S&P Global Ratings

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Summary:

Minneapolis, Minnesota; General Obligation; State Revolving Funds/Pools

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Credit Profile		
US$125.515 mil GO bnds ser 2021 dtd 11/17/2021 due 12/01/2040		
Long Term Rating	AAA/Stable	New
US$15.93 mil taxable GO hsg imp area bnds ser 2021 due 12/01/2040		
Long Term Rating	AAA/Stable	New
Minneapolis GO		
Long Term Rating	AAA/Stable	Outlook Revised
Minneapolis (Common Fd) SRFPOOL		
Long Term Rating	A+/Stable	Outlook Revised

Rating Action

S&P Global Ratings has revised the outlook on the city of Minneapolis, Minn.'s general obligation (GO) debt to stable from negative and affirmed its 'AAA' rating. At the same time, we have assigned our 'AAA' rating, with a stable outlook, to the city's $125.5 million series 2021 GO bonds and $15.9 million series 2021 taxable GO housing improvement area bonds.

The outlook revision reflects our view that despite some lingering uncertainty around both public safety reform and the medium-term pace of economic and revenue recovery from the still-ongoing COVID-19 pandemic, the city has a fiscal roadmap in place that we believe sufficiently demonstrates how it will navigate the next few years while actively managing emerging and ongoing risks, and while keeping reserves aligned with the city's 17% fund balance policy.

We have also revised the outlook to stable from negative and affirmed our 'A+' rating on several series of limited-tax-supported development revenue bonds issued under the city's common bond fund. We rate the bonds four notches below the city's GO rating, given additional risk from the intended payment source, per our criteria, "Issue Credit Ratings Linked to U.S. Public Finance Obligor’s Creditworthiness" (published Nov. 20, 2019, on RatingsDirect).

Minneapolis' GO bonds are eligible to be rated above the sovereign because we believe the city can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above The Sovereign—Corporate And Government Ratings: Methodology And Assumptions" (published Nov. 19, 2013), U.S. local governments have moderate sensitivity to country risk. The institutional framework in the U.S. is predictable for local governments, allowing them significant autonomy and independent treasury management with no history of federal government intervention, and we believe Minneapolis' financial flexibility is sufficiently demonstrated by its very strong budgetary reserves and liquidity.

Credit overview

While the COVID-19 pandemic and its attendant economic effects persist, as does what we now expect will be a multiyear planning effort around public safety reform, the immediate pressures that prompted us to revise Minneapolis's rating outlook to negative last year have either been largely resolved, or, alternatively, have given way to longer-term challenges that the city is addressing in what we believe is a measured fashion over a multiyear period. The outlook revision therefore reflects both greater clarity around the city's immediate fiscal and economic outlook as compared with a year ago, as well as our view that management and city leadership are proactively addressing key budgetary challenges in a way that is likely to preserve its very strong fiscal position through at least the duration of our two-year outlook horizon.

Although public safety reform remains an open issue, we believe the city has sufficiently incorporated potential cost increases into its long-term financial plan. A ballot proposal put to voters on the upcoming November 2 election would eliminate the police department and replace it with a Department of Public Safety. If passed, this would entail the creation of a new city department focusing on a holistic, public health-centered approach to public safety. The department could also employ traditional police officers, though the amendment would do away with the current charter's minimum requirement to employ 1.7 sworn officer per 1,000 residents.

The passage of this amendment would be a milestone for the city, but not one that we expect to create significant unfunded budgetary obligations, as the existing police department budget would simply be reallocated to accommodate new public safety functions. The city's most recent five-year general fund forecast, released in August, already incorporates substantial increases in public safety spending from 2023 through 2027 to fund a return to pre-2020 police staffing levels. While future planning around police staffing levels and public safety priorities may change from the forecast, we believe that planning for upsized spending on public safety in the city's outyear financial projections inherently creates flexibility to reallocate resources to the new public safety department as needed without upsetting long-term budgetary balance.

Other key medium-term challenges include the slow economic recovery, which continues to pressure economically sensitive sales tax receipts, along with a sizeable uptick in claims liabilities in the city's self-insurance fund, related in part to police post-traumatic stress disorder (PTSD) claims following last year's civil unrest. The city plans to leverage a share of its $271 million allocation from the American Rescue Plan Act (ARPA) through fiscal 2024, along with some general fund reserves to fill interim budget gaps, while phasing in a gradual return in service provision and funding ongoing investments in strategic priorities. The revenue projections included in the five-year financial forecast are, we believe, reasonably conservative and do not rely on optimistic growth assumptions to achieve a balanced budget once ARPA funds are exhausted. Further, while we expect some use of reserves, the city's general fund balance was at a historic high of 35% at the end of fiscal 2020, well in excess of the city's minimum fund balance policy requirement of 17%, which we believe offers some latitude for deficit spending without jeopardizing credit quality.

Key factors supporting the 'AAA' include the city's:

- Reserves, which were at a historic high of 35% of expenditures at the end of fiscal 2020 and that we expect will remain above 17% despite planned drawdowns over the coming few years, along with a multiyear budget forecast that details how the city will return to regular budgetary balance without the use of ARPA funds or reserves in a few years;

- Robust economy that, despite the pandemic and events of 2020, continues to grow at a historic rate, supporting per capita wealth and income measures that are unusually strong for a city of its size;
- Proactive management, as evident in a strong Financial Management Assessment (FMA) that includes, among other things, multiyear financial planning and a strong institutional framework; and
- Favorable debt ratios relative to other large and growing U.S. cities and only moderate pension and other postemployment benefit (OPEB) exposure, with little medium-term likelihood of meaningful cost acceleration.

Environmental, social, and governance (ESG) factors

Minneapolis is subject to elevated social risk relative to sector norms, as evident in the civil unrest experienced last summer, which led to significant property damage and a $27 million legal settlement with the family of George Floyd. We believe that ongoing public safety reform may be responsive to public concerns around policing in Minneapolis in a way that limits the likelihood of future unrest. However, the policy trajectory around policing remains fluid, as does public sentiment, and social risks will likely remain elevated in the near term. Governance risks generally align with sector norms, as do environmental risks.

Stable Outlook

Downside scenario

We could lower the rating if the city draws its general fund reserves down more rapidly than currently planned, which we believe could signify unanticipated budgetary pressure and would leave less room for fiscal maneuvering in out-year budgets. We could also lower the rating if the city saw a material increase in liabilities in its self-insurance fund, or if revenue recovery in key funds outside of the general fund significantly lagged current projection, either of which could complicate the city's plan to achieve outyear budgetary balance once stimulus funds are spent.

Credit Opinion

Fiscal roadmap details medium-term plan to manage key challenges while preserving reserves in alignment with policy

The original 2021 budget reflected an $18 million general fund deficit, assuming some revenue loss over 2020 and with 2020 service levels carried forward. Through August, the city's budget forecast shows a larger, $38.5 million deficit, largely driven by a one-time $27 million transfer to the self-insurance fund to pay for the Floyd family legal settlement. The August forecast shows reserves declining to about 27% of projected expenditures by year-end, still well in excess of the city's reserve policy and enough to allow for some out-year use of reserves to balance the budget without, in our view, materially compromising the city's budgetary flexibility, which we expect will remain very strong.

The mayor's 2022 budget is balanced with the use of $47 million in ARPA funding and $17 million in general fund reserves, and includes a 5.45% levy increase, additional funding for core service rebuilding, strategic investments in affordable housing, and a $24 million transfer to the self-insurance fund. The city's five-year general fund forecast shows gradual increases in core service funding, strategic investments, and public safety spending through the 2027 planning horizon. On the revenue front, the forecast envisions using ARPA funding through 2024 and general fund reserves through 2025 to balance the budget, with reserve remaining aligned with the city's fund balance policy throughout.

The city intends to balance its budget once ARPA funding is spent, primarily through levy increases of about 5% per year, on average, and an increase in transfers from other funds by 2025, primarily the Downtown Assets Fund. The latter collects general sales, liquor, lodging, and entertainment taxes, which are used to fund operations, capital, and debt service related to several downtown venues, with residual revenues transferred to the general fund. The various economically sensitive taxes plummeted in the latter two-thirds of 2020 and, though recovering, will likely take several years to reach pre-pandemic levels. The city's forecast reflects a gradual and, we believe, appropriately cautious recovery in revenue performance, to about 75% of 2019 levels by 2025. Management indicates that the city intends to rebuild reserves in the Downtown Assets fund over a multiyear period before resuming an upsized transfer out to the general fund by 2025.

The city self-insurance fund's net position deteriorated significantly in 2020, declining to negative $97.8 million in 2020, again related in part to a spike in police PTSD claims. Following a planned $24 million transfer from the general fund in 2022, the outyear forecast shows the fund essentially breaking even through 2027. While we think that presence of the liability represents a risk, much of the liability emerged only recently as a consequence of what is most likely a one-time event and is to that extent unlikely to continue to grow at the rate seen in the last year. We expect that management will continue to actively monitor the health of the fund and will make budgetary adjustments as necessary to ensure its ability to satisfy claims without ongoing need for general fund support.

In general, we believe that the city's plan to return to balanced operations without reliance on ARPA funding or reserves is measured, with generally conservative revenue assumptions that do not rely on unduly optimistic economic growth assumptions. We expect that absent an unusually sluggish or prolonged economic recovery, the city's forecast return to balanced operations without reliance on nonrecurring stimulus funds or general fund reserves is reasonable, and we believe that overall budgetary performance will therefore remain adequate in the interim. We further expect that deviations from the current long-term forecast--whether from unanticipated cost pressures or lagging revenue performance--will be proactively monitored by management and city leadership, and will be met with corresponding adjustments, as needed.

The city has one variable-rate bank note. The bank agreement includes events of default that allow the banks to accelerate unpaid principal and interest, but specifies that the bank must allow 180 days to cure a default. In accordance with our criteria governing contingent liquidity risk, we believe that the 180-day cure period is sufficient time to allow the city to cure a default or refinance any note in default, and so we do not consider the note a liquidity risk. The city has no swaps associated with the note.

Tax base growth and new development continue apace, with other key economic measures continuing to recover, though well below pre-pandemic levels

The city came into 2020 on the heels of what can aptly be characterized as a historic building boom, as evident in the eight consecutive years of $1 billion or more in permitted construction through 2019, including $2.2 billion in 2019 alone, making it the strongest year on record in terms of the dollar value of new development. While permitting and new development slowed in 2020 relative to prior years, we understand that sizeable new commercial and multiresidential projects continue in the downtown area. Since 2012, economic market value has grown by 87%, from

$33.4 billion to $62.5 billion in 2020-2021. The pace of new development through the next few years may well slow relative to the building boom of the past decade and will likely be influenced by factors such as the pace of the recovery from the pandemic, macroeconomic growth rates, and long-term demand expectations for downtown office and commercial space.

Other local measures continue to signal a slow-moving return to economic normalcy, despite some signs of recovery. City data, for example, indicate current occupancy rates of 37.5% for offices, 46% for hotels, and 49% for seated restaurants, along with light rail ridership of 45% of pre-pandemic levels. While much stronger than a year ago, these indicators could portend a multiyear recovery period before regular economic activity returns to pre-pandemic levels. Countywide unemployment has typically been well under national levels and closely tracks statewide levels. The seasonally unadjusted unemployment rate increased to 9% in April 2020 with the onset of the pandemic, but has since fallen considerably, and was 3.6% in August 2021.

Strong FMA with notable long-term planning to address key challenges while preserving healthy fiscal position

As discussed, the city's key long-term planning tools--in particular, its detailed five-year financial forecast—have, in our view, taken on especial significance in the current fiscal and economic context, as they have enabled the city to lay out a multiyear roadmap for dealing with multiple, concurrent challenges that are unique in character and scope, allowing for a structured response that aims to address these challenges while preserving the city's reserves and fiscal health more generally.

Highlights to the FMA include:

- Strong, well-grounded revenue and expenditure assumptions consistently embedded in the city's annual budget, which, for example, includes reference to historical trends and detailed analyses explaining expected variance from these trends and which places current-year revenue and expenditure forecasts in the context of a multiyear financial plan;
- Quarterly budget-to-actual reporting to the city council to identify potential sources of budget variance and the ability to amend the budget as needed;
- An annually updated, multiyear financial plan that identifies and discusses upcoming issues or variances and possible solutions;
- An annually updated, six-year capital improvement plan (CIP) that includes detailed descriptions of specific projects, along with cost estimates and funding sources;
- A council-approved investment management policy and quarterly reporting to the council of investment holdings and earnings;
- A basic debt management policy that, while lacking detailed quantitative restrictions or limits, includes substantive qualitative guidelines; and
- A formal reserve policy, to which the city has historically adhered, requiring it to maintain a minimum unrestricted general fund balance equal to 17% of the subsequent-year budgeted expenditures to facilitate cash flow and meet unanticipated contingencies.

The city has robust planning around cyber security and environmental risk, and has policies addressing both.

Favorable debt profile relative to peers, with six-year CIP indicating stable liability profile

The city's gross direct debt totals $880.3 million, and, excluding a share of the city's GO debt that we consider for eligible for self-support credit, we calculate net direct debt at $707.1 million. The city's 2021-2026 CIP includes about $1.3 billion in projects, of which 19% will be cash-funded, 61% will be financed through new-money debt, and the rest will be funded through other revenue sources. Though we expect the city to issue new-money debt as part of its CIP in the next year or so, a similar amount of principal is scheduled to roll off over the same period.

Moderate pension and OPEB exposure with some long-term risks, though medium-term costs unlikely to accelerate

We do not believe that pension and OPEB represent a near-term credit pressure for Minneapolis, as the cost-sharing, multiple-employer, defined-benefit pension plans in which the city participates are reasonably well-funded, and annual costs represent only a modest share of total spending. Further, more than one-third of Minneapolis's annual pension costs in fiscal 2020 were nonemployer contributions to its closed pension funds, which were fully merged with the state's multiple employer funds in fiscal 2015 and are fixed in amount and duration by state statute. As such, we expect that likelihood of near-term cost acceleration will be limited.

The city participates in the following plans, which are administered by the Public Employees Retirement Associate of Minnesota (PERA):

- The Minnesota General Employees Retirement Fund (GERF): 79.2% funded as of June 30, 2020, with a city proportionate share of the plan's net pension liability of $283.3 million;
- The Public Employees Police and Fire Fund (PEPFF): 87.2% funded, with a city proportionate share of $218.5 million;
- The Minneapolis Employees Retirement Fund (MERF), the Minneapolis Firefighters Relief Association (MFRA), and the Minneapolis Police Relief Association (MPRA): all closed plans that have been fully merged with PERA and to which the city makes a fixed supplemental contribution annually, with contributions sunsetting in 2031, per state statute;
- The Teachers Retirement Association of Minnesota (TRA): a cost-sharing multiple-employer plan, to which the city has since 2006 made fixed annual contributions of about $2.3 million and to which Minneapolis is required to make fixed payments until the plan is fully funded; and
- A single-employer, defined-benefit OPEB that the city funds on a pay-as-you-go basis: 0% funded, with a $41.2 million net liability.

In the most recent year, plan-level contributions to both GERF and PEPFF met our static funding metric--meaning that employer and employee contributions were enough to match the present value of current-year benefits and the interest on the net pension liability--but fell short of minimum funding progress. Key plan risks include a statutory funding practice that has regularly produced contributions that have fallen short of actuarial recommendations, contributing to an occasional need for intervention on the part of the state legislature to place the plans on a more secure funding trajectory; a 7.5% investment rate of return assumption, which is above S&P Global Ratings' 6.0% guideline and introduces heightened risk of funding volatility from market losses; and a lengthy, 30-year amortization period based on a level percentage of payroll for the net liability, which inherently defers costs into the future. As noted, despite some risks, the plans are reasonably well-funded following the passage of pension reform legislation in

2018, and we expect the city to be able to absorb any likely medium-term costs increases without placing undue pressure on operations.

Institutional framework score

The institutional framework score for Minnesota cities with populations greater than 2,500 is strong, in our view.

Minneapolis--Key Credit Metrics

	Most recent	Historical information		
		2020	2019	2018
Very strong economy				
Projected per capita EBI % of U.S.	119.4			
Market value per capita ($)	147,851			
Population		422,904	422,613	414,972
County unemployment rate(%)		6.6		
Market value ($000)	62,526,635	58,139,146	55,385,306	52,332,573
Top 10 taxpayers % of taxable value	6.4			
Adequate budgetary performance				
Operating fund result % of expenditures		8.1	5.9	-2.7
Total governmental fund result % of expenditures		10.5	-0.7	1.8
Very strong budgetary flexibility				
Available reserves % of operating expenditures		34.3	26.6	21.9
Total available reserves ($000)		167,654	128,040	102,946
Very strong liquidity				
Total government cash % of governmental fund expenditures		37.3	39.1	43.7
Total government cash % of governmental fund debt service		248.5	252.8	304.1
Very strong management				
Financial Management Assessment	Strong			
Adequate debt & long-term liabilities				
Debt service % of governmental fund expenditures		15.0	15.5	14.4
Net direct debt % of governmental fund revenue	76.2			
Overall net debt % of market value	2.5			
Direct debt 10-year amortization (%)	72.2			
Required pension contribution % of governmental fund expenditures		7.4		
OPEB actual contribution % of governmental fund expenditures		0.3		
Strong institutional framework				

EBI--Effective buying income. OPEB--Other postemployment benefits.

Related Research

- Credit Conditions: U.S. Regions' Economies Perk Up As The Pandemic's Impact Ebbs, April 16, 2021
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013

- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of October 25, 2021)		
Minneapolis GO		
Long Term Rating	AAA/Stable	Outlook Revised
Minneapolis GO		
Long Term Rating	AAA/Stable	Outlook Revised
Minneapolis GO		
Long Term Rating	AAA/Stable	Outlook Revised
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Long Term Rating	AAA/Stable	Outlook Revised
Minneapolis GO		
Long Term Rating	AAA/Stable	Outlook Revised
Minneapolis (Common Fd) SRFPOOL (AGC)		
Unenhanced Rating	A+(SPUR)/Stable	Outlook Revised

Many issues are enhanced by bond insurance.

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.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.