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CREDIT OPINION
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New Issue

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City of Highland Park, IL

New Issue - Moody's Assigns Aaa to Highland Park, IL's GO Bonds; Outlook Negative

Summary Rating Rationale

Moody's Investors Service has assinged a Aaa rating to the City of Highland Park, IL's $3.5 million General Obligation (GO) Bonds, Series 2017. Moody's maintains the Aaa rating on the city's outstanding GO debt. Following the sale, the city will have $52.8 million of GO debt outstanding. The outlook on the rating is negative.

The Aaa rating reflects the city's sizable and affluent tax base, stable financial operations underpinned by healthy reserves, and moderate bonded debt burden. These credit strengths mitigate the challenge associated with a high unfunded pension burden, while the risk of additional growth in unfunded pension liabilities is a key consideration in the negative outlook.

Credit Strengths

» Large tax base with high resident income and wealth

» Flexibility to raise revenue given the city's status as an Illinois home rule community

» Ample financial reserves

Credit Challenges

» Large and growing unfunded pension liabilities

» Above average fixed cost burden

» Exposure to economically sensitive sales and income tax revenues

» Despite recent growth, tax base valuation remains 21% below its pre-recession peak

Rating Outlook

The negative outlook reflects risk that unfunded pension liabilities will grow further should asset returns remain weak relative to plan assumptions or the city raises contributions more slowly than anticipated. Given the city's pension liabilities are already high relative to its rating peers, further growth could spur downward rating action.

Factors that Could Lead to an Upgrade (or removal of the negative outlook)

» Moderation of large unfunded pension liabilities

Factors that Could Lead to a Downgrade

- Failure of the city to substantially increase pension contributions as planned
- Material growth in the city's debt burden or continued growth in unfunded pension liabilities
- Significant decline in reserves or liquidity

Key Indicators

Exhibit 1

Highland Park (City of) IL	2011	2012	2013	2014	2015
Economy/Tax Base					
Total Full Value ($000)	$ 7,662,989	$ 6,976,273	$ 6,496,408	$ 6,197,026	$ 6,166,389
Full Value Per Capita	$ 255,578	$ 233,250	$ 217,533	$ 207,821	$ 206,434
Median Family Income (% of US Median)	212.5%	216.9%	213.4%	219.1%	219.1%
Finances					
Operating Revenue ($000)	$ 42,389	$ 44,979	$ 43,083	$ 46,339	$ 42,495
Fund Balance as a % of Revenues	92.8%	97.5%	104.5%	101.1%	69.8%
Cash Balance as a % of Revenues	82.6%	89.1%	95.3%	88.5%	63.1%
Debt/Pensions					
Net Direct Debt ($000)	$ 30,920	$ 27,229	$ 28,327	$ 20,679	$ 40,247
Net Direct Debt / Operating Revenues (x)	0.7x	0.6x	0.7x	0.4x	0.9x
Net Direct Debt / Full Value (%)	0.4%	0.4%	0.4%	0.3%	0.7%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)		2.6x	3.0x	3.1x	3.8x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)		1.7%	2.0%	2.3%	2.6%

Source: Highland Park audited financial statements, Moody's Investors Service and US Census Bureau

Recent Developments

There have been no material changes in the city's credit profile since our last report was published in November 2016.

Detailed Rating Considerations

Economy and Tax Base: Affluent North Shore Chicago Suburb with Large Tax Base

We expect the city's economic profile to remain a credit strength given its favorable location along Lake Michigan and high quality housing stock. Located approximately 26 miles north of the City of Chicago (Ba1 negative), the city is nestled among the state's most affluent communities. Highland Park is primarily a bedroom community with residential properties accounting for 90% of equalized assessed valuation. Resident income is well above the nation with median family income at 220% of the US. The city's sizable $6.5 billion tax base began to recover in the most recent valuation with growth of 6%; however, tax base valuations remain 21% below a prerecession peak. The city's full value per capita remains strong, exceeding $200,000.

Financial Operations and Reserves: Healthy Reserves Expected to Continue

We expect the city to maintain its healthy financial position supported by the financial flexibility resulting from its home rule status, despite a growing fixed cost burden driven by pension expenses. After posting five consecutive operating surpluses through fiscal 2014, the general fund balance declined by $17 million in fiscal 2015 due primarily to a $15 million outflow for the redemption of bonds that were issued in 2004 to address unfunded liabilities of its police and firefighter pension funds. Highland Park and its neighbor, the Village of Northbrook (Aaa negative), both issued $16.6 million in pension bonds that were purchased by the other issuer to fund their respective pension liabilities.

Despite the draw on reserves, the city closed fiscal 2015 with an available operating fund balance of $29.7 million, or a very ample 69.8% of revenues. The city estimates it closed fiscal 2016 with a $4.5 million reduction in reserves due to capital expenses. Despite the planned draw, reserves will likely remain near 60% of revenue, a level that far exceeds the city's policy to maintain 35% of expenditures in general fund reserves. The city has budgeted for a $7.0 million operating surplus in fiscal 2017, supported by two potential asset sales. Should the sales not go through, officials will reduce expenses to balance operations.

Similar to many Illinois (Baa2 negative) cities and villages, Highland Park is relatively dependent upon economically sensitive sales tax receipts (30% of operating revenues in fiscal 2015). Favorably, management has historically maintained healthy reserves to buffer against volatility in receipts.

LIQUIDITY

Net cash across city operating funds totaled $26.8 million, or a strong 63.1% of operating revenues at the close of fiscal 2015. We consider the general, debt service, public safety pension levy, environmental sustainability, and multi-modal transportation as operating funds.

Debt and Pensions: Total Leverage is High and Primarily Consists of Unfunded Pension Liabilities

Highland Park carries a very high pension burden and growth in pension contributions will drive the city's fixed cost burden upwards. The city's fiscal 2015 three-year average adjusted net pension liability (ANPL), our measure of a local government's pension burden, is $160.9 million. This is equivalent to an elevated 2.5% of full value and 3.8 times revenue. The 2015 three-year average ANPL is up nearly 20% relative to the 2014 three-year average, which we discuss in more detail below.

Inclusive of the current sale, the city's debt burden remains moderate at 0.8% of full value, or 1.2 times operating revenue. Total fixed costs inclusive of retirement contributions and debt service typically comprises approximately 30% of revenues. The city plans to issue between $3.4 million and $10 million in bonds annually through 2021 to finance a portion of its capital improvement plan.

DEBT STRUCTURE

All of the city's debt is fixed rate. Amortization is slow with 48% of principal retired within ten years.

DEBT-RELATED DERIVATIVES

The city is not a party to any derivative agreements.

PENSIONS AND OPEB

City employees participate in one of two single employer defined benefit pension plans (police and fire) or the Illinois Municipal Retirement Fund (IMRF) a multiple employer agent plan. Factors contributing to recent unfunded liability growth include updated mortality assumptions, weak investment returns relative to assumed rates of return, and city contributions that, while closely conforming with actuarially determined contributions, were not sufficient to fully cover annual interest accruals on accumulated unfunded liabilities. Furthermore, new accounting standards resulted in increased reporting of both assets and liabilities of the city's account with the IMRF.

Fiscal 2015 city contributions to its pensions plans were 98% of our “tread water” indicator ($6.8 million) across all plans. The “tread water” indicator measures the annual employer contribution required to prevent reported net pension liabilities from growing, under plan assumptions. After accounting for employee contributions, annual government contributions that tread water equal the sum of employer service cost and interest on reported net pension liabilities at the start of the fiscal year.

The state requires 90% of public safety unfunded pension liabilities be amortized over 30 years commencing in 2010. If the city contributed at the state minimum level, payments would be backloaded requiring increasing payments over time. The city intends to significantly boost contributions with the goal of smoothing payments in the long-term. Contributions to the city's police and fire pension plans will increase to $7.5 million in fiscal 2017, a 42% increase from fiscal 2015. Officials are planning to increase contributions again in 2018 to $7.75 million and incrementally thereafter through 2021.

The city has a modest other post employment benefit (OPEB) unfunded liability of $13 million, which primarily represents the implicit rate subsidy of the state mandate to allow retirees to stay on the city's health care plans.

Management and Governance: Willingness and Ability to Increase Revenues

Illinois cities have an institutional framework score of “A,” or moderate. Revenue predictability is moderate, with varying dependence on property, sales, and state-distributed income taxes. Revenue-raising ability is also moderate but varies. Home rule entities have substantial revenue-raising authority. Non-home rule entities are subject to tax rate limitations, and total operating tax yield for nonhome rule entities subject to the Property Extension Limitation Law (PTELL) is capped at the lesser of 5% or CPI growth, plus new construction. Expenditures are moderately predictable but cities have limited ability to reduce them given costs for pension benefits that enjoy strong constitutional protections.

The state has previously considered reducing income tax distributions for local governments. Highland Park received $3.2 million in income tax receipts in fiscal 2015, equivalent to 8% of revenues. The city originally budgeted for the 50% cut in income tax receipts in fiscal 2016, but the reduction did not come to fruition. The amended budget reallocated 50% of the income tax receipts to boost pension funding, which will continue in fiscal 2017. The remainder of the pension funding increase will be financed through the property tax levy. Should the state cut income tax funding, officials report they would consider additional increases of the property tax levy, which has remained relatively flat the past few years. Officials have demonstrated a willingness to exercise its home rule flexibility to increase other taxes in recent years including implementing a 1% food and beverage tax, 1% packaged liquor tax, and a $0.02 per gallon motor fuel tax.

Legal Security

The city's outstanding bonds are secured by the city's GO unlimited tax pledge in which the full faith, credit and resources of the city are pledged, and will be payable from ad valorem taxes, which may be levied without limitation as to rate or amount.

Use of Proceeds

The Series 2017 bonds will finance improvements to the city's water system and street repairs.

Obligor Profile

Located 26 miles north of the Chicago central business district in suburban Lake County (Aaa), Highland Park is one of eight Chicago suburban communities north of Chicago fronting Lake Michigan collectively referred to as the “North Shore”. The population as of the 2010 Census was 29,763.

Methodology

The principal methodology used in this rating was US Local Government General Obligation Debt published in December 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Ratings

Exhibit 2

Highland Park (City of) IL

Issue	Rating
General Obligation Bonds, Series 2017	Aaa
Rating Type	Underlying LT
Sale Amount	$3,465,000
Expected Sale Date	01/23/2017
Rating Description	General Obligation

Source: Moody's Investors Service

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