S&P Global Ratings

RatingsDirect®

Summary:

Waconia, Minnesota; General Obligation

Primary Credit Analyst:
David H Smith, Chicago + 1 (312) 233 7029; david.smith@spglobal.com

Secondary Contact:
Augustin Kazakevicius, Centennial + 1 (303) 721 4782; augustin.kazakevicius@spglobal.com

Table Of Contents

Rating Action

Stable Outlook

Credit Opinion

Related Research

Summary:

Waconia, Minnesota; General Obligation

Credit Profile		
US$5.045 mil GO bnds ser 2020A due 02/01/2031		
Long Term Rating	AA+/Stable	New
Waconia		
Long Term Rating	AA+/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating to the city of Waconia, Minn.'s anticipated $5.045 million series 2020A general obligation (GO) bonds. At the same time, S&P Global Ratings affirmed its 'AA+' long-term rating and underlying rating (SPUR) on the city's existing GO debt. The outlook is stable.

Securing the bonds are a GO pledge of Waconia's full-faith and credit ad valorem property taxes without limitation as to rate or amount. The bonds are expected to be paid from special assessments levied against benefitted properties and utility revenues. Proceeds will finance infrastructure and park improvements.

Credit overview

Generally, our rating outlook time frame is up to two years, but our view of the credit risks to Waconia is centered on the more immediate economic and budget effects over the next six-to-12 months as a result of the COVID-19 pandemic (see "The U.S. Faces A Longer And Slower Climb From The Bottom," published on June 25, 2020, on RatingsDirect and "The Recent Hopeful U.S. Economic Data Could Be Short-Lived," published July 16, 2020). Benefitting from its proximity to the Twin Cities and very strong management team, the city of Waconia has exhibited stable operations in recent years, highlighted by very strong reserves and liquidity. While Waconia's debt burden as very high relative to its operating budget, its rapid amortization schedule and significant amount of self-supporting debt partly mitigates this weakness. Management reports no materially negative effects on major general fund revenue or expenditures as a result of the pandemic and recession, and projects a close to break-even result for fiscal 2020, in line with its budget. While there is uncertainty regarding how the pandemic and recession could affect the city's economy and finances over the upcoming years, we believe Waconia has adequate resources to address potential fiscal pressures.

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 surplus in the general fund and a slight operating surplus at the total governmental fund level in fiscal 2019;

- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 34% of operating expenditures;
- Very strong liquidity, with total government available cash at 111.1% of total governmental fund expenditures and 3.8x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability position, with debt service carrying charges at 29.5% of expenditures and net direct debt that is 225.5% of total governmental fund revenue, but rapid amortization, with 98.7% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Environmental, social and governance factors (ESG)

The rating also incorporates our view of the health and safety risks posed by the COVID-19 pandemic, which we consider social risk factors. 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. Absent the implications of the pandemic, we consider the city's social risks to be in line with those of the sector. We also view environmental risks as being in line with our view of the sector as a whole. Because of our view of the very strong management of the city, we consider its governance risks as being below the sector standard.

Stable Outlook

Downside scenario

The city's rating could be lowered if its budgetary performance were to decline to a level we view as weak or very weak, causing a material deterioration to its budgetary flexibility. In addition, the rating could be lowered if the city's debt service carrying charges were to increase to a level that poses a likelihood of fiscal stress, weakening our view of management.

Upside scenario

Given the current economic conditions, we do not anticipate raising our rating on the city, but could do so if the city's economic metrics were to improve to levels commensurate with those of higher-rated peers, specifically if its incomes and market value per capita were to increase significantly.

Credit Opinion

Very strong economy, with access to the broad and diverse Twin Cities MSA

We consider Waconia's economy very strong. The city, with an estimated population of 13,001, is located in Carver County in the Minneapolis-St. Paul-Bloomington, MN-WI MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 135% of the national level and per capita market value of $120,914. Overall, the city's market value grew by 9.1% over the past year to $1.6 billion in 2019. The county unemployment rate was 2.8% in 2019. In the wake of COVID-19 and the recession in early 2020, the county's unemployment rate increased to 7.3% in June 2020, however.

The city of Waconia is located approximately 35 miles southwest of the Minneapolis- St. Paul metropolitan area. The tax base is primarily residential, with residential and non-homestead residential properties accounting for 76% of the tax base, followed by commercial properties at 21%. We consider the city's tax base very diverse, with its top 10 taxpayers representing 8.9% of adjusted net tax capacity. The city conservatively estimates 3.3% in tax base growth next year. Officials indicate that the effect of COVID-19 on the city's local businesses has not been as pronounced as other areas of the country, with no major layoffs involving major employers in the city. While the precise effect of COVID-19 and the recession on the city's economy in the short-to-medium term is unclear, the city's desirable location and strong wealth and income levels will provide significant support in the event of an extended economic downturn.

Very strong management, with strong financial policies under our FMA methodology

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 developing its budget. The city provides quarterly budget-to-actual performance and investment reports to the council, and the budget can be amended as needed. It maintains a detailed long-term financial plan as well as a 10-year capital improvement plan that identifies sources and uses of funds for future projects, and both plans are updated annually. In addition, the city maintains comprehensive investment and debt management policies. The city also a formal fund balance policy requiring it to maintain no less than 40% of the following year's budgeted expenditures in reserve.

Adequate budgetary performance

Waconia's budgetary performance is adequate in our opinion. The city had surplus operating results in the general fund of 4.0% of expenditures, and slight surplus results across all governmental funds of 1.4% in fiscal 2019. We consider the city subject to an event-based risk because of actual and potential fiscal pressures posed by the COVID-19 pandemic and current recession.

In analyzing the city's budgetary performance, we have adjusted revenues and expenditures for recurring transfers in and out of the general fund, the spending of bond proceeds, and one-time expenditures in the city's total governmental funds. In audited fiscal 2019 (year-ended Dec. 31), the city reported a $299,000 surplus in its general fund, which was driven by higher investment income and increases in building permit and inspection revenue.

For fiscal 2020, management indicates that it is currently on track with its general fund budget, which is structured with a very slight use of reserves of $26,000, or approximately 0.3% of expenditures. Officials report that they have received a strong level of property tax collections for its first property tax installment, at a level similar to most years, and permit revenue continues to be strong. We understand that the city has also received approximately $988,000 in CARES Act funds from the federal government.

While the city has not developed its budget for fiscal 2021 yet, officials expect it to be close to break-even. We expect that Waconia's performance will likely remain at least adequate over the next two years. However, should the ongoing pandemic and recession lead to revenue declines, possibly through state aid reductions, thereby causing a material fiscal imbalance, our view of the city's budgetary performance could worsen.

Very strong budgetary flexibility

Waconia's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 34% of operating expenditures, or $2.6 million. Over the past three years, the total available fund balance has remained at a consistent level overall, totaling 34% of expenditures in 2018 and 36% in 2017.

The city does not have any plans to significantly draw down its reserves in the coming years, and maintains a reserve policy requiring it to maintain 40% of the following year's budgeted expenditures in reserve, with which it is in compliance. We do not anticipate that the city's budgetary flexibility will worsen from its very strong level during the next few years.

Very strong liquidity, with strong access to external liquidity In our opinion, Waconia's liquidity is very strong, with total government available cash at 111.1% of total governmental fund expenditures and 3.8x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary.

After removing unspent bond proceeds, the city held approximately $15 million in cash at fiscal year-end 2019. The city has demonstrated strong access to the capital markets with a history of issuing GO debt in the past 20 years. Furthermore, the city's investments are typically not aggressive--it invests primarily in certificates of deposit and money market funds. The city is not a party to any alternative financing agreements that contain non-standard events of default leading to immediate acceleration. We expect the city's 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 29.5% of total governmental fund expenditures, and net direct debt is 225.5% of total governmental fund revenue. Approximately 98.7% 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 up to $10 million over the next two years for capital improvement projects. We do not expect these future debt plans to worsen the city's debt and contingent liability profile. Moreover, 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. Despite this, should carrying charges continue to increase, and we did not believe that the city retains enough fiscal flexibility to accommodate the additional debt service, our view of management could significantly worsen.

Waconia's pension contributions totaled 1.5% of total governmental fund expenditures in 2019. The city made 105% of its annual required pension contribution in 2019.

We do not believe that Waconia's pension liabilities represent a medium-term credit pressure because contributions are only a modest share of the budget and we believe the city has the capacity to absorb higher costs without pressuring operations.

The city 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.

Waconia participates in the following plans:

- GERF: 80.2% funded (as of June 30, 2019), with an estimated city proportionate share of the plan's net pension liability (NPL) of $1.7 million in 2019.
- Minnesota Police and Fire Fund (PEPFF): 89.3% funded (June 30, 2019), with a proportionate share of the plan's NPL of $39,390 in 2019.
- An implicit rate subsidy arising from retirees staying on the city's plan while paying active premium rates: 0% funded with a liability of $173,000 in 2019.

Total contributions to GERF was 89% of our minimum funding progress metric in 2019. Annual contributions are based on a statutory formula that has typically produced contributions less than the actuarially determined contribution (ADC) for each plan, which we think increases risk of underfunding over time if future funding shortfalls are not met with offsetting adjustments by the state legislature. Other key risks include a 7.5% investment rate of return assumption that indicates some exposure to cost acceleration due to market volatility, and an amortization method that significantly defers contributions into the future 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 think, 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

- U.S. State And Local Government Credit Conditions Forecast, Oct. 29, 2019
- 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
- 2019 Update Of Institutional Framework For U.S. Local Governments
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of August 6, 2020)		
Waconia GO bnds		
Long Term Rating	AA+/Stable	Affirmed
Waconia GO (AGM)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Waconia GO		
Long Term Rating	AA+/Stable	Affirmed

Ratings Detail (As Of August 6, 2020) (cont.)		
Waconia GO		
Long Term Rating	AA+/Stable	Affirmed
Waconia GO		
Long Term Rating	AA+/Stable	Affirmed
Waconia GO		
Long Term Rating	AA+/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.