

# RatingsDirect®

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## Summary:

# Newport, Minnesota; General Obligation

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## Summary:

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### Credit Profile

US\$3.22 mil GO imp bn ds ser 2018A dtd 08/09/2018 due 02/01/2034

*Long Term Rating* AA/Stable New

Newport GO

*Long Term Rating* AA/Stable Affirmed

## Rationale

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

The series 2018A bonds are secured by a pledge of the city's full-faith credit and an agreement to levy ad valorem property taxes without limitation as to rate or amount. The bonds are also payable from special assessments levied on benefited property, but the rating is based on the unlimited ad valorem tax pledge, which we view as the stronger security. Bond proceeds will be used to finance the expansion of the city's water and sewer system.

The rating reflects our view of the city's:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with an operating surplus in the general fund but an operating deficit at the total governmental fund level in fiscal 2017;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2017 of 93% of operating expenditures;
- Very strong liquidity, with total government available cash at 1.8x total governmental fund expenditures and 13.9x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability profile, with debt service carrying charges at 13.1% of expenditures and net direct debt that is 194.8% of total governmental fund revenue, but rapid amortization, with 65.5% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

### Strong economy

We consider Newport's economy strong. The city, with an estimated population of 3,457, is located in Washington County in the Minneapolis-St. Paul-Bloomington, Minn.-Wis., MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 116% of the national level and per capita market value of \$99,147. Overall, the city's market value grew by 5.1% over the past year to \$342.8 million in 2017. The county

unemployment rate was 3.0% in 2017.

The city of Newport is located approximately 10 miles southeast of the city of St. Paul and comprises 3.88 square miles. Its largest employer is Bailey Nurseries, a wholesale landscaping distributor, employing 800 people. Diversified Manufacturing Corp., the city's second-largest employer, recently moved out of the city, but the building has been purchased and is expected to provide higher-wage jobs.

Recent economic developments include new residential and commercial buildings, and as a result, management expects continued growth in net tax capacity. While we expect the tax base to remain stable, we note it is moderately concentrated, with the top 10 taxpayers accounting for 31.6% of assessed value. Xcel Energy is the largest employer, representing 14.3% of the tax base, and St. Paul Park Refining Co. is the second-largest taxpayer, accounting for 3.7%. Management indicates that its major taxpayers and employers remain stable.

### **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.

Key financial management policies and practices include:

- Realistic and well-grounded revenue and expenditure assumptions and the use of historical and external data when formulating the budget;
- Monthly reporting to the city council on budget-to-actual performance;
- A five-year long term financial plan, though the city utilizes flat line assumptions;
- Long-term capital improvement plan that extend through 2023 and is updated throughout the year;
- A formal investment policy, with monthly review of investments;
- A formal debt management policy; and
- A formal policy of maintaining a minimum fund balance of 50% of expenditures for cash flow purposes;

### **Strong budgetary performance**

Newport's budgetary performance is strong in our opinion. The city had surplus operating results in the general fund of 14.8% of expenditures, but a deficit result across all governmental funds of 4.2% in fiscal 2017.

These results reflect quantitative adjustments for analytic consistency, including adjustments for reoccurring transfers out of the general fund and bond proceeds. Management attributes the city's fiscal 2017 surplus to increased building permits and a lower-than-expected police budget. The city began contracting with the county for police protection in 2016, which has resulted in significant personnel savings of approximately \$200,000 per year. The 2018 budget indicates a slight deficit, but management expects at least balanced general fund operations. In 2017, property taxes accounted for 54% of general fund revenues. Local government aid (LGA) represented 20% of revenues, and we expect LGA to remain stable in 2018 and 2019. Based on our conversation with management, we expect the city's revenue and expenditure profile to remain stable and budgetary performance to remain strong.

### **Very strong budgetary flexibility**

Newport's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2017 of 93% of operating expenditures, or \$2.5 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.

Available general fund reserves include combined unassigned and assigned general fund balances. Management has strengthened its reserves over the last few years with plans to draw down \$400,000 towards its water and sewer expansion. We expect reserves will remain very strong and in compliance with the city's 50% minimum reserve policy.

### **Very strong liquidity**

In our opinion, Newport's liquidity is very strong, with total government available cash at 1.8x total governmental fund expenditures and 13.9x governmental debt service in 2017. In our view, the city has strong access to external liquidity if necessary.

We adjusted the city's cash, deducting restricted cash. Newport has demonstrated strong access to the capital markets with a history of issuing GO debt in the last 20 years. We do not consider the city's investments aggressive, as it primarily invests in cash deposits and certificates of deposit. Also, the city has no direct-purchase or variable-rate debt that we expect could pose a contingent liquidity risk. Therefore, we expect the liquidity profile will remain very strong.

### **Weak debt and contingent liability profile**

In our view, Newport's debt and contingent liability profile is weak. Total governmental fund debt service is 13.1% of total governmental fund expenditures, and net direct debt is 194.8% of total governmental fund revenue.

Approximately 65.5% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor.

The city may potentially issue \$1.5 million for street projects over the next two years; however, there are not concrete plans at this time.

Newport's combined required pension and actual other postemployment benefit (OPEB) contributions totaled 3.0% of total governmental fund expenditures in 2017. Of that amount, 2.5% represented required contributions to pension obligations, and 0.5% represented OPEB payments. 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 GERP 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 \$677,000 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 Newport Fire Department Relief Association, a single-employer pension plan. In fiscal 2017, the plan was overfunded. It funds other postemployment benefits on a pay-as-you-go basis. As of Jan. 1, 2015, the most recent actuarial valuation, its unfunded actuarial accrued liability was \$172,000.

### **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 expectation that the city will maintain its very strong reserves and liquidity. It also reflects the city's access to the broad and diverse Minneapolis-St. Paul MSA. We do not expect to change the rating within the two-year outlook period.

### **Upside scenario**

We could raise the rating if the city's economy improved to levels consistent with those of higher-rated peers, and if the rest of its credit profile remained stable.

### **Downside scenario**

We could lower the rating if its budgetary flexibility and performance declined to a level no longer commensurate with that of peers.

## **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 July 17, 2018)**

Ratings Detail (As Of July 17, 2018) (cont.)		
Newport GO imp bnds		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Newport GO imp bnds ser 2013A		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Newport GO util rev bnds		
<i>Long Term Rating</i>	AA/Stable	Affirmed

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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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