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Ratings

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Summary:

Big Lake, Minnesota; General Obligation

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Summary:

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Credit Profile		
US$2.35 mil GO imp bnds ser 2018A due 02/01/2034		
Long Term Rating	AA/Stable	New
Big Lake GO		
Long Term Rating	AA/Stable	Upgraded
Big Lake GO		
Long Term Rating	AA/Stable	Upgraded

Rationale

S&P Global Ratings raised its rating on Big Lake, Minn.'s general obligation (GO) debt to 'AA' from 'AA-'. At the same time, we assigned our 'AA' rating to the city's series 2018A GO improvement bonds. The outlook is stable.

The upgrade reflects our view of the combination of the city's ongoing maintenance of extremely strong available reserves, steady growth in the city's economic base, market value in particular, and the adoption of more robust financial policies and practices, as reflected its now-"strong" Financial Management Assessment (FMA) and very strong overall management.

The series 2018A bonds are secured by special assessments and by the city's full faith and credit GO pledge and ability to levy unlimited ad valorem taxes on all taxable property within its borders. Though secured by multiple revenue streams, we rate the bonds to the city's GO pledge. City officials will use bond proceeds for street improvement projects.

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

- Adequate 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 (FMA) 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 a high available fund balance in fiscal 2017 of 93% of operating expenditures;
- Very strong liquidity, with total government available cash at 1.5x total governmental fund expenditures and 5.1x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability position, with debt service carrying charges at 30.0% of expenditures and net direct debt that is 186.1% of total governmental fund revenue, but rapid amortization, with 86.5% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Adequate economy

We consider Big Lake's economy adequate. The city, with an estimated population of 11,004, is in Sherburne County, approximately 45 miles northwest of Minneapolis-St. Paul and 25 miles southeast of St. Cloud. It is in the Minneapolis-St. Paul-Bloomington MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 99.5% of the national level and per capita market value of $72,528. Overall, market value grew by 8.8% over the past year to $798.1 million in 2018. The county unemployment rate was 3.7% in 2017.

City residents have access to employment in both St. Cloud and the Twin Cities, and the city is the terminal point of the Northstar commuter train, which connects Big Lake to downtown Minneapolis, passing through several northwest suburbs. Top local employers include Xcel Energy (employs 700), Independent School District No. 727 (678), Centracare Medical Center (500), Wal-Mart Supercenter (354), and RTI International Metals Inc. (333).

The city's net tax capacity is 63% residential homestead, 19% commercial and industrial, and 14% residential non-homestead properties. We understand that recent growth has reflected a number of factors, including new commercial developments and expansions, new single- home and multi-family construction, annexations, and a generally improving economy. Given a healthy commercial development pipeline and the pace of new-home construction in particular, we expect to continue to see moderate increases in market value and tax capacity through the next few years.

Very strong management

We view the city's management as very strong, with "strong" financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

We have revised the FMA to "strong" from "good" as the city has adopted a robust, multiyear financial plan and a debt management policy. Highlights to the FMA include:

- A line-item budget incorporating approximately five years of historical data and information from external sources, with annual budgeting done in the context of a multiyear financial plan and with a view toward long-term sustainability and structural balance;
- Monthly budget-to-actual reporting to the city council and the ability to amend the budget as needed;
- A detailed financial projection that extends three years beyond the budget year that is included in each year's annual budget;
- A formal, rolling five-year capital improvement plan that includes funding sources for projects;
- A formal investment policy with monthly reporting on investment holdings and earnings to the city council;
- A formal debt management policy that includes qualitative guidelines and limits direct debt to 3.5% of estimated market value; and
- A formal fund balance policy requiring an unrestricted reserve equal to 50% of the subsequent year's expenditures.

Strong budgetary performance

Big Lake's budgetary performance is strong, in our opinion. The city had surplus operating results in the general fund of 4.0% of expenditures, but a slight deficit result across all governmental funds of negative 0.9% in fiscal 2017.

The city generally budgets conservatively in its general fund and finishes the year ahead of budget, which is evident in recent performance. The fiscal 2018 budget reflects a 10% increase over the prior year's budget and essentially break-even results. At about midyear, management reports that the city's actual results are in line with the budget. Across governmental funds, the city typically sees close to break-even results after adjusting for bond proceeds and other nonrecurring items, and management reports that it does not expect any major changes in any of its governmental funds this year. Given the city's recent history and overall stable and predictable operating environment, as well as management's close monitoring of the budget and multiyear planning, we expect budgetary performance to remain stable and strong.

We have adjusted general expenditures to include a routine transfer out to the city's infrastructure improvement fund and total governmental fund expenditures to exclude a one-time expenditure to write down the value of a parcel of city-owned industrial land to reflect market value and other spending that we consider nonrecurring, and we have included routine transfer into the general fund from the city's municipal liquor store in both general and total governmental fund revenues.

Very strong budgetary flexibility

Big Lake's budgetary flexibility is very strong, in our view, with a high available fund balance in fiscal 2017 of 93% of operating expenditures, or $4.1 million. The available fund balance includes $3.1 million (72.1% of expenditures) in the general fund and $929,000 (21%) that is outside the general fund but legally available for operations.

We have included the city's municipal liquor store cash in available reserves. Through steady increases, the city's reserves have grown to $4.1 million, or 93% of adjusted expenditures, at the end of fiscal 2017. The city's fund balance policy requires a minimum unrestricted fund balance of 50% of the subsequent year's expenditures, though the city has tended to keep general fund reserves closer to 60% in recent years. Management reports no plans to spend down reserves in the next few years, and its available reserves to remain stable in the near term.

Very strong liquidity

In our opinion, Big Lake's liquidity is very strong, with total government available cash at 1.5x total governmental fund expenditures and 5.1x governmental debt service in 2017. In our view, the city has strong access to external liquidity if necessary.

The city's total available cash and investments was $13 million at the end of 2017. Its investments are not invested aggressively, in our view, and are held only in certificates of deposit and money market accounts. Based on the city's regular issuance of debt, in our opinion, it has strong access to external liquidity should it be necessary. We expect the liquidity position to remain very strong.

Weak debt and contingent liability profile

In our view, Big Lake's debt and contingent liability profile is weak. Total governmental fund debt service is 30.0% of total governmental fund expenditures, and net direct debt is 186.1% of total governmental fund revenue. Approximately 86.5% of the direct debt is scheduled to be repaid within 10 years, which is, in our view, a positive credit factor.

We have adjusted the city's direct debt to reflect GO debt paid from enterprise revenues that we consider self-supporting. The city's high carrying charges are somewhat offset by the rapid amortization scheduled for its direct debt, and we note as well that the city is paying much of its debt through a variety of non-ad valorem tax sources. We understand that it could issue about $3.3 million in new-money debt in 2020 for street projects, though this is unlikely to affect our view of its debt profile given that more debt than this will roll off prior to then.

Big Lake's pension contributions totaled 3.5% of total governmental fund expenditures in 2017. The city made 101% of its annual required pension contribution in 2017.

The city made its full annual required pension contribution in 2017. It participates in two cost-sharing multiple-employer defined-benefit pension plans, including the General Employees Retirement Fund (GERF) and the Public Employees Police and Fire Fund (PEPFF) 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 potential for future payment acceleration.

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 $3.1 million in fiscal 2017. We consider historical plan funding levels somewhat weak, and we believe that the history of pension contributions below 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, the city's pension payments as a share of total spending remain low, even if somewhat understated due to statutory rates not matching the plans' ADCs, and we believe the city has sufficient taxing and operational flexibility to manage future increases in pension contributions. Further, management has already incorporated cost increases that are expected to arise from the current-year legislative session into its financial planning for the next fiscal year. So, while we have not made any negative adjustments to the city's debt and liability profile because of pensions, we could do so in the future should costs accelerate in a way that we think will cause budgetary pressure.

The city does not offer other postemployment benefits.

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 view of Big Lake's extremely strong reserves, supported by very strong management and a stable operating budget, which in turn benefits from a local economy that is growing at a moderate pace and is well-positioned to continue to experience manageable growth through the next several years. Because we expect the city's finances to remain stable and other credit factors to either remain stable or improve modestly through the outlook horizon, we do not expect to change the rating in the next two years.

Downside scenario

We could lower the rating with material decline in the city's budgetary performance, leading to weaker reserves and liquidity. Though unlikely, we could also lower the rating if the city were to issue substantial new-money debt, leading to a weaker overall debt profile, particularly if any prospective debt issuance were substantially disproportionate to the city's tax base and revenue growth.

Upside scenario

We could raise the rating if the city's economic metrics were to continue to improve to levels consistent with those of more highly rated peers and if it were to see some moderation in its debt burden.

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

Ratings Detail (As Of June 5, 2018)		
Big Lake taxable GO rfdg bnds ser 2016A dtd 04/15/2016 due 02/01/2030		
Long Term Rating	AA/Stable	Upgraded
Big Lake GO		
Long Term Rating	AA/Stable	Upgraded
Big Lake GO cap imp pln bnds ser 2016B dtd 04/15/2016 due 02/01/2028		
Long Term Rating	AA/Stable	Upgraded
Big Lake GO		
Long Term Rating	AA/Stable	Upgraded

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.