

RatingsDirect®

Summary:

Farmington, Minnesota; General Obligation

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Farmington, Minnesota; General Obligation

Credit Profile

US\$1.365 mil GO equip certs of indebt ser 2020A due 02/01/2026

<i>Long Term Rating</i>	AA+/Stable	New
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Farmington GO

<i>Long Term Rating</i>	AA+/Stable	Affirmed
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<i>Unenhanced Rating</i>	NR(SPUR)	
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Farmington GO bnds

<i>Long Term Rating</i>	AA+/Stable	Affirmed
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Rationale

S&P Global Ratings has assigned its 'AA+' long-term rating to Farmington, Minn.'s series 2020A general obligation (GO) equipment certificates of indebtedness. S&P Global Ratings has also affirmed its 'AA+' rating on the city's existing GO debt. The outlook is stable.

The bonds are secured by the city's GO, full faith and credit pledge, which benefits from an unlimited ad valorem tax. The city will use the series 2020A proceeds to purchase a ladder truck.

Farmington continues to post strong operating results, which in turn have led to further bolstering of its already very strong reserve position. Furthermore, the city maintains strong policies and practices, which should allow for stable operating results as it grows. Economic indicators, although strong, are still modest when compared with those of higher-rated peers, and remain the primary rating constraint.

The rating reflects our assessment of the following factors:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with balanced operating results in the general fund and an operating surplus at the total governmental fund level in fiscal 2018;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 53% of operating expenditures;
- Very strong liquidity, with total government available cash at 1.8x total governmental fund expenditures and 8.9x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability profile, with debt service carrying charges at 20.4% of expenditures and net direct debt that is 89.3% of total governmental fund revenue, but rapid amortization, with 99.5% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Strong economy

We consider Farmington's economy strong. The city, with an estimated population of 24,224, is located in Dakota County in the Minneapolis-St. Paul-Bloomington, MN-WI MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 112% of the national level and per capita market value of \$91,364. Overall, the city's market value grew by 7.5% over the past year to \$2.2 billion in 2019. The county unemployment rate was 2.5% in 2018.

Farmington is primarily residential (82% of tax capacity) with a smaller commercial/industrial (9%) component. Since the Great Recession, its valuation growth has risen steadily, from both the appreciation of properties and new residential development. The city has ample room for expansion, and management reports that it expects several additional developments that will create more housing. Officials expect taxable and market values will increase at similar rates over the next few years. The tax base is diverse, with the top 10 largest taxpayers making up just 7% of total tax capacity. Based on the recent trend and upcoming developments in the city, we view this growth as likely.

Very strong management

We view the city's management as very strong, with strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

The city's policies and practices include:

- Use of at least three years of historical information in the formulation of the upcoming year's revenue and expenditure assumptions with the help of outside sources and a line-by-line approach to budgeting;
- Monthly reporting of budget-to-actual performance to the council, with the ability to make amendments to the budget as needed;
- A five-year capital improvement plan that addresses capital needs, along with sources and uses of funds, that is updated annually;
- An investment management policy with monthly reporting of investments and holdings to the city manager and annual reports to council;
- A debt management policy containing provisions limiting the city from issuing variable-rate debt and derivative-based debt; and
- A fund balance policy to maintain 40% to 50% of operating expenditures for cash flow needs, which the city meets.

Strong budgetary performance

Farmington's budgetary performance is strong in our opinion. The city had balanced operating results in the general fund of 0.2% of expenditures, and surplus results across all governmental funds of 7.4% in fiscal 2018.

We have adjusted revenue and expenditures to account for recurring transfers into and out of the general fund as well as total governmental funds. We also removed one-time transfers and expenditures related to the early retirement of debt.

The city has achieved strong general fund results, with surpluses ranging between 4% and 6% of expenditures between fiscal years 2015 and 2017. Management attributes the strong results to its conservative budgeting of revenue, for such

items such as building permits, and expenditures. Across total governmental funds, the city has used some reserves for capital projects.

For fiscal 2018, Farmington posted more modest general fund operating results, which, although positive, were lower than those in previous years. The smaller surplus is, in large part, due to transfers for capital projects as Farmington aims to maintain its policy level of 40% of expenditures in reserves. For fiscal 2018, the largest revenue sources were taxes (82% of total general fund revenues), intergovernmental (8%), and charges for services (4%). Across total governmental funds, there was a reduction in fund balance related to three bond issues that were optionally redeemed (2010A, 2010B, and 2011A), but management is not expecting any other significant use of reserves.

Management has indicated that it expects to end fiscal 2019 with another modest surplus. The largest variance in terms of revenues will be a decline in charges for services; however, this was partially offset by higher investment returns, which came in over budget. The city has adopted a balanced budget for fiscal 2020; however, we expect our assessment will remain unchanged as it has historically outperformed its budget.

Very strong budgetary flexibility

Farmington's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 53% of operating expenditures, or \$6.8 million. We expect the available fund balance will 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 \$5.4 million (41.9% of expenditures) in the general fund and \$1.4 million (11.1% of expenditures) that is outside the general fund but legally available for operations.

Additional liquidity is provided by cash and cash equivalents in the liquor fund, which can be used for general operations with no repayment provisions. Based on fiscal 2019 expected results and the 2020 budget, we believe the city's available fund balance as a percentage of expenditures will remain very strong.

Very strong liquidity

In our opinion, Farmington's liquidity is very strong, with total government available cash at 1.8x total governmental fund expenditures and 8.9x governmental debt service in 2018. In our view, the city has strong access to external liquidity if necessary.

We base our assessment on city's issuance of GO debt, which demonstrates access to capital markets. In addition, Farmington does not have any potential contingent liabilities that could adversely affect its cash position, and we do not view its investment practices as aggressive because the majority are in U.S. agencies and securities, highly rated municipal bonds, CDs, and mutual funds.

Weak debt and contingent liability profile

In our view, Farmington's debt and contingent liability profile is weak. Total governmental fund debt service is 20.4% of total governmental fund expenditures, and net direct debt is 89.3% of total governmental fund revenue.

Approximately 99.5% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor. Although the amount of debt outstanding remains relatively unchanged, our assessment of the city's burden has changed given we are now using audited total governmental fund revenues in our ratios to reflect actual recent results based on our view of the city's stable revenues with modest growth expectations.

We have adjusted the city's 2018 debt service costs to remove debt payments associated with the early redemption of debt. The city plans to issue an additional \$2.46 million of debt over the next two years.

Farmington's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 4.3% of total governmental fund expenditures in 2018. The city made its full annual required pension contribution in 2018.

- We do not believe that pension and OPEB liabilities represent a medium-term rating 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.
- Farmington 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 OPEB 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): 79.5% funded (as of June 30, 2018), with a city proportionate share of the plan's net pension liability of \$3.37 million.
- Minnesota Police and Fire Fund (PEPFF): 88.8% funded (June 30, 2018), with a proportionate share of \$2.45 million.
- A single-employer, defined-benefit OPEB plan: 0% funded with a net OPEB liability of \$1.11 million.

The district's combined pension and OPEB contributions were 4.3% of governmental fund expenditures in fiscal 2018, of which 4.2% represented required pension contributions and 0.1% OPEB payments. Total contributions to GERF and PEPFF were 81% and 88%, respectively, of our minimum funding progress metric in 2018 and were slightly above static funding in both cases. Annual contributions are based on a statutory formula that has typically produced contributions less than the actuarially determined contribution for each plan, which we think increases risk of underfunding over time if future funding shortfalls are not met with offsetting adjustments by the state legislature. Other key risks include a 7.5% investment rate of return assumption (for both plans) that indicates some exposure to cost acceleration due to market volatility, and, for PEPFF, an amortization method that significantly defers contributions into the future through a lengthy, closed 26-year amortization period based on a level 3.25% payroll growth assumption. Regardless, costs remain only a modest share of total spending and, we think, 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.

Outlook

The stable outlook reflects our view that Farmington will maintain its very strong reserves supported by strong financial performance and management, so we do not expect to change the ratings within the two-year outlook period.

Upside scenario

A higher rating is possible if the city's economic metrics were to improve to levels commensurate with those of higher-rated peers, while the city maintained other credit measures.

Downside scenario

A lower rating is possible if Farmington's budgetary performance were to weaken, causing a significant deterioration in reserves.

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
- 2019 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of January 15, 2020)

Farmington GO imp rfdg bnds ser 2011A dtd: 08/25/2011 due 02/01/2012-2019		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Farmington GO imp rfdg bnds ser 2013A dtd 01/15/2013 due 02/01/2015-2022		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Farmington GO street reconstruction bnds ser 2015A dtd 10/15/2015 due 02/01/2030		
<i>Long Term Rating</i>	AA+/Stable	Affirmed

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