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Oak Lawn (Village of) IL

Update following downgrade to Ba2

Summary

Oak Lawn, IL's (Ba2 stable) credit profile is challenged by weak pension contribution practices that have led to elevated long-term liabilities and rising fixed costs. The village's adopted pension funding plan does not meet state requirements which puts state shared revenue that supports village operations at risk of interception. Local pension plans in Illinois (Baa1 stable) can request that the state withhold revenue from a sponsoring municipality if it does not make minimum statutory pension contributions. While local pension boards have stated they would not do so as long as the village adheres to its own pension funding policy, interception of state funds would stress the village's already narrow financial position. The village's primary credit strength Is its large tax base with economic ties to the City of Chicago (Ba1 stable). Although the village retains significant legal flexibility as a home rule municipality, its revenue raising authority is underutilized as the levy has remained essentially flat over the last decade.

On October 7, Moody's downgraded the village's general obligation unlimited tax (GOULT) ratio to Ba2 and revised the outlook to stable from negative.

Credit strengths

» Moderately sized tax base with economic ties to the City of Chicago that supports resident income levels that are above the national average

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

Credit challenges

» Underutilized revenue raising capacity despite strong legal authority

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

» Narrow fund balance and liquidity coupled with the risk of possible seizure of state revenue because of pension underfunding

Rating outlook

The change of the outlook to stable from negative reflects the recently improved yet still narrow financial position that is, however, expected to remain stable over the next two years.

Factors that could lead to an upgrade

» Budgetary adjustments that enable more adequate funding of pensions and moderate the overall liability

Factors that could lead to a downgrade

» Further narrowing of fund balance and liquidity

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

Key indicators

Exhibit 1

Oak Lawn (Village of) IL

	2017	2018	2019	2020	2021
Economy/Tax Base					
Total Full Value ($000)	$3,652,929	$4,426,303	$4,308,060	$4,328,538	$4,889,122
Population	56,754	56,420	55,936	55,432	55,432
Full Value Per Capita	$64,364	$78,453	$77,018	$78,087	$88,200
Median Family Income (% of US Median)	109.4%	107.7%	106.9%	113.3%	113.3%
Finances					
Operating Revenue ($000)	$61,395	$64,597	$63,137	$64,661	$76,941
Fund Balance ($000)	$3,974	$6,602	$5,845	$5,201	$7,828
Cash Balance ($000)	$2,434	$3,634	$4,510	$5,035	$12,323
Fund Balance as a % of revenue	6.5%	10.2%	9.3%	8.0%	10.2%
Cash Balance as a % of Revenues	4.0%	5.6%	7.1%	7.8%	16.0%
Debt/Pensions					
Net Direct Debt ($000)	$70,842	$68,889	$72,172	$69,465	$64,486
3-Year Average of Moody's ANPL ($000)	$306,603	$319,624	$350,886	$407,204	$434,729
Net Direct Debt / Full Value (%)	1.9%	1.6%	1.7%	1.6%	1.3%
Net Direct Debt / Operating Revenues (x)	1.2x	1.1x	1.1x	1.1x	0.8x
Moody's - ANPL (3-yr average) to Full Value (%)	8.4%	7.2%	8.1%	9.4%	8.9%
Moody's - ANPL (3-yr average) to Revenues (x)	5.0x	4.9x	5.6x	6.3x	5.7x

Sources: US Census Bureau, Oak Lawn (Village of) IL's financial statements and Moody's Investors Service

Profile

The Village of Oak Lawn is a home rule community located about 15 miles southwest of downtown Chicago. The village provides comprehensive municipal services including emergency services, public safety and water distribution and sewer services to an estimated population of about 55,500.

Detailed credit considerations

Tax base and economy: mature tax base outside Chicago

Oak Lawn's tax base is a credit strength relative to the rating category but remains vulnerable to economic downturns because of a large commercial presence. Although the village benefits from the size of its $4.9 billion base, it has underutilized that strength with a property tax levy that has essentially been held flat over the last decade. Property taxes comprise just 19% of operating revenue with the majority of operations dependent in part on economic activity related to generation of sales taxes, motor fuel taxes, utility taxes and other charges and fees such as building permits.

The village's population trend is fairly stable and median family income is 113% of the national level, somewhat weakened from the prior decade when it was 120%. As of July 2022, the village's unemployment rate was 5.4% which is higher than state and national medians of 4.8% and 3.8%.

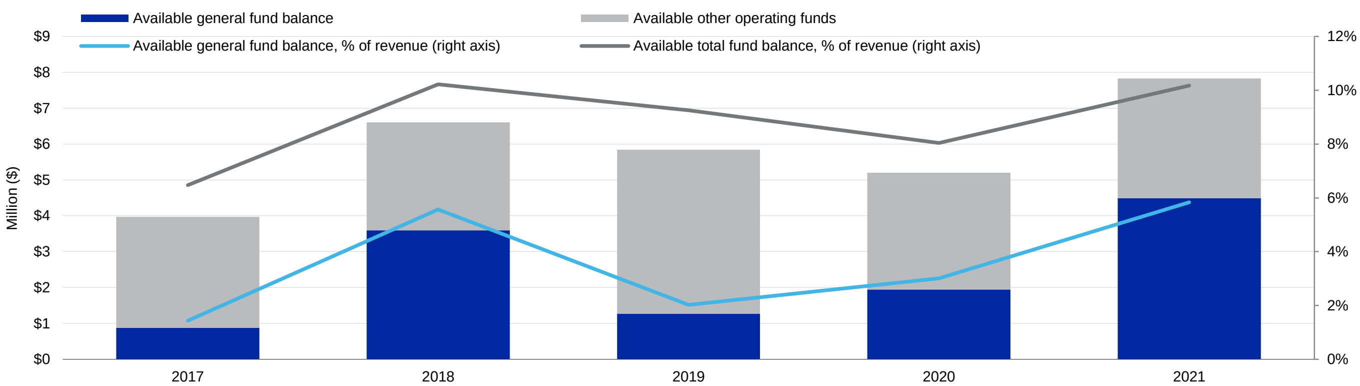
Financial operations and reserves: financial position has improved but remains narrow

The village's financial position is likely to continue to strengthen but will remain narrow because of capital needs and growing costs associated with debt and pensions. Fiscal 2021 closed with $7.8 million in available operating fund balance across the general, motor fuel tax, debt service and police investigation funds, representing just over 10% of revenue. The audited results represent an improvement in reserves that are likely to continue but will ultimately be moderated by growing expenditures. Management reports an expected general fund surplus for fiscal 2022 around $6 million because of conservative budget estimates for new revenue sources including the recently increased home rule sales tax that went into effect in 2021.

Exhibit 2

Available general fund balance improves in fiscal 2021 but remains narrow

Available fund balance in the general fund and other operating funds



Source: Village of Oak Lawn, IL's audited financial statements and Moody's Investors Service

Material growth in reserves in unlikely because of growing demands on the general fund for police and fire pension contributions (see pensions and OPEB below). The village board adopted a funding plan in 2019 that annually increases public safety pension contributions from the general fund by about $680,000 for most years over the next decade. The village is reluctant to raise the levy to support pensions despite substantial revenue-raising authority as a home rule unit of government that is not subject to the state's property tax extension law limit. While operating revenue have grown over 50% over the last decade, the levy has stayed essentially flat shifting reliance to more economically sensitive sources. The village board's reluctance to raise property taxes stems from a desire to maintain a competitive advantage to attract both commercial tenants and new residents.

Across primary operating funds, intergovernmental revenues account for the largest source of revenue at 37%. Intergovernmental sources include state shared income taxes, sales taxes, motor fuel taxes, among other items. Locally collected non-ad valorem taxes, charges for services, fines and fees account for an additional 30%, and property taxes comprise 19%.

Liquidity

Oak Lawn's cash position is narrow and has necessitated the use of short-term borrowing to sustain operations, utilized most recently in 2019. For these purposes, the village retains a line of credit (LOC) with a local bank up to $3 million. At the close of 2021, net cash across major operating funds stood at $12.3 million, representing 16% of revenue and more than double the prior year.

Debt and pensions: elevated pension burden driven by weak pension contributions

The village's primary credit challenge is its large unfunded pension liability related to its two public safety pension plans. Although the village has an adopted plan to increase contribution levels annually, the liability is likely to continue to grow given weak contribution practices that do not meet state requirements. Contributions for fiscal 2022 will fund only 75% of the state's actuarially required contribution of $14.5 million across the two public safety pensions.

The village's debt profile is more moderate with outstanding general obligation unlimited tax (GOULT) debt totaling $81.6 million following a 2022 issuance for capital, representing 1.1x of 2021 operating revenue and 2.0% of full value. Fixed costs for debt service, pension contributions and OPEB contributions totaled a high 30% of operating revenue in 2021, but includes additional pension contributions deferred in 2020. While fixed costs are typically lower, the village's weak pension contributions do not capture the risk of the growing liability.

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

Debt structure
All of the village's GOULT debt is fixed rate. Principal amortization is above average with about 70% of debt paid out in ten years.

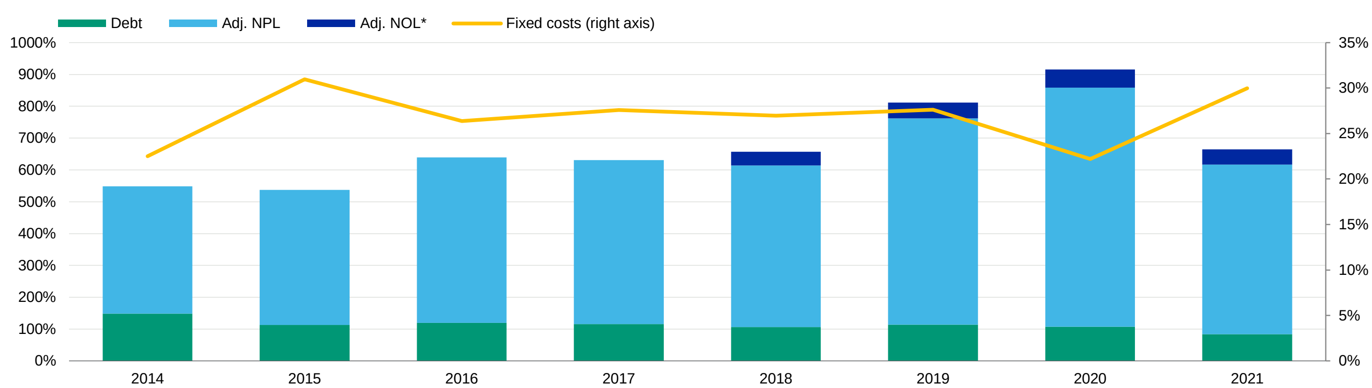
The village maintains a $3 million line of credit (LOC) with a local bank in the event of cash flow needs. The agreement contains a broad material adverse change clause that could lead to the accelerated repayment of debt.

In 2020, the village secured a $20 million revolving LOC with Beverly Bank and Trust Company N.A. which it is using to finance improvements to its regional water system before refunding the debt with state loans. As owner of the regional water system, the village took on $96 million in state loans as of the close of fiscal 2021 to finance large scale improvements to the system with total project costs expected to be about $275 million. The village repays the state loans with increased wholesale charges to its municipal customers. In 2022, the village refunded $18 million from the LOC that were not eligible for reimbursement by the state as Regional Water System Revenue Bonds which will be paid from net revenue of the system.

Debt-related derivatives
The village has no derivative exposure.

Pensions and OPEB
Oak Lawn's growing pension liability related to its two public safety plans remains the village's primary credit challenge. The village board adopted a funding plan in 2019 that does not meet state requirements to fund the plans 90% by 2040 despite annual increases in contributions. Additionally, in 2020 the village deferred approximately $4 million in fire and police pension contributions because of a decline in operating revenue. The contributions were subsequently made in 2021 with available operating surplus. For fiscal 2022, the village remains on track to make its contributions per the adopted funding plan, which represents only about 75% of state actuarially determined contributions.

Exhibit 3
Liabilities remain elevated driven by the village's pension burden; decline in 2021 due to make-up pension contributions deferred in 2020
Debt, adjusted net pension liability and adjusted net OPEB as a % of operating revenue



*Adjusted NOL not available pre-GASB 75.
Source: Moody's Investors Service

In addition to its two defined benefit public safety pension plans, Oak Lawn is also a member of the Illinois Municipal Retirement Fund (IMRF), a defined benefit, multi-employer agent plan. Although the public safety plans are single employer, the village has no control over the benefits because they are established in state statute. Pension contributions in fiscal 2021 totaled just over $15 million to the three pension plans, representing a high 20% of operating revenue. Contributions and fixed costs were higher than previous years due to make-up payments deferred in 2020 (see Exhibit 4 above).

Moody's tread water indicator represents the contribution required to prevent growth in reported net pension liabilities assuming plan assumptions hold. A lower discount rate tends to push the tread water indicator upward, which can result in a wider gap between the indicator and actual contributions. The village's plans use a discount rate of about 7%, which is about average for Illinois cities. Oak Lawn exceeded Moody's tread water benchmark in fiscal 2021 only because of make-up payments. In the prior year, contributions were less than 50% of tread water because of contribution deferral.

ESG considerations

The Village of Oak Lawn's overall ESG Credit Impact Score is highly negative (CIS-4), reflecting highly negative governance risks and neutral to low exposure to environmental and social risks.

Environmental

The village's E issuer profile score is neutral to low (E-2) reflecting neutral to low exposure to environmental risks across all categories, including physical climate risk, natural resources management and waste and pollution.

Social

The village's S issuer profile score is neutral to low (S-2) reflecting a diverse labor market with an average labor force participation rate and educational attainment. Health and safety indices are similar to peers and resident income is above the national average.

Governance

Oak Lawn's G issuer profile score is highly negative (G-4), reflecting weak policy credibility and effectiveness related to the village's underfunded and growing pension liabilities. The village's pension funding policy does not meet state requirements which puts state shared revenue at risk of interception. Further, the institutional structure provides little control over pension benefits because they are established by the state legislature. State courts have broadly interrupted constitutional protections for pension benefits and there is no ability to reduce benefits once granted. While the village benefits from its status as a home rule unit of government which affords greater legal flexibility than the rest of the sector, it has historically underutilized this authority. Budget management is moderately negative and reflected in the village's narrow financial position and reliance on economically sensitive revenue sources. Transparency and disclosure practices are sound.

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.

The final rating differs from the scorecard rating. The final rating incorporates the risk of state revenue interception.

Exhibit 4

Oak Lawn, IL

Scorecard Factors and Subfactors	Measure	Score
Economy/Tax Base (30%) [1]		
Tax Base Size: Full Value (in 000s)	$4,054,134	Aa
Full Value Per Capita	$73,137	Aa
Median Family Income (% of US Median)	113.3%	Aa
Finances (30%)		
Fund Balance as a % of Revenues	10.2%	A
5-Year Dollar Change in Fund Balance as % of Revenues	2.9%	A
Cash Balance as a % of Revenues	16.0%	Aa
5-Year Dollar Change in Cash Balance as % of Revenues	13.3%	Aa
Notching Adjustments:[2]		
Unusually volatile revenue structure		Down
Other Scorecard Adjustment Related to Finances: pension funding below state mandated levels risks intercept of state funds		Down
Management (20%)		
Institutional Framework	A	A
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures (x)	1.0x	A
Notching Adjustments:[2]		
Unusually Strong or Weak Budgetary Management and Planning		Down
Other Scorecard Adjustment Related to Management: home rule unit of government		Up
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	2.0%	A
Net Direct Debt / Operating Revenues (x)	1.1x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	10.7%	Baa
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	5.7x	Baa
Notching Adjustments:[2]		
Unusual Risk Posed by Debt/Pension Structure		Down
Other Scorecard Adjustment Related to Debt and Pensions: high fixed costs		Down
	Scorecard-Indicated Outcome	Baa3
	Assigned Rating	**Ba2**

[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, {OrgName}'s financial statements and Moody's Investors Service

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