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**Summary:**

# South Chicago Heights Village, Illinois; General Obligation

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**Summary:**

# South Chicago Heights Village, Illinois; General Obligation

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| South Chicago Hgts Vill GO (BAM) | | |
| *Unenhanced Rating* | A(SPUR)/Stable | Affirmed |
| Many issues are enhanced by bond insurance. | | |

## Rationale

S&P Global Ratings affirmed its 'A' rating on South Chicago Heights, Ill.'s existing series 2015 general obligation (GO) debt. The outlook is stable.

The ratings reflect our assessment of the village's:

- Weak economy, with projected per capita effective buying income at 55.2% and market value per capita of $48,936, though that is advantageously gaining from access to a broad and diverse metropolitan statistical area (MSA);
- Adequate management, with "standard" financial policies and practices under our Financial Management Assessment methodology;
- Weak budgetary performance, with operating results that we expect could deteriorate in the near term relative to fiscal 2017, which closed with an operating deficit in the general fund but an operating surplus at the total governmental fund level;
- Adequate budgetary flexibility, with an available fund balance in fiscal 2017 of 7.6% of operating expenditures but that is low on a nominal basis at $371,000;
- Very strong liquidity, with total government available cash at 47.6% of total governmental fund expenditures and 11.5x governmental debt service, and access to external liquidity that we consider strong;
- Adequate debt and contingent liability position, with debt service carrying charges at 4.2% of expenditures and net direct debt that is 49.9% of total governmental fund revenue, as well as rapid amortization, with 72.2% of debt scheduled to be retired in 10 years, but 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.

### Weak economy

We consider South Chicago Heights' economy weak. The village, with an estimated population of 4,095, 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 55.2% of the national level and per capita market value of $48,936. Overall, the village's market value was stable over the past year at $200.4 million in 2019. The county unemployment rate was 5.2% in 2017.

South Chicago Heights is a mature community located in Cook County, approximately 28 miles south of downtown Chicago. Residents have easy access to jobs throughout the metro area by way of nearby interstates and a Metra commuter rail line.

Village officials indicate there is no significant new development underway, and anticipates modest equalized assessed valuation growth. Various taxpayers within the village routinely appeal their tax assessments; additionally, some of the older commercial properties are slow to pay their property tax bills. In our view, these issues are ongoing and indicate to us that the village's property tax revenue growth will remain relatively stagnant.

### Adequate management

We view the village's management as adequate, with 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.

Village officials construct the budget using three years of historic financial data as well as outside sources of information. The board receives monthly budget to actual financial reports. Although the board reviews the line item budget on a monthly basis, and could amend to address line item shortfalls if they occur, it typically only amends at year end since the adjustments tend to be minor. The village does not produce any formal forecasting or capital planning. The village's investment policy mirrors state statutes, and the board receives monthly reports. The village's reserve target is equal to 90 days of expenditures, but its reserves are not currently meeting this target.

### Weak budgetary performance

South Chicago Heights' budgetary performance is weak in our opinion. The village had deficit operating results in the general fund of negative 2.6% of expenditures, but a surplus result across all governmental funds of 4.3% in fiscal 2017. Our assessment accounts for the fact that we expect budgetary results could deteriorate from 2017 results in the near term.

The village's 2019 general fund budget calls for a $70,564 deficit after transfers and proceeds, but officials anticipate ending close to breakeven. This follows breakeven results that village officials expect to report for fiscal 2018.

We anticipate that future recurring general fund expenditures could be relatively flat, given the maturity of the community, but for the village's growing pension contributions. As a result, we believe the village's financial operations could structurally deteriorate under the weight of future pension contributions, especially when its revenue, in our view, will likely remain relatively constrained.

The village's general fund revenue has been somewhat stagnant the past several fiscal years, with property tax exhibiting tepid growth, constrained by a slow economic recovery of the tax base and by statutory taxing limitations under the property tax extension limitation law, which limits annual property tax revenue growth for operations to the lesser of 5% or the rate of inflation, except for new construction. Property tax revenue accounts for 30% of general fund revenue, followed by state sales tax revenue (19%) and state income tax revenue (10%). The remaining general fund revenue is derived from various fines, charges for services, and licensing fees, as well as electric and natural gas utility tax revenue.

General fund revenue is augmented by annual transfers from the non-home rule sales tax fund, which is restricted and exists for the purpose of funding capital projects and property tax relief. This fund collects sales tax revenue generated within the village from its 1% sales tax. In fiscal 2017, the fund recognized $424,560 in revenue, down somewhat from fiscal 2016's $446,169. During the past three audited fiscal years, the annual transfers from the non-home rule sales tax fund to the general fund have ranged from $150,000 to $250,000. The village budgeted $500,000 transfer for fiscal 2018 and $425,000 in fiscal 2019.

South Chicago Heights has reported somewhat uneven financial operations in the general fund during the past three audited fiscal years. Fiscal 2015 general fund performance was essentially breakeven, with a modest $17,296 surplus. Fiscals 2016 and 2017 general fund results varied from trend due to accounting changes in revenue recognition of property taxes and long-term lease revenues, with a sizeable $156,715 surplus in 2016, nearly offset by a $116,737 deficit in 2017. The 2016 surplus resulted from the recognition of long-term lease revenue, which was subsequently transferred to the capital projects fund for a building project.

We adjusted general fund revenue and expenditures for transfers in from the non-home rule sales tax fund, as well as transfers out to E911 fund, debt service fund, CDBG fund and property management fund.

We adjusted the village's total governmental funds expenditures in prior years for items such as bond proceed spending. All of the individual governmental funds have positive ending balances at the end of fiscal 2017. Aside from the general fund, the largest fund is the non-home rule sales tax fund. Overall, total governmental fund performance has been positive.

### Adequate budgetary flexibility

South Chicago Heights' budgetary flexibility is adequate, in our view, with an available fund balance in fiscal 2017 of 7.6% of operating expenditures. The village's reserves are low on a nominal basis at $371,000, which we view as vulnerably low and a negative credit factor.

Compared to other, higher-rated credits, we view the village's general fund reserves as nominally low, potentially exposing it to more risk in the event of a significant, unforeseen expenditure, offset only by liquidity in other funds.

South Chicago Heights' unassigned general fund balance dropped to $371,007 in 2017 from $766,641 in 2016 due to a change in revenue recognition as recommended by the village's new audit team. The accounting change negatively affected the fund balance but in our view, provides a more accurate representation of the village's financial position. Given management's expectations of breakeven results for 2018 and 2019, we anticipate that the village's budgetary flexibility will remain adequate.

The village has used the non-home rule sales tax fund to support the general fund through annual transfers, but the board formally restricts the fund for capital spending and property tax relief. We do not include the fund in our assessment of the village's budgetary flexibility, since reserves may fluctuate due to its restricted, intended purposes. The village is planning to update its capital plan in 2019, and depending on the extent and timing of its capital needs, these assets may be affected.

### Very strong liquidity

In our opinion, South Chicago Heights' liquidity is very strong, with total government available cash at 47.6% of total governmental fund expenditures and 11.5x governmental debt service in 2017. In our view, the village has strong access to external liquidity if necessary.

The village has demonstrated strong access to external liquidity, having issued mainly GO bonds, most recently in 2015.

The non-home rule sales tax fund is an important source of liquidity for the village and helps it meet its cash flow needs throughout the year. The fund reported $1.35 million of cash assets out of about $2.5 million of total government cash.

While the non-home rule sales tax fund has a fund balance of $2.47 million, we note the fund lent roughly $1 million to two proprietary funds, the water fund and the property management fund, in the amounts of $740,000 and $272,225, respectively, as of fiscal 2017; cash assets in the fund totaled $1.35 million. The property management fund repaid all but about $20,000 during fiscal 2018, but the water fund has not been generating income to repay the loan. Despite that, we anticipate the village will maintain very strong liquidity for the current and following year.

The village has one bank loan with PNC Bank that it entered into in 2015, with a roughly $1.7 million balance. There are no permissive events of default in the loan that would lead to an acceleration of all amounts due and payable.

### Adequate debt and contingent liability profile

In our view, South Chicago Heights' debt and contingent liability profile is adequate. Total governmental fund debt service is 4.2% of total governmental fund expenditures, and net direct debt is 49.9% of total governmental fund revenue. Approximately 72.2% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor.

The village currently has no plans to issue any bonded debt in the foreseeable future.

In our opinion, a credit weakness is South Chicago Heights' large pension and OPEB obligation, without a plan in place that we think will sufficiently address the obligation. South Chicago Heights' combined required pension and actual OPEB contributions totaled 8.7% of total governmental fund expenditures in 2017. Of that amount, 6.3% represented required contributions to pension obligations, and 2.4% represented OPEB payments. The village made 98% of its annual required pension contribution in 2017. The funded ratio of the largest pension plan is 45.0%.

South Chicago Heights has what we view as a large unfunded pension liability, where the risk of accelerating payment obligations could contribute to budgetary stress. The village participates in three pension plans: one for police, firefighters, and regular employees. Like many Illinois municipalities, its police and firefighters plans are single-employer plans. As of the Jan. 1, 2017 actuarial valuation date, the police pension fund was 45% funded and reported a $4.4 million net pension liability. In the past two calendar years, the village contributed slightly less than the full actuarially determined contribution, falling $15,091 short in 2017 and $18,168 short in 2016 of an actuarially determined contribution (ADC) of $155,069. The village fully funded the ADC in 2014 and 2015. Management attributes the differences in 2016 and 2017 mainly to timing between the actuarial reports and setting its annual property tax levy.

We expect that budgetary stress is likely to increase in the future as a result of increasing costs in the police pension fund plan. The police pension plan's liability was calculated using a 5.1% discount rate. Although no crossover date (under GASB 68) is reported in the village's 2017 audit, a single blended discount rate indicates that under the current funding plan and assumptions, projected assets, future contributions, and investment earnings will be insufficient to cover all benefit payments. Staff turnover and retirements could further hinder funding progress in the plan. Management believes the village is capable of meeting future funding requirements, but currently does not have a specific plan in place to address growing pension payments.

The village has a small firefighters pension fund, with only one retiree and no active members. The plan is only 2.6% funded with a $464,601 net pension liability. The village historically has paid slightly more than the ADC. In 2017, the ADC was $10,266. Given the small size of the plan, we do not consider it to materially contribute to budgetary stress.

South Chicago Heights also participates in the agent multiple-employer pension plan Illinois Municipal Retirement Fund (IMRF). The village's IMRF plan was 83.3% funded in fiscal 2017, and its net pension liability was $1.1 million. The village makes the full ADC to the plan each year.

The village previously provided retiree healthcare benefits to its retirees, but discontinued the benefit for all new hires as of 2006. For employees eligible under the discontinued plan, the village funds the benefits on a pay-as-you-go basis.

### Strong institutional framework

The institutional framework score for Illinois non-home rule cities and villages subject to the Property Tax Extension Limitation Law is strong.

## Outlook

The stable outlook reflects our expectation that South Chicago Heights' management will take the steps necessary to maintain balanced operations and at least adequate budgetary flexibility and very strong liquidity. The village's participation in the Chicago MSA's broad and diverse economy provides stability to the outlook. We therefore do not expect to change the rating over the two-year outlook horizon.

### Downside scenario

We could lower the rating if the village cannot maintain balanced operations, resulting in a deterioration of budgetary performance and flexibility.

### Upside scenario

We could raise the rating if the village's key economic indicators substantially improve to levels commensurate with those of its higher-rated peers, and if positive operations result in stronger budgetary flexibility and pension funding levels.

## Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- 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

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.