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Summary:

Crosslake, Minnesota; General Obligation

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US\$3.815 mil GO cap imp bnds ser 2019A dtd 09/03/2019 due 02/01/2035

Long Term Rating

AA+/Stable

New

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to Crosslake, Minn.'s series 2019A general obligation (GO) capital improvement plan (CIP) bonds. The outlook is stable.

The series 2019A bonds are secured by a pledge of the city's full-faith credit and an agreement to levy ad valorem property taxes without limitation as to rate or amount. Proceeds will finance a new city hall and public safety facility.

Crosslake, in the lakes region of Minnesota, is a property-wealthy small town with a high seasonal population that has consistently maintained an extremely strong financial profile. Its operations are stable with few to no pressures and the city is able to cash-fund many capital projects given its extremely strong and growing tax base. The latter includes over half seasonal/recreational properties, which supports property taxes as the primary revenue source. In our view, the city's limited local economy and lack of participation in a metropolitan area offset these very strong credit factors, and currently preclude the credit being comparable to 'AAA' peers.

The 'AA+' rating reflects our view of Crosslake's:

- Strong economy, with market value per capita of \$500,567 and projected per capita effective buying income (EBI) at 138% of the national level;
- Adequate management, with standard financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Very strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2018;
- Very strong budgetary flexibility, with a high available fund balance in fiscal 2018 of 229% of operating expenditures;
- Very strong liquidity, with total government available cash at 2.3x total governmental fund expenditures and 21.5x governmental debt service, and access to external liquidity we consider strong;
- Strong debt and contingent liability position, with debt service carrying charges at 10.7% of expenditures and net direct debt that is 168.7% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 76.9% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Strong economy

We consider Crosslake's economy strong. The city, with an estimated population of 2,618, is in Crow Wing County. It has a projected per capita EBI of 138% of the national level and per capita market value of \$500,567. Overall, market value was stable over the past year at \$1.3 billion in 2019. The county unemployment rate was 3.9% in 2018.

The city benefits from its location along 14 interconnected lakes, which creates a large number of attractive lakefront properties. About 62% of its real estate is made up of seasonal/recreational properties, many of which serve as second or third homes to wealthy part-time residents. The large percentage of vacation homes contributes to the city's seasonal population of 15,000, which generates the unusually high market value per capita.

Crosslake has few commercial/industrial properties and a very limited local employment base, but management indicates that many residents are retired or run businesses out of their homes. Additionally, management anticipates the imminent completion of a \$20 million, up-to-90-unit private assisted-living facility. Officials expect the facility to employ 30 people and to be added to the tax base by 2021.

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.

Officials rely on seven-to-eight years of budget history when creating the annual budget. The city also presents a cash-basis budget-to-actual report to its city council each month. Management describes the council as extremely engaged with a high level of financial acumen, despite the city's small size and somewhat removed location, given the high number of retired professionals on the council.

Officials do not engage in long-term financial planning. Management indicated that due to the stability of its operations, it has not faced the need to forecast revenues and expenditures.

Management updates a five-year CIP, including funding sources, regularly through the year. The city maintains flexibility in the plan and shares it with the council monthly.

The city has an investment policy, but does not maintain formal debt or reserve policies. Management said that its general goal for debt is to amortize existing debt as quickly as possible. Similarly, it indicates that while the city has no written reserve policy, the city council aims to maintain at least 50% of expenditures in general fund reserves for cash-flow purposes, and attempts to set aside excess revenues to fund projects on an annual basis rather than drawing down reserves.

Very strong budgetary performance

Crosslake's budgetary performance is very strong, in our opinion. The city had operating surpluses of 21% of expenditures in the general fund and 20.3% across all governmental funds in fiscal 2018.

We adjusted general and governmental fund expenditures to exclude one-time items in 2018, including spending bond proceeds for the completion of a road improvement project (\$695,000) and a large transfer from the general fund to the sewer fund for wastewater improvements (\$1.5 million). Management dedicates a large portion of its annual revenue to capital outlay, but we have not removed those expenses because while arguably one-time in nature, the city

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regularly makes a large number of improvements out of its general fund budget. Even accounting for the ongoing support of capital in the city, its general fund consistently generates strong positive operating results, with the surplus size varying depending on how much revenue officials have determined to dedicate to those projects.

In 2019, the adopted \$4.5 million budget is balanced without a significant use of reserves, and one-third of the budget is dedicated to capital outlay, only a portion of which will be financed through bonding. Officials expect to end the year with a stable reserve level compared to 2018, even after cash-funding many capital improvements.

The vast majority of the city's revenue base is property taxes (76%), followed by charges for services (10%). Because it is property-wealthy, it receives no local government aid from the state.

Given the strength of the city's tax base, its currently low tax levy, and the flexibility it has to cut back on capital if needed to cover general administrative costs, we expect the city to maintain very strong operating results.

Very strong budgetary flexibility

Crosslake's budgetary flexibility is very strong, in our view, with a high available fund balance in fiscal 2018 of 229% of operating expenditures, or \$8.0 million. We expect the available fund balance to remain above 75% of expenditures for the current and next fiscal years, which we view as a positive credit factor.

Crosslake's reserves are boosted by the 2016 sale of Crosslake Communications, formerly a city-owned provider of cable, internet, and phone services, which resulted in net proceeds of \$6 million.

Officials plan to spend \$1.3 million of general fund reserves on the city hall and public safety facility project, for which the 2019A bonds are being issued. Beyond that project, management indicates that while it may use reserves in funding certain capital projects, it has no other immediate plans to significantly spend down existing fund balance. Even accounting for the spend-down on the city hall project, we expect reserves will remain very strong and in excess of 75% of expenditures.

Very strong liquidity

In our opinion, Crosslake's liquidity is very strong, with total government available cash at 2.3x total governmental fund expenditures and 21.5x governmental debt service in 2018. In our view, the city has strong access to external liquidity if necessary.

We don't view the city's investments as aggressive.

We believe the city's strong access to liquidity is supported by its issuance of several GO debt offerings over the last decade.

Given the city's long-standing ability to produce at least stable or positive operating results, with few financial pressures, we expect liquidity to remain very strong.

The city has several direct placements, including its 2017A and 2018A GO bonds and 2015B GO equipment certificates, none of which include unusual bond provisions or acceleration.

Strong debt and contingent liability profile

In our view, Crosslake's debt and contingent liability profile is strong. Total governmental fund debt service is 10.7% of total governmental fund expenditures, and net direct debt is 168.7% of total governmental fund revenue. Overall net debt is low at 1.8% of market value, and approximately 76.9% of the direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors.

The city's overall debt burden is \$7.5 million.

Management indicates that the city may issue additional debt in the next two years to finance portions of capital projects, including extending a sanitary sewer line and road projects, but the amount depends on grant receipts and will vary depending on how much of the projects is cash-financed. Given the rapid amortization schedule of the city's existing debt and its history of financing capital projects out of the general fund, we do not expect the issuance of additional debt to materially affect the debt profile.

We do not view the city's pension and other postemployment benefits (OPEBs) as a credit pressure; while the city does offer OPEBs, the liability is small relative to the city's budget and reserve level. Crosslake's combined required pension and OPEB contributions totaled 3.2% of total governmental fund expenditures in 2018. Of that amount, 2.6% represented required contributions to pension obligations, and 0.7% represented OPEB payments. The city made its full annual required pension contribution in 2018.

Employees of Crosslake are covered by defined-benefit pension plans administered by the Public Employees Retirement Association of Minnesota (PERA). The city participates in the General Employees Retirement Fund (GERF) and the Public Employees Police and Fire Fund (PEPFF), which are funded at 79.5% and 87.1%, respectively, as of fiscal 2018. The city's proportionate share of the net pension liability for these plans totaled \$778,000 in fiscal 2018, the most recent year in which data are available.

In addition, Crosslake offers a single-employer defined-benefit plan for fire department volunteers through the Crosslake Firemen's Relief Association.

The city offers health and dental insurance to certain retired employees and their spouses. It funds this liability on a pay-as-you-go basis. The outstanding OPEB liability as of 2018 is \$335,000, which while notable compared to most cities in Minnesota that do not offer a similar benefit to retirees, is relatively small compared to Crosslake's availability liquidity and revenue-raising ability.

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 of Crosslake's very strong financial profile, extremely large tax base (particularly in relation to its full-time population), and favorable debt liabilities. We expect the city's credit factors to remain stable, and do not expect to change the rating within the two-year outlook horizon.

Upside scenario

We could raise the rating if management adopted more robust policies and procedures and if the local economy, which is limited, diversified.

Downside scenario

We could lower the rating with substantial drawdowns of the city's reserves or with a shift to negative operations in the general fund, although we consider these possibilities unlikely in the next two years.

Related Research

- 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
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015

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.

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