

FITCH RATES COMMUNITY COLLEGE DIST. NO. 508 (CITY COLLEGES OF CHICAGO) GOS 'AA-'; OUTLOOK STABLE

Fitch Ratings-New York-26 September 2013: Fitch Ratings has assigned an 'AA-' rating to the following Community College District Number 508 (City Colleges of Chicago) bonds:

--\$250.0 million unlimited tax general obligation bonds (dedicated revenues) series 2013.

Proceeds will be used to construct, acquire and equip improvements to the district's campuses and administrative buildings. The bonds are expected to sell via negotiation the week of October 7th.

The Rating Outlook is Stable.

SECURITY

The bonds are secured by a pledge of tuition and fee revenues and state grant revenues. The bonds also carry the district's unlimited tax general obligation (ULTGO) pledge.

KEY RATING DRIVERS

DUAL ULTGO/REVENUE PLEDGE: Primary support for the 'AA-' rating is derived from the district's ULTGO pledge, although the district anticipates paying debt service from other sources and abating the levy each year.

DIVERSE BUT DEPENDENT REVENUES; SOLID FINANCIAL PROFILE: The district's revenue base is diverse yet dependent on federal and state revenue for over 57.3%. Financial operations are strong and have allowed for the buildup of sizable reserves. Board-designated capital reserves are expected to be drawn down over the next five years to help fund the 2014 - 2018-capital program; however, Fitch expects adequate reserves will be maintained.

LONG-TERM LIABILITY OUTLOOK IS MANAGEABLE: The district has not had any material debt service or pension payments in recent years. State-wide pension reform legislation may result in a shift of pension costs from the state to the district. Fitch believes such a shift would be gradual, and manageable.

SLOWLY IMPROVING ECONOMY: Chicago's status as a major financial and business services center is well established; however, recovery has been slower than expected and unemployment remains persistently high.

RATING SENSITIVITIES

INTERGOVERNMENTAL SUPPORT: The district is highly dependent upon state and federal sources for operations. A material change in the distribution framework for such revenues would likely have a negative effect on the rating.

STATEWIDE PENSION REFORM: Direct impact on the district from any potential pension reform package is expected to be gradual and manageable. However, the effect on overlapping jurisdictions could be more significant and may indirectly negatively impact the district's overall long-term liability profile and revenue flexibility.

USE OF RESERVES FOR CAPITAL PLAN: The district anticipates applying a significant amount of its reserves to the capital program over the next five years. Should the amount of reserves actually drawn materially differ from expectations, the overall financial profile may be altered and trigger a rating change.

CREDIT PROFILE

The district is coterminous with the city of Chicago and provides community college educational services to the Chicago metropolitan area. It is the third largest community college district in the nation, with seven colleges and six satellite sites. The district employs 5,500 faculty and currently serves 110,800 students, or 46,600 full-time equivalent enrollment.

DUAL ULTGO/REVENUE PLEDGE

The current issue features an 'alternate bond' structure, with a revenue pledge of tuition and fee revenue and state grant revenue, supplemented by the district's ULTGO pledge. The debt service tax levy may only be abated if the trustee certifies that funds are on deposit sufficient to satisfy the annual debt service requirement, prior to the levy extension. Otherwise, the debt service levy shall be levied and deposited directly with the trustee into the pledged taxes account.

The 'AA-' rating relies primarily on the strength of the district's ULTGO pledge, although the pledged revenues also provide adequate support. Fitch estimates pro forma MADS coverage by 2012 net revenues at 3.4x.

DIVERSE BUT DEPENDENT REVENUES; SOLID FINANCIAL PROFILE

The district's revenue base is relatively diverse. In fiscal 2012, state appropriated funds (including pension on-behalf payments) contributed about 19.1% of operating revenues, property taxes 25.1%, net tuition a relatively low 9.1%, and federal grants and contracts (including substantial PELL grants), 38.2%.

Reliance on federal funding is relatively high compared to peer institutions. Revenue flexibility is somewhat limited, as increases in the operating property tax levy are limited to the lesser of 5% or the CPI. However, tuition rates are competitive and represent a potential source of flexibility.

Operating trends generally have been positive, with surpluses generated in four of the past five years resulting in the build-up of ample reserves. The operating surplus in fiscal 2012 amounted to \$ 35.4 million, or 7.9% of spending. Available funds, defined by Fitch as cash and investments less restricted net assets, was approximately \$244 million at June 30, 2012, equal to 53.8% of unrestricted operating expenses and 96.8% of pro forma debt. This compares favorably to peer community college institutions. The district anticipates drawing down approximately \$165 million of its reserves over the next five years as part of the current capital program, but Fitch expects adequate reserves to be maintained.

Preliminary fiscal 2013 operating results show an operating deficit before capital appropriations and grants of \$4.3 million on a full accrual basis, equivalent to less than 1% of spending, which was more favorable than the \$5.3 million budgeted use of fund balance. Recognition of \$13.1 million of one-time items contributed to the operating deficit.

The overall change in net position was a positive \$21.4 million, reflecting a \$10 million reimbursement from a city tax increment fund for capital already expended and \$15 million recognition of fixed assets which are owned by the district but were funded from state capital development board funds. The fiscal 2014 budget is balanced without fund balance appropriated. Fitch expects operating results to be positive over the next several years, as the district anticipates deriving \$109 million for the capital program from operations.

LONG-TERM LIABILITY OUTLOOK IS MANAGEABLE

The district's high overall debt burden of 8.1% or \$6,706 per capita is largely reflective of borrowing by overlapping jurisdictions. The current offering represents the district's only debt and amounts to a very modest \$92 per capita or 0.1% of taxable market value. The structure is expected to be level debt service payments, with a slow principal payout of 17% in 10 years. No further

borrowing is anticipated within the 2014 - 2018 capital planning period.

The district's current responsibilities for long-term liabilities are quite modest, as the state pays the vast majority of the pension payment, totaling about \$43.7 million in fiscal 2012, or 9.7% of spending. The OPEB pay-go amount represented a small 1.7% of 2012 spending. Pro forma debt service is projected at the equivalent of 4.2% of 2012 spending.

The state legislature is considering wide-ranging pension reforms, which may result in the district assuming greater responsibility for its pension payment. The district is prudently planning for this potentially increased payment under budget assumptions that show a gradual implementation schedule.

Fitch judges carrying costs for long-term liabilities to be manageable for the district, even conservatively assuming immediate full payment of the actuarially based pension contribution, with no offsetting employee contribution. Under that unlikely scenario, carrying costs for (pro forma) debt service, pension and OPEB paygo would have accounted for a manageable 15% of fiscal 2012 spending. Transition options currently being discussed could result in much lower carrying costs for the district.

The district's exposure to pension liabilities is limited, but that is not the case for other overlapping units of government that share the same tax base. Many of these area governments have severely underfunded pension systems which will likely require drastic funding increases in the near to medium term, potentially resulting in greater pressure on the property tax base.

Fitch is concerned about the cumulative effect of severely underfunded area pension systems on all Chicago area governments; however, believes the district is more insulated than most due its relatively limited reliance upon property taxes and its very small share of the overall property tax levy.

SLOWLY IMPROVING ECONOMY

Chicago (rated 'AA-' on Rating Watch Negative by Fitch) serves as the economic and cultural hub for the Midwest region, and maintains good prospects for long-term stability if not growth. Socioeconomic indicators are mixed with elevated unemployment and individual poverty rates, slightly below average per capita income levels, but strong educational attainment levels. Housing values have been slow to recover and a lag in assessments is expected to further delay any potential near-term increase in assessed value.

Unemployment remains a challenge. The July 2013 rate was a high 11.2%, up from the 10.8% recorded a year prior. The year over year rate increase reflects relatively stable employment while the labor force grew modestly. In 2012, the city gained over 20,000 jobs (a 2.2% increase) primarily in professional and business services despite reductions in both manufacturing and public service. The city's declining population totaled 2.7 million in 2012, down 7% from the 2000 census, but still accounts for 21% of the state's population.

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In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, University Financial Associates, S&P/Case-Shiller Home Price Index, IHS Global Insight, National Association of Realtors, Underwriter, Bond Counsel.

Applicable Criteria and Related Research:

- 'Tax-Supported Rating Criteria' (Aug. 14, 2012);
- 'U.S. Local Government Tax-Supported Rating Criteria' (Aug. 14, 2012).
- 'U.S. College and University Rating Criteria' (May 10, 2013).

Applicable Criteria and Related Research:

Tax-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015

U.S. Local Government Tax-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685314

U.S. College and University Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=708049

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