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CREDIT OPINION
2 December 2021

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St. Charles (City of) IL

Update to credit analysis

Summary

The City of St. Charles (Aa1) is located west of Chicago (Ba1 stable) and the credit profile benefits from stable operating performance that has steadily bolstered reserves to very healthy levels and revenue raising flexibility as a home rule municipality. Median family income and full value per capita are very strong. St. Charles' debt burden is moderate while pension liabilities are high relative to the rating category.

Credit strengths

» Healthy financial operations with strong revenue raising flexibility

» Growing tax base in Chicago metro with strong resident income levels

Credit challenges

» Pension burden is elevated for the rating category

Rating outlook

Moody's does not typically assign outlooks to local governments with this amount of debt.

Factors that could lead to an upgrade

» Moderation of the city's pension burden

» Further bolstering of operating reserves

Factors that could lead to a downgrade

» Erosion of operating reserves

» Material increase in the debt or pension burden

Key indicators

Exhibit 1

St. Charles (City of) IL	2017	2018	2019	2020	2021
Economy/Tax Base					
Total Full Value ($000)	$4,115,626	$4,277,577	$4,454,453	$4,633,771	$4,736,089
Population	32,730	32,772	32,686	32,686	33,081
Full Value Per Capita	$125,745	$130,525	$136,280	$141,766	$143,166
Median Family Income (% of US Median)	163.4%	159.1%	155.6%	155.6%	155.6%
Finances					
Operating Revenue ($000)	$43,405	$44,037	$48,308	$48,995	$53,523
Fund Balance ($000)	$22,844	$23,281	$22,608	$26,109	$30,554
Cash Balance ($000)	$20,096	$22,136	$19,274	$23,832	$28,744
Fund Balance as a % of Revenues	52.6%	52.9%	46.8%	53.3%	57.1%
Cash Balance as a % of Revenues	46.3%	50.3%	39.9%	48.6%	53.7%
Debt/Pensions					
Net Direct Debt ($000)	$70,721	$85,183	$84,562	$90,693	$90,906
3-Year Average of Moody's ANPL ($000)	126,379	$138,827	$148,703	$175,277	$195,193
Net Direct Debt / Full Value (%)	1.7%	2.0%	1.9%	2.0%	1.9%
Net Direct Debt / Operating Revenues (x)	1.6x	1.9x	1.8x	1.9x	1.7x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	3.1%	3.2%	3.3%	3.8%	4.1%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	2.9x	3.2x	3.1x	3.6x	3.6x

Financial metrics include general, debt service and motor fuel tax funds
Net direct debt metrics are net of debt related to water, wastewater and electric enterprises for years when debt service coverage is greater than 1
Source: US Census Bureau, St. Charles (City of) IL's financial statements and Moody's Investors Service

Profile

The City of St. Charles is located in Kane and DuPage (Aaa) Counties in northeastern Illinois (Baa2 stable), about 35 miles west of downtown Chicago. The city provides public safety (police and fire), community development, streets, water, wastewater and electric services to a population of about 33,100.

Detailed credit considerations

Economy and tax base: moderately sized tax base northwest of Chicago

St. Charles' economic base is expected to remain stable given continued economic recovery from the coronavirus pandemic and its location in the greater Chicago area. The tax base is moderately sized at $4.7 billion and grew at an average annual rate of 3.6% over the past five years. Growth in the city includes redevelopment of the former Westside Mall site to a large mixed-use property, downtown development including a riverwalk on the Fox River and mixed-use buildings and new car dealership. The city's proximity to employment centers in the greater Chicago area support very strong resident income, with median family income at 156% of the US. Full value per capita is also strong at $143,000.

The city's September 2021 unemployment rate of 3.8% was below the state (5.5%) and the nation (4.6%) for the same period.

Financial operations and reserves: stable operations with healthy reserves

The city's financial profile will likely remain healthy given significant revenue raising flexibility and prudent fiscal management. For fiscal 2022 (April 30 year end) the city has budgeted for an operating deficit of $3.4 million, though is on track to end better than budgeted with a $1.6 million deficit given stronger than expected sales tax and hotel/motel taxes along with the receipt of ARPA funds. Fiscal 2021 ended with a $3.8 million operating surplus across major operating funds (general, motor fuel tax and debt service funds)

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funds bringing reserves to $30.6 million, equivalent to 57% of revenues. The surplus was due to better than anticipated sales tax, new revenue from cannabis sales tax, CARES revenue which offset losses in hotel/motel taxes and a one year hiatus from motor vehicle replacements.

Sales taxes are the primary revenue source for the city totaling 40% of operating fund revenue for fiscal 2021. Year to date sales tax revenue in 2022 is up $1.4 million over budget. Property taxes are the second largest source at 25% and have been as budgeted for the year. State income tax distributions comprised 7% of revenue and remain steady with the improving economy. The city has strong revenue raising flexibility as a home rule unit of government.

Liquidity

The city's liquidity position is strong, with operating net cash of $28.7 million or 54% of revenue. The city operates water, wastewater and electric enterprises. All have strong liquidity at 192, 437 and 198 days cash on hand, respectively.

Debt and pensions: moderate debt with elevated pension burden relative to rating category

The city's debt burden is moderate and will likely remain manageable given limited additional borrowing plans. Following an upcoming issuance, the city's debt burden will be moderate at 1.9% of full value and 1.7x operating revenue. The net direct debt figure is net of GO debt repaid by the city's wastewater and electric utility systems. Debt for the water enterprise, which totals $8.9 million, is included in net direct debt as total debt service coverage is less than 1 for fiscal 2021. Fixed costs, consisting of debt service, pension and other post-employment benefit contributions consumed 14% of operating revenue in fiscal 2021.

Legal security

Debt service is secured by the city's full faith and credit pledge to levy ad valorem taxes unlimited as to rate and amount. The city typically abates all property taxes related to its general obligation debt, paying debt service through water, wastewater, electric, TIF increment and general revenues.

Debt structure

All of the city's debt is long term and fixed rate, and amortization is average with 60% retired in 10 years.

Debt-related derivatives

The city is not party to any derivative agreements

Pensions and OPEB

St. Charles has two single employer pension plans, a police plan and a firefighters' plan and its non-public safety employees participate in the Illinois Municipal Retirement Fund (IMRF). The city's public safety plans account for a majority of its ANPL. Although the city's public safety plans are single employer, the city has no control over the benefits because they are established in state statute. The city's pension contributions amounted to 12.7% of its revenues in fiscal 2021. The state requires cities to fund single employer public safety plans at a rate that will achieve a 90% funded ratio on a reported basis by 2040, which is a relatively weak contribution requirement, though the city is on target to be 100% funded in this time frame.

In fiscal 2021 pension contributions for the firefighters' plan was 86% of tread water[1] and 90% for the police plan. The city's tread water indicator was based on an assumed discount rate of 6.75% for the public safety plans, slightly lower than those used by a majority of other plans. The tread water indicator is higher when using lower discount rates, making the indicator more conservative. The firefighters' plan is currently funded at 76% while the police plan is 56% funded both have a reported 6.75% discount rate. The three year average Moody's adjusted net pension liability (ANPL), which incorporates our adjustments to reported pension information totals $195 million or 4.1% of full value and 3.6x fiscal 2021 operating revenue.

ESG considerations

Environmental

Environmental considerations are not material to the city's credit profile. According to data from Moody's affiliate Four Twenty Seven, Kane County's environmental hazard scores are no risk two environmental factors including sea level rise and cyclone exposure.
The county is at high risk for heat stress, water stress and extreme rainfall relative to counties nationally. Those risks have not had a significant impact on the city to date, but could moderately drive expenditures in the future and constrain the agricultural component of the regional economy. The city has exposure to water stress through its water enterprise, though the city has three shallow and

seven deep wells and has increased capacity by 176% over the past decade. The city holds a $20 million flood insurance policy and creek expansions will mitigate flooding risk while the healthy reserve position makes it well positioned to respond to unexpected environmental concerns.

Social

The social considerations for St. Charles include a moderately sized tax base with strong resident income and wealth levels and below average poverty. Residents in the city have access to the greater Chicago area for employment. The population has remained relatively flat over the past 10 years.

Governance

St. Charles benefits from sound operating reserves and strong revenue raising flexibility as a home rule unit of government. Property tax rates can be increased to offset valuation declines, and as a home rule municipality the city is not subject to tax caps. The city also has the flexibility to implement and increase sales taxes and other fees without voter approval.

Illinois cities have an institutional framework score [2] of "A", which is moderate. Revenue-raising ability is moderate overall but varies considerably. Non-home rule entities are subject to tax rate limitations. In addition, total operating tax yield for entities subject to the Property Tax Extension Limitation Law (PTELL) is capped to the lesser of 5% or CPI growth, plus new construction. Home rule entities like St. Charles 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. Fixed costs are driven mainly by debt service and employer pension contributions. For single employer public safety plans, the State of Illinois requires most entities to make annual pension contributions that cover current benefit accruals, plus an amount designed to achieve a 90% funded ratio by 2040.

Rating methodology and scorecard factors

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 2

[1] Economy measures are based on data from the most recent year available.
[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology.
[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs publication.
Source: US Census Bureau, St. Charles (City of) IL's financial statements and Moody's Investors Service

Endnotes

1 Our "tread water" indicator measures the annual 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.

2 The institutional framework score assesses a municipality's legal ability to match revenues with expenditures based on its constitutionally and legislatively conferred powers and responsibilities. See US Local Government General Obligation Debt (July 2020) methodology report for more details.

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