S&P Global Ratings

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Summary:

Buffalo, Minnesota; Appropriations; General Obligation; Non-School State Programs

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Credit Profile		
US$9.075 mil GO water and sewer rev rfdg bnds ser 2019A dtd 02/28/2019 due 08/01/2025		
Long Term Rating	A+/Stable	New
Buffalo GO		
Long Term Rating	A+/Stable	Affirmed
Buffalo Hsg & Redev Auth, Minnesota		
Buffalo, Minnesota		
Buffalo Hsg & Redev Auth (Buffalo) bnds (Buffalo Hsg & Redev Auth)		
Long Term Rating	A/Stable	Affirmed
Buffalo Hsg & Redev Auth (Buffalo) lse		
Long Term Rating	A/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'A+' long-term rating to Buffalo, Minn.'s series 2019A general obligation (GO) water and sewer revenue refunding bonds. At the same time, we affirmed our 'A+' rating on the city's existing GO bonds and 'A' long-term rating on the city's previously issued lease revenue debt. The lease revenue bonds outstanding are rated one notch lower than the general creditworthiness as reflected in the GO rating to account for the appropriation risk associated with the lease payment. The outlook on all ratings is stable.

The city's full faith and credit pledge and ability to levy unlimited ad valorem property taxes secures the bonds. Net revenues of the city's water and sewer systems also secures the bonds. The city's existing GO debt is further secured by certain additional pledged revenues, however, we rate to the GO pledge, which we view as the stronger pledge. Proceeds of the series 2019A bonds will refund the city's series 2009B capital appreciation bonds and its series 2009E utility revenue bonds, both for interest cost savings.

The 'A+' rating reflects our assessment of the city's:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Adequate management, with standard financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Weak budgetary performance, with operating results that we expect could deteriorate in the near term relative to fiscal 2017, which closed with balanced operating results in the general fund, but an operating deficit at the total governmental fund level; Very strong budgetary flexibility, with an available fund balance in fiscal 2017 of 19% of operating expenditures;
- Very strong liquidity, with total government available cash at 66.6% of total governmental fund expenditures and

3.1x governmental debt service, and access to external liquidity that we consider strong;

- Weak debt and contingent liability profile, with debt service carrying charges at 21.7% of expenditures and net direct debt that is 527.6% of total governmental fund revenue, but rapid amortization, with 78.8% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Strong economy

We consider Buffalo's economy strong. The city, with an estimated population of 16,515, is located in Wright County in the Minneapolis-St. Paul-Bloomington MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 106.5% of the national level and per capita market value of $80,570. Overall, the city's market value grew by 6.6% over the past year to $1.3 billion in 2018. The county unemployment rate was 3.5% in 2017.

Buffalo has seen a resurgence in residential development in recent years. More than 200 single-family housing lots are in development, along with two new multifamily apartment buildings going up within the next year. With residential home valuations accounting for 58.3% of total net tax capacity (NTC), this new development, coupled with the city's already increasing home values has led to a 23.9% increase in NTC between 2014-2019. Based on these trends, management expects growth to continue for the foreseeable future. Buffalo is also close to the Twin Cities, allowing for accessibility for employment. Top employers include Wright County (861 employees), the local school district (782), and Buffalo Hospital (466).

Adequate management

We view the city's management as adequate, with standard financial policies and practices under our FMA methodology, indicating the finance department maintains adequate policies in some but not all key areas.

Using four years of historical finances, management makes use of both internal and external sources when preparing the budget, however budgetary projections do not account for upcoming pressures that could be related to a significant fund balance deficit in the city's golf fund. Management has made operational changes to address the large civic center receivable in the general fund, however there are still increases projected in the city's golf fund deficit with no long-term plan in place to fund the negative balance. Management reports monthly to the council on budget-to-actual results, and maintains a rolling five-year capital improvement plan. The city maintains its own investment policy, but investments are only reported to the council through the annual audit. Management has an informal general fund reserve target that requires 18%-25% of reserves be kept on hand, however, the city has an interfund receivable from the civic center fund that is currently accounting for a large portion of unassigned reserves. The city does not maintain a long-term financial plan or a debt management policy.

Weak budgetary performance

Buffalo's budgetary performance is weak, in our opinion. The city had balanced operating results in the general fund of negative 0.2% of expenditures, but a deficit result across all governmental funds of 2.2% in fiscal 2017. Our assessment accounts for the fact that we expect budgetary results could deteriorate from 2017 results in the near term, primarily based on a significant fund balance deficit in the city's golf fund.

We adjusted general fund revenues and expenditures, as well as total governmental fund revenues to include annually recurring transfers. We also adjusted for one-time capital spending in total governmental fund expenditures. In the general fund, we included a transfer out to the civic center fund as operating expenditure, totaling $600,000 in fiscal 2017. Management plans to continue this transfer over the next three to four years until the receivable has been repaid, having transferred $400,000 in fiscal 2018, and budgeting to transfer $300,000 in fiscal 2019. The city also allocates funds from its electric fund to pay down this balance. In addition, management reports that operations at the civic center are improving as it has raised fees, is selling more ice time, and is switching to more efficient compressors for cooling the ice.

While general fund performance has not yet been affected by the underperformance of the city's golf fund, we note that the golf fund, although slowing the rate of its deficit growth, has been increasing its deficit balance year over year and could eventually pressure the rating if it were to become reliant on the city's governmental funds. The golf fund is currently supported by other enterprise funds, many of which have been depleting their cash levels. Overall, general fund results in recent years have remained stable, fluctuating slightly around breakeven. We expect this trend to continue, unless the civic center fund or the golf course fund deteriorate. If operations in the civic center fund or the golf fund deteriorate significantly enough that general fund transfers were required, budgetary performance could deteriorate, which could result in a lower rating.

For fiscal 2017, management originally budgeted for a drawdown of about $270,000, or 3.5% of expenditures, however, after making adjustments, year-end results were better than budgeted, resulting in a deficit of 0.2%. Budgetary projections for fiscal 2018 initially called for a surplus of about $8,000, but management is estimating actual year-end results to show a surplus of approximately $533,000 (or 6.0% of expenditures) based on an increase in building permit revenue and franchise fees and lower than budgeted police and park department wages. The 2019 budget calls for an exactly breakeven budget, which, based on past performance, we view as achievable. Total governmental fund performance has been stable in recent years, and management expects this to remain unchanged in the near term. Major general fund revenues in 2017 included property taxes (55%), charges for services (22%), and intergovernmental revenue (15%).

Very strong budgetary flexibility

Buffalo's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2017 of 19% of operating expenditures, or $1.7 million.

We adjusted available reserves by the $2.6 million owed to the general fund from the civic center fund. Management reports that the city has plans to pay off this receivable in the next three to four years, however we do not expect this decrease to be rapid in the near term. While the deficit in the golf fund has not significantly affected general fund balance, at this point, it could eventually weaken reserves if performance in the golf fund is not adequately addressed. Based on better than budgeted fiscal 2017 general fund results, as well as the city's budgetary expectation for a surplus in fiscal 2018 and breakeven budget for fiscal 2019, we expect reserves to continue to be very strong.

Very strong liquidity

In our opinion, Buffalo's liquidity is very strong, with total government available cash at 66.6% of total governmental fund expenditures and 3.1x governmental debt service in 2017. In our view, the city has strong access to external liquidity if necessary.

The city has strong access to external liquidity, in our opinion, because it has issued GO debt within the past 20 years. Its $9.5 million in cash and investments in fiscal 2016 were held primarily in cash deposits and certificates of deposit, which we do not consider aggressive investments. While we consider the city's liquidity position to be very strong, there are significant deficit fund balances in the city's civic center fund and golf fund. If the deficit balances were to materially increase, it could strain the city's liquidity.

Weak debt and contingent liability profile

In our view, Buffalo's debt and contingent liability profile is weak. Total governmental fund debt service is 21.7% of total governmental fund expenditures, and net direct debt is 527.6% of total governmental fund revenue. Approximately 78.8% of the direct debt is scheduled to be repaid within 10 years, which is in our view a credit strength.

Our direct debt calculation excludes revenue bonds supported by the city's water and sewer funds. The city plans to issue about $10 million in GO bonds within the next year to be issued for two purposes: to finance the construction of a new fire station, and to complete various street projects and updates. Based on its elevated debt service carrying charges, we expect debt and contingent liabilities to remain weak.

Buffalo's pension contributions totaled 3.5% of total governmental fund expenditures in 2017. The city made its full annual required pension contribution in 2017.

Buffalo participates in the General Employees Retirement Fund (GERF) and the Public Employees Police and Fire Fund (PEPFF), which are cost-sharing, multiple-employer, defined-benefit pension plans administered by the Public Employees Retirement Association of Minnesota. Required pension contributions to these plans are determined by state statute. Contributions are not based on an actuarial determined contribution (ADC) and have not been keeping up with the plans' increasing liabilities, which indicates that employer contributions may rise in the future. The state recently passed pension legislation that will marginally increase contributions (for PEPFF only), reduce the investment rate of return to 7.5% (from 8.0%), 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, in our view. For more information about the reforms included in the 2018 omnibus retirement bill and the potential for future cost increases, see our analysis titled, "Minnesota’s New Pension Bill Is A Positive Step Toward Sustainable Funding," published June 7, 2018, on RatingsDirect.

The GERF and PEPFF were 79.5% and 88.8% funded, respectively, in fiscal 2018. The city's proportionate share of the net pension liability for these plans totaled $5.6 million in fiscal 2017, the most recent year for which data are available. We consider historical plan funding levels somewhat weak, and we believe that the history of pension contributions below the ADC increases the risk of payment acceleration. Despite these weaknesses, we believe the city has sufficient taxing and operational flexibility to manage future increases in pension contributions. However, if pension contributions absorb a larger share of the city's budget, our view of its debt and contingent liability profile could weaken.

Buffalo also maintains a single-employer defined benefit plan, administered by the Buffalo Firefighters Relief

Association. The plan is available to all members of the Buffalo Fire Department. At fiscal year-end 2017, the plan was overfunded with an asset of roughly $274,000.

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 stable budgetary performance, coupled with a very strong budgetary flexibility and liquidity profile. It also reflects the city's access to the broad and diverse Twin Cities MSA. We do not expect a rating change within the two-year outlook period.

Downside scenario

We could lower the rating if the city's financial performance deteriorates, resulting in much lower reserves, primarily if the civic center fund or golf fund begin to pressure general fund operations.

Upside scenario

We could raise the rating if the city's budgetary performance were to improve, coupled with a significant decrease or elimination of the civic center receivable, stabilization of the golf fund deficit and moderation of the city's debt profile.

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
- 2018 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of January 30, 2019)		
Buffalo GO non sch prog		
Long Term Rating	AAA/Stable	Affirmed
Unenhanced Rating	NR(SPUR)	Current
Underlying Rating for Credit Program	A+/Stable	Affirmed
Buffalo GO street reconstruction bnds ser 2016C dtd 04/14/2016 due 02/01/2032		
Long Term Rating	A+/Stable	Affirmed
Buffalo GO (BAM)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Buffalo GO (BAM)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Buffalo GO (BAM)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Buffalo GO (BAM)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed

Ratings Detail (As Of January 30, 2019) (cont.)		
Buffalo GO		
Long Term Rating	A+/Stable	Affirmed
Buffalo GO		
Long Term Rating	A+/Stable	Affirmed
Buffalo GO		
Long Term Rating	A+/Stable	Affirmed
Buffalo GO		
Long Term Rating	A+/Stable	Affirmed
Buffalo NONSCHSTPR		
Long Term Rating	AAA/Stable	Affirmed
Unenhanced Rating	NR(SPUR)	Current
Underlying Rating for Credit Program	A+/Stable	Affirmed

Many issues are enhanced by bond insurance.

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