit revenues and a restoration of the city's prior share of state income tax receipts. Management aims to conclude fiscal 2018 with a \$3 million to \$4 million operating surplus to raise general fund reserves closer to the city's policy target. A new revenue source in 2018 is a '20 cents per ride' tax on Lyft and Uber rides that went into effect in January. Management projects the tax will generate several hundred thousand in new recurring revenues annually. Decommissioning of the Washington TIF District in Dec. 2017 will allow the city to raise an added \$1 million from the property tax levy starting in 2019. Management expects this combination of new and augmented revenues will positively impact operations and reserves in 2018 and 2019.

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Additional information is available on www.fitchratings.com

Applicable Criteria
U.S. Public Finance Tax-Supported Rating Criteria (pub. 03 Apr 2018)
<https://www.fitchratings.com/site/re/10024656>

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