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Ratings

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Summary:

Oak Lawn Village, Illinois; General Obligation

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Summary:

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Credit Profile		
Oak Lawn Vill GO		
Long Term Rating	BBB/Negative	Downgraded
Oak Lawn Vill GO (ASSURED GTY)		
Unenhanced Rating	BBB(SPUR)/Negative	Downgraded

Rationale

S&P Global Ratings lowered its long-term rating four notches to 'BBB' from 'A+' on the village of Oak Lawn, Ill.'s existing general obligation (GO) debt. The outlook is negative.

The downgrade reflects our view of the structural imbalance in the village's budget and the very weak funding levels in its police and firefighter pension plans, caused by significant underfunding of its annual actuarially determined contributions (ADC) in those plans. The negative outlook indicates that we believe that there is a one-in-three chance of a lower rating within the next two years, given the village's ongoing negative fiscal trends, which have deteriorated its budgetary flexibility and liquidity in recent years.

The village's GO debt is secured by its unlimited tax GO pledge.

As a result of the substantial underfunding of the village's required public safety pension contributions, we consider its budget to be structurally imbalanced. In addition, the village's failure to adhere to minimum pension funding requirements under state law raises the risk of the state withholding certain revenue it shares with the village. The village's general fund reserves fell sharply in audited fiscal 2017, which represented a significant budgetary variance from anticipated results that year. We view the village's tendency to rely on one-time revenue to help balance the budget as a practice that leaves it vulnerable to budget shortfalls, as occurred in fiscal 2017, when the anticipated one-time revenue was delayed. Despite forecasts for a fiscal 2018 general fund surplus, we have assigned a negative outlook, given the village's continued and significant pension underfunding during the next two years.

The rating further reflects our view of the village's:

- Adequate economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Weak management, despite "standard" financial policies and practices under our Financial Management Assessment methodology;
- Weak budgetary performance, with operating deficits in the general fund and at the total governmental fund level in fiscal 2017;
- Weak budgetary flexibility, with an available fund balance in fiscal 2017 of 1.5% of operating expenditures;
- Adequate liquidity, with total government available cash at 5.7% of total governmental fund expenditures and 53.5% of governmental debt service, but access to external liquidity we consider strong;

- Very weak debt and contingent liability position, with debt service carrying charges at 10.7% of expenditures and net direct debt that is 105.2% of total governmental fund revenue, as well as a large pension and other postemployment benefit (OPEB) obligation and the lack of a plan to sufficiently address the obligation; and
- Strong institutional framework score.

Adequate economy

We consider Oak Lawn's economy adequate. The village, with an estimated population of 56,831, is located in Cook County in the Chicago-Naperville-Elgin, IL-IN-WI MSA, which we consider to be broad and diverse. The village has a projected per capita effective buying income of 96.0% of the national level and per capita market value of $62,584. Overall, the village's market value grew by 15.5% over the past year to $3.6 billion in 2018. The county's unemployment rate was 5.2% in 2017.

The village is located 15 miles southwest of downtown Chicago and benefits from access to the broad and diverse Chicago-area economy. After experiencing significant equalized assessed valuation declines in recent years, the village reported a sizeable increase in market value as a result of a reassessment. The village's property composition is primarily residential (72.9%), followed by commercial property (25.5%). The largest employers in the village include Advocate Christ Medical Center (6,500 employees) and Community High School District 218 (1,370). We do not anticipate our view of the village's economy to change in the near term.

Weak management

We view the village's management as weak, despite "standard" financial policies and practices under our Financial Management Assessment methodology, indicating the finance department maintains adequate policies in some but not all key areas.

We have revised our view of the village's management to weak from adequate, based on our assessment of the village's structural imbalance, without a credible plan to correct the imbalance. With regard to specific management policies and practices, in developing revenue and expenditure assumptions, the village has historically underestimated the accrual of overtime by its public safety employees, which has led to deficits. In addition, the village has relied on the receipt of one-time revenue to assist with the balancing of its budget, and the delayed receipt of these funds have caused budgetary imbalances. The management team provides quarterly budget-to-actual updates to the village board. The village does not maintain a formalized long-term financial plan. The village has a five-year capital plan, but the plan does not provide estimated funding sources for later years. The village has investment management policies for its police and fire pension plan and for other funds it maintains. In addition, the village provides quarterly updates regarding investment holdings and earnings to its village board. The village follows state statutes regarding debt management. The village maintains a fund balance target of 10% of general fund expenditures, which it is currently not meeting.

Weak budgetary performance

Oak Lawn's budgetary performance is weak in our opinion. The village had operating deficits of negative 13.6% of expenditures in the general fund and of negative 7.5% across all governmental funds in fiscal 2017.

In analyzing the village's budgetary performance, we have added to general fund expenditures amounts that it has underfunded its police and fire pensions to obtain a more accurate view of the village's fiscal performance. These amounts are $2.9 million for its police pension plan and $1.7 million for its firefighters plan. Of additional concern regarding the village's public safety pension underfunding involves its failure to adhere to state-mandated minimum pension funding requirements. This could potentially lead to an intercept of state-shared revenue for the village, should the village's pension boards exercise its right to file a pension funding deficiency claim with the comptroller under state law against the village. As in previous years, fiscal 2017 performance was negatively affected by a large amount of overtime paid for the village's fire department, which exceeded budgetary projections. In addition, the village had anticipated revenue resulting from an agreement with a local hospital and a property sale that did materialize in 2017 and were received in fiscal 2018.

For unaudited fiscal 2018, the village is projecting a $1.4 million general fund surplus, in part due to the receipt of the aforementioned delayed receipt of revenue originally anticipated in 2017. Preliminary budget estimates for fiscal 2019 demonstrate a 1.2% deficit in the general fund. We note, however, that the village is not expecting to fully fund its police and fire pension plan to its ADC levels in 2018 or 2019, which will artificially inflate budgetary performance.

Given this forecast, we expect the village's budgetary performance to remain at least weak and structurally imbalanced during the next two years, without a plan in place to correct the imbalance. The village has posted three consecutive years of deficits, and in the next two fiscal years the general fund is expected to be in a deficit position when adding its underfunded pension contributions. While the village has adopted a pension funding policy which attempts to increase future contributions to a level closer to its ADC, we believe this plan falls short of a credible remedy to address the structural mismatch between its revenue and expenditures because it still does not contemplate a full ADC funding of police and fire pension plans until a number of years in the future.

Weak budgetary flexibility

Oak Lawn's budgetary flexibility is weak, in our view, with an available fund balance in fiscal 2017 of 1.5% of operating expenditures, or $881,000.

We have revised our view of the village's budgetary flexibility from adequate to weak, based on a substantial decrease in available reserves in fiscal 2017. The village's unadjusted general fund deficit in fiscal 2017 caused by unbudgeted public safety overtime expenditures and the failure to receive one-time revenue anticipated before the end of the fiscal year depleted the village's reserves in fiscal 2017. While the village is forecasting a surplus in fiscal 2018, we anticipate its budgetary flexibility will likely remain weak.

Adequate liquidity

In our opinion, Oak Lawn's liquidity is adequate, with total government available cash at 5.7% of total governmental fund expenditures and 53.5% of governmental debt service in 2017. In our view, the village has strong access to external liquidity if necessary.

We have also revised our view of the village's liquidity position to adequate from very strong, primarily reflecting an increase in restricted amounts in fiscal year 2017 In assessing the village's liquidity, we are removing certain amounts that are considered restricted and unavailable for short-term borrowing by the village, which reduces its cash level to approximately $4.2 million at the end of fiscal year-end 2017. We view the village's access to external liquidity to be strong, as it has issued debt regularly in recent years.

The village has access to a $3.0 million line of credit, reduced from $5.0 million in fiscal 2018, which it has not had to utilize. Including this line of credit, the village has $10.5 million in direct purchase debt and lines of credit, which are primarily used to fund ongoing capital projects. Of this amount, approximately $3.7 million is outstanding under these obligations, with $456,000 due within the next year. We do not consider the village's exposure to these liabilities to be a non-remote contingent liability. While these agreements contain non-standard events of default that could lead to immediate acceleration, we do not consider these unfavorable terms as being likely to be exercised, and moreover, the amounts owed represent less than 10% of the village's general fund revenue.

In 2014, the village's water and sewer system entered into a line of credit totaling $20 million with a local bank; indebtedness owed pursuant to the line of credit is structured as a revenue bond, and amounts owed pursuant to the bonds are not payable from GO taxes. We consider the village's access to external liquidity to be strong, as it has issued debt through the capital market regularly within the past 20 years. We also view the village's investments to be not aggressive, as it primarily invests in CDs and governmental securities. We expect to village's liquidity position to likely remain adequate during the next few years, though continued budgetary shortfalls may pressure the village's liquidity position.

Very weak debt and contingent liability profile

In our view, Oak Lawn's debt and contingent liability profile is very weak. Total governmental fund debt service is 10.7% of total governmental fund expenditures, and net direct debt is 105.2% of total governmental fund revenue.

The village does not have any additional new money GO debt plans within the next two years. Despite this, given the village's current debt and pension burden, we do not anticipate its very weak debt and contingent liability profile as likely to improve.

In our opinion, a credit weakness is Oak Lawn's large pension and OPEB obligation, without a plan in place that we think will sufficiently address the obligation. Oak Lawn's combined required pension and actual OPEB contributions totaled 18.3% of total governmental fund expenditures in 2017. Of that amount, 16.6% represented required contributions to pension obligations, and 1.7% represented OPEB payments. The village made 68% of its annual required pension contribution in 2017. The funded ratio of the largest pension plan is 53.2%.

The village's public safety pension plans are substantially underfunded and we do not view its existing pension funding policy as a credible one to address its public safety pension funding deficiencies. The village fell well short of its ADC in fiscal 2017 in both its police and fire plans by $4.6 million on a combined basis. While the village has adopted a pension funding policy, which commits it to higher contributions in coming years by an increasing amount of $500,000 annually, we believe this plan is insufficient given the magnitude of the village's ADC deficiency. The village has adopted Governmental Accounting Standards Board (GASB) Statement No. 67 and 68 regarding the accounting of pension and OPEB liabilities. The village's Police Pension Fund and Firefighters' Fund were 53% and 55% funded, with a net pension liability of $70 million and $63 million, respectively in 2017.

The village provides employer-paid retiree medical care to employees until age 65. The village funds its OPEB on a pay-as-you go basis, and had a $29 million unfunded actuarial accrued liability as of Jan. 1, 2016. The village contributed $1.25 million to the plan in 2017.

Strong institutional framework

The institutional framework score for Illinois home-rule cities and villages is strong.

Outlook

The negative outlook reflects our view of the village's weakened budgetary flexibility and liquidity, and the possibility of a one-in-three chance of a lower rating within the next two years. In particular, should the village continue to experience budgetary imbalances as well as significant shortfalls with respect to its actuarially determined pension contribution , the rating could be lowered. However, should the village achieve structural balance while consistently making its full actuarially determined pension contribution, , we could revise the outlook back to stable.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- 2018 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of November 12, 2018)		
Oak Lawn Vill taxable GO (AGM)		
Unenhanced Rating	BBB(SPUR)/Negative	Downgraded
Oak Lawn Vill GO taxable Build America bnds ser 2010A dtd 09/03/2010 due 12/01/2012-2028 2030 2035		
Unenhanced Rating	BBB(SPUR)/Negative	Downgraded
Oak Lawn Vill GO (AGM)		
Unenhanced Rating	BBB(SPUR)/Negative	Downgraded
Oak Lawn Vill GO (AGM)		
Unenhanced Rating	BBB(SPUR)/Negative	Downgraded

Many issues are enhanced by bond insurance.

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