S&P Global Ratings

RatingsDirect®

Summary:

Bemidji, Minnesota; General Obligation; Moral Obligation; Non-School State Programs

Primary Credit Analyst:
Jessica Akey, Chicago + 1 (312) 233 7068; jessica.akey@spglobal.com

Secondary Contact:
Augustin Kazakevicius, Centennial + 1 (303) 721 4782; augustin.kazakevicius@spglobal.com

Table Of Contents

Summary:

Bemidji, Minnesota; General Obligation; Moral Obligation; Non-School State Programs

Credit Profile		
US$3.885 mil GO wtr rev bnds ser 2020 due 02/01/2031		
Long Term Rating	AAA/Negative	New
Underlying Rating for Credit Program	A+/Stable	New
Bemidji liquor store rev bnds		
Long Term Rating	BBB+/Stable	Affirmed
Bemidji GO rfdg bnds ser 2019A due 02/01/2032		
Long Term Rating	A+/Stable	Affirmed
Bemidji Issuer Credit Rating due 01/01/2099		
Long Term Rating	A+/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AAA' long-term rating, with a negative outlook, and its 'A+' underlying rating, with a stable outlook, to Bemidji, Minn.'s $3.885 million series 2020 general obligation (GO) water revenue bonds. At the same time, S&P Global Ratings affirmed its 'A+' issuer credit rating, its 'A+' rating on the city's GO debt outstanding, and its 'BBB+' long-term rating on the city's series 2018 liquor store revenue bonds. The outlook is stable.

The city's full faith and credit and unlimited ad valorem tax GO pledge secure the 2020 GO water revenue bonds. The city anticipates that debt service will be paid from water utility revenue. The rating is based on the city's GO pledge. The bond proceeds will be used to finance a portion of the construction of a new city water treatment plant.

The 'AAA' long-term rating on the series 2020 bonds reflects our view of the city's eligibility for, and participation in, Minnesota's credit enhancement program for cities and counties, a state standing appropriation program administered by the Public Facilities Authority to prevent a default on the city's bond issues as authorized by Minnesota State Statutes, Section 446A.086. Under the program, the state will pay debt service on behalf of the city from the state's general fund if Bemidji fails to meet its debt service obligations for the qualified debt. Payments from the state represent a standing appropriation from Minnesota's general fund. We view this standing appropriation pledge as equivalent to a general fund pledge because it does not require adoption of a budget or any action of the legislature to make payment. Furthermore, the standing appropriation is not subject to executive unallotment authority. The credit enhancement program supports projects that are central to the state's operations and purpose. We see no unusual political, timing, or administrative risk related to the debt payment. The rating on obligations that have received enhancement under the program reflects that on the State of Minnesota and moves in tandem with the state rating. The negative outlook on the long-term credit enhancement program rating reflects that on the state of Minnesota and moves in tandem with the state's GO rating and outlook (see "Minnesota Credit Enhancement Program Outlooks

Revised To Negative After State GO Outlook Revision," published Aug. 3, 2020, on RatingsDirect).

The series 2018 liquor store revenue bonds are special limited obligations of the city payable from net revenue of the municipal liquor stores it owns and operates. The bonds are additionally secured by the city's pledge to appropriate funds to fill any deficiencies in the debt service reserve fund should it be used in the event of a deficiency. We rate the bonds to Bemidji's nonstandard appropriation pledge. We note the structure has moral-obligation-like features, but under our "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness" criteria, published Nov. 20, 2019, a moral obligation structure is not in place. The rating on the bonds is three notches off our view of Bemidji's general creditworthiness to reflect the city's pledge to appropriate funds to debt service in case of a deficiency in the debt service fund.

Credit overview

Although the scope of economic and financial challenges posed by the COVID-19 pandemic remains to be seen, given the city's very high reserve levels and lack of reliance on sales or income taxes for governmental operations, we believe Bemidji is well positioned to navigate the possible effects of the pandemic in the short-to-medium term. The city is home to Bemidji State University (BSU) and we believe the economy is moderately reliant on the university student and student-serving population. With students distance learning this year, officials do not report a material difference in the city's economic health, as reflected in increased sales tax collections and a lack of business closures. Generally, our rating outlook time frame is up to two years. Given the current uncertainty around the pandemic, our view of the credit risks to the city are centered on the more immediate budget effects in 2021. (For additional information, see "The U.S. Economy Reboots, With Obstacles Ahead," Sept. 24, 2020.)

The rating reflects our view of Bemidji's:

- Weak economy, with market value per capita of $68,699 and projected per capita effective buying income at 62.5%, but that is benefiting from a local stabilizing institutional influence;
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with balanced operating results in the general fund and 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 62% of operating expenditures;
- Very strong liquidity, with total government available cash at 138.3% of total governmental fund expenditures and 16.9x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability profile, with debt service carrying charges at 8.2% of expenditures and net direct debt that is 275.0% of total governmental fund revenue; and
- Strong institutional framework score.

Environmental, social, and governance factors

The rating also incorporates our view of the health and safety risks posed by the COVID-19 pandemic, which we consider social risk factors. 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. Absent the implications of

COVID-19, we consider the city's social risks to be in line with those of the sector. We view governance and environmental risks as being in line with our view of the sector as a whole.

Stable Outlook

Downside scenario

We could lower the rating if the city were to draw down reserves to a level no longer commensurate with that of peers. Should the city fail to replenish the debt service reserve fund for the series 2018 liquor store revenue bonds, in the event it is drawn upon, we would lower the rating by multiple notches.

Upside scenario

We could raise the rating if Bemidji's debt profile or economic indicators improve and are sustained at a level commensurate with that of higher-rated peers.

Credit Opinion

Weak economy

We consider Bemidji's economy weak. The city, with an estimated population of 14,443, is located in Beltrami County. The city benefits, in our view, from a stabilizing institutional influence. The city has a projected per capita effective buying income of 62.5% of the national level and per capita market value of $68,699. Overall, the city's market value was stable over the past year at $992.2 million in 2019. The county unemployment rate was 4.3% in 2019.

The city's employment base is fairly diverse, but is mostly in education, health care, retail, and government; officials indicate that the pandemic has not materially affected its economic base. The Beltrami County unemployment rate peaked at 9% in April 2020 and was down to 4.5% in September 2020 (the state's unemployment rate was at 5.4% in September). Bemidji serves as a regional center for residents in the county. Leading local employers include Sanford Health System, Bemidji Public Schools, BSU, Walmart, and the county.

We view the presence of BSU as a stabilizing influence with about 5,400 students, a significant portion of the city's population. Management reports that the university is distance learning, with students not on campus; if this were to persist it could have a material negative effect on the city's economy in the medium term. Management estimates approximately 47% of city property is tax exempt. These factors likely suppress per capita incomes and market values.

Officials report two recently completed developments, totaling $3.1 million, a grocery store and apartment building; in addition, a $1.4 million housing project is under construction. Development in the planning stage includes a $16 million addition to the Sanford Health System and a $1.2 million housing development.

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.

Bemidji employs a line-by-line approach for its budgetary process and uses at least three years of historical information. Management can amend the budget if needed and the council receives reports at least quarterly that include budget-to-actual results. The city lacks a long-term financial plan but does have an extensive financial management policy. It has a five-year capital improvement plan (CIP) that it updates and presents to council members each year. Bemidji lacks formal investment and debt management policies. The city has a formal reserve policy to maintain 50% of the subsequent year's budgeted expenditures for cash flow purposes, which it is meeting.

Adequate budgetary performance

Bemidji's budgetary performance is adequate, in our opinion. The city had balanced operating results in the general fund of negative 0.2% of expenditures, and surplus results across all governmental funds of 1.9% in fiscal 2019. General fund operating results of the city have been stable over the past three years, with a result of negative 1.0% in 2018 and a result of 1.2% in 2017.

Property taxes represent the largest general fund revenue source (40%), followed by intergovernmental (36%), gas and electric fees (10%), and charges for services (10%). The city's sales tax collections do not support governmental operations; they are deposited into the enterprise funds. We believe this is important to track due to the city's significant amount of sales tax debt, which also has a GO pledge. Sales tax collections increased 8% over the past two audited years and have increased 3.4% in 2020 (based on collections through Sept. 1).

The fiscal 2020 budget called for a $1.2 million general fund surplus; management expects to outperform the budget. The city is closely watching revenues and expenditures, and has not experienced any reduction in revenue as a result of social distancing or economic pressures. Bemidji received $1.1 million in Coronavirus Aid, Relief, and Economic Security (CARES) Act funding; the city will use the majority of those funds for eligible public health and safety expenses, although many of those expenditures were part of the original budget. The 2021 proposed budget calls for a slight general fund surplus with no reductions in state aid, which we believe is at the greatest risk for revenue declines in fiscal 2021. Officials indicate they would be willing to use a portion of the 2020 surplus to offset state aid reductions, as the city would still be well above its fund balance policy of 50% of expenditures.

We expect budgetary performance will remain adequate over the next two years.

Very strong budgetary flexibility

Bemidji's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 62% of operating expenditures, or $8.2 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 $7.1 million (53.6% of expenditures) in the general fund and $1.1 million (8.2% of expenditures) that is outside the general fund but legally available for operations.

The available reserves include $1 million in liquor fund cash; this was down from $2 million due to one-time expenditures on the constructions of a new liquor store. Based on the expected surplus in 2020, and despite a possible drawdown in 2021 due to potential state aid reduction, we expect budgetary flexibility will remain very strong.

Very strong liquidity

In our opinion, Bemidji's liquidity is very strong, with total government available cash at 138.3% of total governmental fund expenditures and 16.9x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary, based on its frequent issuance of GO bonds during the past 20 years.

At fiscal year-end 2019, the city had almost $25 million in cash and investments available for liquidity purposes in the combined governmental activities and business-type activities. We do not expect Bemidji's cash position will change materially over the next two years with respect to total governmental expenditures and debt service. We do not consider Bemidji's investments aggressive because the city primarily invests in certificates of deposit and U.S. agencies. It has no contingent liquidity risk that could come due in the near term and pressure the budget. Therefore, we expect the liquidity position will remain very strong. The city entered into a $1.9 million private-placement energy equipment lease in 2014. The lease has what we consider standard events of default and does not create a liquidity risk, in our opinion.

Very weak debt and contingent liability profile

In our view, Bemidji's debt and contingent liability profile is very weak. Total governmental fund debt service is 8.2% of total governmental fund expenditures, and net direct debt is 275.0% of total governmental fund revenue.

The city's very weak debt profile is a credit weakness. However, more than 80% is supported by non-property-tax sources. Although we would typically give full self-support for revenue bonds, we have included the 2018 liquor fund bonds in the debt figures above given the additional pledge. We understand the city plans to issue up to $6 million in GO bonds over the next two years.

Bemidji's pension contributions totaled 4.5% of total governmental fund expenditures in 2019. The city made its full annual required pension contribution in 2019.

We do not believe that pension and other postemployment benefits (OPEB) 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 stressing operations.

The city's two largest pension plans have seen improvements in funded status in recent years, although 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. The city pays its OPEBs on a pay-as-you-go basis.

The city participates in the following defined-benefit plans:

- Minnesota General Employees Retirement Fund (GERF): 80% funded (as of June 30, 2019), with a city proportionate share of the plan's net pension liability at $3.17 million.
- Minnesota Police and Fire Fund (PEPFF): 89% funded (as of June 30, 2019), with a proportionate share of the net liability of $2.9 million.
- Pioneer Firefighters' Relief Assn. (single-employer plan): fully funded (as of June 30, 2019), with a net asset of $741,000.
- A single-employer OPEB plan that is 0% funded with a net OPEB liability of $1.18 million (as of Dec. 31, 2018).

Annual contributions are based on a statutory formula, which we view as a negative credit factor. We think this increases risk of underfunding over time if future funding shortfalls are not met with offsetting adjustments by the state legislature. Statutory rates did not meet our minimum funding progress metric last year; however, these fixed rates are scheduled to increase in 2020. Another key risk is a 7.5% investment rate of return assumption, which is higher than our 6.0% guideline. This indicates some exposure to liability acceleration from market volatility. Regardless, costs remain only a modest share of total spending and, in our view, are unlikely to pressure the city's medium-term operational health.

The city provides limited OPEB benefits, which it pays on a pay-as-you-go basis. OPEB costs have generally been small as a share of total spending in recent years; as with pension contributions, we do not view them as a significant source of budgetary pressure.

Strong institutional framework

The institutional framework score for Minnesota cities with a population greater than 2,500 is strong.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 2020 Update Of Institutional Framework For U.S. Local Governments