MOODY'S INVESTORS SERVICE

CREDIT OPINION
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Minneapolis (City of) MN

Update to credit analysis

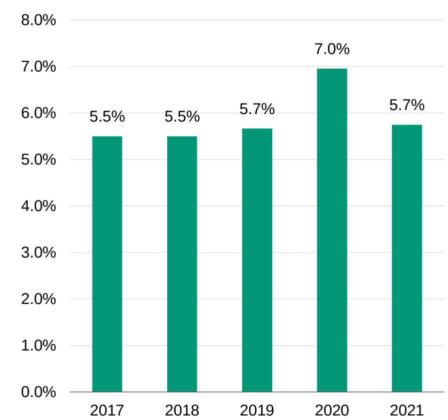
Summary

The City of Minneapolis' (Aa1 stable) strong financial position was unscathed by temporary pandemic-related budget pressures and the costs for a legal settlement, as it implemented timely expenditure controls and received an influx of federal aid. The city also lowered debt service costs through a debt based budget maneuver that it implemented out of caution at the outset of the pandemic. The city is well positioned for continued stability given it is at the center of a strong regional economy and has a steadily growing tax base that it has tapped through steady increases in the property tax levy (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 increasing full value...
Assessed value by class

Dollars billions
Source: Financial statements, Moody's Investors Service

Exhibit 2
...willingness to increase levy to capture growth
Annual change in property tax levy



Source: 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 3

Minneapolis (City of) MN

	2017	2018	2019	2020	2021
Economy/Tax Base					
Total Full Value ($000)	$47,235,358	$52,332,573	$55,385,306	$58,139,146	$62,526,635
Population	411,452	416,021	420,324	424,536	424,536
Full Value Per Capita	$114,802	$125,793	$131,768	$136,948	$147,282
Median Family Income (% of US Median)	110.4%	111.6%	112.4%	114.8%	114.8%
Finances					
Operating Revenue ($000)	$563,422	$570,861	$653,516	$616,438	$566,409
Fund Balance ($000)	$151,910	$133,963	$152,952	$200,299	$203,895
Cash Balance ($000)	$168,713	$152,824	$184,326	$224,096	$225,735
Fund Balance as a % of Revenues	27.0%	23.5%	23.4%	32.5%	36.0%
Cash Balance as a % of Revenues	29.9%	26.8%	28.2%	36.4%	39.9%
Debt/Pensions					
Net Direct Debt ($000)	$538,345	$518,470	$557,370	$757,328	$753,338
3-Year Average of Moody's ANPL ($000)	$2,488,404	$2,497,351	$2,156,337	$2,052,573	$1,906,230
Net Direct Debt / Full Value (%)	1.1%	1.0%	1.0%	1.3%	1.2%
Net Direct Debt / Operating Revenues (x)	1.0x	0.9x	0.9x	1.2x	1.3x
Moody's - ANPL (3-yr average) to Full Value (%)	5.3%	4.8%	3.9%	3.5%	3.0%
Moody's - ANPL (3-yr average) to Revenues (x)	4.4x	4.4x	3.3x	3.3x	3.4x

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 (Aaa stable). 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. Governmental services primarily consist of police, fire, health services, public works and general governmental functions. The city's major enterprise funds include sanitary sewer, stormwater, water treatment, municipal parking, solid waste and community planning.

Detailed credit considerations

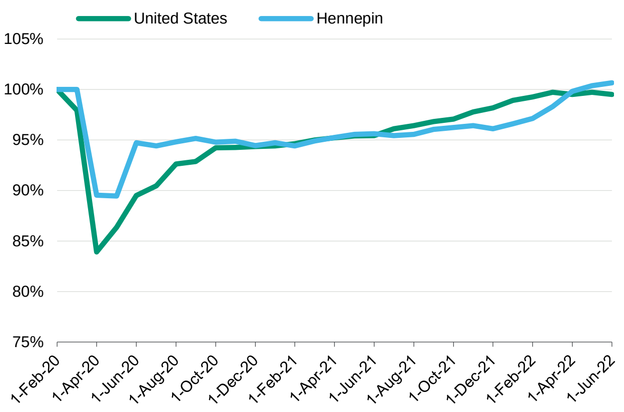
Economy and tax base: center of strong regional economy

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. Hennepin County's labor force has recovered to pre-pandimic levels (Exhibit 4). Minneapolis' unemployment rate is consistently lower than the nation (Exhibit 5).

Exhibit 4

Hennepin County employment has recovered and recent trends outpaced the US

Employment indexed to January 2020

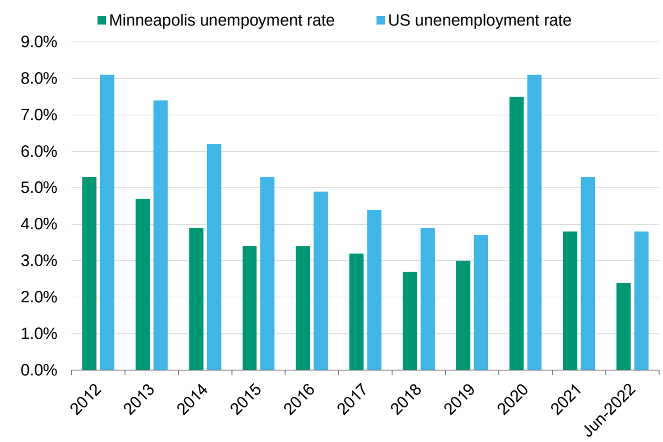


Source: US Bureau of Labor Statistics

Exhibit 5

Minneapolis unemployment rates trend lower than the nation

Unemployment rate



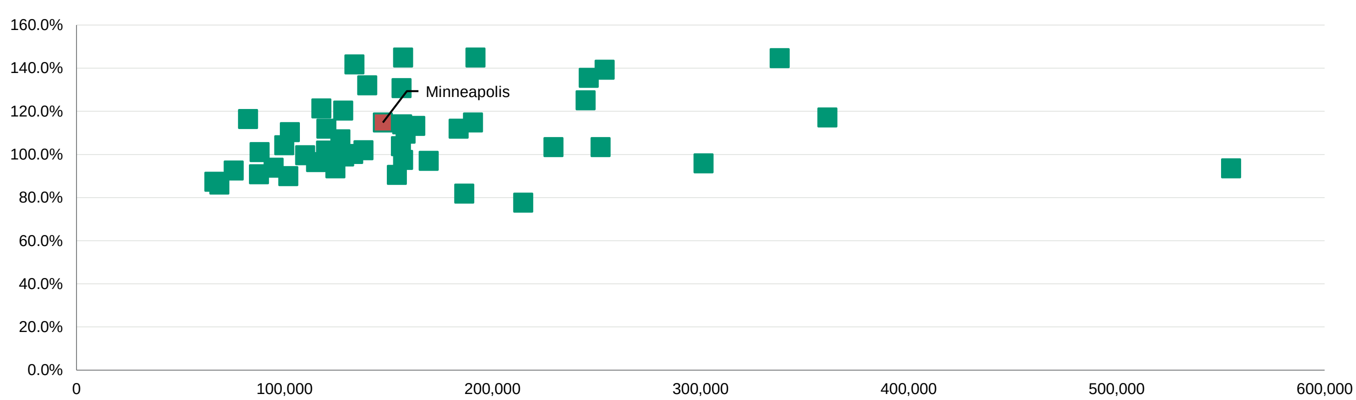
Source: US Bureau of Labor Statistics

Despite its role as the center city of the metropolitan area, the largest portion of the city's tax base is residential property. The city's full value per capita and median family income are in line with other highly-rated large cities (see Exhibit).

Exhibit 6

Minneapolis economic metrics in line with the rating category

Median family income (vertical axis) and full value per capita (horizontal axis) for Aaa-Aa3 cities with population over 250k



Source: US Census Bureau, Official Statements, Continuing disclosures, Moody's Investors Service

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 ended fiscal 2021 with decline in the general fund of about $25 million driven mainly by a $27 million transfer to the self-insurance fund to finance a settlement agreement with George Floyd's family. Across all operating funds, available fund balance increased slightly because debt service costs were lowered from a debt refinancing (see details in debt structure section). 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.

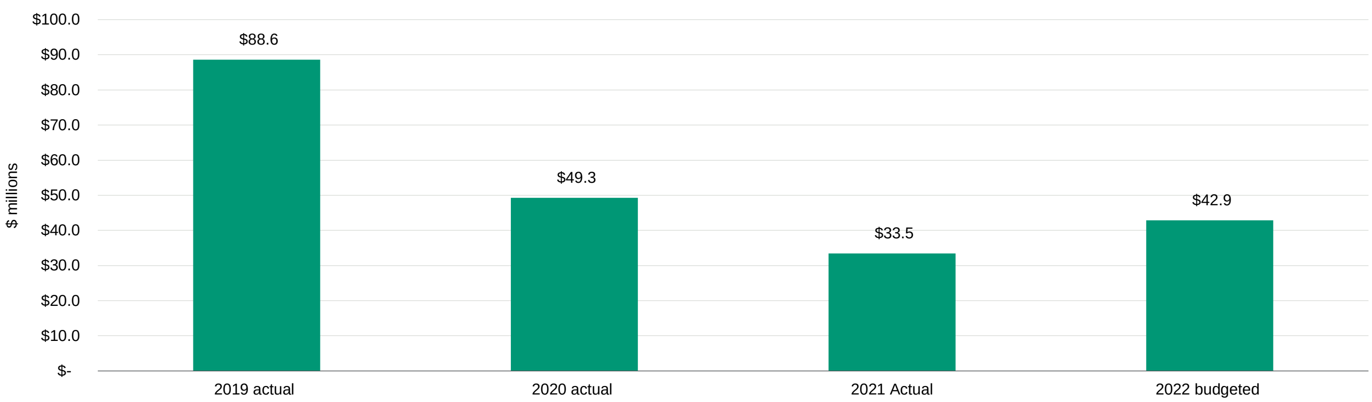
About half of operating fund revenue is generated from property taxes. The city is not subject to any property tax caps and is showing a willingness to steadily increase revenue with a 5.45% increase budgeted in fiscal 2022. The mayor's budget proposes a 6.5% increase for fiscal 2023. State aid comprises 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 fiscals 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 had positive variances in sales tax revenue in fiscal 2021 with actual receipts of $33.5 million compared to budgeted $16.8 million.

Exhibit 7

Sales tax receipts hit low point in fiscal 2021

Downtown asset benefit fund revenue (primarily sales tax with some entertainment, food, liquor and lodging tax revenue)



Source: Minneapolis open government website and financial statements

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 of the 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 40% of revenue in cash across the general fund and debt service fund. Total liquidity across all governmental funds is $743 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 enterprise funds also have healthy cash with nearly a half a year's worth of expenses in reserve across enterprise operations.

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. Its overall leverage is high relative to sector medians incorporating our adjustments to reported pension liabilities using the FTSE Pension Liability Index (FTSE PLI) as a discount rate to compute the present value of accrued benefits (see Exhibit). The city issues GO bonds annually in the spring for capital projects that can range from $50 million to $100 million.

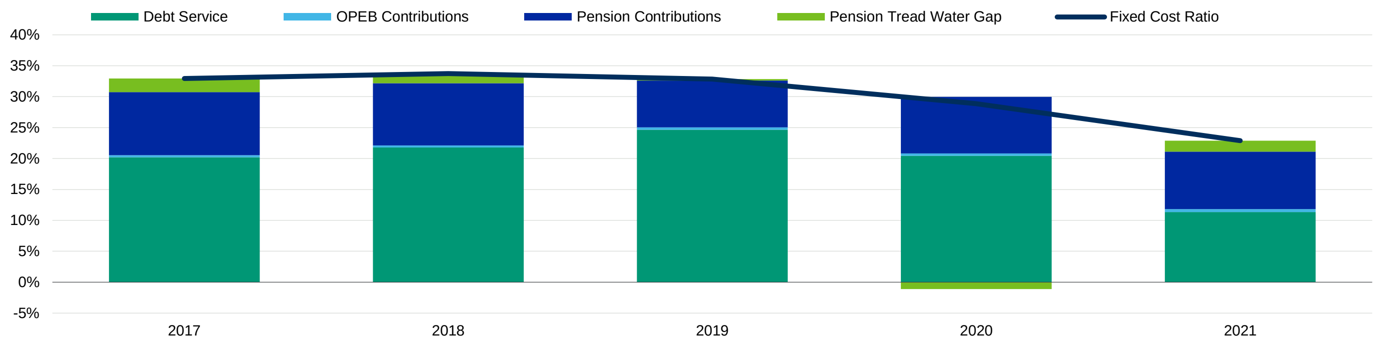
Exhibit 8
Pension adjustment

2021	(000)	% of Operating Revenues	Discount Rate
Operating Revenue	566,409	n/a	n/a
Reported Unfunded Pension Liability	345,994	61%	6.53%
Moody's Adjusted Net Pension Liability	1,605,819	284%	2.84%

Source: financial statements and Moody's Investors Service

The city's fixed costs, inclusive of debt service and retirement contributions typically consume around 30% of revenue (see Exhibit), but debt service costs dropped in 2020 and 2021 due to a refunding (see details in debt structure section).

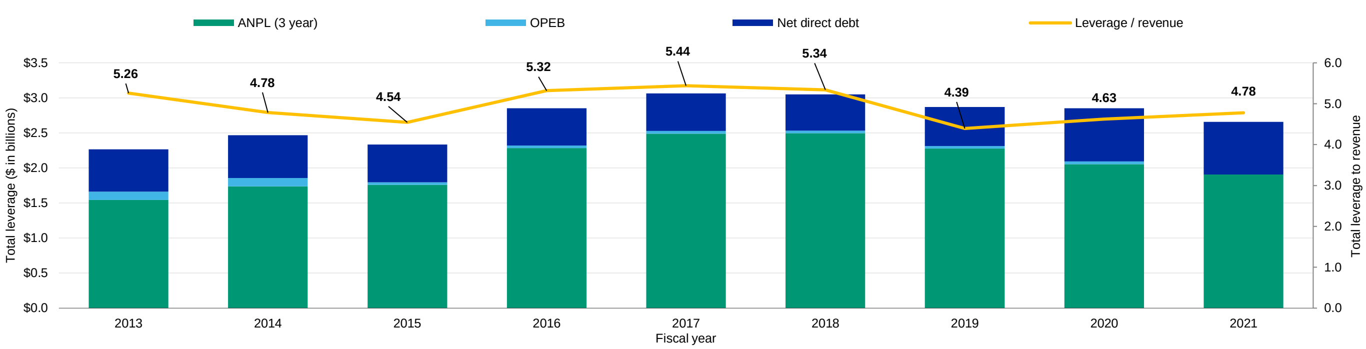
Exhibit 9
Fixed costs typically consume just under a third of revenues



Source: Debt service, OPEB contributions and pension contributions

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

Exhibit 10
Minneapolis' total leverage decreased after 2016 spike, but remains high
ANPL, OPEB and net direct debt / operating revenue



Source: Debt service, OPEB contributions and pension contributions

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. The bonds are additionally secured by statute.

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 based on 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.

Debt-related derivatives
The city is not a party to any derivative agreements.

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. 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.

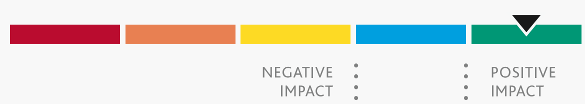
Minneapolis has established reserves which it calls its pension contingency fund in an attempt to mitigate budget pressure should increased pension contributions be required by the state. Those reserves are held within the employee retirement fund, which had a fund balance of $38 million at the close of fiscal 2021.

ESG considerations

Minneapolis (City of) MN's ESG Credit Impact Score is Positive CIS-1

Exhibit 11
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**), indicating that ESG attributes have a positive impact on the rating inclusive of neutral to low exposure to environmental risk and positive exposure to social and governance considerations.

Exhibit 12
ESG Issuer Profile Scores

ENVIRONMENTAL
E-2
Neutral-to-Low

SOCIAL
S-1
Positive

GOVERNANCE
G-1
Positive

Source: Moody's Investors Service

Environmental

Minneapolis' 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 and waste and pollution.

Social

Minneapolis' S issuer profile score is positive (**S-1**), reflecting a growing population, consistently low unemployment rates, improving income metrics, a relatively young population and high educational attainment. 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' G issuer profile score is positive (**G-1**) reflecting a history of prudent budget management. Transparency and disclosure is strong with year-to-date financial performance, financial forecasts and long-term capital plans posted to the city website. Also incorporated is an institutional structure that does not have any caps on the property tax levy.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order 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 13
Minneapolis (City of) MN

Rating Factors	Measure	Score
Economy/Tax Base (30%)[1]		
Tax Base Size: Full Value (in 000s)	$65,938,298	Aaa
Full Value Per Capita	$155,319	Aaa
Median Family Income (% of US Median)	114.8%	Aa
Finances (30%)		
Fund Balance as a % of Revenues	36.0%	Aaa
5-Year Dollar Change in Fund Balance as % of Revenues	10.7%	Aa
Cash Balance as a % of Revenues	39.9%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	11.3%	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 (%)	1.1%	Aa
Net Direct Debt / Operating Revenues (x)	1.3x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	2.9%	A
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	3.4x	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

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