

Minneapolis, Minnesota

New Issue Report

Ratings

Long-Term Issuer Default Rating AAA

New Issues

\$40,000,000 General Obligation Improvement and Variable Purpose Bonds, Series 2017 AAA
 \$40,000,000 Taxable General Obligation Sales Tax Refunding Bonds (Target Center Project), Series 2017 AAA

See Page 3 for a Full Listing of Outstanding Debt.

Rating Outlook

Stable

Related Research

Fitch Rates Minneapolis's (MN) \$80MM GO Bonds 'AAA'; Outlook Stable (April 2017)

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New Issue Summary

Sale Date: May 2, 2017.

Series: General Obligation Improvements and Variable Purpose Bonds, Series 2017, and Taxable General Obligation Sales Tax Refunding Bonds (Target Center Project), Series 2017.

Purpose: To finance various public improvements and to refund a portion of the series 2016 taxable GO sales tax revenue note issued by Minneapolis to finance a portion of the Target Center Project.

Security: Full faith and credit and unlimited ad valorem taxing power of the city.

Analytical Conclusion

The city's 'AAA' IDR and GO ratings reflect the city's favorable revenue growth prospects, broad revenue-raising powers, and superior budgetary flexibility. Debt and retiree benefit liabilities are low relative to the city's economic resource base, which Fitch believes will continue to expand rapidly given Minnesota's healthy economy and a favorable location adjoining the state capital. A track record of conservative budget practices is likely to persist. The city has sufficient budgetary flexibility to offset revenue declines in an average downturn with only limited service cuts and reserve reductions.

Key Rating Drivers

Economic Resource Base: Minneapolis is the largest city in the state of Minnesota with a 2015 population of 410,939. Along with its sister city of St. Paul, Minneapolis forms the core for the second-largest economic center in the U.S. Midwest, after Chicago. The city's broad and diverse economic base benefits from the presence of major employers in the relatively stable healthcare, higher education, and state and county government sectors. Minneapolis also has a sizable retail and financial presence, being home to Ameriprise Financial, U.S. Bancorp, and Target Corporation. Wells Fargo Bank also has a significant presence in the city.

Revenue Framework: 'aaa' factor assessment. Historical revenue growth has generally kept pace with U.S. GDP. Fitch expects this will continue to be the case given the city's growing population, low unemployment, and vibrant and diverse economy. The city's independent legal ability to raise revenues is presently strong, although Fitch notes that the state has enacted temporary tax levy caps in the past.

Expenditure Framework: 'aa' factor assessment. Fitch expects spending to grow roughly in line with, to marginally above, the pace of revenue growth. Overall flexibility of the city's main spending items is adequate given that carrying costs were somewhat elevated at 22% of expenditures in fiscal 2015, and likely to remain in this range for the near term. The city has room to reduce headcount, as staffing levels match their previous 2008 highpoint.

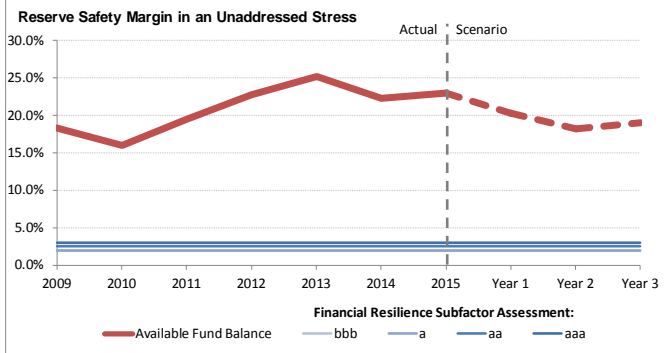
Long-Term Liability Burden: 'aaa' factor assessment. Long-term liabilities are low compared to the economic resource base, reflecting a modest level of direct debt and benefitting from steady increases in both the city's population and per capita income levels.

Operating Performance: 'aaa' factor assessment. Minneapolis's strong revenue-raising ability and satisfactory control over expenditures undergird its capacity to manage through future downturns with only minimal impairments to its financial flexibility. The city's historically low tax revenue volatility and ample reserve levels further support financial resilience. Conservative operations have resulted in consistent operating surpluses since 2010.

Minneapolis (MN)

Scenario Analysis

v. 2.0 2017/03/24



Analyst Interpretation of Scenario Results:

Fitch believes that the city is well-positioned to face the challenges associated with a moderate economic downturn. Fitch calculates a low level of estimated revenue volatility within the city's general fund based on 16 years of historical data. A 1% decline in US GDP would lead to a scenario general fund revenue decline of 1%. In Fitch's view, the city's broad revenue-raising flexibility and adequate spending controls would allow the administration to quickly close the resulting budget gap, likely with minimal to no use of fiscal reserves to bridge the shortfall.

Scenario Parameters:

	Year 1	Year 2	Year 3
GDP Assumption (% Change)	(1.0%)	0.5%	2.0%
Expenditure Assumption (% Change)	2.0%	2.0%	2.0%
Revenue Output (% Change)	(1.0%)	2.5%	5.1%
Inherent Budget Flexibility	High		

Revenues, Expenditures, and Fund Balance	Actuals							Scenario Output		
	2009	2010	2011	2012	2013	2014	2015	Year 1	Year 2	Year 3
Total Revenues	359,255	346,119	352,596	384,195	382,543	464,007	455,883	451,324	462,391	485,894
% Change in Revenues	-	(3.7%)	1.9%	9.0%	(0.4%)	21.3%	(1.8%)	(1.0%)	2.5%	5.1%
Total Expenditures	326,089	331,296	330,958	338,706	354,182	386,216	397,090	405,032	413,132	421,395
% Change in Expenditures	-	1.6%	(0.1%)	2.3%	4.6%	9.0%	2.8%	2.0%	2.0%	2.0%
Transfers In and Other Sources	28,036	22,673	30,000	10,268	13,868	2,323	4,258	4,215	4,319	4,538
Transfers Out and Other Uses	42,623	44,401	40,629	41,658	30,616	74,645	59,499	60,689	61,903	63,141
Net Transfers	(14,587)	(21,728)	(10,629)	(31,390)	(16,748)	(72,322)	(55,241)	(56,474)	(57,584)	(58,603)
Bond Proceeds and Other One-Time Uses	-	-	-	-	-	-	-	-	-	-
Net Operating Surplus(+)/Deficit(-) After Transfers	18,579	(6,905)	11,009	14,099	11,613	5,469	3,552	(10,181)	(8,326)	5,896
Net Operating Surplus(+)/Deficit(-) (% of Expend. and Transfers Out)	5.0%	(1.8%)	3.0%	3.7%	3.0%	1.2%	0.8%	(2.2%)	(1.8%)	1.2%
Unrestricted/Unreserved Fund Balance (General Fund)	67,340	60,092	72,335	86,298	96,970	102,439	104,740	94,559	86,233	92,129
Other Available Funds (Analyst Input)	-	-	-	-	-	-	-	-	-	-
Combined Available Funds Balance (GF + Analyst Input)	67,340	60,092	72,335	86,298	96,970	102,439	104,740	94,559	86,233	92,129
Combined Available Fund Bal. (% of Expend. and Transfers Out)	18.3%	16.0%	19.5%	22.7%	25.2%	22.2%	22.9%	20.3%	18.2%	19.0%
Reserve Safety Margins	Inherent Budget Flexibility									
		Minimal	Limited	Midrange	High	Superior				
	Reserve Safety Margin (aaa)	16.0%	8.0%	5.0%	3.0%	2.0%				
	Reserve Safety Margin (aa)	12.0%	6.0%	4.0%	2.5%	2.0%				
	Reserve Safety Margin (a)	8.0%	4.0%	2.5%	2.0%	2.0%				
Reserve Safety Margin (bbb)	3.0%	2.0%	2.0%	2.0%	2.0%					

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's downturn scenario assumes a -1.0% GDP decline in the first year, followed by 0.5% and 2.0% GDP growth in Years 2 and 3, respectively. Expenditures are assumed to grow at a 2.0% rate of inflation. Inherent budget flexibility is the analyst's assessment of the issuer's ability to deal with fiscal stress through tax and spending policy choices, and determines the multiples used to calculate the reserve safety margin. For further details, please see Fitch's US Tax-Supported Rating Criteria.

Rating History

Rating	Action	Outlook/ Watch	Date
AAA	Affirmed	Stable	9/27/16
AAA	Affirmed	Stable	6/27/06
AAA	Affirmed	Negative	12/3/02
AAA	Assigned	—	6/18/99

Outstanding Debt

(900 Nicollet Mall) General Obligation Tax Increment Refunding Bonds	AAA
(Downtown East Office/Housing/Park Industrial Development District) General Obligation Bonds (Taxable)	AAA
(Heritage Park) General Obligation Tax Increment Bonds	AAA
(Heritage Park) General Obligation Tax Increment Refunding Bonds	AAA
(Laurel Village) General Obligation Tax Increment Refunding Bonds	AAA
(Midtown Exchange) General Obligation Tax Increment Bonds	AAA
(Milwaukee Depot) General Obligation Tax Increment Refunding Bonds	AAA
(St. Thomas/WMEP Parking Ramp) General Obligation Tax Increment Refunding Bonds	AAA
(Target Center Project) General Obligation Tax Increment Refunding Bonds (Taxable)	AAA
(West Side Milling) General Obligation Tax Increment Refunding Bonds (Taxable)	AAA
General Obligation Convention Center Bonds	AAA
General Obligation Convention Center Refunding Bonds	AAA
General Obligation Convention Center Refunding Bonds (Taxable)	AAA
General Obligation Improvement and Variable Purpose Bonds	AAA
General Obligation Improvement Bonds	AAA
General Obligation Library Bonds	AAA
General Obligation Library Referendum Refunding Bonds	AAA
General Obligation Parking Assessment Bonds	AAA
General Obligation Parking Assessment Refunding Bonds	AAA
General Obligation Parking Ramp Bonds	AAA
General Obligation Refunding Bonds	AAA
General Obligation Tax Increment Bonds	AAA
General Obligation Tax Increment Bonds (Taxable)	AAA
General Obligation Tax Increment Refunding Bonds	AAA
General Obligation Variable Purpose Limited Tax Bonds	AAA
General Obligation Variable Purpose Refunding Bonds	AAA
General Obligation Various Purpose Bonds	AAA
General Obligation Various Purpose Refunding Bonds	AAA
General Obligation Various Purpose Park Bonds (Taxable)	AAA
General Obligation Block E Refunding Bonds (Taxable)	AAA
General Obligation Housing Improvement Area Bonds (Taxable)	AAA
General Obligation Pension (MPRA) Bonds (Taxable)	AAA
General Obligation Pension Bonds (MERF)	AAA

Rating Sensitivities

Growth in the Liability Burden: The rating is sensitive to material growth in long-term liabilities that outstrip the pace of expansion in the city’s economic resource base.

Enactment of Revenue-Raising Constraints: The rating is sensitive to constraints that higher levels of government (i.e. the state of Minnesota) could place on the city’s future revenue-raising ability by enacting tax rate and/or levy caps. Such measures would be analyzed for their impact on the city’s budget flexibility and could place negative pressure on the rating.

New Issue Details

\$40,000,000 General Obligation Improvement and Various Purpose Bonds, Series 2017, and \$40,000,000 Taxable General Obligation Sales Tax Refunding Bonds (Target Center Project), Series 2017, are scheduled to sell competitively on the morning of Tuesday, May 2. Proceeds of the tax-exempt series will finance various public improvements and capital projects in the city. Proceeds of the taxable series will be used to refund a portion of the series 2016 taxable GO sales tax revenue note issued by the city on March 23, 2016 to fund a portion of the Target Center Project.

Related Criteria

[U.S. Tax-Supported Rating Criteria \(April 2016\)](#)

Credit Profile

Minneapolis’s economy is extremely diverse. Major employers include entities active in the fields of healthcare, banking, higher education, and the retail trade. The city also includes a significant public-sector presence. The five largest employers are the University of Minnesota

(14,400), Wells Fargo Bank (11,000), Fairview Health Services (10,200), Target Corporation (9,500), and Allina Health (9,400).

The city's employment base is strong with a rapidly growing work force. The city replenished all of the jobs it lost during the recession by the start of 2011 and the workforce has been expanding rapidly ever since. Unemployment in the city has historically tracked below the U.S. average, but has been far below the U.S. rate in recent years. A substantial 48% of the city's population holds a bachelor's degree or higher compared to 31% for the U.S. Like many other large U.S. cities, Minneapolis's 19.5% poverty rate is noticeably above the U.S. rate of 14.7%.

Revenue Framework

The largest general fund revenue sources in 2015 were property taxes (34%) and state aid (18%). Minor sources of revenue include sales and other taxes (18%), service charges (10%), and fees and fines (10%). Property taxes have risen markedly since 2004, but registered modest growth between 2011 and 2015 as the city focused on keeping the levy flat to provide tax relief to residents. Local sales, entertainment, and hotel taxes have risen at a level approaching 4% per annum since 2000.

Fitch estimates the city's 10-year general fund revenue growth rate through 2015 at roughly 3.2% per annum after adjusting for accounting changes made in fiscal 2014 that resulted in sales and entertainment tax revenue streams previously recorded in the convention center fund being shifted permanently to the general fund. Because this relatively healthy growth history — slightly below the rate of U.S. GDP — includes several years when the city held the levy relatively flat, Fitch believes general fund revenues are likely to expand at a slightly faster pace. In light of the city and state's impressive post-recession recovery, Fitch anticipates general fund revenues will continue to rise at, or above, the rate of U.S. GDP expansion.

Significant new residential and commercial construction in various neighborhoods, including downtown, is having a positive impact on city revenues. Building permit values have been above \$1 billion annually since 2012 and experienced an historic peak in 2014 at \$2 billion versus \$750 million three years prior. Assessed value (AV) has also rebounded following several years of decline following the recession. AV grew 2% in 2014 and by 10% in each of 2015 and 2016. They are projected to rise another 7% to 9% in 2017. The fiscal 2017 budget includes a 5.5% tax levy increase to take advantage of rising AV. Sales and entertainment taxes will likely continue to rise at historical levels approaching 4%.

The city's independent legal authority to increase revenues is essentially unlimited given the absolute authority vested in the mayor and city council to increase the property tax levy, along with service charges, user fines, and fees. Together, these revenue sources account for more than 50% of the general fund budget.

In the past, Minnesota has enacted statewide limits to the property tax levies of its local governments. These limits have been temporary in nature, generally expiring after one year. The levy limitations have never been applied to taxes levied to pay debt service. There is no guarantee that the state will not enact similar levy limits in the future or enact limits of a more permanent nature. Minnesota has, on occasion, enacted multiyear property tax levy caps — most recently for fiscal years 2009 to 2011. The longest such period of multiyear caps was from 1972 to 1992 when the tax levy caps were repealed.

Expenditure Framework

The city provides a broad array of services to residents, including police and fire protection, waste removal, water and sewer service, and public parks and recreation. Public safety was the largest general fund expenditure item at 59% of spending in 2015. General government (17%), public works (13%), and economic development (8%) are the other major general fund spending categories. Capital spending is handled primarily out of a separate permanent improvement fund and major public services such as water and sewer each utilize separate enterprise funds.

Fitch believes spending demands are likely to grow at a pace approximately equal to, or slightly above, the natural rate of revenue growth. The city is budgeting for annual salary increases that are slightly above the rate of inflation across all bargaining units in its multiyear projections. Salary growth in this range would be consistent with Minneapolis's recent history. Employee benefit costs linked to health insurance will most likely grow faster than inflation, however.

Fitch regards the flexibility of Minneapolis's main expenditure items as adequate. The city has moderately high carrying costs that approximate 22% of total governmental spending. Carrying costs include spending for debt service, pension contributions, and other post-employment benefits (OPEB). Fixed costs are set to rise in fiscal 2017 and 2018 due to large principal payments scheduled for those years, but are scheduled to drop off considerably beginning in fiscal 2019. In light of the city's high near-term fixed expenditures and planned new debt issuance, Fitch believes Minneapolis's spending flexibility will remain satisfactory, but below that of some peers.

Minneapolis has contracts with 23 bargaining units representing 93% of full-time employees. Public safety makes up 40% of the unionized workforce. Police and fire fighters do not have the right to strike under Minnesota law, but most other collective bargaining units do, including clerical, technical, and maintenance workers. Recent contracts included annual salary increases that were slightly above the rate of inflation. All units have access to binding arbitration under the Minnesota labor statute and arbitrators have to consider economic conditions and their impact on municipal finances.

Roughly 26% of Minneapolis's \$927 million five-year capital program is funded with internal cash resources including fund balances, 45% is bond funded, and 28% is financed from other sources including state and federal grants. The cash-funded portion of the city's capital improvement plan (CIP) represents an area of budgetary flexibility for Minneapolis, as management would be able to reduce capital funding in the event of a recession in order to support recurring operations and conserve fund balances.

Long-Term Liability Burden

Minneapolis's long-term liability burden is low compared to the size and affluence of its economic resource base. The city's combined contractual pension liabilities and net overall debt will account for approximately 9% of the combined resident personal income following the current bond issuance. Total debt is split almost evenly between the net direct debt of the city after factoring out debt supported by user fees and \$604 million in overlapping debt issued by Hennepin County, the Minneapolis school district, and several smaller taxing jurisdictions. Amortization of direct debt is rapid, with 83% scheduled to be retired within 10 years.

The city's five-year 2017–2021 CIP identifies \$927 million in projects, the majority of which (55%) will be financed using a combination of internal resources and state and federal grants. The remaining 45% will be debt-financed with an estimated \$200 million of GO bonds following this sale and \$160 million of revenue bonds. New debt supported by the general fund will be

issued in increments of about \$47 million per annum, which is less than the amount of principal maturing in each fiscal year through 2021. Fitch therefore expects Minneapolis's long-term liability metric to improve over time. Rapid population and personal income growth should also push the metric lower.

Nearly half of Fitch's total long-term liability metric for Minneapolis consists of employee pension liabilities. The city merged its closed police and fire pension funds into the state pension plan several years ago and most current employees are also members of the Minnesota-run Public Employees Retirement Association (PERA), which is divided into several subplans in which employees participate. Minneapolis also participates in the Minnesota Teachers' Retirement Association (TRA) plan as a non-employer contributing entity. The aggregate assets-to-liabilities ratio for all plans was 82% as of June 2015 using a 7.9% rate of return assumption. Using a more conservative 7% rate of return assumption, Fitch estimates the combined assets-to-liabilities ratio of the plans at 75% on the same date. The adjusted unfunded liability for all plans is \$953 million, as per Fitch's calculation.

Annual funding of PERA and TRA is done on a statutory basis, with contributions equal to a percentage of payroll and adjusted gradually upwards to achieve full funding of the various plans in 25 years, or less, depending on the plan. The city expects its employer contributions to increase continually, at a modest rate, in order to reach these state-mandated funding targets. Fitch believes the city has adequate spending flexibility to absorb these cost increases, which have ranged around 5% per annum since 2010.

Operating Performance

Fitch believes that the city is well-positioned to face the challenges associated with a moderate economic downturn. For details, see "Scenario Analysis" on page 2.

After a \$3.6 million operating surplus after transfers in 2015, the available general fund balance equaled \$105 million, equal to nearly 23% of spending. Higher than budgeted building-permit fees and sales tax overperformance drove the surplus as did below-budget police overtime and snow removal costs. Management had also achieved a \$5.5 million operating surplus in 2014 after budgeting \$13 million of reserves to balance the budget. The city has a solid track record of conservative budgeting and cautious revenue estimates. It achieved five consecutive operating surpluses between 2011 and 2015.

The 2016 budget was balanced with a 3.4% property tax levy increase and included the planned use of \$28 million of general fund reserves to fund a variety of capital projects, including repair of a city bridge. Management estimates that the city achieved an \$18.8 million surplus as of 2016 fiscal year-end (Dec. 31), of which \$17.5 million was restricted for use in fiscal 2017. Unassigned general fund balance reportedly finished fiscal 2016 at \$107.5 million, or about 22% of expenditures. The 2017 adopted budget includes a 5.5% property tax levy increase across all funds (10% for the general fund) and the use of \$5.5 million of fund balance as a contingency.

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