S&P Global Ratings

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## Summary:

# Peoria, Illinois; General Obligation; Miscellaneous Tax

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## Summary:

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| Credit Profile | | |
|---|---|---|
| US$25.26 mil taxable GO rfdg bnds ser 2021B due 01/01/2045 | | |
| *Long Term Rating* | A+/Stable | New |
| US$14.2 mil GO rfdg bnds ser 2021C due 01/01/2034 | | |
| *Long Term Rating* | A+/Stable | New |
| Peoria GO | | |
| *Long Term Rating* | A+/Stable | Outlook Revised |
| Peoria GO | | |
| *Long Term Rating* | A+/Stable | Outlook Revised |

## Rating Action

S&P Global Ratings revised its outlook on Peoria, Ill.'s general obligation (GO) debt to stable from negative. At the same time, we affirmed our existing long-term rating on the city's GO debt at 'A+'.

At the same time, S&P Global Ratings assigned its 'A+' rating, with a stable outlook, to Peoria's approximately $25.260 million series 2021B GO refunding bonds and approximately $14.2 million series 2021C GO refunding bonds.

Unlimited ad valorem property taxes secure the series 2021B and 2021C bonds.

Officials will use series 2021B bond proceeds to refund the series 2012A bonds and 2021C bond proceeds to refund series 2011B, 2013B, and 2014A bonds for debt service cost savings.The rating action reflects our view of the city's strong operating surplus in fiscal 2020, resulting in an increase in available general fund reserves from 13.6% in 2019 to 20.2% in 2020. Because of the COVID-19 pandemic, officials projected a possible $25 million revenue loss in fiscal 2020. However, management took significant, and successful, expenditure cuts midyear, the city's revenue came in much better than projected, leading to a $5.2 million surplus. As a result, we believe the city's fund balance is now in a stable position, given further surplus projections for fiscal 2021.

### Credit overview

Peoria, in central Illinois' Peoria County, is a regional employment center and metropolitan statistical area (MSA). Despite midyear fiscal 2020 projections that showed significant lost revenue due to COVID-19, management produced positive general fund results. We think this gain portends fiscal stability through the next few fiscal years, but these gains come against the backdrop of an outsized liability profile we think introduces heightened long-term budgetary pressure.

Debt service, actuarially determined pension contributions, and other postemployment benefit (OPEB) pay-as-you-go costs were 25% of adjusted governmental fund expenditures in fiscal 2020. We also think poorly funded pensions and a large OPEB liability will very likely increase during the next few fiscal years. Without meaningful pension funding gains and a firmer record of maintaining at least very strong budgetary flexibility while sustaining structurally balanced operating budgets, we consider the possibility of raising the rating to be limited.

Additional factors contributing to the rating include our view of Peoria's:

- Weakened economy due to high unemployment rates in 2020, though we view the economic score will likely improve in the future;
- Significant improvement in budgetary performance and flexibility after reporting a large operating surplus in fiscal 2020 and projecting another surplus in 2021;
- Strong management conditions evidenced by management making significant mid-year expenditure adjustments in order to achieve positive results; and
- Weak pension profile with significant underfunded long-term liabilities.

### Environmental, social, and governance (ESG) factors

We view the city's social and environmental risks as in line with sector standard. We believe there is a somewhat heightened governance risk as a result of the city's underfunded pension liabilities, which we believe represents a significant long-term budget pressure.

## Stable Outlook

### Downside scenario

We could lower the rating if the city were to inadequately fund long-term commitments, particularly pensions, such that it suggests credit quality is compromised sufficiently to warrant a lower rating. Such evidence might include chronic or material underfunding of police and firefighter pension funds related to Illinois' statutory requirements, or management's inability to fund growing pension costs while meeting current-year operating and capital needs. Additionally, if the city were to experience general fund drawdowns, a lower rating is likely.

### Upside scenario

We could raise the rating if management were to demonstrate a consistent current-year structurally balanced budget while managing accelerating pension costs and achieving material pension-funding gains. Due to the plans' current funding, coupled with the presence of a very large OPEB liability, management would likely need to sustain significant funding gains during multiple years before we consider raising the rating.

## Credit Opinion

### Economic profile that has deteriorated to weak due to elevated unemployment, though we expect improvement given current unemployment trends

Peoria is 150 miles southwest of Chicago in central Illinois. Despite losing Caterpillar Inc.'s corporate headquarters, along with 300 jobs, to the Chicago suburbs in 2017, Caterpillar remains the city and region's leading presence, with 12,000 employees. Other leading city employers are:

- OSF St. Francis Medical Center (13,500 employees),
- UnityPoint Health (4,991), and
- Methodist Medical Center Foundation (3,000).

Residents commute into nearby Bloomington and Normal for additional employment and business opportunities.

Peoria's economic score weakened temporarily given elevated unemployment levels in 2020, spurred by the pandemic. Because of a statewide stay-at-home order and social distancing guidelines, the county's unemployment spiked to 13.9% in July 2020, but gradually recovered, falling to 7.6% in August 2021. The annual unemployment rate was 10.4%, which triggers a negative adjustment in our criteria. Nevertheless, as economic recovery progresses, unemployment rates have remained below 10%. We anticipate the county's economic score will improve when 2021 unemployment rates are released given historical unemployment rates have been near state and national averages. Despite the economic characterization change, our holistic analysis acknowledges that county's figures do not accurately represent the macroeconomic conditions at the municipal level.

### Volatile revenue stream significantly outperformed midyear projections in fiscal 2020, resulting in budgetary performance and flexibility returning to strong levels

Fiscal year-end Dec. 31, 2020, results reflect the addition of $2.7 million to total governmental funds expenditures, representing the difference between city contributions to police and firefighter pension plans; this reflects the state's statutory standard of achieving 90% funding by fiscal 2040 and actuarially determined contributions that are calculated to reach 100% funding within 20 years.

We view the city's revenue structure as volatile, and this was our primary reason for placing the rating on negative; however, management produced a $5.3 million general fund surplus, due to positive revenue variances and eliminating various expenditures. The general fund revenue stream includes:

- State sales taxes (26%);
- Home-rule sales taxes (24%);
- State income taxes (12%);
- Hotel, motel, and amusement taxes (11%); and
- Service charges, fees, and fines (9%).

These revenue streams account for 82% of general fund revenue, not including other smaller volatile revenue streams. We note property taxes generate only 0.37% of the general fund budget.

In September 2020, management reported the general fund was down by $39.5 million due to COVID-19. To combat this lost revenue and achieve balanced results for fiscal 2020, Peoria quickly cut various operational and capital costs. Due to the swift measures to combat the potential of lost revenue, management was able to produce a surplus. Midyear cuts included:

- Deferring $26.7 million of capital projects;
- Reducing staff, including removing 47 full-time positions and 28 temporary positions;

- Offering early retirement incentives to eligible members of Illinois Municipal Retirement Fund (IMRF);
- Restructuring debt with Jan. 1, 2021, maturities;
- Offering firefighters a voluntary separation incentive; and
- Decommissioning two fire engines, resulting in cutting 22 firefighters.

Officials report the restructured fiscal 2021 budget shows projections of a $10 million general fund surplus, supporting our view that budgetary results have improved to strong levels; this is the primary driver of our returning the outlook back to stable. Management is reporting that state shared revenues are trending $10 million stronger than budget. Management is also projecting it will receive a total of approximately $46 million in federal stimulus money across fiscal years 2021 and 2022, which we imagine will likely improve budgetary results. Over the long term, we think increasing pension costs and sales-tax revenue growth will likely pressure budgetary performance; however, given the minimal impact of the COVID-19 pandemic on the revenue stream, we believe performance will remain strong.

We also note the introduction of the internet sales and cannabis taxes in Illinois should provide additional revenue to the city to mitigate sales-tax variations. Should the city become structurally imbalanced during the next few fiscal years, with no additional options to return to structural balance, we could lower the rating by multiple notches.

Available reserves include assigned and unassigned general fund balances, excluding assigned fund balance for OPEB. Management considers its loan to IMRF an assigned OPEB fund balance; therefore, budgetary flexibility does not reflect the loan.

Due to significant cost-cutting and projected lost revenue performing much stronger than expected throughout fiscal 2020, general fund available reserves have returned to a strong 20%, or $18.5 million. However, since nearly 30% of the city's budget centers on fixed pension and debt costs, coupled with major capital spending and staff cuts in fiscal 2020, it is our opinion the city will likely have limited capacity to cut spending in fiscal 2021 and possibly beyond, if the need arises.

In our opinion, Peoria's various debt issuance demonstrates its strong access to external liquidity. We do not think series 2016A variable-rate GO demand bonds pose a liquidity threat because a bank liquidity facility with standard events of default covers optional and mandatory tender provisions associated with the bonds.

### Strong management conditions supported by good policies and practices

Management prepares each year's rolling biennial budget with a sizable budgeting staff that uses historical data; input from various sources, including Bradley University; and zero-based budgeting. Management provides quarterly budget-to-actual and investment reports to the city council.

Other highlights include its:

- Monthly reports on budget-to-actual results to the council;
- Five-year financial projections, updated annually;
- Five-year capital improvement plan, updated annually;
- Council-approved investment policy, with quarterly reports to the council;

- Council-approved debt-management policy; and
- Reserve policy of maintaining an unassigned general fund balance of at least 25% of expenditures, a level the city is currently not meeting.

### Weak debt profile with additional debt plans not expected to have a material effect on the debt burden

Because just $8.4 million of debt bears interest at a variable rate, we do not consider interest-rate risk substantial.

Officials currently expect to issue $9.7 million of additional debt in 2023 for fire-protection and building related projects. However, we do not expect this will have a material effect on the city's debt profile.

### Weak pension profile with significant unfunded liabilities we believe will result in rising pension costs

- We consider pension and OPEB liabilities a budget pressure for the city because it has exposure to large unfunded liabilities and elevated fixed costs we expect will likely continue to increase, despite additional contributions.
- In particular, Peoria's two single-employer, defined-benefit, public-safety pension plans are poorly funded, which, coupled with actuarial assumptions and methods that defer costs, suggests fixed costs will likely continue to increase. If not proactively managed, this could increasingly pressure operations and lead to credit deterioration.
- The city funds retiree health care benefits on a pay-as-you-go basis, exposing it to some inflationary cost pressure.

At Dec. 31, 2019, the city participates in:

- Single-employer, public-safety plans for police and firefighters, which are 49% and 46% funded, respectively, with net pension liabilities totaling approximately $366 million across both plans;
- IMRF, a multiple-employer agent plan, which was 96% funded, with a net pension liability of $33 million; and
- Health insurance that allows retirees to remain on the city's group medical insurance plan with retirees paying all insurance premiums, creating an implicit subsidy for the city, which it funds on a pay-as-you-go basis.

Due to very low funding for the police, firefighter, and OPEB plans, and the magnitude of their net liabilities, we expect pension and OPEB costs will likely remain elevated and continue to increase during the next few fiscal years. In fiscal 2019, police and firefighter plan contributions were well below our static-funding metric, at 86% for the police plan and 78% for the firefighters plan; this means contributions were less than enough to cover the present value of current-year benefits and interest on unfunded liabilities. Both plans were also well short of our minimum funding progress metric, at 64% and 47%, respectively.

Net pension liabilities amortize based on a level percent of payroll, which, coupled with the plans' weak funding, implies actuarially determined contributions will likely continue to accelerate over the remaining amortization period; at fiscal year-end 2020, this was 21 years, assuming all assumptions are fully met.

### Strong institutional framework

The institutional framework score for Illinois home-rule cities and villages is strong.

## 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 22, 2021) | | |
|---|---|---|
| Peoria GO | | |
| *Long Term Rating* | A+/Stable | Outlook Revised |
| Peoria GO rfdg bnds ser 2015B due 01/01/2027 | | |
| *Long Term Rating* | A+/Stable | Outlook Revised |
| Peoria GO (AGM) | | |
| *Unenhanced Rating* | A+(SPUR)/Stable | Outlook Revised |
| Peoria GO (BAM) | | |
| *Unenhanced Rating* | A+(SPUR)/Stable | Outlook Revised |
| Peoria GO (BAM) | | |
| *Unenhanced Rating* | A+(SPUR)/Stable | Outlook Revised |
| Peoria GO (BAM) | | |
| *Unenhanced Rating* | A+(SPUR)/Stable | Outlook Revised |
| Peoria GO (BAM) | | |
| *Unenhanced Rating* | A+(SPUR)/Stable | Outlook Revised |
| Peoria GO (BAM) | | |
| *Unenhanced Rating* | A+(SPUR)/Stable | Outlook Revised |
| Peoria GO (BAM) | | |
| *Unenhanced Rating* | A+(SPUR)/Stable | Outlook Revised |
| Peoria GO (BAM) (SECMKT) | | |
| *Unenhanced Rating* | A+(SPUR)/Stable | Outlook Revised |
| Peoria GO (BAM) (SECMKT) | | |
| *Unenhanced Rating* | A+(SPUR)/Stable | Outlook Revised |
| Peoria GO (BAM) (SECMKT) | | |
| *Unenhanced Rating* | A+(SPUR)/Stable | Outlook Revised |
| Peoria GO (BAM) (SECMKT) | | |
| *Unenhanced Rating* | A+(SPUR)/Stable | Outlook Revised |
| Peoria GO (BAM) (SECMKT) | | |
| *Unenhanced Rating* | A+(SPUR)/Stable | Outlook Revised |
| Peoria GO (FGIC) (National) | | |
| *Unenhanced Rating* | A+(SPUR)/Stable | Outlook Revised |
| Peoria MISCTAX | | |
| *Long Term Rating* | AA-/Stable | Outlook Revised |

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed