S&P Global
Ratings

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Summary:

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

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Credit Profile		
US$98.285 mil GO bnds ser 2020 due 12/01/2030		
Long Term Rating	AAA/Negative	New
US$26.0 mil taxable GO convention ctr rfdg bnds ser 2020 due 12/01/2025		
Long Term Rating	AAA/Negative	New
US$12.975 mil GO parking assess rfdg bnds ser 2020 due 12/01/2029		
Long Term Rating	AAA/Negative	New
Minneapolis GO		
Long Term Rating	AAA/Negative	Affirmed

Rating Action

S&P Global Ratings has revised the outlook on Minneapolis, Minn.'s general obligation (GO) debt outstanding to negative from stable. At the same, time we affirmed our 'AAA' rating on the city's existing GO debt and assigned our 'AAA' rating to its anticipated $98.3 million series 2020 GO bonds, $12.9 million series 2020 GO parking assessment refunding bonds, and $26 million series 2020 taxable GO convention center refunding bonds.

All three of the 2020 series bonds are secured by the city's unlimited-tax GO pledge, while the GO parking assessment bonds are additionally secured by special assessments and the taxable GO convention center bonds by sales taxes. We rate each series to the city's unlimited-tax GO pledge. Officials will use 2020 GO bond proceeds to finance various capital improvements and equipment purchases, while the other two series will refinance existing debt for interest cost savings.

We have also revised the outlook to negative from stable and affirmed our 'A+' rating on several series of limited-tax-supported development revenue bonds issued under the city's common bond fund. The series 2003-1A, 2010-1, 2010-2A, and 2013-1 bonds are supported by the city's pledge to maintain a tax reserve fund balance equal to twice the amount obtained from multiplying a 0.5% tax rate limit by the city's tax capacity, and the series 2005-1 bonds are secured by this pledge along with a pledge to pay debt service from legally available funds. Under our criteria "Issue Credit Ratings Linked to U.S. Public Finance Obligor’s Creditworthiness" (published Nov. 20, 2019, on RatingsDirect), the rating and outlook on the city's common bond fund obligations are linked to our rating and outlook on the city's GO debt. We currently rate the bonds four notches below the city's GO rating, reflecting additional risk from the intended payment source for the bonds (loan repayments from various corporations) and some uncertainty regarding how the city would budget and appropriate if it did need to provide direct support. (See our most recent rating action press release on Minneapolis, published on April 30, 2020.)

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), 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

Credit overview

The negative outlook reflects our view that there is at least a one-in-three chance of a lower rating within the next one-to-two years, as the city is dealing with concurrent fiscal, economic, and policy challenges that we believe create elevated risk of near-term credit deterioration. The ongoing COVID-19 pandemic has created a budget gap with little precedent in fiscal 2020, and will likely continue to pressure the city's fiscal position in 2021, absent a significant turn of events. At the same time, since the early summer death of George Floyd by Minneapolis police officers, the city has been the epicenter of an ongoing series of nationwide protests calling for a fundamental reassessment of the role of police in U.S. cities. In Minneapolis, the protests have galvanized calls for defunding the police department, including among a supermajority of the city council. While the mayor's proposed 2021 budget includes some early installments toward public safety reform, the overarching policy framework, including specifics on how any money may be allocated, has yet to take definitive shape, which we believe also lends uncertainty as to the likely budgetary and credit implications, if any, of the reform efforts.

We see an elevated likelihood that Minneapolis will struggle to maintain budgetary balance through at least fiscal 2021 due to the twin effects of revenue volatility stemming from the pandemic, alongside cost pressures that could emerge over the same period. In addition to the potential for de facto expenditure mandates that could accompany demands for police reform, the city will likely be subject to liabilities from lawsuits associated with George Floyd's death, and is also reporting elevated worker compensation claims related to the subsequent period of civil unrest. Meanwhile, the economy remains fragile at best, and the recovery from the pandemic-induced national recession is likely to be a slow one. S&P Global Economics' latest forecast ("The U.S. Faces A Longer And Slower Climb From The Bottom," published on RatingsDirect on June 25, 2020) indicates that national GDP will take two years still to recover to pre-recession levels, while the unemployment rate will not return to pre-pandemic levels until late 2023. Thus, even as the city confronts the crises brought on by the pandemic and calls for historic reform of its public safety model, the emerging economic backdrop suggests a slow-moving recovery that could challenge even outyear budgetary balance, absent a proactive response from management and city leadership.

We will continue to monitor the city's response as we progress into the 2021 budget cycle, and, in particular, we will be watching to see how it responds to the budget gap reflected in the mayor's 2021 budget proposal, which projects significant revenue shortfalls through 2021. Along similar lines, we will be watching for more detail on how any prospective police reforms will be incorporated into the budget. Downside rating pressure will increase to the extent that the city relies heavily on reserves and other one-off measures to balance the budget in fiscal 2021, or if we see evidence that a significant budgetary imbalance is likely to persist into the following fiscal year. While some reliance on reserves in a severe economic downturn is reasonable and expected, we think that managing a structural balance without significant use of one-time measures across multiple fiscal years is a hallmark of 'AAA' rated credits, and we would thus expect to see downside rating pressure increase in the absence of firm, structural responses to multiyear fiscal imbalances.

And finally, our assessment of the city's credit trajectory will be informed by its economic performance through the next few years; downside risk will increase if key measures of the city's economic health and recovery underperform those of similarly rated peers across the U.S. We recognize that Minneapolis comes into the current recession following a period of historic growth that has been reflected in considerable gains across virtually all key measures of economic health. Still, an underperforming economy once the recovery is underway could pressure the rating, particularly if accompanied by weakening across other credit factors.

The 'AAA' rating further reflects our assessment 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;
- Weak budgetary performance, with operating results that we expect to deteriorate in the near term relative to fiscal 2019, which closed with an operating surplus in the general fund but a slight operating deficit at the total governmental fund level;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 27% of operating expenditures;
- Very strong liquidity, with total government available cash at 44.1% of total governmental fund expenditures and 2.8x governmental debt service, and access to external liquidity we consider strong, but an exposure to a nonremote contingent liability risk;
- Adequate debt and contingent liability position, with debt service carrying charges at 15.5% of expenditures and net direct debt that is 70.3% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 68% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Environmental, social, and governance factors

The revision of the rating outlook to negative from stable is informed, in part, by our view that the city is subject to elevated social risk relative to sector norms. George Floyd's death has exposed Minneapolis directly to large legal settlements, and the civil unrest and calls for police reform in its aftermath have created an elevated likelihood of the extraordinary costs mentioned previously that could pressure the city's budget for a prolonged period. Although we consider governance factors in line with the sector standards, we could revise our view of the city's governance risk in the future if its approach to police reform perpetuates conditions that could lead to greater social unrest, and with it, greater potential for economic and fiscal volatility. The city's environmental factors are in line with sector norms.

Negative Outlook

Downside scenario

We stress that while our outlook horizon has traditionally encompassed a period of up to one-to-two years, given the unprecedented nature of the pandemic and the rapidity with which circumstances are changing, we could take additional rating action at any time if new information becomes available that we think is actionable. We could lower the rating if Minneapolis closes the projected fiscal 2021 budget gap by relying principally on one-off rather than structural solutions, such that a structural budget gap is carried into the subsequent fiscal year or we otherwise believe its flexibility to address future budgetary contingencies is materially impaired. We could also lower the rating if the social risks that we believe have been on display since earlier this year persist, creating an elevated likelihood for social, economic, and fiscal disruption in the future. We note that our assessment of the city's credit trajectory is holistic and will be informed by other factors as well, such as the pace of its economic recovery relative to peers and the strength of its reserves position and liquidity relative to peers, in particular if Minneapolis sees large one-time costs from legal settlements or otherwise.

Return to stable scenario

We could revise the outlook to stable with clear evidence that the city will address its fiscal 2021 budget gap with substantive structural measures that place it on a sustainable long-term footing, while also covering any extraordinary costs that should arise in the coming year, whether stemming from reform efforts or otherwise. A stable outlook will become more likely if Minneapolis is able to lay out a clear policy and fiscal roadmap for police reform that lend greater certainty as to its ability to manage forthcoming changes while maintaining consistent budgetary balance.

Credit Opinion

Very strong economy

We consider Minneapolis's economy very strong. The city, with a population of 422,613, 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 113% of the national level and per capita market value of $131,054. Overall, market value grew by 5.8% over the past year to $55.4 billion in 2019. The county unemployment rate was 2.8% in 2019.

The city comes into the 2020 recession 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 leading into 2020, including $2.2 billion in 2019 alone, making it the strongest year on record in terms of the dollar value of new development. Since 2012, economic market value has grown by 66%, from $33.4 billion to $55.4 billion in 2018-2019. Although the sales ratio used to compute the 2019-2020 economic market value has yet to be published, the available valuation data suggest yet another strong year of growth.

We expect that the pandemic and recession could portend a slowdown in new development, along with slow or negative valuation growth beyond 2020. And we note as well that the civil unrest during the summer resulted in several commercial corridors and more than 1,000 businesses being damaged or destroyed, which could likewise pressure economic market value in the coming year. Though city tax levies do not depend on valuation growth, the combination of stagnant or declining valuations and high unemployment is more likely to create resistance to large levy increases and, to that end, could make achieving structural budgetary balance more difficult in fiscal 2021 and beyond.

Countywide unemployment has typically been well under national levels and closely tracks statewide levels. The seasonally unadjusted unemployment rate topped out at 7.3% during the last recession in 2009 and declined in each year to 2.8% in 2019. The monthly unemployment rate increased to 9% in April 2020 with the onset of the pandemic and has since remained in the 9% to 10% range. Absent a significant and unlikely turn of events in the last part of the year, we expect that the countywide annual unemployment rate will remain elevated compared to historical levels and could exceed that seen at the height of the last recession.

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, include 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.

Weak budgetary performance

Minneapolis's budgetary performance is weak, in our opinion. The city had surplus operating results in the general fund of 5.9% of expenditures, but a slight deficit result across all governmental funds of negative 0.7% in fiscal 2019. Our assessment of the city's budgetary performance accounts for the deterioration that we expect in fiscal years 2020 and 2021 from the baseline of a budget that has historically been balanced or better in most years, and also acknowledges a good deal of uncertainty and risk regarding the pandemic and its ongoing effects on revenue performance, along with potential cost pressures that could emerge in the coming year.

With the onset of the COVID-19 pandemic and attendant pressure on revenue performance, the city faced a projected $156 million budget gap across all funds in fiscal 2020. While the mayor took administrative action in the early part of the year to close a portion of the projected shortfall and the city council subsequently passed a midyear budget amendment with additional gap-closing measures, the majority of the adjustments consisted of items that were one-time in nature, such as the deferral of discretionary capital spending and the use of cash on hand. In our view, the heavy reliance on one-time rather than structural solutions in fiscal 2020, while reasonable on a short-term basis and amid much uncertainty regarding the pandemic, could defer more difficult budgetary decisions into the future, particularly to the extent that the pandemic persists in something resembling its current form into fiscal 2021.

Following the budget revisions noted above, the city is projecting an $8 million use of reserves in the general fund by year-end and an additional $32.5 million use of reserves in the downtown assets fund. The downtown assets fund has been particularly hard hit during the pandemic, given its reliance on economically sensitive revenues such as liquor sales, restaurant, entertainment, lodging, and local sales taxes. In addition, it regularly transfers substantial resources to the general fund and had budgeted a $32.7 million transfer in 2020 alone, which was reduced to $10.7 million. The $22 million reduction accounts for about 40% of the projected general fund revenue loss. Other major off-budget general fund revenues include property taxes, franchise fees, and licenses and permits, which collectively account for the majority of the revenue shortfall.

Looking to the 2021 budget cycle, we expect that the revenue losses seen in fiscal 2020 may be largely mirrored next year, particularly if the pandemic persists well into the year. And as noted, the city could also see some unusual cost pressures the extent of which is not known at this time. These could include legal settlement costs, outsized worker compensation claims, and costs associated with police reform. While the final 2021 budget will not be formally adopted until December, the mayor's recently released budget proposal reflects a 6% revenue loss from the 2020 adopted budget across all funds and, assuming current service levels are carried forward with no adjustments, an $18 million general fund deficit.

While the mayor's budget address focused heavily on the necessity of police reform, we think there is still a good deal of unresolved policy uncertainty around the issue and, to that end, the fiscal implications also remain unclear. We think that it is possible, however, that cost pressures could emerge beginning in fiscal 2021 that could challenge the city's ability to maintain budgetary balance, particularly when viewed in combination with the difficult economic environment that appears likely to carry into next year along lines that are similar to what we have experienced this year.

Very strong budgetary flexibility

Minneapolis's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 27% of operating expenditures, or $128.0 million.

At the end of fiscal 2019, Minneapolis' unassigned general fund balance of $128 million was at the highest level in recent memory, both as a share of operating expenditures and in dollar terms. The city has long had a formal fund balance policy requiring a minimum unrestricted reserve equal to 17% of following year's budgeted expenditures. We expect reserves to decline in fiscal 2020 with the currently projected drawdown, and we expect they will remain pressured in fiscal 2021. Still, we expect the city will continue to observe its reserve policy and it has some latitude to deficit spend while keeping its reserves in alignment with the minimum policy requirement and at levels that we consider very strong.

Very strong liquidity

In our opinion, Minneapolis's liquidity is very strong, with total government available cash at 44.1% of total governmental fund expenditures and 2.8x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary. Weakening Minneapolis's liquidity position, in our assessment, is the city's exposure to a nonremote contingent liability that could come due within 12 months.

Available cash and cash equivalents totaled $417.7 million at the end of fiscal 2019. We have adjusted cash and cash equivalents for primary government to exclude unspent bond proceeds and amounts that carry restrictions. Our overall liquidity assessment reflects our view that the city currently has outsized exposure to contingent risk stemming from the legal liability associated with George Floyd's death. Its self-insurance internal service fund also functions as a tort liability fund and has covered sizable settlement payouts in the past. The fund held $93.6 million in cash and equivalents at the close of fiscal 2019; while we see an elevated risk that the city could be subject to similar settlements, we also recognize that cash levels are likely to remain very strong, even supposing a large payout in the near term.

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. Minneapolis has not borrowed for cash-flow purposes historically, nor does management project needing to do so in the near future, given its ample internal cash.

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. The city has no swaps associated with the loans.

Adequate debt and contingent liability profile

In our view, Minneapolis' debt and contingent liability profile is adequate. Total governmental fund debt service is 15.5% of total governmental fund expenditures, and net direct debt is 70.3% of total governmental fund revenue. Overall net debt is low at 2.7% of market value, and approximately 68.2% of the direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors.

We calculate direct debt at $836.2 million, and excluding a share of the city's GO debt that we consider eligible for self-support credit, we calculate net direct debt at $662 million. The city's 2020-2024 CIP includes about $923.3 million in projects, of which 23% will be cash-funded, 55% 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. While we anticipate no material weakening in the overall debt profile from new-money issuance, we believe that debt as a share of economic market value could increase should property values decline over the next several years.

Pension and other postemployment benefits

We do not believe that pension and other postemployment benefits (OPEBS) 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' annual pension costs in fiscal 2019 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): 80.2% funded as of June 30, 2019, with a city proportionate share of the plan's net pension liability (NPL) of $261.5 million;
- The Public Employees Police and Fire Fund (PEPFF): 89.3% funded with a city proportionate share of $187.2 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 plan that the city funds on a pay-as-you-go basis: 0% funded with a $36.7 million net liability.

Fiscal 2019 pension and OPEB contributions were 6.6% of adjusted governmental fund expenditures. 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 NPL--but fell short of our minimum funding progress metric. Key plan risks include a statutory funding practice that has regularly produced contributions that have fallen short of actuarial recommendations, which has contributed 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% 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.

Strong institutional framework

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

Related Research

- 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 September 9, 2020)		
Minneapolis GO		
Long Term Rating	AAA/Negative	Affirmed
Minneapolis GO		
Long Term Rating	AAA/Negative	Affirmed
Minneapolis GO		
Long Term Rating	AAA/Negative	Affirmed
Minneapolis GO		
Long Term Rating	AAA/Negative	Affirmed
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Minneapolis GO		
Long Term Rating	AAA/Negative	Affirmed
Minneapolis GO		
Long Term Rating	AAA/Negative	Affirmed
Minneapolis (Common Fd) SRFPOOL		
Long Term Rating	A+/Negative	Affirmed
Minneapolis (Common Fd) SRFPOOL (AGC)		
Unenhanced Rating	A+(SPUR)/Negative	Affirmed

Many issues are enhanced by bond insurance.