

# RatingsDirect®

---

## Summary:

# Excelsior, Minnesota; General Obligation

### **Primary Credit Analyst:**

Andrew Bredeson, Centennial + 1 (303) 721 4825; [andrew.bredeson@spglobal.com](mailto:andrew.bredeson@spglobal.com)

### **Secondary Contact:**

John A Kenward, Chicago (1) 312-233-7003; [john.kenward@spglobal.com](mailto:john.kenward@spglobal.com)

## Table Of Contents

---

Rationale

Outlook

Related Research

## Summary:

# Excelsior, Minnesota; General Obligation

### Credit Profile

US\$5.985 mil GO str reconstruction bnds ser 2019A due 02/01/2040

*Long Term Rating* AAA/Stable New

Excelsior GO bnds ser 2017A due 02/01/2033

*Long Term Rating* AAA/Stable Upgraded

## Rationale

S&P Global Ratings raised its long-term rating to 'AAA' from 'AA+' on the city of Excelsior, Minn.'s general obligation (GO) bonds outstanding. At the same time, S&P Global Ratings assigned its 'AAA' long-term rating to the city's series 2019A GO street reconstruction bonds. The outlook is stable.

The raised rating reflects our view of the city's track record of sustaining very strong available reserves in excess of 75% of general fund expenditures, and our view that this is likely to continue.

### Security and use of proceeds

A full faith and credit GO pledge of the city secures the bonds, supported by its ability to levy direct general ad valorem taxes on all taxable property within its borders and without limit. The city expects to use special assessments and net revenue from its water, sewer, and surface water utilities to pay a portion debt service on the bonds, though these revenues are not pledged

The city plans to apply the proceeds of the \$5.99 million series 2019A bonds to fund street and utility reconstruction projects.

### Credit overview

Excelsior's credit profile reflects its favorable location within the large, broad and diverse Minneapolis-St. Paul-Bloomington metropolitan statistical area (MSA). Though small, at about one square mile large, the city's location on Lake Minnetonka, its distinctive downtown area, and its proximity to larger communities with abundant employment opportunities within the MSA all support very strong credit fundamentals. The city's finances are well-managed, and although its debt burden is relatively high, the city's demonstrated willingness and ability to raise property taxes and user fees to fund rising expenditures, including debt service, continues to enable it to produce favorable financial metrics.

The rating reflects our view of the city's:

- Very strong economy, given its very strong wealth and income levels and location within a broad and diverse MSA;
- Strong management, with good financial policies and practices under our financial management assessment methodology;

- Strong budgetary performance, with operating results that we expect could improve in the near term relative to fiscal 2018, which closed with a slight operating deficit in the general fund and an operating deficit at the total governmental fund level in fiscal 2018, per our calculations;
- Very strong budgetary flexibility, with a high available fund balance in fiscal 2018 of 174% of operating expenditures;
- Very strong liquidity, with total government available cash at 2.4x total governmental fund expenditures and 42.5x governmental debt service, and access to external liquidity that we consider strong;
- Very weak debt and contingent liability position, with debt service carrying charges at 5.7% of expenditures and net direct debt that is 294.7% of total governmental fund revenue; and
- Adequate institutional framework score.

### **Very strong economy**

We consider Excelsior's economy very strong. The city, with an estimated population of 2,364, is located in Hennepin County in the Minneapolis-St. Paul-Bloomington, MN-WI MSA, which we consider broad and diverse. Excelsior has a projected per capita effective buying income of 189% of the national level and per capita market value of \$228,789. Overall, the city's market value grew by 4.8% over the past year to \$540.9 million in 2019. The county unemployment rate was 2.5% in 2018, below the U.S. rate of 3.9%.

The city's wealth and income levels reflect its status as an attractive suburban community located along the shores of Lake Minnetonka. The city's downtown area is home to many shops and restaurants, and the city is home to up to frequent outdoor events during the summer months, attracting visitors from throughout the Twin Cities and beyond.

The city is substantially built out and has no significant area for greenfield development. However, the city encourages renovation and rehabilitation of existing buildings. Given the ongoing renovation and rehabilitation activities, in addition to its attractiveness and the continued economic and population growth throughout the MSA, Excelsior's property values have continued to demonstrate strong growth in recent years.

### **Strong management**

We view the city's management as strong, with good financial policies and practices under our Financial Management Assessment methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Highlights include:

- Strong, well-grounded revenue and expenditure assumptions consistently embedded in the city's annual budget, which, for example, includes reference to historical trends and detailed analyses explaining expected variance from these trends and which places current-year revenue and expenditure forecasts in the context of a multiyear financial plan;
- Monthly budget-to-actual reporting to the city council to identify potential sources of budget variance and the ability to amend the budget as needed;
- An annually-updated, multiyear financial plan that identifies and discusses upcoming issues or variances and possible solutions;

- An annually-updated, 10-year capital improvement plan (CIP) that includes detailed descriptions of specific projects, along with cost estimates and funding sources;
- A council-approved investment management policy, though only annual reporting to the council on investment holdings and earnings; and
- A formal fund balance policy requiring a minimum of 40% in unrestricted general fund balance, a level the city has historically maintained.

The city does not have a debt management policy.

### **Strong budgetary performance**

Excelsior's budgetary performance is strong in our opinion. Based on our calculations, inclusive of adjustments such as adding recurring transfers in to the general fund from the city's commercial docks operation, the city had slight deficit operating results in the general fund of negative 0.7% of expenditures, and deficit results across all governmental funds of negative 6.3% in fiscal 2018. However, the general fund posted very strong surpluses of 27.8% in fiscal 2017 and 9.6% in fiscal 2016.

We understand that a lag in billing led to somewhat overstated expenditures related to especially high building inspections recorded on fiscal 2018's financial statements. The activity related to especially strong building permits dispersed in fiscal 2017, which in turn contributed to especially strong revenue recorded in that year. We do not consider the slight deficit indicated for fiscal 2018 as indicative of a weakening financial condition for the city.

Our assessment accounts for the fact that we expect budgetary results will likely improve from 2018 results in the near term. Based on year-to-date performance, we understand the city expects a modest general fund surplus in fiscal 2019, and the city expects to pass a balanced budget for fiscal 2020.

### **Very strong budgetary flexibility**

Excelsior's budgetary flexibility is very strong, in our view, with a high available fund balance in fiscal 2018 of 174% of operating expenditures, or \$3.8 million. The city's historically robust operating results has translated to exceptionally strong overall fund balances. In recent years, the city has made discretionary one-time transfers from the general fund, in an effort to bring the general fund available fund balance down to the 40% level specified by the city's fund balance policy.

We expect the available fund balance to remain above 75% of expenditures for the current and next fiscal years, which we view as a positive credit factor. The available fund balance includes \$1.1 million (52.4% of expenditures) in the general fund and \$2.6 million (121% of expenditures) that is outside the general fund but legally available to support the city's general operations.

### **Very strong liquidity**

We consider the city's liquidity very strong. The city's \$7.7 million in unrestricted cash and investments on balance sheet at fiscal year-end 2018 equated to 2.4x of total governmental fund expenditures and 42.5x governmental debt service in fiscal 2018. Our calculations of the city's liquidity includes unrestricted cash and investments held in the city's enterprise funds but that is available to the city to fund any legal purpose. We consider the city's access to external liquidity strong, reflecting our view that the city has demonstrated and continues to maintain sufficient access

to capital markets.

In our opinion, the state permits the use of aggressive investments; however, we do not view the city's investments as aggressive, as it invests primarily in certificates of deposit and U.S. governmental securities. In addition, the city does not have direct-purchase or variable-rate debt. We believe the city's liquidity will remain very strong.

### **Very weak debt and contingent liability profile**

Based on our criteria, we consider Excelsior's debt and contingent liability profile is very weak. As calculated from projected net direct debt following issuance of the series 2019A bonds, projected net direct debt equates to 294.7% of fiscal 2018 actual total governmental fund revenue.

We calculate the city's net direct debt as its total outstanding GO debt net of the amount that is fully supported by net revenue of the city's water and sewer utilities. Though the city's debt burden is very high, we believe the support provided by its utility funds and its very strong tax base somewhat mitigates related credit risk.

Following the issuance of the series 2019A bonds, the city will have approximately \$12.0 million in GO debt outstanding. Net of self-supporting debt paid by water and sewer revenue, the city will have approximately \$8.7 million in net direct debt. We understand the city may issue additional debt in the near-term for street repair work, though the timing and sizing of any future issuances is indeterminate.

We note that the city has increased its levy for three consecutive years--2% in fiscal 2017, 3% in fiscal 2018, and 6% in fiscal 2019, in part to strengthen its financial foundation as it entered a period of relatively higher capital needs. We expect the city's very strong tax base and its recent levy increases will likely enable it to maintain budgetary performance metrics that support the current rating.

Excelsior's pension contributions totaled 1.6% of total governmental fund expenditures in 2018. The city made its full annual required pension contribution in 2018.

Excelsior participates in the Minnesota General Employees' Retirement Fund (GERF) cost-sharing, multiple-employer pension plan. The Minnesota Public Employees' Retirement Association administers the plan. State statute determines the plan's required pension contributions. Statutory contributions have generally not kept pace with actuarially determined contributions, indicating potential for payment acceleration.

The state recently passed pension legislation that will:

Reduce the investment rate of return to 7.5% from 8.0%, and

Reduce some employee benefits, primarily cost-of-living adjustments.

While we view these plan-funding changes positively, we believe the lack of an actuarial funding policy remains a weakness. (For more information about the reforms included in the 2018 omnibus retirement bill and the potential for future cost increases, please see our article titled "Minnesota's New Pension Bill Is A Positive Step Toward Sustainable Funding," published June 7, 2018.)

GERF was 79.5% funded at fiscal year-end 2018. The city's proportionate share of GERF's net pension liability totaled

\$549,210 million in fiscal 2018, the most recent year data are available.

We consider historical plan funding somewhat weak, and we think the history of pension contributions below actuarially determined contributions increases payment-acceleration risk. In addition, in our view, the plan's investment portfolio has exposure to significant market risk with only 22% of investments allocated to fixed income and cash; this increases the risk of plan-funding volatility. Despite these weaknesses, in our opinion, the city has sufficient taxing and operational flexibility to manage future pension contribution increases. However, if pension contributions were to absorb a larger share of the budget, our view of Excelsior's debt and contingent liability profile could weaken.

Excelsior also provides other postemployment benefits (OPEBs) in the form of health care coverage for eligible retirees and their spouses. The city funds OPEB costs on a pay-go basis. As of Dec. 31, 2018, there were only 10 active plan members covered by the city's OPEB benefits.

### **Adequate institutional framework**

The institutional framework score for Minnesota cities with a population between 1,000 and 2,500 and no annual audit required by state statute is adequate.

The local ratings' relationship with the U.S. sovereign

The city's GO bonds are eligible to be rated above the sovereign, because we believe the authority can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above the Sovereign--Corporate and Government Ratings: Methodology and Assumptions" (published on Nov. 19, 2013, on RatingsDirect), U.S. local governments are considered to have moderate sensitivity to country risk. The city's locally derived tax revenue is the source of security for the bonds, and the institutional framework in the U.S. is predictable, with significant U.S. local government autonomy. In a potential sovereign default scenario, U.S. local governments would maintain financial flexibility through the ability to continue collecting locally derived revenue and U.S. local governments have independent treasury management.

## **Outlook**

The stable outlook reflects our expectation that Excelsior's very strong income levels and tax base will enable the city to continue generating revenue that is sufficient to offset its very high debt burden, enabling the city to continue demonstrating strong financial performance. It indicates that we do not expect to lower the rating during our two-year outlook horizon.

### **Downside scenario**

We could lower the rating if the city unexpectedly spends down its available fund balances below 75% of total general fund expenditures, or if it issues a material amount of additional debt that is not offset by higher tax revenue, and if budgetary performance or flexibility worsen as a result.

## **Related Research**

- U.S. State And Local Government Credit Conditions Forecast, Oct. 24, 2018
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- 2018 Update Of Institutional Framework For U.S. Local Governments

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

Copyright © 2019 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, [www.standardandpoors.com](http://www.standardandpoors.com) (free of charge), and [www.ratingsdirect.com](http://www.ratingsdirect.com) (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at [www.standardandpoors.com/usratingsfees](http://www.standardandpoors.com/usratingsfees).

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.