

CREDIT OPINION

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Contacts

Benjamin J VanMetre +1.312.706.9951
 AVP-Analyst
 ben.vanmetre@moody's.com

Douglas Goldmacher +1.212.553.1477
 VP-Senior Analyst
 douglas.goldmacher@moody's.com

CLIENT SERVICES

Americas 1-212-553-1653
 Asia Pacific 852-3551-3077
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 EMEA 44-20-7772-5454

Naperville (City of) IL

Update to credit analysis

Summary

The [City of Naperville, IL](#) (Aaa stable) benefits from its substantial and affluent tax base located in the [Chicago](#) (Ba1 stable) metropolitan area, sound financial profile with considerable budgetary flexibility provided by the city's home rule status and a low debt burden. These credit strengths offset challenges associated with an above average pension burden.

Credit strengths

- » Large and growing tax base located in the [Chicago](#) (Ba1 stable) metropolitan area
- » Resident income levels are among the strongest in the nation among cities with a population over 100,000
- » Significant financial flexibility afforded by the city's home rule status

Credit challenges

- » Reserves are solid but trail other Aaa rated entities
- » Above average pension burden

Rating outlook

The stable outlook reflects the city's robust tax base and broad revenue raising ability will allow the city to absorb growing pension costs without materially impacting its strong reserves.

Factors that could lead to an upgrade

- » Not applicable

Factors that could lead to a downgrade

- » Deterioration of the city's financial profile
- » Increased leverage and fixed costs

Key indicators

Exhibit 1

Naperville (City of) IL	2016	2017	2018	2019	2020
Economy/Tax Base					
Total Full Value (\$000)	\$18,854,823	\$20,023,030	\$20,878,589	\$21,680,737	\$22,376,736
Population	145,789	146,431	147,411	147,501	149,540
Full Value Per Capita	\$129,330	\$136,740	\$141,635	\$146,987	\$149,637
Median Family Income (% of US Median)	191.3%	189.9%	191.4%	191.5%	191.5%
Finances					
Operating Revenue (\$000)	\$137,249	\$142,531	\$143,709	\$157,203	\$158,323
Fund Balance (\$000)	\$35,955	\$37,592	\$40,541	\$52,802	\$63,990
Cash Balance (\$000)	\$21,432	\$29,892	\$30,481	\$46,862	\$59,185
Fund Balance as a % of Revenues	26.2%	26.4%	28.2%	33.6%	40.4%
Cash Balance as a % of Revenues	15.6%	21.0%	21.2%	29.8%	37.4%
Debt/Pensions					
Net Direct Debt (\$000)	\$129,239	\$100,269	\$94,296	\$83,810	\$88,491
3-Year Average of Moody's ANPL (\$000)	\$345,611	\$410,843	\$433,493	\$490,228	\$565,995
Net Direct Debt / Full Value (%)	0.7%	0.5%	0.5%	0.4%	0.4%
Net Direct Debt / Operating Revenues (x)	0.9x	0.7x	0.7x	0.5x	0.6x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	1.8%	2.1%	2.1%	2.3%	2.5%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	2.5x	2.9x	3.0x	3.1x	3.6x

Sources: Census Bureau, audited financial statements and Moody's Investors Service

Profile

The City of Naperville is in DuPage County (Aaa) in northeastern Illinois (Baa2 stable), about 28 miles southwest of downtown Chicago. The city provides an array of municipal services including public safety, street maintenance and utilities to about 150,000 residents.

Detailed credit considerations

Tax base and local economy: large and affluent tax base

The City of Naperville is positioned well for a stable to improving local economy going forward because of continued economic development, a growing population with strong resident income levels and the relatively limited impact from the ongoing coronavirus pandemic. Naperville has a large and growing tax base that now totals more than \$23 billion and is primarily comprised of residential properties (81%) though it also maintains a notable commercial and industrial presence (19%). New residential building permits have averaged about \$110 million annually for the last five years, a trend that is expected to continue. Management notes that there are dozens of commercial and residential developments currently underway. Edward Hospital is the largest employer in the city (4,500 employees) and is reportedly stable. The city also benefits from its proximity to employment centers throughout the broader Chicago metropolitan area.

Financial operations and reserves: healthy financial position is likely to remain stable

The city's financial profile will remain solid because of strong financial management, considerable budgetary flexibility, healthy and improving reserves and the limited financial impact from the ongoing coronavirus pandemic. Fiscal 2022 is likely to produce positive operations because of a combination of continued expense restraint and the strong recovery of economically sensitive revenue. Unaudited fiscal 2021 results are also positive, with an estimated \$13 million increase in general fund reserves again because of conservative budgeting practices and strong revenue performance. The city closed fiscal 2020 with a combined available fund balance of \$64 million, equal to about 40% of revenue across the general fund, debt service fund, motor fuel tax fund, fair share assessment

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fund, foreign fire insurance fund, E-911 surcharge fund, food and beverage tax fund and the drug forfeiture fund. Throughout the coronavirus pandemic, the city's economically sensitive revenue streams have been relatively resilient. Sales tax revenue grew by about 3% in 2020 and dipped by only about 2% during 2021. Intergovernmental revenues, which include sales taxes and state shared income taxes, comprise about half of the city's operating revenue while property taxes make up about 20%.

Liquidity

Fiscal 2020 closed with a net cash position of about \$59 million, equal to a solid 37% of revenue. Across all governmental funds, the city's cash and investments total about \$98 million. The city's enterprise funds closed fiscal 2020 with about \$65 million in cash, which is equal to about 120 days cash on hand.

Debt, pensions and OPEB: above average pension burden remains the primary credit challenge

The city's debt burden will remain low given the relatively quick payout of the existing debt, limited borrowing plans for the next few years and a targeted approach to pay-as-you-go financing of a portion of the outstanding capital needs. The city's net direct debt burden, excluding GOULT debt associated with the self-supporting and essential enterprises, totals about \$85 million, equal to 0.5x revenue and 0.4% of full value.

The city's adjusted net pension liability (ANPL), based on an adjusted discount rate of about 2.5%, totals \$680 million while the three year average totals \$566 million, equal to 2.4% of full value and 3.6x operating revenue. In comparison, the city's reported net pension liability, based on a higher discount rate, totals about \$95 million. The city's pension burden is above average, but contributions practices are solid having met or exceeded tread water for several years.

Legal security

The city's GOULT bonds are supported by the city's full faith and credit pledge and the authority to levy a dedicated property tax unlimited as to rate and amount

Debt structure

All of the city's debt is fixed rate and long term, with about 80% of existing principal to be retired in the next 10 years.

Debt-related derivatives

The city has no derivative exposure.

Pensions and OPEB

Naperville has two single-employer public safety pension plans for police and fire and its other employees participate in the Illinois Municipal Retirement Fund (IMRF). The public safety plans account for most of the city's ANPL. Although the public safety plans are single-employer plans, the city has no control over benefits because they are established in state statute.

Pension contributions in fiscal 2020 totaled about \$20 million, or 13% of operating revenue. 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. The city sizes its contributions to achieve a 100% funded ratio by 2033, which is notably stronger than the state minimum. The city's fiscal 2020 pension contributions were equal to about 130% of tread water and the plan's discount rate assumptions for the year were 6.85% and 7.25% for public safety and IMRF, respectively. The city's contributions have consistently met or exceeded our tread water benchmark for several years.

The city offers an implicit rate subsidy to employees for post employment health benefits but the OPEB liabilities do not have a material impact on either the overall unfunded liabilities or fixed costs of the city.

ESG considerations

Environmental

Environmental risks do not present a material credit risk for the district. According to data from Moody's affiliate, Moody's ESG Solutions, DuPage County is primarily exposed to heat stress and extreme rainfall. One of the primary impacts of extreme heat is on agricultural production, which is not an economic driver for the county. The district is mostly developed and outdoor labor is limited, mitigating heat stress factors. The county is ultimately responsible for operating flood control facilities during extreme rainstorms and ensuring adequate maintenance is performed on these facilities.

Social

Social considerations are generally a positive factor in city's credit profile. The city's population increased by more than 250% since the 1980s, growing to about 150,000 residents in 2020 from about 43,000 in 1980. Naperville is one of the wealthiest cities with a population over 100,000 residents in the nation, with a median family income of 191% of the national median. The median age of city residents (39) is on par with the state and national medians (38) and the city's school-age population (20%) slightly higher than state and national rates (17%).

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. The city's local economy, financial profile and economically sensitive revenues have been resilient throughout the pandemic.

Governance

Naperville has a wide array of revenue raising options afforded by the city's home rule status. The city implemented its first home rule sales tax of 0.5% in 2015 and increased the rate to 0.75% during 2018 to reduce the property tax burden on residents. The city targets pension funding to reach 100% funded by 2033, a goal that exceeds the state minimum of 90% by 2040.

Illinois cities have an institutional framework score ¹ 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 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

Naperville (City of) IL

Scorecard Factors and Subfactors	Measure	Score
Economy/Tax Base (30%) ^[1]		
Tax Base Size: Full Value (in 000s)	\$23,361,980	Aaa
Full Value Per Capita	\$156,226	Aaa
Median Family Income (% of US Median)	191.5%	Aaa
Finances (30%)		
Fund Balance as a % of Revenues	40.4%	Aaa
5-Year Dollar Change in Fund Balance as % of Revenues	16.9%	Aa
Cash Balance as a % of Revenues	37.4%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	22.5%	Aa
Management (20%)		
Institutional Framework	A	A
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures (x)	1.0x	Aa
Notching Adjustments: ^[2]		
Standardized Adjustments ^[3] : Home Rule Unit of Government		Up
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	0.4%	Aaa
Net Direct Debt / Operating Revenues (x)	0.5x	Aa
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	2.4%	A
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	3.6x	A
Scorecard-Indicated Outcome		Aaa
Assigned Rating		Aaa

[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.

Sources: US Census Bureau, audited financial statements and Moody's Investors Service

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Endnotes

- 1 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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1318142

Contacts

Benjamin J VanMetre
AVP-Analyst
ben.vanmetre@moody's.com

+1.312.706.9951

Douglas Goldmacher
VP-Senior Analyst
douglas.goldmacher@moody's.com

+1.212.553.1477

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