MOODY'S
INVESTORS SERVICE

Rating Update: Moody's downgrades Oak Lawn, IL's GO to A2; outlook remains negative

Global Credit Research - 24 Jun 2014

A2 applies to $70.8M of GO debt

OAK LAWN (VILLAGE OF) IL
Cities (including Towns, Villages and Townships)
IL

Opinion

NEW YORK, June 24, 2014 --Moody's Investors Service has downgraded to A2 from A1 the Village of Oak Lawn, IL's general obligation (GO) rating, affecting $70.8 million of rated GO debt; the negative outlook has been maintained. The bonds are secured by the village's general obligation unlimited tax pledge. The village has an additional $26.1 million of unrated debt outstanding, which was considered in the credit analysis.

SUMMARY RATINGS RATIONALE

The A2 rating reflects financial risk stemming from the village's elevated unfunded pension liabilities and statutory requirements that require the village to increase its contributions to two single-employer defined benefit pension plans to levels substantially above those of recent years. The village's operating reserves are narrow, but have improved recently; however, reserves have grown partly because the village has not made adequate pension contributions. The rating also incorporates the village's mature and relatively diverse tax base that is favorably located within the Chicago (Baa1 negative) metro area; favorable revenue raising flexibility afforded by its home rule status; and an elevated level of debt outstanding, of which 26% is comprised of variable rate debt, creating a moderate level of interest rate and liquidity risk.

The negative outlook is based on the potential for future budgetary imbalances, as the village must come into compliance with statutorily required contributions in fiscal 2016 or risk losing state shared revenues.

STRENGTHS

-Broad legal authority to levy property taxes and sales taxes as an Illinois home rule unit of government

-Mature and diverse tax base favorably located in the Chicago area

-Resident income indices exceed state and national medians

-Recent growth in operating reserves

CHALLENGES

-Budgetary pressure arising from the imperative to improve pension contributions in fiscal 2016

-Large unfunded pension liabilities

-Operating reserves remain narrow

-Recent declines in tax base value

-Elevated debt burden with moderate interest rate risk

DETAILED CREDIT DISCUSSION

SUBSTANTIAL UNDERFUNDING OF PUBLIC SAFETY PENSIONS

The village's contributions to its single employer police and fire pension plans have fallen far short of the

actuarially-determined annual required contribution (ARC) in recent years. In fiscals 2010 through 2012, the ARC was underfunded by 68%, 81%, and 71%, respectively. During this time period, the village underfunded its ARC by a cumulative $15.8 million, an amount more than double the size of its fiscal 2012 audited General Fund balance. Underfunding of its police and fire pension plans is estimated to have continued in fiscal 2013, with a $2.4 million contribution underfunding the ARC by a substantial $4.8 million, or 67% of the ARC. Based on estimated, but unaudited, financial reports, had the village fully funded the ARC in fiscal 2013, its finances would have been materially impacted, as the estimated underfunded amount in 2013 alone comprised 9.4% of General Fund revenues and 41.4% of General Fund balance.

Illinois Public Act 96-1495 requires cities and villages to make, at a minimum, annual contributions of an amount sufficient to bring public safety plans to a 90% funded ratio by 2040. Starting in fiscal 2016, state shared revenues may be diverted from local governments that do not comply with the requirement. The village has budgeted to increase its public safety funding contributions to 43% of ARC in fiscal 2014, and management may opt to divert additional revenues toward pension funding throughout the fiscal year, including $1.4 million currently earmarked for streets projects.

Management's goal for fiscal 2015 is to increase police and fire contributions to $6 million, or 75% of ARC. For fiscal 2016, management expects to contribute an amount equal to 90% of the ARC, in compliance with PA 96-1495. Based on the existing ARC, the fiscal 2016 contribution would be $7.2 million, however, we note that continued underfunding in fiscals 2014 and 2015 may contribute to further growth in the ARC by fiscal 2016. Officials have identified a variety of options to finance the contribution increases; however, many of the options require additional board action to put in place and/or may be politically unpopular. The village's ability to increase pension contributions is also hindered by the restrictive nature of its fire fighter's union contracts, which limit the village's ability to manage personnel costs.

In addition to the two single employer public safety pension plans, the village participates in one multi-employer agent plan, the Illinois Municipal Retirement Fund (IMRF). The village has consistently made all of its required contributions to IMRF. Inclusive of the three pension plans, Moody's 2010 to 2012 average adjusted net pension liability (ANPL) for the village, under our methodology for adjusting reported pension data, is $190 million, or 3.27 times operating revenues and 4.94% of full value. Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. The adjustments are not intended to replace village's reported liability information, but to improve comparability with other rated entities. The village also has a sizable unfunded other post-employment benefit (OPEB) liability of $28.4 million, or 94.5% of covered payroll, for retiree health care.

GENERAL FUND BALANCE RESTORED TO POSITIVE LEVELS, PARTLY THROUGH PENSION UNDERFUNDING

We believe that the village will remain pressured, despite the improving General Fund balance, due to still narrow reserves and expenditure pressures from increased pension costs in the coming years. After posting large deficits in fiscals 2009 and 2010, the village's General Fund balance was reduced to -$2.3 million (-6% of revenues) at the conclusion of fiscal 2010. The deficits were largely driven by declining economically-sensitive revenue streams, as well as public safety expenditure pressures associated with overtime and manpower issues that resulted in negative budget-to-actual variances. For fiscal 2011, the General Fund posted a surplus primarily due to sales tax revenues coming in above budgeted levels, as well as expenditure savings, including the underfunding of the village's contribution to the police and firefighters' pension plans. The surplus of $1.3 million, along with GASB 54 restatements of beginning balance, resulted in a General Fund balance of $712,000 or a narrow 1.5% of revenues. Notably, however, the unassigned balance was still negative at -$2 million due to $2.7 million of non-spendable advances made to support the village's tax increment funds. In fiscal 2011, the village utilized interfund loans to maintain a positive cash balance in its General Fund. The General Fund's interfund loans at the end of fiscal 2011 totaled $7.0 million.

In fiscal 2012, the village realized the sale of a parking lot to Target for $4.3 million and it increased sales tax revenues following the July 1st increase of its local sales tax rate to 0.75% from 0.50%. However, the village faced continued expenditure pressure from overtime costs in the fire department that exceeded budget by $1.1 million. The year ended with a substantial $6.1 million increase in General Fund balance to $6.6 million (12.7% of revenues), though the unassigned fund balance remained limited at only $2.7 million (5.2% of revenues). Notably, despite the large increase in General Fund balance in fiscal 2012, the General Fund net cash position declined modestly from fiscal 2011 to $1.4 million, or a narrow 2.7% of revenues, following the repayment of interfund loans borrowed in prior years to maintain a positive cash balance in the General Fund.

For fiscal 2013, the village adopted a balanced General Fund budget that includes $1.8 million of one-time revenues from the sale of a capital asset. Estimated fiscal 2013 results indicate a strong $4.3 million surplus was

realized. While overtime costs in the village's fire department were nearly $1 million over budget, positive variances in other areas led to surplus operations. The village received $2.1 million of unbudgeted building permit fees related to an expansion at Advocate Christ Medical Center. Additionally, sales tax collections unexpectedly rebounded to pre-recessionary levels and the village experienced positive expenditure variances due to open position freezes and outsourcing certain functions for cost savings. The village has implemented a balanced General Fund budget for fiscal 2014 and has increased the overtime budget for the fire department to $2 million, in line with past years' annual expenditures. Going forward, we will assess the village's ability to attain structural balance, without continued reliance on one-time budgetary items or underfunding of its single-employer pension plans.

MATURE AND RELATIVELY DIVERSE INNER-TIER CHICAGO SUBURB

We expect the village's tax base contraction will moderate in the near term, with modest growth expected as redevelopment continues. Located approximately 15 miles southwest of downtown Chicago, the village is favorably located with access to suburban employment centers. The village is relatively mature, primarily relying on redevelopment projects for tax base growth. The village's tax base, currently valued at $3.3 billion, has declined during non-assessment as well as reassessment years, with the most recent triennial reassessment occurring in 2012. This is largely related to overall depreciation in real estate values, both residential and commercial. Management reports Advocate Christ Medical Center, the village's largest employer, has undergone a $500 million expansion. A retail development at 111th and Cicero is also underway, anchored by a Mariano's grocery store. The April 2014 unemployment rate for the village is elevated at 7.8%, compared to 7.2% for the state and 5.9% for the US. Resident wealth levels, as indicated by the 2006-10 American Community Survey, are above average, with median family income at 115.5% of the US.

ABOVE AVERAGE DEBT BURDEN LARGELY SUPPORTED BY NON-PROPERTY TAX SOURCES

The village's debt burden is above average, at 2.7% of full value on a direct basis and 6.4% overall. The payout of debt is average, with 68.9% of principal paid in 10 years. Direct debt includes a $22.8 million bank loan issued in fiscal 2012, with a variable interest rate that resets monthly based on LIBOR + 1.15%. Proceeds from the note were used to purchase property for redevelopment, with the bulk of principal due at final maturity in August 2017. The village plans to retire the debt prior to maturity with proceeds from the expected sale of the property to developers plus tax increment and sales tax revenues derived from the development. While the variable rate poses moderate interest rate risk, the final maturity could pose a more substantial liquidity risk if the village either fails to sell the property or receives less than is needed to repay principal. Village management plans to extend the maturity with the issuing bank, Fifth Third Bancorp (senior unsecured Baa1 stable) or issue tax increment revenue bonds to refinance the loan if necessary. The village plans to issue water revenue debt in the mid to near term, but reports no other planned debt. We believe that the village's debt burden will continue to remain elevated in the near term.

OUTLOOK

The negative outlook is based on the potential for future budgetary imbalances, as the village must come into compliance with statutorily required contributions in fiscal 2016 or risk losing state shared revenues.

WHAT COULD MAKE THE RATING GO UP (REMOVAL OF THE NEGATIVE OUTLOOK)

- Pension funding at actuarially-sound levels, coupled with balanced General Fund operations

-Sustained growth in operating reserves

WHAT COULD MAKE THE RATING GO DOWN

-Inability to increase General Fund balance and liquidity without one-time revenue sources or underfunding of pension contributions

-Continued tax base contraction

-Inability to retire or refinance promissory note before maturity

-Further growth in the village's ANPL

KEY STATISTICS:

2013 Full valuation: $3.3 billion

2013 Estimated full value per capita: $57,854

2007-2011 American Community Survey median family income: 115.5% of US

Fiscal 2012 Available Operating Fund balance: 4.7% of revenues

5-Year Dollar Change in Operating Fund Balance as % of Revenues: -4.9%

Fiscal 2012 Net operating net cash balance: 2.4% of revenues

5-Year Dollar Change in Cash Balance as % of Revenues: -2.5%

Institutional Framework: "Aa"

Operating History: 5-Year Average of Operating Revenues / Operating Expenditures: 0.95

3-Year Average of Moody's ANPL / Full Value: 4.9%

3-Year Average of Moody's ANPL / Operating Revenues: 3.3x

Net Direct Debt / Full Value: 2.7%

Net Direct Debt / Operating Revenues: 1.5x

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was US Local Government General Obligation Debt published in January 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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Analysts

Andrea Stenhoff
Lead Analyst
Public Finance Group
Moody's Investors Service

Rachel Cortez
Additional Contact
Public Finance Group

Moody's Investors Service

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1653

Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
USA

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