S&P Global Ratings

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Summary:

Chatfield, Minnesota; General Obligation

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Credit Profile		
US$4.4 mil GO swimming pool bnds ser 2018A dtd 09/10/2018 due 02/01/2039		
Long Term Rating	AA/Stable	New
Chatfield GO		
Long Term Rating	AA/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA' long-term rating to Chatfield, Minn.'s series 2018A general obligation (GO) swimming pool bonds. At the same time, we affirmed our 'AA' long-term rating on the city's outstanding GO bonds. The outlook is stable.

The bonds are general obligations of the city and are secured by the city's pledge to levy unlimited ad valorem taxes. This issuance brings total direct debt to $13.5 million. Bond proceeds will be used to finance the reconstruction of the municipal swimming pool.

The rating reflects our view of the city's:

- Weak economy, with market value per capita of $68,893 and projected per capita effective buying income at 95.6% of the national level;
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with a slight operating surplus in the general fund and an operating surplus at the total governmental fund level in fiscal 2017;
- Very strong budgetary flexibility, with a high available fund balance in fiscal 2017 of 91% of operating expenditures;
- Very strong liquidity, with total government available cash at 1.5x total governmental fund expenditures and 10.0x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability profile, with debt service carrying charges at 15.4% of expenditures and net direct debt that is 196.7% of total governmental fund revenue, and high overall net debt at greater than 10% of market value, but rapid amortization, with 79.3% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Weak economy

We consider Chatfield's economy weak. The city, with an estimated population of 2,827, is located in Fillmore and Olmsted counties, approximately 20 miles southeast of Rochester. The city has a projected per capita effective buying income of 95.6% of the national level and per capita market value of $68,893. Overall, the city's market value grew by 7.4% over the past year to $194.8 million in 2018. The weight-averaged unemployment rate of the counties was 3.2%

in 2017.

Because of its location, Chatfield residents have access to employment throughout Rochester and are benefitting residually from the Destination Medical Center development, which is expected to bring significant investment to the area over the next 20 years. Top employers have been stable and include a fiberglass manufacturer, a nursing care facility, a furniture design and manufacturing company, and the public school district. Management expects some modest growth in the tax base due to new residential and commercial growth, although we expect the economy will remain weak. We consider the tax base very diverse, with the top 10 taxpayers accounting for 8.6% of the tax base.

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 regularly monitor all of them.

Highlights of the city's policies and practices include:

- The use of at least three years of historical information, with the help of outside sources and a line-by-line approach to budgeting, in the formulation of the upcoming year's revenue and expenditure assumptions;
- Quarterly reporting of budget-to-actual performance to the council with the ability to make amendments to the budget as needed; however, reports lack detail;
- A formalized long-term financial plan that looks out five years with straight-line assumptions and is updated annually;
- A formalized combined long-term capital plan that looks out nine years, contains additional individual department plans that identify sources and uses of funds, and is updated on an annual basis;
- A formalized investment management policy, with quarterly reporting of investments and holdings;
- A formalized debt management policy; and
- A formalized fund balance policy of maintaining 40%-60% reserves.

Strong budgetary performance

Chatfield's budgetary performance is strong in our opinion. The city had slight surplus operating results in the general fund of 1.3% of expenditures, and surplus results across all governmental funds of 16.0% in fiscal 2017. The city's general fund operating results have been stable over the last three years, with results of 2.2% in 2016 and 3.2% in 2015.

These results reflect quantitative adjustments for analytic consistency, including adjustments for reoccurring transfers in and out of the general fund and the use of bond proceeds. For fiscal 2017 (Dec. 31), the city's primary sources of revenue included property taxes (55%) and local government aid (LGA; 37%). However, management expects LGA to remain stable in 2018 and 2019. Management attributes the positive variance in the general fund primarily to higher-than-budgeted tax revenues.

For fiscal 2018, the city's adopted budget calls for a $10,000 general fund deficit. Based on historical performance and management's projections, we believe the city will likely end the year with balanced operations. In addition, the city's municipal pool operations are a part of the general fund, and management does not expect pool operations to become self-supporting. Given the city's expectation to continue to subsidize pool operations, we anticipate the city will continue its efforts to maintain balanced operations. From a total governmental standpoint, we expect the city to report a negative net result, which is primarily driven by capital expenditures, though once adjusted, results are expected to be closer to break even.

Very strong budgetary flexibility

Chatfield's budgetary flexibility is very strong, in our view, with a high available fund balance in fiscal 2017 of 91% of operating expenditures, or $2.0 million. We expect the available fund balance to remain above 75% of expenditures for the current and next fiscal years, which we view as a positive credit factor. The available fund balance includes $1.1 million (49.1% of expenditures) in the general fund and $933,000 (42% of expenditures) 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 89% of expenditures in 2016 and 90% in 2015.

Available reserves include the general fund and capital goods internal service fund. Although the capital goods fund is typically used for acquiring capital equipment, management can use these reserves to support general operations when necessary. Given the city's budgeted performance, we expect the flexibility to remain very strong, above 75% of expenditures. However, we believe the capital goods fund reserve may fluctuate, and should the city's total reserves dip below 75% of expenditures as a result of either marginal capital spending or budgetary pressure, the rating may be affected.

Very strong liquidity

In our opinion, Chatfield's liquidity is very strong, with total government available cash at 1.5x total governmental fund expenditures and 10.0x governmental debt service in 2017. In our view, the city has strong access to external liquidity if necessary.

We've adjusted the city's available cash to remove unspent bond proceeds at the end of 2017. The city has demonstrated strong access to the capital markets, with a history of issuing GO debt in the past 20 years. Furthermore, we note that the city is not investing its funds aggressively, as it invests primarily in U.S. treasury notes and certificates of deposit. The city has $1.2 million of alternative financing obligations outstanding, which will fully mature in 2028 and do not include any permissive events of default or acceleration provisions. Therefore, we expect the liquidity profile to remain very strong over the near term.

Very weak debt and contingent liability profile

In our view, Chatfield's debt and contingent liability profile is very weak. Total governmental fund debt service is 15.4% of total governmental fund expenditures, and net direct debt is 196.7% of total governmental fund revenue. Negatively affecting our view of the city's debt profile is its high overall net debt of 15.0% of market value. Approximately 79.3% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor.

The city does not have plans to issue additional debt over the next couple of years. While we consider the city's debt burden very weak, we believe its carrying charges are manageable compared to those of peers statewide.

Chatfield's pension contributions totaled 3.1% of total governmental fund expenditures in 2017. The city made its full annual required pension contribution in 2017.

The city 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 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%), 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 "Minnesota's New Pension Bill Is A Positive Step Toward Sustainable Funding," published on 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 $1.1 million in fiscal 2017, the most recent year in which data are available. 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, 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 also participates in the Chatfield Fire Department Relief Association, a single-employer pension plan. 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 that the city will maintain its very strong budgetary flexibility and liquidity, supported by strong budgetary performance. We do not anticipate changing the rating within the two-year outlook horizon.

Downside scenario

We could lower the rating should the city's operating performance weaken or if reserves drop below 75% of expenditures as a result of modest capital spending.

Upside scenario

We could raise the rating should the city see significant economic gains and a lower 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
- 2017 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of August 21, 2018)		
Chatfield GO cap imp plan rfdg bnds ser 2010A dtd 05/01/2010 due 12/01/2010-2026		
Long Term Rating	AA/Stable	Affirmed
Chatfield GO crossover rfdg bnds ser 2016A dtd 02/15/2016 due 02/01/2028		
Long Term Rating	AA/Stable	Affirmed