

CREDIT OPINION

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Skokie (Village of) IL

Update to credit analysis

Summary

The village benefits from a large tax base with economic ties to the city of Chicago (Ba1 negative), sound fund balance with strong legal authority to raise local revenues as a home rule unit of local government and a low debt burden. The village's primary credit challenge is an above average and growing pension burden.

Credit strengths

- » Large tax base with economic ties to the City of Chicago
- » As a home rule unit of government, the village maintains the flexibility to raise revenue without voter approval
- » Low debt burden

Credit challenges

- » Elevated and growing pension burden with high fixed costs
- » Modest socioeconomic profile relative to other highly rated local governments

Rating outlook

The negative outlook reflects the likelihood that unfunded pension liabilities will continue to grow given current contribution practices. Absent significant future tax base and revenue growth, increases in the liability could result in downward rating movement given the pension burden is already above average.

Factors that could lead to an upgrade

- » Moderation of the village's pension burden

Factors that could lead to a downgrade

- » Further tax base deterioration or a weakened socioeconomic profile
- » Narrowing of financial reserves or liquidity
- » Growth in overall leverage (debt and pensions) and fixed cost burden

Key indicators

Exhibit 1

Skokie (Village of) IL	2013	2014	2015	2016	2017
Economy/Tax Base					
Total Full Value (\$000)	\$7,091,911	\$6,212,307	\$6,371,887	\$6,274,935	\$7,322,251
Population	64,885	65,056	65,061	64,873	64,784
Full Value Per Capita	\$109,300	\$95,492	\$97,937	\$96,726	\$113,026
Median Family Income (% of USMedian)	117.7%	119.0%	118.7%	118.5%	118.5%
Finances					
Operating Revenue (\$000)	\$62,296	\$67,763	\$70,592	\$74,038	\$76,419
Fund Balance (\$000)	\$16,448	\$16,364	\$20,364	\$23,342	\$25,109
Cash Balance (\$000)	\$16,288	\$17,179	\$13,428	\$19,312	\$22,654
Fund Balance as a % of Revenues	26.4%	24.1%	28.8%	31.5%	32.9%
Cash Balance as a % of Revenues	26.1%	25.4%	19.0%	26.1%	29.6%
Debt/Pensions					
Net Direct Debt (\$000)	\$49,851	\$61,552	\$57,196	\$50,419	\$43,627
3-Year Average of Moody's ANPL (\$000)	\$189,427	\$221,773	\$254,357	\$287,054	\$320,434
Net Direct Debt / Operating Revenues (x)	0.8x	0.9x	0.8x	0.7x	0.6x
Net Direct Debt / Full Value (%)	0.7%	1.0%	0.9%	0.8%	0.6%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	3.0x	3.3x	3.6x	3.9x	4.2x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	2.7%	3.6%	4.0%	4.6%	4.4%

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

Profile

The village is located approximately 16 miles northwest of downtown Chicago and encompasses 10 square miles in Cook County (A2 stable).

Detailed credit considerations

Economy and tax base: mature tax base benefits from location within Chicago metro area

We expect Skokie's tax base to benefit over the long term from its location within the Chicago metropolitan area, which provides local residents with a diverse array of employment opportunities. After several years of valuation decline, the village's tax base has begun to recover including a 17% increase in the most recent valuation year. More modest tax base growth is expected over the near term given increased commercial and residential development activity. The recent growth increased the village's full valuation to \$7.3 billion, or 21% below its prerecessionary high. The declines have limited impact on the village's generation of revenue given its flexibility to raise taxes. Taxpayer concentration is above average, with the top ten accounting for 16% of assessed valuation. The largest taxpayer, Old Orchard Shopping Center, accounts for 7% of assessed valuation. The center is a significant draw of shoppers throughout the metro area.

Skokie's population is relatively stable, having grown a modest 2.3% between 2000 and 2010. Median family income is estimated at 119% of the national figure, a level significantly below that of many high Aa-rated local governments. As a share of US median family income, the village is down from 136% in 2000 and 125% in 2010. As of December 2017, the village's unemployment rate was 3.8% and compares favorably to state and national figures of 4.7% and 3.9% respectively. Both total employment and the labor force within the village remain modestly below pre-recession peaks.

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Financial operations and reserves: sound financial operations expected to remain stable

The village's financial profile benefits from sound reserve levels and strong revenue raising flexibility as a home rule unit of government. Inclusive of a \$940,000 surplus in fiscal 2017, available general fund reserves have increased to \$17.5 million and a healthy 26.2% of revenue. Five years prior, in fiscal 2012, available general fund reserves were \$8.7 million and 16.6% of revenue. Steady improvement of fund balance has been supported by strong expenditure control and utilization of available revenue raising flexibility including a .25% increase in the village's local home rule sales tax rate in 2016. Across village operating funds (combined general, debt service and IMRF funds) available fund balance was \$25.1 million and 32.9% of operating revenue.

The village has conservatively budgeted for essentially balanced operations in fiscal 2018; however, management regularly outperforms budgeted expectations.

LIQUIDITY

The village's net operating fund cash at close of fiscal 2017 was \$22.7 million and 29.6% of operating revenue. Village operating liquidity is expected to remain stable over the near-term.

Debt and pensions: elevated pension burden with rising fixed costs

While the village's debt burden is low, its pension burden is high and growing. Inclusive of the current offering, the village's debt burden is low at 0.7% of full valuation and 0.6x operating revenue. The village's debt burden is expected to remain low given a lack of future borrowing plans and extensive pay-as-you-go capital financing. The village's five year capital improvement plan calls for approximately \$20 million in pay as you go capital improvements every year over the next five years.

At the close of fiscal 2017, the village's three-year average Moody's adjusted net pension liability (ANPL), our measure of a local government's pension burden, was high at \$320 million 4.2x operating revenue. The three year average ANPL has grown from \$151 million and 2.5x revenue since 2012.

DEBT STRUCTURE

All of the village's debt is fixed rate and long term with a healthy 79% of principal set to be retired over the next ten years.

DEBT-RELATED DERIVATIVES

The village has no derivative exposure.

PENSIONS AND OPEB

Skokie manages two single-employer, defined benefit pension plans and is also a member of Illinois Municipal Retirement Fund (IMRF), a defined benefit, multi-employer agent plan. Key sources of growth in the village's pension burden in recent years include changes in mortality assumptions and village contributions that, while closely conforming with actuarially determined contributions, have not been sufficient to fully cover annual interest accruals on accumulated unfunded liabilities. The Moody's ANPL referenced above reflects the use of a market-based discount rate to value the plans' liabilities.

Net of enterprise support, Skokie's fiscal 2017 pension contribution was \$9.4 million and 12.3% of revenue. The village's public safety plans are by far the largest of its plans, and Skokie contributed \$7.6 million to those plans in fiscal 2017. The public safety plan contributions were \$4.4 million short of the amount necessary to forestall growth in the plans' reported net pension liabilities assuming other plan assumptions hold, that is, tread water¹.

The gap between the village's public safety pension contributions and the two plans' aggregate tread water needs was 5.8% of operating revenue in fiscal 2017 and up from 4.6% of revenue in fiscal 2016. Public safety contributions are set to increase by \$850,000 in fiscal 2018 and will be short of tread water. The village funds its public safety pension plans to achieve a 100% reported funded ratio by 2040, while making additional supplemental contributions when possible from surplus operations.

The village's implicit rate subsidy results in a low other post-employment benefits (OPEB) unfunded actuarial liability of \$8.3 million as of fiscal 2017. The village's fixed costs (combined debt service, pension and OPEB expenditures) in fiscal 2017 were equivalent to a high 25.6% of revenue.

Management and governance: moderate institutional framework enhanced by home rule status

Skokie's revenue streams are relatively diverse as they include sales taxes (28%) and property taxes (21%). Although the village is reliant upon sales tax receipts, an economically vulnerable revenue stream, this risk is offset somewhat by the financial flexibility afforded by the village's designation as a home-rule unit of government. As a home-rule government, the village can implement a variety of revenue enhancements (including property, sales, utility, and food and beverage taxes) without local voter approval. The village also retains flexibility to adjust its aggressive approach for pay as you go capital investment should budgetary pressures arise. The village's fund balance policy calls for a minimum unassigned balance of 25% of expenditures. State income tax distributions represent the village's primary exposure to the state, accounting for 8% of operating revenue in fiscal 2017.

Illinois villages have an institutional framework score of "A," or moderate. Revenue predictability is moderate, with varying dependence on property, sales, and state-distributed income taxes. Revenue-raising ability is also moderate but varies. Home-rule entities, such as Skokie, have substantial revenue-raising authority that exceeds the sector framework. This flexibility is a key strength of the village's credit profile, helping to offset challenges tied to underfunded retirement liabilities and the potential loss of state funding. Expenditures are moderately predictable but villages have limited ability to reduce them given costs for pension benefits that enjoy strong constitutional protections.

Endnotes

- 1 Our "tread water" indicator measures the annual government contribution required to prevent reported net pension liabilities from growing, given the entity's actuarial assumptions. An annual government contribution that treads water equals the sum of employer service cost and interest on the reported net pension liability at the start of the fiscal year. A pension plan that receives an employer contribution equal to tread water will end the year with an unchanged net pension liability relative to the beginning of the year if all plan assumptions hold. Net liabilities may decrease or increase in a given year due to factors other than the contribution amount, such as investment performance that exceeds or falls short of a plan's assumed rate of return. Still, higher contributions will always reduce unfunded liabilities faster, or will allow unfunded liabilities to grow more slowly than lower contributions. The degree to which contributions fall below the "tread water" indicator can help quantify a structural operating imbalance stemming from pensions, even under reported assumptions. A contribution below the "tread water" level in effect suppresses expenditures by leaving an implied interest on net pension liabilities unpaid, akin to borrowing at the assumed rate of return for operations.

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