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Summary:

Metropolitan Water Reclamation District of Greater Chicago, Illinois; General Obligation

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Long Term Rating

AA/Stable

Downgraded

Rating Action

S&P Global Ratings lowered its long-term rating to 'AA' from 'AA+' on Metropolitan Water Reclamation District of Greater Chicago (MWRD), Ill.'s existing general obligation (GO) debt. The outlook is stable.

We rate the MWRD's limited-tax GO debt on par with the obligor's general creditworthiness as reflected in the rating on the unlimited-tax GO bonds under our linked ratings criteria, "Criteria FAQ: S&P Global Ratings' Approach To Rating U.S. Local Government Bonds Secured By Dedicated Limited Ad Valorem Tax Pledges," published Feb. 5, 2018, on RatingsDirect. The fungibility of resources, and the ability to manage those resources, determine our view of the obligor's ability and willingness to pay.

The MWRD's GO alternate revenue source bonds are secured by its unlimited-tax GO pledge and revenue from its stormwater management fund. The bonds are rated based on the MWRD's GO pledge.

Credit overview

The downgrade reflects our view of the MWRD's poorly funded pension plan with a sizable liability of over \$1.2 billion, which we believe weakens its overall creditworthiness, and represents a governance risk that, in our view, is above the sector standard, despite management's efforts to improve the funded status during the past seven years.

MWRD provides flood control and wastewater treatment in a treatment area encompassing roughly 882 square miles. This consists mostly of Cook County, including Chicago and 128 suburbs, with a population of over 5 million. Having completed a series of large capital projects, the MWRD's capital program is focused on meeting regulatory standards and relies mainly on loans through the Environmental Protection Agency (EPA) and state revolving fund. MWRD's primary challenge, in our view, is absorbing continuing pension contributions in a climate of tepid revenue growth, given that its budget is mainly property tax funded. While the MWRD is not seeking revenue increases that go beyond statutory limits, we note that local taxpayers are facing tax increases from a variety of jurisdictions, which may contribute to future revenue softness and taxing considerations.

The COVID-19 pandemic has caused the national economy to fall into recession, as reported by S&P Global Economics (see "The U.S. Economy Reboots, With Obstacles Ahead," published Sept. 24, 2020, on RatingsDirect). We believe that that recessionary pressures will likely affect revenue prospects at the state and local levels. Still, we recognize that the MWRD's very strong reserves provide a meaningful hedge against near-term revenue volatility. We thus expect that its fiscal position over the near term will remain very strong and in line with what we typically see

among its similarly rated peers. We will continue to monitor the effects of COVID-19 on revenue and expenses.

The 'AA' rating also reflects our view of the MWRD's:

- Participation in the deep and diverse Chicago metropolitan area economy;
- Good incomes and very strong per capita market value;
- Limited purpose nature with inherent expenditure flexibility; and
- Moderate debt burden with limited future debt needs.

Environmental, social, and governance factors

Our rating incorporates our view regarding the social risk posed by the COVID-19 pandemic, which could primarily affect revenue growth. Beyond the aforementioned social risk, we believe that the MWRD's governance risk is elevated due to its weakly funded pension plan, but its environmental risks are in line with those of the sector.

Stable Outlook

Downside scenario

Should the MWRD draw down on its reserves significantly, to levels below its target, or it amends or pauses its policy with respect to funding its pensions, and we believe its financial operations are compromised, we could lower the rating.

Upside scenario

If the MWRD's future pension contributions remain manageable, while it maintains or improves on other relevant credit factors, we could raise the rating.

Credit Opinion

Large and stable service area that encompasses Cook County

MWRD's tax base has a value of \$164.05 billion in levy year 2019, and it is very diverse. The tax base has shown steady historic equalized assessed value growth of roughly 5% annually in the previous two years. Officials anticipate a 3% increase for levy year 2020. Market value stood at \$586 billion. Income levels are good, and per capita market value is extremely strong. These various factors provide a good basis for the MWRD's ability to rely on steady property tax revenue growth in the coming year. Cook County's unemployment rate edged up to 18% in April 2020 before subsiding somewhat to 13.7% in August (preliminary).

Finances are sound, but fitting pension contributions into the budget could prove challenging

MWRD's fiscal year end is Dec 31. For the 2020 fiscal year, officials anticipate ending the year with an at least breakeven result. Officials plan to adopt a breakeven 2021 budget. MWRD's primary operations revolve around operating and maintaining seven wastewater treatment plants (including one of the world's largest at Stickney, Ill.) and 560 miles of intercepting sewers and force mains.

About 63% of general fund revenue, or \$215 million, is from property taxes, which remain sound. The general fund

collects user charges from tax exempt entities and heavy users, and land rentals, both of which are steady and account for 22% of annual revenue, followed by personal property replacement taxes (PPRT) of \$27 million or 8%, which are more economically sensitive in nature. As a non-home rule entity, the MWRD's revenue raising capability is fairly limited; property tax revenue growth is subject to the property tax extension limitation law, which allows for year-over-year revenue growth of 5% or the rate of inflation, whichever is less. Officials forecast overall revenue growth will be steady in 2021 but could come in at a slower pace than in recent history. Officials are also committed to the district's pension funding policy, which calls for contributions in excess of the actuarially determined contributions, and incorporated them into the 2021 budget. Given the funding levels of the pension plan, we anticipate contributions will continue to rise and pressure the budget. However, MWRD officials have a history of managing discretionary expenditures and we expect very strong financial reserves will be maintained in 2020 and 2021.

Fiscals 2018 and 2019 showed, on a GAAP basis, general fund shortfalls of about \$7 million in each year. However, the MWRD reported an available fund balance (which excludes nonspendable reserves) of \$237 million at the close of fiscal 2019, equal to a very strong 67% of expenditures.

Sound financial management

The budget is constructed using historical information and forecasts from external sources. The board receives quarterly updates of revenue and expenditure performance. The annual budget includes a five year forecast and capital improvement plan. Long term capital planning looks out five years and 30 years. MWRD has policies that guide reserve levels in the corporate fund, working cash fund, and reserve claim fund, all geared toward ensuring cash flows in the event of unanticipated revenue fluctuations.

Manageable debt burden with modest future capital needs

We consider the district's overall debt burden moderate at 4% of market value and at \$4,572 per capita. Amortization is slower than average, with 44% of debt service due to be retired within 10 years. Debt service carrying charges are elevated at 36% of total governmental funds' expenditures, reflecting the limited-purpose nature inherent in an issuer of this type.

MWRD's CIP for 2021-2025 totals \$1.1 billion, with most funded from bonds and loans from the Illinois EPA, the state revolving fund, and a planned \$120 million of general obligation issuance in 2021. The debt service extension base is currently \$173.1 million, and MWRD has capacity to issue additional limited tax debt.

Pension and other postemployment benefits liabilities are not bearing acute financial pressure, but longer-term risks exist

Pension and OPEB contributions accounted for 11% of total governmental funds expenses in fiscal 2019 and are likely to increase. We believe that pension and OPEB liabilities represent:

- A potentially worsening medium-term source of credit pressure, and could weigh on its budget performance, particularly in light of the current weak revenue climate.
- MWRD's single-employer defined benefit pension plan is poorly funded and growing pension contributions could add to budgetary stress each year, despite management's policies and efforts.
- OPEB costs are not currently pressuring the MWRD. We note MWRD has adopted a policy with the intention to fully fund the plan by 2026.

MWRD participates in the following plans as of Dec. 31, 2019:

- MWRD Retirement Fund: 52% funded, with a net pension liability of \$1.24 billion.
- MWRD Retiree Health Care Benefit Plan, a single-employer, defined benefit OPEB plan, which is 59% funded with a net liability of \$133 million.

MWRD's actuarially determined contributions (ADC) for its pension plan are sized to exceed the 90% state requirement; instead the goal is to reach 100% funding by 2050. Since the MWRD adopted its pension funding policy in 2013, it has contributed amounts in excess of the ADC. Most recently, in 2019, the total actual contribution was about \$87 million, which was \$22 million above the \$65 million ADC. However, despite these efforts, the actual minimum funding progress for the plan in 2019 was 71% and static funding was 90%, meaning contributions were not enough to cover the present value of current-year benefits and interest on unfunded liabilities. The plan's somewhat long 32-year closed amortization, a level 3% payroll growth assumption, and 7.25% discount rate, above our 6% baseline threshold, could lead to contribution volatility and slower than desired progress in improving funding levels. This indicates that despite the larger contributions made by the MWRD, its progress in improving funding levels will take time, and in the meantime, they face contribution volatility, even if smoothed over multiple fiscal years.

Related Research

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

Ratings Detail (As Of October 27, 2020)		
Metro Wtr Reclamation Dist of Greater Chicago GO <i>Long Term Rating</i>	AA/Stable	Downgraded
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