S&P Global
Ratings

RatingsDirect®

Summary:

Shakopee, Minnesota; General Obligation; Tax Increment

Primary Credit Analyst:
Andrew J Truckenmiller, Chicago + 1 (312) 233 7032; andrew.truckenmiller@spglobal.com

Secondary Contact:
Katelyn A Kerley, Centennial + 1 (303) 721 4683; katelyn.Kerley@spglobal.com

Table Of Contents

Summary:

Shakopee, Minnesota; General Obligation; Tax Increment

Credit Profile		
US$8.165 mil GO tax increment rev bnds ser 2020A due 02/01/2037		
Long Term Rating	AA+/Stable	New
Shakopee GO tax increment rev bnds		
Long Term Rating	AA+/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA+' rating and stable outlook to Shakopee, Minn.'s roughly $8.165 million series 2020A general obligation (GO) tax-increment revenue bonds and affirmed its 'AA+' rating, with a stable outlook, on the city's existing GO debt.

The city's full-faith-and-credit GO pledge secures the series 2020A bonds. The pledge benefits from a property tax levy, unlimited as to rate or amount. The bonds are also payable from tax-increment revenue collections within Shakopee Tax-Increment-Financing District No. 18. We, however, rate to the city's GO pledge.

Officials intend to use series 2020A bond proceeds to finance various public improvements within Tax-Increment-Financing District No. 18, Canterbury Commons.

Credit overview

Shakopee is a rapidly growing suburb southwest of Minneapolis. We view its location in the Twin Cities metropolitan statistical area (MSA) as a strength. Due to new residential and commercial-and-industrial developments, the city has seen strong market value appreciation and increased net tax capacity. We view management as strong because it has consistently posted surplus general fund results and maintained, what we consider, very strong reserves. We consider debt weak but not a rating pressure.

Due to uncertainty in the current economic environment from COVID-19 and the possible financial repercussions and pressure that could occur, in our view, Shakopee could face pressure similar to past recessions, possibly including reduced property values and intergovernmental revenue, which could lead to decreased revenue during the next few fiscal years. Even with a recession, however, we think Shakopee has sufficient financial flexibility to address uncertainties and budget pressure. Generally, our rating outlook is up to two years; due to current uncertainty surrounding COVID-19, however, our view of credit risks centers on the more-immediate effect on the fiscal 2020 budget.

The rating reflects our view of the city's:

- Very strong economy, with access to a broad and diverse MSA;

- Strong financial management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with operating results we expect could deteriorate in the near term relative to fiscal 2019, which closed with operating surpluses in the general fund and at the total governmental-fund level;
- Very strong budgetary flexibility, with available fund balance in fiscal 2019 at 52% of operating expenditures;
- Very strong liquidity, with total government available cash at 1.7x total governmental-fund expenditures and 21.8x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt-and-contingent-liability position, with debt service carrying charges at 7.9% of expenditures and net direct debt that is 103.1% of total governmental-fund revenue; and
- Strong institutional framework score.

Environmental, social, and governance factors

We have analyzed the city's environmental, social, and governance risks relative to its economy, management, financial measures, and debt-and-liability profile and determined all are in-line with our view of the sector standard.

Stable Outlook

Downside scenario

We could lower the rating if Shakopee were to experience budgetary pressure, leading to significantly decreased available reserves.

Upside scenario

Assuming no deterioration in other credit factors, we could raise the rating if income and market value per capita were to improve to levels we consider commensurate with 'AAA' rated entities or debt were to improve.

Credit Opinion

Very strong economy

We consider Shakopee's economy very strong. The city, with a population estimate of 42,641, is in Scott County in the Minneapolis-St. Paul-Bloomington MSA, which we consider broad and diverse. The city has a projected per capita effective buying income at 113% of the national level and per capita market value of $124,363. Overall, market value grew by 8.2% during the past year to $5.3 billion in fiscal 2019. County unemployment was 2.7% in 2019.

Residential properties account for 54% of the property tax base and commercial-and-industrial properties account for 44%. Shakopee Mdewakanton Sioux Community (4,200 employees) is the leading employer, with several enterprises, including two casinos. Other leading employers include:

- Seagate Technology (1,800 employees);
- Valleyfair (1,600), an entertainment park; and
- Canterbury Park (1,200), horse racing.

Market value and net tax capacity have demonstrated strong growth recently. During the past five years, economic market value has grown by nearly an average of 8% annually. Net tax capacity growth has been nearly as strong, growing by an average of 6% annually. We expect strong growth to continue because the city has many residential developments under construction and several hundred market-rate apartment in the pipeline, as well as a sizable number of commercial expansions and new buildings. The city is currently about 88% built out, but we expect it will likely continue to grow because it has an annexation agreement with one of its two neighboring townships. Shakopee's current population estimate is 42,641; the city expects it to grow to 64,000 by 2040.

Due to recent trends and ongoing development and appreciating home values throughout the MSA, we expect the tax base to continue to exhibit strong growth during the next few years. We, however, expect recessionary pressure will likely weaken some economic indicators, such as unemployment, which has historically been very low; income; and growth. We will continue to monitor the effect of these pressures on credit quality. (For more information on S&P Global Economics' latest economic forecast, please see the article, titled "An Already Historic U.S. Downturn Now Looks Even Worse," published April 16, 2020, on RatingsDirect.)

Strong management

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

Officials use, at least, three years' historical trends and outside sources of information when building the budget. During the year, management provides the city council monthly reports on budget-to-actual results; the council can amend the budget, as needed. The city conducts internal financial forecasting for the general fund that goes out 10 years, but it does not formally share it with the council; the council does not approve it either. Management maintains a five-year capital improvement plan that identifies costs and funding sources, which the city updates and the council approves annually.

Shakopee has its own investment-management policy, and management provides quarterly investment-holdings-and-earnings reports to the council. Its formal debt-management policy is somewhat more restrictive than state guidelines. The city's formal fund-balance policy calls for maintaining unassigned general fund balance between 35% and 50% of next year's budgeted expenditures for cash flow. Management has processes and plans in place to protect, prepare, and educate staff regarding cyberattacks; it maintains insurance against such attacks through the League of Minnesota Cities.

Adequate budgetary performance

Shakopee's budgetary performance is adequate, in our opinion. The city had operating surpluses at 13% of expenditures in the general fund and 9.9% across all governmental funds in fiscal 2019. Our assessment accounts for the fact that we expect budgetary results could deteriorate somewhat from fiscal 2019 results during the next few fiscal years.

We adjusted general fund expenditures to account for recurring transfers out, and we removed one-time transfers the city made to remain in compliance with its fund-balance policy. We also adjusted total governmental-funds expenditures to account for one-time capital projects and payments related to debt refunding.

After our adjustments, Shakopee closed each of the past three audited fiscal years with more than a 9% general fund surplus, which management primarily attributes to strong building permits and development-related revenue. Across total governmental funds, the city also posted positive results in fiscal 2019 after adjustments for one-time capital expenditures. Due to the city's financial history, we think it will likely continue to produce strong-to-adequate budgetary performance. We, however, think COVID-19 and the related recession pose an event risk that could increase medium-term performance volatility. We will continue to monitor the city's performance through the economic cycle. Therefore, we expect that performance results will be, at least, adequate and that they could return to strong once the pandemic and recession conclude.

The fiscal 2020 budget contains a $795,000 deficit due to the city using accumulated reserves from prior-year surpluses for capital projects. Year-to-date, management reports building permit revenue is already tracking better than budgeted. If the city achieves favorable variances compared to the budget in other areas, which we view as likely, management will transfer any excess above its fund-balance policy to other funds for one-time use. Management also expects, at least, breakeven results across total governmental funds. Due to the city's financial history, we posit these results are likely.

In fiscal 2019, property taxes generated 55% of general fund revenue while charges for services accounted for 23%, licenses and permits for 15%, and intergovernmental revenue for 5%. We note the city does not rely on any agreements with the local casino or horse track. We expect these revenue sources will likely remain relatively stable during the next two fiscal years. Due to COVID-19 and the related recession, however, we imagine these could be slightly lower than typical.

Very strong budgetary flexibility

Shakopee's budgetary flexibility is very strong, in our view, with available fund balance in fiscal 2019 at 52% of operating expenditures, or $14.1 million. We expect available fund balance will likely remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor.

Due to Shakopee's large buildup of reserves recently, history of positive general fund results, and fund-balance policy, we expect available general fund balance will likely remain very strong.

Very strong liquidity

In our opinion, Shakopee's liquidity is very strong, with total government available cash at 1.7x total governmental-fund expenditures and 21.8x governmental debt service in fiscal 2019. In our view, the city has strong access to external liquidity if necessary.

We think Shakopee has strong access to external liquidity because it has issued GO debt recently, demonstrating access to capital markets. We do not consider investment practices risky because Shakopee's formal investment-management policy restricts authorized investments to U.S. government obligations, certificates of deposit, investment-grade obligations of state and local governments and public authorities, money-market mutual funds, and local government investment pools. It does not have any direct-placement debt; it, however, has a small capital lease, which we do not view as a contingent-liquidity risk.

Adequate debt-and-contingent-liability profile

In our view, Shakopee's debt-and-contingent-liability profile is adequate. Total governmental-fund debt service is 7.9% of total governmental-fund expenditures, and net direct debt is 103.1% of total governmental-fund revenue.

Following this issuance, Shakopee will have $43 million of net direct debt outstanding. Management currently expects it could issue roughly $5 million of additional debt in 2021 for improvement projects, but nothing is certain. Despite this possible debt, we do not expect debt to change materially during the outlook. While debt went to adequate from weak, we note this is due to a marginal improvement in the carrying charge that decreased to 7.9% in fiscal 2019. With the new debt issuance, our view of the debt profile will likely revert to weak.

Shakopee's combined required pension and actual other-postemployment-benefit (OPEB) contribution totaled 4.1% of total governmental-fund expenditures in fiscal 2019. The city made its full annual required pension contribution in fiscal 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 management has the capacity to absorb higher costs without pressuring operations. Shakopee participates in two multiple-employer, defined-benefit pension plans that have seen recent funding improvements; plan 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 and cost-acceleration risk. Although the city funds OPEB on a pay-as-you-go basis, exposing it to cost acceleration and volatility, we expect medium-term costs will likely remain only a small share of total spending and, therefore, not a significant budgetary pressure.

At June 30, 2019, the city participates in:

- Minnesota General Employees' Retirement Fund (GERF), which was 80.2% funded, with the city's proportionate share of the plan's net pension liability at $5.8 million;
- Minnesota Public Employees' Police & Fire Fund (PEPFF), which was 89.3% funded, with a proportionate share of $5.5 million; and
- Shakopee's single-employer, defined-benefit OPEB plan, which is 0% funded with a net OPEB liability of $2.3 million.

Total contributions to GERF and PEPFF were 89% and 94%, respectively, of our minimum-funding-progress metric; both were slightly above static funding. Annual contributions reflect a statutory formula that has typically produced contributions lower than the actuarially determined contribution for each plan; in our view, this increases the risk of underfunding 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 for both plans, indicating 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. We imagine they are unlikely to pressure Shakopee'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
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- 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