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Ratings

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Summary:

Polk County, Minnesota; General Obligation; Non-School State Programs

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US$2.935 mil GO cap imp plan bnds ser 2020A due 02/01/2031		
Long Term Rating	AAA/Stable	New
Underlying Rating for Credit Program	AA/Stable	New
US$1.625 mil GO watershed dist rfdg bnds ser 2020B due 02/01/2033		
Long Term Rating	AA/Stable	New
Polk Cnty GO		
Long Term Rating	AA/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AAA' long-term rating and 'AA' underlying rating to Polk County, Minn.'s series 2020A general obligation (GO) capital improvement plan bonds and its 'AA' long-term rating to the county's series 2020B GO watershed district refunding bonds. At the same time, we affirmed our 'AA' rating on the county's GO debt outstanding. The outlook is stable.

Security and use of proceeds

The county's full faith and credit unlimited ad valorem tax GO pledge secures the series 2020A and 2020B bonds. The series 2020B bonds are further supported by special assessments levied against benefited properties, but we rate to the GO pledge. Proceeds of the 2020A bonds will be used to finance capital improvements to the county's government center building, highway department buildings, and human services building. Proceeds of the 2020B bonds will be used to refund a portion of the county's debt outstanding for interest rate savings.

The 'AAA' long-term rating on the 2020A series reflects our view of the county'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 county'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 county from the state's general fund if the county fails to meet its debt service obligations for the qualified debt. Payments from the state represent a standing appropriation from the state's general fund. We view this standing appropriation pledge as equivalent to a general fund pledge because the standing appropriation 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. In addition, the credit enhancement program supports projects that are central to the State of Minnesota'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 is on par and moves in tandem with the rating on the state.

Credit Overview

The county is situated in northwestern Minnesota, on the North Dakota border and in the Grand Forks metro. The economy is largely agricultural, as it is one of the largest producers of sugar beets and wheat, which is represented in extremely strong market value per capita metrics. The county has experienced yearly deficits over the past several years as a result of elevated capital outlay, but anticipates returning to balanced or surplus results in 2026, when a large portion of debt service requirements falls off. The county's debt profile is very strong, as the county has recently spent down reserves in lieu of issuing additional debt and its amortization is rapid. Despite the county's expectation of continued capital expenses, we believe its budgetary flexibility will remain very strong, above management's formal policy of 50% of operating expenditures, and a key credit strength.

The underlying rating further reflects our view of the county's:

- Adequate economy, with market value per capita of $181,273 and projected per capita effective buying income at 87.5% of the national level;
- Adequate management, with standard financial policies and practices under our financial management assessment methodology;
- Weak budgetary performance, with operating deficits in the general fund and at the total governmental fund level in fiscal 2018;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 55% of operating expenditures;
- Very strong liquidity, with total government available cash at 34.9% of total governmental fund expenditures and 5.8x governmental debt service, and access to external liquidity we consider strong;
- Very strong debt and contingent liability position, with debt service carrying charges at 6.0% of expenditures and net direct debt that is 45.0% of total governmental fund revenue, as well as low overall net debt at less than 3.0% of market value and rapid amortization, with 79.4% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Adequate economy

We consider Polk County's economy adequate. The county has an estimated population of 31,748. The county has a projected per capita effective buying income of 87.5% of the national level and per capita market value of $181,273. Overall, the county's market value fell by 5.3% over the past year to $5.8 billion in 2019. The county unemployment rate was 3.7% in 2018.

Polk County is located in northwestern Minnesota on the North Dakota border. It includes approximately 2,028 square miles, 58 townships, and 15 cities. Its seat is Crookston, which is 25 miles southeast of Grand Forks. The county's economic base is primarily agricultural, with such property representing 56% of net tax capacity. The county is a leading producer in the state of wheat and sugar beets. The county's net tax capacity has recently fluctuated as a result of changes in commodity prices, but the overall trend has been positive. Net tax capacity has grown by 34% since fiscal 2014 to $52.7 million. Although agricultural commodity prices have stabilized since the beginning of 2019, the region's agricultural sector remains stressed because of reduced and delayed plantings across the region caused by rainy weather in April, May, and early June. This will hurt harvests and farm incomes, and, according to Macrotrends, spring wheat is nearly the same as in July 2018 but up 18% from April 2019. The largest employers in the county include American Crystal Sugar Co., a sugar beet refining business (563 employees), First Care Medical Service Hospital (501), sugar manufacturer Michael J. Andringa -- L T S Sugar (402), and bus manufacturer New Flyer of America Inc. (400). Officials report that residential property growth is relatively steady, but that the population is aging. We note that population trends have remained stable in recent years. We anticipate that the local economy will remain at least stable on average over the next few years.

Weak budgetary performance

Polk County's budgetary performance is weak, in our opinion. The county had operating deficits of 3% of expenditures in the general fund and across all governmental funds in fiscal 2018.

We have made adjustments to the county's operating budget by including public safety fund revenue and expenditures for better analytical comparison among peers. The county's adjusted operating revenue is composed primarily of tax revenue (66%), followed by intergovernmental revenue (16%). The county has reported deficits over the past three fiscal years, is estimating a deficit at fiscal year-end (Dec. 31) 2019, and is budgeting for a deficit in fiscal 2020. Officials have been spending down the county's extremely strong reserves for largely recurring capital needs, in lieu of issuing a large amount of debt. Officials anticipate continued spending of reserves until 2026, when a substantial portion of the county's debt service falls off. Nevertheless, officials are committed to remaining in compliance with their formal fund balance policy of maintaining six months of operating expenditures (net of public safety expenditures) in reserves. Net of adjusted revenue and expenditures, the county is well above its formal target. We anticipate that the county's budgetary performance will remain weak over the next two years.

Very strong budgetary flexibility

Polk County's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 55% of operating expenditures, or $11.7 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.

Budgetary flexibility includes the public safety fund assigned balance and general fund assigned and unassigned balances. We note that our adjusted calculation is not what management uses for their formal reserve policy.

Although officials anticipate continued draws on reserves over the next two years, we expect the county to maintain very strong budgetary flexibility. Reserves are fairly large on a nominal basis and officials are committed to maintaining an operating fund balance above their formal reserve policy of 50% of operating expenditures while drawing down for various capital needs in lieu of issuing additional debt. We anticipate reserves will remain very strong for the foreseeable future.

Adequate management

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

When developing the budget, officials use three years of historical data and a line-item approach. Budget-to-actual comparisons are reviewed at least quarterly and amendments can be made as needed. The county has no formal long-term financial or capital planning process and lacks a debt management policy. Investment reports are reviewed annually with the audit, and the county follows state statute. It has a formal policy of maintaining six months of operating expenditures in reserve, which the county has historically been in compliance with.

Very strong liquidity

In our opinion, Polk County's liquidity is very strong, with total government available cash at 34.9% of total governmental fund expenditures and 5.8x governmental debt service in 2018. In our view, the county has strong access to external liquidity if necessary.

The county's investments are allocated primarily between money market funds, certificates of deposit, and a local government investment pool. As a result, we do not consider the county's investment exposure aggressive. Of the county's audited $25.8 million of cash and investments (including cash equivalents), $24 million is unrestricted. There are no contingent liabilities that will pressure liquidity. We expect liquidity to remain very strong.

Very strong debt and contingent liability profile

In our view, Polk County's debt and contingent liability profile is very strong. Total governmental fund debt service is 6% of total governmental fund expenditures, and net direct debt is 45% of total governmental fund revenue. Overall net debt is low at 1.9% of market value, and approximately 79.4% of the direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors.

The county has no privately placed or variable-rate debt. With no plans to issue debt over the next two to three years, the county's debt profile will likely remain very strong.

Polk County's required pension and actual other postemployment benefits (OPEB) contributions totaled 2.3% of total governmental fund expenditures in 2018. The county made its full annual required pension contribution.

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 county has the capacity to absorb higher costs without pressuring operations.

Polk County 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. The county also offers OPEB in the form of a single-employer defined health care plan to retirees and their spouses. The plan is funded on a pay-as-you-go basis, which could represent increased costs in the medium-to-long term as costs are realized.

The county participates in the following plans:

- Minnesota General Employees Retirement Fund (GERF): 80.2% funded (as of June 30, 2019), with a county proportionate share of the plan's net pension liability of $12.8 million
- Minnesota Police and Fire Fund (PEPFF): 89.3 % funded (June 30, 2019), with a proportionate share of $2.1 million
- OPEB, which is funded on a pay-as-you-go basis with a net pension liability of $844,000 (as of Jan. 1, 2018)

The county's combined pension contributions were 3.4% of governmental fund expenditures in fiscal 2018. Total contributions to GERF and PEPFF were 81% and 88%, respectively, of our minimum funding progress metric and were slightly above static funding in both cases. Annual contributions are based on a statutory formula that has typically produced contributions lower than the actuarially determined contribution for each plan, and we think that this increases risk of underfunding over time if the state legislature does not make adjustments to offset future funding shortfalls. Other key risks include a 7.5% investment rate-of-return assumption (for both plans) that indicates some exposure to cost acceleration as a result of market volatility, and, for PEPFF, an amortization method that significantly defers contributions 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 county's medium-term operational health.

Strong institutional framework

The institutional framework score for Minnesota counties with a population greater than 5,000 is strong.

Outlook

The stable outlook on the underlying rating reflects our view that the county will maintain reserves above its formal target over the next two years while maintaining a very strong debt profile.

The stable outlook on the 'AAA' program rating reflects our view of the state's creditworthiness and that Minnesota's support for the program will likely remain strong.

Downside scenario

We could lower the rating if the county significantly draws on reserves to levels that pressure the county's finances and fall below a level commensurate with similarly rated peers, with all else held constant.

Upside scenario

We could raise the rating in the unlikely event that the county's economy significantly expands and diversifies, as evidenced by improved income metrics, and if the county's budgetary performance improves.

Ratings Detail (As Of February 14, 2020)		
Polk Cnty GO rfdg bnds ser 2012B dtd 05/15/2012 due 01/01/2025		
Long Term Rating	AA/Stable	Affirmed
Polk Cnty GO watershed dist bnds ser 2012 dtd 02/08/2012 due 02/01/2014-2022 2024 2026 2029 2032 2033		
Long Term Rating	AA/Stable	Affirmed