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Ratings

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Summary:

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

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Credit Profile		
US$1.86 mil GO wtr rev bnds ser 2022 due 02/01/2042		
Long Term Rating	AAA/Stable	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 GO wtr rev bnds ser 2020 due 02/01/2031		
Long Term Rating	AAA/Stable	Current
Underlying Rating for Credit Program	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, and its 'A+' underlying rating, to Bemidji, Minn.'s $1.8 million series 2022 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 on all ratings is stable.

The city's full faith and credit and unlimited ad valorem tax GO pledge secure the 2022 GO water revenue bonds and the city's existing GO debt. The city anticipates that debt service on the series 2022 GO water revenue bonds will be paid from water utility revenue, although the rating on the bonds is based on the city's GO pledge, as we view this pledge as stronger pledge and there is insufficient information to rate the bonds to the city's utility pledge. The bond proceeds will be used to finance water treatment plant improvements.

The 'AAA' long-term rating on the series 2022 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 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

The city is home to Bemidji State University and we believe that it represents a stabilizing influence on Bemidji, given the relatively high proportion of the population that is students. Despite this, we view the city as being fairly limited economically. The city experienced strong operating performance in its general fund in fiscal years 2020 and 2021, which bolstered its very strong general fund reserve position, which we believe the city will maintain based on the city's general fund projections. Offsetting this city's strong financial performance is its very weak debt burden, which we believe is unlikely to improve during the next few years.

The rating reflects our view of Bemidji's:

- Weak economy, with relatively low projected per capita effective buying income (EBI), but benefits from the presence of Bemidji State University, from a local stabilizing institutional influence;
- Strong budgetary performance, with two consecutive general fund surpluses in fiscal years 2020 and 2021 and another budgeted surplus in fiscal 2022;
- Very weak debt and contingent liability profile, with high net direct debt as a percent of total governmental fund revenue; and
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology and strong institutional framework score.

The stable outlook on the enhanced program rating reflects that on Minnesota and moves in tandem with the state GO rating and outlook (see "Minnesota School District, Minnesota Credit Enhancement Programs Outlook Revised To Stable After GO Outlook Revised," published Aug. 26, 2021, on RatingsDirect).

Environmental, social, and governance

Based on the city's participation in the Minnesota State Standing Appropriation program, we view the environmental, social, and governance risks as the same as those for the State of Minnesota.

We consider the city's environmental risks to be elevated. Bemidji has elevated levels of PFAS (per-and poly-fluoroalkyl substances) in its wells. The city reached a settlement with manufacturer 3M for the company to treat this contamination at 3M's expense. In addition, the city experienced significant rainstorms that have caused flooding in city facilities in recent years. We consider the city's social and governance risks to be neutral.

Stable Outlook

Downside scenario

We could lower the rating if the city experiences a trend of fiscal imbalances leading to a drawdown of reserves to a level that is no longer commensurate with that of peers.

Upside scenario

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

Credit Opinion

Weak economy, although the presence of Bemidji State University is a stabilizing institution

Bemidji is in Beltrami County, approximately 225 miles northwest of the Twin Cities in north central Minnesota. The city's incomes are below average, in our view, reflecting the sizable student population of Bemidji State. The city experienced steady market value growth in recent years, averaging 3.1% annual growth the past three years. The city's employment base is mostly represented in the education, health care, retail, and government sectors, with leading local employers include Sanford Health System, Bemidji Public Schools, and Bemidji State.

We view the presence of Bemidji State as a stabilizing influence, with about 5,400 students--a significant portion of the city's population. Management estimates approximately 47% of city property is tax exempt. These factors likely suppress per capita incomes and market values, leading to our conclusion that the university is a stabilizing influence on the city. In terms of new economic development, officials report that a new $35 million veterans' home is scheduled to open in 2023.

Strong management, highlighted by good FMA

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 it 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.

Strong budgetary performance, with very strong budgetary flexibility and liquidity

After posting two consecutive small general fund deficits in fiscal years 2018 and 2019, the city rebounded in fiscal 2020 with a large surplus and another positive result in 2021. Officials have structured the city's 2022 general fund budget with another surplus. Property taxes represent the largest general fund revenue source (46%), followed by intergovernmental revenue (42%). The city's sales tax collections do not support governmental operations; they are deposited into the enterprise funds.

For unaudited 2021 (fiscal year-end Dec. 31), the city expects to report a slight 0.4% general fund surplus. Contributing to this result were higher revenues, particularly with respect to the city's gas and electric revenue, coupled with expenditures that were consistent with budget. Bemidji was allocated $1.8 million in American Rescue Plan Act funding. For fiscal 2022, the city adopted a general fund budget with a 1.1% general fund surplus. Officials report that the general fund is tracking relatively close to budget, except for higher fuel costs.

In fiscal 2020, the city posted a 9.3% general fund surplus, after transfers, which was driven in part by the receipt of $1.1 million in CARES Act revenue. Officials report that the city also experienced savings from budget with regard to positive expenditure variances. We expect the city's budgetary performance will remain strong during the next few years.

The city's available fund balance includes $8.35 million in the general fund and $1.35 million that is outside the general fund but legally available for operations in the city's liquor fund. We expect the city's budgetary flexibility will remain very strong.

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. 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 it does not create a liquidity risk, in our opinion.

Very weak debt and contingent liability profile

The city's very weak debt profile is a credit weakness, in our view, with very high net direct debt as a percent of total governmental funds revenue. We understand the city plans to issue up to $2.2 million in additional debt over the next two years for wastewater treatment plant projects.

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, at 5.1% of total governmental funds expenditures in fiscal 2020, and we believe the city can 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 OPEB on a pay-as-you-go basis.

The city participates in the following defined-benefit 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 at $3.8 million
- Minnesota Police and Fire Fund (PEPFF): 87.2% funded (as of June 30, 2020), with a proportionate share of the net liability of $3.4 million
- Pioneer Firefighters' Relief Assn. (single-employer plan): fully funded (as of June 30, 2020), with a net pension asset of $1.3 million
- A single-employer OPEB plan that is 0% funded with a net OPEB liability of $1.2 million (as of Dec. 31, 2020)

For both GERF and PEPFF, plans use 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.

Bemidji, Minn.--Key Credit Metrics

	Most recent	Historical information		
		2020	2019	2018
Weak economy				
Projected per capita EBI % of U.S.	60.7			
Market value per capita ($)	71,273			
Population		14,399	14,443	
County unemployment rate(%)	3.7			
Market value ($000)	1,088,983	1,046,726	992,215	
Ten largest taxpayers % of taxable value	8.8			
Strong budgetary performance				
Operating fund result % of expenditures		9.3	(2.4)	(1.0)
Total governmental fund result % of expenditures		3.1	1.9	(6.7)
Very strong budgetary flexibility				
Available reserves % of operating expenditures		74.8	61.8	73.3
Total available reserves ($000)		9,702	8,154	9,276
Very strong liquidity				
Total government cash % of governmental fund expenditures		140.9	138.3	147.8
Total government cash % of governmental fund debt service		2,058.1	1,691.6	1,818.8
Strong management				
Financial Management Assessment	Good			
Very weak debt & long-term liabilities				
Debt service % of governmental fund expenditures		6.8	8.2	8.1
Net direct debt % of governmental fund revenue	241.2			
Overall net debt % of market value	5.3			
Direct debt 10-year amortization (%)	47.1			
Required pension contribution % of governmental fund expenditures		5.1		
OPEB actual contribution % of governmental fund expenditures		0.0		
Strong institutional framework				

Data points and ratios may reflect analytical adjustments. EBI--Effective buying income. OPEB--Other postemployment benefits.

Related Research

- Credit Conditions North America Q2 2022: Hazard Ahead: Risk Intersection, April 16, 2021
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- 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
- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022
- 2020 Update Of Institutional Framework For U.S. Local Governments