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Credit Analysis of General Obligation Refunding Bonds, Series 2019A

Ms. Sherburn,

Our credit rating agency utilizes several metrics to weight and measure the rating of municipal bonds. In Appendix A, listed below, you will be able to reference and understand how we came to our final bond rating. Similarly, Appendix A consists of comparisons between your bond issue and the bond issues of both Byron and Goodview. In our analysis, we consider four primary components of varying weights of importance, including: a city’s economic base, its financial health, its debt levels, and the management policies and practices. Each component also has subcomponents, which are similarly listed in Appendix A (with values taken from city’s respective bond issue and page numbers referenced according to its place in their issue’s pdf). In regards to the components listed above, each will be ranked on a 1 to 5 scale, with 1 being “poor” and 5 being “excellent.”

In regards to the economic base of the city, we are considered with the trends underlying this component. As noted in Appendix A, St. Charles has the least diverse economic composition, with few major employers and limited property tax to levy. Of the two comparable cities, St. Charles is closest to Goodview in population estimates and growth. For instance, St. Charles had growth of 11.13% between 2000 and 2010, while Goodview had 19.65% and Byron had 40.4%, respectively. Unfortunately, assessed property value estimates for St. Charles lags tens of millions of dollars behind both Byron and Goodview at $206MM, relative to Byron’s $582MM and Goodview’s $301MM. Similarly, current population is estimated at a loss for St. Charles relative to 2010, whereas estimations are that Byron is still gaining residents, while Goodview maintains its population. Lastly, the diversity of industry and employers for St. Charles lags behind both Byron and Goodview, and is particularly vulnerable to economic downturns. The overall rating given to this component is a 2.

For the financial health component, there are several concerns for St. Charles position and its position to both Byron and Goodview. As shown in Appendix A, the net and annual pension obligations outpace both Byron and Goodview in terms of both net ($1,185,859MM) and annual ($105,439) liabilities. According to your audit, your top taxpayers also contain mainly government services or LLC property owners. Moreover, consider St. Charles revenue stream is composed of 39% property tax, 35% grants, and 10% charges, whereas Byron’s is composed of 72.5% property taxes, 13.3% charges, and only 6.3% grants. A positive area to note is the general fund balance levels, which are approximately ¾ of Byron. However, when considering the large pension liabilities, dependency on state assistance to raise revenues, and revenue raising methods for the general fund (which is supported primarily from LAGs), this is given a score of 1.

The third component, debt levels, is the most concerning of all four components listed. St. Charles’ debt to assessed value is at 2.78%, while Byron’s is 1.57% and Goodview’s is 1.39%. Moreover, debt service and its interest paid out far exceeds either Byron or Goodview. Byron and St. Charles have comparable debts per capita, but Byron benefits from its stronger economic base, and its associated higher assessed property values. For these reasons, and because St. Charles is broaching the state legal limit, the rating given to this component is 1.

Lastly, St. Charles is in a much different position than both Byron and Goodview vis-à-vis its management policies and practices. As shown in Appendix A, St. Charles relies on local government assistance for approximately 64% of its general fund revenues, and its expenditures have recently exceeded its revenues. All three cities report auditing of their finances in recent years, but none evaluate or explicitly list climate adaptation planning. Byron recently called for a balanced budget, and both Byron and Goodview benefit from consistent surpluses. Explicitly defining measures to work towards a balanced budget, general funds supported to a greater extent by the town, and forecasting information to account for outstanding bonds and growth will help the city become a competitive issuer. As it stands, the rating given for this component is a 2.

Unfortunately, based on our current calculation, this bond would be given a grade below BBB- and would be considered speculative. However, this isn’t to say that St. Charles is likely to default nor can reach a higher credit rating over time. Since this is a refunded bond on prior issues, and given that the state is likely to support St. Charles with LGAs into the future, the holder should feel confident in receiving its return.[[1]](#footnote-1) Moreover, as St. Charles continues to pay off its outstanding bonds, which this current issue is intended to accomplish, the city can find itself in a much more favorable position in the future. However, this future is also contingent on continued growth and diversification; its closeness to the Mayo Clinic and other Olmsted County employers offer it a strong foundation for future residential growth.

**Appendix A**

|  |  |  |  |
| --- | --- | --- | --- |
| **Components in bold**  *Subcomponents in italics* | **St. Charles** | **Byron** | **Goodview** |
| **Credit Rating on Bonds** | **Speculative (< BBB-)** | **AA** | **AA-** |
| **Economic Base** |  |  |  |
| *Strength/Composition/*  *Diversity of economy* | not diverse; not much property tax; few major employers | very diverse for its size; employment not concentrated in one sector (pg. 21-22) | Less diverse than Byron, more than St. Charles; diverse employer composition |
|  |  |  | (pp. 30,16,89) |
| *Assessed property value* | 2017: $206,861,66) (pg. 21) | 2019 ($582,189,000); strong valuation trends year over year (pg. 27, 29) | 2017/18 ($301,176,800); strong valuation trend (pg. 15) |
| *taxable retail sales* | (N/A; state has approx. 7.38%, excluding groceries/clothing) | (N/A; state has approx. 7.38%, excluding groceries/clothing) | (N/A; state has approx. 7.38%, excluding groceries/clothing) |
| *population growth* |  |  |  |
| *\* 2000* | 3,295 | 3,500 | 3,373 |
| *\* 2010* | 3735 (+ 11.33%) | 4914 (+ 40.4%) | 4036 (+ 19.65%) |
| *\*current* *estimates by y r*(St. C - 2017; Byr - 2015; GV - 2016 | 3726 (- .2%) | 5404 (+ 9.97%) | 4036 (0%) |
| **Financial Health** |  |  |  |
| *predictable revenue streams* | prop tax: 39%; grants: 35%; charges: 10% | Prop tax: 72.5%; charges: 13.3%; grants (unrestricted) 6.3% | predictable revenue streams over time from property taxes and assessed values (pg. 82) |
| *reserve/general fund balance levels* | $777,754 (2017) (pg. 19) | $ 1,049,857 (pg. 80) | Recently stabilized w/ population growth stagnant (pg. 29) |
| *concentration of key taxpayers* | mostly llc property owners; 8% of tax capacity (pg. 26) | top ten largest taxpayers comprised approximately 11.12% of | General fund balance consistently growing (pg. 29) |
|  |  | tax capacity; very diverse sources (pg. 22) | diverse employers and strong property tax base (pg. 29, 30) |
| *pensions and OPEB liabilities* | PERA (2017 - $105,439; net $1,185,859) (pg. 69, 128) | GERF: (total: $624,752); 2019: $66,115. NO OPEB. | minimal obligations (pg. 26) |
| *past short-term borrowing* | street reconstruction (2011/18) & public safety building (2015) (pg. 13) | 2011/2016 - improvement bonds; 2018 public works building | total GO debt $5,749,000 (pg. 17) |
|  | street reconstruction/public safety refunding portion (2011) |  |  |
|  | equipment lease (2012/16/17) |  |  |
| **Debt Levels** | Section 475.53: limited to net debt in excess of 3% of its estimated market value | Section 475.53: limited to net debt in excess of 3% of its estimated market value | Section 475.53: limited to net debt in excess of 3% of its estimated market value |
| *Debt to assessed value* | 2.78% ($7,614,777/$274,295,374) (pg. 14) | 1.57% (pg. 29) | 1.39% (23) |
| *Debt to personal income* | debt ratio per capita: $2,044 | debt ratio per capita: $2,052 | debt ratio per capita: $1,051 |
| *Debt service expenditures* | approx. $168,796 (pg. 113) | $72,953 in 2019 (pg. 132) | $52,498 in 2016 (pg. 87) |
| **Management Policies & Practices** |  |  |  |
| *Reserve fund policies* | Relies on LGA for 64% of GF revenues | Consistent surplus; budget calls for revenues & expenditures to be equal (pg. 57, 65) | Consistent surplus; smaller gains than Byron (pg. 29) |
| *Capital improvement planning/budgeting practices* | fund balance of $36,487 for 2017, total $242,379. (pp. 63, 96) | No plan, but no expectation of need w/in next 6 months (pg. 10) | city has no plans for more financing w/in next 12 months (pg. 23) |
| *revenue forecasting practices* | auditor: provides government-wide financial & fund financial statements, | Describes budgets, rates, growth and future (pg. 67) | describes levy limit laws (pg. 25), general fund and previous audits of budget |
|  | with statements and schedule (pp. 74/75; 132/33) |  | (pg. 29), but no explicit declarations |
| *climate adaptation planning* | Not explicit | Not explicit | No explicit |

1. https://www.investopedia.com/terms/r/refundedbond.asp [↑](#footnote-ref-1)