

CREDIT OPINION

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Northbrook (Village of) IL

Update to credit analysis

Summary

[Northbrook, IL's \(Aaa\)](#) main credit strengths are its high resident wealth and incomes derived from close ties to the extensive [Chicago \(Ba1 stable\)](#) economy and its strong operating reserves and liquidity. Further, the village's home-rule designation grants it broad legal flexibility to raise local taxes and fees to address rising expenditure pressures. The village's main credit challenge is its elevated pension burden. The village recently took steps to increase pension contributions by dedicating an increase in its ambulance fee for public safety pension funds and will now be modestly exceeding the state minimum statutory contribution of 90% funded by 2040. The increase is positive, but the village's funding practices still remain less aggressive than many of its Aaa Illinois rated peers.

Credit strengths

- » Large, affluent and diverse tax base with economic ties to the [Chicago \(Ba1 stable\)](#) economy
- » High degree of financial flexibility as the village's home rule status grants it broad legal authority to raise local revenue
- » Healthy operating fund balance and liquidity relative to budget

Credit challenges

- » Elevated pension burden
- » High fixed costs

Rating outlook

The negative outlook reflects the village's large and growing pension burden. The burden is likely to increase given the village's contribution practices trail many of its Aaa peers in the sector and are not sufficient to forestall the growth in unfunded liabilities.

Factors that could lead to an upgrade

- » Not applicable

THIS REPORT WAS REPUBLISHED ON 16-11-2018 WITH CORRECTIONS MADE TO TEXT REFERENCING THE VILLAGE'S GOULT RATING.

Factors that could lead to a downgrade

- » Further growth in unfunded pension liabilities
- » Failure to continue strengthening pension contributions as anticipated
- » Material declines in operating reserves and/or available liquidity

Key indicators

Exhibit 1

Northbrook (Village of) IL	2014	2015	2016	2017	2018
Economy/Tax Base					
Total Full Value (\$000)	\$6,442,676	\$6,556,872	\$6,234,268	\$7,459,029	\$7,770,501
Population	33,396	33,572	33,538	33,170	33,170
Full Value Per Capita	\$192,918	\$195,308	\$185,887	\$224,873	\$234,263
Median Family Income (% of US Median)	217.0%	217.5%	210.5%	210.5%	210.5%
Finances					
Operating Revenue (\$000)	\$48,086	\$50,335	\$47,673	\$51,515	\$52,460
Fund Balance (\$000)	\$18,477	\$20,962	\$21,256	\$22,744	\$21,263
Cash Balance (\$000)	\$22,427	\$26,272	\$28,090	\$26,317	\$36,022
Fund Balance as a % of Revenues	38.4%	41.6%	44.6%	44.1%	40.5%
Cash Balance as a % of Revenues	46.6%	52.2%	58.9%	51.1%	68.7%
Debt/Pensions					
Net Direct Debt (\$000)	\$68,875	\$67,557	\$71,756	\$74,224	\$79,801
3-Year Average of Moody's ANPL (\$000)	\$114,488	\$136,602	\$170,429	\$194,855	\$215,759
Net Direct Debt / Full Value (%)	1.1%	1.0%	1.2%	1.0%	1.0%
Net Direct Debt / Operating Revenues (x)	1.4x	1.3x	1.5x	1.4x	1.5x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	1.8%	2.1%	2.7%	2.6%	2.8%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	2.4x	2.7x	3.6x	3.8x	4.1x

The table above reflects fiscal year end data through fiscal 2018. The cash balance in 2018 includes \$11.5 million of unspent bond proceeds.

Source: Village's Audited Financial Statements, Moody's Investors Service, Inc., U.S. Census Bureau

Profile

Northbrook is located 25 miles from downtown [Chicago \(Ba1 stable\)](#) and encompasses 13 square miles in [Cook County \(A1 stable\)](#). The village provides general governmental services including public safety (police and fire), water (treatment and distribution), sewer (collection only) and stormwater services to approximately 33,000 residents.

Detailed credit considerations

Economy and tax base: affluent Chicago suburb with sizable commercial presence

We expect the village's economic profile to remain a credit strength given its close ties to the Chicago metropolitan area and high quality housing stock. The village's tax base is diverse, combining corporate and commercial developments with a wealthy residential tax base. The top taxpayer is the Northbrook Court Shopping Center, which comprises 2.3% of equalized assessed valuation. The large high-end regional mall anchors the village's significant retail sector. In addition to the shopping center, other top employers include Underwriters Labs and Glenbrook High School, all of which employ nearly 4,000. Median family income in the village is strong at 211% of the US median.

The village's sizable \$7.8 billion tax base has increased nearly 25% over the last two years driven largely by Cook County's reassessment in 2016, but the village's tax base remains below its 2009 peak. Declines in valuation have not negatively impacted revenue given the

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village's flexibility to adjust tax rates upwards and maintain annual levy stability. There are several notable projects under development, which should contribute to a rising tax base in the coming years. Lurie Children's Hospital recently completed its expansion and a large mixed-use development was also completed. In addition, Lifetime Fitness is set to open in the fall of 2018, a 300-unit residential development will also be constructed and developers recently purchased a 130 acre country club that will likely be a site for future development.

Financial operations and reserves: strong financial profile benefits from significant revenue raising flexibility

The village's financial position is strong and operations are supported by substantial flexibility provided by home rule status. The village closed fiscal 2018 with an available operating fund (general, debt service and pension contribution funds) balance of \$21.2 million, or 41% of operating fund revenues. The vast majority of the reserves were in the general fund. For fiscal 2019, the village has adopted a balanced budget.

In addition to the operating funds, the village maintains significant reserves in its Capital Projects Fund, which the village uses to finance infrastructure improvements. The primary revenues source of the Capital Projects Fund is a quarter percent share of the village's home rule sales taxes. As of fiscal 2018, the fund held a fund balance of \$10.4 million.

LIQUIDITY

The village closed fiscal 2018 with an operating net cash position of \$36 million, or a healthy 69% of revenues. Of the \$36 million cash held in the operating funds, \$10.7 million is unspent bond proceeds. Net of the bond proceeds, the cash position across the village's operating funds is \$25.3 million, or a still healthy 48% of revenues.

The village's primary enterprise operations are its water, sanitary sewer and stormwater utilities. Total enterprise liquidity was very strong at the close of fiscal 2018 with well over a year's cash on hand across all enterprise funds. Of the \$26 million cash held in enterprise funds, \$11.8 million is unspent bond proceeds. Net of the bond proceeds, unrestricted cash is equivalent to over 500 days of operating expenses.

Debt and pensions: above average debt burden and growing pension liabilities

We expect Northbrook's fixed costs will rise given growing pension obligations. Net of \$48.4 million of GO debt that is repaid by the village's utility funds, the direct debt burden is above average for the rating category at 1.0% of full value and 1.5x fiscal 2018 operating revenues. As part of its five-year capital plan, the village expects to issuer up to \$26 million of GO debt over the next five years.

The village's fixed costs, consisting of debt service and retirement contributions, have grown from nearly 20% of operating revenues in fiscal 2014 to 27% in fiscal 2018 largely due to growing pension contributions.

DEBT STRUCTURE

All the village's debt is fixed rate and 60% of principal is scheduled to be repaid within the next ten years.

DEBT-RELATED DERIVATIVES

The village does not have any debt-related derivatives.

PENSIONS AND OPEB

Village employees participate in one of three defined benefit pension plans: a single-employer police plan, single-employer fire plan, or the multi-employer agent Illinois Municipal Retirement Fund (IMRF). On a reported basis, liabilities more than doubled since 2014 growing to \$89 million in fiscal 2018 from \$44 million in fiscal 2014, driven in part by a lowering of the discount rate. The village's three-year average Moody's adjusted net pension liability grew 88% over the same period to \$216 million, or an elevated 4.1x revenues

For fiscal 2018, the village's contribution to its police and fire plan were short of "tread water", that is forestall the growth in the reported net pension liabilities of the plans assuming other plan assumptions hold. Across the two plans, the village's fiscal 2018 contribution fell \$770,000 short of treading water, equal to 1.5% of operating revenues. The IMRF contribution was stronger at 103% of the amount to necessary to tread water. After accounting for employee contributions, government contributions that tread water are equal to the sum of the current year service cost and interest on the reported net pension liabilities at the start of the year.¹ For fiscal 2019, the village increased its ambulance fee and dedicated that increase to public safety pensions. The fee increase is expected to generate an additional \$400,000 annually for the village's public safety pensions. Although the increase in contributions is notable,

the increase was less than the tread water gap in fiscal 2017 and if plan assumptions are not met the village's pension burden will likely grow in the coming year.

The village has a modest other post-employment benefit (OPEB) unfunded liability of \$9.0 million, which primarily represents the implicit rate subsidy of allowing retirees to stay on the village's healthcare plans. Retirees pay 100% of post-employment healthcare premiums.

Management and governance: home rule status provides ample revenue raising 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, such as Northbrook, 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.

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.

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