

# RatingsDirect®

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## Summary:

# Waconia, Minnesota; General Obligation

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### Credit Profile

US\$5.45 mil GO bonds ser 2019A dtd 08/22/2019 due 02/01/2030

<i>Long Term Rating</i>	AA+/Stable	New
Waconia		
<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

## Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to Waconia, Minn.'s series 2019A 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 previously issued GO debt. The outlook is stable.

Securing the bonds are a pledge of Waconia's full-faith credit and an agreement to levy ad valorem property taxes without limitation as to rate or amount. The majority of the bonds are also payable from special assessments levied against benefitted properties and utility revenues. However, we base the rating on the unlimited ad valorem tax pledge, which we view as the stronger security. Proceeds will finance infrastructure improvements, the lake Waconia regional park utility project, the acquisition of a public works grader, and will refund the city's series 2010 bonds for interest savings.

### Credit overview

Waconia is a suburb of the Twin Cities and benefits from its proximity to it. The city also benefits from an exceptional management team, as exhibited in consistent general fund performance, and very strong reserves and liquidity. Waconia's debt burden as very high relative to its operating budget, but its rapid amortization schedule mitigates this, somewhat. In addition, the city has special assessments and other revenues that pay for portions of the debt service, allowing it to maintain the financial flexibility to repay debt head-of-the, already very rapid, debt service schedule.

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 methodology;
- Strong budgetary performance, with slight operating surpluses in the general fund and at the total governmental fund level in fiscal 2018;

- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 34% of operating expenditures;
- Very strong liquidity, with total government available cash at 112.0% of total governmental fund expenditures and 3.2x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability position, with debt service carrying charges at 34.6% of expenditures and net direct debt that is 254.8% of total governmental fund revenue, but rapid amortization, with 99.1% 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 12,842, is in Carver County in the Minneapolis-St. Paul-Bloomington MSA, which we consider 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 \$112,247. Overall, its market value grew by 6.6% over the past year to \$1.4 billion in 2018. The county unemployment rate was 2.5% in 2018.

Waconia is approximately 35 miles southwest of the Twin Cities, and benefits from its easy access to the MSA, with about half of working residents commuting outside the city. The tax base is primarily residential, with residential and non-homestead residential properties accounting for 84% of the tax base. Valuations have increased over the past few years, in line with trends throughout the Twin Cities metro area. Management attributes the growth primarily to new development and is conservatively projecting 6% growth for 2020. 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 Waconia's management as very strong, with strong financial policies and practices under our Financial Management Assessment 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 and it can be amended, as required. It provides quarterly budget-to-actual performance and investment reports to the council. Waconia has a formal investment policy. 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; it updates both annually. The debt management policy limits direct debt to 3% of market value. In addition, the city has a formal fund balance policy to maintain a minimum of 40% of next year's expenditures in reserves, for cash flow purposes.

### **Strong budgetary performance**

Waconia's budgetary performance is strong in our opinion. The city had slight operating surpluses of 0.9% of expenditures in the general fund and of 1.1% across all governmental funds in fiscal 2018.

We adjust revenues and expenditures for recurring transfers in and out of the general fund. We also adjust total governmental funds expenditures for bond proceeds and the early repayment of debt. Waconia has a history of general fund surpluses and budgets conservatively, in our view. The fiscal 2018 (year end Dec. 31) surplus of \$85,000 was primarily due to conservative budgeting. The fiscal 2019 budget calls for a surplus of about \$27,000, including

transfers. Management reports revenues and expenditures are tracking in line with the budget, and expects a balanced total governmental fund result.

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 2018 of 34% of operating expenditures, or \$2.3 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 (which is slightly different than the method we use to calculate the fund balance for our analysis). Given Waconia's budgeted general fund surplus for 2019 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 112.0% of total governmental fund expenditures and 3.2x governmental debt service in 2018. In our view, the city has strong access to external liquidity if necessary.

We've adjusted Waconia's available cash to remove unspent bond proceeds at the end of 2018. The city has demonstrated strong access to the capital markets with a history of issuing GO debt in the past 20 years. Furthermore, it is not investing its funds aggressively, because it invests primarily in certificates of deposit and money markets. Waconia has not entered any alternative financing agreements. Therefore, 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 34.6% of total governmental fund expenditures, and net direct debt is 254.8% of total governmental fund revenue. Approximately 99.1% 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. Waconia might issue approximately \$3.5 million over the next two years. We believe the city's high carrying charges are somewhat mitigated by rapid amortization and debt supported by enterprise and special-assessment revenue sources; however, should carrying charges continue to increase, and we do believe that fiscal flexibility to accommodate the debt service would not suffice, pressure on the rating and our evaluation of management would follow.

Waconia's pension contributions totaled 1.3% of total governmental fund expenditures in 2018. The city made 106% of its annual required pension contribution in 2018.

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. State statute determines required pension contributions to this plan. Statutory contributions rates have generally not kept pace with actuarially determined contribution (ADC) rates, indicating potential for payment acceleration. For more information about the reforms included in the 2018 omnibus retirement bill and the potential for future cost increases see our report, "Minnesota's New Pension Bill Is A Positive Step Toward Sustainable Funding," published June 7, 2018, on RatingsDirect.

The GFRF was 75.9% funded in fiscal 2018. Waconia's proportionate share of the net pension liability totaled \$1.7 million in fiscal 2018, 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 ADC increases the risk of payment acceleration. In addition, and 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, if pension contributions absorb a larger share of Waconia's budget, our debt and contingent liability profile assessment could weaken.

The city also participates in the Statewide Volunteer Firefighter Retirement Plan, an agent multiple-employer lump-sum defined benefit pension plan. It funds other postemployment benefits on a pay-as-you-go basis. As of Jan. 1, 2017, the most recent actuarial valuation, its unfunded actuarial accrued implicit liability was \$156,000.

### **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 stable financial profile, supported with robust management policies and practices, as well as our continued view that the city can maintain financial flexibility while supporting rapid debt amortization. We do not expect to raise or lower the rating in the next two years.

### **Downside scenario**

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

### **Upside scenario**

We could raise the rating if Waconia's economic indicators and debt profile improved to levels commensurate with those of higher-rated peers.

## **Related Research**

- 2018 Update Of Institutional Framework For U.S. Local Governments
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013

Ratings Detail (As Of July 23, 2019)		
Waconia GO bnds		
<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
<b>Waconia GO</b>		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

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