

RatingsDirect®

Summary:

Northfield, Minnesota; Appropriations; General Obligation

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Table Of Contents

Rationale

Outlook

Related Research

Summary:

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Credit Profile

US\$1.765 mil GO bnds ser 2018B dtd 10/11/2018 due 02/01/2029

Long Term Rating AA/Stable New

Northfield certs of part

Long Term Rating AA-/Stable Affirmed

Northfield GO cap imp bnds

Long Term Rating AA/Stable Affirmed

Rationale

S&P Global Ratings assigned its 'AA' long-term rating to Northfield, Minn.'s series 2018B general obligation (GO) bonds. At the same time, we affirmed our 'AA' rating on the city's existing GO debt, and our 'AA-' rating on the city's series 2012B certificates of participation (COPs). The outlook is stable.

The series 2018B bonds are secured by the city's full faith and credit GO pledge, including an ability to levy unlimited ad valorem property taxes. Officials will use 2018B proceeds to fund various street projects and some surface improvements to parking lots in the downtown and city hall. The city plans to use special assessments and property tax revenue to pay for debt service on the bonds.

As part of the current rating action, we also affirmed our 'AA' ratings on several GO bonds secured by city's unlimited-tax GO pledge and various other revenue such as tax increment, special assessment revenue, and various enterprise fund revenue, though in each case we rate to the city's GO pledge. The 2012B COPs are special obligations of the city, secured by annually appropriated legally available funds. We rate this obligation one notch lower than the city's general creditworthiness (as reflected in the GO rating) to reflect the appropriation risk associated with the annual payment. We view these bonds as having a strong relationship to the obligor. This obligation provided funding for a public safety center, which we believe is significantly important to the obligor. The city pledges to annually appropriate from its operating revenue. In our opinion, there is no unusual political, timing, or administrative risk related to the debt payment.

The 'AA' rating reflects our view of the city's:

- Adequate economy, with a local stabilizing institutional influence;
- Strong management, with "good" financial policies and practices under our Financial Management Assessment methodology;
- Strong budgetary performance, with an operating surplus in the general fund but a slight operating deficit at the total governmental fund level in fiscal 2017;

- Very strong budgetary flexibility, with an available fund balance in fiscal 2017 of 77% of operating expenditures;
- Very strong liquidity, with total government available cash at 1.7x total governmental fund expenditures and 8.9x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability position, with debt service carrying charges at 17.1% of expenditures and net direct debt that is 166.0% of total governmental fund revenue, but rapid amortization, with 80.2% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Adequate economy

We consider Northfield's economy adequate. The city, with an estimated population of 20,950, is located in Dakota and Rice counties. The city benefits, in our view, from a stabilizing institutional influence. The city has a projected per capita effective buying income of 88.9% of the national level, which is below average, and per capita market value of \$72,726. Overall, the city's market value grew by 1.5% over the past year to \$1.5 billion in 2018. The weight-averaged unemployment rate of the counties was 3.2% in 2017.

Though not technically part of an MSA, Northfield is centrally located between the Twin Cities, Rochester, and Mankato, all of which are roughly an hour away. Local employment is available in higher education, health care, and food processing, with top employers including St. Olaf College (employs 860), Northfield Hospital (a component unit of the city, 839), local school district No.659 (730), Carleton College (700), and Post Breakfast Cereal (manufacturing, 675). St. Olaf and Carleton colleges, located in the city, are stabilizing institutions.

The city's net tax capacity is comprised mostly residential homestead properties, at 58% of the total, though with a good mix of commercial/industrial (23%) and nonhomestead residential (15%) properties.

The city has recently seen and will likely continue to see steady valuation growth, reflecting rising existing property values, along with several larger new developments, which include a new science center at Carleton and a new hotel. Residential growth also continues, both in terms of single-family development and multi-family development. We anticipate that the city's economic ratios may improve, but overall its profile will likely remain adequate in the current and following year.

Strong management

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

Highlights include its:

- Use of at least three years of historical information in the formulation of the upcoming-year revenue and expenditure assumptions with the help of outside sources and a line-by-line approach to budgeting;
- Quarterly reporting of budget-to-actual performance to the council with the ability to make amendments to the budget as needed;
- Five-year capital plan that is updated on an annual basis and includes sources and uses of funds;

- Formalized investment management policy; quarterly board reports include investment holdings;
- A formalized debt management policy that sets various qualitative standards around debt issuance, and sets a goal to amortize 65% of GO bonds within 10 years; and
- Formalized fund balance policy to maintain 40% of budgeted expenditures for cash flow and contingency purposes.
- The city does not produce a multiyear financial plan.

Strong budgetary performance

Northfield's budgetary performance is strong in our opinion. The city had surplus operating results in the general fund of 4.7% of expenditures, but a slight deficit result across all governmental funds of negative 0.7% in fiscal 2017.

The city reports its finances on the basis of a fiscal year ending on Dec. 31. We have adjusted revenue for the annual \$125,000 transfer in to the general fund from the liquor fund and we have adjusted total governmental fund expenditures to exclude those paid from bond proceeds.

After adjustments, the city's budgetary results in the general fund and across total governmental funds have generally been positive in recent years. Aside from the general fund, the city's other governmental activities are mainly capital projects and various special revenue funds, such as its community resource center, library, and various tax increment funds.

Fiscal 2017 ended with favorable results in the general fund due to positive budget variances. The 2018 budget calls for breakeven general fund operations, and more than midway through the year, revenue and expenditures are on track with the budget. Officials indicate there was no significant capital spending or revenue in 2017, or expected in 2018, thus we do not expect material fluctuations in total governmental fund performance. Looking ahead to 2019, city officials anticipate passing a balanced general fund budget. There may be heightened capital spending in fiscal 2019, which may in part be funded from capital reserve funds but also from bond proceeds. Overall, we expect the city's budgetary performance will likely remain strong in the current and following year.

City operations are funded primarily by taxes, which were 47% of fiscal 2017 general fund revenue, followed by intergovernmental aid (31%) and charges for services (10%).

Very strong budgetary flexibility

Northfield's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2017 of 77% of operating expenditures, or \$8.7 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 available fund balance includes \$7.5 million (66.1% of expenditures) in the general fund and \$1.2 million (10.8% of expenditures) that is outside the general fund but legally available for operations. Over the past three years, the total available fund balance has remained at a consistent level overall, totaling 76% of expenditures in 2016 and 75% in 2015.

We have included available cash in the municipal liquor store fund in our calculation of the city's available fund balance. The city has a formal fund balance policy requiring a minimum general fund reserve equal to 40% expenditures, and its general fund reserves have been well in excess of the policy minimum for a number of years. Management has indicated that the city has no plans to use reserves in fiscal 2018 and in its outlook for 2019; given its

stable operating environment and consistently strong budgetary performance, we expect reserves to remain stable and in excess of the city's policy requirement for the foreseeable future.

Very strong liquidity

In our opinion, Northfield's liquidity is very strong, with total government available cash at 1.7x total governmental fund expenditures and 8.9x governmental debt service in 2017. In our view, the city has strong access to external liquidity, if necessary.

Northfield regularly issued debt within the past 20 years, and we believe the city will continue to experience strong access to external liquidity as needed. Minnesota statutes allow for investments that we consider aggressive, though we do not consider Northfield's investment portfolio--comprising mainly of pooled municipal investments and U.S. agency and Treasury securities--a source of liquidity risk. The city has no variable-rate debt or direct-purchase exposure, and we expect cash levels to remain stable and overall liquidity to remain very strong.

Weak debt and contingent liability profile

In our view, Northfield's debt and contingent liability profile is weak. Total governmental fund debt service is 17.1% of total governmental fund expenditures, and net direct debt is 166.0% of total governmental fund revenue.

Approximately 80.2% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor.

We understand that the city will issue approximately \$1 million to \$2 million in new money GO debt annually, mainly for street and improvement projects. The city is also considering a \$20 million ice arena project, but the project would first have to clear a bond referendum, tentatively planned for fall 2018. The city's higher overall debt burden has resulted in a weak debt profile.

Northfield's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 23.9% of total governmental fund expenditures in 2017. The city made its full annual required pension contribution in 2017.

Northfield participates in two cost-sharing multiple-employer pension plans, including the General Employees Retirement Fund (GERF) and the Public Employees Police and Fire Fund (PEPFF), which are administered by the Public Employees Retirement Association of Minnesota (PERA). Required pension contributions to these plans are determined by state statute. Statutory contributions rates have generally not kept pace with actuarially determined contribution (ADC) rates, indicating the potential for future payment acceleration. The state recently passed pension legislation that will marginally increase contributions (for PEPFF only), reduce the investment rate of return to 7.5% (from 8.0%), and reduce some employee benefits (primarily cost-of-living adjustments). While we view these as positive changes for future plan funding levels, the lack of an actuarial funding policy remains a weakness in these plans. For more information about the reforms included in the 2018 omnibus retirement bill and the potential for future cost increases, see our bulletin titled, "Minnesota's New Pension Bill Is A Positive Step Toward Sustainable Funding" (published June 7, 2018, on RatingsDirect).

The GERF and PEPFF were 75.9% and 85.4% funded, respectively, in fiscal 2017. The city's proportionate share of the net pension liability for these plans totaled \$49.9 million. We consider historical plan funding levels somewhat weak, and we believe that the history of pension contributions below the ADC increases the risk of payment acceleration.

Additionally, in our view, the plan's investment portfolio is exposed to significant market risk, with only 22% of its investments allocated to fixed income and cash, which increases the risk for volatility in plan funding levels. Despite these weaknesses, we believe the city has sufficient taxing and operational flexibility to manage future increases in pension contributions. However, in the future, if pension contributions absorb a larger share of the city's budget, our view of its debt and contingent liability profile could weaken.

The city's seven city council members are covered by a defined-contribution plan, and the city contributes to a single-employer OPEB plan on a pay-as-you-go basis.

Strong institutional framework

The institutional framework score for Minnesota cities with a population greater than 2,500 is strong.

Outlook

The stable outlook reflects our expectation that the city's financial performance will remain strong and its reserves in line with the city's 40% policy minimum for the foreseeable future, as has been the city's past practice. Stability is supported by the city's steadily growing local economy, and as such, we do not expect to change the rating within the two-year outlook horizon.

Upside scenario

We could raise the rating if the city's economic measures, such as its per capita incomes and market value, improve to levels commensurate with those of higher-rated peers, all other credit factors remaining equal.

Downside scenario

However unlikely, we could lower the rating with substantial deterioration in the city's budgetary performance and reserve levels, such that these were no longer commensurate with 'AA'-rated peers.

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
- 2017 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of September 13, 2018)

Northfield GO		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Northfield GO		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Northfield GO		
<i>Long Term Rating</i>	AA/Stable	Affirmed

Ratings Detail (As Of September 13, 2018) (cont.)		
Northfield GO		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Northfield GO		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Northfield GO		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Northfield GO		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Northfield GO tax inc rfdg bnds		
<i>Long Term Rating</i>	AA/Stable	Affirmed

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