MOODY'S INVESTORS SERVICE

CREDIT OPINION
25 February 2022

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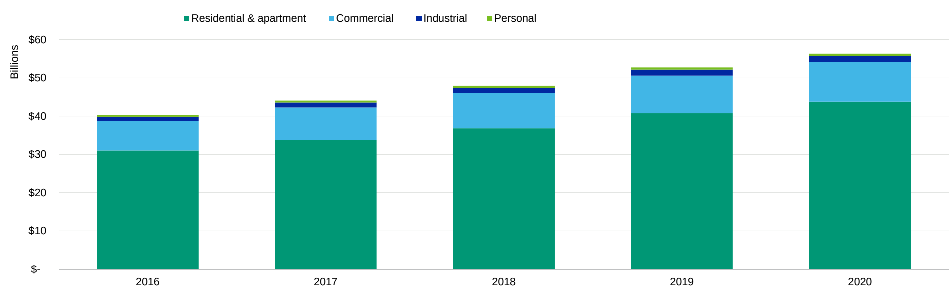
Minneapolis (City of) MN

Update to credit analysis

Summary

The City of Minneapolis' (Aa1 stable) strong financial position was unscathed by temporary pandemic-related budget pressures, as it implemented timely expenditure controls and received an influx of federal aid. General fund reserves will remain very healthy after draws in fiscal 2021 and fiscal 2022, which includes the costs for a legal settlement with the family of George Floyd and the funding of other nonrecurring expenditures. The city is well positioned for continued stability given its position at the center of a strong regional economy and a steadily growing tax base (see Exhibit). The primary constraint on the credit profile is its elevated pension burden and significant fixed costs.

Exhibit 1
Growing residential tax base driving full value growth
Assessed value by class



Source: Issuer Financial Statements, Moody's Investors Service

Credit strengths

» Institutional presence and diverse employment opportunities that support strong labor market trends

» Very healthy reserve position supported by strong financial management practices including comprehensive multiyear budgeting

Credit challenges

» Elevated pension burden and fixed costs

Rating outlook

The stable outlook is based on the expectation that reserves will remain very strong because of an influx of federal aid, growing local revenue and minimal planned fund balance draws. Also considered is the city's resilient economic base and an expectation that leverage will not materially increase.

Factors that could lead to an upgrade

» Moderation of leverage and fixed costs

Factors that could lead to a downgrade

» Substantial decline in reserves and liquidity

» Significant increase in leverage and fixed costs

Key indicators

Exhibit 2

Minneapolis (City of) MN

	2016	2017	2018	2019	2020
Economy/Tax Base					
Total Full Value ($000)	$43,273,457	$47,235,358	$52,332,573	$55,385,306	$58,139,146
Population	404,670	411,452	416,021	420,324	420,324
Full Value Per Capita	$106,935	$114,802	$125,793	$131,768	$138,320
Median Family Income (% of US Median)	107.5%	110.4%	111.6%	112.4%	112.4%
Finances					
Operating Revenue ($000)	$536,077	$563,422	$570,861	$653,516	$616,438
Fund Balance ($000)	$143,013	$151,910	$133,963	$152,952	$167,987
Cash Balance ($000)	$161,647	$168,713	$152,824	$184,326	$224,096
Fund Balance as a % of Revenues	26.7%	27.0%	23.5%	23.4%	32.4%
Cash Balance as a % of Revenues	30.2%	29.9%	26.8%	28.2%	36.4%
Debt/Pensions					
Net Direct Debt ($000)	$530,367	$538,345	$518,470	$557,370	$757,328
3-Year Average of Moody's ANPL ($000)	$2,283,450	$2,488,404	$2,497,351	$2,276,215	$2,052,573
Net Direct Debt / Full Value (%)	1.2%	1.1%	1.0%	1.0%	1.3%
Net Direct Debt / Operating Revenues (x)	1.0x	1.0x	0.9x	0.9x	1.2x
Moody's — ANPL (3-yr average) to Full Value (%)	5.3%	5.3%	4.8%	4.1%	3.5%
Moody's — ANPL (3-yr average) to Revenues (x)	4.3x	4.4x	4.4x	3.5x	3.3x

Sources: US Census Bureau, Minneapolis (City of) MN's financial statements and Moody's Investors Service

Profile

The City of Minneapolis is located in Hennepin County (Aaa stable), in southeastern Minnesota (Aa1 positive). The city is directly west of St. Paul (Aa1 stable), with the Mississippi River creating the border between the two cities. With a population that exceeds 420,000 residents, it is the largest city in the state.

Detailed credit considerations

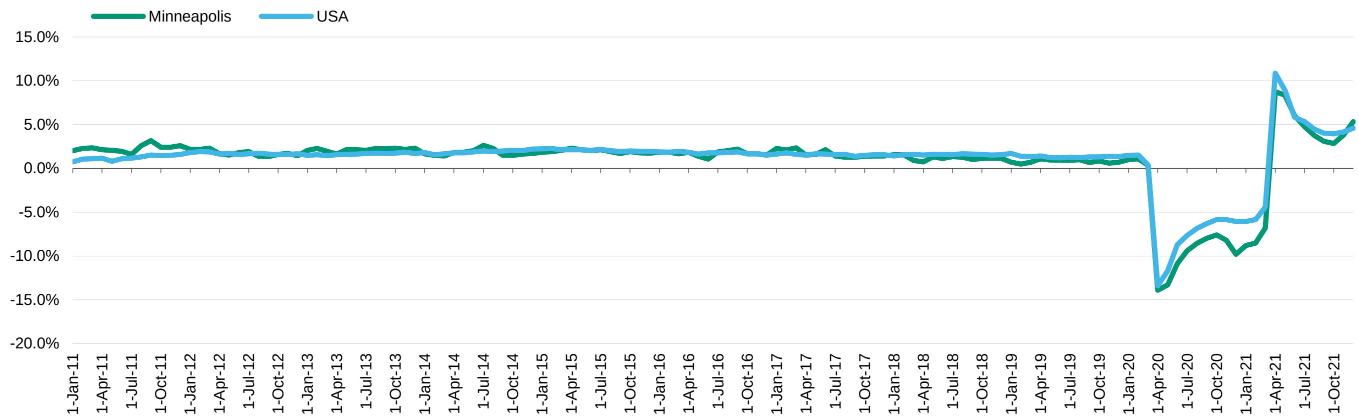
Economy and tax base: strong regional economy

Minneapolis benefits from its role at the center of a sizable regional economy. The city is home to a highly educated labor force with major research institutions and corporate headquarters. The largest employers include the University of Minnesota (Aa1 stable), Allina Health System (Aa3 negative), Fairview Health Services (A3 negative), and Target Corporation's (A2 stable) headquarters. The city's unemployment rate of 2.5% is well below the national rate, but the workforce declined at slightly greater than the nation during the onset of the coronavirus (see Exhibit) and has not yet recovered to pre-pandemic levels.

Exhibit 3

Employment dropped at a slightly greater rate than the US, but is recovering in line with the nation

Month over month change in employment



Source: U.S. Bureau of Labor Statistics (BLS): Current Employment Statistics (CES)

Despite its role as the center city of the metropolitan area, most the city's tax base is residential property. The nationwide trend of appreciating home values should support continued growth of the city's tax base for at least the next year or two.

Financial operations and reserves: very healthy finances to continue

The city's reserves will remain very strong because of an influx of federal aid, growing local revenue and minimal planned draws. The city posted a large general fund surplus of nearly $40 million in fiscal 2020 because of $32 million in federal aid, a debt refinancing (see debt section for details) and two rounds of expenditure reductions. Neither audited financial statements or firm estimates are yet available for fiscal 2021, but officials report that the most recent projections indicated that fund balance would decline by no more than $34 million, driven mainly by a $27 million transfer to the self-insurance fund to finance a settlement agreement with George Floyd's family. The fiscal 2022 budget includes the use of $17 million in general fund balance for nonrecurring expenses. The city usually draws less from fund balance than what is budgeted because of conservative expenditure assumptions. Even if the two years of draws are fully realized, fund balance would remain very healthy.

About half of operating fund revenue is generated from property taxes. The city is not subject to any property tax caps and is showing a willingness to steadily increase revenue with a 5.45% increase budgeted in fiscal 2022 and plans to continue to increase the levy at around 5% through fiscal 2027. State aid comprises about a quarter of revenue. Distributions have been stable for several years and are expected to remain so.

The city's sales taxes are deposited into the downtown asset fund, which is dedicated to capital and economic development including an annual transfer to the general fund that can be upward of $20 million. Receipts declined in fiscal 2020 and 2021 because of pandemic pressures (see Exhibit). Sales tax receipts were also reduced beginning in 2021 because revenues were diverted for debt service payments for US Bank Stadium. The city is likely to experience positive variances in sales tax revenue in fiscal 2021 and fiscal 2022 because it budgeted conservatively for receipts.

Exhibit 4
Sales tax receipts conservatively budgeted in fiscal 2021 and fiscal 2022
Downtown asset benefit fund revenue (primarily sales tax with some entertainment, food, liquor and lodging tax revenue)

Source: Minneapolis open government website

The city was allocated a substantial $271 million through the American Rescue Act Plan (ARPA), which it is using for revenue replacement to offset most estimated revenue losses experienced in 2020 ($119 million), additional resources for the Community Planning and Economic Development Fund ($65 million) and for other initiatives.

Liquidity

The city has ample liquidity with well over $200 million, or 36% of revenue in cash across the general fund and debt service fund. Total liquidity across all operating funds $631 million, with the cash primarily held in the Community Planning and Economic Development Fund and the Permanent Improvement Fund. The former is dedicated to housing and economic development, with revenue generated from tax increment, administrative fees, rents and land sales. The latter is dedicated to capital and is financed by a combination of bond proceeds, and state and federal aid. Over $150 million is held in the internal services funds.

The city's major enterprise funds include sanitary sewer, stormwater, water treatment, municipal parking, solid waste and community planning. Cash is sound in those funds with nearly a half a years of expenses in reserve, but have been declining the last few years because of capital expenditures. Officials project cash will increase across enterprise funds in fiscal 2021.

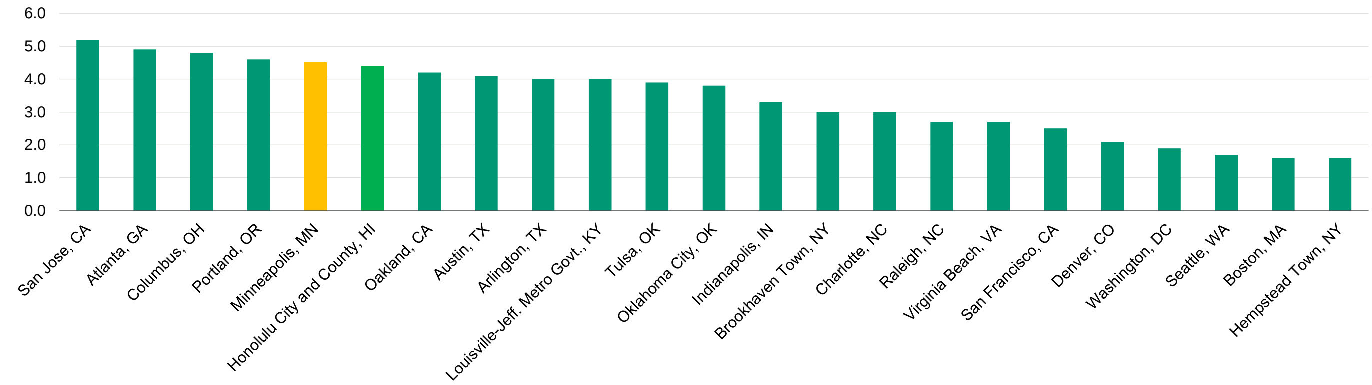
Debt and pensions: elevated leverage is due primarily to unfunded pension liabilities

Minneapolis' elevated leverage could moderate over many years if steady revenue growth continues, debt issuances are restrained and pension contributions remain adequate to stem liability growth. The city's fixed costs, inclusive of debt service and retirement contributions consume around 30% of revenue. Its overall leverage is high relative to sector medians and to cities of similar size and rating level (see Exhibit). The city issues GO bonds annually in the spring for capital projects that can range from $50 million to $100 million.

Exhibit 5

Leverage is above median of peers

Debt and ANPL compared to revenue of Aaa, Aa1 and Aa2 rated cities with similar sized populations



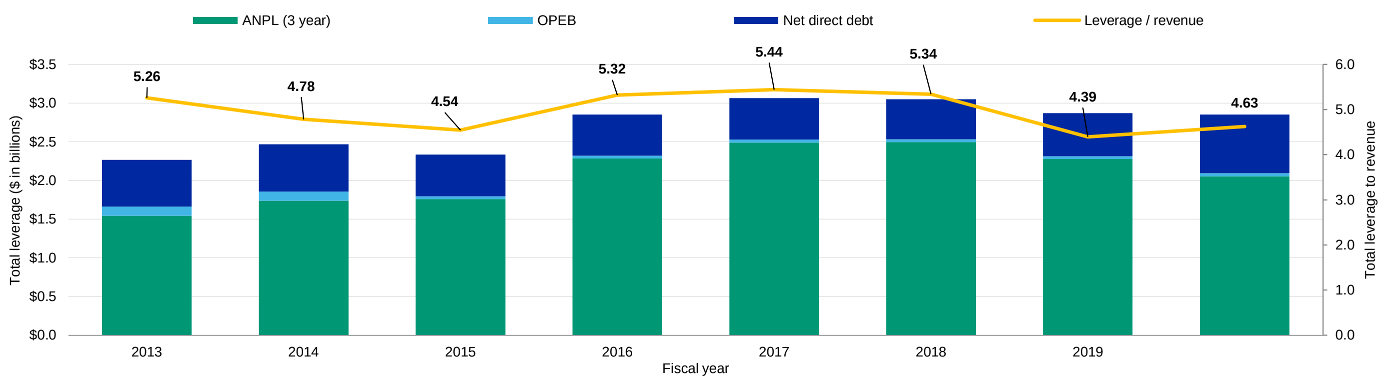
Source: Moody's MFRA

The city's leverage is primarily from pensions (see Exhibit)

Exhibit 6

Minneapolis' total leverage decreased after 2016 spike, but remains high

ANPL, OPEB and net direct debt / operating revenue



Source: issuer financial statements, Moody's Investors Service

Legal security

Minneapolis' GO bonds are secured by the city's full faith and credit pledge to levy a dedicated property tax unlimited as to rate and amount.

Debt structure

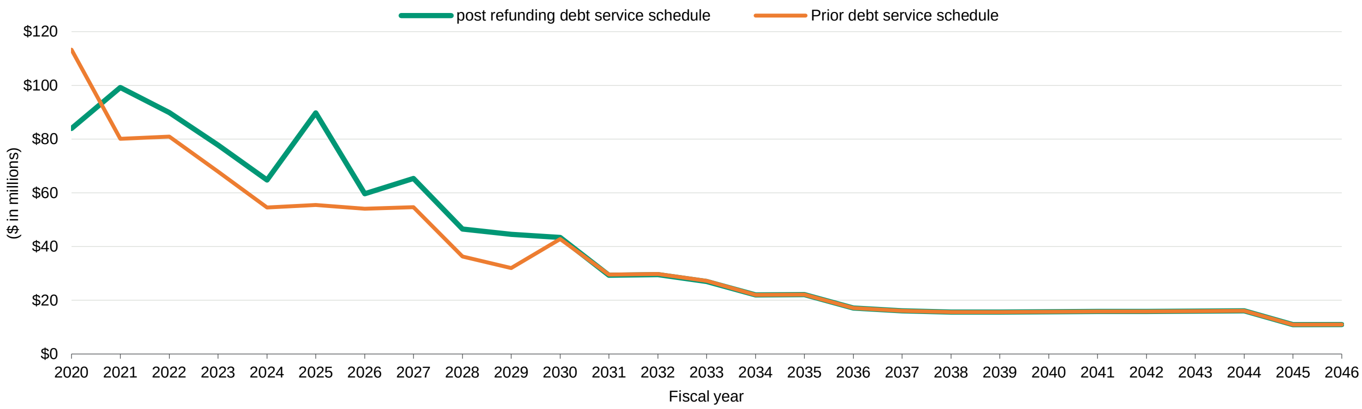
The city's debt service schedule is rapidly descending. Future bond issuances will be wrapped around the current schedule so there is not likely to be a rapid drop in fixed costs. Still, the descending schedule is credit positive because it provides the city with flexibility in structuring future bonds issuances. The city tapped that flexibility in 2020 when it issued refunding bonds that changed the timing of some debt service payments to reduce costs in the uncertainty of pandemic. Such debt-based budget relief maneuvers can be an indicator of stress, but Minneapolis implemented the transaction out of an abundance of caution and amortization of debt remained rapid post-issuance.

The city has modest exposure to variable rate risk consisting of one series of GO variable rate bonds (2011B bonds) that is equal to about 3% of total outstanding GO debt. The variable rate debt stems from a direct purchase loan with US Bank (A1 stable). Per the term loan agreement, rates are reset the first of every week and are equal to 30% of the SIFMA index plus a spread based on the city's GO rating. The city has ample liquidity, which mitigates the risks of unbudgeted increases in interest rates.

Exhibit 7

City's quickly descending debt service schedule provides flexibility to address future capital needs

Minneapolis debt service schedule



Source: City of Minneapolis

Debt-related derivatives

The city is not a party to any debt-related derivatives.

Pensions and OPEB

The city participates in two multiple-employer cost-sharing plans, the General Employees Retirement Fund (GERF) and the Public Employees Police and Fire Fund (PEPFF) that are administered by the public employee retirement association (PERA). Most employees hired before 1980 are covered by one of three closed pension plans that were subsequently merged into the state plans. The Minneapolis Employees Retirement Fund (MERF) merged into GERF in 2015. The Minneapolis Police Relief Association (MPRA) and Minneapolis Fire Relief Association (MFRA) were absorbed into the PEPFF plan in 2011.

Minnesota statutes establish local government retirement contributions as a share of payroll. The 2020 employer contribution rates were set at 7.5% of payroll for GERF and at 16.95% of payroll for PEPFF. In addition to those contributions, the city is required to make fixed contributions for the closed plans through 2031. Those extra contributions result in the city's allocation of unfunded pension liabilities reported by PERA being higher than they otherwise would be. If payments stop in 2031 as outlined in current statute, the city's reported unfunded pension obligations, and our adjusted net pension liability (ANPL) will decline. The ANPL of nearly $2 billion is based on a 2.7% discount rate. The city's reported net pension liability based on PERA's employers' allocation reports and a 7.5% discount rate, is under $500 million.

The contributions to PERA from all participating governments in aggregate, exceeded 100% of each plan's "tread water" indicator in 2020, meaning that under plan assumptions contributions were sufficient to stem unfunded liability growth. Minneapolis has established reserves which it calls its pension contingency fund in an attempt to mitigate budget pressure should increased pension contributions be required by the state. Those reserves are held within the employee retirement fund, which had a cash balance of $23 million at the close of fiscal 2020.

ESG considerations

MINNEAPOLIS (CITY OF) MN's ESG Credit Impact Score is Positive CIS-1

Exhibit 8
ESG Credit Impact Score

CIS-1
Positive

For an issuer scored CIS-1 (Positive), its ESG attributes are overall considered as having a positive impact on the rating. The overall positive influence from its ESG attributes on the rating is material.

Source: Moody's Investors Service

Minneapolis' ESG Credit Impact Score is positive (**CIS-1**), reflecting positive social attributes, a very strong governance profile and low exposure to environmental risks, all which support Minneapolis' credit rating, resilience, and capacity to respond to shocks.

Exhibit 9
ESG Issuer Profile Scores

ENVIRONMENTAL	SOCIAL	GOVERNANCE
E-2	S-1	G-1
Neutral-to-Low	Positive	Positive

Source: Moody's Investors Service

Environmental

Minneapolis' overall E issuer profile score is neutral to low (**E-2**), reflecting relatively low exposure to environmental risks across all categories, including physical climate risk, carbon transition, natural capital, waste and pollution.

Social

We assess the S issuer profile score as positive **(S-1)**, reflecting positive attributes that carry credit benefits. Minneapolis benefits from a growing population, expanding labor force, consistently low unemployment rates, improving income metrics, a relatively young population compared to the aging state and nation and high educational attainment, all of which highlights the positive impact to the credit. Although housing costs are rising, they remain affordable in comparison to other high demand areas of the country. In March 2021, the city reached a settlement agreement with George Floyd's family for $27 million. In November 2021, voters voted down a proposal to replace the city's police department with a new department of public safety. The police department is under federal civil rights investigation.

Governance

Minneapolis' very strong governance profile supports its rating, as captured by a positive G issuer profile score (**G-1**) and reflects both strong institutional structure and established history of prudent budget management. Minneapolis' strong transparency and disclosure, which includes posting year-to-date financial performance as well as long-term financial forecasts and long-term capital plans, are also incorporated into the **G-1** issuer profile score.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. To view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Rating methodology and scorecard factors

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 10

Minneapolis (City of) MN

Rating Factors	Measure	Score
Economy/Tax Base (30%)[1]		
Tax Base Size: Full Value (in 000s)	$62,526,635	Aaa
Full Value Per Capita	$148,758	Aa
Median Family Income (% of US Median)	112.4%	Aa
Finances (30%)		
Fund Balance as a % of Revenues	32.4%	Aaa
5-Year Dollar Change in Fund Balance as % of Revenues	5.9%	A
Cash Balance as a % of Revenues	36.4%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	12.9%	Aa
Management (20%)		
Institutional Framework	Aa	Aa
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures	1.0x	A
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	1.2%	Aa
Net Direct Debt / Operating Revenues (x)	1.2x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	3.3%	A
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	3.3x	A
Notching Factors:[2]		
Unusually Strong or Weak Security Features		Up
	Scorecard-Indicated Outcome	Aa1
	Assigned Rating	Aa1

[1] Economy measures are based on data from the most recent year available.
[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology.
[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs publication.
Sources: US Census Bureau, {OrgName}'s financial statements and Moody's Investors Service

REPORT NUMBER 1315953

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