Summary:

North Mankato, Minnesota; General Obligation; Non-School State Programs

Credit Profile		
US$3.4 mil GO imp bnds ser 2020B due 02/01/2036		
Long Term Rating	AA/Stable	New
North Mankato GO		
Long Term Rating	AA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA' long-term rating to North Mankato, Minn.'s series 2020B general obligation (GO) improvement bonds. At the same time, we affirmed our 'AA' underlying rating on the city's GO bonds outstanding. The outlook is stable.

Securing the bonds is the city's full faith and credit pledge and ability to levy unlimited ad valorem property taxes. The bonds are payable from special assessments, but the rating is based on the unlimited ad valorem tax pledge. Proceeds will be used to finance various street improvements throughout the city, including contributions to safe routes to school with sidewalk and trail expansions.

Credit overview

North Mankato, having maintained a stable history of balanced operational performance, complete with very strong available reserves, has placed itself in a positive position to hold steady during uncertain economic times. This reflects the city's management policies and practices, which we view as strong, and includes a strong management team that monitors financial performance regularly and continuously updates long-term plans for both operations and capital projects. Historically, the city has consistently maintained reserves at a level compliant with its fund balance policy of 25%-35% of expenditures, a trend we expect will continue, even given any potential pressures due to the current COVID-19 pandemic, which has caused the national economy to fall into recession, as reported by S&P Global Economics (see "The U.S. Faces A Longer And Slower Climb From The Bottom," published June 25, 2020 on RatingsDirect).

The recession, we believe, likely foreshadows a near-term economic slowdown at both the local and state levels. Still, we recognize that North Mankato's very strong reserves provide a meaningful hedge against near-term revenue volatility, and we expect that its fiscal position over the near term will remain strong and in line with what we typically see among similarly rated peers. While the scope of economic and financial challenges posed by COVID-19 remains unknown, but could include delayed local property taxes or state aid, based on the city's historical tax base stability and resilience, coupled with very strong reserves and significant taxing flexibility, we think North Mankato is well-positioned to navigate the possible negative effects of COVID-19 on finances. We also understand that management is involved in very comprehensive planning practices surrounding the potential effects, and is constantly monitoring and revising its budgetary position as part of its contingency planning. We will continue to monitor the effects of COVID-19 on revenue and expenses. Generally, our rating outlook timeframe is up to two years; given the current uncertainty around the pandemic, our view of the credit risks to the city centers on the more immediate budget effects in 2020.

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

- Adequate economy, with market value per capita of $90,307 and projected per capita effective buying income (EBI) at 100.8% of the national level;
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with a slight operating deficit in the general fund but an operating surplus at the total governmental fund level in fiscal 2019;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 28% of operating expenditures;
- Very strong liquidity, with total government available cash at 68.2% of total governmental fund expenditures and 3.2x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability position, with debt service carrying charges at 21.7% of expenditures and net direct debt that is 147.8% of total governmental fund revenue, but rapid amortization, with 76.3% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Environmental, social, and governance factors

The rating incorporates our view of the health and safety risks posed by the COVID-19 pandemic, which we consider a social risk factor. Although the scope of economic and financial challenges posed by the pandemic remains unknown, we believe a prolonged disruption could weaken the city's local economy and potentially affect state and local revenues. However, the COVID-19 pandemic is not affecting the city more than other sector standards. We also analyzed North Mankato's environmental and governance risks relative to its economy, management, financial measures, and debt and liability profile, and determined that all are in line with our view of the sector standard.

Stable Outlook

Downside scenario

We could lower the rating if financial performance and reserves were to experience sustained deterioration, specifically if budgetary balance cannot be sustained with any considerable decreases to state aid, resulting in much lower reserve levels. We could also do so if the debt profile worsens, in conjunction with sustained budgetary imbalance.

Upside scenario

While we don't view this as likely given current macroeconomic conditions, we could raise the rating if the city's wealth and income indicators improve to those of higher-rated peers, while it also strengthens its debt profile.

Credit Opinion

Adequate economy

We consider North Mankato's economy adequate. The city, with a population of 14,098, is in Nicollet County. It has a projected per capita EBI of 100.8% of the national level and per capita market value of $90,307. Overall, market value grew by 1.4% over the past year to $1.3 billion in 2019.

North Mankato acts as a regional hub for south-central Minnesota, providing extensive employment opportunities to the surrounding areas. Due to the spread of COVID-19, the city has experienced some slowdown in regard to local economic activity, with the closure of restaurants and small local businesses. While some of the larger area employers, including Taylor Corp., the local hospital, and MRCI, had immediate reductions in staff when the pandemic hit, most employees have returned to work, and management reported no major shutdowns or layoffs as a direct effect of COVID-19. Even given the temporary staff reductions, the recent county unemployment rates, 6.9% and 7.3% in April and May, respectively, were roughly half of the national averages of 14.7% and 13.3%.

The tax base is primarily residential (57%), with a sizable commercial/industrial component (27%). Even through the duration of the pandemic, growth in the residential sector has endured, with many single- and multifamily homes currently under construction. While we believe that economic metrics and property values could be pressured over the medium term, we think that the city's historic tax base growth and general economic stability will lead to minimal credit implications, and that our view of the local economy will remain adequate.

Strong management

We view the city'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.

The city has strong revenue and expenditure assumptions, making use of historical data when formulating the budget. Management reports monthly to the city council on budget-to-actual performance and investment cash balances. The city also maintains comprehensive long-term financial and capital improvement plans that are updated annually and shared with the council. It has an investment management policy, as well as a debt management policy that goes beyond state guidelines. While the debt policy does not contain quantitative restrictions or guidelines for issuing debt, it does limit debt to capital projects identified in its capital plan and refunding for interest cost savings. Its general fund balance policy establishes a minimum fund balance of 25%-35% of expenditures, which the city has historically met.

Adequate budgetary performance

North Mankato's budgetary performance is adequate, in our opinion. The city had slight deficit operating results in the general fund of negative 0.5% of expenditures, but a surplus result across all governmental funds of 13.8% in fiscal 2019. General fund operating results of the city have been stable over the last three years, with results of negative 0.5% in 2018 and positive 1.3% in 2017. We have adjusted the city's revenues and expenditures to account for recurring budgeted transfers in and out of its general fund. We've also adjusted total governmental revenues to account for transfers to enterprise funds and expenditures to remove one-time expenses funded with bond proceeds.

General fund results have fluctuated just around break-even in recent years, specifically after accounting for one-time costs incurred in fiscal 2019. The fiscal 2020 budget, after midyear adjustments, is now calling for a break-even result in the general fund, although the budget update does not include the $1.06 million of CARES Act fund that the city received, nor does it account for any additional expenditures savings that have been realized throughout the year. After accounting for these changes, management expects a $100,000-$200,000 reserve increase for 2020. While the city's operational budget has been historically stable, in our view, pressures resulting from the pandemic and recession could pose budgetary challenges in the near term. The budgetary performance score of adequate reflects our view of revenue uncertainty facing the city in the current economic climate, particularly regarding potential delays or cuts to property tax receipts or state aid.

The general fund benefits from a revenue structure that has historically been stable and predictable, consisting mostly of property taxes (63%) and intergovernmental sources (28%), with a majority of that coming from state aid, which is referred to as local government aid [LGA] in Minnesota. Management noted that the city has already received its first property tax payment from the county, which was in line with prior years. Additionally, while we are not currently aware of reductions to LGA, cuts to certain government types have occurred during previous recessions. Given this understanding, management has already begun planning for a potential decrease in LGA for fiscal 2021, currently structuring the budget with flat state revenues, and examining what other areas of the budget could be cut if further decreases are realized. Built into each budget are standardized amounts for various expenses, including capital improvements and vehicle replacements, each of which could be reallocated if there was a substantial decrease in revenues. We believe the city is well placed to manage expenditures and make appropriate budgetary adjustments to maintain structural balance.

Very strong budgetary flexibility

North Mankato's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 29% of operating expenditures, or $2.7 million.

Previously, our calculation of the city's available fund balance excluded portions of general fund receivables that were classified as available. However, in the fiscal 2019 audit, the full receivable, amounting to $1.0 million, was classified as nonspendable and therefore no longer affects our view of available fund balance. The total receivable continues to shrink, dropping from $1.3 million in 2018, with resolutions in place for each individual interfund loan, complete with specific repayment schedules for each. The entirety of the receivable is planned to be repaid by 2030, and the city is on track for the current repayment schedule. We do not anticipate any material changes in the city's reserves for fiscal 2020, given management's expectation for a general fund surplus, and we believe our view of the fund balance will remain very strong.

Very strong liquidity

In our opinion, North Mankato's liquidity is very strong, with total government available cash at 68.2% of total governmental fund expenditures and 3.2x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary. Its $9.7 million in cash and investments (after removing unspent bond proceeds) were held primarily in municipal and U.S. government securities, mutual accounts, and certificates of deposit, which we do not consider aggressive. Based on past issuance of debt, we believe the city has strong access to capital markets to provide for additional liquidity if necessary. Management confirmed that it has no direct-purchase or variable-rate debt that we expect could pose a liquidity risk. Even given current recessionary pressures, we do not believe that any potential delays in property tax filings will affect liquidity, and we believe that there is sufficient cash levels and will maintain a very strong liquidity profile.

Weak debt and contingent liability profile

In our view, North Mankato's debt and contingent liability profile is weak. Total governmental fund debt service is 21.7% of total governmental fund expenditures, and net direct debt is 147.8% of total governmental fund revenue. Approximately 76.3% of the direct debt is scheduled to be repaid within 10 years, which is, in our view, a positive credit factor.

We calculate total direct debt at about $28.1 million; when excluding self-supporting GO debt paid from the city's enterprise funds, net direct debt amounts to roughly $22.6 million. The city plans to continue its annual issuance for capital improvement projects amounting to roughly $3.0 million annually; we believe that these issuances will likely be offset by maturing debt. Management also noted that the city will likely issue around $2.0 million in sales tax bonds in 2021 for an indoor recreation facility. Voters approved up to $9.0 million in sales tax debt authorization, but at this time, management only expects to move forward with issuing $2.0 million, but more could be issued in the future. The additional debt could worsen our view of the city's debt profile, depending on the timing and structure of the forthcoming issuances.

Pensions and other postemployment benefits

North Mankato's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 3.4% of total governmental fund expenditures in 2019. The city made 101% of its annual 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. North Mankato 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. Although the city funds its OPEBs 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.

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 $2.0 million
- Minnesota Police and Fire Fund (PEPFF): 89.3% funded (as of June 30, 2019), with a proportionate share of $1.2 million
- A single-employer, defined-benefit OPEB plan: 0% funded with a net OPEB liability of $892,000

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 that indicates some exposure to cost acceleration as a result of market volatility, and an amortization method that significantly defers contributions through a lengthy, closed 30-year amortization period based on a level 3.25% payroll growth assumption. Regardless, costs remain only a modest share of total spending, and we believe they are unlikely to pressure the city'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

- 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
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of August 5, 2020)		
North Mankato GO		
Long Term Rating	AA/Stable	Affirmed
North Mankato GO		
Long Term Rating	AA/Stable	Affirmed
North Mankato GO		
Long Term Rating	AA/Stable	Affirmed
North Mankato GO		
Long Term Rating	AA/Stable	Affirmed
North Mankato GO		
Long Term Rating	AA/Stable	Affirmed
North Mankato GO bnds		
Long Term Rating	AA/Stable	Affirmed
North Mankato GO (Non School Prog)		
Long Term Rating	AAA/Negative	Affirmed
Unenhanced Rating	NR(SPUR)	
Underlying Rating for Credit Program	AA/Stable	Affirmed
North Mankato Port Auth Comm, Minnesota		
North Mankato, Minnesota		
North Mankato Port Auth Comm (North Mankato) GO		
Long Term Rating	AA/Stable	Affirmed
North Mankato Port Auth Comm (North Mankato) GO rfdg bnds		
Long Term Rating	AA/Stable	Affirmed