S&P Global
Ratings

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Summary:

Minneapolis; General Obligation; State Revolving Funds/Pools

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Credit Profile		
US$123.635 mil GO bnds ser 2022 due 12/01/2041		
Long Term Rating	AAA/Stable	New
Minneapolis GO		
Long Term Rating	AAA/Stable	Affirmed

Rating Action

S&P Global Ratings has assigned its 'AAA' rating to the city of Minneapolis, Minn.'s $123.6 million series 2022 general obligation (GO) bonds. At the same time, we have affirmed our 'AAA' rating on the city's GO debt outstanding. The outlook is stable.

We have affirmed our 'A+' rating, with a stable outlook, 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

Fiscal 2022 marks the second in the city's multiyear recovery plan following the twin crises of the COVID-19 pandemic and the George Floyd killing, which resulted in significant social unrest and galvanized calls for police reform. Its current financial forecast envisions using 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. At midyear fiscal 2022, management reports no significant revisions from the template laid out last year, and we expect that absent a significant departure from its current trajectory, the city is positioned to realize more or less stable operations without ongoing use of reserves or other one-time funds to balance its operating budget within a few years.

Other key medium-term challenges include the ongoing pandemic recovery, which continued to pressure

economically sensitive sales tax receipts through 2021, and an increasing likelihood of recession in the coming 12 months, which could dampen economic growth and revenue performance. The city has also seen a sizable uptick in claims liabilities in its self-insurance fund, related in part to police post-traumatic stress disorder (PTSD) claims following 2020's civil unrest, and although we do not expect the fund to be an ongoing source of budgetary pressure, we note that the deterioration in the fund's net position leaves the city more vulnerable to unexpected changes in outyear budget cycles. While we expect some use of reserves through the next few years, the city's general fund balance was at a historic high of 35% at the end of fiscal 2020, well in excess of its 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 Minneapolis':

- Very strong reserves, which 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 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

Minneapolis has a recent history of elevated social risk, as evident in the civil unrest experienced in 2020 summer. We believe that ongoing public safety reform may be responsive to public concerns around policing in the city 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 and environmental risks are credit neutral.

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 outyear budgets. We could also lower the rating if it 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 its 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 $582.6 million 2022 general fund budget is balanced with the use of $47 million in ARPA funding and $17 million in reserves, and includes a 6.11% levy increase, additional funding for core service rebuilding, and strategic investments in affordable housing. 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. For fiscal 2022, we understand that budget revisions and an updated five-year forecast will be published in August, when the mayor releases his 2023 budget proposal.

The city intends to balance its budget once ARPA funding is spent largely 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, restaurant, 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 city's forecast reflects a gradual and, we believe, appropriately cautious recovery in revenue performance in the Downtown Assets Fund to just under 75% of 2019 levels by 2025, when the upsized general fund transfer is schedule to resume.

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 and lawsuits. The 2022 budget and outyear forecast shows the fund essentially breaking even through 2027. While we think that the 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 2020. 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

The city came into the pandemic in 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. Both 2020 and 2021 saw growth along similar lines and marked a continuation of pre-pandemic trends. All told, economic market value has basically doubled over the past decade, growing from $33.4 billion in 2012 to $65.9 billion in 2021-2022. However, as S&P Global Economics is now assessing the likelihood of a recession in the next 12 months at 40% (within a 35% to 45% band) amid rising interest rates, stubbornly high inflation, and geopolitical turmoil, we expect that the pace of new development may well slow in the near term 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. (For our latest U.S. economic forecast, see "Economic Outlook U.S. Q3 2022: The Summer Of Our Discontent," published on RatingsDirect on June 27, 2022).

Other local measures continue to signal a slow-moving return to economic normalcy, despite some signs of recovery. City data, for example, show local sales taxes (including general sales, liquor, lodging, restaurant, and entertainment taxes) plummeting by 44.7% in 2020 and growing by 14.9% in 2021, though still down 36.5% from 2019 levels. Year-to-date data through April show collections that are approximately on par with both 2019 and 2020 levels, though it remains to be seen whether the trend will be sustained through the remaining two-thirds of the year, and, as noted, the macroeconomic environment points toward a slower path to economic normalization, particularly as reflected in more economically sensitive measures such as sales tax performance. 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 3.4% in 2021.

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

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 $929.5 million, and, excluding a share of its GO debt that we consider for eligible for self-support credit, we calculate net direct debt at $745.1 million. Its 2022-2027 CIP includes about $1.1 billion in projects, of which more than half 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 are 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 2021 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. Therefore, 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): 87% funded as of June 30, 2021, with a city proportionate share of the plan's net pension liability of $216.4 million;
- The Public Employees Police and Fire Fund (PEPFF): 93.7% funded, with a city proportionate share of $144.3 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 $47.2 million net liability.

In the most recent year, plan-level contributions to both GERF and PEPFF met both our static and minimum funding progress metrics. 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		
		2021	2020	2019
Very strong economy				
Projected per capita EBI % of U.S.	117			
Market value per capita ($)	155,916			
Population		422,909	422,904	422,613
County unemployment rate(%)	3.4			
Market value ($000)	65,938,298	62,526,635	58,139,146	
Ten largest taxpayers % of taxable value	5.6			
Adequate budgetary performance				
Operating fund result % of expenditures		(4.7)	8.1	5.9
Total governmental fund result % of expenditures		(2.2)	10.5	(0.7)
Very strong budgetary flexibility				
Available reserves % of operating expenditures		27.0	34.3	26.6
Total available reserves ($000)		142,828	167,654	128,040
Very strong liquidity				
Total government cash % of governmental fund expenditures		35	37	39
Total government cash % of governmental fund debt service		461	249	253
Very strong management				
Financial Management Assessment	Strong			
Very strong debt & long-term liabilities				
Debt service % of governmental fund expenditures		7.7	15.0	15.5
Net direct debt % of governmental fund revenue	91			
Overall net debt % of market value	2.5			
Direct debt 10-year amortization (%)	70			
Required pension contribution % of governmental fund expenditures		7.2		
OPEB actual contribution % of governmental fund expenditures		0.3		
Strong institutional framework				

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

Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

Ratings Detail (As Of July 15, 2022)		
Minneapolis taxable GO hsg imp area bnds ser 2021 due 12/01/2040		
Long Term Rating	AAA/Stable	Affirmed
Minneapolis GO		
Long Term Rating	AAA/Stable	Affirmed
Minneapolis GO		
Long Term Rating	AAA/Stable	Affirmed
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Long Term Rating	AAA/Stable	Affirmed
Minneapolis GO		
Long Term Rating	AAA/Stable	Affirmed
Minneapolis GO		
Long Term Rating	AAA/Stable	Affirmed
Minneapolis (Common Fd) SRFPOOL		
Long Term Rating	A+/Stable	Affirmed
Minneapolis (Common Fd) SRFPOOL (AGC)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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