MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns Aa2 to Lake Elmo's (MN) $5.7M GO Bonds, Series 2013A

Global Credit Research - 05 Sep 2013

Aa2 applies to $15.6M 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 2013A	Aa2

Sale Amount $5,725,000
Expected Sale Date 09/11/13
Rating Description General Obligation

Moody's Outlook NOO

Opinion

NEW YORK, September 05, 2013 --Moody's Investors Service has assigned a Aa2 rating to the City of Lake Elmo's (MN) $5.7 million General Obligation Bonds, Series 2013A. Concurrently, Moody's has affirmed the Aa2 rating on $15.6 million of the city's post-sale general obligation debt. The series 2013A bonds are secured by the city's general obligation unlimited tax pledge, and proceeds of the bonds will finance water and sewer improvements within the city.

SUMMARY RATING RATIONALE

The Aa2 rating reflects the moderately-sized but affluent tax base located in the Twin Cities metro region; strong finances supported by conservative budgeting, annual surpluses, and healthy unreserved fund balance; low direct debt burden and favorable pension liability.

STRENGTHS

- Affluent tax base favorably located in Twin Cities metropolitan area

- Maintenance of healthy General Fund reserves and liquidity

CHALLENGES

- Trend of declining tax base valuations

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

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 despite recent trends of valuation declines due to its favorable location within the Twin Cities metropolitan area and large amount of land available for development. Located in Washington County (general obligation rated Aaa/stable outlook), 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 has experienced several years of declines due to residential

housing depreciation. Large declines of 9.0% and 5.7% occurred in 2010 and 2011, respectively due to depreciation as well as a legislative change that occurred in 2011. However, depreciation has begun to taper off and the city experienced a more moderate 3.0% decline in 2012 and then a 0.1% increase in 2013. 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 5-7 years. Management reports that seven separate residential developments are planned and several have been platted. City officials project a $423 million increase in valuation over seven years, or approximately $60 million per year, solely from these residential developments. Given the planned development for the area, it is expected that the tax base will experience substantial growth in the medium term.

Lake Elmo is primarily a bedroom community with the majority of residents commuting to employment opportunities throughout the Twin Cities area. Based upon assessed value, the city is 79% residential and 19% commercial and industrial. The largest employer of city residents is 3M Company (senior unsecured rated Aa2/stable outlook), 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. Recently, the city entered a tolling agreement in order to begin substantive negotiations with 3M about the current groundwater conditions. The tolling agreement allows the city to negotiate with 3M, but waives 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 outlook) estimates that the city's 2010 population of 8,069 could grow to 24,000 by 2030. Washington County's unemployment rate of 4.8% in June of 2013 remained below the national (7.8%) and state (5.2%) levels for same period. Lake Elmo's resident income levels significantly exceed those of the nation, with median family income equivalent to 186.1% and per capital income equivalent to 157.5% of the nation according to 2006 to 2010 estimates from the American Community Survey.

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 a demonstrated history of 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 made several years ago to help finance the initial planning for the Old Village redevelopment project. The project stalled during the economic downturn and then was stopped completely. The city plans to write-off $200,000 in both 2013 and 2014, which will reduce the non-spendable portion of the fund balance. A portion of the advance will remain as it is attributable to water and sewer improvements that are part of the current issuance. Despite these advances, 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 undesignated fund balance at or above 50% of the next year's budgeted tax revenues. Management projects that fiscal 2013 will result in modest $120,000 surplus. City officials expect the tax levy and tax rate to remain flat in 2014 with balanced to modestly surplus operations.

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. A property tax rate limit is in place for 2014; however, officials report this will not impact Lake Elmo as it expect to maintain operations under the same rate as the previous year.

MODERATE DEBT BURDEN WITH ADDITIONAL BORROWING PLANNED

Currently, the city's direct debt burden is a moderate 0.9% of full value, and though some additional borrowing is planned, the debt burden is expected to remain manageable given long-term plans of growth. Debt service was 18.8% of revenues in 2012; however, nearly one half of the city's outstanding general obligation debt is supported by water or sewer revenue, reducing the impact on the city's general tax levy. Due to the substantial growth that is planned within the city, management expects to borrow an additional $9M over the course of the next five years. It is likely that much of this debt would also be supported by water and sewer revenues. Assuming there was no change in full value, the city's debt burden would increase to an above average but manageable 1.7% of full value. Amortization of existing debt is average, with 65.7% 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.

Lake Elmo has a favorable employee pension burden, based on unfunded liabilities for its participation in one multiple-employer cost-sharing plan administered by the state and a single employer plan administered by the Lake Elmo Volunteer Firefighter's Relief Association. Reported unfunded pension liabilities include an estimated $703,000 for Lake Elmo's portion of the statewide General Employees Retirement Funds (GERF) as of June 30, 2011, and no unfunded liability for Lake Elmo Volunteer Firefighter's Relief Association which has a funded ratio of 118.2% as of December 31, 2010. The city has consistently made its required contributions to these pension plans, which was a total of $104,000 in 2011 or 2.9% of operating revenues.

Moody's adjusted net pension liability (ANPL) for the city, under our methodology for adjusting reported pension data, is $1.6 million, or a moderate 0.47 times operating revenues, compared to just below 1 times on average in the sector. The ANPL for the city's share of GERF is $1.8 million, and the ANPL for the Lake Elmo Volunteer Firefighter's Relief Association is -$177,000, indicating the plan is currently fully funded. Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. The adjustments are not intended to replace Lake Elmo's reported liability information, but to improve comparability with other rated entities. We determined Lake Elmo's share of liability for GERF in proportion to its contributions to the plan.

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

Population (2010 Census): 8,069 (17.6% increase since 2000)

2013 full valuation: $1.1 billion (2.5% five-year average annual decrease)

Estimated full value per capita: $135,566

2006-2010 American Community Survey median family income as a % of nation: 186.1%

2006-2010 American Community Survey per capita income as a % of nation:157.5%

Unemployment rate for Washington County (June 2013): 4.8% (Minnesota: 5.2%; U.S.: 7.8%)

Fiscal 2012 General Fund balance: $3.2 million (105.3% of revenues)

Fiscal 2012 unassigned General Fund balance: $2.4 million (73.9% of revenues)

Fiscal 2013 net cash and investments: $2.1 million (65.1% of revenues)

Overall debt burden as a % of full value (direct): 2.7% (0.9%)

Payout of principal (10 years): 65.7%

Post-sale general obligation debt outstanding: $15.6 million ($14.4 million rated by Moody's)

Moody's ANPL (2011): $1.7M (0.47x fiscal 2011 operating revenues)

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was General Obligation Bonds Issued by US Local Governments published in April 2013. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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