S&P Global Ratings

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Summary:

Tonka Bay, Minnesota; General Obligation

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Credit Profile		
US$8.5 mil GO bnds ser 2024A due 02/01/2045		
Long Term Rating	AA/Stable	New

Credit Highlights

- S&P Global Ratings assigned its 'AA' underlying rating to Tonka Bay, Minn.'s anticipated $8.5 million series 2024A general obligation (GO) bonds.
- The outlook is stable.

Security

The series 2024A bonds are secured by a pledge of the city's full faith and credit and power to levy ad valorem taxes without limitation as to rate or amount. The bonds are further secured the city's water, wastewater, and storm sewer utility net revenues, though we rate to the GO pledge because legal provisions are insufficient to rate to the utility net revenue pledge. Proceeds will be used to finance street and utility capital projects.

Credit overview

Tonka Bay's small population boasts exceptionally strong wealth and income metrics, reflecting the city's abundance of Lake Minnetonka shoreline properties and the city's proximity to ample jobs within the Twin Cities metropolitan area. Operating results have been mixed, and we expect performance to be adequate on a forward-looking basis, with some pay-as-you-go funding of capital projects introducing volatility augmented by the city's small budget size.

To bolster the general fund after two years of deficits and facing general inflationary cost pressures, the city adopted a 13% levy increase for fiscal 2023 and a 12% increase for fiscal 2024. We expect these increases to help the city post near-balanced results and maintain its very strong budgetary flexibility. Unaudited estimates provided by management indicate a robust 8% general fund surplus for fiscal 2023, supported by the levy increase, with stable general fund cash reserves. The city's fiscal 2024 budget shows another surplus, though we expect performance to likely moderate as operating and capital costs rise.

Though the city's liquor store closed more than 15 years ago, the city maintains a small unrestricted balance in the liquor fund that is available to support operations if needed, such as in an emergency. Management indicates this balance will likely be deployed at some point, but that it has been steady in recent years and there are no plans to use the funds at this time. Our fund balance metrics include the $150,000 in available liquor fund cash.

As it proceeds with is large capital program, including this issuance, we view the city's debt profile as very weak. We note the city plans to pay a substantial portion of its series 2023A and series 2024A bond debt service with utility revenue. Should utility revenue cover the bond's debt service on a consistent basis, our assessment of the city's debt could improve, as we could adjust certain metrics for the self-supported debt.

Key credit factors include our view of the city's:

- Extraordinarily strong economic metrics for the wealthy residential lakefront city, with outstanding recent property value growth with market values rising 53% from 2018 to 2022 and net tax capacity also increasing 20% during that time.
- Fluctuating operating performance and recent deficits. We anticipate approved levy increases to support the city's ability to maintain available reserves within 40%-50% of budgeted expenditures outlined as a target by its fund balance policy. The city consistently maintains very strong total liquidity.
- Cash-basis accounting, which we consider a credit limitation as it presents a more opaque view of an entity's financial condition than accrual-basis accounting.
- Adequate management with a standard financial management assessment (FMA), and strong institutional framework. Highlights of the FMA include detailed budget-to-actual and investment reports shared with council quarterly, an adopted investment policy, a basic debt policy, and capital plans by fund updated annually extending out at least five years. The city does not maintain a multi-year operating forecast.
- Very weak debt profile given substantial debt additions, though we note the annual strain on the governmental funds will be limited by water utility revenue support. The city implemented substantial (37%) water rate increases effective for fiscal 2021 designed to enable utility revenue to cover GO bond debt service tied to utility improvements.
- Moderate pension obligations with low carrying costs. With a 76.7% plan funded ratio and annual contributions falling below our minimum funding progress metric, we do not expect current fixed-rate contribution practices to materially reduce unfunded liabilities in the near term. For more information, see "Pension Spotlight: Minnesota," published Aug. 10, 2023, on RatingsDirect.

Environmental, social, and governance

The city, like many communities around Lake Minnetonka, experienced some flooding in 2014. The city ran its pumping stations 24-hours a day for a time, and many homeowners engaged in sandbagging to protect property. Since that time, the city has implemented changes designed to ensure its infrastructure can withstand similar events, should they recur, including enhanced sewer inspection requirements whenever a home is sold, as well as instituting a regular schedule for repairing and replacing sewer mains and other infrastructure. Overall, we consider the city's environmental, social, and governance risks neutral within our credit ratings analysis.

Outlook

The stable outlook reflects our expectation that the city will maintain available reserves in accordance with its fund balance policy, and that water utility net revenue will likely help reduce the burden on governmental funds to repay substantial near-term debt additions.

Downside scenario

If the city fails to achieve consistent self-support of GO bond debt service, resulting in extremely high debt metrics for the governmental funds, or if it draws down reserves below its targeted level without quickly replenishing them, we could lower the rating.

Upside scenario

Although unexpected, we could raise the rating if the city grows available reserves to stronger levels we expect to be sustained, and if its debt burden materially moderates.

Tonka Bay, Minnesota--key credit metrics				
	Most recent	**Historical information**		
		2022	**2021**	**2020**
Very strong economy				
Projected per capita EBI % of U.S.	208			
Market value per capita ($)	608,344			
Population		1,496	1,488	1,479
County unemployment rate(%)	2.6			
Market value ($000)	910,083	743,559	669,022	640,568
Ten largest taxpayers % of taxable value	9.0			
Adequate budgetary performance				
Operating fund result % of expenditures		(6.1)	(4.1)	7.3
Total governmental fund result % of expenditures		(27.2)	2.2	13.2
Very strong budgetary flexibility				
Available reserves % of operating expenditures		51.5	56.5	58.2
Total available reserves ($000)		797	890	955
Very strong liquidity				
Total government cash % of governmental fund expenditures		96	164	106
Total government cash % of governmental fund debt service		--	--	--
Adequate management				
Financial Management Assessment	Standard			
Very weak debt & long-term liabilities				
Debt service % of governmental fund expenditures		0.0	0.0	0.0
Net direct debt % of governmental fund revenue	680			
Overall net debt % of market value	4.5			
Direct debt 10-year amortization (%)	37			
Required pension contribution % of governmental fund expenditures		1.3		
OPEB actual contribution % of governmental fund expenditures		0.0		
Strong institutional framework				

EBI--Effective buying income. OPEB--Other postemployment benefits. Data points and ratios may reflect analytical adjustments.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

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.spglobal.com/ratings for further information. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings.