

CREDIT OPINION

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Update

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Oak Lawn (Village of) IL

Update - Moody's Downgrades Oak Lawn, IL's GO to Baa2; Outlook Remains Negative

Summary Rating Rationale

Moody's Investors Service has downgraded to Baa2 from Baa1 the rating on the Village of Oak Lawn, IL's outstanding general obligation unlimited tax (GOULT) bonds. The village has \$79 million of GOULT bonds outstanding, of which \$57 million is rated by Moody's. The outlook on the rating remains negative.

The downgrade to Baa2 is largely based on the village's very high and growing pension burden coinciding with a weak financial position and budgetary risk posed by the village's weak pension contribution practices. The rating also incorporates the village's broad legal flexibility to raise local taxes but limited willingness to apply that authority. Further considered in the rating are the village's moderately-sized tax base, average demographic profile, and moderate debt burden.

Credit Strengths

- » Large tax base tied into the Chicago economy
- » Broad legal flexibility to raise local taxes stemming from the village's home rule status
- » Descending debt service schedule with no plans to take on additional governmental debt

Credit Challenges

- » Narrow fund balance and liquidity
- » Very high pension burden is likely to grow given village contributions fall short of plan funding needs
- » Elevated fixed cost burden and state constitutional protection of pension benefits limits expenditure flexibility

Rating Outlook

The negative outlook reflects our expectation that although village actions to increase pension funding will slow the rate at which unfunded liabilities are growing, plan status will continue to worsen and potentially strain the village's budget over the next several years. The city's pension underfunding also creates a direct risk to liquidity because it is not in compliance with state law. Per Public Act 96-1495, local pension boards may notify the state if municipalities do not make minimum funding contributions. The state would then divert certain funding directly to the pension funds.

Factors that Could Lead to an Upgrade

- » Significant and sustained improvement in fund balance and liquidity
- » A moderated pension burden achieved through improved plan status and/or material tax base and revenue growth
- » Material budgetary adjustments that enable more adequate annual funding of pensions

Factors that Could Lead to a Downgrade

- » Further narrowing of fund balance and liquidity
- » Slow revenue growth that constrains financial flexibility and keeps the village's pension burden from moderating
- » Pension plan investment returns that fall short of current assumptions

Key Indicators

Exhibit 1

Oak Lawn (Village of) IL	2012	2013	2014	2015	2016
Economy/Tax Base					
Total Full Value (\$000)	\$ 3,812,274	\$ 3,468,158	\$ 3,272,165	\$ 3,044,524	\$ 2,953,214
Full Value Per Capita	\$ 67,445	\$ 61,097	\$ 57,438	\$ 53,431	\$ 52,094
Median Family Income (% of USMedian)	115.5%	112.8%	111.6%	108.2%	108.2%
Finances					
Operating Revenue (\$000)	\$ 58,019	\$ 57,482	\$ 55,627	\$ 60,814	\$ 60,013
Fund Balance as a % of Revenues	2.0%	9.0%	7.5%	7.5%	6.0%
Cash Balance as a % of Revenues	2.9%	11.0%	6.3%	5.4%	0.3%
Debt/Pensions					
Net Direct Debt (\$000)	\$ 90,549	\$ 88,527	\$ 86,417	\$ 76,517	\$ 72,344
Net Direct Debt / Operating Revenues (x)	1.6x	1.5x	1.6x	1.3x	1.2x
Net Direct Debt / Full Value (%)	2.4%	2.6%	2.6%	2.5%	2.4%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	3.1x	3.4x	3.7x	3.8x	4.6x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	4.8%	5.6%	6.3%	7.6%	9.4%

The table presents data as of the noted fiscal year. We adjusted 2015 revenue to net out the impact of large transfer and early payment of debt.

Source: Oak Lawn's audited financial statements, US Census Bureau and Moody's Investors Service

Detailed Rating Considerations

Economy and Tax Base: Mature suburb of Chicago

Oak Lawn is a mature and middle income suburb of Chicago. The village is very closely linked to the Chicago economy, with residents having direct transportation access to the city's central business district via regional commuter rail. Consistent with many communities in northeast Illinois (Baa3 negative), Oak Lawn's tax base valuation fell dramatically after the 2007-09 recession. Though it increased 4.4% in the current year to \$3.1 billion, this remains far below its 2011 peak of \$4.5 billion. The prior declining trend in value had little negative effect on the village's budget given home rule flexibility to adjust local tax rates without voter approval.

Median family income in the village is 108% of the US median. The village's local labor market expanded modestly in recent years, and the unemployment rate is now under 5%, much improved from over 10% between 2009 to 2011. Multiple redevelopment projects are underway in the village and Advocate Medical Center remains a principal employer. The health system is positioned to build a new clinic on redeveloped land in the village's downtown.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Financial Operations and Reserves: Narrow financial position susceptible to rising expenses

Oak Lawn's financial position is narrow and rising pension contributions will pose an ongoing budgetary challenge. The village closed fiscal 2016 with an available fund balance across its general and debt service funds of \$3.6 million, or a limited 6% of revenue. Total fund balance was higher at \$8.8 million, but consisted of \$5.1 million of long-term advances in support of local capital projects. The fiscal 2016 year-end fund balance was the product of a \$1 million operating shortfall in the village's general fund. Though half of the shortfall was due to a budgeted but delayed property sale, the other \$500,000 was driven by high overtime spending in the fire department.

To date in fiscal 2017, the village reports spending to be on track with budget, but revenue is slightly underperforming. Recent unbudgeted sales of land may close the resulting budget gap by the close of the year and the village may add to fund balance. However, even if the current year gap is closed, the village's capacity to continuously build up fund balance will be constrained by pension funding needs.

The village plans to increase public safety pension contributions nearly \$1 million per year over the next decade to address a large and growing unfunded burden. Accommodating these contributions will be aided by declines of between \$300,000 and \$500,000 per year in scheduled debt service paid with general fund revenue. But without renewed growth in baseline revenue, the village risks budgetary imbalance unless it raises local property taxes.

LIQUIDITY

The fiscal 2016 operating shortfall combined with increased cash advances for local projects brought Oak Lawn's operating liquidity down to a very narrow \$151,000 and 0.3% of revenue. However, the village issued bonds in July 2017, with nearly \$2 million of proceeds used to reimburse the general fund for the earlier cash advance. Still, accounting for these proceeds leaves combined general and debt service fund cash at a very weak 3% of revenue, though fiscal 2017 has yet to close.

Across all governmental funds, liquidity is also relatively limited. Fiscal 2016 governmental cash was just over 8% of revenue and rises to only 11% of revenue accounting for the 2017 bond proceeds. This is a low net governmental cash position relative to other local governments. The village maintains a \$5 million line of credit with a local bank, which expires in October 2018. The village has made modest draws in recent years, but typically carries balances for only short periods of time.

Cash held in the village's water and sewer enterprise was also comparatively narrow, equivalent to a modest 32 days of utility operations. Positively, operating cash flow in the enterprise is healthy. This will enable the village to improve system liquidity, though a large portion of annual net revenue may be used to address outstanding capital needs.

Debt and Pensions: Debt burden is moderate while high pension burden continues to rise

Oak Lawn's debt burden is moderate, but its pension and fixed cost burdens are high and likely to rise without steady economic and revenue growth. Direct debt of the village is equal to 2.5% of current full value and 1.3x fiscal 2016 operating revenue. A small share of outstanding general obligation debt is repaid with net water and sewer enterprise revenue. The village retains a \$20 million revolving line of credit with Northern Trust Company, which it is using to finance initial improvements to its regional water system. As owner of the regional water system, the village may take on up to \$200 million of state loans to finance large scale improvements to the system. It would repay the loans with increased wholesale charges to its municipal customers. By the close of 2019, the village will likely refinance its credit line with long-term bonds secured by its own net revenue. At this time, the village has no plans to issue new debt for governmental purposes.

DEBT STRUCTURE

The village issued bonds in fiscal 2017 to retire a private bank loan initially issued to finance road and infrastructure improvements in support of a local commercial development. As of fiscal 2016 year-end, the village had drawn \$14.4 million on its revolving water system line of credit. According to the terms of the agreement, any balance not paid in full by December 1, 2019 will be due to the bank in equal installments through December 1, 2021. The village is likely to retire the line of credit with new bonds before December 2019.

The village's current debt service schedule is descending. From fiscal 2017 to fiscal 2024, currently scheduled debt service paid from the general fund falls from \$6.6 million to \$3.2 million. Amortization of outstanding principal is slow, with 49% scheduled to be repaid

within ten years. However, proceeds from the sale of property in the village's tax increment financing districts could be used to pay down some outstanding obligations.

DEBT-RELATED DERIVATIVES

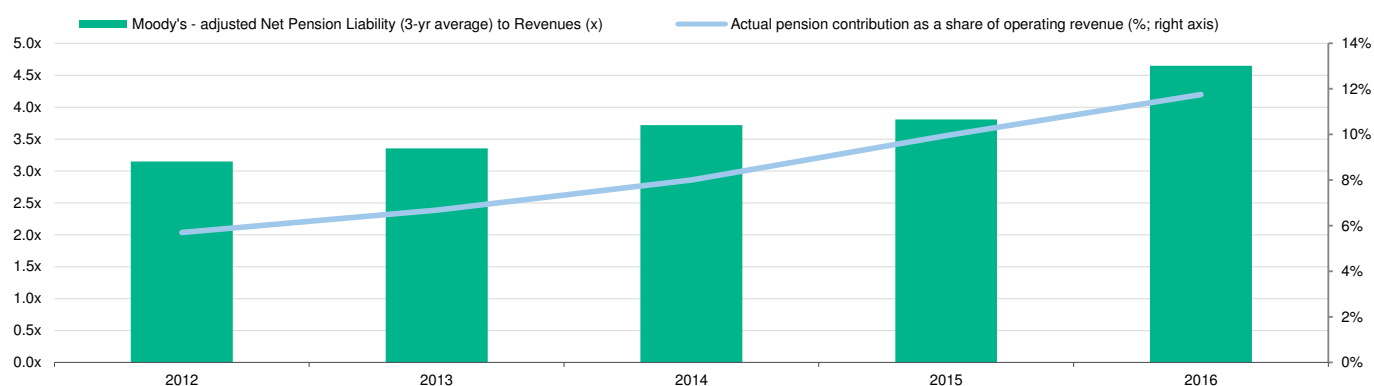
The village is not party to any derivative agreements.

PENSIONS AND OPEB

Oak Lawn's unfunded pensions liabilities are set to grow further on both a reported and Moody's-adjusted basis. From 2012 to 2016, Oak Lawn's three-year average Moody's adjusted net pension liability (ANPL) rose to 4.6x from 3.1x operating revenue. Over this same period, the village's annual contribution to its pension plans grew from consuming less than 6% of revenue to nearly 12% of revenue (see Exhibit 2). The village's ANPL and contributions are net of a modest amount of payment support from its water and sewer enterprise. The ANPL is our measure of a local government's pension burden that uses a market-based interest rate to value accrued liabilities. Oak Lawn manages two single employer defined benefit pension plans for its police and fire employees. General employee pension benefits are accounted for in the village's account with the Illinois Municipal Retirement Fund (IMRF).

Exhibit 2

The village's pension burden and payments are rising



Source: Oak Lawn's audited financial statements and Moody's Investors Service

Despite steady growth in the village's pension contributions, its payments remain far below amounts necessary to arrest growth in unfunded liabilities. We measure the extent to which contributions may be sufficient to keep unfunded liabilities from rising with our "tread water" indicator. Contributions that tread water, using the local government pension plans' own discount rate assumptions, will keep unfunded liabilities from rising as long as other pension plan assumptions hold.¹

Across its three plans, the difference between Oak Lawn's actual contributions and the amount necessary to tread water was equivalent to 8.7% of revenue in fiscal 2015 and 9.4% of revenue in fiscal 2016. This indicates that, in order to cover current year benefit accruals and interest accruing on accumulated liabilities, the village would have to pay 20% of its operating budget to its pension plans. This is a high funding burden among US local governments.

The village adopted a plan to increase its public safety pension contributions approximately \$1 million per year over the next decade. We estimate the fiscal 2017 difference between the village's budgeted contributions to its police and fire plans and the amounts needed for just those two plans to tread water is \$5 million. Despite increasing contributions \$1 million annually, the village will continue to fall short of its pension plans' annual funding needs, driving growth in unfunded liabilities. The village's expected 2017 contribution also falls just over \$2 million short of the payment required by a state statutory formula. Due to this gap, there is risk that the State of Illinois will divert a portion of the village's fiscal 2018 state shared revenue directly to the pension plans, which could create a budgetary gap for the village.

Unfunded OPEB liabilities do not pose a significant credit challenge to the village. Oak Lawn closed fiscal 2015 with an unfunded OPEB liability of \$29.1 million, or 0.5x operating revenue. The village's pay-go OPEB cost in fiscal 2016 was a modest 2% of revenue.

Management and Governance: Home rule status enhances legal revenue flexibility

Illinois cities have an Institutional Framework score of A, which is moderate compared to the nation. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. The Institutional Framework of home rule entities like Oak Lawn is enhanced by those municipalities' substantial revenue-raising authority. Revenue predictability remains moderate, with varying dependence on property, sales, and state-distributed taxes. Expenditures are moderately predictable but cities and villages have limited ability to reduce them given strong public sector unions and pension benefits that enjoy strong constitutional protections. Although Oak Lawn benefits from broad legal capacity to raise local revenue, the village has kept its property tax levy fairly flat in recent years and has indicated no plans to significantly increase its levy in the near term.

Legal Security

Outstanding general obligation bonds are secured by the village's pledge and authorization to levy taxes unlimited as to both rate and amount to pay debt service.

Use of Proceeds

Not applicable.

Obligor Profile

The Village of Oak Lawn is an inner ring Chicago suburb located approximately twenty miles southwest of downtown with an estimated population of just over 56,000.

Methodology

The principal methodology used in this rating was US Local Government General Obligation Debt published in December 2016. Please see the Rating Methodologies page on www.moody.com for a copy of this methodology.

Endnotes

- 1 Our "tread water" indicator measures the annual government contribution required to prevent reported net pension liabilities from growing, given the entity's actuarial assumptions. An annual government contribution that treads water equals the sum of employer service cost and interest on the reported net pension liability at the start of the fiscal year. A pension plan that receives an employer contribution equal to the tread water indicator will end the year with an unchanged net pension liability relative to the beginning of the year if all plan assumptions hold. Net liabilities may decrease or increase in a given year due to factors other than the contribution amount, such as investment performance that exceeds or falls short of a plan's assumed rate of return. Still, higher contributions will always reduce unfunded liabilities faster, or will allow unfunded liabilities to grow more slowly than lower contributions.

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