

## CREDIT OPINION

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New Issue

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## Lake Elmo, MN

New Issue: Moody's Assigns Aa2 to Lake Elmo, MN's \$9.9M GOULT Bonds, Ser. 2016A

### Summary Rating Rationale

Moody's Investors Service has assigned a Aa2 rating to the City of Lake Elmo's (MN) \$9.9 million General Obligation (GO) Bonds, Series 2016A. Concurrently, Moody's maintains the Aa2 rating on city's outstanding GO debt. Post-sale, the city will have \$31.4 million of GO debt outstanding.

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 budget strategies and healthy unassigned fund balance; moderate direct debt burden; and modest exposure to unfunded pension liabilities.

### Credit Strengths

- » Affluent tax base favorably located in Twin Cities metropolitan area
- » Strong financial operations and healthy financial reserves and liquidity

### Credit Challenges

- » Small tax base size relative to others in the rating category
- » Above average fixed costs

### Rating Outlook

Outlooks on the underlying credit are usually not assigned to local governments with this amount of debt.

### Factors that Could Lead to an Upgrade

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

### Factors that Could Lead to a Downgrade

- » Deterioration of the tax base or weakening of the demographic profile
- » Material declines in the city's financial reserves
- » Significant increase in debt levels

## Key Indicators

Exhibit 1

### Lake Elmo, MN

Lake Elmo (City of) MN	2010	2011	2012	2013	2014
Economy/Tax Base					
Total Full Value (\$000)	\$ 1,200,076	\$ 1,131,733	\$ 1,099,376	\$ 1,098,898	\$ 1,174,148
Full Value Per Capita	\$ 148,727	\$ 140,257	\$ 136,247	\$ 136,188	\$ 145,513
Median Family Income (% of US Median)	186.1%	186.1%	194.1%	194.1%	194.1%
Finances					
Operating Revenue (\$000)	\$ 3,612	\$ 3,572	\$ 3,867	\$ 4,361	\$ 4,068
Fund Balance as a % of Revenues	90.1%	146.8%	153.0%	69.8%	79.5%
Cash Balance as a % of Revenues	152.3%	152.3%	145.9%	75.5%	86.8%
Debt/Pensions					
Net Direct Debt (\$000)	\$ 7,310	\$ 7,811	\$ 8,270	\$ 6,522	\$ 8,787
Net Direct Debt / Operating Revenues (x)	2.0x	2.2x	2.1x	1.5x	2.2x
Net Direct Debt / Full Value (%)	0.6%	0.7%	0.8%	0.6%	0.7%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	N/A	N/A	0.6x	0.6x	0.8x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	N/A	N/A	0.2%	0.2%	0.3%

The above table does not include the most recent full value or sale data. Post sale, the district will have \$12 million in net direct debt outstanding, equal to 0.9% of full value and 0.8 times operating revenue.

Source: Moody's Investors Service, Audited Financial Results, US Census Bureau

## Detailed Rating Considerations

### Economy and Tax Base: Modestly-Sized 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. The city's full value of \$1.3 billion experienced three years of significant residentially-driven growth, recovering losses in prior years. This trend is expected to continue given several ongoing and planned developments. 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.

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, 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's population has grown in recent decades, including 17.6% 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 18,200 by 2040. Washington County's unemployment rate of 3.7% in March of 2016 remained below the national (5.0%) and on par with the state (3.7%) 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 closed five out of the past six fiscal years with modest operating surpluses, which management attributes to conservative budget assumptions. A minimal \$4,000 operating surplus in fiscal 2014 increased the General Fund balance to \$3.2 million, or a substantial 93.5% of revenues. Approximately \$600,000 of the city's fund balance is

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reserved for an advance to the city's Old Village Fund, which is being repaid by property tax revenues associated with the ongoing mixed-use development. According to the city officials, the amount is projected to be paid in full by 2017. 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% of budgeted operating revenues. For fiscal 2015, the city's budget was balanced and management estimates a modest operating surplus of approximately \$50,000 due to favorable budget variances. The city adopted a balanced budget for fiscal 2016, conservatively assuming no additional revenue coming from the new developments.

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.

#### 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: Low Debt Burden with No Additional Borrowing Planned

The city's direct debt burden is a low 0.9% of full value and has modest long-term pension and OPEB liabilities. The direct debt burden excludes \$19.4 million of GO debt that is expected to be repaid by the city's self-supporting water and sewer enterprises. The city's total fixed costs of \$4.5 million, including debt service, pension, and OPEB expenditures make up 21% of fiscal 2014 operating revenues.

#### DEBT STRUCTURE

All of the district's direct debt is fixed rate and amortizes over the long term. Principal amortization is below average with 67% of all debt retired in ten years.

#### DEBT-RELATED DERIVATIVES

The city has no derivative agreements.

#### PENSIONS AND OPEB

Lake Elmo has a low employee pension burden, based on unfunded liabilities for its participation in a multi-employer cost sharing plan administered by the state, the General Employees Retirement Fund (GERF) and one single employer pension plan the Lake Elmo Firefighter's Relief Association plan. Moody's three-year average adjusted net pension liability (ANPL) for the city, through fiscal 2014, is \$3.7 million, or 0.3% of full value and 0.8 times operating revenues (General Fund and Debt Service Funds). Moody's ANPL reflects certain adjustments we make to improve the 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. We determined the city's share of liability for GERF in proportion to its contributions to the plan. The city's fiscal 2014 total contribution to both plans was \$140,000 or 3.4% of operating revenues.

The city administers a single-employer defined benefit healthcare plan that provides benefits to retirees until Medicare eligibility and funds these liabilities on a pay-as-you-go basis. The city funds its plan on a pay as you go basis and in fiscal year 2014, the city did not contribute anything to the plan as there were no retiree participants. As of January 1, 2014, the actuarial accrued liability for benefits was \$204,437, all of which was unfunded.

#### Management and Governance: Strong Institutional Framework Score

Minnesota cities have an institutional framework score of "Aa," or strong. Revenues are moderately predictable as cities rely primarily on property taxes. Some cities also rely on State Local Government Aid (LGA), which is distributed based on demographic and tax base factors. Revenue-raising flexibility is moderate as cities generally benefit from unlimited levying authority, except during years in which the state has imposed limits. Levy limits are not in place for the 2016-2017 biennium. Expenditures mostly consist of personnel costs, which are highly predictable. Cities typically maintain low fixed costs and have a moderate ability to reduce expenditures.

Management has a fund balance policy of maintaining 35% of the following year's budgeted expenditures in reserves. Favorably, the city does not rely on LGA and is less impacted by the state's fiscal condition.

## 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. The security benefits from a statutory lien and there is no lock box structure for debt service.

## Use of Proceeds

Proceeds of the bonds will be used to provide street, water, sewer and storm water improvement projects.

## 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.

## Methodology

The principal methodology used in this rating was US Local Government General Obligation Debt published in January 2014. Please see the Ratings Methodologies page on [www.moody.com](http://www.moody.com) for a copy of this methodology.

## Ratings

Exhibit 3

### Lake Elmo (City of) MN

Issue	Rating
General Obligation Bonds, Series 2016A	Aa2
Rating Type	Underlying LT
Sale Amount	\$9,860,000
Expected Sale Date	05/17/2016
Rating Description	General Obligation

Source: Moody's Investors Service

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