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Fitch Rates Chicago Housing Authority, IL GO Bonds 'AA-'; Outlook Stable.

Fitch Ratings-New York-30 August 2018: Fitch Ratings has assigned a 'AA-' rating to the Chicago Housing Authority's (CHA) 2018 A & B general obligation (GO) bonds. The Rating Outlook is Stable.

CHA expects to issue its series 2018 A&B bonds in the amount \$325 million during the week of Sept. 4, 2018. Proceeds of the series 2018 A&B bonds will be used to finance certain capital costs of the authority and related projects within its portfolio. In addition, the proceeds will be used to fund the debt service reserve fund and pay the cost of issuance.

SECURITY

The series 2018 AB bonds are secured by the general obligation pledge of CHA.

ANALYTICAL CONCLUSION

CHA's rating reflects continuing demand for public and affordable housing within the city of Chicago. In addition, CHA exhibits stable and predictable revenue and cash flow derived from its rented properties, as well as public housing grants. It further exhibits strong and prudent management of operations evidenced by its management of finances and its good standing with the federal oversight provided by the Housing and Urban Development (HUD).

KEY RATING DRIVERS

Revenue Defensibility: Midrange

Fitch assesses CHAs revenue defensibility as midrange given the authority's pricing characteristics. Although, Fitch expects demand to remain strong within the city of Chicago, CHA has limited flexibility to raise rates on its existing portfolio given income and rental rate limits for public housing. CHA shows healthy occupancy (95%) and turnover within its housing properties. Demand is evidenced by the authority's current waiting list of 108,922 Chicago residents in need of low income housing. In addition, CHA operates with a collection rate of 99% of tenant rent. It also manages a housing choice voucher (HCV) program, which allows the authority to house an additional 47,000 tenants. This program permits residents to take their affordability voucher to units outside of the CHA portfolio, fulfilling its mission of providing affordable housing to the city.

Operating Risk: Stronger

CHA's 'stronger' operating risk is supported by its designation as one of 39 Moving-To-Work (MTW) PHAs, which allows for flexibility and fungibility in the use of its intergovernmental grants from HUD for cost efficiency. Participation in the rental assistance demonstration (RAD) further provides greater funding certainty for potential lenders and increased operational flexibility for the authority. Strong resource management is also reflected in CHA's year-over-year funding from HUD and its recently renewed MTW status through 2028; both indicate the oversight agency's view of the authority's overall management capabilities.

Financial Profile: Stronger

Low debt levels, healthy cash balances and net annual surpluses over the last five years support CHA's 'stronger' financial profile. The authority's business plan forecasts positive funds available for debt service (FADS) as they continue to transform nearly 44% of its public housing portfolio units to Section 8 and mixed-income properties through the RAD conversion program, where rent rates may become more flexible. Despite anticipated debt issuance, Fitch expects CHA's net leverage to remain consistent with the assessment over the next five years.

Asymmetric Additive Risk Factors

Asymmetric risk factors are neutral to the rating. Debt characteristics are manageable with level debt service payments. In addition, the governing body is solid with sound extensive experience and stability.

RATING SENSITIVITIES

Lower Grants and Transfers: CHA could be subject to negative rating pressure if a consistent decline in grants and transfers were to weaken funds available for debt service and increase the authority's leverage ratio.

CREDIT PROFILE

CHA was created in 1937 to own and operate housing built by the federal government under President Franklin Roosevelt's Public Works Administration. CHA is one of the largest PHA's in the United States with 21,359 housing units in 117 properties. The first three housing projects, built in the late 1930s, included Jane Addams, Julia C. Lathrop and Trumbull Park Homes. They were all part of Roosevelt's New Deal programs to provide affordable housing for low-income families and combat blight.

CHA provides homes to more than 50,000 families and individuals, while supporting healthy communities in neighborhoods throughout the city. It has utilized the flexibility of the MTW agreement to test innovative, locally-designed strategies that use federal dollars to more efficiently help residents become self-sufficient and to increase housing choices for low-income families. In 2000, 15% of work-eligible heads-of-household were employed. Now more than 58% are employed. CHA is a municipal not-for-profit corporation, governed by a Board of Commissioners consisting of 10 members. The commissioners are appointed by the Mayor.

The authority is one of 40 (out of 3,300) public housing agencies participating in HUD's MTW Demonstration Program. The authority's original MTW Demonstration Agreement was executed with HUD in February 2000 and was amended and restated in 2008. Congress extended the authority's agreement through 2028. The MTW Agreement gives the authority latitude in implementing its transformation plan via the exemptions from many existing HUD related public housing and voucher rules, and allows for more flexibility with how they use federal funds. In addition, it incorporates numerous waivers and modifications of HUD administrative, regulatory and/or legal requirements which further support the authority's transformation plan.

Revenue Defensibility

Demand for public housing remains strong within the city of Chicago and any changes in the rents that PHA's are able to charge would be unlikely to materially affect demand. CHA recently completed their five-year strategic plan along with a five-year capital and operating program. This plan expands from 2018-2022. The authority has delivered a diverse range of housing assets that are high quality and in high demand. As of June 30, 2018, the authority has delivered approximately 24,000 units towards its goal. The overall portfolio is comprised of approximately 11,000 family units, 11,000 senior/elderly units, and 2,000 supportive housing units. The authority plans to deliver an additional 1,000 units in 2018 for an overall total of 25,000 housing units. Average occupancy for

the units over the past three has been at 96.7%.

CHA administers 47,000 housing choice vouchers, which accounts for 92% utilization rate of the program. Based on the Institute for Housing Studies at DePaul University in Chicago report, "2018 State of Rental Housing in Cook County," the growth in renters is leveling off, but there are still about 182,000 more people who need low-cost housing than there are affordable apartments in Cook County. The report explains that since 2012, the number of affordable rental units in Chicago has declined by more than 10% while demand for affordable housing has declined by less than 5% over the same period. CHA had a total of 108,922 households on their waitlists at the beginning of FY 2018.

Given the core mission and industry standard for rental rates for PHAs, CHA's pricing characteristics coupled with the makeup of its current portfolio drive the authority's midrange revenue defensibility. Like all PHAs within the U.S. with public housing or Section 8 units, rental rates are set using residents income levels to create affordability. This limits flexibility in raising revenue through rental income.

Currently, rental income is roughly 5% of CHAs total revenue, which is in line with industry standards. CHA sets its rental rates using HUD guidelines. HUD sets the lower income limits at 60% and very low income limits at 30% (for public housing) of the area median income (AMI) for the county or metropolitan area in which residents reside. CHAs current portfolio consists of 23,810 public housing units.

The authority applied for, and HUD accepted, applications for CHA to participate in the RAD program allowing the conversion of over 10,000 of its public housing units to project based Section 8 with 20-year housing assistance payment (HAP) agreements, or to mixed-income properties utilizing HCVs. To date CHA has converted 2,815 units to RAD. Upon transformation of the portfolio Fitch expects that CHA will have more flexibility in the pricing characteristics as revenue from the properties, via partnerships with private developers as an equity member, show a return on the units from either mixed-income properties or fees associated with administering the PBV or HCV programs that will maintain affordability in the converted units.

The income levels for those units converted must adhere to other HUD regulated programs such as section 8 and low income housing tax credit (LIHTC). Those projects are likely to have eligible income limits of 60% of AMI for units deemed affordable. CHA's overall conversion of public housing units to RAD will become realized within the next two to five years as projects are converted.

Operating Risk

CHA, like all public housing authorities in the U.S., receives an operating grant deposited into the authority's operating fund. The operating fund is available by formula distribution to PHAs to cover operating and management costs. Funding eligibility is offset by the amount of expected tenant rental revenue. In FY 2017 CHA received a total of \$178 million for operations. CHA has received a five-year average operating grant in the amount of \$170 million. The cost to operate the units and the grant provided fluctuates based on the number public housing units in the portfolio along with the overall budget allocations to HUD programs from the appropriations committee within congress. While the HUD grant is not anticipated to cover the entire operating cost for the authority, it covers a very significant portion, on average 85% operating expenses from 2013-2016.

CHA can use operating funds for operating and management costs, including administration, routine maintenance, anti-crime and anti-drug activities, resident participation in management, insurance costs, energy costs, and costs, as appropriate, related to the operation and management of mixed

finance projects, as well as repayment of debt service to finance rehabilitation and development of public housing units. CHA has full discretion in how it allocates this grant in its operating fund. CHA may leverage operating funds to make capital improvements through the operating fund financing program by pledging a portion of their operating reserves to make future debt service payments. CHA may also leverage operating funds to enter into energy performance contracts, by pledging, in accordance with section 30 of the U.S. Housing Act of 1937 and, with HUD's approval, to use energy savings for debt service payments.

Resource Management Risk

CHA manages its resources via its MTW plan approved by HUD along with its five-year strategic plan. To obtain MTW status CHA had to demonstrate solid and robust financial management, allowing them the flexibility to expend the federal revenue stream that makes up 91% of the CHA's balance sheet, as they see fit. CHA has no supply constraints for labor or resources in terms of amount and cost. The authority's average number of employees was 651 in FY 2017 and is set to stay at this level. Wages and salaries are assumed to increase by 3% each year while fringe benefit rates are expected to remain unchanged. Total personnel costs were estimated at \$61.2 million in FY 2017. With increases CHA budgeted for FY 2018 a 4.7% increase over FY 2017. The authority's pension contribution is over 100% funded and has been at least 100% of the actuarially determined contribution for the past three years.

The preparation of the authority's Annual Budget is the culmination of a seven-month budget process, which begins in May and ends in November of each calendar year. CHA's budget is organized into 12 divisions: Executive Offices, Internal Audit, Legal Services, and Office of the Inspector General, Finance, Investment Management, Administration, Procurement, Property Office, Capital Construction & Development, Housing Choice Voucher and Resident Services.

CHA has demonstrated a history of successful capital planning and execution. The authority has adequate mechanisms for capital planning and funding, and has demonstrated generally effective management. Capex benefits from documented assessment and aligns to plan in a reasonable way. Capital expenses are primarily covered by a variety of funding mechanisms including the capital fund grant provided to the authority by HUD for capital projects. As CHA develops newer units the expense for capital repairs are expected to decline.

Financial Profile

CHA's available funds, defined as cash and investments not permanently restricted, have declined in recent years, but remained robust at \$224 million at year end 2017. CHA's liquidity cushion has remained well above 1.0x over the past five years.

Lower grant funding from HUD in FY 2017, as a result of prior overfunding, contributed to the decline in liquidity, as well as to lower Fitch-calculated FADS. Income generated from public housing activities has been relatively consistent year over year, with rental income from public housing being at or slightly above \$51M over the past five fiscal years. During the same period, the proportion of revenue from public housing rents has been between 5%-7% of total revenue. CHA, like most PHA-MTW authorities, receives more than 90% of their revenue from HUD subsidies in the form of various grants. Whereas CHA's FADS averaged approximately \$130 million over the period 2013-2016 reflecting consistently strong grant funding, lower funding in 2017 resulted in FADS of only \$59 million.

CHAs leverage profile has remained low in recent years as available funds have exceeded total debt obligations. Fitch's five-year forward scenario analysis indicates that the authority's leverage and financial profile should remain strong, even after considering the proposed issuance of the 2018AB

general obligation bonds. Fitch expects FADS to migrate higher toward historical levels beginning in 2018, based on year to date results, which should support a ratio of net debt to FADS of between 3.0x and 4.1x through 2022 even through a temporary stress in CHA's revenue base.

Asymmetric Additive Risk Factors Debt Profile

CHA issued \$25 million in taxable Build America Bonds (BABS) in FY 2010 that were special obligations of the authority. The bonds are fully amortizing and debt service is level at around \$1.80 million a year. The debt was backed by the full faith and credit of the CHA, consisting of all revenues and funds pledged for the payment of debt service. The bonds were issued to take advantage of HUDS energy use and cost reduction incentives. The proceeds were used for the removal of 50 year old boilers/controls domestic hot water heaters, asbestos abatement and disposal and demolition of existing equipment, such facilitates to be replaced by 85% efficiency boilers/controls and hot water heaters. This resulted in the installation of remote monitoring devices at 22 of the authority's developments affecting 4, 8111 residential units.

The authority maintains a \$20 million line of credit from Federal Home Loan Bank of Chicago at an interest rate not to exceed 2.5% for a period not to exceed 36 months from the time of lending. The line of credit is collateralized by cash and investments held by CHA. Proceeds from the line of credit are designated for the authority's unit acquisition program. In 2016, the Board approved a resolution to expand the use of funds borrowed under this line. There was an outstanding balance of \$3.0 million and \$3.35 million at Dec. 31, 2017 and 2016, respectively.

The authority also maintains an unsecured, \$20 million line of credit, from BMO Harris Bank N.A. at an interest rate not to exceed 2.0% for a period of 12 months. Proceeds from the line of credit are designated for the authority's acquisition of the former Presbyterian Homes senior housing units. There was an outstanding balance of \$20.0 million and \$19.0 million at Dec. 31, 2017 and 2016, respectively.

Governance and Management

CHA is governed by a 10 member board of commissioners including a board chairperson. Members are appointed by the Mayor and confirmed by City Council. At least two commissioners are CHA residents. In the last few years, numerous board members have been appointed in order to strengthen the board as well as due to members stepping down after reaching the maximum five-year term. Board members bring a broad range of experience and are deeply rooted in public service.

Day-to-day operations are managed by an executive team that includes the chief executive, chief operating officer, chief financial officer, chief investment officer, chief administrator, chief legal officer, chief development officer and chief property officer. Most of the executive staff joined CHA or have taken on their respective role since 2015. This is the result of a review to refocus the team on strategic change and to help drive their mission and build new partnerships involving people, process data and systems and to create a more efficient and effective structure. Each team member brings extensive experience reaching all facets of the sector and maintains a strong relationship with HUD and key stakeholders. The chief executive has over 35 years' experience in the industry and has recently renewed his contract with CHA for the next two years.

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

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