MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns Aa2 to Lake Elmo's (MN) $6.2M GO Bonds, Ser. 2014A

Global Credit Research - 10 Jun 2014

Maintains Aa2 on $21.1M of GO debt post-sale

LAKE ELMO (CITY OF) MN
Cities (including Towns, Villages and Townships)
MN

Moody's Rating

ISSUE		RATING
General Obligation Bonds, Series 2014A		Aa2
Sale Amount	$6,235,000	
Expected Sale Date	06/17/14	
Rating Description	General Obligation	

Moody's Outlook NOO

Opinion

NEW YORK, June 10, 2014 --Moody's Investors Service has assigned a Aa2 rating to the City of Lake Elmo's (MN) $6.2 million General Obligation Bonds, Series 2014A. Concurrently, Moody's maintains the Aa2 rating on $21.1 million of the city's post-sale general obligation debt. The series 2014A bonds are secured by the city's general obligation unlimited tax pledge, and proceeds of the bonds will finance street, water, and sewer improvements within the city.

SUMMARY RATING RATIONALE

The Aa2 rating reflects the city's moderately-sized but affluent tax base located in the Twin Cities metro region; strong finances supported by conservative budgeting and healthy unassigned fund balance; moderate direct debt burden; and modest exposure to unfunded pension liabilities.

STRENGTHS

- Affluent tax base favorably located in Twin Cities metropolitan area

- Strong financial operations and healthy General Fund reserves and liquidity

CHALLENGES

- Small tax base size relative to others in the rating category

- Above average fixed costs

DETAILED CREDIT DISCUSSION

MODERATELY-SIZED AND AFFLUENT TAX BASE NEAR THE TWIN CITIES

The city's tax base is expected to grow in the medium term due to its favorable location within the Twin Cities metropolitan area and large amount of land available for development. Located in Washington County (Aaa stable), the city lies along the eastern edge of the metropolitan region, and is one of only a few communities in the area with a large amount of land available for development. The city's full value of $1.1 billion experienced three years of large declines during the recent economic downturn, largely attributable to residential housing depreciation.

However, housing values have stabilized and the area has experienced modest growth in the past two years with full value increasing by 0.1% in 2013 and 1.3% in 2014. City officials report that approximately 45% of the city's land is available for development and, of that available land, 60% will be developed within the next 5 to 10 years. Major development areas include a mixed use development along I-94, the "Old Village" section of the city, and the northern edge of the city along Highway 36. Recent estimates show approximately 1,200 new homes being built in the 1-94 area over the next 5 years as well as 1,600 new residences in the Old Village area between 2013 and 2030. Given the planned development for the area, it is expected that the tax base will experience substantial growth in the medium term. The city is in the process of constructing substantial water and sewer improvements throughout the city in order to accommodate the planned development. The city has an Infrastructure Debt Participation Policy in place that requires infrastructure for private development to be funded by the developer or benefiting parties. The city collects fees and special assessments at preliminary plat mitigating the risk of non-payment.

Lake Elmo is primarily a bedroom community with the majority of residents commuting to employment opportunities throughout the Twin Cities area. Based upon net tax capacity, the city is 77% residential and 17% commercial and industrial. The largest employer of city residents is 3M Company (Aa2 stable), which is headquartered in nearby Maplewood (Aa1) and employs approximately 10,000. The city was party to a lawsuit along with the State of Minnesota seeking damages from 3M for allowing perfluorochemicals (PFCs) to leach into groundwater in Washington County over several decades. The city has entered a tolling agreement through December 2014, which allows the city to negotiate with 3M and puts on hold the statute of limitations should the city decide to return to litigation. Conservatively, the city has not included any potential settlement money in its budget projections, and will use any such funds for one time expenditures or to pay debt service. Management reports that the city's other major employers and taxpayers remain stable.

The city has experienced ongoing population growth in recent decades, including 17.6% growth between 2000 and 2010, and the Metropolitan Council (Aaa stable) estimates that the city's 2010 population of 8,069 could grow to 20,500 by 2040. Washington County's unemployment rate of 4.7% in March of 2014 remained below the national (6.8%) and state (5.4%) levels for same period. Lake Elmo's resident income levels significantly exceed those of the nation, with median family income equivalent to 194.1% and of the nation.

STABLE FINANCIAL OPERATIONS SUPPORTED BY HEALTHY RESERVES

The city's financial operations are expected to remain stable given its history of sound financial management and maintenance of healthy General Fund liquidity and reserves. The city has demonstrated conservative financial management, having closed the past six fiscal years with modest operating surpluses. Management attributes the surpluses to conservative budgeting of both revenues and expenditures. The city closed fiscal 2012 with a $525,000 operating surplus and a General Fund balance of $3.4 million, or a substantial 105.3% of revenues. Approximately $1 million of the city's fund balance is reserved for an advance to the city's Old Village Fund. The advance was made several years ago to finance the initial planning for the Old Village redevelopment project, but the project stalled during the economic downturn. The development has restarted and the planning and surveying have been completed. Because some of the initial planning could not be repaid by the developers, the city internally repaid $200,000 of the advance in fiscal 2012 and fiscal 2013 using unbudgeted General Fund revenues. The city plans to repay an additional $200,000 in fiscal 2014. At the end of fiscal 2014, a total of $600,000 of the advance will remain, which is expected to be repaid by environmental impact fees paid by the developers by fiscal 2016. Despite the advance, General Fund liquidity remains healthy, with 2012 unrestricted cash and investments totaling $2.1 million, or 65.1% of revenues. Likewise, the city's fiscal 2012 unassigned fund balance of $2.4 million, which is equivalent to 73.9% of revenues, remains healthy and above the city's policy of maintaining unassigned fund balance of 35% to 50% of budgeted operating revenues. Draft financial statements for fiscal 2013 indicate that the unassigned General Fund Balance decreased by $100,000 to $2.3 million, or approximately 64% of revenues primarily due to weather related costs and staffing additions in the city's Planning Department. For fiscal 2014, the city passed a balanced budget and officials report that revenues and expenditures are tracking to budget. Management expects no significant change in fund balance.

Property taxes comprise 78% of Lake Elmo's revenues, and the city's collection rate is high with few appeals. The city does not receive any local government aid; therefore, it is not subject to any risk associated with budgetary pressures at the state. The state implemented property tax limits for 2014 only, but the cap did not impact Lake Elmo as the city had planned to keep its levy flat.

MODERATE DEBT BURDEN WITH MODEST ADDITIONAL BORROWING PLANNED

The city's direct debt burden is a moderate 0.8% of full value, and though some additional borrowing is planned, the debt burden is expected to remain manageable given the city's expected growth. The city's net direct debt does not include $12.1 million of GO debt that is expected to be repaid by the city's self-supporting water enterprise. The city's gross debt burden, inclusive of the self-supporting debt, is a more substantial 1.9% of full value. The city's fixed costs related to debt service, inclusive of the GO debt supported by the water enterprise, are above average at 18.8% of operating expenditures in 2012. The city expects to issue an additional $2 million to $3 million of GO debt for water and sewer improvements over the next few years. Amortization of existing debt is average, with 66.8% of principal expected to be retired within ten years. All of the city's outstanding debt is fixed rate, and the city is not a party to any interest rate swap agreements.

MODEST EXPOSURE TO UNFUNDED PENSION LIABILITIES

The city has a moderate employee pension burden, based on unfunded liabilities for its share of two multiple-employer cost sharing plans, the General Employees Retirement Fund (GERF) and the Public Employees Police and Fire Fund (PEPFF), and one single employer plan administered by the Lake Elmo Volunteer Firefighter's Relief Association. Moody's has allocated liabilities of state cost-sharing plans in proportion to its contributions to each plan for analytic purposes. The city's share of unfunded pension liabilities allocated by Moody's on a reported basis is an estimated $868,000 across the three plans. The actuarial valuation dates for the state plans are as of June 30, 2012. The city's annual contribution to the three retirement plans in fiscal 2012 was $104,000 equal to 3.1% of operating expenditures (General Fund and Debt Service Fund).

Moody's adjusted combined net pension liability (ANPL) for the city as of fiscal 2013, under our methodology for adjusting reported pension data, is $3.0 million. The city's three-year average ANPL is equal to 0.57 times operating revenues and 0.20% of full value. Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. The adjustments are not intended to replace the city's reported liability information, but to improve comparability with other rated entities.

WHAT COULD CHANGE THE RATING - UP

- Growth in the city's tax base to levels consistent with higher-rated entities

- Maintenance of healthy financial reserves and liquidity

WHAT COULD CHANGE THE RATING - DOWN

- Deterioration of the tax base or weakening of the demographic profile

- Material declines in the city's financial reserves

- A significant increase in the city's net direct debt burden

KEY STATISTICS

Tax Base Size - 2014 Full Value (economic market): $1.1 billion

Full Value Per Capita: $137,327

Socioeconomic Indices - MFI: 194.1% of the US

Fiscal 2012 Available Operating Funds Balance: 62.7% of revenues

5-Year Dollar Change in Available Operating Fund Balance as % of Revenues: 30.4%

Fiscal 2013 Operating Funds Cash Balance: 55.0% of revenues

5-Year Dollar Change in Cash Balance as % of Revenues: 14.4%

Institutional Framework: Aa

Operating History: 5-Year Average of Operating Revenues / Operating Expenditures: 1.12x

Net Direct Debt / Full Value: 0.79%

Net Direct Debt / Operating Revenues: 2.26x

3-Year Average of Moody's Adjusted Net Pension Liability / Full Value: 0.20%

3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues: 0.57x

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was US Local Government General Obligation Debt published in January 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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