

RatingsDirect®

Summary:

Chanhassen, Minnesota; General Obligation

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Credit Profile

US\$6.795 mil GO util rev bnds ser 2020A dtd 03/09/2020 due 02/01/2031

Long Term Rating AAA/Stable New

Chanhassen GO

Long Term Rating AAA/Stable Affirmed

Rating Action

S&P Global Ratings assigned its 'AAA' rating to Chanhassen, Minn.'s series 2020A general obligation (GO) utility revenue bonds (approximately \$6.795 million). At the same time, S&P Global Ratings affirmed its 'AAA' rating on the city's existing GO debt (approximately \$36 million of parity bonds outstanding). The outlook is stable.

The bonds are secured by Chanhassen's GO pledge and are payable from ad valorem taxes against all taxable property within the city without limit as to rate or amount. The water, sanitary sewer, and storm water system's net revenues further secure the bonds, but we rate the bonds to Chanhassen's GO pledge. We similarly rate the existing GO bonds also secured by other revenue streams to the GO pledge. City officials will use proceeds for various utility system improvements.

Chanhassen's GO bonds are eligible to be rated above the sovereign because we believe the city 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 Nov. 19, 2013), U.S. local governments are considered to have moderate sensitivity to country risk. The institutional framework in the U.S. is predictable for local governments, allowing them significant autonomy, independent treasury management, and no history of government intervention. We believe Chanhassen's very strong budgetary reserves and liquidity sufficiently demonstrate financial flexibility.

Credit overview

Chanhassen's comprehensively strong credit profile is reflected in all aspects. The city is an affluent residential Minneapolis suburb and is home to Prince's Paisley Park. The city has a strong housing market and is also seeing growth in the retail and commercial sectors. The city's strong management is forward-looking and supports its stable finances and large general fund reserves. Chanhassen's debt profile is not as strong as the other credit aspects, but the city has proven its ability to afford these fixed costs.

The stable outlook reflects our view of the city's very strong economic characteristics, financial indicators, and management, all of which support the 'AAA' rating and all of which we expect will remain stable. Therefore, we do not anticipate a rating change within the two-year outlook horizon.

The 'AAA' rating reflects our view of the city's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2018;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 49% of operating expenditures;
- Very strong liquidity, with total government available cash at 1.9x total governmental fund expenditures and 33.2x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability profile, with debt service carrying charges at 5.8% of expenditures and net direct debt that is 180.0% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value; and
- Strong institutional framework score.

Stable Two-Year Outlook

Downside scenario

Although unlikely, we could lower the rating if the city were to issue substantial new money debt resulting in a weaker overall debt profile that, in our view, is no longer consistent with that of 'AAA'-rated peers. We could also lower the rating with substantial deterioration in the city's budgetary performance and flexibility, although again, we consider this unlikely to occur in the next two years.

Credit Opinion

Very strong economy

We consider Chanhassen's economy very strong. The city, with an estimated population of 25,547, is located in Carver County in the Minneapolis-St. Paul-Bloomington MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 214% of the national level and per capita market value of \$189,982. Overall, the city's market value grew by 9.9% over the past year to \$4.9 billion in 2019. The county unemployment rate was 2.5% in 2018.

Chanhassen is an affluent residential suburb about 17 miles southwest of Minneapolis in Carver County, with a small portion in Hennepin County. The 24-square-mile city has a tax base composed primarily of residential homestead properties, followed by commercial and industrial. Following the Great Recession, market value declined through levy year 2013, and has risen about 5% per year, on average, since, reaching a recent high of \$4.55 billion in 2019. Life Time Fitness (a health club and fitness center company) is the largest employer in the city and it has recently expanded its headquarters. Notably, Chanhassen is home to Prince's Paisley Park, which is now a tourist attraction; a large portion of the park's land was donated to the city to turn into a public park. As with much of the rest of the MSA, we expect Chanhassen will see sustained, moderate growth in property values through the next several years due to new construction and appreciation in existing property values.

Very strong management

We view the city's management as very strong, with strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Highlights of the FMA include:

- A line-item budget that relies on at least three years of historical information and information from external sources;
- Monthly budget-to-actual reporting to the council and the ability to amend the budget as needed;
- A five-year financial projection that is shared with the council and used as a long-term planning tool and updated annually, and a five-year capital improvement plan that is updated annually and which includes funding sources;
- A formal investment policy and quarterly reporting to the council on investment holdings;
- A formal debt policy that includes certain thresholds that are to be maintained when issuing debt; and
- A formal reserve policy that requires a minimum fund balance of at least 50% of next year's property tax revenues and state aid for cash flow purposes.

Strong budgetary performance

Chanhassen's budgetary performance is strong, in our opinion. The city had operating surpluses of 3.2% of expenditures in the general fund and of 4.6% across all governmental funds in fiscal 2018.

Chanhassen uses a Dec. 31 fiscal year-end in reporting its finances. We have adjusted general fund revenues and expenditures to account for routine transfers and total governmental fund revenues, and expenditures to account for transfers and a one-time expenditure for a bond refunding. The fiscal 2018 surplus results reflect conservative budgeting practices and continued revenue growth. For fiscal 2019, the city adopted a break-even general fund budget that reflects expenditures coming in under budget and building permit revenues coming in over budget, but typically Chanhassen will transfer the previous year's surplus to a capital projects fund. After these transfers, the city will likely show a very slight deficit in the general fund and break-even results across all governmental funds. The fiscal 2020 budget is break-even and similarly reflects only modest changes over the prior year.

After adjustments, Chanhassen's budgetary performance has been strong in recent years, which we expect will continue. The city's strong tax base and reliance on locally derived revenues in the general fund lend stability to the operating budget. The largest general fund revenues in fiscal 2018 included 73% property taxes, and 14% licenses and permits.

Very strong budgetary flexibility

Chanhassen's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 49% of operating expenditures, or \$5.7 million. We expect the available fund balance will remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor. Over the past three years, the total available fund balance has remained consistent overall, totaling 48% of expenditures in 2017 and 50% in 2016.

The city's available (unassigned and assigned) general fund balance has consistently been at or near 50% of expenditures for at least the past three years and has been in line with the formal fund balance policy, which requires a minimum fund balance equal to 50% of the subsequent year's expected property tax levy. Given Chanhassen's stable

operating environment and no plans to draw down reserves, we expect the city's overall budgetary flexibility will remain very strong.

Very strong liquidity

In our opinion, Chanhassen's liquidity is very strong, with total government available cash at 1.9x total governmental fund expenditures and 33.2x governmental debt service in 2018. In our view, the city has strong access to external liquidity, if necessary.

We expect Chanhassen's overall cash levels will be stable, so overall liquidity will remain very strong. Having issued GO debt on a number of occasions over the past 20 years, the city has a sufficient record of capital market access to support our view that it has strong access to external liquidity if needed. State statutes allow for investments that we consider aggressive, although Chanhassen's investments include money market funds, certificates of deposit, and highly rated bonds and notes, which we do not consider aggressive. The city has no variable-rate or direct-purchase debt.

Adequate debt and contingent liability profile

In our view, Chanhassen's debt and contingent liability profile is adequate. Total governmental fund debt service is 5.8% of total governmental fund expenditures, and net direct debt is 180.0% of total governmental fund revenue. Overall net debt is low at 2.3% of market value, which is, in our view, a positive credit factor.

Our direct debt calculation excludes GO debt supported by the water enterprise that we consider self-supporting. Management reports that the city is considering issuing up to \$4 million in new money debt in the next few years.

Chanhassen's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 3.9% of total governmental fund expenditures in 2018. The city made its full annual required pension contribution in 2018.

We do not believe that pension liabilities represent a medium-term rating pressure, as contributions represent only a modest share of the budget and we believe the city has the capacity to absorb higher costs without affecting operations.

Chanhassen participates in two multiple-employer, defined-benefit pension plans that have seen recent improvements in funded status, although plan statutory contributions have regularly fallen short of actuarial recommendations. Along with certain plan-specific actuarial assumptions and methods, this introduces some long-term risk of funding volatility and cost acceleration, including the recent extension of the amortization period to 30 years.

The city also participated in a single-employer, defined-benefit plan for firefighters.

The city provides health insurance benefits to employees via a single-employer, self-insured OPEB plan that it funds on a pay-as-you go basis.

Chanhassen participates in the following plans:

- Minnesota General Employees Retirement Fund (GERF): 80.2% funded (as of June 30, 2019), with a city proportionate share of the plan's net pension liability of \$4.2 million (as of June 30, 2018).

- Chanhassen Fire Department Relief Association: 70.5% funded (June 30, 2018), with a proportionate share of \$886,000 (as of June 30, 2018).
- Public Employees Police and Fire Fund (PEPFF): 88% funded (as of June 30, 2018), with a city proportionate share of the plan's net pension liability of \$205,718 (as of June 30, 2018).

Total contributions to GERF and the firefighter pensions were 81% and 113%, respectively, of our minimum funding progress metric and were above static funding in both cases in 2018. Annual contributions to GERF are based on a statutory formula that has typically produced contributions lower than the actuarially determined contribution for each plan, and we think that this increases the risk of underfunding over time if the state legislature does not make adjustments to offset future funding shortfalls.

Other key risks include a 7.5% investment rate-of-return assumption for GERF that indicates some exposure to cost acceleration as a result of market volatility; and an amortization method that significantly defers contributions through a lengthy, closed 30-year amortization period based on a level 3.25% payroll growth assumption. Regardless, pension costs remain only a modest share of total spending, and we believe they are unlikely to pressure Chanhassen's medium-term operational health.

Strong institutional framework

The institutional framework score for Minnesota cities with a population greater than 2,500 is strong.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- 2019 Update Of Institutional Framework For U.S. Local Governments

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Ratings Detail (As Of March 3, 2020)		
Chanhassen GO		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Chanhassen GO bnds		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Chanhassen GO wtr rev bnds		
<i>Long Term Rating</i>	AAA/Stable	Affirmed

Ratings Detail (As Of March 3, 2020) (cont.)

Chanhassen GO wtr rev bnds		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Chanhassen GO (AMBAC)		
<i>Unenhanced Rating</i>	AAA(SPUR)/Stable	Affirmed
Chanhassen GO (MBIA)		
<i>Unenhanced Rating</i>	AAA(SPUR)/Stable	Affirmed
Carver Cnty Comnty Dev Agy, Minnesota		
Chanhassen, Minnesota		
Carver Cnty Comnty Dev Agy GO		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Carver Cnty Comnty Dev Agy GO		
<i>Long Term Rating</i>	AAA/Stable	Affirmed

Many issues are enhanced by bond insurance.

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