

FITCH RATES CCD NO. 508 (CITY COLLEGES OF CHICAGO), IL GOS 'A+'; OUTLOOK TO NEGATIVE

Fitch Ratings-New York-09 November 2017: Fitch Ratings has assigned an 'A+' rating to the following Community College District Number 508, City Colleges of Chicago, IL (the district) bonds:

--\$80 million unlimited tax general obligation bonds (dedicated revenues) series 2017.

The bonds are expected to sell via negotiation the week of Nov. 27. Proceeds will fund various capital projects.

Fitch also affirms the following district ratings at 'A+':

--Issuer Default Rating (IDR);

--\$241.8 million unlimited tax general obligation bonds (dedicated revenues) series 2013.

The Rating Outlook is revised to Negative from Stable.

SECURITY

The bonds are alternate revenue bonds, whose primary pledge is tuition and fee revenues and state grant revenues. The bonds also carry the district's unlimited tax general obligation pledge.

ANALYTICAL CONCLUSION

The Outlook revision to Negative reflects the district's weakened reserve position and growing expenditure pressures. The 'A+' IDR reflects Fitch's expectation that the financial operations will stabilize in fiscal 2018. The passage of the state budget brings more certainty to the district's state funding, albeit at a lower level than before the budget impasse. The district received only limited and sporadic funding during the two-year state budget impasse, which contributed to financial deterioration and impaired the district's overall financial resilience. The 'A+' rating also reflects the solid expenditure flexibility and moderate long-term liability burden.

Economic Resource Base

City Colleges of Chicago Community College District provides community college educational services to Chicago. It is the third largest community college district in the nation, with seven colleges and six satellite sites. The district employs 3,900 faculty and staff, and currently serves 86,331. Its taxing jurisdiction is coterminous with the city of Chicago.

Chicago serves as the economic and cultural center for the Midwestern region of the United States. The city's population totaled 2.7 million in 2016, up 1% from the 2010 census, and accounts for 21% of the state's population. Socioeconomic indicators are mixed with elevated individual poverty rates, above average per capita income levels, and strong educational attainment levels. The district derives about a third of its revenues from the state of Illinois ('BBB'/ Negative Outlook).

KEY RATING DRIVERS

Revenue Framework: 'bbb'

Fitch expects revenues to continue their pattern of slow growth, below the level of inflation. Tuition revenues tend to behave countercyclically to the economy. Independent legal ability to raise revenues is limited to tuition adjustments, which are insufficient to offset expected revenue shortfalls.

Expenditure Framework: 'a'

The natural pace of expenditure growth is likely to be well above the expected slow revenue growth; however, the district retains substantial ability to adjust staffing levels in response to enrollment fluctuations.

Long-Term Liability Burden: 'aa'

The long-term liability burden, comprised primarily of overlapping debt, is moderate relative to the resource base.

Operating Performance: 'a'

Adequate gap-closing ability is provided by solid expenditure flexibility and reserves that, while currently sufficient, could become stressed if enrollment declines or state aid cuts cause revenues to underperform expectations.

RATING SENSITIVITIES

ADEQUATE RESERVES: The 'A+' rating is sensitive to the ability of the district to fund expenses within available resources while maintaining adequate reserves, particularly given enrollment declines and reduced state support and growing expenditure pressure.

CREDIT PROFILE

Chicago acts as the economic engine for the Midwestern region of the U.S. The city's residents are afforded abundant employment opportunities within this deep and diverse regional economy. The city also benefits from an extensive infrastructure network, including a vast rail system, which supports continued growth. The employment base is represented by all major sectors with concentrations in the wholesale trade, professional and business services and financial sectors. Socioeconomic indicators are mixed as is typical for an urbanized area, with above average per capita income and educational levels, but also elevated individual poverty rates. Enrollment has been declining, which management attributes to reduced state funded grants, improving local unemployment rates, as well as an increase in the local minimum wage. Falling high school graduation rates across Illinois may also contribute to falling declining enrollment trends. The district anticipates a slowing of the rate of enrollment decline as state-funded grants to lower income students have been restored.

City Colleges relies on state funding for a significant amount of support. Illinois (IDR 'BBB'/ Negative Outlook) is a large, wealthy state with a diverse economy centered on the Chicago metropolitan area. The passage of a fiscal 2018 budget that incorporates a permanent increase in taxes to more closely align revenues with spending was an important step in stabilizing the state's operations and should significantly reduce the liquidity stress that had threatened its investment-grade rating. However, the state's financial resilience has been materially weakened by the two-year period in which it spent far in excess of tax revenues while accumulating an extraordinary level of budgetary liabilities, adding to the strain presented by the state's large unfunded retiree benefit liabilities and rising contribution burden, and implementation risks to the budget remain.

Revenue Framework

State revenues provided an unusually large 36% of fiscal 2017 revenues, in part to receipt of delayed funding from prior fiscal years. Taxes are generally the district's largest revenue source, with property taxes providing 27% and personal property replacement taxes (PPRT) another 4% of fiscal 2017 revenues. Federal grants (mainly Pell grants) accounted for 18% of revenues. Tuition

revenues, net of scholarship allowance, provide an additional 12% of revenues. State funding for community colleges was cut by approximately 10% in the fiscal 2018 budget from fiscal 2015, pre-budget impasse levels.

Fitch expects revenue growth to be flat to below the rate of inflation. The district will be challenged to realize revenue growth given recent cuts to state aid and declining enrollment. Fitch does not anticipate further cuts to state aid going forward, but expects increases to be limited.

Annual growth in the property tax levy is limited by the Property Tax Extension Limitation Law to the lesser of 5% or the rate of inflation. The district retains the independent legal ability to adjust tuition rates as needed.

Expenditure Framework

Salaries and benefits comprise 72% of the district's expenses.

Expenditure growth is largely enrollment-driven and should generally track growth in tuition. Overall, Fitch expects expenditures to grow at a rate well above that of revenues, absent active management, due to the limited prospects for state aid growth. Expenditure growth will also be pressured as the district will be required to assume the normal cost for pensions associated with new employees beginning fiscal 2019.

The district has considerable control over staffing costs; 52% of faculty are part-time, making staffing levels somewhat easier to adjust. Fixed carrying costs for debt service and OPEB are low at about 5% of spending, aided by state assumption of pension costs for current employees. Fitch expects carrying costs to rise gradually as the district recognizes pension costs of new tier employees, as mentioned above.

Long-Term Liability Burden

The long-term liability burden is moderate, with overall debt at about 16% of personal income. Direct debt is modest, comprising less 2% of the overall burden. Overlapping debt accounts for the remainder. The five year capital program includes \$523 million of projects. No further bonding is anticipated.

The district records no liability for pensions, as the state assumes its share of the state-wide plan. There have been proposals at the state level to move all or a portion of these costs to the districts, but so far these efforts have been limited to the creation of a new tier requiring the district to fund the normal cost of new employees. If the district were required to assume the entire liability, the liability burden would be elevated but still within the moderate range. The OPEB liability is negligible, at about 0.1% of personal income.

Operating Performance

Gap-closing ability is adequate, given moderate expected revenue volatility, solid expenditure flexibility, and currently adequate reserves. The district has drawn upon reserves in the recent past, as planned contributions to its large capital program. Fiscal 2016 was additionally challenged by steep declines in both state and federal funding, which were only slightly offset by a tuition increase.

The state budget impasse affected the timing of state funding receipts in fiscals 2016 and 2017. Approximately \$34 million of fiscal 2017 state funding was appropriated after the revenue recognition period and booked in fiscal 2018. As a result, ending unrestricted cash reserves fell to about 10% in fiscal 2017, down from 24% in fiscal 2016. Reserves may improve in fiscal 2018 due to the receipt of the \$34 million delayed portion of fiscal 2017 aid, reimbursement of \$6 million prior capital outlay from bond proceeds, and the sale of some assets, some \$24 million of which have already been completed. An additional approximately \$20 million asset sale is assumed in

the fiscal 2018 budget and inability to complete that sale within the fiscal year would significantly impact operating results. The district has significant expenditure flexibility to manage revenue volatility. Failure to return to balanced operations including reduced reliance upon non-recurring sources of revenue and maintain reserves in line with the 'a' financial resilience assessment could pressure the rating.

Budget management has been adequate, characterized by maintenance of strong gap-closing capacity and significant capital investment. Community college districts tend to experience economic stresses in a counter-cyclical fashion, as economic trends tend to have an inverse relationship to community college enrollment. Fitch views the recent period of economic expansion, compounded by state funding irregularity, to be an acute stress scenario for the district. State funding plummeted by two-thirds to \$20 million in fiscal 2016. The state's stopgap budget provided a \$26 million appropriation for fiscal 2017, well below the \$54 million original budgeted amount. To offset the stress of the state's budget impasse and lower enrollment, the district implemented a non-faculty hiring freeze and scaled back its capital spending. The fiscal 2018 budget includes a 16% cut in expenditures and assumes reduced amounts of state funding in line with the 10% funding cut included in the state budget.

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Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (pub. 31 May 2017)
<https://www.fitchratings.com/site/re/898466>

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