S&P Global Ratings

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Summary:

Palatine Village, Illinois; General Obligation

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Credit Profile		
US$17.73 mil GO rfdg bnds ser 2020 due 12/01/2034		
Long Term Rating	AA+/Stable	New
Palatine Vill GO		
Long Term Rating	AA+/Stable	Affirmed
Palatine Vill GO		
Long Term Rating	AA+/Stable	Affirmed

Rating Action

S&P Global Ratings has assigned its 'AA+' long-term rating to Palatine Village, Ill.'s series 2020 general obligation (GO) refunding bonds. S&P Global Ratings has also affirmed its 'AA+' long-term rating on the village's GO debt outstanding. The outlook is stable.

The bonds are secured by the village's GO unlimited-tax pledge. Proceeds from the series 2020 bonds will be used to refund the series 2010C bonds for interest cost savings.

Credit overview

Palatine has maintained a very strong reserve position through consistent surpluses while decreasing its debt burden through early redemption of debt. Although the economy is recovering, residual impacts from the recession have pressured sales taxes. However, other revenue streams are expected to offset sales tax losses; specifically, economic expansion has led to an increased sales tax base, stable property taxes, and rising use taxes. Management has taken a conservative approach and has allowed for significant decreases in expenditures to preserve capital and limit the impacts from potentially decreased revenues. However, management does not expect to have to make material adjustments and we expect reserves will remain very strong. For S&P Global Economics' latest U.S. forecast, see "The U.S. Economy Reboots, With Obstacles Ahead" (published Sept. 24, 2020, on RatingsDirect).

The rating reflects our view of the following factors:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2019;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 38% of operating expenditures;
- Very strong liquidity, with total government available cash at 94.9% of total governmental fund expenditures and 9.6x governmental debt service, and access to external liquidity we consider strong;

- Adequate debt and contingent liability profile, with debt service carrying charges at 9.9% of expenditures and net direct debt that is 54.3% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 78.8% 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.

Environmental, social, and governance factors

Our rating incorporates our view regarding the social risk posed by the COVID-19 pandemic, which could diminish the village's sales tax revenues. In addition, we analyzed the village's environmental and governance risks and determined they are in line with the sector.

Stable Outlook

Downside scenario

We could take a negative rating action should operating deficits lead to a material decline in reserves to levels no longer in line with the rating.

Upside scenario

We could raise the rating should economic expansion lead to a marked improvement in incomes and wealth indicators to levels commensurate with those of 'AAA' rated peers, while Palatine maintains or improves other credit factors.

Credit Opinion

Strong economy

We consider Palatine's economy strong. The village, with an estimated population of 69,574, is located in Cook County about 30 miles northwest of downtown Chicago, in the Chicago-Naperville-Elgin, IL-IN-WI MSA, which we consider broad and diverse. It has projected per capita effective buying income of 128% of the national level and per capita market value of $95,025. Overall, the village's market value grew by 23.9% over the past year to $6.6 billion in 2020. The county unemployment rate was 3.8% in 2019; however, we expect this figure to increase materially on an annualized basis for 2020.

The village's equalized assessed value (EAV) rose a sizable 16% in 2017 related to its triennial reassessment, and is projected to increase about 14% in 2020. Economic expansion is ongoing and includes the opening of two new car dealerships and a large home design showroom, and the expected opening of an Amazon distribution center. Management indicates no material impacts from the pandemic and minimal residual impacts from the recession.

Strong management

We view the village's management as strong, with good financial policies and practices under our FMA methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Key policies and practices include:

- Revenue and expenditure assumptions based on three years of historical data and the consultation of outside sources;
- Monthly budget-to-actual reports provided to the village board, as well as a quarterly budget-to-actual report that provides greater detail. Budget amendments are typically made quarterly, although they can happen more frequently as necessary;
- Five-year capital investment plan that is annually updated;
- Long-term financial plan, covering the budget year and four additional years, that is used internally by management;
- Investment management policy; the council receives quarterly investment reports;
- Debt management policy, although it is not comprehensive, in our opinion;
- General fund reserve policy of 25% to 33% of expenditures; and
- Economic stabilization fund of $1 million, which the village currently exceeds.

Adequate budgetary performance

Palatine's budgetary performance is adequate in our opinion. The village had operating surpluses of 4.0% of expenditures in the general fund and 2.9% across all governmental funds in fiscal 2019.

Our assessment of operating results includes adjustments for one-time transfers from the general fund for redemption of debt. Fiscal year-end 2019 (Dec. 31) results are a continuation of mostly positive historical operating results in recent years. The general fund depends on a diverse mix of revenue streams: state-shared revenues, which make up about 36% of total revenues; property taxes (34%); charges for services (8%); and home-rule sales taxes (7%).

Management expects minimal impact to general fund revenues from the pandemic and minimal lingering impacts from the recession. Management expects sales taxes to decline; however, this will be mitigated by additional revenues from the opening of two new car dealerships in 2020, increased tax distributions from the state due to a large upswing in online sales, and no material impacts to income or property taxes. Palatine has a contingency plan in place to cut about $5 million in expenditures to offset potential revenue declines; however, management does not expect declines that large to materialize. Expenditure offsets would come from hiring freezes, operating expenditure cuts, and delays to discretionary capital projects. We expect the village's strong management team will make the appropriate adjustments and maintain adequate budgetary performance through 2020.

Very strong budgetary flexibility

Palatine's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 38% of operating expenditures, or $21.4 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.

We expect budgetary flexibility to remain very strong despite potential declines in revenues caused by the effects of the recession. The village has the flexibility to significantly cut expenditures, if needed, in order to preserve capital and maintain very strong reserves.

Very strong liquidity

In our opinion, Palatine's liquidity is very strong, with total government available cash at 94.9% of total governmental fund expenditures and 9.6x governmental debt service in 2019. In our view, the village has strong access to external liquidity if necessary.

The village reported $76.2 million in total cash and investments in 2019, which we consider very strong. It has strong access to external liquidity, in our opinion, because of the strengths in its credit profile and because it has issued GO debt in the past 20 years. Palatine does not have any variable-rate or private placement debt, nor does it have any existing or planned debt containing adverse provisions that could cause a contingent liquidity risk.

Adequate debt and contingent liability profile

In our view, Palatine's debt and contingent liability profile is adequate. Total governmental fund debt service is 9.9% of total governmental fund expenditures, and net direct debt is 54.3% of total governmental fund revenue. Overall net debt is low at 2.4% of market value, and approximately 78.8% of the direct debt is scheduled to be repaid within 10 years, which are in our view positive credit factors.

The village has about $45 million of net-direct debt outstanding, net of GO debt supported by enterprise funds. Management has indicated that there are no plans to issue additional debt over the next two years.

Pension and OPEB obligations

- We believe that pension and OPEB liabilities represent a potential medium-term source of credit pressure, as the village is exposed to large unfunded liabilities and high fixed costs that we expect will continue to accelerate.
- In particular, Palatine's single-employer, defined-benefit public safety 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 place increasingly greater pressure on operations and could lead to credit deterioration.
- Although the village funds its OPEB on a pay-as-you-go basis, exposing it to cost acceleration and volatility, we expect that medium-term costs will remain only a small share of total spending and, therefore, not a significant budgetary pressure.

Palatine participates in the following plans:

- Single-employer police pension plan: 61.5% funded (as of Dec. 31, 2019) with net pension liability totaling $55.6 million.
- Single-employer firefighter plan: 59.7% funded (as of Dec. 31, 2019) with a net pension liability of $55.1 million.
- Illinois Municipal Retirement Fund (an agent plan): 85.2% funded (as of Dec. 31, 2019), with a net pension liability of $11.5 million.
- Single-employer OPEB health care: 0% funded, with a total OPEB liability of $15.37 million (as of Dec. 31, 2019).

In fiscal 2019, the village's combined pension and OPEB contributions were 12% of governmental fund expenditures, of which 11.3% represented required pension contributions and 0.7% represented OPEB contributions. The police and firefighter pension plans fell short of our minimum funding metric, 76% and 79%, respectively, but made funding progress per our static funding metric, 102% and 105%, respectively. Palatine sizes its contributions to meet actuarially determined contributions to fully fund its police plan and fire plans by 2040. Both plans include a 7.25% assumed rate of return, which is higher than our 6% guidance and, we believe, exposes the plan to greater volatility.

Strong institutional framework

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

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 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
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013