S&P Global Ratings

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Summary:

Elk River, Minnesota; General Obligation

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Credit Profile		
US$9.895 mil GO cap imp plan bnds ser 2020A due 02/01/2042		
Long Term Rating	AA+/Stable	New
US$7.295 mil taxable GO swr rev rfdg bnds ser 2020C due 02/01/2035		
Long Term Rating	AA+/Stable	New
US$5.97 mil GO cap imp plan rfdg bnds ser 2020B due 02/01/2033		
Long Term Rating	AA+/Stable	New
Elk River GO		
Long Term Rating	AA+/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating to Elk River, Minn.'s series 2020A general obligation (GO) capital improvement, 2020B GO capital improvement refunding, and 2020C GO sewer revenue refunding bonds. At the same time, S&P Global Ratings affirmed its 'AA+' rating on the city's previously issued GO bonds. The outlook on all ratings is stable.

The series 2020A, 2020B, and 2020C bonds are secured by the city's full faith and credit pledge and ability to levy unlimited ad valorem property taxes. The proceeds of the 2020A bonds will be used to finance public safety building expansions and security upgrades. The 2020B and 2020C bonds will finance the refunding of debt outstanding for interest cost savings.

The city is also pledging revenue from its sewer utility system toward the repayment of the 2020C bonds; however, the rating is based on the unlimited ad valorem tax pledge.

Credit overview

Elk River benefits from being close to both the Minneapolis-St. Paul metropolitan statistical area (MSA) and the St. Cloud MSA. The city is a suburban center with good quality schools, sports facilities, and small local company headquarters. The area is seeing substantial development, particularly on the eastern edge of the city, and management anticipates this will continue as the state is working on improvements to transportation routes to the area. Growth drives capital needs, which is the primary reason for the taxing jurisdiction's high debt level. Elk River funds its routine maintenance work on a pay-as-you-go basis to reduce borrowing in the future. Although the debt burden is elevated, the carrying charges have not impaired the city's operating performance nor do we anticipate it pressuring future budgets. Management reports minor budgetary effects from the COVID-19 pandemic, as it implemented proactive cost-cutting measures and additional costs have been offset with federal aid. We expect the city will maintain reserves and liquidity close to current levels over the near term even with the uncertainty surrounding the pandemic.

The rating reflects our view of Elk River's:

- Very strong economy, with access to a broad and diverse MSA;
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with operating results that we expect will remain stable even with risks stemming from the pandemic, which closed with an operating surplus in the general fund but an operating deficit at the total governmental fund level in fiscal 2019;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 78% of operating expenditures;
- Very strong liquidity, with total government available cash at 2.3x total governmental fund expenditures and 31.7x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability profile, with debt service carrying charges at 7.3% of expenditures and net direct debt that is 237.9% of total governmental fund revenue; and
- Strong institutional framework score.

Environmental, social, and governance factors

Our rating incorporates our view regarding the health and safety risks posed by the COVID-19 pandemic, which we consider a social risk factor that could lead to budgetary pressure depending on the duration of the pandemic. Absent the implications of COVID-19, we consider Elk River's social risks in line with those of the sector. We view the city's environmental and governance risks as being in line with the sector.

Stable Outlook

Downside scenario

Should Elk River develop a persistent imbalance in its operations or significantly spend down its reserves, we could lower the rating.

Upside scenario

We could raise the rating if economic metrics and the city's debt profile improved to levels commensurate with those of higher-rated peers.

Credit Opinion

Very strong economy

We consider Elk River's economy very strong. The city, with an estimated population of 24,921, is located in Sherburne County in the Minneapolis-St. Paul-Bloomington, MN-WI MSA, which we consider broad and diverse. The city has projected per capita effective buying income of 111% of the national level and per capita market value of $103,339. Overall, the city's market value grew by 7.7% over the past year to $2.6 billion in 2019. The county unemployment rate was 3.5% in 2019.

Our view of the local economy changed from strong to very strong as projected per capita effective buying incomes have increased at a faster pace than the national average. However, Elk River's incomes and market value per capita remain below those of higher-rated peers. The city's proximity to the expanding Minneapolis-St. Paul and St. Cloud metropolitan areas provides residents access to broad employment opportunities. In addition, as the county seat of Sherburne, Elk River has several government jobs available. Management reports all the local employers are anticipated to remain at least stable and cited a few that are expanding. The unemployment rate in Sherburne County was 3.5% in 2019. In April 2020, the unemployment rate was 9.0% and in August it was 6.3%, according to the Bureau of Labor Statistics.

Although the pandemic creates economic uncertainty in the near term, we expect the city's net tax capacity will continue to grow due to the appreciation of existing properties and development anticipated to occur in the medium term. The strong economic expansion in the Minneapolis-St. Paul and St. Cloud MSAs should encourage further growth in suburbs such as Elk River, supporting our view that the local economy should remain at least strong in the near-to-medium term.

Very strong management

We have revised upward our assessment of the city's management to very strong from strong due to the adoption of a five-year financial forecast that assists Elk River's proactive budgetary management efforts. The assessment reflects the city's strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

When building the line-item budget, the city uses three-five years of historical information to forecast trends and uses the county assessor, the Minnesota League of Cities, and the state's budget. The budget can be amended at any time. For capital planning, Elk River annually updates a detailed five-year rolling capital improvement plan with funding sources identified. Management has adopted a formalized five-year budgetary projection. This formalized planning, in addition to the discussions between management and the city council about future budgetary pressures, will assist the city in proactively addressing said pressures.

The council receives a detailed budget to actual report every month and an investment holdings report every quarter. Elk River has an investment policy and debt management policy that adhere to the state guidelines for allowable holdings and debt limitations and both include strong additional objectives. The fund balance policy indicates reserves shall be maintained at a level no less than 40% to 45% of expenditures for cash flow and contingency purposes.

Adequate budgetary performance

Elk River's budgetary performance is adequate in our opinion. The city had surplus operating results in the general fund of 2.8% of expenditures, but a deficit result across all governmental funds of 6.1% in fiscal 2019. Our assessment accounts for the fact that we expect budgetary results could improve from 2019 results in the near term. Over the past three years, general fund operating results were stable, with a result of 2.4% in 2018 and 3.7% in 2017.

Our assessment reflects recurring transfers into the general fund from the city's proprietary funds and recurring transfers out of the general fund to other governmental funds--excluding the transfers made to the capital reserve fund due to reserves exceeding the fund balance policy maximum. We also adjusted the total governmental funds for recurring transfers from the proprietary funds and capital outlays funded with bond proceeds.

Management reports that 2019 was a stable year, with operations ending very close to expectations. Approximately 69% of adjusted general fund revenue was derived from local property tax receipts and 12% was from transfers from the proprietary funds. Total governmental funds recorded a $1.7 million deficit, or 6.1% of expenditures. Capital outlays, net of the costs financed by bond proceeds, were elevated in 2019 relative to the previous three years. Elk River has had and will continue to have larger capital outlays every other year for planned street reconstruction; it has started collecting franchise fees to pay for these outlays. Management noted that larger capital projects have been completed, which will reduce maintenance and operating costs in future budgets.

Management reports that the pandemic has affected various revenue sources and expenditures in the fiscal 2020 general fund operations. With support grants, reduced seasonal hiring, and departments minimizing expenditures since the start of the pandemic, Elk River is on target to end the year with at least a $150,000 general fund surplus. Other governmental funds have experienced some volatility and the city has cut expenditures where possible to maintain balanced operations. In addition, management states it plans to maintain reserves at the current level and has been building reserves to help offset any unforeseen budgetary pressure. The city will adopt a balanced budget for 2021 and management reports that there are vacant positions that it is waiting to fill until there is more certainty regarding the effects of the pandemic.

Very strong budgetary flexibility

Elk River's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 78% of operating expenditures, or $12.3 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 $7.7 million (48.6% of expenditures) in the general fund and $4.6 million (29% of expenditures) that is outside the general fund but legally available for operations. In the past three years, the total available fund balance has remained at a consistent level, totaling 78% of expenditures in 2018 and 76% in 2017.

The city's fund balance policy calls for reserves to be between 40% and 45% of expenditures and management plans to maintain them near 45%. When reserves exceed the policy maximum, transfers are made to fund capital projects. Management states it has no intention of spending down reserves in the near term.

Very strong liquidity

In our opinion, Elk River's liquidity is very strong, with total government available cash at 2.3x total governmental fund expenditures and 31.7x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary.

The city has $64.4 million in cash and equivalents after adjusting for unspent bond proceeds. We do not view investments to be aggressive, as the majority are in high investment-grade municipal bonds, money market accounts, and certificates of deposit. The city does not have any contingent liabilities that we believe could strain liquidity.

Very weak debt and contingent liability profile

In our view, Elk River's debt and contingent liability profile is very weak. Total governmental fund debt service is 7.3% of total governmental fund expenditures, and net direct debt is 237.9% of total governmental fund revenue.

The city will have approximately $57.3 million in net direct debt outstanding following this issuance. The net direct debt excludes approximately $8.5 million in GO debt, which is fully supported by the water and sewer enterprises and $19.0 million in revenue utility debt. Elk River plans on issuing $6 million in additional GO debt in the first quarter of 2021 to build a fire station. There is no private-placement or variable-rate debt outstanding.

Pension and other postemployment benefits

Elk River's required pension contributions totaled 5.7% of total governmental fund expenditures in 2019. The city made its full required pension contribution in 2019.

- We do not believe that pension liabilities represent a medium-term credit pressure, as contributions are only a modest share of the budget, and we believe the city has the capacity to absorb higher costs without pressuring operations.
- Elk River participates in two multiple-employer, defined-benefit pension plans that have seen recent improvements in funded status, though plan statutory contributions have regularly fallen short of actuarial recommendations. Along with certain plan-specific actuarial assumptions and methods, this introduces some long-term risk of funding volatility and cost acceleration.

The city participates in the following plans:

- Minnesota General Employees Retirement Fund (GERF): 80.2% funded (as of June 30, 2019), with a city proportionate share of the plan's net pension liability of $8.0 million.
- Minnesota Police and Fire Fund (PEPFF): 89.3% funded (June 30, 2019), with a proportionate share of $3.4 million.
- Elk River Fire Department Relief Assn. Plan: 106% funded (Dec. 31, 2018) with a net pension asset of $205,000.
- OPEB: Pay-as-you-go funding with an implicit liability of $835,000 million (as of Dec. 31, 2018).

Total contributions to GERF and PEPFF were 89% and 94%, respectively, of our minimum funding progress metric and were slightly above static funding in both cases. Annual contributions are based on a statutory formula that has typically produced contributions lower than the actuarially determined contribution for each plan. In our view, this increases the risk of underfunding over time, if the state legislature does not make adjustments to offset future funding shortfalls. Other key risks include a 7.5% investment rate-of-return assumption (for both plans) that indicates some exposure to cost acceleration as a result of market volatility, and, for PEPFF, an amortization method that significantly defers contributions through a lengthy payroll growth assumption. Regardless, costs remain only a modest share of total spending, and we believe they are unlikely to pressure Elk River's medium-term operational health.

Strong institutional framework

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

Related Research

- The U.S. Economy Reboots, With Obstacles Ahead, Sept. 24, 2020
- 263. Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 256. 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

- 214. S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013

Ratings Detail (As Of December 2, 2020)		
Elk River GO sales tax rev bnds		
Long Term Rating	AA+/Stable	Affirmed
Elk River GO swr rev bnds ser 2014B due 08/01/2035		
Long Term Rating	AA+/Stable	Affirmed
Elk River Econ Dev Auth, Minnesota		
Elk River, Minnesota		
Elk River Econ Dev Auth (Elk River) GO rfdg bnds		
Long Term Rating	AA+/Stable	Affirmed