MOODY'S
INVESTORS SERVICE

Rating Update: Moody's upgrades Shakopee, MN's GO to Aa1

Global Credit Research - 19 Nov 2015

Aa1 applies to $13.8M of outstanding GO debt

SHAKOPEE (CITY OF) MN
Cities (including Towns, Villages and Townships)
MN

NEW YORK, November 19, 2015 --Moody's Investors Service has upgraded Shakopee, MN's general obligation (GO) rating to Aa1 from Aa2. The Aa1 rating applies to $13.8 million of Moody's rated GO debt.

SUMMARY RATING RATIONALE

The upgrade to Aa1 reflects the city's large growing tax base twenty five miles southwest of Minneapolis (Aa1 Stable); history of stable financial operations and ample reserve levels despite ongoing capital improvements expenditures; and modest debt burden and exposure to unfunded pension liabilities.

OUTLOOK

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

WHAT COULD MAKE THE RATING GO UP

- Substantial expansion of the city's tax base and continued strengthening of the city's demographic profile

- Increases in reserves or liquidity

WHAT COULD MAKE THE RATING GO DOWN

- Erosion of the tax base or socio economic profile

- Declines in operating reserves or liquidity

- Significant increase in the city's debt burden

STRENGTHS

- Growing local economy favorably located in the Twin Cities metro area

- Ample reserve levels

- Modest debt burden

CHALLENGES

- Substantial capital improvement spending

RECENT DEVELOPMENTS

Since our last report on December 6, 2013, the city's tax base continued to grow and appreciate in value. Total valuation grew to $3.9 billion in 2015, which is an increase of 14% over the prior year. Other recent developments are incorporated in the balance of this report.

DETAILED RATING RATIONALE

ECONOMY AND TAX BASE: LARGE GROWING TAX BASE SOUTHWEST OF MINNEAPOLIS

The city's $3.9 billion tax base (economic market value) is expected to grow in the medium term due to continued development and population growth. Located twenty five miles southwest of the City of Minneapolis (Aa1 Stable), Shakopee serves as the county seat of Scott County (Aa1). The city experienced rapid growth in the last decade. The city's population has more than tripled in the past few decades from 9,941 in 1980 to 37,076 in 2010 and is projected to reach 39,144 at the end of 2015. The city's economic market value increased by 3.9% in 2014 and 14% in 2014.

Only about 60% of the community is developed, with ample room for growth. The city is a mix of both residential (56.1% of net tax capacity) and commercial and industrial land (41.6% of net tax capacity). The city is reporting several large developments underway including the addition of a two million square-foot Amazon.com distribution facility, a new 211,000-square-foot facility for a pharmaceutical company AmerisourceBergen, and a 242,000-square-foot facility for audio-visual manufacture Milestone AV Technologies. Long-time business Rahr Malting Corp. is also expanding its corporate campus in Shakopee with the addition of a new warehouse for their Brewers Supply Group, an additional malt house, a new maintenance building and a two-story tech center.

Resident wealth levels are above the nation, with median family income at 141% of the U.S. according to the 2008 through 2012 American Community Survey estimates. The unemployment rate in Scott County was a low 2.8% in September 2015, comparing favorably to state (3.8%) and national (5.1%) rates.

FINANCIAL OPERATIONS AND RESERVES: SOLID FINANCIAL POSITION DESPITE CAPITAL IMRPOVEMENTS EXPENDITURES

We expect the city's solid financial position to continue despite some portion of reserves being allocated for capital improvements projects. In fiscal 2014, the General Fund ended with a total balance of $9.8 million, or a sizable 41% of revenues. However, a significant $2.7 million of the General Fund balance was transferred into the capital improvement fund. The city is forecasting a reduction in reserves in fiscals 2015 and 2016 of roughly $2 million each year due to transfers out of the General Fund for capital improvement projects. It is worth noting that the city's available fund balance across operating funds, which includes the city's Debt Service Fund, is $16.9 million, or a substantial 71% of revenue.

The city's primary operating revenue source is property taxes, which comprised 67% of fiscal 2014 General Fund revenues, followed by charges for services at 18% of revenues. Intergovernmental aid makes up only 5% of General Fund revenues, mitigating its exposure to any reductions in state aid.

Liquidity

In 2014, the city's net General Fund cash position was $10.3 million, or a healthy 43% of revenues.

DEBT AND PENSIONS: MANAGABLE DEBT LEVELS

The city's debt burden will increase slightly in the near term, but will remain manageable based on current borrowing plans. The city's direct and overall debt burdens are 0.4 % and 6.2% of full valuation, respectively. The city is planning to issue $31 million in debt for a construction of a community center in December 2015. This issuance will increase the direct debt burden to approximately 1.0% of full value. Once complete, the operations of the community center are going to be supported partially by the city's property tax levy as well as various facility rental fees. The city does not anticipate adding staff to support the operations. The levy for the facility will start in 2017.

Debt Structure

All of the city's direct debt is fixed rate and amortizes over the long term. Principal amortization is rapid at 97.3% retired within ten years.

Debt-Related Derivatives

The city has no derivative agreements.

Pensions and OPEB

Shakopee has a moderate employee pension burden, based on unfunded liabilities for its participation in two multiple-employer cost-sharing plans administered by the state, the General Employees Retirement Fund (GERF) and the Public Employees Police and Fire Fund (PEPFF). Moody's three-year average adjusted net pension liability (ANPL) for the city, through fiscal 2014, is $42.7 million, or 1% of full value and 1.6 times operating revenues (General Fund and Debt Service Funds). Moody's ANPL reflects certain adjustments we make to improve the comparability of reported pension liabilities. The adjustments are not intended to replace the city's reported liability information, but to improve comparability with other rated entities. We determined the city's share of liability for GERF and PEPFF in proportion to its contributions to the plans. The actuarial valuation dates for the state plans are as of June 30, 2014. The city's fiscal 2014 total contribution to the two plans was $1 million or 0.04% of operating revenues.

MANAGEMENT AND GOVERNANCE: STRONG INSTITUTIONAL FRAMEWORK

Minnesota cities have an institutional framework score of "Aa" or strong. Cities rely on property taxes to fund the majority of operations followed by state aid. State Local Government Aid (LGA) typically comprises the second largest source and ranges approximately from 0% to 80%, or on average 25% of GF revenues. The state increased aid for next biennium, after years of state aid cuts and stagnant aid. Cities typically have above average debt related expenditures. Notably, overall expenditures are predictable and cities have the ability to reduce expenditures if necessary, and benefit from unlimited operating levy authority.

The city has a history of stable financial operations with General Fund reserves remaining within its policy of maintaining 40% to 45% of expenditures in reserve for at least the last five years. It is the city's practice to transfer any excess reserves to its capital projects fund, resulting in minimal borrowing needs over the past several years and a low debt burden.

KEY STATISTICS

- 2015 Full valuation: $3.9 billion

- 2015 Estimated full value per capita: $100,249

- 2008-2012 American Community Survey median family income: 141% of US

- Fiscal 2014 Available Operating Fund balance: 67.8% of revenues

- 5-Year Dollar Change in Operating Fund Balance as % of Revenues: 21.8%

- Net operating cash balance: 70% of revenues

- 5-Year Dollar Change in Cash Balance as % of Revenues: 21.8%

- Institutional Framework: Aa

- Operating History: 5-Year Average of Operating Revenues / Operating Expenditures: 0.94x

- Net Direct Debt / Full Value: 0.4%

- Net Direct Debt / Operating Revenues: 0.6x

- 3-Year Average of Moody's ANPL / Full Value: 1.0%

- 3-Year Average of Moody's ANPL / Operating Revenues: 1.6x

OBLIGOR PROFILE

Shakopee is located 25 miles southwest of the City of Minneapolis. The city encompasses approximately 30 square miles and its resident population was 37,076 as of 2010.

LEGAL SECURITY

Debt service on all of the city's GO debt is ultimately secured by the city's GO unlimited tax pledge, which benefits from a dedicated property tax levy unlimited by rate or amount.

USE OF PROCEEDS

N/A

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was US Local Government General Obligation Debt published in

January 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

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