FitchRatings

Public Finance
Tax-Supported
U.S.A.

Minneapolis, Minnesota

New Issue Summary

Sale Date: Sept. 17 competitively.

Series: $26,000,000 Taxable General Obligation Convention Center Refunding Bonds, Series 2020; $12,975,000 General Obligation Parking Assessment Refunding Bonds, Series 2020; and $98,285,000 General Obligation Bonds, Series 2020.

Purpose: Proceeds will be used to finance various capital projects within Minneapolis (the city) as well as to currently refunding several series of prior GO bonds for net present value savings.

Security: The bonds are GOs of the city, backed by the city's full faith and credit pledge and ad valorem taxing power.

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 reflect 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. The city has sufficient gap-closing capacity to offset the revenue declines associated with the current, severe downturn by making limited cuts to services coupled with modest reductions to its reserve cushion.

The Stable Rating Outlook reflects recent declines in the city's long-term liability burden driven by statewide pension reforms and growing evidence that these improvements are sustainable in light of continued population and income growth. The Stable Rating Outlook also reflects Fitch Ratings' expectation that revenue growth will rebound strongly following the 2020 recession.

Economic Resource Base: Minneapolis is the largest city in the state of Minnesota with an estimated 2019 population of 429,606. 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 healthcare, higher education and state & county government sectors. Minneapolis has a sizable retail and financial presence, being home to Ameriprise Financial, US Bancorp, Target Corporation and Wells Fargo Bank. The city's economy, like that of most other U.S. localities, has been strongly affected by the coronavirus pandemic. The city's unemployment rate was 10.5% in July compared with 3% in July 2019, roughly equal to that of the nation as a whole, but well above the state of Minnesota's unemployment rate of 7.4% for the same month.

Key Rating Drivers

Revenue Framework: 'aaa': Revenue growth generally kept pace with U.S. GDP growth during the expansion that followed the Great Recession. Fitch expects longer term growth will continue in light of recent population gains, low unemployment and 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, reflecting the city's capacity to reduce headcount (staffing currently exceeds the pre-recession high point by nearly 600 employees). Carrying costs for debt service and pension contributions are temporarily elevated at over 20% of governmental spending, but are set to decline in 2020 and 2021 as several debt issues mature and debt service returns to historical levels in the 17% to 18% of spending range.

Ratings

Long-Term Issuer Default Rating	AA+

New Issues

$26,000,000 Taxable General Obligation Convention Center Refunding Bonds, Series 2020	AA+
$12,975,000 General Obligation Parking Assessment Refunding Bonds, Series 2020	AA+
$98,285,000 General Obligation Bonds, Series 2020	AA+

Outstanding Debt

(Downtown East Office/Housing/Park Industrial Development District) General Obligation Bonds (Taxable)	AA+
(Heritage Park) General Obligation Tax Increment Refunding Bonds	AA+
(Target Center Project) General Obligation Sales Tax Refunding Bonds (Taxable)	AA+
(Target Center Project) General Obligation Tax Increment Refunding Bonds (Taxable)	AA+
General Obligation Bonds (Taxable)	AA+
General Obligation Bonds (green Bonds)	AA+
General Obligation Capital Improvement Bonds	AA+
General Obligation Convention Center Refunding Bonds (Taxable)	AA+
General Obligation Improvement & Variable Purpose Bonds	AA+
General Obligation Improvement Bonds	AA+
General Obligation Library Bonds	AA+
General Obligation Library referendum Refunding Bonds	AA+
General Obligation Parking assessment Refunding Bonds	AA+
General Obligation Tax Increment Bonds	AA+
General Obligation Various Purpose Bonds	AA+
General Obligation Various Purpose park Bonds (Taxable)	AA+
General Obligation housing Improvement area Bonds (Taxable)	AA+

Rating Outlook

Stable

Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (March 2020)

Related Research

Fitch Rates Minneapolis, MN's $137 Million GO Bonds 'AA+'; Outlook Stable (September 2020)

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Long-Term Liability Burden: 'aa': Long-term liabilities are low-to-moderate compared to the economic resource base, which has benefited from steady increases in population and per capita income levels. The liability level reflects rising direct and overlapping debt and moderate net pension liabilities that are becoming more sustainable as a result of recent statewide pension reforms. Amortization of direct debt is rapid.

Operating Performance: 'aaa': Minneapolis's strong revenue-raising ability and satisfactory control over spending undergird its capacity to manage through downturns with only minimal impairment to financial flexibility. Historically low revenue volatility and ample reserve levels add further support to financial resilience. General fund operations have resulted in consistent operating surpluses.

Rating Sensitivities

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

- Further evidence that recent pension reforms have improved the long-term sustainability of city pension systems relative to the economic resource base.

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

- State implementation of new or permanent tax levy caps for localities that constrains revenue raising ability and limits future budgetary flexibility;
- Carrying costs remaining above their historical averages for an extended duration, weakening the city's expenditure flexibility and gap-closing capacity;
- Economic contraction extending well into 2021 or beyond, consistent with Fitch's coronavirus downside scenario, which triggers sustained and deep revenue declines that leave the city materially less financially resilient.

Current Developments

Sectorwide Coronavirus Implications

The outbreak of coronavirus and related government containment measures worldwide has created an uncertain global environment for U.S. state and local governments and related entities. Fitch's ratings are forward-looking in nature, and Fitch will monitor the severity and duration of the budgetary impact on state and local governments and incorporate revised expectations for future performance and assessment of key risks.

While the initial phase of economic recovery has been faster than expected, GDP in the U.S. is projected to remain below its 4Q19 level until at least 4Q21. In its baseline scenario, Fitch assumes continued strong GDP growth in 3Q20 followed by a slower recovery trajectory from 4Q20 onward amid persisting social distancing behavior and restrictions, high unemployment and a further pullback in private-sector investment. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the report entitled, "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases - Update" (https://www.fitchratings.com/research/sovereigns/fitch-ratings-coronavirus-scenarios-baseline-downside-cases-update-08-09-2020), published Sept. 8, 2020 on www.fitchratings.com.

Coronavirus Impact on Minneapolis

Minneapolis's adopted $1.7 billion 2020 budget included a 6.9% tax levy increase, including a 13.3% rise in the general fund levy and the use of $10 million of fund balance as a contingency. The property tax levy increase was expected to raise $24.3 million in new revenues. The budget focused on affordable housing, violence prevention, and inclusive economic development with a particular focus on job training for the technology sector. The levy's significant increase was intended to fund a variety of short-term capital projects and allow for smaller annual increases from 2021 through 2025.

The mayor and city council began implementing a phased series of spending reductions in March 2020 to offset the projected impact of containment measures related to the coronavirus

Rating History (IDR)

Rating	Action	Outlook/ Watch	Date
AA+	Affirmed	Stable	9/8/20
AA+	Downgraded	Stable	11/8/17
AAA	Affirmed	Stable	6/27/06
AAA	Affirmed	Negative	12/3/02
AAA	Assigned	—	6/18/99

pandemic on city revenues, particularly the local sales tax. Phase 1 actions included a hiring and salary freeze, delays in capital projects, and changes to professional service contracts and discretionary spending. Management estimates these actions will reduce spending by $58 million in fiscal 2020 (Dec. 31 fiscal year-end).

At the time the Phase 1 actions were implemented, the pandemic's actual revenue impact on Minneapolis was unclear. As a result, the city government waited until early July before announcing its proposed Phase 2 budget reductions. In the interim between March and July, Minneapolis was shaken by its most serious civil unrest in decades following the death of resident George Floyd during the course of an arrest by police officers. The subsequent civil disturbances resulted in an estimated $106 million worth of property damage in the city including public property. The Phase 2 proposals included $98 million of overall expenditure reductions and other gap-closing measures, after netting out the planned use of $58 million of cash resources and factoring in expenses related to repairs of public property.

As of July 24, management estimated that 2020 revenues would underperform budget by $98.4 million, or 5.8%. The amended Phase 2 budget cuts reduce spending across all funds by a further $28 million beyond the $58 million of cuts enacted in March, for a total 2020 spending reduction of $86.3 million (5.1% from budget) not including the aforementioned use of $58 million in cash (separate and distinct from the $58 million in Phase I cuts). The remaining $12.4 million gap will be filled by debt funding for some capital projects that the city had originally planned to fund with cash. Nearly 48% of the spending cuts ($41.4 million) will be to appropriations made from the city's general fund, equaling an 8% cut in general fund spending versus the 2020 adopted budget. Fitch views these budget cuts as achievable, and believes they will leave the city well-positioned to adapt to further revenue pressures in 2021.

Credit Profile

Minneapolis's economy is extremely diverse. Major employers include entities active in the fields of 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 County Medical Center (7,100) and Wells Fargo Bank (7,000).

The employment base is strong. Unemployment has historically tracked below the national average, and has been far below the U.S. rate in recent years. Approximately 48% of residents hold a bachelor's degree or higher compared with 31% nationally. Like many other large U.S. cities, Minneapolis's poverty rate of 21% is noticeably above the U.S. rate of 15%. Population growth following the last recession was 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. Population has climbed by an estimated 12% since 2010.

Revenue Framework

The largest general fund revenue sources in 2019 were taxes (50%) and state aid (19%). Other notable revenues include service charges and licenses & permits (both at 12%). Property taxes accounted for the bulk of general fund tax revenues in 2019 following an administrative and accounting decision to shift collections of sales taxes to the newly-created Downtown Assets fund from the general fund starting in fiscal 2018. The city sales tax is a term applied to a 'grab bag' of different local taxes that includes the general sales tax, liquor tax, lodging tax, restaurant tax and an entertainment tax. These taxes totaled $89.2 million in 2019.

Fitch estimates the 10-year general fund revenue growth rate through 2019 at 3.1% per annum after adjusting for accounting changes made in 2014. 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. Building permit values have exceeded $1.2 billion annually since 2012 and reached $2.2 billion in 2019. AV growth since 2013 increased between 9% and 10% annually from 2014 through 2019. Fitch believes these trends are sustainable over the longer term, but acknowledges downside risk related to the medium-term effects of both the pandemic and recent civil unrest.

Continued population growth is likely to sustain a steady expansion in sales and entertainment taxes, along with growth in the tax base. The population has increased by an estimated 12%

since 2010, or twice the national rate of expansion (6%) over the same period. Continued population and revenue growth will be affected by the city government's ability to address the underlying causes of recent public disturbances and ensure the city's safety and economic vibrancy for all residents.

The city's independent legal authority to increase revenues is essentially unlimited given the absolute authority vested in the mayor and city council to adjust the property tax levy, along with service charges and user fees. 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 multiyear tax levy caps — most recently for fiscal years 2009 to 2011. The longest period of multiyear 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 2019. General government (17%) and public works (14%) were the next largest categories.

Fitch believes spending demands are likely to grow at a pace approximately equal to, or slightly above, the natural rate of revenue growth. As part its most recent contract negotiations, the city awarded annual salary increases that were above the rate of inflation for fiscal years 2018 and 2019. Salary growth in this range represents a departure from Minneapolis's recent history, during which time salary increases more closely paced inflation but are consistent with regional averages. Employee benefit costs linked to health insurance will also likely grow above the inflation rate, although management projects that the city's decision to switch to self-insurance in 2018 will result in longer term cost savings.

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. The city has elevated carrying costs for debt service, actuarially determined pension contributions, and other post-employment benefits (OPEB) that have topped 20% of governmental spending in all but one year since 2014. Debt service expense has been the main driver of higher carrying costs. Debt service will drop substantially in 2021 following large principal repayments in 2019 and 2020. Carrying costs are projected to drop below 20% of governmental spending starting in 2021.

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 recent statewide pension reforms reduces, but does 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, covering general, uniformed and former teaching employees, are fixed through statutorily defined end dates. In the case of general and uniformed employees, the end dates reflect former city plans absorbed into statewide plans since 2015.

Minneapolis's $1 billion five-year capital program through 2024 is funded with a combination of debt (58%), cash largely from the city's enterprise funds (21%) and state and federal grants (21%). 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 to support recurring operations and conserve fund balances. The city does not plan on taking advantage of that flexibility in 2021, but is considering reducing capital spending and bonding in 2022 if revenues are compromised in 2021 and beyond due to the coronavirus or other economic factors.

Minneapolis has contracts with 23 bargaining units representing 93% of full-time employees. Public safety makes up 40% of the unionized workforce. Police and firefighters 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.

The workforce reached approximately 4,252 full-time positions in March 2019, equal to a 15% increase in head count since bottoming out at 3,650 employees in 2013 after the last recession. Fitch believes a larger workforce gives management more room to trim positions in pursuit of cost savings.

Long-Term Liability Burden

Minneapolis's long-term liability burden, at 9% of personal income, is low-to-moderate compared with the size and affluence of its economic resource base. Fitch-adjusted net pension liabilities account for 40% of the total liability, debts of overlapping governmental entities account for 35% and net direct debt for 26%. Amortization of direct debt is rapid with 68% of principal scheduled to mature within the next 10 years. The city plans to issue new tax-supported debt in increments of $47 million per annum.

The city reports proportionate shares of the NPLs for three statewide retirement systems: The General Employees Retirement Fund (GERF), Public Employees Police and Fire Fund (PEPFF), and Teachers Retirement Association (TRA). The reported assets-to-liabilities ratio for all plans in aggregate was 86% as of June 30, 2019, reflecting the 7.5% discount rates used by all plans. The city's combined NPL for the three plans was estimated at $425 million in 2019. Using its standard 6% discount rate for U.S. state and local governments, Fitch calculates an adjusted NPL of $949 million.

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 (ADCs) 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

Fitch believes that the city is well positioned to face the challenges associated with a moderate economic downturn and its broad revenue-raising flexibility and solid spending controls should allow it to quickly close budget gaps resulting from the current downturn, likely with minimal use of fiscal reserves to bridge any shortfall. Fitch calculates a low level of estimated general fund revenue volatility based on historical data using the Fitch Analytical Stress Test (FAST) tool, which has been adjusted to show that a 5.6% decline in U.S. GDP in 2020 caused by the pandemic would lead to an estimated FAST-generated general fund revenue decline of 10%.

The city has a solid track record of conservative budgeting and cautious revenue estimates. Fiscal 2019 concluded with a $24 million operating surplus driven by solid growth in permit, license and property tax revenues based on solid underlying economic performance. Restrained spending growth and lower overtime costs for public safety personnel also contributed to surplus operations. Available reserves finished 2019 at $128 million, equal to 25% of general fund spending and transfers out.

The 2020 budget was balanced with a 6.9% property tax levy increase and included $5 million as a contingency. Management anticipates that the general fund will close the year with an operating deficit in the $10 million to $13 million range and a similar draw on accumulated fiscal reserves due to revenue stresses associated with the coronavirus pandemic — particularly an estimated 59% drop in local sales tax collections because of the convention center having been closed since late March and the lengthy closure and reduced patronage at the city's many retail outlets. The general fund would then finish 2020 with approximately $116 million of available reserves, equal to 23% of 2020 spending and transfers out.

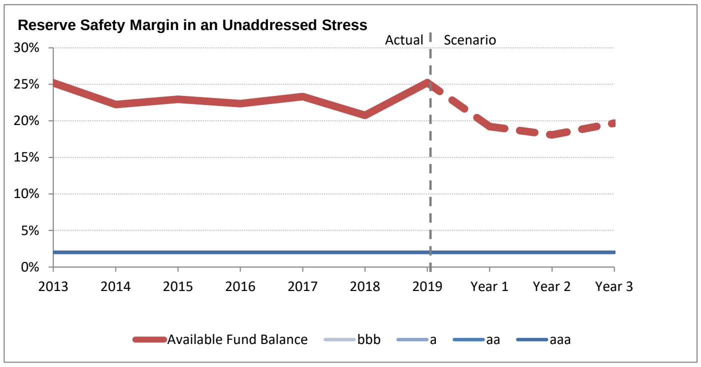
The city is guided by an official policy of keeping general fund reserves at minimum of 17% of current year spending and transfers out. Minneapolis kept reserves above this policy floor during the last recession and economic expansion.

ESG Considerations

The highest level of environmental, social and governance (ESG) credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Minneapolis (MN)

Scenario Analysis



Analyst Interpretation of Scenario Results:

Fitch believes that the city is well-positioned to face the challenges associated with a moderate economic downturn and its broad revenue-raising flexibility and solid spending controls should allow it to quickly close budget gaps resulting from the current downturn, likely with minimal use of fiscal reserves to bridge any shortfall. Fitch calculates a low level of estimated general fund revenue volatility based on historical data using the Fitch Analytical Stress Test (FAST) tool, which has been adjusted to show that a 5.6% decline in U.S. GDP in 2020 caused by the pandemic would lead to an estimated FAST-generated general fund revenue decline of 10%.

Scenario Parameters:		Year 1	Year 2	Year 3
GDP Assumption (% Change)		(5.6%)	4.3%	2.5%
Expenditure Assumption (% Change)		0.0%	2.0%	2.0%
Revenue Output (% Change)	*Min Y1 Stress:* **-5%** *Case Used:* **Baseline**	(10.2%)	7.7%	4.8%
Inherent Budget Flexibility			Superior	

Revenues, Expenditures, and Fund Balance	Actuals							Scenario Output		
	2013	2014	2015	2016	2017	2018	2019	Year 1	Year 2	Year 3
Total Revenues	382,543	464,007	455,883	472,676	493,619	443,615	471,531	423,374	455,918	477,784
% Change in Revenues	-	21.3%	(1.8%)	3.7%	4.4%	(10.1%)	6.3%	(10.2%)	7.7%	4.8%
Total Expenditures	354,182	386,216	397,090	419,037	437,130	467,391	478,710	478,710	488,284	498,050
% Change in Expenditures	-	9.0%	2.8%	5.5%	4.3%	6.9%	2.4%	0.0%	2.0%	2.0%
Transfers In and Other Sources	13,868	2,323	4,258	4,029	12,499	39,887	60,182	54,036	58,189	60,980
Transfers Out and Other Uses	30,616	74,645	59,499	56,162	59,388	29,013	29,154	29,154	29,737	30,332
Net Transfers	(16,748)	(72,322)	(55,241)	(52,133)	(46,889)	10,874	31,028	24,882	28,452	30,648
Bond Proceeds and Other One-Time Uses	-	-	-	-	-	-	-	-	-	-
Net Operating Surplus(+)/Deficit(-) After Transfers	11,613	5,469	3,552	1,506	9,600	(12,902)	23,849	(30,455)	(3,914)	10,382
Net Operating Surplus(+)/Deficit(-) (% of Expend. and Transfers Out)	3.0%	1.2%	0.8%	0.3%	1.9%	(2.6%)	4.7%	(6.0%)	(0.8%)	2.0%
Unrestricted/Unreserved Fund Balance (General Fund)	96,970	102,439	104,740	106,236	115,835	102,946	128,040	97,585	93,671	104,054
Other Available Funds (GF + Non-GF)	-	-	-	-	-	-	-	-	-	-
Combined Available Funds Balance (GF + Other Available Funds)	96,970	102,439	104,740	106,236	115,835	102,946	128,040	97,585	93,671	104,054
Combined Available Fund Bal. (% of Expend. and Transfers Out)	25.2%	22.2%	22.9%	22.4%	23.3%	20.7%	25.2%	19.2%	18.1%	19.7%

Reserve Safety Margins	Inherent Budget Flexibility				
Moderate	Minimal	Limited	Midrange	High	Superior
Reserve Safety Margin (aaa)	16.0%	8.0%	5.0%	3.0%	2.0%
Reserve Safety Margin (aa)	12.0%	6.0%	4.0%	2.5%	2.0%
Reserve Safety Margin (a)	8.0%	4.0%	2.5%	2.0%	2.0%
Reserve Safety Margin (bbb)	3.0%	2.0%	2.0%	2.0%	2.0%

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's scenario analysis assumes the GDP and expenditure growth sequence shown in the 'Scenario Parameters' section. Inherent budget flexibility is the analyst's assessment of the issuer's ability to deal with fiscal stress through tax and spending policy choices, and determines the multiples used to calculate the reserve safety margin. For further details, please see Fitch's US Tax-Supported Rating Criteria.

The ratings above were solicited and assigned or maintained at the request of the rated entity/Issuer or a related third party. Any exceptions follow below.