S&P Global
Ratings

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Summary:

Victoria, Minnesota; Appropriations; General Obligation

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Summary:

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Credit Profile		
US$2.16 mil GO bnds ser 2018A due 02/01/2034		
Long Term Rating	AAA/Stable	New
Victoria GO		
Long Term Rating	AAA/Stable	Upgraded
Victoria Economic Development Authority, Minnesota		
Victoria, Minnesota		
Victoria Economic Development Authority (Victoria) APPROP		
Long Term Rating	AA+/Stable	Upgraded

Rationale

S&P Global Ratings raised its rating to 'AAA' from 'AA+' on the City of Victoria, Minn.'s existing general obligation (GO) debt, and raised its rating to 'AA+' from 'AA' on the Victoria Economic Development Authority's series 2014A lease revenue and limited-tax bonds, issued for the city. At the same time, we assigned our 'AAA' long-term rating to the city's series 2018A GO bonds. The outlook is stable.

The raised ratings reflect the city's strong budgetary performance, very strong reserve levels, and very strong economy with extremely strong market value per capita and very strong incomes, supported by very strong management policies and practices.

The city'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, on RatingsDirect, U.S. local governments are considered to have moderate sensitivity to country risk. The city's locally derived revenues are 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 revenues and U.S. local governments have independent treasury management.

The 2018A bonds are secured by the city's full faith and credit and obligation to levy unlimited ad valorem taxes on taxable property within the city. The bonds are additionally secured by special assessments against benefitted properties and tax increment revenues, but we rate to the GO pledge as we view it as the stronger pledge. Bond proceeds will be used to finance street and drainage improvements within the city as well as street and parking improvements in Tax Increment Financing District 1-6.

We rate the series 2014A bonds one notch lower than the city's general creditworthiness to account for the appropriation risk, based on the application of our Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness criteria, published Jan. 22, 2018.

The ratings reflect our assessment 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 2017;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2017 of 54% of operating expenditures;
- Very strong liquidity, with total government available cash at 1.6x total governmental fund expenditures and 5.7x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability profile, with debt service carrying charges at 28.1% of expenditures and net direct debt that is 229.5% of total governmental fund revenue, but rapid amortization, with 73.9% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Very strong economy

We consider Victoria's economy very strong. The city, with an estimated population of 8,523, is located in Carver County in the Minneapolis-St. Paul-Bloomington, Minn.-Wis., MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 202% of the national level and per capita market value of $172,587. Overall, the city's market value grew by 8.9% over the past year to $1.5 billion in 2018. The county unemployment rate was 2.9% in 2017.

The roughly 10.7-square-mile city is located in Carver County, about 25 miles southwest of the Minneapolis/St. Paul MSA, and is part of the seven-county metropolitan area. The city's tax base is primarily residential with a small commercial and industrial presence. The city has seen a sizable increase in residential development over the last few years. Prior to 2016, the three-year average of building permits issued was 598. In 2016 and 2017, building permits averaged 1,288, driven primarily by new home permits. So far in 2018, the city's building permit activity is trending positively. Due primarily to the increase in residential developments, the city is expecting continued growth in terms of economic market values and net tax capacity. Based on our assessment of the city's economic developments, we view these expectations as likely. In addition, we consider the tax base diverse, with the top 10 taxpayers representing 4.3% of net tax capacity.

In terms of employment, city residents primarily commute to the Minneapolis/St. Paul MSA for employment opportunities. Within the city, some of the leading employers include Holy Family Catholic High School (125 employees), Victoria Elementary School (95), and Bethesda Homes (50). While a majority of the residents commute, we understand that the leading employers within the city are stable.

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 city's policies and practices include:

- The use of at least three years of historical information in the formulation of the upcoming year's revenue and expenditure assumptions with the help of outside sources and a line-by-line approach to budgeting;
- Quarterly reporting of budget-to-actual performance to the council with the ability to make amendments to the budget as needed;
- A formalized long-term financial plan that looks out 10 years and is updated throughout the year;
- A formalized long-term capital plan that looks out five years, identifies sources and uses of funds, and is updated on an annual basis;
- A formalized investment management policy, with quarterly reporting of investments and holdings;
- A formalized debt management policy that restricts the city's debt limitations and refunding savings thresholds; and
- A formalized fund balance policy of maintaining at least 30% of the subsequent year's budgeted expenditures.

Strong budgetary performance

Victoria's budgetary performance is strong in our opinion. The city had operating surpluses of 12.1% of expenditures in the general fund and of 21.3% across all governmental funds in fiscal 2017. Our assessment accounts for the fact that we expect budgetary results could deteriorate somewhat from 2017 results in the near term.

These results reflect quantitative adjustments for analytic consistency, including adjustments for reoccurring transfers out of the general fund and the use of bond proceeds. For fiscal 2017 (Dec. 31), the city's primary sources of revenue included property taxes (66%) and license and permit revenues (16%). Management attributes the positive variance in the general fund primarily to the increase in licenses and permits and to the city's conservative budgeting practices.

For fiscal 2018, the city's adopted budget calls for a $50,000 general fund surplus. Based on historical performance and increased building permit revenues, we believe the city will likely end the year with a positive variance. From a total governmental standpoint, we expect the city to report a negative net result, which is primarily driven by continued capital expenditures, though once adjusted, results could be closer to break even.

Very strong budgetary flexibility

Victoria's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2017 of 54% of operating expenditures, or $2.3 million. We expect the available fund balance to remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor.

As additional flexibility, we included a committed portion of the general fund balance that is for revenue stabilization and would be available with no restrictions following a city council vote. Based on the current budget for fiscal 2018 and management's plan to maintain its reserves going forward, we believe the city's available fund balance as a percentage of expenditures will remain very strong and above 30%.

Very strong liquidity

In our opinion, Victoria's liquidity is very strong, with total government available cash at 1.6x total governmental fund expenditures and 5.7x governmental debt service in 2017. In our view, the city has strong access to external liquidity if necessary.

We believe that the city has strong access to external liquidity, having issued GO debt, which demonstrates access to capital markets. We do not expect its cash position, with respect to its total governmental expenditures and debt service, to change much during the next two years and therefore expect it to remain very strong. We understand that the city has no potential contingent liabilities that could have an adverse impact on its cash position. Regarding investments, the city invests primarily in certificates of deposit, U.S. treasuries, and state agencies. Therefore, we do not consider the city's investments aggressive.

Weak debt and contingent liability profile

In our view, Victoria's debt and contingent liability profile is weak. Total governmental fund debt service is 28.1% of total governmental fund expenditures, and net direct debt is 229.5% of total governmental fund revenue. Approximately 73.9% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor.

In our analysis we adjusted net direct debt by offsetting GO debt paid for from enterprise revenues. We understand that the city may issue an additional $6.4 million of debt in the upcoming three years for various street reconstruction projects, a new well, and a sewer project.

Victoria's pension contributions totaled 1.5% of total governmental fund expenditures in 2017. The city made its full annual required pension contribution in 2017.

The city participates in two cost-sharing multiple-employer pension plans, including the General Employees Retirement Fund (GERF) and the Public Employees Police and Fire Fund (PEPFF), which are administered by the Public Employees Retirement Assn. of Minnesota (PERA). Required pension contributions to these plans are determined by state statute. Statutory contributions rates have generally not kept pace with actuarially determined contribution (ADC) rates, indicating potential for future payment acceleration. The state recently passed pension legislation that will marginally increase contributions (for PEPFF only), reduce the investment rate of return to 7.5% (from 8%), and reduce some employee benefits (primarily cost-of-living adjustments). While we view these as positive changes for future plan funding levels, the lack of an actuarial funding policy remains a weakness in these plans. For more information about the reforms included in the 2018 omnibus retirement bill and the potential for future cost increases see our bulletin "Minnesota's New Pension Bill Is A Positive Step Toward Sustainable Funding," published June 7, 2018.

The GERF and PEPFF were 75.9% and 85.4% funded, respectively, in fiscal 2017. The city's proportionate share of the net pension liability for these plans totaled $1.4 million in fiscal 2017, the most recent year for which data are available. We consider historical plan funding levels somewhat weak, and we believe that the history of pension contributions below the ADC increases the risk of payment acceleration. Additionally, in our view, the plan's investment portfolio is exposed to significant market risk, with only 22% of its investments allocated to fixed income and cash, which increases the risk for volatility in plan funding levels. Despite these weaknesses, we believe the city has sufficient taxing and operational flexibility to manage future increases in pension contributions. However, in the future, if pension contributions absorb a larger share of the city's budget, our view of its debt and contingent liability profile could weaken.

The city also participates in the Statewide Volunteer Firefighter Retirement Plan, a multiple-employer lump-sum defined benefit plan administered by PERA. In fiscal 2017, the plan was overfunded. The city does not offer any postemployment benefits.

Strong institutional framework

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

Outlook

The stable outlook reflects our view that we do not expect to change the ratings within the next two years, given our view of the city's very strong economy, budgetary flexibility, and liquidity position, which we expect will be maintained, all supported by very strong management.

Downside scenario

We could lower the ratings if the city's budgetary performance were to decline, causing a deterioration in overall flexibility to a level that we no longer consider at least strong and no longer comparable to that of similarly rated peers, or if the city's debt burden substantially worsens.

Related Research

- 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
- 2017 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of August 6, 2018)		
Victoria GO		
Long Term Rating	AAA/Stable	Upgraded
Victoria GO		
Long Term Rating	AAA/Stable	Upgraded
Victoria GO		
Long Term Rating	AAA/Stable	Upgraded
Victoria GO		
Long Term Rating	AAA/Stable	Upgraded
Victoria GO		
Long Term Rating	AAA/Stable	Upgraded
Victoria GO tax abatement and rfdg bnds ser 2016C dtd 11/01/2016 due 02/01/2032		
Long Term Rating	AAA/Stable	Upgraded