Evanston (City of) IL

Update to credit analysis

Summary
Evanston, IL (Aa2) has a strong economic profile characterized by a large tax base which is anchored by Northwestern University (Aaa negative) and an affluent residential profile. The city’s credit profile benefits from broad legal ability to raise revenues which management has utilized to balance operations. Despite that ability, reserves remain below its peers in the state though are adequate and in line with the rating category. The city has a moderate debt burden, and overall leverage is high due to a large and growing pension burden.

Credit strengths
» Higher education and health care institutions anchor an affluent and diverse tax base that plays a key role in the Chicago (Ba1 negative) regional economy
» Significant financial flexibility afforded by the city’s status as a home rule unit of local government

Credit challenges
» Cash and fund balance relative to operating revenue is modest compared to similarly rated entities
» Elevated pension and fixed cost burdens

Rating outlook
Outlooks are usually not assigned to local government credits with this amount of debt.

Factors that could lead to an upgrade
» Moderated debt, pension and fixed cost burdens
» Significant growth in fund balance and liquidity

Factors that could lead to a downgrade
» Narrowed fund balance or liquidity
» Growth in the city’s debt or pension burden
» Material tax base contraction or a weakened socioeconomic profile
# Key indicators

## Exhibit 1

<table>
<thead>
<tr>
<th>Evanston (City of) IL</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Economy/Tax Base</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Full Value ($000)</td>
<td>$7,551,416</td>
<td>$6,611,703</td>
<td>$6,740,450</td>
<td>$6,594,659</td>
<td>$8,019,255</td>
</tr>
<tr>
<td>Population</td>
<td>74,937</td>
<td>75,282</td>
<td>75,603</td>
<td>75,472</td>
<td>75,472</td>
</tr>
<tr>
<td>Full Value Per Capita</td>
<td>$100,770</td>
<td>$87,826</td>
<td>$89,156</td>
<td>$87,379</td>
<td>$106,255</td>
</tr>
<tr>
<td>Median Family Income (% of US Median)</td>
<td>165.1%</td>
<td>159.0%</td>
<td>158.9%</td>
<td>153.8%</td>
<td>153.8%</td>
</tr>
</tbody>
</table>

## Finances

| Operating Revenue ($000) | $120,162 | $123,812 | $122,141 | $126,422 | $126,253 |
| Fund Balance ($000)      | $34,791  | $34,121  | $25,778  | $23,029  | $20,116  |
| Cash Balance ($000)      | $26,495  | $19,543  | $17,357  | $17,632  | $14,656  |
| Fund Balance as a % of Revenues | 22.0% | 15.8% | 14.2% | 13.9% | 11.6% |

## Debt/Pensions

| Net Direct Debt ($000) | $134,910 | $134,123 | $130,885 | $126,763 | $147,149 |
| 3-Year Average of Moody’s ANP L ($000) | $296,956 | $313,131 | $341,766 | $383,714 | $439,614 |
| Net Direct Debt / Full Value (%) | 1.8% | 2.0% | 1.9% | 1.9% | 1.8% |
| Net Direct Debt / Operating Revenues (x) | 1.1x | 1.1x | 1.1x | 1.0x | 1.2x |
| Moody’s - adjusted Net Pension Liability (3-yr average) to Full Value (%) | 3.9% | 4.7% | 5.1% | 5.8% | 5.5% |
| Moody’s - adjusted Net Pension Liability (3-yr average) to Revenues (x) | 2.5x | 2.5x | 2.8x | 3.0x | 3.5x |

The above exhibit reflect data through fiscal year 2017.

Source: Audited financial statements, US Census Bureau and Moody’s Investors Service

# Profile

The City of Evanston, a home rule municipality, is located in Cook County (A2 stable) along Chicago’s (Ba1 negative) northern border and 13 miles north of Chicago’s downtown loop. As of the 2016, the city had an estimated population of over 75,000. Evanston is home to Northwestern University (Aaa negative).

# Detailed credit considerations

## Economy and tax base: sizable tax base bolstered by institutional presence

We expect the city’s economic profile will remain robust and continue to be a credit strength. Evanston is home to Northwestern University (Aaa negative), the city’s top employer with more than 5,000 employees. In addition to higher education, healthcare is an anchor of the city’s economy. North Shore University HealthSystem (Aa2 stable) and St. Francis Hospital employ over 5,800 and 1,200, respectively. Interstate 94, rapid transit, and commuter rail stations provide residents easy access to employment throughout the Chicago region. The city’s tax base is large with a full valuation of $8.0 billion. After falling a cumulative 33% from 2011 through 2014, the city’s full valuation grew over 21% in the most recent three years.

Despite university students accounting for more than 10% of the city’s population, per capita income, median family income, and median home value of Evanston residents consistently exceeds state and national levels. As of 2016 median family income in Evanston was estimated at 153.8% of the national median. Nearly 80% of the city’s assessed valuation is classified as residential though valuation figures do not include the substantial tax exempt property in the city.

## Financial operations and reserves: satisfactory financial position supported by revenue raising flexibility

Evanston’s financial position remains supported by a high degree of revenue raising flexibility despite fund balance and liquidity being more limited than similarly rated local governments. The city closed fiscal 2017 with a general fund surplus of $1.7 million, which was supported by close monitoring of revenues and expenditures. Available fund balance across major operating funds in fiscal 2017 was

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$20.1 million or a satisfactory 15.9% of revenue. We consider the general, debt, emergency telephone system, economic development, and general assistance funds as major operating funds. The city’s 2018 general fund budget shows a $600,000 surplus.

Evanston’s home rule status provides it broad legal flexibility to raise revenue as it is not subject to property tax levy limits, has no statutory debt ceiling, and has the power to impose a variety of taxes without voter approval. We view this as a key credit strength. Approximately 40% of the city’s operating revenue comes from property taxes. Another 6.4% is from sales taxes and 14.3% is classified as intergovernmental – the city’s share of various taxes distributed by the State of Illinois (Baa3 negative).

LIQUIDITY
While general fund cash was narrow at 4.9% of revenues at the close of fiscal 2017, total operating liquidity across major funds was a more satisfactory $14.7 million, or 11.6% of revenues. With the exception of the solid waste fund, the city’s major enterprise operations (water, sewer, and parking) all have more than 200 days of cash on hand. The city’s solid waste fund carries limited cash and a deficit unrestricted net asset position and requires annual general fund support. However, the annual subsidy is not a significant source of budgetary pressure for the city.

Debt and pensions: moderate direct debt burden; high and growing pension burden
At 2.0% of full value and 1.3x operating revenue, Evanston’s direct debt burden is above average. These ratios do not include $36.8 million of general obligation debt being repaid by the city’s self-supporting water and sewer enterprises. The city plans annual bond sales to finance capital improvements, consistent with plans developed years ago. However, we do not expect material increases in the debt burden because a large portion of future debt will likely be supported by the city’s enterprises.

The three-year average Moody’s adjusted net pension liability (ANPL), our measure of a local government’s pension burden that uses a market-based interest rate to value accrued liabilities, is a high 5.5% of full value and 3.5x operating revenue. The city’s fixed costs, consisting of debt service net of a refunding and retirement plan contributions, were also high at 28% of operating revenue in fiscal 2017.

DEBT STRUCTURE
Principal repayment on GO debt is average with 61.5% retired within ten years.

DEBT-RELATED DERIVATIVES
The city is not a party to any derivative agreements.

PENSIONS AND OPEB
The City of Evanston has an elevated and growing pension burden. Employees participate in one of three pension plans: two single employer plans (police and fire) and one multi-employer agent plan (Illinois Municipal Retirement Plan - IMRF). The city’s three-year average ANPL has grown to $439.6 million in fiscal 2017 from $297 million in fiscal 2013 due to investment returns that have fallen short of plan assumptions and city contributions that, while conforming with actuarially determined contributions, have not been sufficient to fully cover annual interest accruals on accumulated unfunded liabilities and a 2016 change in reporting for IMRF.

Net of enterprise support, Evanston’s fiscal 2017 pension contributions were $21.2 million and a significant 16.8% of operating revenue. The city’s public safety plans are by far the largest of its plans, and Evanston contributed $18.5 million to the public safety plans in fiscal 2017. The public safety plan contributions were equal to 105% of the amount needed for both plans to “tread water,” that is, forestall growth in reported net pension liabilities if other plan assumptions hold. Evanston lowered its plans’ assumed rate of return to 6.5% from 6.75% in 2015. Even if contributions continue to tread water at the plans’ reported discount rates, the city’s ANPL may grow, indicating sustained balance sheet challenges.

Unfunded OPEB liabilities do not pose a significant credit challenge to the city. The liability reflects the implicit rate subsidy of permitting retirees to remain on the city’s health care plan. Evanston’s unfunded OPEB liability was $15.3 million as of December 31, 2017, the most recent actuarial valuation date. The city’s fiscal 2017 pay-go contribution of $823,000 was a modest 0.6% of operating revenue.

Management and governance: home rule status enhances legal revenue flexibility
Illinois cities have an Institutional Framework score of A, which is moderate. Institutional Framework scores measure a sector’s legal ability to increase revenues and decrease expenditures. Revenue-raising ability is moderate overall but varies considerably. Home
rule entities, like Evanston, have much greater legal flexibility than the rest of the sector with substantial revenue-raising authority. Revenue predictability is moderate, with varying dependence on property, sales, and state-distributed income taxes. Expenditures are moderately predictable but cities have limited ability to reduce them given strong public sector unions and pension benefits that enjoy strong constitutional protections. Given the state’s fiscal stress, cuts in local government revenue sharing, particularly allocation of state income tax revenue, remains a potential operating challenge.

Endnotes

1 Our “tread water” indicator measures the annual government contribution required to prevent reported net pension liabilities from growing, given the entity’s actuarial assumptions. An annual government contribution that treads water equals the sum of employer service cost and interest on the reported net pension liability at the start of the fiscal year. A pension plan that receives an employer contribution equal to the tread water indicator will end the year with an unchanged net pension liability relative to the beginning of the year if all plan assumptions hold. Net liabilities may decrease or increase in a given year due to factors other than the contribution amount, such as investment performance that exceeds or falls short of a plan’s assumed rate of return. Still, higher contributions will always reduce unfunded liabilities faster, or will allow unfunded liabilities to grow more slowly than lower contributions.