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Ratings

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Summary:
Hopkins, Minnesota; General Obligation

Primary Credit Analyst:
Emily Powers, Chicago + 1 (312) 233 7030; emily.powers@spglobal.com

Secondary Contact:
Andrew J Truckenmiller, Chicago + 1 (312) 233 7032; andrew.truckenmiller@spglobal.com

Table Of Contents

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Credit Profile		
US$8.425 mil GO bnds ser 2021A dtd 04/06/2021 due 02/01/2036		
Long Term Rating	AA+/Stable	New

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating to Hopkins, Minn.'s series 2021A general obligation (GO) bonds. The outlook is stable.

The city's full-faith-and-credit pledge and ability to levy unlimited ad valorem property taxes secure the bonds. Officials intend to pay debt service with special assessments, net revenues of the sewer, water, and storm systems, tax abatements, and ad valorem property taxes, but the rating is based on the unlimited ad valorem tax pledge. The city's existing GO debt also includes various other pledged revenues such as tax-increment, tax abatement, special assessment revenues, and various enterprise fund revenues, but in each case, we rate to the city's GO pledge. Proceeds will be used to finance various road and utility system improvements.

Credit overview

Hopkins, having maintained a strong history of mostly stable operational performance, complete with very strong available reserves, has placed itself in a positive position to hold steady during uncertain economic times. It maintains sizable general fund receivables, including loans to the Arts Center fund, water fund, and various other governmental funds, and even excluding those amounts from the city's available fund balance, it has been able to maintain very strong reserves. However, if these interfund loans continue to grow, there could be pressure on the city's general fund. Hopkins is backed by a strong management team that has implemented robust policies and practices, helping it maintain stability in operations. The city's debt profile, while somewhat elevated, has been historically managed within its budget and, even given sizable debt service carrying charges, we expect that to continue. Additionally, its other long-term liabilities (pension and other postemployment benefits [OPEBs]) are manageable, further supporting its underlying credit quality.

Highlighted by its proximity to the Twin Cities, Hopkins is in an area that is likely to easily navigate the pressures of the COVID-19 pandemic, given its high reliance on property taxes as a revenue stream. Its historically strong financial profile and stable operations are backed by conservative budgeting and a sophisticated management team that monitors and adjusts finances based on the city's robust policies and procedures. We believe that the city will be able to maintain steady operations, even given any pressures that could result from the current COVID-19 pandemic (see "Staying Home For The Holidays," published Dec. 1, 2020, on RatingsDirect). We recognize that Hopkins' very strong reserves provide a meaningful hedge against near-term revenue volatility, and we expect that its fiscal position over the near term will remain stable and in line with what we typically see among similarly rated peers.

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

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2019;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 21% of operating expenditures;
- Very strong liquidity, with total government available cash at 86.6% of total governmental fund expenditures and 3.6x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability position, with debt service carrying charges at 23.8% of expenditures and net direct debt that is 253.6% of total governmental fund revenue, but rapid amortization, with 77.7% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Stable Outlook

Downside scenario

We could lower the rating if budgetary pressures outside of the general fund, such as with the enterprise and Arts Center funds, continue to drain general fund resources, and if debt were to increase substantially beyond current expectations.

Upside scenario

While we don't view this as likely given current macroeconomic conditions, we could raise the rating if the city's balance sheet improves and economic measures, such as its income levels and per capita market values, were to improve to levels commensurate with those of higher-rated peers, all other credit factors remaining equal.

Environmental, social, and governance factors

The rating incorporates our view of the health and safety risks posed by the COVID-19 pandemic, which we consider a social risk factor. Although the scope of economic and financial challenges posed by the pandemic remains unknown, we believe a prolonged disruption could weaken the city's local economy and potentially affect state and local revenues. However, the COVID-19 pandemic is not affecting the city more than other sector standards. We also analyzed Hopkins' environmental and governance risks relative to its economy, management, financial measures, and debt and liability profile, and determined that all are in line with our view of the sector standard.

Credit Opinion

Very strong economy

We consider Hopkins' economy very strong. The city, with a population of 19,213, is in Hennepin County in the Minneapolis-St. Paul-Bloomington MSA, which we consider to be broad and diverse. It has a projected per capita effective buying income of 114% of the national level and per capita market value of $123,788. Overall, market value grew by 10.8% over the past year to $2.4 billion in 2020.

Hopkins' proximity to the Twin Cities allows easy access to employment and retail opportunities, and will become more easily accessible with the expansion of the Minneapolis METRO light-rail system, which will include three new stops in Hopkins that are currently under development. The city's economy experienced some slowdown with the spread of COVID-19, but it was primarily concentrated in minimal temporary closures of restaurants and small businesses. However, development throughout the city has continued, including the ongoing expansions of some of its large employers, and management reported no major shutdowns or layoffs as a result of the pandemic. Unemployment at the county level peaked in May at 10.3% but has since fallen to 4.4% (in December). The tax base primarily consists of residential (homestead/non-homestead) properties (64%), followed by commercial and industrial properties (35%). While we believe that economic metrics and property values could be pressured over the medium term, we think that the city's historic tax base growth, coupled with general economic stability, will lead to minimal credit implications, and that our view of the local economy will remain stable.

Very strong management

We view the city's management as very strong, with strong 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.

Highlights of the city's financial practices and policies include:

- Use of at least three years of historical information in the formulation of the upcoming year's revenue and expenditure assumptions with the help of outside sources and a line-by-line approach to budgeting;
- Quarterly reporting of budget-to-actual performance to the council with the ability to make amendments to the budget as needed;
- A five-year, long-term financial plan that projects revenues and expenditures and is updated on an annual basis;
- A rolling five-year, long-term capital plan that addresses capital needs of the city with sources and uses of funds identified;
- Formalized investment management policy with quarterly reporting of investments and holdings;
- Formalized debt management policy that sets guidelines for short-term borrowing, maturity lengths, and minimum allowable coverage on revenue debt; and
- Formalized fund balance policy to maintain 42% of expenditures for cash-flow needs, which the city has mostly been in compliance with, with the exception of 2018, and which we calculate differently than the city given our adjustments to available reserves.

Adequate budgetary performance

Hopkins's budgetary performance is adequate, in our opinion. The city had operating surpluses of 3.2% of expenditures in the general fund and 6.9% across all governmental funds in fiscal 2019. In our analysis of budgetary performance, we adjusted for recurring transfers out of the general fund and recurring transfers into all governmental funds from the city's enterprise funds. We also adjusted total governmental fund expenditures to account for one-time capital spending funded with bond proceeds. While the city's operational budget has been very stable in recent years, in our view, pressures resulting from the pandemic and recession could pose budgetary challenges in the near term. The budgetary performance score of adequate reflects our view of revenue uncertainty facing Hopkins in the current economic climate, particularly regarding potential delays to property tax receipts.

In fiscal 2019, the general fund outperformed its budget, showing a $466,000 surplus (3.2% of expenditures), which reflected positive revenue variances. Compared to the initial break-even budget that was projected for fiscal 2020, year-end unaudited results showed a roughly $624,000 increase to fund balance (roughly 4.1% of expenditures); midyear adjustments to revenue include the receipt of roughly $1.5 million in CARES Act funding. Expenditure adjustments were also made, including hiring freezes and reduced part-time hiring, lessened travel expenditures, and some deferred maintenance, which amounted to roughly $550,000 in savings. Many expenditure adjustments made in fiscal 2020 were carried forward to fiscal 2021, the budget of which is currently calling for a break-even result. We expect the city will continue to manage its overall operating budget to alleviate any potential pressure on the general fund and ease its reliance on interfund loans. Should interfund loans and negative operations in the other funds rise in such a way that we believe the city's budgetary performance is compromised, it could lead to a weakening in our view of its overall credit quality.

The general fund benefits from a revenue structure that has historically been stable and predictable, consisting mostly of property taxes (79%), with only 9% coming from state aid, which is referred to as local government aid in Minnesota. While the city had initially budgeted for a slight delay in some property tax receipts, all tax collections were on time and in line with prior years. Therefore, there was no substantial disruption to Hopkins' operations for fiscal 2020, and we do not anticipate any for fiscal 2021. We believe the city is well placed to manage expenditures and make appropriate budgetary adjustments to maintain structural balance.

Very strong budgetary flexibility

Hopkins' budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 21% of operating expenditures, or $3.0 million.

We have reduced the city's available fund balance to account for interfund loans to its Arts Center fund, water fund, and various other governmental funds, which amounted to roughly $2.8 million in 2019. Even with this portion removed, the city's reserves have been historically maintained at levels we consider very strong. We note that the total interfund loan has increased year over year and if it continues to rise, it could put downward pressure on what we consider the available fund balance.

The Arts Center fund has historically held a deficit fund balance, all of which was marked as a loan from the general fund. The city realizes economic benefits from the Arts Center, so management plans to continue providing financial support for it from the general fund. The receivable showed a slight decrease in 2019, to $1.14 million from $1.20 in 2018, which was due to efforts by Arts Center staff to bring in more revenue and lower expenses. Initially, the budget for fiscal 2020 called for a deficit reduction of roughly $60,000 funded by a direct levy for this purpose, and at year-end, the city was able to reduce the deficit by roughly $80,000, even after accounting for certain facility disruptions due to COVID-19. The levy is expected to continue, but there is no specified timeline for when the full receivable will be repaid.

The general fund also has receivables from the water fund and various other governmental funds, all of which (including the Arts Center fund receivable) amounted to $2.8 million in fiscal 2019. The receivable from the water fund increased slightly between 2018 and 2019, to $1.1 million. Water rate hikes were implemented in January 2020 to pay down the amount owed to the general fund, and while there is no specified timeline for full repayment, management expects it will likely occur within a five-year period, with $130,000 decrease in 2020. The remainder of the receivable to the general fund, totaling roughly $600,000 in 2019, is accounted for in various nonmajor governmental and enterprise funds and the pavilion fund, the negative balances of which primarily reflect timing of bond proceeds. An additional loan to the city's HRA fund of $200,000 increased the amount in 2019; however, this portion was repaid in 2020.

Very strong liquidity

In our opinion, Hopkins' liquidity is very strong, with total government available cash at 86.6% of total governmental fund expenditures and 3.6x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary. Its available $24.6 million in available cash and investments (after removing unspent bond proceeds) were held primarily in federal and municipal securities, money market accounts, and certificates of deposit, which we do not consider aggressive. Based on past issuance of debt, we believe the city has strong access to capital markets to provide for liquidity needs if necessary. It has no direct-purchase or variable-rate debt that we expect could pose a liquidity risk. We believe that the city has sufficient cash levels and will maintain a very strong liquidity profile.

Weak debt and contingent liability profile

In our view, Hopkins' debt and contingent liability profile is weak. Total governmental fund debt service is 23.8% of total governmental fund expenditures, and net direct debt is 252.4% of total governmental fund revenue. Approximately 79.7% of the direct debt is scheduled to be repaid within 10 years, which is, in our view, a positive credit factor. We calculate total direct debt at $81.3 million; when excluding self-supporting GO debt paid from the city's enterprise funds, net direct debt amounts to approximately $76.8 million. The city plans to issue approximately $6.8 million in new-money GO debt in 2022 for street projects and a water main project, and could potentially issue an additional $7.0 million for a residential street project. We believe the debt profile will likely remain weak. While debt service costs make up a considerable portion of the budget, the city has historically managed these costs well, which we expect will continue.

Pensions and other postemployment benefits (OPEBs)

Hopkins' combined required pension and actual other postemployment benefit (OPEB) contributions totaled 4.3% of total governmental fund expenditures in 2019. Of that amount, 3.6% represented required contributions to pension obligations, and 0.7% represented OPEB payments. The city made its full annual required pension contribution in 2019.

We do not believe that pension liabilities represent a medium-term credit pressure, as contributions are only a modest share of the budget, and we believe the city has the capacity to absorb higher costs without pressuring operations. Hopkins 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. Although the city funds its OPEBs on a pay-as-you-go basis, exposing it to cost acceleration and volatility, we expect that medium-term costs will remain only a small share of total spending and, therefore, not a significant budgetary pressure.

The city participates in the following plans:

- Minnesota General Employees Retirement Fund (GERF): 79.1% funded (as of June 30, 2020),with a city proportionate share of the plan's net pension liability of $4.5 million.
- Minnesota Police and Fire Fund (PEPFF): 87.2% funded (June 30, 2020), with a proportionate share of $3.3 million.
- A single-employer, defined-benefit OPEB plan: 0% funded with a net OPEB liability of $952,000.

Total contributions to GERF and PEPFF were 89% and 94%, 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. In our view, this increases the 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 indicate some exposure to cost acceleration as a result of market volatility, and an amortization method that significantly defers contributions through a lengthy, closed 30-year amortization period based on a level 3.25% payroll growth assumption. Regardless, costs remain only a modest share of total spending, and we believe they are unlikely to pressure the city's medium-term operational health.

Strong institutional framework

The institutional framework score for Minnesota cities with a population greater than 2,500 is strong.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020