Summary:

Elgin, Illinois; General Obligation

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Credit Profile

| US$8.665 mil GO rfdg bnds ser 2020A due 12/15/2028 |
|-------------|----------------------------------|--------|
| **Long Term Rating** | **AA+/Stable** | **New** |

| Elgin GO |
|-------------|----------------------------------|--------|
| **Long Term Rating** | **AA+/Stable** | **Affirmed** |

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to Elgin, Ill.'s series 2020A general obligation (GO) refunding bonds. At the same time, S&P Global Ratings affirmed its 'AA+' rating on the city's existing GO debt. The outlook is stable.

The series 2020A GO refunding bonds are secured by the city's unlimited-tax GO pledge. Proceeds from the bonds will be used to refund existing obligations for interest cost savings.

The city benefits from its access to the broad and diverse Chicago MSA, with easy access to downtown Chicago and O'Hare International Airport. While the city's riverboat casino has seen declines in revenue in recent years, it serves as a source of fund for capital improvements within the city that has enabled to keep its overall debt burden low. Improvement in the city's public safety pension plan funded levels is necessary to adequately manage the potential stress these fixed costs may weigh on the city's budget in future years.

The rating reflects the following characteristics of the city:

- Adequate economy, with projected per capita effective buying income at 84.3% and market value per capita of $64,679, though that is advantageously gaining from access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with good financial policies and practices under our Financial Management Assessment methodology;
- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in 2018;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 60% of operating expenditures;
- Very strong liquidity, with total government available cash at 113.4% of total governmental fund expenditures and 41.5x governmental debt service, and access to external liquidity we consider strong;
- Strong debt and contingent liability position, with debt service carrying charges at 2.7% of expenditures and net direct debt that is 23.7% of total governmental fund revenue, as well as rapid amortization, with 90% of debt scheduled to be retired in 10 years, but a large pension and other postemployment benefit (OPEB) obligation, and a lack of a plan to sufficient address the obligation; and
Strong institutional framework score.

Adequate economy
We consider Elgin’s economy adequate. The city, with an estimated population of 112,665, is located in Cook and Kane counties in the Chicago-Naperville-Elgin, IL-IN-WI MSA, which we consider broad and diverse. The city has a projected per capita effective buying income of 84.3% of the national level and per capita market value of $64,679. Overall, the city's market value grew by 3.7% over the past year to $7.3 billion in 2019. The weight-averaged unemployment rate of the counties was 4.7% in 2018.

Elgin is located approximately 38 miles northwest of downtown Chicago and covers approximately 38 square miles. The city is located near Interstate 90, which connects residents to O’Hare International Airport and downtown Chicago. In addition, the city has access to downtown Chicago via commuter rail transportation through the Milwaukee Road Metra rail line, which has three train stations within the city. We consider the local tax base to be very diverse, with the city’s top 10 taxpayers representing 4.2% of equalized assessed valuation (AV). Kane County represents approximately 82% of the city’s 2017 AV, with Cook County comprising the remainder. In addition, we understand that major taxpayers and employers within the city are stable. We anticipate our view of the city's economy to remain adequate during the next few years.

Strong management
We view the city's management as strong, with "good" financial policies and practices under our Financial Management Assessment (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.

In developing its budget, the city examines three to five years of historical trends and uses zero-based budgeting. The city reports to the city council on expenditures, with comparisons to budget, for those expenditures that exceed $20,000. In addition, the city provides monthly budget-to-actual reporting for major revenue streams to its council. The city conducts financial and capital planning for a three-year period for its general fund and riverboat fund, which are updated annually. The city also maintains a five-year long-term financial forecast and capital plan for utility funds, which are also updated on an annual basis. The city has recently revised its formal debt management policy which contains ceilings for certain debt ratios and addresses short-term borrowing and speed of amortization. The city also updated its investment management policy in 2019 and provides monthly updates to its council regarding investments. In addition, it has a formal policy to keep reserves at a level above 30% and 25% of expenditures, in its general and utility funds, respectively, with which it is in compliance.

Strong budgetary performance
Elgin's budgetary performance is strong, in our opinion. The city had operating surpluses of 8.7% of expenditures in the general fund and of 12.8% across all governmental funds in fiscal 2018. Our assessment accounts for the fact that we expect budgetary results could deteriorate from 2018 results in the near term.

Our analysis of the city's budgetary performance reflects the adjustment of recurring transfers and one-time expenditures from the spending of bond proceeds. General fund revenue includes gaming and lease revenue from a privately owned riverboat casino, which the city uses the majority of revenue from for capital projects. These revenue have gradually decreased in recent years, with increased competition from a neighboring casino and the introduction
of statewide video gaming in 2012.

After reporting a deficit in the general fund in fiscal 2017, the city achieved a large surplus in fiscal 2018 (year-ended Dec. 31) of approximately $10.5 million. Driving this outcome was strong sales tax revenue, which benefited from a 0.25-cent increase implemented by the city in July 2018, as well as higher investment income and increased ambulance fee revenue as a result of the city revising its rate structure. General fund revenue is comprised of property taxes (33.2%), followed by sales taxes (21.9%), and intergovernmental revenue (17.2%). With regard to fiscal 2019, the city is currently on track to report a 1.2% surplus in the general fund. In addition to the 0.25-cent increase in sales tax, the city also implemented a 4.00-cent local motor fuel tax in 2018. The city expects to adopt a general fund budget in fiscal 2020 structured with a $1.5 million use of reserves. We understand that the city intends to draw down its reserves during fiscals 2020-2022 to better align its reserves with its 30% fund balance policy, which it is well above. We anticipate the city's budgetary performance will remain at least adequate during the next few years.

**Very strong budgetary flexibility**

Elgin's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 60% of operating expenditures, or $73.2 million. We expect the available fund balance to remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor.

Despite planned drawdowns in its general fund from fiscal 2020 to 2022, we anticipate that the city's budgetary flexibility will remain very strong and above 30% over the next few years, in line with its reserve policy.

**Very strong liquidity**

In our opinion, Elgin's liquidity is very strong, with total government available cash at 113.4% of total governmental fund expenditures and 41.5x governmental debt service in 2018. In our view, the city has strong access to external liquidity, if necessary.

In calculating the city's liquidity, we have removed certain restricted amounts from its cash and investments, including amounts in its tax increment financing and cemetery funds. The city's strong access to external liquidity is supported by its frequent issuance of GO debt. The city has not entered into any alternative financing arrangements or direct purchase agreements that could create contingent liquidity risks. We do not anticipate that city's liquidity position will weaken in the next few years.

**Strong debt and contingent liability profile**

In our view, Elgin's debt and contingent liability profile is strong. Total governmental fund debt service is 2.7% of total governmental fund expenditures, and net direct debt is 23.7% of total governmental fund revenue. Approximately 90% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor.

The city plans to issue an additional $19.5 million in GO debt for capital projects within the next two years. This amount of additional debt is not expected to affect our view of the city's strong debt and contingent liability profile as it is amortizing approximately the same amount of debt during the two-year outlook horizon.

In our opinion, a credit weakness is Elgin's large pension and OPEB obligation, without a plan in place that we think will sufficiently address the obligation. Elgin's combined required pension and actual OPEB contributions totaled 14.3% of total governmental fund expenditures in 2018. Of that amount, 13.2% represented required contributions to
pension obligations, and 1.2% represented OPEB payments. The city made 99% of its annual required pension contribution in 2018. The funded ratio of the largest pension plan is 48.1%.

We view the city's pension and OPEB liabilities as sizeable, with low pension funded ratios. We view these liabilities as a source of credit pressure for Elgin, given that costs exceed 10% of budget, and are likely to increase.

• The Police Pension Plan is 48% funded, with a net pension liability of $123 million;
• The Firefighters Plan is 46% funded, with a net pension liability of $96.8 million;
• The Illinois Municipal Retirement Fund (regular plan) was 101% funded with a net pension asset of $1.9 million (as of Dec. 31, 2017);
• The city's OPEB Plan is 35.5% funded with net OPEB liability of $20.8 million.

The discount rate for both the Police Pension Plan and Firefighters Plan is 7%. We view these revised discount rates to be somewhat higher than ideal, which could lead to contribution volatility. While the city plans to fully fund the past service cost of public safety pension plans by 2040, a rate greater than the statutory minimum of 90% funding for these funds by that date, the city's contributions to the plans fall short of our static funding and minimum funding progress metrics. We also note that funded ratios dropped in both plans in 2018 due to weaker investment returns.

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

**Outlook**
The stable outlook reflects our expectation that we will not change the city's rating within the two-year outlook horizon because we believe that the city will maintain its very strong financial flexibility and liquidity. The city's participation in the Chicago-Naperville-Elgin, IL-IN-WI MSA provides further support for the rating.

**Downside scenario**
We may lower the rating if the city were to experience a pattern of operating deficits, which materially weakens its finances. In addition, if the city fails to improve the funding levels of its police and fire pensions, a lower rating is possible.

**Upside scenario**
If the city were to demonstrate significantly improved economic characteristics and improve the funding of its large unfunded pension liabilities, a higher rating is possible.

**Related Research**
• S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
• 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
• 2019 Update Of Institutional Framework For U.S. Local Governments
## Ratings Detail (As Of November 22, 2019)

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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 for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.