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Summary:

Northfield, Minnesota; General Obligation; Tax Increment

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Credit Profile

US\$4.475 mil GO str reconstruction, imp & equip bnds ser 2021A dtd 09/09/2021 due 02/01/2032

| | | |
|-------------------------|-----------|-----|
| <i>Long Term Rating</i> | AA/Stable | New |
|-------------------------|-----------|-----|

Northfield GO

| | | |
|-------------------------|-----------|----------|
| <i>Long Term Rating</i> | AA/Stable | Affirmed |
|-------------------------|-----------|----------|

Rating Action

S&P Global Ratings assigned its 'AA' long-term rating to Northfield, Minn.'s \$4.475 million series 2021A general obligation (GO) street reconstruction, improvement, and equipment bonds. At the same time, S&P Global Ratings affirmed its 'AA' rating on the city's existing GO debt. The outlook is stable.

The city's full faith and credit pledge and ability to levy unlimited ad valorem property taxes secure the bonds. Officials will use proceeds to finance various public improvements, street reconstruction projects, and the purchase of capital equipment.

Credit overview

Northfield continues to experience strong economic growth and consistent, positive financial performance, even through the turbulence of the last year-and-a-half following the onset of the COVID-19 pandemic. The fiscal 2021 budget reflects a small operating deficit and only incremental changes over the prior year, and we expect that, as in most years, favorable variances will likely narrow the budget gap or eliminate it entirely by year-end. Management further reports that the city anticipates receiving approximately \$1.1 million in American Rescue Plan (ARP) funding this year with another installment coming next year, none of which has yet been earmarked. We expect that the combination of a growing economic base and stable, strong financial profile will continue to provide credit stability through at least the two-year outlook horizon, while upside rating potential will largely turn on sustained improvements in the city's key economic metrics to levels that better align with those of more highly rated peers.

The 'AA' rating further reflects our assessment of the city's:

- Economic stature as a college town that is home to both Carleton and St. Olaf colleges, and location approximately an hour away from the Twin Cities, Rochester, and Mankato metropolitan statistical areas (MSAs), which we believe will continue to support new development and valuation growth;
- Strong financial performance, as evident in consecutive operating surpluses in each of the last six audited fiscal years, supporting very strong reserves and liquidity with an available fund balance of 71% of expenditures at the end of fiscal 2020 (including available general fund reserves and unrestricted cash in the city's liquor store fund);
- Good financial policies and practices under our Financial Management Assessment (FMA) methodology, and a

strong institutional framework; and

- Adequate debt and liabilities profile with about 84% of direct debt currently scheduled to be retired within 10 years, and with only moderate pension and other postemployment benefit (OPEB) costs that we believe are unlikely to accelerate meaningfully in the medium term.

Environmental, social, and governance factors

The city's location along the Cannon River creates some risk of flooding, though we understand that it has not had a significant flood in years. Northfield has adopted a climate action plan that includes resiliency planning and has moved certain critical assets--such as power transformers--above a 500-year flood level, which we believe indicates active risk management. The city's social and governance risks align with sector norms.

Stable Outlook

Upside scenario

We could raise the rating if the city's economic measures, especially per capita incomes and market value, improve to levels commensurate with what we typically see among more highly rated peers.

Downside scenario

However unlikely in the next two years, we could take negative rating action if the city's reserves were to fall materially below its 40% reserves policy floor without a plan for timely replenishment.

Credit Opinion

College town with access to three MSAs experiencing consistently strong valuation growth, though with below-peer wealth and income measures

Though not in an MSA, Northfield is within about an hour's drive of the Twin Cities, Rochester, and Mankato and is 45 miles due south of Minneapolis. The city is perhaps best known as the home of both Carleton and St. Olaf colleges, which we consider stabilizing institutions that together serve more than 5,000 undergraduates and are among its largest employers. We understand that attendance remains steady at both schools and both plan to offer full in-person learning this coming fall semester.

The local economy continues to perform well, as indicated by consecutive years of market value growth of around 5% or greater going back to at least the 2016 levy year. Permitting activity through the end of May further suggests that 2021 may be the strongest in the last five years in terms of the valuation of building permits, and we understand that new-home construction and multifamily development have been strong, with housing demand largely outstripping available supply in the area. Management reports no significant business closures as a consequence of the pandemic, and we understand that the city deployed \$500,000 of its CARES Act funding in fiscal 2020 to support local businesses and nonprofits. The weighted county unemployment rate for Dakota and Rice counties was 5.3% in 2020 and, we expect, will likely remain steady or improve in the near term.

As previously discussed, despite recent strong economic performance, Northfield's per capita wealth and income metrics are below average compared to similarly rated peers--at least in part owing to the presence of Carleton and St.

Olaf colleges--and so the most likely path to upward rating transition is through ongoing and sustainable improvements in these key areas.

Surplus operations and historically strong reserves follow in the wake of the pandemic, with near-term signs pointing to more of the same through the outlook period

Fiscal 2020 results reflect various data adjustments, most notably for the expenditure of bond proceeds in governmental funds. Despite the pandemic, fiscal 2020 ended with an unusually large operating surplus as key revenues were on budget and the city saw characteristically favorable expenditure variances. Management reports that despite early expectations in fiscal 2020, property taxes (which were 53% of budgeted general fund revenues) and local government aid (LGA, 29%) largely aligned with the budget, and extraordinary costs tied to the city's pandemic response were more than offset through the \$1.5 million in CARES Act funding it received.

The fiscal 2021 budget reflected incremental changes over the prior year and a small deficit, which is typical. Management indicates that at midyear, the city is expecting break-even or better results by year-end, which we think is reasonable given its record of conservative-to-on-target expenditure budgeting and the stability of major revenue streams. Management has indicated that the \$1.1 million in ARP funding that the city will receive this year, along with a similar amount expected for next year, remain unallocated, though it is exploring how to best put the funds to use. Absent an unexpected turn in the local economy or a cut in LGA, we expect Northfield's budget to remain structurally balanced and to produce surplus results in most years.

Reserves and liquidity remain very strong. The city has a long-standing reserve policy requiring a minimum 40% fund balance, and it has historically kept its reserve balances well in excess of the policy floor. Management reports no definite plans to spend down reserves at this time, though we understand it could spend a portion of its reserves in the upcoming budget cycle. Management reports, however, that the city will plan on keeping its general fund balance at 50%, at minimum. We expect cash and investment balances to remain stable and very strong.

Strong management with formalized policies in most key areas and proactive management of environmental and cyber security risks

The city has a formal climate action plan that includes a resiliency planning component, and its practices around cyber security align with its peers. Highlights of Northfield's good FMA include:

- Strong budget assumptions for the annual budget forecast, which is formulated using at least three years of historical data and information from external sources;
- Quarterly budget-to-actual reporting to the city council with the ability to amend the budget as needed;
- A five-year, rolling capital improvement plan (CIP) that includes sources both and uses of funds;
- A formal investment management policy and quarterly reporting to the council on investment holdings;
- A formal debt management policy that includes qualitative standards around debt issuance a goal to amortize 65% of GO bonds within 10 years; and
- A formal fund balance policy setting a reserve floor equal to 40% of expenditures for cash-flow purposes and to meet contingencies.

The city does not have a multiyear financial plan.

Some future bonding plans pursuant to the CIP and moderate pension and OPEB exposure with medium-term costs unlikely to change materially

Northfield's direct debt totals \$28.3 million, and we calculate net direct debt (excluding self-supporting enterprise-backed debt) at \$26.8 million. The city regularly issues debt pursuant to its five-year CIP, which calls for issuing a total of \$10.9 million in bonded debt through 2025. As a similar amount of debt rolls off over the same period, we do not expect a significant change in Northfield's liability profile from new debt. The city has no direct-purchase or variable-rate exposure.

We do not consider pension and OPEB liabilities a source of medium-term credit pressure, as the defined-benefit plans to which the city contributes are reasonably well funded and required contributions, which represent a moderate share of the budget, are unlikely to accelerate in a meaningful way in the next few years.

The city participates in the following plans:

- Minnesota General Employees Retirement Fund (GERF): 79.1% funded (June 30, 2020), with a city proportionate share of the plan's net liability of \$43.5 million when including the Northfield municipal hospital (a component unit) and approximately \$6.5 million when including only the city share;
- Minnesota Police and Fire Fund (PEPFF): 87.2% funded, with a city proportionate share of \$2.6 million; and
- A single-employer defined-benefit OPEB plan that the city funds on a pay-as-you-go basis with a liability of \$2.3 million (as of Jan. 1, 2020).

City contributions to all plans (excluding the hospital's share) came to approximately 5.1% of adjusted governmental fund expenditures in fiscal 2020 and have been similarly large in years past. While the pension funds are not funded on an actuarial basis and include actuarial assumptions and methods that we believe introduce some risk of funding volatility, we expect medium-term costs to more or less align with historical experience and remain manageable.

| Northfield, MN -- Key Credit Metrics | | | | |
|--|-------------|------------------------|-----------|-----------|
| | Most recent | Historical information | | |
| | | 2020 | 2019 | 2018 |
| Adequate economy | | | | |
| Projected per capita EBI % of U.S. | 80.2 | | | |
| Market value per capita (\$) | 75,209 | | | |
| Population | | 21,350 | 21,200 | 21,048 |
| County unemployment rate (%) | 5.3 | | | |
| Market value (\$000) | | 1,605,718 | 1,564,714 | 1,642,934 |
| Top 10 taxpayers % of taxable value | 10.7 | | | |
| Strong budgetary performance | | | | |
| Operating fund result % of expenditures | | 6.3 | 1.5 | 5.0 |
| Total governmental fund result % of expenditures | | 15.7 | (0.6) | (1.6) |
| Very strong budgetary flexibility | | | | |
| Available reserves % of operating expenditures | | 71.0 | 70.5 | 75.8 |
| Total available reserves (\$000) | | 10,344 | 9,323 | 9,137 |
| Very strong liquidity | | | | |

Northfield, MN -- Key Credit Metrics (cont.)

| | Most recent | Historical information | | |
|---|-------------|------------------------|--------|--------|
| | | 2020 | 2019 | 2018 |
| Total government cash % of governmental fund expenditures | | 173.9 | 170.4 | 175.1 |
| Total government cash % of governmental fund debt service | | 1265.7 | 1181.0 | 1143.1 |
| Strong management | | | | |
| Financial Management Assessment | Good | | | |
| Adequate debt & long-term liabilities | | | | |
| Debt service % of governmental fund expenditures | | 13.7 | 14.4 | 15.3 |
| Net direct debt % of governmental fund revenue | 113.3 | | | |
| Overall net debt % of market value | 3.9 | | | |
| Direct debt 10-year amortization (%) | 84.1 | | | |
| Required pension contribution % of governmental fund expenditures | 4.7 | | | |
| OPEB actual contribution % of governmental fund expenditures | 0.4 | | | |
| Strong institutional framework | | | | |

EBI--Effective buying income. OPEB--Other postemployment benefits.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- Credit Conditions: U.S. Regions' Economies Perk Up As The Pandemic's Impact Ebbs, April 16, 2021
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- 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

Ratings Detail (As Of August 10, 2021)

| | | |
|----------------------------|-----------|----------|
| Northfield GO | | |
| Long Term Rating | AA/Stable | Affirmed |
| Northfield GO | | |
| Long Term Rating | AA/Stable | Affirmed |
| Northfield GO | | |
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| Long Term Rating | AA/Stable | Affirmed |
| Northfield GO | | |
| Long Term Rating | AA/Stable | Affirmed |
| Northfield GO cap imp bnds | | |
| Long Term Rating | AA/Stable | Affirmed |

Ratings Detail (As Of August 10, 2021) (cont.)

Northfield GO tax inc rfdg bnds

Long Term Rating

AA/Stable

Affirmed

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.

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