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Ratings

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Summary:

Redwood Falls, Minnesota; General Obligation; Non-School State Programs

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Credit Profile		
US$8.0 mil GO util rev bnds ser 2022B dtd 06/01/2022 due 02/01/2048		
Long Term Rating	AAA/Stable	New
Underlying Rating for Credit Program	AA-/Stable	New
US$3.495 mil GO street reconstruction and util rev bnds ser 2022A dtd 06/01/2022 due 02/01/2043		
Long Term Rating	AA-/Stable	New
Redwood Falls GO		
Long Term Rating	AA-/Stable	Downgraded
Redwood Falls GO bnds		
Long Term Rating	AA-/Stable	Downgraded
Redwood Falls GO wtr rev bnds		
Long Term Rating	AAA/Stable	Affirmed
Underlying Rating for Credit Program	AA-/Stable	Downgraded

Rating Action

S&P Global Ratings lowered its underlying rating on Redwood Falls, Minn.'s general obligation (GO) debt outstanding by one notch to 'AA-' from 'AA'. At the same time, we assigned our 'AA-' underlying rating on the city's anticipated $3.495 million series 2022A GO street reconstruction and utility revenue bonds, and $8 million series 2022B GO utility revenue bonds. We also assigned our 'AAA' (program-enhanced) rating to the anticipated $8.0 million series 2022B GO utility revenue bonds. The outlook is stable.

The downgrade reflects the city's deteriorating debt and contingent liability profile, which we view as very weak, with the new debt issuance. The downgrade also reflects our view of the city's lower income metrics, which are no longer comparable with those of peers.

The city's full-faith-and-credit unlimited ad valorem tax GO pledge secures both the series 2022A and 2022B bonds. The 2022A and 2022B bonds will be further payable from a combination of water, sewer, and storm revenue. However, we rate the bonds based on the GO pledge. Bond proceeds on both the series 2022A and 2022B bonds will be used to finance the city's various utility construction projects.

The 'AAA' program rating reflects our view of the city's eligibility for, and participation in, the Minnesota State Standing Appropriation program for cities and counties, a state standing-appropriation program to prevent a default on the city's bond issues, as authorized by Minnesota State Statutes, Section 446A.086. Under the program, Minnesota will pay debt service on behalf of the city from the state's general fund if the city fails to meet debt service obligations for qualified debt. Payments from Minnesota represent a standing appropriation from the state's general fund. We view this standing-appropriation pledge equal to a general fund pledge because the standing appropriation does not require budget adoption or any Minnesota Legislature action to make payment. Furthermore, the standing appropriation is not subject to executive unallotment authority. Additionally, the credit-enhancement program supports projects central to Minnesota's operations and purpose. In our opinion, there is no unusual political, timing, or administrative risk related to debt payment.

The stable outlook on the program rating reflects S&P Global Ratings' assessment of the outlook on Minnesota and moves in tandem with the state GO rating and outlook.

Credit overview

With increased project costs and supply chain issues materially raising the amount borrowed for the series 2022A and 2022B bond issuances, the city's debt profile has deteriorated to a level we consider very weak. We expect Redwood Falls' debt profile to remain very weak, based on its plan to issue new debt in 2023. Further driving the downgrade are the city's below-average economic characteristics, which are no longer comparable with higher-rated peers, in combination with its deteriorating debt profile. Offsetting these weaknesses is the city's maintenance of available reserves at 90% of expenditures which has historically been above the fund balance policy target. Although officials have indicated that they will spend down some available reserves over the next few years to fund various capital improvement projects, we believe reserves will remain above the city's 50% fund balance policy target. Based on historical performance and conservative budgeting practices, we expect that the city will maintain balanced operations, supporting the stable outlook.

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

- Weak economy, with below-average market value per capita and effective buying incomes (EBI) that are not commensurate with those of higher-rated peers, albeit with appreciation in housing prices and some commercial growth;
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology, with an institutional framework we consider strong;
- History of very strong general fund reserves, with the city continuing to maintain general fund reserves at levels greater than its formal target of 50%; and
- Very weak debt and contingent liability profile due to new debt issuance, slower amortization, and future debt plans.

Environmental, social, and governance

We have analyzed the city's environmental risks relative to the city's economy, management, financial measures, and debt and liability profile, and consider them in line with the sector standard. The rating also incorporates our view of the county's declining population trend, which we consider a long-term social risk factor that could potentially affect the city's economic profile. Mitigating the county's projections for population decline is the city's relatively stable population, supported by its status as the county seat and regional economic center.

We believe the city's governance risks are also in line with our view of the sector standard, including measures it has taken to protect against emerging risks, such as cyber attacks. We note that the city was a victim of a $1.2 million fraudulent wire transfer in March 2021, which resulted in the vendor's IT system being compromised. The city was able to recover approximately half of the money, with the other half arriving in approximately a few weeks. In response to the fraud, the city has required voice verification for future wire transfers that meet certain criteria. We also note that the city's staff engages in monthly cyber security training on various topics.

Stable Outlook

Upside scenario

We could take positive rating action if the city's debt profile were to materially improve, or if the economic profile were to improve to levels comparable with those of higher-rated peers.

Downside scenario

We could take further negative rating action if there was a sustained decrease in reserves because of a significant deterioration in financial performance or one-time capital spending.

Credit Opinion

Below-average wealth and income indicators contribute to a weak economy despite appreciating home values and commercial growth

The city of Redwood Falls is located 100 miles west of Minneapolis and 100 miles southwest of St. Cloud. While the city does not have access to a broader and more diverse economy, it does serve as the county seat and considers itself a regional center for Redwood County. The city has below-average EBI and market value per capita that is not commensurate with that of higher-rated peers. Leading area employers include a hotel/casino, small manufacturers, the county, the school district, and a hospital, as well as a large agricultural component. Residential growth continues, with a 13% increase in home values over the past year, with a developer planning to convert the city's former hospital into 47 apartment units. Growth in commercial properties remains steady, as two manufacturers plan expansions worth approximately $16 million.

Management reports there were no major layoffs or closures among leading area employers due to COVID-19. While we note the countywide population has decreased over the last 10 years, the city's population has remained relatively stable, likely due to its presence as the county's employment center and county seat. If the city's population were to materially decline, our view of its economy could further weaken.

For S&P Global Economics' latest U.S. forecast, see "Economic Outlook U.S. Q2 2022: Spring Chills," published March 29, 2022, on RatingsDirect.

Strong financial management policies and practices

Highlights of Redwood Falls' financial management assessment include:

- Realistic and well-grounded assumptions when setting the annual budget;
- Monthly budget-to-actual monitoring, with reports given to the council;
- Lack of a formal long-term financial projection;
- Maintenance of a basic five-year capital projection that is updated every year and shown to the council;

- Formal investment management policy which mirrors state guidelines, with quarterly investment reports monitored by council;
- Lack of a formal debt management policy; and
- Formal fund balance policy that calls for the city's available general fund balance to be 50% of general fund expenditures, a level with which it has historically been in compliance.

History of stable operations with reserves above the fund balance policy target

For our analysis, we adjusted for routine transfers in and out of the general fund and removed one-time capital expenditures. After adjusting for these one-time expenditures and transfers, the city has historically reported a trend of consecutive operating surpluses, with a slight deficit reported for fiscal 2020. The general fund benefits from a revenue structure that has historically been stable and predictable, consisting mostly of property taxes (43%) and state aid (38%), referred to as local government aid in Minnesota.

The city adopted a break-even budget for fiscal year 2022, with some funds from the general fund to be used to pay for a development project. The city is also budgeting for a 4.75% levy increase. Officials have indicated that for fiscal 2023, they anticipate a deficit due to drawdowns to pay for capital improvement projects. However, the city has flexibility to draw down, as their reserves are well above their fund balance policy target. As additional flexibility, we have included cash in the liquor fund, which can be used with no restrictions for general operations. We expect the available fund balance to remain above the city's 50% reserve policy for the current and next fiscal years, which we view as a positive credit factor.

For year-end fiscal 2021, the city projects a slight surplus in the general fund and in all governmental funds due to cost savings. The city also received $271,000 in American Rescue Plan (ARP) funds, which is allocated for a development project. The other $271,000 ARP allocation will be received in 2022, which will be used for park and playground equipment, and police.

Fiscal 2020 results showed the city ended with a slight deficit in the general fund due to a large $1.8 million dollar transfer out to the Port Authority for a land purchase for development. The city was also allocated $400,000 in Coronavirus Aid, Recovery, and Economic Security (CARES) Act funding, which was spent primarily on facility improvements and personal protective equipment.

In our view, the city's $22.7 million in unrestricted cash represents very strong liquidity. It has strong access to external liquidity, if necessary, given its issuance of GO debt. We understand that the city has no potential contingent liabilities that could adversely affect its cash position. The city maintains a majority of its investments in certificates of deposit and highly rated government securities, which we do not view as aggressive.

The city's series 2015A, 2019A, 2020A, 2020B, and 2021B bonds were direct purchases. We understand that the events of default are standard, and that the bonds do not contain any unusual provisions, such as acceleration, that could pressure liquidity.

New debt issuances and slower amortization contribute to very weak debt and contingent liability profile

We have revised our view of the city's debt profile to very weak from very strong, with overall net debt as a percentage of market value exceeding 3%, coupled with slower amortization, with approximately 51% of direct debt scheduled to be repaid in 10 years.

The city plans on issuing $2.8 million of new debt in 2023 for another utility reconstruction project. Officials state that a portion of this issuance will be funded with GO utility revenue bonds, which, in our view, may further increase debt levels. However, credit for the city's self-supporting enterprise debt could be given in the future, to the extent the enterprise funds generate net revenues sufficient to cover debt service payments on the bonds.

Modest pension and other postemployment benefits (OPEB) liability, with medium costs unlikely to change meaningfully

We do not consider pension and OPEB liabilities a source of medium-term credit pressure, as the defined-benefit plans to which the city contributes are reasonably well-funded, and required contributions, which represent a moderate share of the budget, are unlikely to accelerate in a meaningful way in the next few years.

The city participates in the following plans:

- Minnesota General Employees Retirement Fund (GERF): 79.1% funded (as of June 30, 2020), with a city proportionate share of the plan's net pension liability of $2.8 million.
- Minnesota Police and Fire Fund (PEPFF): 87.2% funded (June 30, 2020), with a proportionate share of $952,000.
- An implicit subsidy contribution on behalf of its retirees, with an unfunded liability as of Jan. 1, 2019 (the most recent evaluation date), of $581,000.

The city's two largest pension plans have seen improvements in funded status in recent years, although plan statutory formula 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 over time, if the state does not offset future funding shortfalls with adjustments. 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 populations greater than 2,500 is strong.

Redwood Falls--Key Credit Metrics

	Most recent	Historical information		
		2020	2019	2018
Weak economy				
Projected per capita EBI % of U.S.	76.6			
Market value per capita ($)	68,057			
Population		5,104	5,045	5,104
County unemployment rate (%)		5.5		
Market value ($000)		347,362	320,152	314,887
Top 10 taxpayers % of taxable value		16.7		
Adequate budgetary performance				
Operating fund result % of expenditures		-1.7	9.6	12.3

Redwood Falls--Key Credit Metrics (cont.)				
	Most recent	Historical information		
		2020	2019	2018
Total governmental fund result % of expenditures		21.2	27.2	13.7
Very strong budgetary flexibility				
Available reserves % of operating expenditures		91.4	81.4	74.8
Total available reserves ($000)		5,695	5,846	5,019
Very strong liquidity				
Total government cash % of governmental fund expenditures		283.1	269.4	272.1
Total government cash % of governmental fund debt service		5181.8	12212.9	2072.9
Strong management				
Financial Management Assessment	Good			
Very weak debt & long-term liabilities				
Debt service % of governmental fund expenditures		5.5	2.2	13.1
Net direct debt % of governmental fund revenue	176.6			
Overall net debt % of market value	5.2			
Direct debt 10-year amortization (%)	50.8			
Required pension contribution % of governmental fund expenditures		5.2		
OPEB actual contribution % of governmental fund expenditures		0.3		
Strong institutional framework				

EBI--Effective buying income. OPEB--Other postemployment benefits.

Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022