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Ratings

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**Summary:**

# Scott County, Minnesota Scott County Community Development Agency; General Obligation

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| US$5.995 mil hsg dev rev rfdg bnds unltd tax GO (Scott Cnty) (Glendale Place Proj) ser 2017A due 02/01/2042 | | |
| *Long Term Rating* | AAA/Stable | New |

## Rationale

S&P Global Ratings assigned its 'AAA' long-term rating to the Scott County Community Development Agency (CDA), Minn.'s series 2017A unlimited-tax general obligation (GO) housing development revenue refunding bonds, which are supported by Scott County's unlimited-tax GO pledge. At the same time, we affirmed our 'AAA' rating on existing bonds backed by the county's GO pledge. The outlook is stable.

The CDA will use the proceeds to refund existing debt for interest cost savings. Scott County's unlimited-tax GO pledge secures the series 2017 bonds, and the rating reflects Scott County's GO pledge. The CDA intends to pay debt service on the bonds with a combination of net revenues of the Glendale Place Apartments and an annually appropriated portion of its special benefits tax, both of which are also pledged to payment. Pursuant to the indenture, the CDA will covenant to maintain a debt service reserve fund, which the agency anticipates it will fund at an amount equivalent to 50% of the maximum annual debt service (MADS) on the bonds. Several of the CDA's existing bond issues that we rate have multiple revenue pledges similar to those of the series 2017 bonds, though in each case we rate to the county's GO pledge.

The county's GO bonds are eligible to be rated above the sovereign because we believe the county 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 institutional framework in the U.S. is predictable for local governments, allowing them significant autonomy, independent treasury management, and no history of government intervention. Scott County's financial flexibility is demonstrated by its very strong budgetary flexibility and liquidity.

The 'AAA' GO rating reflects our view of the county's:

- 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;
- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2016;

- Very strong budgetary flexibility, with an available fund balance in fiscal 2016 of 36% of operating expenditures;
- Very strong liquidity, with total government available cash at 35.0% of total governmental fund expenditures and 5.2x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability position, with debt service carrying charges at 6.7% of expenditures and net direct debt that is 61.2% of total governmental fund revenue; and
- Strong institutional framework score.

### Very strong economy

We consider the county's economy very strong. Scott County, with an estimated population of 142,911, encompasses 375 square miles adjacent to Hennepin County. It is in the southwestern part of the Minneapolis-St. Paul-Bloomington MSA, which we consider to be broad and diverse. It has a projected per capita effective buying income of 126% of the national level and per capita market value of $122,856. Overall, market value grew by 8.1% over the past year to $17.6 billion in 2017. The county unemployment rate was 3.3% in 2016.

The county's larger communities and locus of much of its economic activity include the cities of Shakopee, Savage, and Prior Lake. While residents can access the broader MSA for employment, the county itself is home to a number of larger employers that include the Shakopee Mdewakanton Sioux Community (entertainment, employs 4,200), Amazon (fulfillment center, 2,500), Seagate Technology LLC (computer hardware, 1,800), Valleyfair (entertainment park, 1,600), and Independent School Districts Nos. 719 and 720 (serving Prior Lake-Savage and Shakopee with a combined 2,406 employees).

For assessment year 2016, the county's adjusted taxable net tax capacity consisted mainly of residential and commercial properties, which were 70% and 23%, respectively, of the total, and the county has experienced consecutive years of moderate-to-strong growth in property values over the past five years, fueled mainly by new residential and commercial developments in and around its larger cities. Given the pace of new development and the number and scope of projects currently in the pipeline, we expect to see a continuation of the recent economic development and tax base growth into the next few years, and stable-to-improving economic indicators.

### Strong management

We view the county'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 monitor all of them on a regular basis.

Highlights to the FMA include:

- Strong revenue and expenditure assumptions incorporated into the annual budget, as the county uses a priority-based budgeting model that is informed by historical trends and external data and requires the annual review and justification of expenditures;
- Quarterly budget-to-actual reporting to the county board and the ability to amend the budget as needed, though budget amendments are rare in practice;
- A five-year financial plan for the general fund that is updated annually and used as a reference point for current-year budgeting and wherein structural balance and long-term fiscal stability are goals;
- A detailed five-year capital improvement plan that is updated annually and that includes projected project costs and funding sources;
- A formal investment policy and quarterly reporting to the board on investment holdings; and

- A formal fund balance policy requiring a 25% to 30% minimum reserve to support cash flow during a normal fiscal year and to better enable the county to manage its budget during economic downturns.

The county does not currently have a debt management policy, though we understand is working on one.

### Strong budgetary performance

Scott County's budgetary performance is strong, in our opinion. The county had operating surpluses of 2.5% of expenditures in the general fund and 3.7% across all governmental funds in fiscal 2016. General fund operating results of the county have been stable over the last three years, with results of 3.1% in 2015 and 1.6% in 2014.

The county's general fund performance has been positive each year since 2009, and its results across all governmental funds have been positive in most years over the same period. For fiscal 2017 (ending Dec. 31), the county budgeted for break-even results in the general fund, and management is currently projecting an increase in unrestricted fund balance of approximately $1 million by year-end after a discretionary transfer of approximately $2 million to the capital improvement fund. We understand that the county will likely see status quo results across total governmental funds as well in 2017.

The fiscal 2018 budget has yet to be finalized and adopted, though management currently expects a levy increase sufficient to keep pace with inflation and growth related to new construction, and no major structural expenditure changes. Given the lack of any discernable sources of budgetary pressure at this time, the county's healthy and growing economic base, and management's close budget control and monitoring and long-term planning, we expect it to continue to see strong budgetary performance. The county's operating budget is funded primarily from property taxes, which accounted for 50% of fiscal 2016 general fund revenues, followed by intergovernmental revenues (34%) and charges for services (10%).

### Very strong budgetary flexibility

Scott County's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2016 of 36% of operating expenditures, or $33.5 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. Over the past three years, the total available fund balance has remained at a consistent level overall, totaling 36% of expenditures in 2015 and 35% in 2014.

The county's available (assigned and unassigned) fund balance has ranged from 35% to 36% of expenditures at the end of the past three fiscal years. Its formal reserve policy requires a minimum ending unrestricted (assigned, unassigned, and committed) fund balance of 25% to 30% of expenditures to support cash flow to provide cushion in an economic downturn, and the county has been in compliance with the policy since adopting it. Management reports no plans to draw on reserves in the next few years, and we expect the county's overall budgetary flexibility to remain very strong, with reserves at minimum in the 25% to 30% range and likely somewhat higher, as has been the case historically.

### Very strong liquidity

In our opinion, Scott County's liquidity is very strong, with total government available cash at 35.0% of total governmental fund expenditures and 5.2x governmental debt service in 2016. In our view, the county has strong access to external liquidity if necessary.

We have excluded $22 million in unavailable cash and pooled investments from the county's fiscal 2016 ending liquidity, leaving adjusted cash and investments at about $49 million. Management has indicated no major plans to draw on adjusted cash, and we accordingly expect cash levels to remain relatively stable and very strong. The county has a well-established record of issuing GO-backed debt every few years, and we believe it will continue to enjoy strong access to external liquidity. State statutes allow for what we consider the aggressive use of investments; the county's investments are primarily in U.S. government securities, certificates of deposit, and money market funds, and we do not consider its investment portfolio aggressive. The county has no contingent liabilities, direct-purchase debt, or variable-rate debt.

### Adequate debt and contingent liability profile

In our view, Scott County's debt and contingent liability profile is adequate. Total governmental fund debt service is 6.7% of total governmental fund expenditures, and net direct debt is 61.2% of total governmental fund revenue.

We understand that the county anticipates issuing approximately $65 million in GO debt in fiscal 2019 for the construction of a new health and human services center.

Scott County's combined required pension and actual other postemployment benefit (OPEB) contributions totaled 3.6% of total governmental fund expenditures in 2016. Of that amount, 2.8% represented required contributions to pension obligations, and 0.9% represented OPEB payments. The county made 100% of its annual required pension contribution in 2016.

Scott County contributes to the General Employees Retirement Fund (GERF), the Public Employees Police and Fire Fund (PEPFF), and the Public Employees Correction Fund (PECF) for pension benefits, all of which are costs-sharing, multiemployer retirement plans administered by the Public Employees Retirement Assn. of Minn. (PERA) and where benefit provisions and contribution rates are established by state statute and can only be amended by the state legislature. It also participates in the Public Employees Defined Contribution Plan (PEDCP), also administered by PERA, for three county commissioners and provides OPEBs for retired employees through a single-employer defined-benefit plan.

Using updated reporting standards in compliance with GASB Statement No. 68, the county reported its proportionate share of the net pension liability at $50.4 million for GERF and $14.4 million for PEPFF, and $8.1 million for PECF at the end of fiscal 2016. The county has also established a revocable trust to accumulate funds for OPEB's future costs. Though technically 0% funded at the end of fiscal 2016, the trust held $14.8 million in investments, compared to an actuarially accrued liability of $20.8 million. As of June 30, 2016, the PERA plan GASB valuations showed funding ratios of 68.9% for GERF, 63.9% for PEPFF, and 58.2% for PECF. While we believe these funding ratios are low and suggest inadequate funding, we also note that the county's pension costs in recent years have been modest as a share of total spending, and believe it could absorb increased costs without pressuring its budget.

### Strong institutional framework

The institutional framework score for Minnesota counties with a population greater than 5,000 is strong.

## Outlook

The stable outlook reflects our expectation that Scott County will maintain its very strong budgetary flexibility and liquidity and strong budgetary performance throughout the two-year outlook horizon. This expectation is supported by the county's demonstrated commitment to its reserve policy to maintain at least 25% of expenditures in its available general fund balance, its trend of positive operating results, and its strong financial management which includes long-term planning practices. The outlook also reflects our expectation that the county's economy will remain very strong, supported by continued growth in the tax base. Accordingly, we do not expect a rating change within the two-year outlook horizon.

### Downside scenario

Given the county's credit strengths, including a robust economy that is seeing good growth, stable and very strong finances, and strong management conditions, we do not think that planned new-money debt issuance in 2019 will be substantial enough to pressure the 'AAA' rating, though a significant increase in direct debt and fixed costs resulting in a weak or very weak debt profile and overall credit profile inconsistent with 'AAA' rated peers could pressure the rating.

## 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

| Ratings Detail (As Of November 28, 2017) | | |
|---|---|---|
| Scott Cnty GO | | |
| *Long Term Rating* | AAA/Stable | Affirmed |
| Scott Cnty GO | | |
| *Long Term Rating* | AAA/Stable | Affirmed |
| **Scott Cnty Comnty Dev Agy, Minnesota** | | |
| Scott Cnty, Minnesota | | |
| Scott Cnty Comnty Dev Agy (Scott Cnty) governmental hsg dev bnds GO | | |
| *Long Term Rating* | AAA/Stable | Affirmed |
| Scott Cnty Comnty Dev Agy (Scott Cnty) govt dev bnds unltd tax GO (Scott Cnty) (Jordan Proj) ser 2012C dtd 05/08/2012 due 02/01/2014-2022 2026 2029 20 | | |
| *Long Term Rating* | AAA/Stable | Affirmed |
| Scott Cnty Comnty Dev Agy (Scott Cnty) govt dev rfdg bnds unltd tax GO (Scott Cnty) (Northridge Proj) ser 2012B dtd 04/15/2012 due 02/01/2013-2030 203 | | |
| *Long Term Rating* | AAA/Stable | Affirmed |

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria.

Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.