FitchRatings

Fitch Rates Chicago Sales Tax 2nd Lien 'AA-'; Downgrades 1st Lien on Criteria Change; Outlook Stable

Fitch Ratings - New York - 14 January 2020:

Fitch Ratings has assigned a 'AA-' rating to the following Chicago Sales Tax Securitization Corporation, IL (the corporation) bonds:

--$602.9 million second lien sales tax securitization bonds, series 2020A;

--$309.1 million second lien sales tax securitization bonds, taxable series 2020B.

Fitch has also downgraded the following first lien bonds to 'AA-' from 'AAA' due to a criteria change:

--$169.1 million sales tax securitization bonds, series 2017A;

--$400.6 million sales tax securitization bonds (taxable), series 2017B;

--$171.0 million sales tax securitization bonds (taxable) series 2017C;

--$376.3 million sales tax securitization bonds, series 2018A;

--$304.0 million sales tax securitization bonds (taxable), series 2018B;

--$612.4 million sales tax securitization bonds, series 2018C;

--$605.4 million sales tax securitization bonds (taxable), series 2019A.

The Rating Outlook is Stable.

SECURITY

The sales tax securitization bonds have a lien on the state-collected portion of the city's home rule sales and use taxes and the local share of the state-wide sales and use taxes; the second lien bonds are secured by a lien that is subject to and subordinate to the first priority lien securing the first lien bonds issued and to be issued by the corporation.

ANALYTICAL CONCLUSION

Solid revenue growth prospects and very strong resilience of the dedicated tax security contribute to the 'AA-' rating for the second lien subordinate bonds. The bankruptcy-remote, statutorily defined nature of the issuer and a bond structure including a true sale of the sales tax revenues are key credit strengths that allow a rating of up to six notches above the city of Chicago (Issuer Default Rating [IDR] of BBB-/Stable).

The downgrade of the first lien bond rating to 'AA-' from 'AAA' reflects a change in Fitch's 'U.S. Public Finance Tax Supported Rating Criteria' (January 2020), which limits the rating for true sale structures to a maximum of six notches above the associated government's IDR. The 'AA-' ratings for both the first and second lien bonds are, therefore, limited to six notches above the city of Chicago's IDR of 'BBB-'. The ratings for both liens would be higher absent the rating cap. For more information on the rationale for developing a notching relationship between IDRs and corporations' security ratings, please see "Feedback Report: Comments on Exposure Draft: U.S. Public Finance Tax-Supported Rating Criteria," (January 2020).

KEY RATING DRIVERS

Solid Growth Prospects: Sales tax revenues have been growing at a solid rate, above the rate of inflation and below U.S. GDP growth. While area-wide tax increases may pressure revenue stream growth in the near term, Fitch expects solid growth over the medium-to-long term.

Very Strong Financial Resilience: The revenue stream is very resilient to anticipated declines in an economic downturn scenario, able to tolerate a 34% decline before reaching 1x coverage of aggregate maximum allowable leverage.

Sound Economic Resource Base: Chicago serves as the economic and cultural center for the Midwestern region of the U.S. Socioeconomic indicators are mixed with elevated individual poverty rates but above average per capita income levels and strong educational attainment levels.

RATING SENSITIVITIES

Material Decline in Coverage: Fitch's dedicated tax analysis demonstrates that the bond structure, including a conservative additional bonds test, provides for solid financial resilience relative to revenue declines envisioned in a normal economic downturn as well as the largest historical decline. Severe declines of a scale beyond Fitch's expectations could pressure the rating.

City IDR Constrains Ratings: The ratings are constrained to a maximum of six notches above the city's IDR of 'BBB-.' A change in the city's IDR would cause a change to the corporation's sales tax ratings.

ECONOMIC RESOURCE BASE

Economic Resource Base

The city's population totaled 2.7 million in 2018, up less than half a percent from the 2010 census, and accounts for 21% of the state's population. 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 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.

DEDICATED TAX CREDIT PROFILE

Strong Legal Framework: The bankruptcy-remote, statutorily defined nature of the issuer and a bond structure involving a true sale of the pledged sales tax revenues are key credit strengths that lead Fitch to assign a bond rating at the maximum permitted by criteria of six notches above that of the city of Chicago. The city has sold all right, title and interest in the pledged revenues to the corporation, a limited purpose entity. The state directs all pledged sales tax revenues to the trustee for the benefit of bondholders and the residual flows to the city for any lawful purpose.

Pledged revenues include the portions of the city's home rule sales taxes that are collected by the state as well as its local share of state sales taxes, some of which are subject to state appropriation. Fitch excludes the taxes that are subject to appropriation in its analysis because their value is limited to one notch below the state's 'BBB' IDR, while recognizing that the 1.75x subordinate lien additional bonds test includes all pledged revenues, including those subject to appropriation. This yields an effective ABT of approximately 1.5x, based upon the composition of 2018 revenues.

The pledged home rule sales and use taxes comprise three separate taxes: a 1.25% Home Rule Municipal Retailers' Occupation Tax on most non-titled tangible personal property, a 1.25% Home Rule Municipal Service Occupation Tax on tangible personal property purchased from a service provider, and a 1.25% Home Rule Municipal Use Tax on Titled Personal Property. There is no legal limit to the rate the city may impose for these. Some of the pledged revenues collected by the state are net of a 2% administrative fee imposed by the state.

The pledged local share sales tax revenues comprise four separate taxes. They include: the Illinois Retailers' Occupation Tax (city portion is currently equivalent to 1% of sales within the city); Illinois Service Occupation Tax (city portion is currently equivalent to 1% of sales within the city); Illinois Use Tax (city receives 4% of net receipts of a 6.25% tax on most non-titled personal property purchased outside of the state and 20% of a statewide 1% tax on grocery food, drugs and medical appliances purchased out of state); and the Illinois Service Use Tax (city receives 4% of net receipts of a statewide 6.25% tax on most tangible personal property purchased from a service provider and 20% of a statewide 1% tax on grocery food, drugs and medical appliances purchased from a service provider). Any changes to the tax rates or allocation of local share sales tax revenues would require action by the Illinois General Assembly. A portion of the Illinois Use Tax and Illinois Service Use Tax are subject to appropriation by the Illinois General Assembly and together represent about 12% of pledged revenues; the Illinois Retailers' Occupation Tax and the Illinois Service Occupation Tax are not subject to appropriation.

The authorizing act assures that the state "will not limit or alter the basis on which transferred receipts are to be paid to the issuing entity as provided in this Article, or the use of such funds, so as to impair the terms of any such contract."

Pledged Revenue Growth Prospects

Pledged revenues have grown at a solid rate, with a 10-year CAGR above CPI but below growth in U.S. GDP. The city's sales tax rates have been very stable, with the most recent rate increase recorded in 2005. Several overlapping units of government also levy sales taxes. An increase by Cook County may have affected demand and contributed to a slowdown in the city's receipts in 2016 and imposition of state fees have affected results since 2017. Pledged revenues (excluding the portion subject to state appropriation) grew by 3.1% in 2018 and preliminary estimates for 2019 indicate 2.1% growth.

Revenue Stream Sensitivity and Resilience

To evaluate the sensitivity of the dedicated revenue stream to cyclical decline, Fitch considers both revenue sensitivity results (using a 1% decline in national GDP scenario) and the largest decline in revenues over the period covered by the revenue sensitivity analysis. Based on the historical performance of pledged sales tax revenues, net of those subject to appropriation that are excluded from the analysis, the Fitch Analytical Stress Test (FAST) model generates a moderate 3.6% scenario decline. The largest cumulative decline was 11.2% between 2007 and 2009.

Assuming the revenue stream is leveraged to the maximum amount allowed under the 1.75x subordinate lien additional bonds test, non-appropriated pledged revenues could withstand a 34% decline before they were insufficient to fully cover combined maximum allowable debt service. This is 3.0x the largest actual historical cumulative decline, or 9.4x the recessionary impact estimated in Fitch's FAST scenario, consistent with a 'aa' assessment of resilience.

The first lien bond structure exhibits stronger resilience; non-appropriated pledged revenues could withstand a 71% decline to 1x coverage. This is 6.3x the largest actual historical cumulative decline, or 9.4x the FAST scenario impact, consistent with a 'aaa' resilience assessment.

Recent and potential future tax rate increases by Chicago area governments could negatively affect demand, and thus the pledged sales tax receipts; even so, Fitch believes sales tax revenue performance will benefit from economic growth and inflation and continue to support very strong financial resilience.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

Public Ratings with Credit Linkage to Other Ratings

The ratings are capped at a maximum of six notches above the city of Chicago IDR.

RATING ACTIONS

ENTITY/DEBT	RATING		PRIOR
Chicago Sales Tax Securitization Corporation (IL)			
Chicago Sales Tax Securitization Corporation/Sales Tax Revenues/1 LT	LT AA- Downgrade		AAA
Chicago Sales Tax Securitization Corporation (IL) /Sales Tax Revenues - Second Lien/1 LT	LT AA- New Rating		

Additional information is available on www.fitchratings.com

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Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (pub. 10 Jan 2020)

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