

CREDIT OPINION

21 June 2018



Contacts

Benjamin J VanMetre +1.312.706.9951
Analyst
ben.vanmetre@moodys.com

Matthew Butler +1.312.706.9970
VP-Senior Analyst
matthew.butler@moodys.com

CLIENT SERVICES

Americas 1-212-553-1653
Asia Pacific 852-3551-3077
Japan 81-3-5408-4100
EMEA 44-20-7772-5454

Lakeville (City of) MN

Update to credit analysis

Summary

The City of Lakeville ([Aa1](#)) benefits from a large and growing tax base located in the Twin Cities metropolitan area, above average resident income indices and a healthy financial profile. The credit attributes are balanced by above average leverage related to long-term debt and pension liabilities, both of which contribute to high fixed costs.

Credit strengths

- » Wealthy and growing tax base near the Twin Cities
- » Very healthy reserves

Credit challenges

- » Above average leverage related to long-term debt and pension liabilities
- » High fixed costs

Rating outlook

Outlooks are generally not assigned to local government credits with this amount of debt.

Factors that could lead to an upgrade

- » Reduced leverage and fixed cost burden

Factors that could lead to a downgrade

- » Substantial tax base contraction or weakening of resident income indices
- » Narrowing of operating fund balance or liquidity
- » Growth in leverage or fixed costs

Key indicators

Exhibit 1

Lakeville (City of) MN	2013	2014	2015	2016	2017
Economy/Tax Base					
Total Full Value (\$000)	\$5,387,471	\$5,694,638	\$6,157,266	\$6,520,717	\$6,921,610
Population	-	57,715	58,592	59,786	61,993
Full Value Per Capita	\$94,920	\$98,668	\$105,087	\$109,068	\$111,651
Median Family Income (% of USMedian)	158.9%	160.6%	158.7%	161.1%	161.1%
Finances					
Operating Revenue (\$000)	\$29,727	\$36,278	\$35,704	\$37,269	\$39,818
Fund Balance (\$000)	\$19,916	\$24,990	\$24,918	\$28,536	\$34,238
Cash Balance (\$000)	\$41,849	\$50,605	\$39,041	\$40,163	\$33,625
Fund Balance as a % of Revenues	67.0%	68.9%	69.8%	76.6%	86.0%
Cash Balance as a % of Revenues	140.8%	139.5%	109.3%	107.8%	84.4%
Debt/Pensions					
Net Direct Debt (\$000)	\$109,605	\$114,590	\$108,220	\$115,545	\$109,802
3-Year Average of Moody's ANPL (\$000)	\$49,152	\$52,766	\$49,467	\$57,795	\$60,853
Net Direct Debt / Full Value (%)	2.0%	2.0%	1.8%	1.8%	1.6%
Net Direct Debt / Operating Revenues (x)	3.7x	3.2x	3.0x	3.1x	2.8x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	0.9%	0.9%	0.8%	0.9%	0.9%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	1.7x	1.5x	1.4x	1.6x	1.5x

Source: Moody's Investors Service, US Census Bureau, the city's audited financial statements

Profile

The City of Lakeville is located 25 miles south of downtown Minneapolis and encompasses nearly 40 square miles in Dakota County ([Aaa stable](#)). The city has 60,000 residents.

Detailed credit considerations

Economy and tax Base: large, affluent tax base near Twin Cities

The city's large tax base is expected to remain healthy due to its economic ties to the Twin Cities metropolitan area (Minneapolis, [Aa1 negative](#); St. Paul [Aa1 negative](#)), which supports the city's strong resident income indices and favorable demographic trends. Fully valued at \$6.9 billion, as measured by economic market value, the city's tax base grew at an average of 5.3% annually during the last five years and currently exceeds its pre-recession peak of \$6.4 billion in 2009. The growth in the city's tax base has largely been driven by residential development to support the city's growing population. From 1990 to 2010, the city's population more than doubled to nearly 56,000 residents and has shown continued growth in recent years. The city notes that approximately 30% of the city is available to accommodate future development.

Median family income is estimated at 161% of the national median. Underscoring the health of the Twin Cities regional economy are the city's strong employment trends, with March 2018 employment levels nearly 20% above the pre-recession peak and a low 2.4% unemployment rate.

Financial operations and reserves: healthy financial operations supported by ample reserves

The city's financial profile is expected to remain sound due to sizeable operating fund reserves and conservative budgeting practices. The city's fiscal 2017 budget included a more than \$2 million use of fund balance though positive revenue variances coupled with expenditure reductions allowed the city to close the year balanced. The city closed fiscal 2017 with an available operating fund balance

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

of \$34 million, or more than 85% of revenue across the General Fund and Debt Service Fund. Fiscal 2018 is tracking better than budget and current projections reflect a \$350,000 surplus driven by higher than budgeted building permit revenue.

Property taxes are the city's primary revenue source, comprising 62% of fiscal 2017 revenue. State levy limits are not in place for municipalities for the 2017-2019 biennium. The city receives limited state and federal aid and does not have significant reliance on economically sensitive revenues.

The city's two major enterprise funds include its Liquor Fund and the Utility Fund. The Liquor Fund accounts for operations of the city's three liquor stores, while the Utility Fund accounts for water and sanitary sewer activities. Both funds ended fiscal 2017 with healthy liquidity. Net income from the operations of the city's three liquor stores totaled \$1.2 million while net revenue for the Utility Fund totaled \$3 million. Total debt service coverage across all bonds supported by enterprise revenues exceeded 4x in fiscal 2017. Neither enterprise has relied on General Fund support.

LIQUIDITY

The city's liquidity is strong with fiscal 2017 operating cash at \$34 million, or 85% of operating revenue. Across the city's liquor and utility enterprise funds, unrestricted cash and investments totaled \$9.7 million, or nearly 300 days cash on hand.

Debt and pensions: high and growing leverage

The city's leverage related to long-term debt and pension liabilities is elevated. Inclusive of the 2018 bonds, the city has a net debt burden equal to \$109 million, or 1.6% of full value and 2.7x fiscal 2017 operating revenue. The city's adjusted net pension liability (ANPL), which we calculate using a market-based interest rate, totaled \$61 million in fiscal 2017, equal to 0.9% of full value and 1.5x operating revenue. In comparison, the city's reported net pension liability, based on the use of higher discount rates, was \$12 million.

The city's total fixed costs, consisting of debt service and retirement contributions, are high, totaling more than 30% of operating revenue. While we view this as a credit challenge, the high ratio is mitigated by the very high share of fixed costs consisting of debt service. Most of the city's debt service is supported by the authorization to levy taxes unlimited by rate or amount.

DEBT STRUCTURE

All of the city's debt is fixed rate and long term with almost 70% of outstanding principal retired within 10 years.

The city's GO bonds are secured by the city's pledge and authorization to levy a dedicated property tax unlimited as to rate and amount. The security benefits from a statutory lien, but there is no lockbox structure.

The city's lease revenue debt is secured by its pledge to pay lease payments, subject to annual appropriation.

DEBT-RELATED DERIVATIVES

The city has no debt-related derivatives.

PENSIONS AND OPEB

The city participates in two multiple-employer cost-sharing plans, the General Employees Retirement Fund (GERF) and the Public Employees Police and Fire Fund (PEPFF). Minnesota statutes establish local government retirement contributions as a share of annual payroll. The fiscal 2017 employer contribution rates were set at 7.5% of payroll for GERF and at 16.2% of payroll for PEPFF. Lakeville's fiscal 2017 pension contribution totaled approximately 4% of operating revenue.

Contributions to PEPFF from all participating governments in aggregate amounted to only 90% of the plan's "tread water" indicator in 2017. Employer contributions that tread water equal the sum of current year service cost and interest on reported net pension liabilities at the start of the year, using reported assumptions. If plan assumptions are met exactly, contributions equal to the tread water indicator will prevent the reported net pension liabilities from growing.

Other post-employment benefits (OPEB) do not represent a material credit risk for the city. The city does not offer explicit OPEB benefits, but allows retired employees to stay on its health care plan, creating an implicit rate subsidy. The city's most recent unfunded actuarial accrued liability was \$530,000.

Management and governance: strong institutional framework reflects ability to easily adjust revenues and expenditures

Minnesota cities have an Institutional Framework score of Aa, which is high. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. The sector has one or more major revenue sources that are not subject to any caps. Revenues tend to be predictable, as cities rely primarily on property taxes and 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 2017-2018 biennium. Across the sector, fixed and mandated costs are relatively high. Minnesota has public sector unions, which can limit the ability to cut expenditures. Expenditures mostly consist of personnel costs, which are highly predictable.

© 2018 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. AND ITS RATINGS AFFILIATES ("MIS") ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND MOODY'S PUBLICATIONS MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

MOODY'S CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS OR MOODY'S PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER. ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY ANY PERSON AS A BENCHMARK AS THAT TERM IS DEFINED FOR REGULATORY PURPOSES AND MUST NOT BE USED IN ANY WAY THAT COULD RESULT IN THEM BEING CONSIDERED A BENCHMARK.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing the Moody's publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any rating, agreed to pay to Moody's Investors Service, Inc. for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moody.com under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657 AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be reckless and inappropriate for retail investors to use MOODY'S credit ratings or publications when making an investment decision. If in doubt you should contact your financial or other professional adviser.

Additional terms for Japan only: Moody's Japan K.K. ("MJJK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJJK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJJK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJJK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJJK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJJK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000.

MJJK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.

Contacts

Benjamin J VanMetre
Analyst
ben.vanmetre@moodys.com

+1.312.706.9951

Matthew Butler
VP-Senior Analyst
matthew.butler@moodys.com

+1.312.706.9970

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454