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Ratings

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Summary:
Oak Lawn Village, Illinois; General Obligation

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Table Of Contents

Summary:
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Credit Profile		
Oak Lawn Vill taxable GO (AGM)		
Unenhanced Rating	BBB-(SPUR)/Negative	Downgraded, Removed from CreditWatch
Oak Lawn Vill GO		
Long Term Rating	BBB-/Negative	Downgraded, Removed from CreditWatch
Oak Lawn Vill GO (ASSURED GTY)		
Unenhanced Rating	BBB-(SPUR)/Negative	Downgraded, Removed from CreditWatch

Rating Action

S&P Global Ratings lowered its long-term rating to 'BBB-' from 'BBB' on the Village of Oak Lawn, Ill.'s general obligation (GO) debt. The outlook is negative. At the same time, we removed the rating from CreditWatch, where it had been placed on Nov. 16, 2020, with negative implications.

The downgrade reflects our view of the village's weakened operational performance and reserve position, exacerbated by the recent recession and COVID-19 pandemic. These factors have created a sizable shortfall in one of the village's primary revenue streams, sales tax revenue, which we think could lead to a large deficit in fiscal 2020. In addition, the village's continued pension funding deficiencies highlight another aspect of its credit profile that is experiencing stress. The negative outlook reflects our view that without significant improvement in operating performance and reserves, there is at least a one-in-three chance during the next year of a lower rating. A lower rating is also a possibility given our view of the village's exposure to economically vulnerable revenue streams, with a worsening COVID-19 pandemic potentially negatively affecting revenues and operations.

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

Credit overview

Generally, our outlook timeframe is as long as two years, but our view of the credit risks center on the more immediate economic and budget effects over the next 12 months as a result of the COVID-19 pandemic. (See "The U.S. Economy Reboots, With Obstacles Ahead," published on Sept. 24, 2020, on RatingsDirect.) We consider Oak Lawn to be challenged on a number of fronts, a situation that has been exacerbated by the COVID-19 pandemic. We view its debt and contingent liabilities profile as very weak, partly as a result of sizable unfunded pension liabilities in its police and fire pension plans. Further, the village is structurally imbalanced in our view, capping the rating at 'BBB+', an adverse credit factor that will likely remain, absent significant increases in revenue and improvement of its pension funding levels. At the same time, we see the village's location, approximately 15 miles southwest of Chicago, and stable tax base as bolstering credit quality.

The 'BBB-' long-term rating 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 (FMA) methodology;
- Very weak budgetary performance, with operating deficits in the general fund and at the total governmental fund level in fiscal 2019;
- Very weak budgetary flexibility, with an available fund balance that we expect will decrease in the near term from its fiscal 2019 level of 2.1% of operating expenditures, as well as limited capacity to reduce expenditures;
- Strong liquidity, with total government available cash that we expect will decline in the near term relative to its fiscal 2019 levels at 17.5% of total governmental fund expenditures and 147.0% of governmental debt service, and access to external liquidity that we consider strong, but an exposure to high refinancing risk;
- Very weak debt and contingent liability profile, with debt service carrying charges at 11.9% of expenditures and net direct debt that is 107.6% of total governmental fund revenue, as well as a large pension and other postemployment benefits (OPEB) obligation and the lack of a plan to sufficiently address the obligation; and
- Strong institutional framework score.

Environmental, social, and governance factors

The rating also incorporates our view of the health and safety risks posed by the COVID-19 pandemic, which we consider social risk factors according to our environmental, social, and governance framework. Although the scope of economic and financial challenges posed by the pandemic remains unknown, we believe a prolonged disruption could weaken the village's local economy. Absent the implications of the pandemic, we consider the village's environmental and social risks to be in line with our view of the sector. Because of our view of the village's weak management, we consider its governance risks above the sector standard.

Negative Outlook

Downside scenario

We could lower the rating during the next year if operational pressure continues to affect the village, leading to further deficits, or if the village fails to achieve and sustain improvement in the funding levels of its public safety pension plans. In addition, should the village's liquidity position become pressured, we could lower the rating.

Return to stable scenario

Should we see evidence that the village's efforts to stabilize operations are coming to fruition, leading to an improvement in our view of both budgetary performance and flexibility, we could revise the outlook to stable.

Credit Opinion

Adequate economy

We consider Oak Lawn's economy adequate. The village, with an estimated population of 56,067, is located in Cook

County in the Chicago-Naperville-Elgin, IL MSA, which we consider to be broad and diverse. The village has a projected per capita effective buying income of 94.0% of the national level and per capita market value of $61,548. Overall, the village's market value was stable over the past year at $3.5 billion in 2020. The county unemployment rate was 3.8% in 2019.

The village is 15 miles southwest of downtown Chicago and benefits from access to the broad and diverse Chicago-area economy. 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). The village's tax base has experienced slight declines in recent years, but it has remained generally stable. Should the county's 2020 unemployment remain above 10% on an annualized basis in 2020, our view of the village's economy could weaken.

Weak management

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

We consider the village's management to be weak, based on our assessment of its 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 of the type whereby it forecasts the performance of its operating funds multiple years in the future. The village maintains a five-year capital plan that it updates annually. Oak Lawn has investment management policies for its police and fire pension plan and for other funds that 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. It maintains a fund balance target of 10% of general fund expenditures, which it is currently not meeting.

Very weak budgetary performance

Oak Lawn's budgetary performance is very weak, in our opinion. The village had operating deficits of 11.1% of expenditures in the general fund and of 10.6% across all governmental funds in fiscal 2019. In addition, we consider the village's operations to be structurally imbalanced, which caps its rating at BBB+. Furthermore, we consider it to be subject to significant performance volatility, because of event risk due to the ongoing COVID-19 pandemic.

In analyzing the village's budgetary performance, and to obtain a more accurate view of the village's fiscal performance in fiscal 2019, we have added approximately $3.3 million to general fund expenditures that the village has underfunded its police and fire pensions by. As in previous years, fiscal 2019 performance was negatively affected by a large amount of overtime paid for the village's fire department, which exceeded budgetary projections.

For fiscal 2020, the village is projecting a $3.9 million general fund deficit. Including unfunded actuarially determined contribution (ADC) pension amounts, this deficit would increase to approximately $5.9 million, or 9.6% of projected expenditures. Driving this fiscal 2020 year-end estimate are the effects of the pandemic, which have created significant shortfalls in the village's major revenue streams. Specifically, management projects sales tax revenue will decline $2.4 million, or 14%, as compared with the fiscal 2020 budget. In response, the village eliminated certain employee positions, instituted furloughs, and froze hiring, saving itself approximately $1 million. Despite this, the village incurred significant overtime costs for its fire department as compared to budget, which also has contributed to its projected fiscal 2020 deficit.

Preliminary budget estimates for fiscal 2021 indicate a 2.5% 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 2021, incurring a deficiency of at least $2 million, which will artificially inflate budgetary performance.

Given this forecast, we expect the village's budgetary performance will remain very weak and structurally imbalanced during the next two years, without a plan in place to correct the imbalance. The village has posted five-consecutive deficits on an adjusted basis, with another deficit currently forecast for fiscal 2020. Although the village adopted a pension funding policy that 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.

Very weak budgetary flexibility

Oak Lawn's budgetary flexibility is very weak, in our view, with an available fund balance that we expect could decrease in the near term from its fiscal 2019 level of 2.1% of operating expenditures, or $1.3 million. Negatively affecting budgetary flexibility, in our view, is limited capacity to reduce expenditures.

We have revised our view of the village's budgetary flexibility to very weak from weak, based on a projection that village's available reserves could weaken significantly at the end of fiscal 2020. The village's anticipated fiscal 2020 deficit may deplete reserves to a projected negative $2.6 million, or 4.3% of expenditures. The village could obtain certain one-time revenue that will improve its available fund balance position, but we still consider it likely that the village's budgetary flexibility will remain very weak. In addition, we consider the village's budgetary flexibility adversely affected by its limited capacity to reduce expenditures, particularly mandatory pension contributions and firefighter staffing requirements, which have led to operational deficits and weakened budgetary flexibility.

Strong liquidity

In our opinion, Oak Lawn's liquidity is strong, with total government available cash that we expect will decline in the near term relative to its fiscal 2019 levels at 17.5% of total governmental fund expenditures and 147.0% of governmental debt service in 2019. In our view, the village has strong access to external liquidity if necessary. Weakening the village's liquidity profile is an exposure to high refinancing risk.

In analyzing the village's liquidity, we are including funds in its police investigation fund, its capital projects funds, motor fuel tax fund, sewer retail division fund, and the Oak Lawn Regional Emergency Center fund, which officials indicate are available for short-term borrowing, if necessary. In making these adjustments, the village's cash position declines to $14 million from $18.1 million. We view the village's access to external liquidity to be strong, as it has issued debt regularly in recent years.

Oak Lawn is a party to approximately $12 million of direct-purchase obligations with lenders that contain non-standard events of default that could lead to immediate acceleration against the village. While we view the potential for the triggering of these provisions by the village's lenders as not probable, should this occur, the village could be forced to refinance these obligations rather quickly, which we believe exposes it to high refinancing risk. We view the village's investments to be not aggressive, as it primarily invests in certificates of deposit and governmental securities.

We note that the village expects to enter an arrangement with a third party that will likely lead to a large infusion of one-time revenue, which it believes will improve its liquidity position. Nevertheless, given the village's adverse revenue climate, we view a worsened liquidity position as a potential downside risk.

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 11.9% of total governmental fund expenditures, and net direct debt is 107.6% 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 17.9% of total governmental fund expenditures in 2019. Of that amount, 16.3% represented required contributions to pension obligations, and 1.6% represented OPEB payments. The village made 75% of its annual required pension contribution in 2019. The funded ratio of the largest pension plan is 48.4%.

We believe that Oak Lawn's pension and OPEB liabilities represent a continuing source of rating pressure, as the village is exposed to large unfunded liabilities and high fixed costs that we expect will continue to accelerate. The village is not making its statutory minimum contribution that would allow it to reach 90% funding by 2040, potentially subjecting it to having state-shared revenue intercepted by its police and firefighters' pension funds. Officials have advised us that the pension funds have provided written assurances that they do not intend to use this option. We note that the village has been making some progress in closing the gap between its required and actual annual contribution but is still posting annual funding deficiencies for these plans.

- The village's single-employer defined benefit police and fire pension plans are poorly funded, which, in combination with actuarial assumptions and methods that defer costs into the future, suggests that fixed costs will continue to rise. If not proactively managed, this could increase pressure on operations and could lead to credit deterioration.
- The village funds its OPEB on a pay-as-you-go basis, exposing it to cost acceleration and volatility. We consider the village's OPEB liability a potential source of long-term credit stress.

The village participates in the following plans:

- A single employer defined benefit police pension plan: 48.4% funded (as of Dec. 31, 2019) with a net pension liability totaling $88 million;
- A single-employer defined benefit firefighters' pension plan: 51.2% funded (as of Dec. 31, 2019) with a net pension

liability totaling $76 million;

- An implicit rate subsidy arising from retirees' staying on the village's plan while paying active premium rates: 0% funded with a liability of $31 million.

The village did not make funding progress in its police and firefighters' plans in 2019, as contributions fell well short of our minimum and static funding metrics for both plans, as well as the its ADCs for these plans. The police and firefighters' plans both achieved only 53% of our minimum funding progress calculation and reached 72.5% (police) and 75.2% (firefighters) of our actual static funding calculation. While the village has adopted a revised pension funding policy in 2019, which commits it to higher contributions in the coming years, we do not consider the plan to be credible at the present time given the magnitude of the village's continuing ADC deficiency. The village uses a discount rate of 7% for the both the police and firefighters' plans, we view as more aggressive than the 6% rate that we consider most prudent.

The village provides employer-paid retiree medical care to employees until age 65. It funds its OPEB on a pay-as-you go basis, and had a $31.3 million unfunded actuarial accrued liability as of Dec. 31, 2019. The village contributed $2.5 million to the plan in 2019.

Strong institutional framework

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

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
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 2020 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of November 24, 2020)		
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, Removed from CreditWatch
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Many issues are enhanced by bond insurance.