

RatingsDirect®

Summary:

Waconia, Minnesota; General Obligation

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Credit Profile

US\$1.565 mil GO bnds ser 2018A dtd 09/12/2018 due 02/01/2029

Long Term Rating AA+/Stable New

Waconia

Long Term Rating AA+/Stable Affirmed

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to Waconia, Minn.'s series 2018A general obligation (GO) bonds. At the same time, we affirmed our 'AA+' long-term rating and underlying rating (SPUR) on the city's previously issued GO debt. The outlook is stable.

The series 2018A 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. The bonds are also payable from special assessments levied against benefitted properties and net water and sanitary sewer system revenues, but the rating is based on the unlimited ad valorem tax pledge, which we view as the stronger security. Bond proceeds will be used to finance the city's 2018 infrastructure improvement project.

The ratings reflect our view 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 an operating deficit in the general fund but an operating surplus at the total governmental fund level in fiscal 2017;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2017 of 36% of operating expenditures;
- Very strong liquidity, with total government available cash at 139.8% of total governmental fund expenditures and 3.5x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability profile, with debt service carrying charges at 39.8% of expenditures and net direct debt that is 225.9% of total governmental fund revenue, but rapid amortization, with 99.6% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Very strong economy

We consider Waconia's economy very strong. The city, with an estimated population of 12,619, is located in Carver County in the Minneapolis-St. Paul-Bloomington, Minn.-Wis., MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 124% of the national level and per capita market value of

\$114,167. Overall, the city's market value grew by 6.5% over the past year to \$1.4 billion in 2018. The county unemployment rate was 2.9% in 2017.

Located approximately 35 miles southwest of the Twin Cities, Waconia benefits from its easy access to the MSA, with roughly half of working residents commuting outside the city. The tax base is primarily residential, with residential and nonhomestead residential properties accounting for 76% of tax capacity, followed by commercial and industrial properties, at 22%. In addition, we consider the tax base very diverse, with the top 10 taxpayers--a mix of commercial, utility, and residential properties--representing 10.7% of the city's net tax capacity. Valuations have been increasing over the last few years, in line with trends throughout the Twin Cities metro area. Management attributes the growth primarily to new development and is conservatively projecting 4% growth for 2019. Given recent trends and the projected continued development, we expect the city's economy to remain very strong over the next two years.

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 are strong, well embedded, and likely sustainable.

The city uses at least three years of historical data, line-by-line budgeting, and internal and external sources when formulating its budget. The city provides quarterly budget-to-actual performance and investment reports to the council. It maintains a comprehensive long-term financial plan as well as a 10-year capital improvement plan that identifies sources and uses of funds for projects. Both plans are updated annually. The city's debt management policy limits direct debt to 3% of market value. Additionally, the city has a formal fund balance policy of maintaining a minimum of 40% of next year's expenditures in reserves.

Adequate budgetary performance

Waconia's budgetary performance is adequate in our opinion. The city had deficit operating results in the general fund of 3.1% of expenditures, but a surplus result across all governmental funds of 31.9% in fiscal 2017.

We adjusted revenues to account for one-time revenues and adjusted revenues and expenditures for recurring transfers into and out of the general fund. We also adjusted total governmental funds expenditures for bond proceeds. The city has a history of general fund surpluses and budgets conservatively, in our view. The city intentionally drew down its reserves in fiscal 2017 to bring reserves closer to its 40% fund balance policy. The fiscal 2018 budget calls for roughly a \$130,000 surplus (2.0% of expenditures), including transfers, primarily due to increases in building permits. Management reports revenues and expenditures are tracking in line with the budget, and it expects a balanced total governmental fund result.

Property taxes accounted for 68% of general fund revenues in fiscal 2017, followed by licenses and permits (13%). The city receives very little intergovernmental revenue (2%). We expect that performance will likely remain at least adequate over the next two years, given the city's history of outperforming its budget.

Very strong budgetary flexibility

Waconia's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2017 of 36% of operating expenditures, or \$2.2 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.

The city has a formal general fund reserve policy of maintaining 40% of next year's budget in reserve. Given the city's budgeted general fund surplus for 2018 and plans to adhere to its reserve policy going forward, we expect that budgetary flexibility will remain very strong above 30% of expenditures over the next two years.

Very strong liquidity

In our opinion, Waconia's liquidity is very strong, with total government available cash at 139.8% of total governmental fund expenditures and 3.5x governmental debt service in 2017. In our view, the city has strong access to external liquidity if necessary.

We've adjusted the city's available cash to remove unspent bond proceeds at the end of 2017. The city has demonstrated strong access to the capital markets with a history of issuing GO debt in the past 20 years. Furthermore, we note that the city is not investing its funds aggressively, as it invests primarily in certificates of deposit and money markets. The city has not entered into any alternative financing agreements. Therefore, we expect the liquidity profile to remain very strong over the near term.

Weak debt and contingent liability profile

In our view, Waconia's debt and contingent liability profile is weak. Total governmental fund debt service is 39.8% of total governmental fund expenditures, and net direct debt is 225.9% of total governmental fund revenue. Approximately 99.6% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor.

We have adjusted our calculation of the city's debt burden to account for self-supporting debt from the city's enterprise funds. The city may issue approximately \$4 million for street reconstruction in 2019 and another \$8 million in 2020 for a new fire station. We believe the city's high carrying charges are somewhat mitigated by its rapid amortization and debt supported by enterprise and special assessment revenue sources; however, should carrying charges continue to increase, approaching 50% of expenditures, or impose budget stress, the ratings could be pressured.

Waconia's pension contributions totaled 1.3% of total governmental fund expenditures in 2017. The city made 107% of its annual required pension contribution in 2017.

The city participates in the General Employees Retirement Fund (GERF), a cost-sharing multiple-employer pension plan, which is administered by the Public Employees Retirement Assn. of Minnesota (PERA). Required pension contributions to this plan is determined by state statute. Statutory contributions rates have generally not kept pace with actuarially determined contribution (ADC) rates, indicating potential for future payment acceleration. For more information about the reforms included in the 2018 omnibus retirement bill and the potential for future cost increases see our bulletin "Minnesota's New Pension Bill Is A Positive Step Toward Sustainable Funding," published June 7, 2018, on RatingsDirect.

The GERF was 75.9% funded in fiscal 2017. The city's proportionate share of the net pension liability totaled \$1.9 million in fiscal 2017, the most recent year in which data are available. We consider historical plan funding levels somewhat weak, and we believe that the history of pension contributions below the ADC increases the risk of payment acceleration. Additionally, in our view, the plan's investment portfolio is exposed to significant market risk, with only 22% of its investments allocated to fixed income and cash, which increases the risk for volatility in plan funding levels.

Despite these weaknesses, we believe the city has sufficient taxing and operational flexibility to manage future increases in pension contributions. However, in the future, if pension contributions absorb a larger share of the city's budget, our view of its debt and contingent liability profile could weaken.

The city also participates in the Statewide Volunteer Firefighter Retirement Plan, an agent multiple-employer lump-sum defined benefit pension plan administered by PERA. It funds other postemployment benefits on a pay-as-you-go basis. As of Jan. 1, 2015, the most recent actuarial valuation, its unfunded actuarial accrued liability was \$150,589.

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 Waconia's very strong budgetary flexibility and liquidity, supported by very strong management policies and practices. We do not anticipate changing the ratings within the next two years.

Upside scenario

We could raise the ratings if the city's economic indicators and debt profile improved to a level commensurate with those of higher-rated peers.

Downside scenario

We could lower the ratings if the city's budgetary performance deteriorates, reducing budgetary flexibility, or should the city's high carrying charges impose budgetary stress.

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
- 2017 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of August 16, 2018)		
Waconia GO		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Waconia GO		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Waconia GO		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Waconia GO		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Waconia GO		

Ratings Detail (As Of August 16, 2018) (cont.)

<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

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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