Sales Tax Securitization Corporation (STSC)

Issuer: Sales Tax Securitization Corporation		
Affirmed	**Rating**	**Outlook**
Sales Tax Securitization Bonds	AAA	Stable
Second Lien Sales Tax Securitization Bonds	AA+	Stable

Methodology:

Public Finance: U.S. Special Tax Revenue Bond Rating Methodology

ABS: General Global Rating Methodology for Asset-Backed Securities

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Rating Summary: KBRA has affirmed the long-term ratings assigned to the Sales Tax Securitization Corporation (the Corporation) Sales Tax Securitization Bonds at AAA and Second Lien Sales Tax Securitization Bonds at AA+. The outlook remains stable.

The COVID-19 pandemic and resulting restrictions on business and leisure activity have had a significant impact on sales tax collections in the City of Chicago. Since the bonds are secured solely by sales taxes, KBRA has analyzed the ability of the pledged revenues to continue to support debt service obligations amid a severe economic stress.

KBRA modeled a range of breakeven coverage scenarios to demonstrate the magnitude of pledged revenue declines that the Corporation can experience before compromising debt service obligations. We concluded that pledged revenues could withstand sustained monthly declines in pledged revenue versus last year of nearly 84% commencing in mid-June through year-end before reaching 1.0x debt service coverage. This scenario mirrors the timing of the current crisis because revenues received by the Trustee lag economic activity by 3 months, with the impact from the mid-March implementation of emergency measures to contain the spread of the virus anticipated to be reflected in June pledged revenue receipts. This tolerance dramatically exceeds overall national estimates of retail sales declines of 19.9% in April and 6.1% May[1] – which though not a perfect match with Chicago area specific sales tax collections, does serve as a reasonable proxy of magnitude.

The bonds and second lien bonds are secured by first and second liens, respectively, on the pledged sales tax revenues which have been previously sold by the City of Chicago to the Corporation, a bankruptcy remote special purpose entity, pursuant to State law and a Sale Agreement. The Corporation was established to facilitate the refinancing of outstanding higher cost City of Chicago general obligation and sales tax revenue debt. As of June 1, 2020, there was approximately $2.64 billion of Bonds and $1.02 billion of Second Lien Bonds.

There is no debt service reserve fund requirement for either lien. However, the Indenture directs the Trustee after paying the Corporation's capped operating expenses, to set aside 150% of the monthly accrual of interest, and then 150% of 1/12th of the annual principal due on the senior lien bonds. After payment of all monthly senior debt service, the Corporation is required to deposit 120% of 1/12th of the monthly accrual of second lien interest, then 120% of 1/12th of the annual second lien principal requirements. For the senior lien bonds, this results in the accumulation of semi-annual interest requirement in month four and month ten instead of months six and twelve, respectively, while the annual principal requirement is accumulated in month eight instead of month twelve. Similarly, because of the 120% deposit requirement described above, the semi-annual second lien interest requirements are accumulated in months five and eleven and the annual second lien principal requirement is accumulated in month ten. These early accumulations allow the Corporation to withstand greater reductions in pledged revenues than would a schedule of even monthly set-asides.

The Stable Outlook reflects KBRA's expectation that even under severe economic downturns and other stressful scenarios, the pledged sales tax revenues will remain more than sufficient to meet timely principal and interest requirements on the Corporation's debt. Furthermore, even in the unlikely event of City insolvency or bankruptcy, KBRA believes the assets of the Corporation, including the right to the pledged revenues, will not be consolidated with the City's assets and the cash flow supporting the Corporation's debt will not be disrupted.

[1] U.S. Census Advance Monthly Retail Trade Report for May 2020.

Key Credit Considerations

KBRA continues to monitor the direct and indirect credit impacts of COVID-19. Please refer our ongoing publications on the top topic **here** for more information.

The ratings were affirmed because of the following key credit considerations:

Credit Positives

- The combination of State law, the bankruptcy remoteness of the Corporation, the Sale Agreement, and the Indenture provide the Bonds with a strong legal framework that KBRA believes will insulate the pledged sales tax revenues and the Corporation from the operating and credit conditions of the City.
- The broad base of goods and services included in the pledged revenues combined with a long track record of collection and distribution mechanics provide for strong underlying asset characteristics.
- Additional bonds test of 4.0x on senior and 1.75x on junior obligations prevents the Corporation from diluting the substantial cushion provided by the pledged revenues.
- Chicago's deep, diverse, and resilient underlying economic base supports substantial residential and tourist retail activity.
- Strong projected coverage of monthly deposit and annual debt service requirements that withstand KBRA's stress scenarios.

Credit Challenges

- Economic headwinds tied to COVID-19 will reduce revenues in the near to medium term.
- The high overall sales tax rate in the City may weaken growth of the pledged sales tax revenues.

Rating Sensitivities

• N/A	+
• A significant decline in pledged sales tax revenues that results in material weakening of debt service coverage ratios.	-

ESG Considerations

When relevant to credit, ESG factors are incorporated into the credit analysis in the same manner as all other credit-relevant factors. Among the ESG factors that have impact on this rating analysis are:

- Discussions in RD 1 of our **report** published January 13, 2020 reflect Governance Factors. KBRA has examined the STSC's revenue-raising flexibility and policies and practices that limit over leveraging the pledged sales tax revenues as well as ensure ample debt service coverage for the benefits of bondholders.
- Discussions in RD 3 of said report reflect Social Factors such as population and demographic changes, education, employment trend, income profile, and poverty levels in the service area.

More information on ESG Considerations for the Public Finance sector can be found **here**.

Building Upon Prior Stress Analysis

Stress scenarios presented in KBRA's prior January 2020 **report** considered the long-term impact of extremely adverse exogenous sales tax revenue impacts on bond repayment. With the advent of shelter in place, and non-essential business closures, KBRA re-examined the near-term tolerance of the transaction to withstand sharp reductions in pledged revenues. Available sales tax data does not yet reflect Coronavirus related headwinds as the Corporation discloses pledged revenue data on a quarterly basis. Furthermore, due to the aforementioned three-month lag between retail activity and when the corporation receives the associated revenues, we may not have a clear picture of pledged revenue performance through the height of the shelter in place orders for some time. With this in mind, KBRA applied a range of breakeven coverage scenarios to evaluate the tolerance of the two liens to withstand sustained revenue declines.

Breakeven Debt Service Coverage Analysis

In the most relevant scenario, KBRA applied the breakeven revenue stress in mid-June (three months after the mid-March implementation of social distancing measures) through year end against actual 2020 (BYE 1/1/2021) debt service requirements.

Shown in Figure 1, same month year over year pledged revenues would need to decline by nearly 84% commencing in mid-June through year end before a payment deficiency would occur. In this analysis, the Corporation would experience shortfalls relative to the interest and principal set-aside requirements in the months of July through November (highlighted below in red), which would be made up by the end of December, just in time for the 1/1/2021 semi-annual bond payment date. The two yellow highlighted boxes in the center of the figure illustrate sufficiency of funds leading

up to the July 1 and January 1 interest payment dates, while the bottom right yellow highlight indicates a nominal $1,000 deficiency ahead of the 1/1/2021 payment illustrating, for demonstrative purposes, a revenue decline just past the breakeven coverage point.

FIGURE 1

Breakeven Cashflow Analysis for Actual 2020 DS Debt Service and Revenue Stress Applied Mid-June through December (dollars in thousands)

2020 (Bond Year Ending January 1, 2021)

	Pledged Revenues					First Lien Interest						First Lien Principal					
	2019 Gross Revenues	Δ YoY	2020 Gross Revenues	Less Admin Fee	2020 Net Revenues	Set Aside Requirement	Surplus (Deficit) After Setaside	Accumulated Shortfall Before Application of Surpluses	Application of Current Month Surplus to Accumulated Shortfall	Accumulated Shortfall at End of Month	Revenues Available After Senior Interest Set Aside	Set Aside Requirement	Surplus (Deficit) After Setaside	Accumulated Shoftfall Before Application of Surpluses	Application of Current Month Surplus to Accumulated Shortfall	Accumulated Shortfall, If Any, At End of Month	Revenues Available After Senior Principal Set-Aside[1]
January	61,216	6.18%	64,997	250	64,747	14,728	50,020	-	-	-	50,020	394	49,626	-	-	-	49,626
February	58,577	1.68%	59,559	-	59,559	14,728	44,832	-	-	-	44,832	394	44,438	-	-	-	44,438
March	67,115	4.48%	70,123	-	70,123	14,728	55,395	-	-	-	55,395	394	55,001	-	-	-	55,001
April	47,204	0.00%	47,204	-	47,204	14,728	32,477	-	-	-	32,477	394	32,083	-	-	-	32,083
May	49,398	0.00%	49,398	-	49,398	-	49,398	-	-	-	49,398	394	49,004	-	-	-	49,004
June	59,656	-41.95%	34,632	-	34,632	-	34,632	-	-	-	34,632	394	34,238	-	-	-	34,238
July	58,068	-83.89%	9,352	-	9,352	14,728	(5,375)	(5,375)	-	(5,375)	-	394	(394)	(394)	-	(394)	-
August	62,154	-83.89%	10,010	-	10,010	14,728	(4,717)	(10,092)	-	(10,092)	-	394	(394)	(788)	-	(788)	-
September	63,816	-83.89%	10,278	-	10,278	14,728	(4,449)	(14,542)	-	(14,542)	-	-	-	(788)	-	(788)	-
October	62,149	-83.89%	10,010	-	10,010	14,728	(4,718)	(19,260)	-	(19,260)	-	-	-	(788)	-	(788)	-
November	62,398	-83.89%	10,050	-	10,050	-	10,050	(19,260)	10,050	(9,210)	-	-	-	(788)	-	(788)	-
December	62,069	-83.89%	9,997	-	9,997	-	9,997	(9,210)	9,210	-	787	-	787	(788)	787	(1)	-
Total	**713,820**		**385,611**		**385,361**												
		Revenue Stress Applied 83.89%				**Annual Interest** 117,820						**Annual Principal** 3,150					

[1]Revenues available each month after First Lien interest and principal set asides continue to flow through the flow of funds to required Second Lien interest and principal set-asides, and any previously accumulated set-aside shortfalls thereof. Excess funds thereafter are transferred to the City and are not available for set-aside shortfalls occurring in subsequent months.

Note: Yellow highlighted boxes reflect periods ending upon bond interest and principal payment dates. Negative values indicate a shortfall in resources needed to pay debt service when due.

It is noted that annual debt service requirements across the two liens are scheduled to increase from $121 million in the bond year ending 1/1/2021 to $262 million in the bond year ending 1/1/2024, with no principal or interest due on second lien obligations until the bond year ending 1/1/2024. This structure accommodates a post-pandemic recovery and a potentially slow recessionary rebound.

To assess the capacity of bonds to withstand pledged revenue reductions outside of the current context as well as the sensitivity of the coverage breakeven point to the month that revenue stress commences, KBRA modeled a matrix of coverage breakeven scenarios with: (i) revenue stresses commencing at five different periods in the year; and, (ii) recognizing the escalating debt service schedule and potential for further leveraging of the two liens, three debt service scenarios to illustrate breakeven coverage points across debt service scenarios including:

- Actual 2020 Debt Service (BYE 1/1/2021);
- Actual 2023 Debt Service (BYE 1/1/2024), illustrating revenue decline tolerances relative to 2019 collections for the two liens in a more typical "Normal Year" of the existing debt service schedule; and,
- A hypothetical scenario in which the first and second lien have been leveraged up to their respective 4.00x and 1.75x coverage additional bonds tests based on 2019 revenues, through the issuance of $360 million in additional First Lien Bonds and $5 billion in additional Second Lien Bonds. Level debt service requirements commencing this year were assumed.

FIGURE 2

Revenue Decline to Breakeven Coverage Matrix

	Actual 2020 DS (BYE 1/1/2021)		Actual 2023 DS (BYE 1/1/2024) "Normal Year"		DS Assuming Leverage to Full First and Second Lien ABT	
Revenue Stress Period	First Lien	Combined First and Second Lien[1]	First Lien	Combined First and Second Lien	First Lien	Combined First and Second Lien
January to December	82.76%	na	76.10%	63.21%	74.97%	42.84%
April to December	83.89%	na	79.79%	67.57%	78.72%	48.37%
Mid June to December	83.89%	na	80.87%	69.89%	78.72%	49.21%
July to December	83.89%	na	80.87%	69.89%	78.72%	49.21%
October to December	92.11%	na	92.41%	85.39%	90.82%	69.08%

[1]Amortization structure for Second Lien bonds includes no principal repayment and capitalized interest in the bond year ending 1/1/2021.

In the 2023 debt service scenario, pledged revenue could withstand an 80.87% decline beginning in mid-June before reaching 1.00x coverage on first lien bonds and an also very large 69.89% decline before reaching 1.00x coverage on a combined lien basis.

Furthermore, in the full leverage scenario, pledged revenues could withstand a 78.72% decline commencing in mid-June before reaching 1.00x coverage on first lien bonds and a smaller but still very extreme 49.21% decline before reaching 1.00x coverage on a combined lien basis.

Conclusion

While significant sales tax revenue declines are anticipated, KBRA's expectation is that reductions will not approach these modeled declines. Based upon this assessment, KBRA views both liens as very well positioned to weather the impact of the ongoing COVID-19 crisis while providing ample coverage of annual debt service requirements.

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