S&P Global Ratings

130 East Randolph Street
Suite 2900
Chicago, IL 60601
tel 312-233-7000
reference no.: 1634871

October 7, 2020

City of Mound
5341 Maywood Road
Mound, MN 55364
Attention: Ms. Catherine Pausche, Finance Director

Re: ***US$8,915,000 City of Mound, Minnesota, (Hennepin County), General Obligation Bonds, Series 2020A, dated: November 04, 2020, due: February 01, 2036***

Dear Ms. Pausche:

Pursuant to your request for an S&P Global Ratings rating on the above-referenced obligations, S&P Global Ratings has assigned a rating of "AA" . S&P Global Ratings views the outlook for this rating as stable. A copy of the rationale supporting the rating is enclosed.

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Please send hard copies to:
S&P Global Ratings
Public Finance Department
55 Water Street
New York, NY 10041-0003

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Summary:

Mound, Minnesota; General Obligation

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Table Of Contents

Rating Action

Stable Outlook

Credit Opinion

Related Research

Summary:

Mound, Minnesota; General Obligation

Credit Profile		
US$8.915 mil GO bnds ser 2020A dtd 11/04/2020 due 02/01/2036		
Long Term Rating	AA/Stable	New
Mound taxable Go bnds ser 2013B dtd 05/02/2013 due 02/01/2014-2024		
Long Term Rating	AA/Stable	Affirmed
Mound GO rfdg bnds ser 2012B dtd 07/12/2012 due 02/01/2013-2025		
Long Term Rating	AA/Stable	Affirmed
Mound GO util & imp bnds ser 2013A dtd 05/02/2013 due 02/01/2015-2034		
Long Term Rating	AA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA' long-term rating to the City of Mound, Minn.'s $8.9 million general obligation (GO) bonds, series 2020A. At the same time, we affirmed our 'AA' long-term rating on the city's outstanding GO debt. The outlook is stable.

Securing the bonds is the city's full faith, credit, and unlimited ad valorem property tax pledge. The city anticipates that the refunding portion of the bonds will be paid entirely from net revenues from its utility systems. Proceeds from the bonds will be used to finance sewer improvement projects, the acquisition of a fire pumper truck, and the current refunding of the city's outstanding 2011B bonds.

Credit overview

The city continues to maintain very strong reserves and has recently implemented a number of additional capital reserves to build up additional funds for capital projects, and reduce future reliance on debt issuance. The city has posted two deficit operating results since fiscal 2018, which are due in part to the restructuring of its reserves. Impacts from the COVID-19 pandemic and the recession have remained relatively minimal on its finances, with revenues tracking in line with or better than previous years, though we note it is currently anticipating some impacts for future fiscal years. The economy, primarily residential, has remained relatively stable in the past few months. We note that the city continues to maintain relatively high debt service carrying charges. Given uncertainties regarding lingering effects from the COVID-19 pandemic and the recession, we believe additional impacts could still materialize on the city's finances or its economy (see: "The U.S. Economy Reboots, With Obstacles Ahead," published Sept. 24, 2020, on RatingsDirect).

Our view of the city's creditworthiness includes:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;

- Adequate budgetary performance, with operating results that we expect could improve in the near term relative to fiscal 2019, which closed with an operating deficit in the general fund but an operating surplus at the total governmental fund level in fiscal 2019;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 70% of operating expenditures;
- Very strong liquidity, with total government available cash at 88.0% of total governmental fund expenditures and 2.6x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability profile, with debt service carrying charges at 34.3% of expenditures and net direct debt that is 318.2% of total governmental fund revenue, but rapid amortization, with 81.7% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Environmental, social, and governance factors

The rating incorporates our view of the health and safety risks posed by the COVID-19 pandemic, which we consider a social risk factor according to our environmental, social, and governance framework. Absent the implications of COVID-19, we have also analyzed the city's environmental and governance risks, as they relate to its economy, finances and debt profile and believe that all are in line with sector peers.

Stable Outlook

Downside scenario

If the city's financial performance were to weaken due to imbalance or lingering effects from the recession, resulting in declining reserves no longer comparable with those of similarly rated peers, we could lower the rating.

Upside scenario

If the city's debt profile were to experience significant and sustained improvement, we could raise the rating.

Credit Opinion

Very strong economy

We consider Mound's economy very strong. The city, with an estimated population of 9,570, is located in Hennepin County in the Minneapolis-St. Paul-Bloomington, Minn.-Wis., MSA, which we consider broad and diverse. The city has a projected per capita effective buying income of 163% of the national level and per capita market value of $148,027. The city's market value grew by 7.3% over the past year to $1.4 billion in 2019. The county unemployment rate was 2.8% in 2019.

The City of Mound is located approximately 20 miles west of Minneapolis, along the western shore of Lake Minnetonka. Estimated market value has grown approximately 31.5% over the last five years, and the tax base remains primarily residential (91%), followed by commercial/industrial (6%).

Impacts from the COVID-19 pandemic and the recession have remained relatively minimal. The city's largest employers include the local school district, which is currently hiring, and the River Valley Church, which management believes has remained stable.

Despite the city being fully built out, there is ongoing residential development in terms of renovations and upgrades, which continue to support a growing tax base. The city also recently approved the sale of a downtown parcel for a Lifestyle Communities development.

Given uncertainties regarding lingering effects from the pandemic and the recession, we believe additional impacts could still materialize over the next few months.

Strong management

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

The city uses historical data and available outside sources of information when preparing budgetary forecasts. Detailed budget-to-actual reports are shared with the council monthly, and the budget can be amended as needed. The city maintains a 10-year capital improvement plan that projects capital expenses and funding sources, and is updated annually. The city maintains an investment management policy and shares monthly holdings and earnings reports with the council. The city also maintains a formal reserve policy that states the city will maintain an unassigned general fund balance of not less than 20% of budgeted operating expenditures, which was chosen for cash flow purposes. While the city does not itemize long-term operating expenditures, it does maintain a ten-year general fund levy projection. We note that the city lacks a debt management policy.

Adequate budgetary performance

Mound's budgetary performance is adequate, in our opinion. The city had deficit operating results in the general fund of 1.7% of expenditures, but a surplus result across all governmental funds of 5.0% in fiscal 2019. Our assessment accounts for our expectation budgetary results could improve from 2019 results in the near term.

Our assessment of the city's budgetary performance reflects adjustments made for recurring transfers. Primary operating revenues in fiscal 2019 included property taxes (75%) and local government aid (8%). The city historically budgets for deficits, while operating results tend to be better than budgeted.

The city reported deficit operating results for fiscal years 2018 and 2019. In fiscal 2018, the city implemented several capital reserve funds in order to maintain reserves outside of the general fund and reduce its need to issue debt in the future. The deficits in both fiscal years were primarily caused by transfers out to the capital reserve funds and to the area fire service fund.

For fiscal 2020, the city is currently budgeting a deficit result of approximately $400,000, and latest estimates are in line with the budget. Management has indicated that it intends to continue transferring to its capital reserve funds, given the very strong general fund balance. Despite the pandemic and the recession, the city has seen an increase in utility payment receipts, while property tax receipts were in line with previous years, due in part to escrowed payments. Management has identified approximately $40,000 in additional personal protective equipment and sanitation costs, but plans to get these reimbursed by the state. The city did receive approximately $704,000 in Coronavirus Aid, Relief, and Economic Security (CARES) Act funding, of which it allocated $500,000 to the school district and maintains $200,000 for city-eligible expenses and emergency assistance for individuals.

Initial budget estimates for fiscal 2021 project another deficit operating result, due in part to planned transfers, though we note that the council approved an 8% increase in the property tax levy to offset an expected drop in local government aid of approximately $90,000. In addition, the council has also approved a 5% increase in total levy, which is expected to add an additional $775,000 to the capital reserve funding.

Given potential lingering effects from the COVID-19 pandemic and the recession, we believe negative budgetary variances could materialize in the form of tax-based weaknesses or additional impacts on local government aid.

Very strong budgetary flexibility

Mound's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 70% of operating expenditures, or $3.7 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. The available fund balance includes $3.2 million (61.4% of expenditures) in the general fund and $460,000 (8.8% of expenditures) that is outside the general fund but legally available for operations.

In our assessment of budgetary flexibility, we have included cash in the city's municipal liquor fund, approximately $460,000, which can be transferred to the general fund and used for operational purposes if needed. In 2018, the city established several capital reserve funds, in which it plans to maintain reserves to pay for future capital expenditures. Management has indicated that these funds, totaling approximately $1.9 million, could be available for operational purposes if needed, though we have decided not to include these reserves in our calculation of available fund balance, given their primary purpose of funding future capital expenditures. Given the city's very strong reserves, we believe it is well situated to absorb potential additional pressures from the pandemic and the recession.

Very strong liquidity

In our opinion, Mound's liquidity is very strong, with total government available cash at 88.0% of total governmental fund expenditures and 2.6x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary.

The city has approximately $9.5 million in cash and temporary investments across governmental and business-type activities. It has demonstrated strong access to the capital markets with a history of issuing GO debt within the past 20 years. We do not consider its investments aggressive, as a majority of cash is held in certificates of deposit and money market accounts. Due to the city's strong operating performance and very strong reserves, we believe the liquidity profile will likely remain very strong.

Weak debt and contingent liability profile

In our view, Mound's debt and contingent liability profile is weak. Total governmental fund debt service is 34.3% of total governmental fund expenditures, and net direct debt is 318.2% of total governmental fund revenue. Approximately 81.7% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor.

With the issuance of the series 2020A bonds, the city will have approximately $48.6 million debt outstanding. We note that some of its GO debt is self-supported with revenue from its utility funds. Management indicates it is not currently planning any new-money debt issuance over the next two years. We believe the city's debt profile will likely remain relatively stable over the next few years.

Pension and other postemployment benefit obligations

Mound's pension contributions totaled 1.4% of total governmental fund expenditures in 2019. The city made its full annual required pension contribution in 2019.

- We do not think pension liabilities represent a medium-term credit pressure because contributions are only a modest share of the budget, and we imagine the city has the capacity to absorb higher costs without pressuring operations.
- Mound participates in two multiple-employer, defined-benefit pension plans whose funding has recently improved. The plans' statutory contributions, however, have regularly fallen short of actuarial recommendations. Along with certain plan-specific actuarial assumptions and methods, this introduces some long-term funding volatility risk and cost acceleration.

The city participates in:

- Minnesota General Employees Retirement Fund (GERF), which was 80.2% funded at June 30, 2019, and
- Minnesota Public Employees Police and Fire Plan (PEPF), which was 89.3% funded at June 30, 2019.

The city does not offer postemployment benefits.

Mound's pension contributions totaled 1.4% of total governmental fund expenditures in fiscal 2019. The city made 100% of its annual required pension contribution in fiscal 2019.

Total contributions to GERF and PEPF were 80.2% and 89.3% of our minimum-funding-progress calculation and slightly above static funding. Annual contributions reflect a statutory formula that has typically produced lower than actuarially determined contributions for these plans. In our view, this increases underfunding risk over time if the Minnesota Legislature does not make adjustments to offset future funding shortfalls.

Other key risks include a 7.5% investment rate of return assumption that indicates some cost acceleration exposure due to 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, costs remain only a modest share of total spending; in our opinion, they are unlikely to pressure the city'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

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 2019 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of October 8, 2020)		
Mound GO		
Long Term Rating	AA/Stable	Affirmed
Mound GO bnds		
Long Term Rating	AA/Stable	Affirmed
Mound GO		
Long Term Rating	AA/Stable	Affirmed