

CREDIT OPINION

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 Rate this Research

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Metro. Water Reclam. Dist. of Greater Chicago

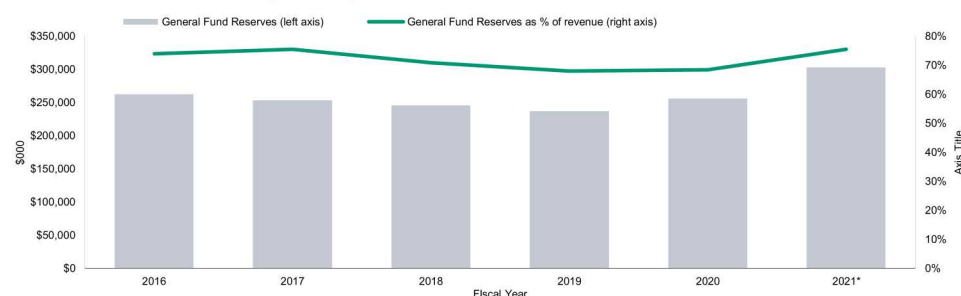
Update to credit analysis

Summary

The Metropolitan Water Reclamation District of Greater Chicago, IL's (Aa2 stable) credit profile is supported by its substantial and largely stable financial position that has benefited from high levels of revenue predictability and strong expenditure control. While the district is coterminous with [Cook County](#) (A2 stable), its governance is independent from other local governments. The district benefits from a very large tax base and diverse economic composition that serves as the largest regional economic center in the Midwest. The district's challenges include elevated debt and pension burdens of the district and overlapping local governments.

Exhibit 1

District reserves are strong and expected to remain stable



Fiscal 2021 reflects projected results

Source: Audited financial statements, Moody's Investors Service

Credit strengths

- » Large diverse economy anchored by [Chicago](#) (Ba1 stable)
- » Healthy financial operations with ample fund balance and liquidity
- » Governance structure is independent from other local governments

Credit challenges

- » Property taxes, the district's key revenue source, are subject to caps on rates and annual levy increases
- » Elevated direct and overall debt and pension burdens

- » Fixed costs comprise a high percentage of the operating budget

Rating outlook

The stable outlook reflects the district's ability to maintain reserves while absorbing growing fixed costs into its budget. Revenue and expenditure pressures related to the pandemic have been minor and are expected to remain so.

Factors that could lead to an upgrade

- » Moderation of the direct and overlapping debt and pension burdens

Factors that could lead to a downgrade

- » Declines in operating reserves or liquidity
- » Growth in the direct or overlapping debt or pension burdens

Key indicators

Exhibit 2

Metropolitan Water Reclamation District of Chicago	2016	2017	2018	2019	2020
Economy/Tax Base					
Total Full Value (\$000)	\$529,670,327	\$559,685,160	\$585,788,374	\$609,562,341	\$609,562,341
Population	5,227,575	5,238,541	5,223,719	5,198,275	5,198,275
Full Value Per Capita	\$101,322	\$106,840	\$112,140	\$117,262	\$117,262
Median Family Income (% of US Median)	103.2%	103.1%	103.2%	104.5%	104.5%
Finances					
Operating Revenue (\$000)	\$713,250	\$675,381	\$738,590	\$695,845	\$763,825
Fund Balance (\$000)	\$471,809	\$469,531	\$469,326	\$432,908	\$447,076
Cash Balance (\$000)	\$389,200	\$412,433	\$395,097	\$417,152	\$435,492
Fund Balance as a % of Revenues	66.1%	69.5%	63.5%	62.2%	58.5%
Cash Balance as a % of Revenues	54.6%	61.1%	53.5%	59.9%	57.0%
Debt/Pensions					
Net Direct Debt (\$000)	\$2,968,045	\$3,032,770	\$2,956,022	\$2,861,341	\$2,801,370
3-Year Average of Moody's ANPL (\$000)	\$1,921,929	\$2,095,119	\$2,172,533	\$2,234,710	\$2,374,718
Net Direct Debt / Full Value (%)	0.6%	0.5%	0.5%	0.5%	0.5%
Net Direct Debt / Operating Revenues (x)	4.2x	4.5x	4.0x	4.1x	3.7x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	0.4%	0.4%	0.4%	0.4%	0.4%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	2.7x	3.1x	2.9x	3.2x	3.1x

Full valuation and population are not currently available for 2020 and are carried forward from the prior year. Full valuation is displayed on an estimated fiscal year basis.

Source: Audited Financial Statements, US Census, Moody's Investors Service

Profile

The Metropolitan Water Reclamation District of Greater Chicago is the sanitary district for nearly all of Cook County. It provides collection and treatment services for approximately 5.2 million people over 882 square miles, including residents of the City of Chicago and 129 suburban communities.

Detailed credit considerations

Economy and tax base: large, diverse tax base with substantial tax rate headroom

The district's tax base, which is largely coterminous with the county, serves as the economic center for a large portion of the Midwest and the third largest regional economy in the country. Chicago comprises about half of the population and tax base of the county. The 2020 census reflected a 2% increase in population from 2010 to 5.3 million residents. Unemployment has improved from last year but remains high, similar to other large metropolitan areas.

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The district's tax base, valued at \$609 billion, has grown steadily at an annual average rate of 5.8% over the last five years, driven by appreciation of existing property and substantial construction activity in and around Chicago. Although residential housing values (about 75% of equalized valuation) will likely strengthen, commercial values could face some headwinds. This could result in a shift in the property tax burden among taxpayers, but the district is unlikely to see a decline in tax revenue even if there is a decline in valuations. The district has ample headroom under tax rate limitations. For example, in 2020 the corporate fund tax rate was 0.158 compared with a statutory cap of 0.410. The district sets its annual levy at a dollar amount, which the Cook County assessor distributes among taxpayers and applies the applicable tax rate up to the statutory limits.

Financial operations and reserves: strong reserve position with limited financial impact from the pandemic

The district is experiencing minimal financial impacts from the pandemic, given strong expenditure control and a revenue base that is heavily reliant on predictable property taxes. For fiscal 2021, the district expects to close the year with an increase in general fund reserves of approximately \$50 million. The projected results are supported by stability in property tax receipts, the district's largest revenue source, favorable variances in personal property replacement taxes (PPRT) and holding the line on expenditures. The district has collected over 100% of its debt service levy for the past nine consecutive years. As of October 2021, the district had collected 95% of its annual debt service levy and another year of full collections is anticipated. The district's recommended budget for fiscal 2022 is balanced based on reasonable assumptions for revenue and expenditures and we expect reserves to increase slightly given its history of strong budget to actual performance. For fiscal 2020, the district closed the year with an increase in general fund reserves of \$20 million, which was also supported by lower than budgeted spending and ongoing stability of property tax revenue. The district was not eligible for federal relief aid as a result of the pandemic.

The district is primarily reliant on property taxes, which accounted for 85% of operating revenue in fiscal 2020. Property taxes revenue is typically stable from year to year, as the district maintains room under statutory rate caps and typically increases the levy by the amount allowed under the Property Tax Limitation Law (PTELL). Charges for services represents the district's second largest revenue source at approximately 10% of operating revenue. Revenue generation from charges for services has not materially changed over the last five years.

Liquidity

Net cash across district operating funds is expected to remain strong. At the close of fiscal 2020 net cash totaled \$435 million, equal to a healthy 59% of operating revenue.

Debt, pensions and OPEB: long-term leverage is primary credit challenge

Long-term leverage related to debt and pensions will remain the district's primary credit challenge. As of fiscal 2020, the district's direct debt burden was low relative to tax base valuation at 0.5%. However, the direct debt burden was elevated when compared to operating revenue at 3.7x. Debt service accounted for a high 31% of operating revenues in fiscal 2020. The district's high debt service costs are largely attributable to the capital intensive nature of the district. The capital program calls for approximately \$1 billion in system improvements over the next five years. The district's debt burden will remain high, but the use of grants and pay-go capital financing should prevent material growth in the debt burden.

Overall fixed costs (combined debt service, pension and other post-employment benefits) equaled a very high 45% of operating revenue. Pension liabilities are above average. As of fiscal 2020, the district's three year average Moody's adjusted net pension liability (ANPL) totaled \$2.4 billion, equal to a significant 3.1x operating revenue and 0.4% of full valuation.

Debt structure

All of the district's debt is fixed rate. Amortization of debt is moderate, with 44% of principal set to be retired over the next ten years. The district's \$2.9 billion in debt includes state revolving fund (SRF) loans, general obligation unlimited tax (GOULT) bonds, general obligation limited tax (GOLT) debt service extension base (DSEB) bonds, bond anticipation notes (BANs) and capital leases. GOLT DSEB debt is paid from the district's DSEB, which totaled \$169 million in fiscal 2019. The DSEB provides sufficient coverage on outstanding GOLT debt, assuming no growth in the DSEB.

Debt-related derivatives

The district is not a party to any derivative agreements.

Pensions and OPEB

Eligible district employees participate in the Metropolitan Water Reclamation District Retirement Fund, a single-employer defined benefit pension plan. Employee and employer contribution levels are defined by state statute and have historically been insufficient to reduce unfunded liabilities. In August 2012, the Illinois General Assembly passed Public Act 97-0894, which provides for additional pension funding through increased employer and employee contributions. As a result, the district's statutory employer multiplier was increased to 4.19 times from 2.19 times. The reform increased employee contributions by 1% annually for three years, going from 9% to its current 12%. The reform requires the district to contribute the lesser of 4.19 times the employee contribution or the actuarially determined amount. However, Section 5.9 of 70 ILCS 2605 also allows the district, by a vote of two-thirds of its board members, to contribute interest earnings from some of the district's operating funds to the Retirement Fund. Beginning January 1, 2022, the district will be allowed to make contributions from a wider swath of operating revenue, upon a two-thirds vote by the District's Board of Commissioners, given the recent passage of P.A. 101-0670. In addition to its legislated pension reform, in September 2014, the district adopted a new funding policy that directs it to contribute an annual amount to the fund that will result in a funded ratio of 100% by 2050.

Due to these changes, the district's pension contributions have increased significantly in recent years. In fiscal 2020, district contributions were \$107 million and 14% of operating fund revenues, up from \$30 million and 6% revenues in fiscal 2010. Fiscal 2020 contributions were equivalent to a strong 113% of tread water. The district has budgeted for an additional one-time \$30 million pension contribution from the corporate fund in fiscal 2022.

The district's reported unfunded other post employment benefit (OPEB) liability as of December 31, 2020, the most recent actuarial valuation date, was \$72 million or a minimal 0.1x operating revenue. The district recently amended its funding policy to achieve a 100% funding level by 2027, using an assumed discount rate of 6.5%.

ESG considerations

Environmental

Environmental considerations are driving the system's extensive capital needs and high debt burden. According to data of Moody's ESG Solutions, Cook County is at high risk for extreme rainfall events relative to counties nationally. The system's Tunnel and Reservoir Plan (TARP, deep tunnel) aims to reduce flooding and protect waterways by substantially increasing reservoir capacity. MWRD is currently in phase two, which is expected to be completed in 2029. TARP is one of the country's largest public works projects for pollution and flood control.

Social

The system's local economy benefits from its role as the business, finance, transportation and tourism hub for the Midwest, as detailed in the Economy and Tax Base section. Overall resident income metrics are average, and unemployment rates are on par with the state and median trends.

Governance

The district maintains legal separation of management and governance from other overlapping units of local government. The district's legal separation reduces the risk that financial pressures experienced by the other Chicago area local governments will directly impact the district's financial position. Cook County residents elect the district's Board of Commissioners, a board of nine members who serve six-year terms. The executive director, who is appointed by the Board of Commissioners, manages and controls district operations. Management has demonstrated a willingness to control operating expenditures.

Illinois utility districts have an institutional framework score of "Aa" or strong. We expect property tax revenues to remain largely stable given significant margin under rate limits to adjust for fluctuations in the tax base. However, in addition to rate caps, the district is subject to the PTELL, which limits growth in property tax extensions to the lesser of 5% or the CPI.

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