

## Staff Responses to Council Questions 7/19/2022

**Active Agenda - C. A motion authorizing staff to proceed with the completion of all obligations in connection with the issuance of General Obligation Bonds, Series 2022, including the execution of all required documents and payment of all required fees in connection therewith**

- ***At the request of Commissioner Kulovany, this item has been removed from the Consent Agenda.***

1. *What are the elements that the S&P Global Ratings use to determine the Village's financial rating? What items are within the Village's control? What items are not in the Village's control?*

Generally speaking, S&P Global Ratings uses a seven category quantitative and qualitative system to determine and assign a financial rating. A numeric score of 1 to 5 (1 being the best) along with a weighting are applied to each of the seven categories. S&P has twelve different ratings ranging from AAA (best) to B (lowest rating) based on the weighted final numeric scores. More information about S&P Global Ratings approach to rating governments can be found [here](#).

<b>Category</b>	<b>Weighting</b>
Institutional Framework	10%
Economy	30%
Management	20%
Budgetary Flexibility	10%
Budgetary Performance	10%
Liquidity	10%
Debt and Contingent Liabilities	10%

The Village has direct control over *Management, Budgetary Flexibility, Budgetary Performance* and *Liquidity* (50% of the total score). The other categories are not within the Village's direct control (50% of the total score). The *Institutional Framework* and *Debt & Contingent Liabilities* score is greatly dependent upon the financial condition and general practices of the State of Illinois. While the State has improved its own credit rating in the past few years, it is very difficult for municipalities located in Illinois to achieve good scores in these two categories.

The Village's most recent rating took place in February 2020 (see attached report). Since the last rating the Village has taken the following actions which should be viewed positively by the rating agency:

- **Achieved Surplus General Fund Budgets in 2019, 2020 & 2021**
- **Successfully Responded to the Pandemic**
  - *Reduced Expenses*
  - *Obtained \$7.46 Million in Grants*
- **Reduced OPEB Liability by Creating and Funding an OPEB Trust**
- **Increased the Funded Ratio of Both Public Safety Pensions**
- **Enhanced Revenues**
  - *Increased the Food & Beverage Tax Rate*
  - *Increased Ambulance Fee Revenue through the GEMT Program*
- **Retired the Downtown Tax Increment Financing District and Paid Off the Bonds**

# RatingsDirect®

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**Summary:**

## Downers Grove Village, Illinois; General Obligation

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## Summary:

# Downers Grove Village, Illinois; General Obligation

### Credit Profile

US\$20.425 mil taxable GO rfdg bn ds ser 2020 due 01/01/2038

*Long Term Rating* AAA/Stable New

Downers Grove Vill GO

*Long Term Rating* AAA/Stable Affirmed

## Rationale

S&P Global Ratings assigned its 'AAA' long-term rating to Downers Grove Village, Ill.'s series 2020 taxable general obligation (GO) refunding bonds. At the same time, S&P Global Ratings affirmed its 'AAA' long-term rating on the village's existing GO debt. The outlook is stable.

The village's unlimited ad valorem tax GO pledge secures the 2020 bonds. The bond proceeds will advance refund outstanding portions of the village's series 2012 bonds for interest cost savings.

The village's GO bonds are eligible to be rated above the sovereign, because we believe Downers Grove can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions" (published Nov. 19, 2013, on RatingsDirect), U.S. local governments are considered to have moderate sensitivity to country risk. The institutional framework in the U.S. is predictable for local governments, allowing them significant autonomy, independent treasury management, and no history of federal government intervention. In our view, the village demonstrates financial flexibility with its very strong budgetary flexibility and liquidity as well as its locally sourced operating revenue.

## Credit Overview

Downers Grove's comprehensively strong credit profile reflects in all aspects, with the exception of its outstanding pension and retiree healthcare obligations. The village is a Chicago suburb with high wealth and income indicators. Its strong management supports the village's stable finances and large general fund reserves. In our view, the village's police and firefighter pension plans are poorly funded, but officials have a formal pension and an other postemployment benefit (OPEB) funding policy with a goal to reach 100% funding in the plans. We anticipate the village will continue to accommodate growing pension contributions into its budget without jeopardizing structural balance, but over time, this may become more difficult, given some of the methods and assumptions in place.

The rating reflects our assessment of the village's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with strong financial policies and practices under our Financial Management Assessment

methodology;

- Strong budgetary performance, with an operating surplus in the general fund and break-even operating results at the total governmental fund level in fiscal 2018;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 39% of operating expenditures;
- Very strong liquidity, with total government available cash at 81.4% of total governmental fund expenditures and 8.7x governmental debt service, and access to external liquidity that we consider strong;
- Very weak debt and contingent liability position, with debt service carrying charges at 9.4% of expenditures and net direct debt that is 43.9% of total governmental fund revenue, and significant medium-term debt plans and a large pension and OPEB obligation with no plan to sufficiently address the obligation, but low overall net debt at less than 3% of market value; and
- Strong institutional framework score.

### **Very strong economy**

We consider Downers Grove's economy very strong. The village, with an estimated population of 48,098, is located in DuPage 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 157% of the national level and per capita market value of \$159,321. Overall, the village's market value grew by 4.7% over the past year to \$7.7 billion in 2019. The county's unemployment rate was 3.1% in 2018.

Downers Grove is a home-rule village in DuPage County, approximately 23 miles southwest of Chicago's Loop. About 75% of the tax base is residential. A mature community, most of its new construction is infill-type development that drives estimated assessed value (EAV) growth as well as steady home value appreciation. The village has not had any issues with tax appeals or collections. Given its advantageous location, with access to jobs in Chicago but also in the outlying suburbs, and its steady development, we expect the village's economy to remain very strong over the next two years.

### **Very strong management**

We view the village's management as very strong, with strong financial policies and practices under our Financial Management Assessment methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Strengths of the assessment, in our opinion, include strong revenue and expenditure assumptions and the use of historical data when formulating the budget. Other highlights include management's monthly reporting to the village board on budget-to-actual performance and investment holdings. The village has a long-term financial plan and capital plan that is updated annually and shared with the board. The capital plan includes cost estimates and funding sources. The village maintains formal reserve, investment, and debt policies. The village's fund balance policy is to maintain an available general fund balance of between two months and four months of expenditures, a level it has historically met.

### **Strong budgetary performance**

Downers Grove's budgetary performance is strong in our opinion. The village had surplus operating results in the general fund of 1.8% of expenditures, and balanced results across all governmental funds of negative 0.4% in fiscal

2018. General fund operating results of the village have been stable over the past three years, with a result of 0.0% in 2017 and a result of 0.1% in 2016.

We have made adjustments to the village's financial data in order to better analyze its typical operations and facilitate comparisons with its peers. For instance, we adjusted the village's general fund results to include transfers, and we reduced total governmental fund expenditures for TIF expenditures paid from accumulated reserves. The village tends to report positive financial operations and this continued in fiscal 2018, which ended with a modest general fund surplus after transfers and fairly steady total governmental fund results. The village is planning a municipal building project, and if they move forward with the project, they expect to issue debt to cover most of the project cost. In 2018, their general fund budget permitted an \$800,000 transfer out to help build a potential equity contribution to the future municipal building project. There is currently \$2.7 million in the municipal building fund, and it could grow from additional contributions. Officials expect to report roughly breakeven results for fiscal 2019 in the general fund, and potentially a \$2.7 million increase in the total governmental fund as a result of favorable TIF performance. We expect that the village budgetary performance will be strong in most years, with fairly steady general fund results. Total governmental fund performance may vary but overall will remain balanced, with the village accumulating reserves for capital or economic development purposes, and then spending them down. The 2020 budget calls for essentially breakeven general fund operations. The village is not expecting any major fluctuations in revenue, though they may see an uptick in sales tax revenue from online transactions. Though some of its labor contracts are being negotiated, we anticipate that its personnel and related expenditures will remain fairly predictable. Thus we anticipate the village's budgetary performance will remain strong in the current and following year. Intergovernmental revenue (mostly state shared income and sales taxes) accounted for 36% of general fund revenue followed by property taxes at 27% in fiscal 2018.

### **Very strong budgetary flexibility**

Downers Grove's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 39% of operating expenditures, or \$18.7 million. We expect the available fund balance to remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor.

The village benefits from its status as a home-rule entity, which provides it with a greater array of revenue raising and debt issuance flexibility. Given its balanced financial operations, we do not anticipate our view of the village's budgetary flexibility to change in the near future.

### **Very strong liquidity**

In our opinion, Downers Grove's liquidity is very strong, with total government available cash at 81.4% of total governmental fund expenditures and 8.7x governmental debt service in 2018. In our view, the village has strong access to external liquidity, if necessary.

The village has strong access to liquidity, as demonstrated by its regular GO issuance during the past 15 years. The village has roughly \$1.1 million of outstanding direct-purchase debt issued in 2017, however, we do not consider it a contingent liability or liquidity risk, and we expect its liquidity profile will remain very strong.

### **Very weak debt and contingent liability profile**

In our view, Downers Grove's debt and contingent liability profile is very weak. Total governmental fund debt service is 9.4% of total governmental fund expenditures, and net direct debt is 43.9% of total governmental fund revenue. Negatively affecting our view of the village's debt profile is its significant medium-term debt plans. Overall net debt is low at 1.1% of market value, which is in our view a positive credit factor.

We adjusted the village's debt profile to exclude self-supporting GO debt paid from the village's enterprise funds. The village plans to fund upcoming water projects with the Illinois Environmental Protection Agency (IEPA) loans currently in the amount of \$7.1 million. Village officials are considering plans for a combined police station and village hall, with an estimated price tag of \$40 to \$44 million, with \$30 million to \$34 million paid from debt. The village may move forward with the project in the next year, and bond issuance within the next two years.

### **Pension and OPEB**

In our opinion, a credit weakness is Downers Grove's large pension and OPEB obligation, without a plan in place that we think will sufficiently address the obligation. Downers Grove's combined required pension and actual OPEB contributions totaled 13.7% of total governmental fund expenditures in 2018. Of that amount, 12.8% represented required contributions to pension obligations, and 0.8% represented OPEB payments. The village made 99% of its annual required pension contribution in 2018. The funded ratio of the largest pension plan is 51.3%.

The village's budget is not currently burdened by its pension and OPEB obligations, but there are assumptions and methods that backload contributions and introduce risk of funding volatility if assumptions are not met. Downers Grove participates in three pension plans:

- The Illinois Municipal Retirement Fund (IMRF), fully funded with \$557,744 of net pension assets and 100.6% funded;
- The police pension employees retirement system, \$49.7 million net pension liability and 51.3% funded; and
- The firefighters' pension employees retirement system, \$47.9 million net pension liability and 52.4% funded.

The village has a formal pension funding policy that calls for 100% funding by 2040 and the use of actuarially determined contributions (ADC) when determining the annual payments (as opposed to the state requirement of only funding to 90% by 2040). However, the village's fiscal 2018 actuarially determined contributions to the police and firefighters pension plans fell short of our minimum-funding-progress metric (62% and 70%, respectively) and static-funding metric (81% and 89%, respectively), which means that contributions fell short of the present value of benefits earned that year plus the interest on the unfunded liability. Additionally, we expect slower progress toward full funding due to the plans' level-percent-amortization basis during a closed 22-year period and a 4% payroll growth assumption. Furthermore, we think the plans' 7% discount rate could lead to employer cost volatility. However, we anticipate the village will continue to accommodate growing pension contributions into its budget without jeopardizing structural balance, but over time, this may become more difficult given some of the methods and assumptions in place. The village's OPEB plan is funded on a pay-as-you-go basis and the plan is 0% funded. The village recently adopted an OPEB policy in late 2019, established a trust fund, and dedicated \$600,000 to the fund. It is the village's goal to attain 100% ADC funding.

## **Strong institutional framework**

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

## **Outlook**

The stable outlook reflects our expectation that we will not change the rating over the two-year horizon because we anticipate that the village will continue to benefit from its very strong economy, budgetary flexibility, and liquidity, all of which are supported by the its very strong management.

## **Downside scenario**

However, should the village report deteriorated budgetary performance or if pension obligations pressure the village's financial position more than currently anticipated, we could lower the rating.

## **Related Research**

- U.S. State And Local Government Credit Conditions Forecast, Oct. 29, 2019
- 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
- 2019 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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.



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