

MOODY'S

INVESTORS SERVICE

New Issue: **Moody's assigns Aa2 to Lake Elmo, MN's \$2.8M GO Bonds, Ser. 2015A**

Global Credit Research - 29 Jun 2015

Aa2 rating applies to \$22.8 million of post-sale GOULT debt

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

Moody's Rating

| ISSUE | RATING |
|-------|--------|
|-------|--------|

| | |
|--|-----|
| General Obligation Bonds, Series 2015A | Aa2 |
|--|-----|

| | |
|--------------------|-------------|
| Sale Amount | \$2,815,000 |
|--------------------|-------------|

| | |
|---------------------------|----------|
| Expected Sale Date | 07/07/15 |
|---------------------------|----------|

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|---------------------------|--------------------|
| Rating Description | General Obligation |
|---------------------------|--------------------|

Moody's Outlook NOO

NEW YORK, June 29, 2015 --Moody's Investors Service has assigned an Aa2 rating to the City of Lake Elmo's (MN) \$2.8 million General Obligation (GO) Bonds, Series 2015A. Concurrently, Moody's maintains the Aa2 rating on city's outstanding GO debt. Post-sale, the city will have \$22.8 million of GO debt outstanding.

SUMMARY RATING RATIONALE

The Aa2 rating reflects the city's modestly-sized and affluent tax base experiencing growth, 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.

OUTLOOK

Outlooks are usually not assigned to local government credits with this amount of debt outstanding.

WHAT COULD MAKE THE RATING GO UP

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

WHAT COULD MOVE THE RATING DOWN

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

-Material declines in the city's financial reserves

-Significant increase in debt levels

STRENGTHS

-Affluent tax base favorably located in Twin Cities metropolitan area

-Strong financial operations and healthy financial reserves and liquidity

CHALLENGES

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

-Above average fixed costs

RECENT DEVELOPMENTS

Recent developments are incorporated in the Detailed Rating Rationale.

DETAILED RATING RATIONALE

ECONOMY AND TAX BASE: MODESTLY-SIZED AFFLUENT TAX BASE NEAR THE TWIN CITIES EXPERIENCING GROWTH

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. The city's full value of \$1.3 billion experienced two years of significant growth, following declines in previous years, due to new residential development. In 2014 economic market value increased by 6.8% and in 2015 it increased by a sizeable 12.7%. City officials report that the increases are due to approximately 45% of the city's land being available for development and 60% of that land being 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 1,900 new homes being built in city in the next 10 years. Given the planned development for the area, it is expected that the tax base will experience significant 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 15% commercial and industrial. The largest employer of city residents is 3M Company (Aa3 negative), which is headquartered in nearby Maplewood (Aa1) and employs approximately 9,100. 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 (Minn-St. Paul Area) (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 3.7% in March of 2015 remained below the national (5.6%) and state (4.5%) 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.

FINANCIAL OPERATIONS AND RESERVES: 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 five out of 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 2014 with a \$4,000 operating surplus and a General Fund balance of \$3.2 million, or a substantial 93.5% of revenues. Approximately \$600,000 of the city's fund balance is reserved for an advance to the city's Old Village Fund. The entire balance is expected to be paid in full by 2016. The city's fiscal 2014 unassigned fund balance of \$2.5 million, which is equivalent to 74.7% of revenues, remains healthy and above the city's policy of maintaining unassigned fund balance of 35% to 50% of budgeted operating revenues. For fiscal 2015, the city presented a balanced budget, and year to date estimates indicate that the city is on target and may expect a modest operating surplus of approximately \$50,000 due to favorable budget fluctuations.

Property taxes comprise 72.3% of Lake Elmo's General Fund revenues, and the city's collection rate is high with few appeals. The city does not receive any local government aid from the state; therefore, it is subject to minimal 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.

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 entered a tolling agreement through October 2015, which allowed the city to negotiate with 3M and put on hold the statute of limitations should the city have decided to return to litigation. Conservatively, the city did not include any

potential settlement money in its budget projections, and will use any such funds for one time expenditures or to pay debt service.

Liquidity

In 2014, the city's unrestricted net operating cash position across major operating funds (General Fund and Debt Service Fund) was \$3.5 million or a very healthy 86.9% of revenues.

DEBT AND PENSIONS: MODERATE DEBT BURDEN WITH MODEST ADDITIONAL BORROWING PLANNED

The city's direct debt burden is a moderate 1.7% 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 direct debt of \$23 million includes \$13 million of GO debt that is expected to be repaid by the city's self-supporting water enterprise. The city's fixed costs related to debt service, inclusive of the GO debt supported by the water enterprise, were above average at 17.6% of operating expenditures in 2014. The city expects to issue an additional \$2 million to \$3 million of GO debt annually for water and sewer and road improvements over the next few years.

Debt Structure

All of the district's direct debt is fixed rate and amortizes over the long term. Principal amortization is below average with 66.3% of all debt retired in ten years.

Debt-Related Derivatives

The district has no derivative agreements.

Pensions and OPEB

Moody's three year average adjusted net pension liability (ANPL), through fiscal 2014 is \$3.3 million, equivalent to 0.3% of full value, and 0.8 times operating revenue. The ANPL is based upon our allocation of the reported unfunded liabilities of two multi-employer cost-sharing pension plans, the General Employees Retirement Fund (GERF) and the Public Employees Police and Fire Fund (PEPFF), and one single employer pension plan the Lake Elmo Firefighter's Relief Association plan. 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. The actuarial valuation dates for the cost sharing plans are June 30, 2013. The city's total fiscal 2014 contribution to the plans, was \$86,000 or 2.1% of operating expenditures.

MANAGEMENT AND GOVERNANCE: STRONG INSTITUTIONAL FRAMEWORK; SIZABLE RESERVES PROVIDE CUSHION

Minnesota cities have an institutional framework score of "Aa" or strong. Cities rely on property taxes to fund the majority of operations followed by state aid. State Local Government Aid (LGA) typically comprise the second largest source and ranges approximately from 0% to 80%, or on average 25% of GF revenues. The State increased aid for next biennium, after years of state aid cuts and stagnant aid. Cities typically have above average debt related expenditures. Notably, overall expenditures are predictable and cities have the ability to reduce expenditures if necessary, and benefit from unlimited operating levy authority.

We believe management will continue to maintain positive to balanced operations based on the city's trend of growing reserves.

KEY STATISTICS

-2014 Full value: \$1.3 Billion

-2014 Estimated full value per capita: \$164,000

-2008-2012 Median family income (as a % of US): 194.1%

-Fiscal 2014 Available Operating Fund Balance: 79.5%

-Fiscal 2009 to Fiscal 2014 Change in Available Operating Fund Balance as a % of revenues: 10.0%

- Fiscal 2014 Operating Fund Cash Balance: 86.9%
- Fiscal 2009 to Fiscal 2014 Change in Operating Fund Cash Balance as a % of revenues: 10.5%
- Fiscal 2009 to Fiscal 2014 Average Operating Revenues / Operating Expenditures: 0.98x
- Institutional Framework: Aa
- Net Direct Debt / Full Value: 1.7%
- Net Direct Debt / Operating Revenues: 5.6 times
- 3-year average of Moody's ANPL / Full Value: 0.3%
- 3-year average of Moody's ANPL / Operating Revenues: 0.8 times

OBLIGOR PROFILE

Located in Washington County (Aaa stable), the city lies along the eastern edge of the Twin Cities metropolitan region. The 2010 population was 8,069 according to census estimates.

LEGAL SECURITY

The bonds are secured by the city's general obligation unlimited tax (GOULT) pledge to levy a dedicated debt service tax that is not limited by rate or amount.

USE OF PROCEEDS

Proceeds of the bonds will be used to finance street improvement and utility projects.

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.moody.com for a copy of this methodology.

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