

RatingsDirect®

Summary:

Naperville, Illinois; General Obligation

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Credit Profile

US\$6.59 mil GO bnds ser 2022A due 12/01/2041

Long Term Rating AAA/Stable New

Naperville GO

Long Term Rating AAA/Stable Affirmed

Rating Action

S&P Global Ratings assigned its 'AAA' long-term rating to Naperville, Ill.'s \$6.590 million series 2022A general obligation (GO) bonds. S&P Global Ratings also affirmed its 'AAA' long-term rating on the city's existing GO debt. The outlook is stable.

The city's unlimited-tax GO pledge secures the series 2022 bonds and rated debt. Naperville will use the bond proceeds to fund water metering infrastructure projects. Although they are not pledged, the city intends to repay the bonds with water utility revenues.

Naperville's GO debt is eligible to be rated above the sovereign, because we believe the city can maintain better credit characteristics than the nation in a stress scenario. Under our criteria, "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions," published Nov. 19, 2013, we consider U.S. local governments to have moderate sensitivity to national risk. The city's ad valorem tax pledge is the primary source of debt security, which severely limits the possibility of negative sovereign intervention in the payment of the debt or in the city's operations. The nation's institutional framework for local governments is predictable, allowing Naperville significant autonomy and independent treasury management. In addition, there is no history of government intervention.

Credit overview

Naperville continues to make progress toward building reserves and decreasing its debt burden, aided by a strong management team and a recent increase in its home-rule sales tax. The city faced modest pressure in fiscal 2020 from the COVID-19 pandemic, due to a slight decline in sales tax revenues, but sales tax revenue has fully recovered and is increasing. Furthermore, we expect stable tax base growth will support property tax revenues and expect use taxes will keep rising due to more online purchases in the city.

The rating further reflects our view of the city's:

- Very strong and expanding local economy that participates in Chicago's broad and diverse economy;
- Several years of surplus financial operations and a very strong reserve and liquidity position, supported by sound management practices and strong institutional framework score; and
- Very strong debt and contingent liability profile, with a credible plan to address the large pension contributions.

Environmental, social, and governance

We analyzed Naperville's overall environmental, social, and governance risk factors within the context of our criteria. We note that the state allows poor pension funding discipline, although Naperville has significantly more conservative pension funding assumptions than is standard for the state, but we will continue to monitor the city's pension funding methodology and discipline.

Stable Outlook

Downside scenario

We could lower the rating should Naperville's operating results deteriorate, leading to a significant drawdown on available reserves with no plan to correct.

Credit Opinion

Wealthy and growing tax base with high residential housing demand

Naperville is in southwestern DuPage County with a portion in Will County and covers 40 square miles. It is Chicago's second largest suburb, situated about 32 miles west of downtown Chicago, which is accessible via Metra commuter train. Most residents work in Naperville or DuPage County.

Management reports that building permits increased 20% in 2021 from the previous year and several hundred new single-family homes, senior living, and apartment units are under development. The tax base consists mostly of residential properties, which made up 80% of 2020 equalized assessed value and has no material exposure to any one taxpayer. Commercial development, including the completion of a second Costco and second Amazon grocery store, is expanding, which will add to Naperville's property and sales tax base. Management reports no material impacts on businesses from the COVID-19 pandemic. For S&P Global Economics' latest U.S. forecast, see "Economic Outlook U.S. Q1 2022: Cruising At A Lower Altitude," published Nov. 29, 2021, on RatingsDirect.

Strong management with above-average policies and practices that focus on financial stability

When developing its annual budgets, the city uses in-house revenue and expenditure projections based on historical trends and economic data. It also consults with Illinois Municipal League for projections regarding state income tax.

Naperville also provides monthly reports on budget-to-actual results to the city council. Management maintains a five-year capital improvement plan that it updates annually with funding sources and costs for projects identified.

The city has its own investment policy and management provides quarterly reports to the council summarizing investment earnings and holdings.

The formal debt management policy includes debt limits.

The formal fund balance policy calls for holding 20% of general fund expenditures in reserve, with provisions in place to ensure fund balance replenishment should fund balance fall below the stated 20% reserve policy. In addition, management's goal is to increase the reserve policy to 25% of general fund expenditures.

The city estimates a large surplus for fiscal 2021, bolstering already very strong reserves

The fiscal 2020 general fund \$3 million surplus was aided by \$7.2 million in federal aid, which was largely used for higher public safety costs, including additional personnel and technology improvements, but also to fill the budget gap from the 7% drop in sales tax.

For fiscal 2021, management estimates a \$13.5 million surplus (10% of expenditures), spurred by large increases in property taxes and state-shared revenues, particularly state-shared sales and use taxes (including the new online sales tax) and income taxes. Naperville received \$6 million in federal stimulus in fiscal 2021, but deposited it in a separate fund and is not inflating the 2021 results. The city has benefited from the revised sales and use taxes distribution, which is now based on the buyer's location instead of a per capita basis. The largest revenue source is state-shared revenues, which made up 48% of total general fund revenues, followed by property taxes (18%) and utility taxes (10%). The city is a home rule city, giving it broader revenue-raising ability; accordingly, Naperville increased its home rule sales taxes to 0.75% from 0.50% in 2018. The money is deposited in the capital projects fund and is used to pay down debt, fund capital projects, and increase liquidity. Sales taxes have recovered from a 7% dip during the onset of the pandemic and outperformed the budget by 20%.

The fiscal 2022 general fund budget is structurally balanced with a \$2 million surplus and does not include the additional \$7 million of federal stimulus that will be deposited into a separate fund.

Based on the estimates for fiscal 2021, Naperville will have about \$50 million in general fund reserves (39% of expenditures); there are no plans to draw down reserves over the next several years. Based on the 2022 budget, we expect the city will maintain strong budgetary performance and very strong budgetary flexibility and liquidity through 2022. The city does not have any direct-purchase, private-placement, or variable-rate debt that could pressure liquidity.

Our analysis of budgetary performance reflects adjustments made for recurring transfers and for expenditures in total governmental funds funded with bond proceeds. Thanks to the city's home-rule powers, operating revenue is diverse and Naperville has managed to increase revenues while keeping property taxes flat.

Low debt, with new issuances expected to be supported by enterprise funds

After the issuance of the series 2022 bonds, Naperville will have about \$81.4 million of net direct outstanding, which is net of GO debt supported by net revenues of the enterprise funds. Management has indicated that there are plans to issue about \$10 million, annually, in additional debt in fiscal 2023 through 2026; however, we do not expect this will have a material impact on our assessment of the city's debt burden. In addition, we expect this debt will be self supported by enterprise funds.

Pension funding levels have increased and the potential for accelerated costs is becoming less likely

We do not view Naperville's pension and other postemployment benefits (OPEB) as a budgetary pressure. Although it is a large portion of the city's budget, consistent funding discipline has led to contribution stability.

Naperville participates in the following plans as of Dec. 31, 2020:

- Firefighters' Pension Fund: 79% funded, with a net pension liability of \$57.8 million.
- Police Pension Fund: 84% funded, with a net pension liability of \$42.4 million.

- Illinois Municipal Retirement Fund: 103% funded, with a net pension asset of \$11.0 million.

The city offers other postemployment benefits, funded on a pay-as-you-go basis, with a net liability of \$21.4 million.

Naperville funding assumptions call for 100% funding by 2033, and entry-age normal funding method, which lead to less potential for future accelerated payments. Its assumed rate of return of 6.85% is close to the 6.00% specified in our pension guidelines. However, the amortization schedule is based on a level percentage of payroll and uses static longevity amortization assumptions, which become quickly outdated. This is mitigated by a relatively shorter amortization period of 12 years. Naperville's plan contributions (which exceed the actuarially determined contribution) are exceeding minimum funding progress, which we believe will result in a decreased likelihood of escalated costs over time.

Strong institutional framework

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

Naperville, Illinois -- Key Credit Metrics				
	Most recent	Historical information		
		2020	2019	2018
Very strong economy				
Projected per capita EBI % of U.S.	157			
Market value per capita (\$)	158,362			
Population		147,375	147,429	146,078
County unemployment rate(%)		8.4		
Market value (\$000)	23,338,617	22,354,359	21,659,055	
Ten largest taxpayers % of taxable value	2.3			
Strong budgetary performance				
Operating fund result % of expenditures		3.1	4.8	(0.1)
Total governmental fund result % of expenditures		9.0	8.9	5.1
Very strong budgetary flexibility				
Available reserves % of operating expenditures		30.4	27.2	23.1
Total available reserves (\$000)		37,482	33,666	27,754
Very strong liquidity				
Total government cash % of governmental fund expenditures		97	80	69
Total government cash % of governmental fund debt service		1,908	1,002	793
Strong management				
Financial Management Assessment	Good			
Very strong debt & long-term liabilities				
Debt service % of governmental fund expenditures		5.1	8.0	8.7
Net direct debt % of governmental fund revenue	45			
Overall net debt % of market value	1.3			
Direct debt 10-year amortization (%)	82			
Required pension contribution % of governmental fund expenditures		14.1		
OPEB actual contribution % of governmental fund expenditures		0.0		

Naperville, Illinois -- Key Credit Metrics (cont.)

	<u>Most recent</u>	<u>Historical information</u>		
		2020	2019	2018

Strong institutional framework

EBI--Effective buying income. OPEB--Other postemployment benefits. Data points and ratios may reflect analytical adjustments.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

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