FitchRatings

RATING ACTION COMMENTARY

Fitch Assigns 'AA+' to Minneapolis, MN's GO Bonds; Outlook Revised to Positive

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Fitch Ratings - New York - 22 Oct 2021: Fitch Ratings has assigned a 'AA+' rating to the following City of Minneapolis, MN bonds:

--$125.5 million unlimited tax general obligation (ULTGO) bonds, series 2021;

--$15.9 million taxable ULTGO housing improvement area bonds, series 2021.

Fitch also affirmed the 'AA+' rating on the Minneapolis's Issuer Default Rating and $732 in outstanding ULTGO bonds.

The Rating Outlook is Revised to Positive from Stable.

The series 2021 bond proceeds will finance the construction of various assessable public improvements, utility system improvements, parking projects, capital projects, and capital improvements. The series 2021 taxable housing bonds will finance repairs and improvements to housing units within the Summit House Housing Improvement Area in the City. The bonds will sell via competition on October 27.

SECURITY

The bonds are general obligations of the city, backed by the city's full faith and credit and unlimited ad valorem taxing power. To pay debt service, the city is obligated to levy a tax without limit as to rate or amount on all taxable property within the city.

ANALYTICAL CONCLUSION

The revised Outlook to Positive from Stable reflects the city's strong operating performance through the disruptions during 2020, including the pandemic and civil unrest. Fitch believes there could be positive pressure on the current rating if the city is able to manage expenditure pressures associated with civil unrest and ongoing pandemic concerns and maintain structurally balanced operations once the federal stimulus funds are exhausted. The Positive Outlook also reflects Fitch's belief that the city's long-term liability burden will remain moderately low driven by statewide pension reforms and strong trends of population and income growth.

The 'AA+' rating reflects the city's strong revenue growth prospects driven by an expanding population and income levels, broad independent revenue-raising ability, and solid budgetary management that has resulted in healthy reserves and considerable gap-closing capacity. The ratings also the city incorporate recent changes that have reduced the share of statewide net pension liabilities attributable to the city, along with pension reforms that have improved the long-term sustainability of the pension systems.

Economic Resource Base

Minneapolis is the largest city in the state of Minnesota with an estimated 2020 population of 429,954, an increase of 12.4% over the 2010 Census. Population growth has been strong as educated, younger workers have been attracted to the diverse employment opportunities in the city, as well as to the city's amenities and cultural attractions and easy commutability. Approximately 50% of residents hold a bachelor's degree or higher, compared with 32% nationally.

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 major employers in the stable health care, higher education and state and county government sectors. Minneapolis has a sizable retail and financial presence, being home to Ameriprise Financial, US Bancorp, Target Corporation and Wells Fargo Bank.

KEY RATING DRIVERS

Revenue Framework: 'aaa'

Revenue growth generally kept pace with U.S. GDP growth over the past decade through 2020. Fitch expects longer-term growth will continue in light of recent population gains, and a vibrant and diverse local economy, with some risk to the downside given the unknown long-term effects of the recent civil unrest. The city's independent legal ability to raise revenues is strong, but Fitch notes that the state has enacted temporary tax levy caps in the past.

Expenditure Framework: 'aa'

Fitch expects spending to grow in line with, to marginally above, the pace of revenue growth. Expenditure flexibility is solid and carrying costs for debt service and pension contributions are expected to remain moderate as a percentage of spending.

Long-Term Liability Burden: 'aa'

Fitch's belief that the city's long-term liability burden will remain moderately low based on the city's future borrowing plans and statewide pension reforms and growing evidence that these improvements are sustainable in light of continued population and income growth.

Operating Performance: 'aaa'

The city maintains superior financial resilience given its ability to adjust tax rates and spending to address both cyclical revenue shortfalls and other fiscal pressures. Reserve levels remain very high primarily driven by healthy general fund operations that have resulted in consistent operating surpluses.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Ability to manage through the current fiscal challenges that are arising from civil unrest and somewhat slow economic recovery to ensure structural balanced operations once the federal stimulus funds have been depleted. The city plans to utilize federal stimulus to bolster general fund revenues through 2024.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A slow-down in the city's economic growth driven by a weaker than currently anticipated economic recovery and/or lingering effects of the civil unrest within the city, that lower the revenue growth prospects over time;

--State implementation of new or permanent tax levy caps for localities that constrains revenue raising ability and limits future budgetary flexibility;

--Rising long-term liabilities that exceed 10% of personal income over a sustained period;

--Carrying costs increasing above their historic averages for an extended duration, weakening the city's expenditure flexibility and gap-closing capacity.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

CURRENT DEVELOPMENTS

Minneapolis has historically maintained very strong financial operations and ended 2020 with a large general fund surplus that bolstered general fund reserves to $167.7 million, 33.6% of general fund spending, almost double the city's fund balance target of 17%. The $39.6 million general fund surplus was driven by receipt of $32 million in federal stimulus funds, spending reductions and unbudgeted state aid.

The spending cuts included a hiring and salary freeze, delays in capital projects, and changes to professional service contracts and discretionary spending. Sales tax revenues were negatively affected by the pandemic related economic disruption and containment efforts, with local option sales taxes declining $44.4 million yoy. They are expected to slowly recover over the next two years.

The city estimates that it will end 2021 with a fund balance of $127 million, $45.9 million above target, providing the city ample financial resilience. The $40 million use of general fund reserves includes planned use for capital projects and a $27 million transfer to support the city's self-insurance fund. The 2021 budget incorporated a 5.75% property tax levy increase.

The 2022 budget assumes a further 5.45% increase in the property tax levy and includes the use of federal stimulus funding for affordable housing and technology infrastructure investments. The 2022 budget will include police reforms to address issues associated with racial equality including plans to increase the number of police officers hired after reductions due to higher than average attrition and the hiring freeze implemented in 2020 and 2021.

The city's five-year outlook assumes that the city will annually increase its property tax levy by up to 5% from 2023-2026. Management plans on using $118.8 million in ARPA funds for revenue replacement in 2022 through 2024, which will supplement general fund revenues as the economy continues to recover from the pandemic related economic disruption. Fitch believes that the city may be challenged to maintain structurally balanced operations if revenue growth is slower than projected, given its use of federal stimulus to fund the operating budget.

CREDIT PROFILE

Minneapolis's economy is very diverse. Major employers include entities in health care, banking, higher education and the retail trade. The city also includes a significant public-sector presence given the nearby presence of the state government. The five largest employers in the city are Allina Health (20,000), the University of Minnesota (20,000), Target Corporation (8,300), the Hennepin Health Care (7,100) and Wells Fargo Bank (7,000). Unemployment has historically tracked below the national average, and has been far below the U.S. rate in recent years.

The city's assessed taxable values have grown between 9% and 10% annually since 2013, including a 6.8% increase in 2020. Commercial property values are expected to decline by almost 5% for 2022 as vacancy rates remain depressed, although they are beginning to improve as the economy recovers from the impacts of the pandemic. The short-term decline is expected to be offset by increases in the residential housing market.

Revenue Framework

The largest general fund revenue sources in 2020 were taxes (50%) and state and federal aid (22.5%). Other notable revenues include service charges and licenses and permits, which accounted for 9.9% and 8.8%, respectively. Property taxes accounted for the bulk of general fund tax revenues in 2020.

Fitch believes general fund revenues are likely to expand at or above U.S. GDP due to significant ongoing and planned residential and commercial construction. Fitch believes this growth trend is sustainable over the longer-term, but acknowledges medium-term downside risk if the economic recovery is slower than currently anticipated.

Sales tax revenue growth is expected to remain below pre-pandemic levels in 2021, primarily driven by a decrease in lodging and entertainment taxes. Continued population growth is likely to sustain a steady expansion in sales and entertainment taxes, along with growth in the tax base.

The city's independent legal authority to increase revenues is essentially unlimited given the authority vested in the mayor and city council to adjust the property tax levy, along with service charges and user fees subject to approval by the city's board of estimates and taxation. These revenue sources account for more than 50% of the general fund budget.

Minnesota has enacted statewide limits to local property tax levies in the past and could potentially do so again in the future. Statewide levy limits have generally been temporary in nature, expiring after one year; however, there is no guarantee that the state will not enact limits of a more permanent or comprehensive nature in the future. Minnesota has occasionally enacted multi-year tax levy caps -- most recently for fiscal years 2009 to 2011. The longest period of multi-year caps was from 1972 to 1992, at which time all caps were repealed. The limitations have never applied to taxes levied for debt service.

Expenditure Framework

The city provides a broad array of services to residents, including police and fire protection, waste removal, water and sewer, public parks and recreation. Public safety was the largest general fund expenditure item at 58% of spending in 2020, followed by general government (17%) and public works (13%).

Fitch believes spending demands are likely to grow at a pace approximately equal to, or slightly above, the natural rate of revenue growth. Employees did receive annual salary step increases, approved by city council in April 2021. Employee benefit growth will likely exceed the rate of inflation over the next several years. Management actively manages expenditure growth by managing the size of workforce through attrition and hiring freezes. The city froze over 300 positions in 2020 in response to the pandemic driven revenue shortfalls but plans to add back 100 police officers in 2021.

Fitch believes Minneapolis's expenditure flexibility is solid despite high fixed costs and a sizable workforce, given management's ability to adjust staffing levels and services-related spending. Minneapolis has a strong track record of reducing expenditures during times of economic stress.

Carrying costs are projected to drop below 20% of governmental spending starting in 2021, following large principal repayments in 2019 and 2020. Minneapolis $1.3 billion six-year capital plan is 19% cash funded ($244.3 million), 61% debt funded ($778.4 million), with the remaining 20% funded from various sources. The cash-funded portion of general government projects affords Minneapolis added budgetary flexibility, as management could cut back on cash-funded capital spending during a cyclical downturn.

Contributions to the statewide pension plans in which the city participates are statutorily determined by the state, and are set below actuarially-determined levels. The impact of statewide pension reforms implemented in 2018 will likely reduce, but not eliminate, the risk that inadequate statutory contributions will expand the liability burden over time. A mitigating factor for the city is that a share of its contributions to each of its three plans are fixed through statutorily-defined end dates.

Minneapolis has contracts with 23 bargaining units representing 9% of its 4,252 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 have the right to strike, including clerical, technical and maintenance workers.

Long-Term Liability Burden

Minneapolis's long-term liability burden, which is approximately 9% of personal income, is low compared with the size and affluence of its economic resource base. Fitch-adjusted net pension liabilities account for almost 43% of the total liability, with direct and overlapping debt at 57%. Fitch believes that the long-term liability burden will remain low as steady increases in population and per capita income levels and rapid amortization of direct debt are likely to offset future borrowing.

The city reports proportionate shares of the NPLs for three statewide retirement systems: General Employees Retirement Fund, Public Employees Police and Fire Fund, and Teachers Retirement Association. The reported assets-to-liabilities ratio for all plans in aggregate was 83% as of June 30, 2020, reflecting the 7.5% discount rates used by all plans. The city's combined NPL for the three plans using a Fitch adjusted 6% discount rate indicates a 70% asset-to-liability ratio.

Minnesota's 2018 Omnibus Pension and Retirement Bill was signed into law on May 30, 2018, with provisions aimed at stabilizing the state's major pension plans. Reforms varied by plan and included reduced cost of living adjustments for current employees and higher employer and employee contributions. The savings generated by the reforms over a 30-year time horizon are estimated at $3.4 billion. Because the bill did not mandate funding the full actuarially-determined contributions for all plans, unfunded liabilities likely will continue to rise over the long term if the plans' investment assumptions are not consistently achieved.

Operating Performance

The Fitch Analytical Stress Test scenario analysis tool, which relates historical revenue volatility to U.S. GDP to support Fitch's assessment of operating performance, assumes a moderate economic downturn. Fitch believes that the city has superior gap-closing ability given its broad revenue-raising flexibility and solid spending controls that provide the framework to quickly close budget gaps resulting from moderate economic downturns. The city is guided by an official policy of keeping general fund reserves at minimum of 17% of current year spending and transfers out, although reserves generally exceed the target.

The city has a solid track record of conservative budgeting and revenue estimates, which have resulted in six general fund surpluses from 2014 through 2020. Unrestricted general fund balances have exceeded 22% of general fund spending over the same time frame and grew to 33.6% in 2020.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

None of the public ratings of the city are associated with any 'upstream' ratings.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Minneapolis (MN) [General Government]	LT IDR	AA+ Rating Outlook Positive	Affirmed	AA+ Rating Outlook Stable
• Minneapolis (MN) /General Obligation - Unlimited Tax/1 LT	LT	AA+ Rating Outlook Positive	Affirmed	AA+ Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 04 May 2021) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Minneapolis (MN)	EU Endorsed, UK Endorsed

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