MOODY'S INVESTORS SERVICE

CREDIT OPINION
13 November 2020

Update

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Oak Lawn (Village of) IL

Update to credit analysis

Summary

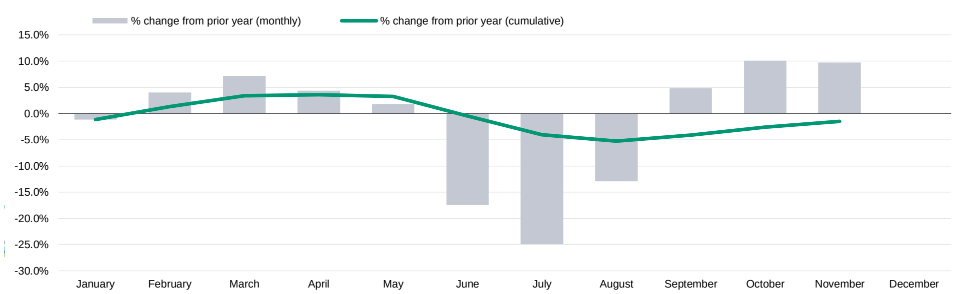
Oak Lawn, IL's (Ba1 negative) credit profile is constrained by a narrow financial position that is being challenged by a weak revenue environment and rising fixed costs to fund post employment benefit obligations. Some one-time revenue infusions have the potential to mitigate some of the pressure. The village's pension contribution practices are weak despite material increases in recent years, which will likely lead to additional growth in already unusually large unfunded pension liabilities. It also raises financial risks to the Village because local pension plans in Illinois (Baa3 negative) can request the state to withhold revenue because it is not meeting the minimum statutory pension contributions. Under the Village's pension funding policy, public safety contributions will increase by about $1 million per year supported by recent revenue enhancements and descending debt service costs. The Village's large tax base with economic ties to Chicago (Ba1 negative), broad legal flexibility to raise local revenue and descending debt schedule are credit strengths.

On November 11th we affirmed the Ba1 rating on the Village's previously issued general obligation unlimited tax debt and revised the outlook to negative from stable.

Exhibit 1

Sales tax performance has nearly reached fiscal 2019 levels but remains well off budget

Total sales tax receipts for fiscal 2020 compared to fiscal 2019 actual



Source: Audited financial statements; Illinois Department of Revenue

Credit strengths

» Moderately sized tax base with economic ties to the City of Chicago

» Significant legal flexibility to raise local revenue as a home rule unit of local government

» Descending debt service schedule with no plans for additional governmental debt

Credit challenges

» Narrow fund balance and liquidity coupled with risks associated with possible revenue diversion

» Elevated pension burden that is expected to grow given contributions that remain well below plan funding needs

» High fixed costs and state constitutional and statutory protection of pension benefits limits expenditure flexibility

Rating outlook

The negative outlook reflects our expectation that the Village's financial position will remain challenged over the next several years given a strained revenue environment and growing fixed costs. The Village's pension underfunding also creates a direct risk to liquidity because it is not in compliance with state law. Finally, the negative outlook reflects the Village's high pension burden which is likely to continue to grow given the Village's funding practices.

Factors that could lead to an upgrade

» Significant and sustained improvement in fund balance and liquidity

» A moderated pension burden

» Material budgetary adjustments that enable more adequate 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

» Diversion of state revenues to pension funds that creates additional operating pressures

Key indicators

Exhibit 2

Oak Lawn (Village of) IL

Oak Lawn (Village of) IL	2015	2016	2017	2018	2019
Economy/Tax Base					
Total Full Value ($000)	$3,044,524	$2,953,214	$3,083,694	$3,560,270	$3,458,447
Population	56,980	56,774	56,754	56,420	56,420
Full Value Per Capita	$53,431	$52,017	$54,334	$63,103	$61,298
Median Family Income (% of US Median)	108.2%	107.9%	109.4%	107.7%	107.7%
Finances					
Operating Revenue ($000)	$67,033	$60,110	$61,396	$64,574	$63,137
Fund Balance ($000)	$6,421	$4,895	$3,292	$5,897	$5,845
Cash Balance ($000)	$5,254	$1,566	$1,877	$3,054	$4,510
Fund Balance as a % of Revenues	9.6%	8.1%	5.4%	9.1%	9.3%
Cash Balance as a % of Revenues	7.8%	2.6%	3.1%	4.7%	7.1%
Debt/Pensions					
Net Direct Debt ($000)	$76,517	$72,344	$70,842	$68,889	$72,172
3-Year Average of Moody's ANPL ($000)	$231,375	$278,832	$306,603	$319,624	$350,886
Net Direct Debt / Full Value (%)	2.5%	2.4%	2.3%	1.9%	2.1%
Net Direct Debt / Operating Revenues (x)	1.1x	1.2x	1.2x	1.1x	1.1x
Moody's - ANPL (3-yr average) to Full Value (%)	7.6%	9.4%	9.9%	9.0%	10.1%
Moody's - ANPL (3-yr average) to Revenues (x)	3.5x	4.6x	5.0x	4.9x	5.6x

Source: Audited financial statements, US Census Bureau, Moody's Investors Service

Profile

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

Detailed credit considerations

Tax base and economy: mature tax base near Chicago

Oak Lawn has exposure to the economic slowdown given a revenue base with high dependence on economically sensitive revenues, and a tax base with material exposure to commercial properties. While the city's moderately sized tax base is very large for it's rating category, the Village has been hesitant to leverage that strength with a property tax levy that has been held flat or reduced annually since 2012. Property taxes comprise just 24% of revenue, with the majority of Village revenues dependent at least in part on economic activity. Officials have been hesitant to increase the levy, in part, because of concern about potential impacts on economy and population. There is evidence of economic erosion in the Village with a stagnant population trend, and a median family income that is estimated to have declined to a still solid 108% of the national level, from 120% in 2010. As of September 2020, the Village's unemployment rate was 11.1% which is higher than state and national medians of 9.8% and 7.7%.

The largest portion of the Village's equalized assessed valuation (EAV) is comprised of residential property (73%), which we expect will fair better than in the past recession. Commercial properties which we expect will experience the most significant impacts comprises a material 25% of the Village's EAV. Fluctuations in values have little impact on property tax revenues because as a home rule municipality the Village sets it property tax at a total levy with no limits on tax rates. The Village has consistently collected between 96% and 98% of it's tax levy including during the last recession.

Financial operations and reserves: limited operational liquidity will be challenged by pandemic driven revenue declines and climbing fixed costs

The city's financial position across its main operating funds will remain narrow because of challenges stemming from growing fixed costs and pandemic related revenue declines. As a result of the current pandemic, which has pressured the Village's economically sensitive revenue, the Village expects to close fiscal 2020 with a draw on general fund reserves of between $1 to 1.5 million driven by an estimated variance in annualized sales tax receipts of 8% compared to budget, and inclusive of $1 million in expenditure reductions. If fully realized available general fund reserves would decline to approximately $0. Operating results could close the year in a better position if the recovery in sales tax receipts continues. The Village's expenditure reductions included eliminating certain positions, furloughs, capital project delays and hiring freezes. The balance of the Village's general fund reserves of approximately $2.8 million is considered non-spendable and is associated with a long-term interfund advance. Across the Village's major operating funds (combined general, debt service, police investigation and motor fuel tax), available reserves are $5.8 million, or a fair 9.3% of revenue.

Beyond fiscal 2020, the Village will be challenged to regain structural balance and improve financial reserves given continued growth in post employment retirement costs. The Village currently projects a budgetary shortfall of $1.3 million in fiscal 2021. However, Village management expects to be able to close that shortfall before the start of the fiscal year with additional expenditure cuts and revenue enhancements. The Village expects to increase public safety plan contributions by approximately $1 million per year for several years to address a large and growing unfunded pension burden. These increased contributions will be serviced by revenue enhancements and declines in certain expenditures including debt service. Additionally, the Village has been working with several potential partners on a lease agreement for certain Village assets. The Village expects the lease will be executed in the spring and will bring in an estimated $4 million which would be paid in a lump sum or as annuities and an ongoing revenue sharing agreement.

Liquidity

Oak Lawn's cash position is narrow and has necessitated the use of short-term borrowing to sustain operations in previous years. Across major operating funds, net cash was limited at $4.5 million and 7% of revenue. Oak Lawn recently renewed its agreement for a $3 million LOC but does not expect to need to draw on it in fiscal 2020. The agreement contains a broad material adverse change clause that could lead to the accelerated repayment of debt if future draws were made. The Village's primary operating fund, the general fund, ended fiscal 2019 with a cash balance of $0. Across all governmental funds, liquidity is also limited. Fiscal 2019 governmental cash was equivalent to 12% of revenue. Notably, the audit typically represents a cash low point for the Village and the average general fund balance throughout the fiscal year approximates $1 million.

Debt, pensions and OPEB: heavy pension burden is expected to grow given weak contributions

Despite sizeable increases in pension plan contributions over the last several years, current contribution levels will be insufficient to stem future growth in the Village's already high unfunded pension liabilities. At 5.6x operating revenue in fiscal 2019, the Village's three year average adjusted net pension liability (ANPL) is among the highest of all rated credits, increasing from 3.3x operating revenue in fiscal 2013. The Village's net direct debt to full value (1.9%) is higher than the US median. That said, outstanding bonded debt has steadily declined and the Village has no plan for additional governmental debt at this time.

Legal security

The Village's GOULT debt is secured by its full faith and credit pledge including a dedicated property tax levy, unlimited as to rate or amount.

Debt structure

The Village recently renewed its agreement for a $3 million LOC but does not expect to need to draw on it in fiscal 2020 or 2021. The agreement contains a broad material adverse change clause that could lead to the accelerated repayment of debt if future draws were made.

Oak Lawn's debt service schedule is descending, providing additional financial flexibility over the longer term. From fiscal 2019 to 2025, currently scheduled debt service paid from the general fund falls from approximately $6 million to $3 million. Amortization of existing debt is average with 57% of principal set to be retired over the next 10 years.

In 2020, the Village secured a $20 million revolving line of credit (LOC) with Beverly Bank and Trust Company N.A. which it is using to finance initial improvements to its regional water system before refunding the debt with state loans. The current balance is approximately $13 million. 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. The Village anticipates up to 95% of costs will be paid by the Illinois Environmental Protection Agency.

Debt-related derivatives

The Village has no derivative exposure.

Pensions and OPEB

Oak Lawn's pension burden is high and expected to grow. Although the police and fire plans are single employer plans, the Village has no control over the benefits because they are established in state statute. All the Village can control are contributions. The Village's contribution to its pension plans in fiscal 2019 consumed 12% of operating revenue, up significantly from 6% in fiscal 2013. Total fixed costs consisting of debt, pension and other post employment benefit (OPEB) expenditures have approximated between 30% and 36% of revenue over each of the last five years. The Village's fiscal 2019 pension contribution fell far below the amount necessary to arrest growth in unfunded liabilities. We measure the extent to which contributions may be sufficient to keep unfunded liabilities from rising under plan assumptions with our “tread water” indicator. Contributions that tread water, using the local government pension plans' own discount rate assumptions, will keep unfunded liabilities from growing as long as other plan assumptions hold.

Across its three plans, the difference between Oak Lawn's actual contributions and the amount necessary to tread water was equivalent to a substantial 8% of operating revenue in fiscal 2019. While contributions have increased substantially each year, the Village remains below the statutorily required contribution amount for single employer public safety plans. Given this gap, the local pension boards could request that the Illinois Comptroller divert state revenue to the pension funds from the Village. Officials report that no such request is imminent and that both boards have signed agreements that they will not seek a revenue diversion so long as the Village adheres to its adopted pension funding plan. Still, we view the shortfall in from the statutory contribution as a risk especially given the limited reserve position. Oak Lawn has adopted a plan to increase its total public safety pension contributions across the two plans by approximately $1 million per year over the next decade.

Unfunded OPEB liabilities do not pose a significant credit challenge. As of January 1, 2018, the most recent actuarial valuation date, the plan had an adjusted net OPEB liability of $27 million or 0.5x operating revenue. The plan is funded on a pay as you go basis and fiscal 2019 contributions were $1.2 million or 2% of operating revenue.

ESG considerations

Environmental

Environmental considerations are not a material driver of Oak Lawn's credit profile. According to data of Moody's affiliate, Four Twenty-Seven, Cook County is at low risk for water stress exposure, cyclone exposure and sea level rise. Four twenty-seven has identified Cook County has having high exposure to heat stress. One of the primary impacts of heat is on agricultural production, which given its urban nature, is not applicable to the Village. Water stress has also been identified as high risk by Four Twenty-Seven. Flooding throughout the county is expected to be relieved by the Tunnel and Reservoir Plan (TARP) currently underway through the Metropolitan Water Reclamation District of Greater Chicago (MWRD, Aa2 stable).

Social

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. The pandemic is creating increased budgetary pressure at the Village which is already contending with rising fixed costs and low fund balance and liquidity. Social issues such as demographic, labor force, income and education are key influencers of the tax base and financial and leverage trends.

Governance

Illinois cities have an institutional framework score [1] of "A", which is moderate. Revenue-raising ability is moderate overall but varies considerably. Non-home rule entities are subject to tax rate limitations. In addition, total operating tax yield for entities subject to the Property Extension Limitation Law (PTELL) is capped to the lesser of 5% or CPI growth, plus new construction. Home rule entities, such as Oak Lawn have much greater legal flexibility than the rest of the sector with substantial revenue-raising authority. Revenue predictability is moderate, with varying dependence on property, sales, and state-distributed income taxes. Expenditures are moderately predictable but cities have limited ability to reduce them given strong public sector unions and pension benefits that enjoy strong constitutional protections. Fixed costs are driven mainly by debt service and employer pension contributions. For single employer public safety plans, the State of Illinois requires most entities to make annual pension contributions that cover current benefit accruals, plus an amount designed to achieve a 90% funded ratio by 2040, a requirement Oak Lawn is not in compliance with.

The Village's operating revenue primarily consists of property taxes (23%), sales taxes (18%), state shared income taxes (9%) and charges for services (9%). Like many local governments the Village is experiencing a decline in sales tax receipts which are expected to be down for the year. The Village had increased its home rule sales tax rate by 0.25% for 2020 but ultimately pushed the increase off until 2021 because of the pandemic. The Village has also recently doubled its motor fuel tax rate, increased gaming taxes and secured a revenue sharing agreement with a local hospital.

Rating methodology and scorecard factors

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 3

Oak Lawn (Village of) IL

Scorecard Factors and Subfactors	Measure	Score
Economy/Tax Base (30%) [1]		
Tax Base Size: Full Value (in 000s)	$3,454,225	Aa
Full Value Per Capita	$61,223	A
Median Family Income (% of US Median)	107.7%	Aa
Finances (30%)		
Fund Balance as a % of Revenues	9.3%	A
5-Year Dollar Change in Fund Balance as % of Revenues	-2.6%	Baa
Cash Balance as a % of Revenues	7.1%	A
5-Year Dollar Change in Cash Balance as % of Revenues	-3.8%	Baa
Notching Factors:[2]		
Other Scorecard Adjustment Related to Finances: pension funding below state mandated levels raises liquidity issues		Down
Management (20%)		
Institutional Framework	A	A
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures	1.0x	Baa
Notching Factors:[2]		
Unusually Strong or Weak Budgetary Management and Planning		Down
Other Scorecard Adjustment Related to Management: home rule status		Up
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	2.1%	A
Net Direct Debt / Operating Revenues (x)	1.1x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	10.2%	Baa
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	5.6x	Baa
Notching Factors:[2]		
Other Scorecard Adjustment Related to Debt/Pensions weak pension contributions and high fixed costs		Down
	Scorecard-Indicated Outcome	Baa3
	Assigned Rating	Ba1

[1] Economy measures are based on data from the most recent year available.

[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology.

[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs publication.

Sources: US Census Bureau, Moody's Investors Service

Source: Audited financial sources, Moody's Investors Service, US Census

Endnotes

1 The institutional framework score assesses a municipality's legal ability to match revenues with expenditures based on its constitutionally and legislatively conferred powers and responsibilities. See US Local Government General Obligation Debt (July 2020) methodology report for more details.

REPORT NUMBER 1252875

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