S&P Global
Ratings

RatingsDirect®

Summary:

Waconia, Minnesota; General Obligation; Non-School State Programs

Primary Credit Analyst:
Cora Bruemmer, Chicago (312) 233-7099; cora.bruemmer@spglobal.com

Secondary Contact:
Blake E Yocom, Chicago (1) 312-233-7056; blake.yocom@spglobal.com

Table Of Contents

Rationale

Outlook

Related Research

Summary:

Waconia, Minnesota; General Obligation; Non-School State Programs

Credit Profile		
US$7.98 mil GO bnds ser 2017A dtd 08/15/2017 due 02/01/2028		
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 2017A general obligation (GO) bonds. At the same time, we affirmed our 'AA+' long-term rating on the city's existing GO bonds. The outlook is stable.

The city's unlimited-tax, full faith, and credit GO pledge secures the series 2017A bonds. The bonds are additionally secured by a pledge of special assessments, but the rating is based on the city's GO pledge. The city has outstanding GO debt additionally secured by various revenue sources, but all existing GO debt is rated to the GO pledge. The city's series 2009A GO bonds are additionally secured by the state of Minnesota's credit enhancement program. The enhancement program rating moves in tandem with the state rating.

Proceeds of the 2017A bonds will finance the city's 2017-2018 infrastructure improvement projects and the purchase of a fire truck.

The 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;
- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2016;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2016 of 40% of operating expenditures;
- Very strong liquidity, with total government available cash at 116.0% 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 30.3% of expenditures and net direct debt that is 262.3% of total governmental fund revenue, but rapid amortization, with 90.8% 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 11,752, is in Carver County approximately 35 miles southwest of the Twin Cities. It is 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 122% of the national level and per capita market value of $106,417. Overall, market value grew by 6.2% over the past year to $1.3 billion in 2016. The county unemployment rate was 3.3% in 2016.

Waconia benefits from its easy access to the Twin Cities MSA. Management estimates that half of working residents work outside the city. The tax base is primarily residential, with residential and non-homestead residential properties accounting for 75% of tax capacity, followed by commercial and industrial properties at 23%. Valuations have been increasing over the last few years, in line with trends throughout the Twin Cities MSA. Management attributes about half of the growth to new development and half to the appreciation of existing properties.

The city's population grew rapidly in the early 2000s, increasing 57% between 2000 and 2010. Since the recession, growth has been more moderate, increasing just under 10% between 2010 and 2015, according to state demographer estimates. City officials expect approximately 100 new single-family homes to be developed each year. New developments typically begin with annexation of new land, and the city has an annexation agreement in place with Laketown Township to the east. 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 five 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 ten 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 debt to 3% of market value. Additionally, the city has a formal fund balance policy to maintain a minimum of 40% of next year's expenditures in reserves.

Strong budgetary performance

Waconia's budgetary performance is strong, in our opinion. The city had operating surpluses of 4.4% of expenditures in the general fund and 4.3% across all governmental funds in fiscal 2016.

We adjusted revenues to account for one-time revenues as well as recurring transfers from the city's enterprise funds. We adjusted expenditures to account for recurring transfers to support its Safari Island and Ice Arena funds' operations and debt service. We also adjusted total governmental funds expenditures for one-time capital spending.

The city has a history of general fund surpluses and budgets conservatively, in our view. The city's original fiscal 2016 budget called for a slight use of reserves to bring the fund balance closer to its policy of 40% of expenditures; however, the budget was amended midyear to account for higher-than-budgeted development related revenue, and the year closed with a $272,000 surplus, after our adjustments. Across total governmental funds, the city also achieved surplus operations, after adjustments for spending of bond proceeds. The fiscal 2017 budget calls for roughly a $500,000 deficit after transfers, again to bring the city's reserves closer to its fund balance policy. Year-to-date, management says revenues and expenditures are tracking to budget.

In the spring of 2016, the city contracted with a management company to oversee operations of its Safari Island community center and its ice arena. It expects that the new management will help increase revenues for the facilities. The city expects to continue to make transfers to these funds but will begin to decrease transfers by $43,000 for Safari Island and $10,000 for the ice arena in 2017.

In prior years, Waconia made transfers out of the general fund to cover delinquent special assessments related to the Interlaken and Legacy Village housing developments. However, it no longer needs to make these transfers, and total delinquent special assessments receivable has declined to $10,499. Approximately $4 million of deferred special assessment remain, but these are expected to be repaid on their regular repayment schedule. Also, the city has acquired two properties through the forfeiture process and expects to sell them to continue to pay down the special assessments receivable.

Property taxes accounted for 59% of general fund revenues in fiscal 2016, followed by licenses and permits (19%) and charges for services (14%). The city receives very little intergovernmental revenue (3%). While we expect general performance to weaken in 2017 due to the budget deficit, 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 2016 of 40% of operating expenditures, or $2.4 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 to maintain 40% of next year's budget in reserve. While it plans to draw down on reserves in 2017, we expect that it will remain above its policy level and budgetary flexibility will remain very strong over the next two years.

Very strong liquidity

In our opinion, Waconia's liquidity is very strong, with total government available cash at 116.0% of total governmental fund expenditures and 3.8x governmental debt service in 2016. In our view, the city has strong access to external liquidity if necessary.

We've adjusted the city's available cash to remove $144,000 of unspent bond proceeds at the end of 2016. Waconia 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 government securities, money markets, and certificates of deposit. Waconia entered into a $1.22 million lease-purchase agreement with First Resource Bank in 2016 for a grandstand at the city's baseball field. The agreement does not include any events or remedies of default we view as a contingent liquidity risk. 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 30.3% of total governmental fund expenditures, and net direct debt is 262.3% of total governmental fund revenue. Approximately 90.8% 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 its enterprise funds. It does not expect to issue any debt in fiscal 2018, but may issue approximately $6 million of GO and/or revenue debt for road construction and utility infrastructure in 2019. Given its rapid amortization, we do not expect the additional issuance to have a material effect on the city's debt profile.

Waconia's pension contributions totaled 1.2% of total governmental fund expenditures in 2016. The city made 107% of its annual required pension contribution in 2016. It participates in the General Employees Retirement Fund (GERF), a cost-sharing multiemployer defined-benefit pension plan, and the Statewide Volunteer Firefighter Retirement Plan (SVF), an agent multiemployer lump-sum defined-benefit pension plan. Both plans are administered by the Public Employees Retirement Association of Minnesota (PERA).

The city's annual required pension contribution to GERF is determined by state statute and based on a percentage of payroll. Contributions are not based on an actuarial determined contribution, and have not been keeping up with the plan's increasing liabilities, indicating that employer contributions may rise in the future. Using updated reporting standards in accordance with Governmental Accounting Standard Board (GASB) Statement Nos. 67 and 68, the city's net pension liability for GERF was $3.1 million, and its funded ratio, which is calculated as the plan fiduciary net position as a percent of the total pension liability, was 68.9% in fiscal 2016.

The SVF is funded by fire state aid, investment earning, and, if necessary, employer contributions. The city was not required to make a contribution in 2016, but made a voluntary contribution of $10,000. The city reported a net pension asset of $402,599 for the SVF plan as of Dec. 31, 2016.

The city is legally required to include any retirees in the same insurance pool as its active employees, but the premiums are paid by the retiree, resulting in an implicit rate subsidy. The city funds its OPEBs on a pay-as-you-go basis. As of Jan. 1, 2015, the most recent actuarial valuation date, the city's 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 rating in the next two years.

Upside scenario

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

Downside scenario

We could lower the rating if the city's budgetary performance deteriorates, reducing budgetary flexibility.

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

Ratings Detail (As Of July 6, 2017)		
Waconia GO		
Long Term Rating	AA+/Stable	Current
Unenhanced Rating	NR(SPUR)	
Underlying Rating for Credit Program	AA+/Stable	Affirmed
Waconia GO		
Long Term Rating	AA+/Stable	Affirmed
Waconia GO		
Long Term Rating	AA+/Stable	Affirmed
Waconia GO		
Long Term Rating	AA+/Stable	Affirmed
Waconia GO		
Long Term Rating	AA+/Stable	Affirmed
Waconia GO		
Unenhanced Rating	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.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.