**Summary:**

# Minneapolis; General Obligation

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**Summary:**

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| Credit Profile | | |
|---|---|---|
| US$118.0 mil GO imp & various purp bnds ser 2019 due 12/01/2033 | | |
| *Long Term Rating* | AAA/Stable | New |
| US$4.15 mil taxable GO hsg imp area bnds ser 2019 due 12/01/2037 | | |
| *Long Term Rating* | AAA/Stable | New |
| Minneapolis GO | | |
| *Long Term Rating* | AAA/Stable | Affirmed |

## Rationale

S&P Global Ratings has assigned its 'AAA' rating to Minneapolis' series 2019 general obligation (GO) improvement and various purpose bonds and its series 2019 taxable GO housing improvement area bonds. At the same time, S&P Global Ratings affirmed its 'AAA' ratings on the city's existing GO debt. The outlook is stable.

Each series of bonds is secured by the city's full-faith-and-credit GO pledge and ability to levy unlimited ad valorem taxes against all taxable property within its borders. The improvement and various purpose bonds are additionally secured by special assessments and net revenues of several of the city's utilities, though we rate the bonds to the city's GO pledge. Proceeds from the improvement and various purpose bonds will finance various public improvements and capital projects, and proceeds for the taxable GO housing improvement area bonds will finance improvements within a housing improvement area.

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, titled "Ratings Above The Sovereign—Corporate And Government Ratings: Methodology And Assumptions" (published Nov. 19, 2013, on RatingsDirect), U.S. local governments are considered to have moderate sensitivity to country risk. The institutional framework in the U.S. is predictable for local governments, allowing them significant autonomy, 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.

The 'AAA' rating reflects our view of the city's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with operating results that we expect could improve in the near term relative to fiscal 2017, which closed with an operating surplus in the general fund but an operating deficit at the total governmental fund level in fiscal 2017;

- Very strong budgetary flexibility, with an available fund balance in fiscal 2017 of 24% of operating expenditures;
- Very strong liquidity, with total government available cash at 47.4% of total governmental fund expenditures and 4.0x governmental debt service, and access to external liquidity we consider strong;
- Strong debt and contingent liability position, with debt service carrying charges at 11.8% of expenditures and net direct debt that is 68.2% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 74.8% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

At the heart of one of the largest economic centers in the upper Midwest, Minneapolis is experiencing a period of historic economic growth, marked by multiple consecutive years of a billion or more dollars in permitted construction and ongoing expansion and diversification in its employment base. With general fund reserves at historic highs at the end of the 2017 fiscal year, the city began to draw down its fund balance in fiscal 2018 on elective capital projects, and we expect it will continue to draw on its reserves until they more closely align with its 17% fund balance policy. Still, operations remain healthy, and we expect that economic growth will continue to underwrite the city's very strong financial condition. Despite the growth since the Great Recession, its overall debt burden has come down significantly and remains modest in comparison with peers, and we believe that its pension burden remains manageable. The convergence of these various factors continues to support stable, strong credit quality, and we think downward rating pressure unlikely within the two-year outlook horizon.

### Very strong economy

We consider Minneapolis' economy very strong. The city, with an estimated population of 412,891, is in Hennepin County in the Minneapolis-St. Paul-Bloomington MSA, which we consider to be broad and diverse. It has a projected per capita effective buying income of 115% of the national level and per capita market value of $126,757. Overall, market value grew by 10.8% over the past year to $52.3 billion in 2018. The county unemployment rate was 3.0% in 2017.

Minneapolis' economy is growing at a solid pace, as signaled most obviously by its multiyear run of very healthy tax-base growth. Buoyed by gains in residential and apartment valuations, along with some commercial and industrial growth, the city's net tax capacity saw back-to-back years of essentially double-digit increases from 2014 (for taxes payable 2015) through 2018, most recently increasing 9.9% in fiscal 2018 to $586.4 million. Economic market value, totaling $52.3 billion, has grown along similar lines in the same period. In 2018, the city experienced its seventh consecutive year of $1 billion or more in permitted construction, with major developments in recent years including several large, high-profile projects, such as the new Minnesota Vikings stadium and the nearby Wells Fargo office towers, along with numerous smaller multiresidential developments, office developments, and hotels throughout the downtown area. Management further reports that early 2019 year-to-date permitting activity suggests the city's strong trend of new development will likely continue through at least this year.

While we believe it will be difficult for the city to sustain nearly double-digit growth in tax capacity and market value indefinitely and that growth will likely begin to moderate, the amount of new construction and number and scope of projects in various stages of development suggest that the near- to medium-term growth prospects should remain strong.

With steady job gains, low unemployment, and a generally strong private sector anchored by a number of well-known Fortune 500 companies, the city's employment base remains strong and diverse. As of the third quarter of 2018, its largest industries by share of total jobs included health care and social assistance (18.6% of total employment), professional and technical services (11.5%), finance and insurance (10.1%), educational services (9.3%), and accommodation and food services (8.7%). Countywide unemployment in Hennepin County peaked at 7.3% during the Great Recession in 2009 and has since declined to 3.0% in 2017. Management reports that major employers and taxpayers are stable, with several expanding.

### Very strong management

We view the city's management as very strong, with strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

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, five-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.

### Strong budgetary performance

Minneapolis' budgetary performance is strong, in our opinion. The city had surplus operating results in the general fund of 2.0% of expenditures, but a deficit result across all governmental funds of negative 5.9% in fiscal 2017. Our assessment accounts for the fact that we expect budgetary results could improve from 2017 results in the near term. General fund operating results of the city have been stable over the last three years, with results of 0.3% in 2016 and 0.8% in 2015.

The city's general fund budget has seen surpluses for the past seven audited fiscal years, resulting in the addition of $56.8 million to its total fund balance over the same period. With reserves at the highest level in recent memory at the end of fiscal 2017 (Dec. 31) and in excess of the 17% minimum required by the city's fund balance policy, management indicates the city will use reserves in the next few years on nonrecurring capital projects and as part of an effort to more closely align reserves with its policy.

The fiscal 2018 general fund budget was structured with an approximately $17.3 million planned use of fund balance due to the capital projects being rolled over from previous years, and management's year-end estimates reflect a more modest $12.9 million use of reserves. Other highlights to the 2018 fiscal year included a 5.5% levy increase, the establishment of a self-insurance fund to control health care costs, and the creation of a downtown assets fund, which will collect sales and entertainment taxes that had previously been collected in the general fund to finance downtown improvement projects.

The adopted fiscal 2019 budget does not, in our view, reflect a significant departure from previous years and includes a 3.8% increase in total spending (excluding a large, nonrecurring capital outlay for the city's new public services building, which is under construction), an increase of approximately 48 full-time equivalents, and a $40 million investment in affordable housing. The city's overall property tax levy increase of 5.7% is consistent with prior years' levy increases.

While we expect the city's reserves to likely decline in fiscal 2019 and perhaps beyond due to one-time projects, we recognize that this is planned and believe the city's structural budgetary performance will remain strong, as it has been historically, supported by comprehensive and well-embedded long-term planning practices and a solid, rapidly growing economic base. Most of the city's operating revenues are locally derived and are therefore tied in some fashion to local economic activity. Fiscal 2017 (audited) general fund revenue sources included mostly taxes (58% of revenues), intergovernmental aid (17%), charges for services and sales (10%), and licenses and permits (9%), and with full-time equivalents exceeding prerecession highs starting in 2018, we believe the city has flexibility on the expenditure side to reduce costs to balance the budget should its revenue performance soften.

### Very strong budgetary flexibility

Minneapolis' budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2017 of 24% of operating expenditures, or $115.8 million.

The city's total and available (assigned and unassigned) fund balances were at recent highs at the end of fiscal 2017, and with some reserves earmarked for capital spending, we believe the fund balance will likely fall closer to its 17% policy level in the next few years. While we therefore expect reserves could decline, we still expect them to remain at levels we consider very strong and, at minimum, in compliance with the city's reserve policy.

### Very strong liquidity

In our opinion, Minneapolis' liquidity is very strong, with total government available cash at 47.4% of total governmental fund expenditures and 4.0x governmental debt service in 2017. In our view, the city has strong access to external liquidity if necessary.

We have adjusted cash and cash equivalents for primary government to exclude unspent bond proceeds and amounts that carry restrictions. We expect overall cash levels to remain stable and very strong for at least the next several years. The city has a record of frequently accessing capital markets to issue GO debt, which supports our view that it has strong access to external liquidity if needed. Most of its investments are in obligations guaranteed by the U.S.

government, so we do not believe the city is exposed to liquidity risk stemming from an aggressive investment portfolio. We expect overall cash levels to remain stable, and liquidity to remain very strong for the near future.

The city has two variable-rate bank notes outstanding that were issued in 2011 and 2015. Each of the bank agreements includes events of default that allow the banks to accelerate unpaid principal and interest, but each specifies that 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 notes a liquidity risk.

### Strong debt and contingent liability profile

In our view, Minneapolis' debt and contingent liability profile is strong. Total governmental fund debt service is 11.8% of total governmental fund expenditures, and net direct debt is 68.2% of total governmental fund revenue. Overall net debt is low at 2.7% of market value, and approximately 74.8% of the direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors.

Our direct debt calculation excludes a share of the city's GO debt that we consider eligible for self-support credit. The city's current five-year CIP includes about $1.1 billion in projects, of which 21% will be cash-funded, 62% will be financed through new-money debt, and the rest 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, so we anticipate no material weakening in the overall debt profile from new-money issuance. We note, as well, that the city's current GO debt burden (totaling about $680 million) is less than half of what it was a decade ago and has remained relatively constant over the past five years.

Minneapolis' combined required pension and actual other postemployment benefit (OPEB) contributions totaled 7.0% of total governmental fund expenditures in 2017. The city made its full annual required pension contribution in 2017.

The city contributes to two multiple-employer, cost-sharing defined-benefit plans administered by the Public Employees Retirement Association of Minnesota (PERA). These include the General Employees Retirement Fund (GERF), the Public Employees Police and Fire Fund (PEPFF). The city's closed, single-employer plans were fully merged with the PERA plans starting in fiscal 2015. It also contributes to the Teacher Retirement Association Fund (TRA) of Minnesota, pursuant to 2006 legislation that consolidated the Minneapolis Teachers Retirement Fund Association with TRA.

For its closed plans, the city is required to make fixed payments to PERA totaling approximately $27.9 million per year through 2031, when the contribution requirement sunsets, and it is similarly required to make fixed contributions of about $2.3 million per year to TRA until the plan is fully funded. For its open pension plans, the city's PERA contributions are treated like any other PERA participant's, and contribution rates, benefit provisions, and actuarial standards are governed by state statute.

Following a request for clarification from the Governmental Accounting Standards Board (GASB), the city calculates its proportionate share of the net pension liability for the PERA plans and TRA using an alternative method, which resulted in a restatement of its net pension liability as reflected in its 2017 Comprehensive Annual Financial Report (CAFR) and will also be incorporated into its subsequent years' financial statements. At issue was how PERA has calculated the city's proportionate share of the net pension liability under GASB Statement Nos. 67 and 68. In short, PERA had allocated the city's proportionate share of the net pension liability for PERA and TRA based on the proportion of its contributions relative to total plan contributions, irrespective of whether the contributions were employer contributions (for the open plans) or nonemployer contributions (for the closed plans, which are statutorily fixed, and for PERA, sunset in 2031). The upshot was that the city's proportionate share had been overstated significantly, and the alternative calculation accordingly yielded a reduced city net pension liability calculation starting in fiscal 2016 (as restated) onward.

Under the revised calculation, the city's proportionate share of the net pension liability as of Dec. 1, 2018, was $313.6 million for GERF (75.9 % funded as of the plan's June 30, 2018 GASB valuation), $240.1 million for PEPFF (88.8%), and $26.6 million for TRA (76.9%). The city also allows retirees to stay on its health care plan at full cost, giving rise to an implicit rate subsidy. As of the most recent valuation (Jan. 1, 2018), the city's OPEB liability was calculated at $33.7 million.

### Strong institutional framework

The institutional framework score for Minnesota cities with a population greater than 2,500 is strong.

## Outlook

The stable outlook reflects our expectation that Minneapolis' economy should continue to see strong growth through at least the two-year outlook horizon, with its very strong economic base supporting ongoing revenue growth and overall budget stability. We also believe that debt levels should remain relatively low for a city with such an extensive capital program, and its pension costs manageable, even if modest cost increases should materialize following pension reform in the state legislature. Given that we expect management to proactively address any prospective signs of fiscal stress in a way that would allow it to sustain a healthy financial position through a period of moderate distress, as it did in the years immediately following the last recession, we do not anticipate lowering the rating in the two-year outlook horizon.

### Downside scenario

Downside pressure would most likely come via weakening across multiple factors, such as a slowdown in the economy leading to weaker economic metrics, resulting in weaker revenue performance, and perhaps accompanied by rising pension costs or worsening debt metrics. We could lower the rating if we were to see some such combination of individual credit factors declining sufficiently to warrant a downgrade.

## Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015

| Ratings Detail (As Of May 2, 2019) |
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| Ratings Detail (As Of May 2, 2019) (cont.) | | |
|---|---|---|
| Minneapolis taxable GO bnds | | |
| *Long Term Rating* | AAA/Stable | Affirmed |
| Minneapolis taxable GO bnds (downtown/E project) ser 2014 due 03/01/2044 | | |
| *Long Term Rating* | AAA/Stable | Affirmed |
| Minneapolis taxable GO hsg imp area bnds | | |
| *Long Term Rating* | AAA/Stable | Affirmed |
| Minneapolis taxable GO various purp pk bnds | | |
| *Long Term Rating* | AAA/Stable | Affirmed |
| Minneapolis GO convention ctr rfdg bnds | | |
| *Long Term Rating* | AAA/Stable | Affirmed |
| Minneapolis GO imp and various purp bnds | | |
| *Long Term Rating* | AAA/Stable | Affirmed |
| Minneapolis GO imp bnds | | |
| *Long Term Rating* | AAA/Stable | Affirmed |
| Minneapolis GO imp bnds ser 2012 dtd 12/04/2012 due 12/01/2013-2019 2022 2025 2028 2032 | | |
| *Long Term Rating* | AAA/Stable | Affirmed |
| Minneapolis GO imp bnds ser 2014 due 12/01/2034 | | |
| *Long Term Rating* | AAA/Stable | Affirmed |
| Minneapolis GO parking assessment rfdg bnds ser 2012 dtd 10/30/2012 due 12/01/2013-2026 | | |
| *Long Term Rating* | AAA/Stable | Affirmed |
| Minneapolis GO tax increment rfdg bnds (Heritage Park) ser 2012 dtd 10/04/2012 due 03/01/2013-2026 | | |
| *Long Term Rating* | AAA/Stable | Affirmed |
| Minneapolis GO various purp bnds ser 2014 due 12/01/2019 | | |
| *Long Term Rating* | AAA/Stable | Affirmed |
| Minneapolis GO var purp bnds ser 2012 dtd 10/30/2012 due 12/01/2013-2024 | | |
| *Long Term Rating* | AAA/Stable | Affirmed |
| Minneapolis GO imp bnds ser 2011 dtd 11/22/2011 due 12/01/2031 | | |
| *Long Term Rating* | AAA/Stable | Affirmed |

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.