

# RatingsDirect®

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**Summary:**

## Inver Grove Heights, Minnesota; General Obligation; Non-School State Programs

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### Table Of Contents

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Rationale

Outlook

Related Research

## Summary:

# Inver Grove Heights, Minnesota; General Obligation; Non-School State Programs

### Credit Profile

US\$3.645 mil GO imp bnnds ser 2017B dtd 12/28/2017 due 02/01/2033

*Long Term Rating* AA+/Stable New

Inver Grove Hgts GO

*Long Term Rating* AA+/Stable Upgraded

## Rationale

S&P Global Ratings raised its long-term rating to 'AA+' from 'AA' on Inver Grove Heights, Minn.'s existing general obligation (GO) bonds. At the same time, we assigned our 'AA+' long-term rating to the city's series 2017B GO improvement bonds. The outlook is stable.

The raised rating reflects our view of sustained improvements in the city's economic metrics to levels that align well with those of similarly rated peers, along with the ongoing maintenance of a solid financial position, characterized by consistently strong budgetary performance and very strong reserves and liquidity.

The AA+ rating reflects our view of the city's:

- Very 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 operating surpluses in the general fund and at the total governmental fund level in fiscal 2016;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2016 of 52% of operating expenditures;
- Very strong liquidity, with total government available cash at 1.7x total governmental fund expenditures and 15.8x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability position, with debt service carrying charges at 10.8% of expenditures and net direct debt that is 125.8% of total governmental fund revenue, as well as rapid amortization, with 67.8% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

### Very strong economy

We consider Inver Grove Heights' economy very strong. The city, with an estimated population of 35,506 over roughly 29.6 square miles, is in Dakota County, around 10 miles south of the Minneapolis-St. Paul-Bloomington MSA, which we consider to be broad and diverse. It has a projected per capita effective buying income of 125% of the national level and per capita market value of \$106,289. Overall, market value grew by 5.8% over the past year to \$3.8 billion in 2017. The county unemployment rate was 3.4% in 2016.

The city is primarily residential, which makes up roughly 63.5% of its tax base, though also has a sizable commercial/industrial base, totaling around 19.9% of the city's tax base. The city's tax base and economic market values have grown consistently for each of the past three years at an average 4.8% to current valuations and management expects this trend to continue.

We understand that the city has seen an increase in residential developments with new single-family homes, townhouses, condos, and apartments coming on line. In addition, the city anticipates a fairly sizable increase in commercial development as the Minnesota Vikings headquarters moved to a neighboring city (Eagan), generating additional local retail and hotel development. Based on these trends, we view management's expectations of rising taxable and market valuations to be likely.

Due to the location of the city, residents have ample employment opportunities within the Minneapolis-St. Paul MSA, though there are employment opportunities within Inver Grove Heights itself. Some of the leading employers include CHS Inc. (2,500 employees), Inver Grove Heights Independent School District (557), and Inver Hills Community College (448).

### **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.

The city performs a line-by-line approach for its budgetary process with focus on the prior two years when preparing a budget and uses historical information that dates back at least 10 years. The budget can be amended if needed, and the council receives a quarterly report that depicts budget-to-actual results.

The city has a long-term capital plan that is five years long, which is updated annually and presented to the council with sources and uses identified. Within this plan is a long-term financial plan for the general fund, which is also five years long and updated each year with presentation to the council members.

Inver Grove Heights does have its own investment policy and reports on a quarterly basis to its council members on holdings and performance. There is no debt management policy, but the city adheres to state guidelines. We understand that the city does not have a debt management policy, though it may adopt a formal one.

The city has a formal reserve policy which aims to maintain between 40% and 45% of operating expenditures each year, and it identified this amount for cash flow purposes.

### **Strong budgetary performance**

Inver Grove Heights' budgetary performance is strong, in our opinion. The city had operating surpluses of 6% of expenditures in the general fund, and 1.5% across all governmental funds in fiscal 2016. Our assessment accounts for our expectation that budgetary results could deteriorate somewhat from 2016 results in the near term. General fund operating results of the city have been stable over the past three years, with results of 4.3% surplus in 2015 and 6.5% surplus in 2014.

We believe the city will likely maintain strong budgetary performance since it has consistently been able to outperform

the budget and end with favorable operating results.

For fiscal 2016 (Dec. 31), the city's primary sources of revenue included taxes (85.7%) and license and permit revenues (6%). We made adjustments for expenditures and transfers that we view as one-time in nature, and added annually recurring transfers out of the general fund as expenditures. In addition, we have computed a three-year average of capital outlay and adjusted total governmental expenditures up or down based on that year's capital outlay and the three-year average. The city originally had budgeted for a slight negative net result of \$143,000, but ended with better-than-budgeted results and a positive net result of \$1.1 million in its general fund (after adjustments for transfers), and a net positive result across total governmental funds of \$1.4 million (after adjustments for one-time capital expenditures and recurring enterprise transfers). Management attributes the positive variance in the general fund primarily to higher-than-budgeted revenues and conservative budgeting practice of the city across various expenditure line items.

For fiscal 2017, the city adopted budget calls for a \$133,000 general fund deficit, and year to date, is trending positively and management expects to end the year with roughly a \$300,000 to \$400,000 positive variance. Across total governmental funds, we expect the city to report break-even net results after adjustments for one-time capital expenditures. For fiscal 2018, the budget is balanced. Based on historical performance and expenditures savings primarily due to lower-than-budgeted personnel costs, we believe the city will likely end the year with a positive variance.

### **Very strong budgetary flexibility**

Inver Grove Heights' budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2016 of 52% of operating expenditures, or \$9.6 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.

Based on the current budget for the fiscal years 2017 and 2018, we believe the city's available fund balance as a percentage of expenditures will remain very strong and remain above 30%.

### **Very strong liquidity**

In our opinion, Inver Grove Heights' liquidity is very strong, with total government available cash at 1.7x total governmental fund expenditures and 15.8x governmental debt service in 2016. In our view, the city has strong access to external liquidity if necessary.

We believe that the city has strong access to external liquidity given its credit rating and GO and revenue-backed debt issuance within the past 20 years, which demonstrates access to capital markets. We do not expect its cash position, with respect to its total governmental expenditures and debt service, to change much during the next two years and believe it will remain strong. We understand that currently, the city does not have any potential contingent liabilities that could have an adverse impact on the cash position. The majority of its investments are in highly rated securities, which we feel are not aggressive.

### **Adequate debt and contingent liability profile**

In our view, Inver Grove Heights' debt and contingent liability profile is adequate. Total governmental fund debt service is 10.8% of total governmental fund expenditures, and net direct debt is 86.7% of total governmental fund

revenue. Approximately 67.8% of the direct debt is scheduled to be repaid within 10 years, which is, in our view, a positive credit factor.

We excluded debt that was supported by water and sewer revenues. We understand that the city could potentially issue an additional \$9.6 million in 2018 for fire station improvements.

Inver Grove Heights' combined required pension and actual other postemployment benefit (OPEB) contributions totaled 3.8% of total governmental fund expenditures in 2016. The city made its full annual required pension contribution in 2016.

The city participates in cost-sharing, multiemployer, defined-benefit pension plans administered by the Public Employees Retirement Association of Minnesota (PERA). PERA administers the General Employees Retirement Fund (GERF) and the Public Employees Police and Fire Fund (PEPFF). The city's annual required pension contribution to all three funds is determined by state statute and based on a percentage of payroll. Contributions are not based on an actuarial determined contribution, and have not been keeping up with the plan's increasing liabilities, which indicate that employer contributions may rise in the future.

Using updated reporting standards in accordance with Governmental Accounting Standard Board (GASB) Statements Nos. 67 and 68, the city's net pension liability as of 2016 was \$8.6 million and \$13.3 million for the GERF and PEPFF, respectively. The plans' funded ratios, which are calculated as the plan fiduciary net position as a percent of the total pension liability, were 78.2% for GERF and 86.6% for PEPFF. Notably, following some assumption changes and lower investment returns, the plans' GASB funded ratios fell to 68.9% for GERF and 64.9% for PEPFF in fiscal 2016. Still, the city's total contribution to PERA is a small percentage of its total budget. If contribution rates were to increase, we expect the city will have the ability to manage the increase.

### **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 Inver Grove Heights will maintain its very strong financial position, so we do not expect to revise the ratings within the two-year outlook period. We expect the city will be able to address any potential budgetary pressures to maintain fiscal balance and very strong reserves in compliance with its formalized fund balance policy.

### **Downside scenario**

A lower rating is possible if the city's budgetary performance were to decline to levels that we view as weak or very weak, causing a significant decline in its available fund balance to levels we no longer consider very strong.

### **Upside scenario**

A higher rating is possible if the city's overall net debt were to decrease, causing an increase to its debt profile, coupled with continued improvement in the economic indicators and maintenance of its strong financial 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

Ratings Detail (As Of December 7, 2017)		
Inver Grove Hgts GO bnds ser 2015A due 02/01/2031		
<i>Long Term Rating</i>	AA+/Stable	Upgraded
Inver Grove Hgts GO cap imp rfdg bnds		
<i>Long Term Rating</i>	AA+/Stable	Upgraded
Inver Grove Hgts GO rfdg bnds ser 2011A dtd 08/18/2011 due 02/01/2019		
<i>Long Term Rating</i>	AA+/Stable	Upgraded
Inver Grove Hgts GO swr rev bnds		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
<i>Underlying Rating for Credit Program</i>	AA+/Stable	Upgraded
Inver Grove Hgts GO swr rev bnds ser 2015B due 02/01/2031		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
<i>Underlying Rating for Credit Program</i>	AA+/Stable	Upgraded
Inver Grove Hgts GO swr rev rfdg bnds		
<i>Long Term Rating</i>	AA+/Stable	Upgraded
Inver Grove Hgts GO util rev rfdg bnds ser 2012A dtd 04/24/2012 due 02/01/2014-2022		
<i>Long Term Rating</i>	AA+/Stable	Upgraded

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