Minneapolis, Minnesota

New Issue Report

Ratings

Long-Term Issuer Default Rating AAA

New Issue

$120,000,000 General Obligation Improvement and Various Purpose Bonds, Series 2016 AAA

Outstanding Debt

See page 4 for a full listing of Outstanding Debt.

Rating Outlook

Stable

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New Issue Summary

Sale Date: Oct. 5, 2016.

Series: $120,000,000 General Obligation Improvement and Various Purpose Bonds, Series 2016.

Purpose: To fund various capital improvements to the Minneapolis' (the city) infrastructure.

Security: Full faith and credit and unlimited ad valorem taxing power of the city.

Analytical Conclusion: Fitch Ratings' affirmation of the city's 'AAA' Issuer Default Rating (IDR) and GO rating reflects Minneapolis' favorable growth prospects, broad revenue-raising powers and solid budgetary flexibility. Long-term liabilities are low relative to the economic resource base, which Fitch believes will continue to expand rapidly given Minnesota's healthy economy. Conservative budget practices are likely to persist. The city has sufficient budgetary flexibility to offset revenue declines with limited service cuts and reserve reductions.

Key Rating Drivers

Economic Resource Base: Minneapolis is the largest city in the state, with a 2015 population of 410,939. Along with its sister city, St. Paul, Minneapolis forms the core for the second largest economic center in the Midwest after Chicago. The city's broad and diverse economic base benefits from the presence of major employers in the relatively stable healthcare, higher education and state and county government sectors. The city also has a sizable retail and financial presence, being home to Ameriprise Financial, U.S. Bancorp and Target Corp. Wells Fargo Bank also has a significant presence in the city.

Revenue Framework: 'aaa' factor assessment. Revenue growth over the past decade has generally kept pace with U.S. GDP. Fitch expects this trend to continue given the city's growing population, low unemployment and vibrant and diverse economy. The city's independent legal ability to raise revenues is strong, although Fitch notes that the state has enacted temporary tax levy caps in the past.

Expenditure Framework: 'aa' factor assessment. Fitch expects spending to grow roughly in line with to marginally above the pace of revenue growth. Overall flexibility of the city's main spending items is adequate given that carrying costs were somewhat elevated at 22% of expenditures in 2015 (Dec. 31 fiscal year end), and are likely to remain in this range for the near term. The city has room to reduce headcount, as staffing levels match their 2008 peak.

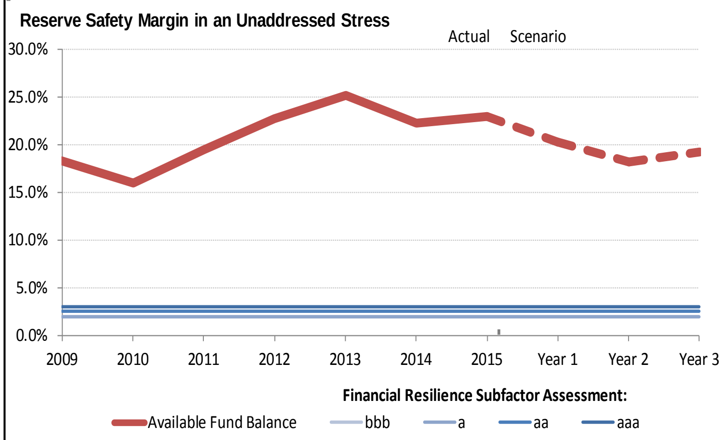
Long-Term Liability Burden: 'aaa' factor assessment. Long-term liabilities are low compared to the economic resource base, reflecting a modest level of direct debt and benefiting from steady increases in both the city's population and per capita income levels.

Operating Performance: 'aaa' factor assessment. Minneapolis' strong revenue-raising ability and satisfactory control over expenditures undergird its capacity to manage through future downturns with only minimal impairments to financial flexibility. The city's low tax revenue volatility and ample reserve levels further support financial resilience. Conservative operations have resulted in consistent operating surpluses since 2010.

Minneapolis (MN)

Scenario Analysis

v. 1.10 2016/06/22



Analyst Interpretation of Scenario Results:

Fitch believes that the city is well-positioned to face the challenges associated with a moderate economic downturn. Fitch calculates a low level of estimated revenue volatility within the city's general fund based on 16 years of historic data. A 1% decline in US GDP would lead to a general fund revenue decline of less than 1%. In our view, the city's broad revenue-raising flexibility and adequate spending controls would allow the administration to quickly close the resulting budget gap, likely with minimal to no use of fiscal reserves to bridge the shortfall.

Scenario Parameters:	Year 1	Year 2	Year 3
GDP Assumption (% Change)	(1.0%)	0.5%	2.0%
Expenditure Assumption (% Change)	2.0%	2.0%	2.0%
Revenue Output (% Change)	(1.0%)	2.5%	5.2%
Inherent Budget Flexibility	High		

Revenues, Expenditures, and Fund Balance	Actuals							Scenario Output		
	2009	2010	2011	2012	2013	2014	2015	Year 1	Year 2	Year 3
Total Revenues	359,255	346,119	352,596	384,195	382,543	464,007	455,883	451,324	462,679	486,628
% Change in Revenues	-	(3.7%)	1.9%	9.0%	(0.4%)	21.3%	(1.8%)	(1.0%)	2.5%	5.2%
Total Expenditures	326,089	331,296	330,958	338,706	354,182	386,216	397,090	405,032	413,132	421,395
% Change in Expenditures	-	1.6%	(0.1%)	2.3%	4.6%	9.0%	2.8%	2.0%	2.0%	2.0%
Transfers In and Other Sources	28,036	22,673	30,000	10,268	13,868	2,323	4,258	4,215	4,321	4,545
Transfers Out and Other Uses	42,623	44,401	40,629	41,658	30,616	74,645	59,499	60,689	61,903	63,141
Net Transfers	(14,587)	(21,728)	(10,629)	(31,390)	(16,748)	(72,322)	(55,241)	(56,474)	(57,581)	(58,596)
Bond Proceeds and Other One-Time Uses	-	-	-	-	-	-	-	-	-	-
Net Operating Surplus(+)/Deficit(-) After Transfers	18,579	(6,905)	11,009	14,099	11,613	5,469	3,552	(10,181)	(8,034)	6,637
Net Operating Surplus(+)/Deficit(-) (% of Expend. and Transfers Out)	5.0%	(1.8%)	3.0%	3.7%	3.0%	1.2%	0.8%	(2.2%)	(1.7%)	1.4%
Unrestricted/Unreserved Fund Balance (General Fund)	67,340	60,092	72,335	86,298	96,970	102,439	104,740	94,559	86,525	93,162
Other Available Funds (Analyst Input)	-	-	-	-	-	-	-	-	-	-
Combined Available Funds Balance (GF + Analyst Input)	67,340	60,092	72,335	86,298	96,970	102,439	104,740	94,559	86,525	93,162
Combined Available Fund Bal. (% of Expend. and Transfers Out)	18.3%	16.0%	19.5%	22.7%	25.2%	22.2%	22.9%	20.3%	18.2%	19.2%

Reserve Safety Margins	Inherent Budget Flexibility				
	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 downturn scenario assumes a -1.0% GDP decline in the first year, followed by 0.5% and 2.0% GDP growth in Years 2 and 3, respectively. Expenditures are assumed to grow at a 2.0% rate of inflation. 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.

Rating History — IDR

Rating	Action	Outlook/ Watch	Date
AAA	Affirmed	Stable	9/27/16
AAA	Affirmed	Stable	6/27/06
AAA	Affirmed	Negative	12/3/02
AAA	Affirmed	—	6/23/99
AAA	Assigned	—	6/18/99

Related Research

Fitch Rates Minneapolis' (MN) $120MM GO Bonds 'AAA'; Outlook Stable (September 2016)

Related Criteria

U.S. Tax-Supported Rating Criteria (April 2016)

Rating Sensitivities

Growth in Liability Burden: The IDR and GO rating are sensitive to material growth in the liability burden such that future increases to liabilities outstrip the pace of expansion in the city's economic resource base.

Enactment of Revenue-Raising Constraints: The IDR and GO rating are sensitive to constraints that the state could place on the city's future revenue-raising ability, such as tax rate and/or levy caps. Such measures would be analyzed for their impact on the city's budget flexibility and could place negative pressure on the rating.

Credit Profile

Minneapolis' economy is extremely diverse. Major employers include entities active in the fields of healthcare, banking, higher education and the retail trade. The city also includes a significant public-sector presence in the form of both city and county government (Minneapolis is the seat of Hennepin County) and Minneapolis public schools. The five largest employers are the University of Minnesota (14,400), Wells Fargo Bank (11,000), Fairview Health Services (10,200), Target Corp. (9,500) and Allina Health (9,400).

The city's employment base is strong, with a rapidly growing workforce. The city replenished all of the jobs it lost during the recession by the start of 2011, and the workforce has been expanding rapidly ever since. Unemployment in the city has historically tracked below the U.S. average, but has been far below the U.S. rate in recent years. A substantial 48% of the city's population holds a bachelor's degree or higher, compared to 31% for the U.S. In common with many other large U.S. cities, Minneapolis' poverty rate, at 19.5%, is noticeably above the U.S. rate of 14.7%.

Revenue Framework

The general fund's largest revenue sources are property taxes (34%) and state aid (18%), which together account for more than one-half of operating revenues. Minor, albeit important, revenue sources include sales and use taxes (8%), other taxes (10%), service charges (10%) and fees and fines (10%). Property taxes have risen markedly since 2004, but registered only modest growth between 2011 and 2015 as the city focused on keeping the levy flat to provide tax relief to residents. Local sales, entertainment and hotel taxes have risen at a level approaching 4% per annum since 2000.

Fitch estimates the city's 10-year general fund revenue growth rate at roughly 3.2% per annum after adjusting for accounting changes made in 2014 that resulted in sales and entertainment tax revenue streams previously recorded in the convention center fund being shifted permanently to the general fund. Because this relatively healthy growth history — slightly below the rate of U.S. GDP growth — includes the period of the Great Recession and its impact on city finances, as well as several years when the city held the levy relatively flat, Fitch believes general fund revenues are likely to expand at a slightly faster pace. In light of the city's and state's impressive post-recession recoveries, Fitch anticipates general fund revenues will continue to rise at or above the rate of U.S. GDP expansion.

Significant new residential and commercial construction in various neighborhoods, including downtown, is having a positive impact on city revenues. Building permit values have been above $1 billion annually since 2012 and experienced a historic peak in 2014 at $2 billion versus $750 million three years prior. Assessed values (AV) have also rebounded following several years of decline in the wake of the recession. AVs grew 2% in 2014 and 10% in 2015 and 2016. They are projected to rise another 7% to 9% in 2017. The proposed 2017 budget

Outstanding Debt

(900 Nicollet Mall) General Obligation Tax Increment Refunding Bonds	AAA
(Downtown East Office/Housing/Park Industrial Development District) General Obligation Bonds (Taxable)	AAA
(Heritage Park) General Obligation Tax Increment Bonds	AAA
(Heritage Park) General Obligation Tax Increment Refunding Bonds	AAA
(Laurel Village) General Obligation Tax Increment Refunding Bonds	AAA
(Midtown Exchange) General Obligation Tax Increment Bonds	AAA
(Milwaukee Depot) General Obligation Tax Increment Refunding Bonds	AAA
(St. Thomas/WMEP Parking Ramp) General Obligation Tax Increment Refunding Bonds	AAA
(Target Center Project) General Obligation Tax Increment Refunding Bonds (Taxable)	AAA
(West Side Milling) General Obligation Tax Increment Refunding Bonds (Taxable)	AAA
General Obligation Convention Center Bonds	AAA
General Obligation Convention Center Refunding Bonds	AAA
General Obligation Convention Center Refunding Bonds (Taxable)	AAA
General Obligation Improvement Bonds	AAA
General Obligation Parking Assessment Bonds	AAA
General Obligation Parking Ramp Bonds	AAA
General Obligation Refunding Bonds	AAA
General Obligation Tax Increment Bonds	AAA
General Obligation Tax Increment Bonds (Taxable)	AAA
General Obligation Tax Increment Refunding Bonds	AAA
General Obligation Variable Purpose Limited Tax Bonds	AAA
General Obligation Variable Purpose Refunding Bonds	AAA
General Obligation Various Purpose Bonds	AAA
General Obligation Various Purpose Refunding Bonds	AAA
General Obligation Various Purpose Park Bonds (Taxable)	AAA
General Obligation Block E Refunding Bonds (Taxable)	AAA
General Obligation Housing Improvement Area Bonds (Taxable)	AAA
General Obligation Library Bonds	AAA
General Obligation Library Referendum Refunding Bonds	AAA
General Obligation Parking Assessment Refunding Bonds	AAA
General Obligation Pension (MPRA) Bonds (Taxable)	AAA
General Obligation Pension Bonds (MERF)	AAA

calls for a 5.5% tax levy increase to take advantage of rising AV. Sales and entertainment taxes will likely continue to rise at historical levels approaching 4.0%.

The city's independent legal authority to increase revenues is essentially unlimited given the absolute authority vested in the mayor and city council to increase the property tax levy as well as service charges, user fines and fees. Together, these revenue sources account for more than 50% of the general fund budget. Further, the city can raise property tax revenues by increasing the millage tax rate.

In the past, Minnesota has enacted statewide limits to the property tax levies of its local governments. These limitations have been temporary in nature, generally expiring after one year. They have never applied to taxes levied to pay debt service. There is no guarantee that the state will not enact similar limits in the future, or limits of a more permanent nature. Minnesota has, on occasion, enacted multiyear property tax levy caps, most recently for 2009–2011. The longest such period of multiyear caps was from 1972–1992, when the caps were repealed.

Expenditure Framework

The city provides a broad array of services to residents, including police and fire protection, waste removal, water and sewer service, and public parks and recreation. Public safety was the largest general fund expenditure item in 2015 at 59% of spending. General government (17%), public works (13%), and economic development (8%) are the other major general fund spending categories. Capital spending is handled primarily out of a separate permanent improvement fund, and major public services such as water and sewer each utilize separate enterprise funds.

Fitch believes spending demands are likely to grow at a pace approximately equal to, or slightly below, the natural rate of revenue growth. The city is budgeting for annual salary increases that are slightly above the rate of inflation across all bargaining units in its multiyear projections. Salary growth in this range would be consistent with Minneapolis' recent history. Employee benefit costs linked to health insurance will most likely grow faster than inflation, however. Given that Fitch expects general fund revenues to expand by over 3% annually, and potentially at rates as high as 4% per annum, it seems reasonable to expect spending to grow no faster than revenues.

Fitch regards the flexibility of Minneapolis' main expenditure items as adequate. The city has moderately high carrying costs that approximated 22% of total governmental spending for the prior two years. Carrying costs include spending for debt service, pension contributions and funding for OPEB. Fixed costs are set to rise in 2017 and 2018 due to large principal payments scheduled for those years, but are scheduled to drop off considerably beginning in 2019. In light of the city's high near-term fixed expenditures and planned new debt issuance, Fitch believes Minneapolis' spending flexibility will remain satisfactory, but below that of some peers.

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, including clerical, technical and maintenance workers. Recent contracts included annual salary increases that were slightly above the rate of inflation. The city's labor agreement with its police union expired on Dec. 31, 2014 and is still under negotiation. All collective bargaining units have access to binding arbitration under the Minnesota labor statute, and arbitrators have to consider economic conditions and their impact on municipal finances.

Roughly 25% of Minneapolis' $906 million five-year capital program is funded with internal cash resources and fund balances, including approximately $5 million of general fund balances per annum and more than $30 million of transfers from various special revenue funds. The cash-funded portion of the city's capital improvement plan (CIP) represents an area of potential budgetary flexibility for Minneapolis, as management would be able to easily pull back on capital funding if the economy went into a recession in order to fund recurring operations and conserve fund balances.

Long-Term Liability Burden

Minneapolis' long-term liability burden is low compared to the size and affluence of its economic resource base. The city's combined contractual pension liabilities and net overlapping debt will account for 9.1% of combined resident personal income following the current bond issuance. Total debt is split almost evenly between the net direct debt of the city — after factoring out debt supported by user fees — and $520 million in overlapping debt issued by Hennepin County, the Minneapolis school district and several smaller taxing jurisdictions. Amortization of the city's direct debt is rapid, with 86% scheduled to be retired within 10 years, potentially resulting in some additional operating flexibility to reallocate resources within the budget to support operations.

The city's five-year 2017–2021 CIP identifies $906 million in projects, the majority of which (about 60%) will be financed using a combination of internal resources and state and federal grants. The remaining 40% will be debt-financed with an estimated $241 million of GO bonds and $160 million of revenue bonds. New debt supported by the general fund will be issued in increments of roughly $47 million per annum, which is less than the amount of principal maturing in each year through 2021. Fitch therefore expects Minneapolis' long-term liability metric to improve over time. Rapid population and personal income growth will also push the metric lower.

Nearly one-half of Fitch's total long-term liability metric for Minneapolis consists of employee pension liabilities. The city merged its closed police and fire pension funds into the state pension plan several years ago, and most current employees are also members of the state-run Public Employees Retirement Association (PERA), which is divided into several sub-plans in which employees participate. Minneapolis also participates in the Minnesota Teachers' Retirement Association (TRA) plan as a non-employer contributing entity. The aggregate assets-to-liabilities ratio for all plans was 82.0% as of June 2015 using a 7.9% rate of return assumption. Using a slightly more conservative 7.0% rate of return assumption, Fitch estimates the combined assets-to-liabilities ratio of the plans at 75.0% as of the same date. The adjusted unfunded liability for all plans is $953 million, as per Fitch's calculation.

Annual funding of PERA and TRA is done on a statutory basis, with contributions equal to a percentage of payroll and adjusted gradually upwards to achieve full funding of the various plans in 25 years or less, depending on the plan. The city expects its employer contributions to increase continually, at a modest rate, in order to reach these state-mandated funding targets. Fitch believes the city has adequate spending flexibility to absorb these cost increases, which have ranged around 5% per annum since 2010.

Operating Performance

Fitch believes that the city is well-positioned to face the challenges associated with a moderate economic downturn. For details, see "Scenario Analysis," page 2.

With a $3.6 million operating surplus after transfers in 2015, the general fund held an available fund balance of $105 million, equal to nearly 23% of spending. Higher-than-budgeted building permit fees and sales tax over-performance drove the surplus, as did below-budget police overtime and snow removal costs. Management also achieved a $5.5 million operating surplus in 2014. Recent results are notable, given that the city had budgeted $24 million of reserves to balance the 2014 budget and had projected a $7 million to $9 million deficit as late as October 2014 — just two months prior to year end. The 2015 budget was balanced with $13 million of general fund reserves. The city has a solid track record of conservative budgeting and cautious revenue estimates. It achieved five consecutive operating surpluses from 2011–2015.

The 2016 budget was balanced with a 3.4% property tax levy increase and included the planned use of $28.0 million of general fund reserves to fund a variety of capital projects, including repair of a city bridge. Management now estimates using only $14.0 million to $20.0 million of the planned drawdown, and Fitch believes it is likely that the city will spend even fewer reserves by 2016 year end. The draft 2017 budget includes a 5.5% property tax levy increase across all funds (10.0% for the general fund), and the planned use of $5.5 million of general fund balance as a contingency.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.