S&P Global
Ratings

RatingsDirect®

Summary:

Hennepin County Regional Railroad Authority, Minnesota; CP; General Obligation

Primary Credit Analyst:
Scott Nees, Chicago (1) 312-233-7064; scott.nees@spglobal.com

Secondary Contact:
Cora Bruemmer, Chicago + 1 (312) 233 7099; cora.bruemmer@spglobal.com

Table Of Contents

Rationale

Outlook

Related Research

Summary:

Hennepin County Regional Railroad Authority, Minnesota; CP; General Obligation

Credit Profile		
US$80.0 mil limited tax GO bnds ser 2019A due 12/01/2038		
Long Term Rating	AAA/Stable	New
Hennepin Cnty GO		
Long Term Rating	AAA/Stable	Affirmed
Hennepin Cnty Regl Railroad Auth		
Long Term Rating	AAA/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AAA' rating to the Hennepin County Regional Railroad Authority (RRA), Minn.'s series 2019A limited-tax bonds and affirmed its 'AAA' rating on the RRA's series 2010A limited-tax refunding bonds. At the same time, we affirmed our 'AAA/A-1+' rating on the county's series 2018B and series 2017B variable-rate general obligation (GO) bonds, our 'AAA' ratings on its outstanding fixed-rate GO debt, and our 'A-1+' short-term rating on its series A (tax-exempt) and B (taxable) GO commercial paper (CP) programs. The outlook is stable for all ratings.

The 'AAA' rating on the RRA's series 2019A and 2010A bonds reflects the application of our "Issue Credit Ratings Linked to U.S. Public Finance Obligor's Creditworthiness" criteria (published Jan. 22, 2018, on RatingsDirect), under which we rate the RRA's limited-tax bonds on par with our GO rating on the county. In our view, the likelihood of payment is tied to the credit fundamentals of the county, rather than just the RRA, because of the shared tax base, the significant oversight that the county has over the RRA and its debt issuance, and the core function that the RRA provides for the county. Additionally, we view resources to be generally fungible, even if specific revenues are designated for a particular purpose.

Both the series 2019A and 2010A bonds are secured by the authority's limited ad valorem property tax levy, which is limited to 0.04835% of the estimated market value of all taxable property in Hennepin County. Officials will use 2019A proceeds to finance the RRA's share of METRO Green Line extension project.

The 'A-1+' short-term component ratings on the county's variable-rate debt reflects our short-term rating on the liquidity providers, which are providing enhancement for the bonds in the form of a standby bond purchase agreement (SBPA). The 'A-1+' rating on the county's CP programs reflects our view of the county's high underlying credit quality, with good market access and sufficient self-liquidity to support the CP programs.

The county's GO bonds are eligible to be rated above the sovereign because we believe the county can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria, "Ratings Above The Sovereign—Corporate And Government Ratings: Methodology And Assumptions" (published Nov. 19, 2013, 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, and no history of government intervention. Hennepin County's financial flexibility is demonstrated by its very strong budgetary flexibility and liquidity.

Encompassing the city of Minneapolis and several of its northern and western inner-ring suburbs, Hennepin County is at the core of one of the largest economic centers in the upper Midwest and is home to a significant share of the state's population and employment base. The county's general fund is currently operating at a modest structural deficit—as evident in consecutive drawdowns since fiscal 2015—though its budgetary reserves and liquidity remain healthy and at near-historic highs, and management is currently projecting closing the budget gap within the next two-to-three years. Despite consecutive years of solid economic expansion amid a flurry of new development and redevelopment centered around downtown Minneapolis, the county's overall debt burden remains quite modest in comparison to peers. The convergence of these various factors continues to support stable credit quality and the continued affirmation of the county's long-standing 'AAA' GO rating.

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

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with an operating deficit in the general fund but an operating surplus at the total governmental fund level in fiscal 2017;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2017 of 27% of operating expenditures;
- Very strong liquidity, with total government available cash at 52.3% of total governmental fund expenditures and 11.7x governmental debt service, and access to external liquidity we consider exceptional;
- Strong debt and contingent liability position, with debt service carrying charges at 4.5% of expenditures and net direct debt that is 76.0% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value; and
- Strong institutional framework score.

Very strong economy

We consider the county's economy very strong. Hennepin County, with an estimated population of 1.2 million, is 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 133% of the national level and per capita market value of $151,701. Overall, market value grew by 7.0% over the past year to $188.6 billion in 2019. The county unemployment rate was 3.0% in 2017.

The county is home to 22% of the state's population and 30% of its jobs, and 12 of the state's 19 Fortune 500 companies are headquartered there, with the largest publicly traded corporations including United Health Group, Target, Best Buy, U.S. Bancorp, Supervalu, and General Mills. The county's employment base is diverse, with no single subsector accounting for more than 18% of total employment. The largest sectors include trade, transportation, and utilities (18% of total employment); professional and business services (16%); health care and social assistance (14%);

and state and local government (12%). Countywide unemployment has been under the state unemployment rate and well under the national rate since the Great Recession and was at a post-recessionary low of 3% in 2017 (seasonally unadjusted).

The county's tax capacity in 2017 included mainly single-family residential properties (56%), followed by commercial/industrial (32%), and multiunit residential properties (10%). Economic market value saw consecutive years of decline in the years leading up to and immediately following the Great Recession before reaching a low of $126.4 billion in 2012. Since then, valuations have grown at a rate of about 7% per year on average, reaching $188.6 billion in 2018. With demand for housing, particularly multiunit apartments and condos, still running strong and with ongoing commercial growth concentrated in Minneapolis and its inner-ring suburbs, we expect countywide valuations to continue to grow at a healthy rate and other measures of economic health to remain stable or show modest improvements through at least the next few years.

Strong management

We view the county's management as strong, with good financial policies and practices under our FMA methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

FMA highlights include the use of historical trends and outside sources in making budget assumptions and a five-year financial forecast that we understand is updated at least annually and used to inform budgetary decisions. Management produces a formal report detailing budget-to-actual performance for key funds twice a year. Hennepin has a five-year capital improvement plan (CIP) that includes funding sources and is updated annually. It has its own investment policy, but provides the board a report on investment holdings only once a year. The county's debt management policy covers areas such as maximum allowable GO debt outstanding and maximum allowable debt service levy as a share of total tax levy. The county also sets a number of other qualitative and quantitative guidelines, which we consider strong overall, though we note that the policy does not deal in any substantive fashion, in our opinion, with the CP program. Hennepin County does not have a reserve policy but has a target of adding 1% to 2% of revenue to its fund balance each year to maintain its level of reserves as the budget increases. Given that this policy is only very loosely defined and has not been consistently adhered to, we do not give it credit under our FMA scoring.

Adequate budgetary performance

Hennepin County's budgetary performance is adequate, in our opinion. The county had deficit operating results in the general fund of negative 2.7% of expenditures, but a surplus result across all governmental funds of 4.4% in fiscal 2017.

The fiscal 2017 general fund budget was structured with a deficit, as in most years, with actual results reflecting a more modest drawdown. Management attributes the fiscal 2017 deficit, in part, to lower-than-anticipated revenues from fees and permitting revenue. Across governmental funds, the county has experienced modest budgetary pressure in its human services fund stemming from increases in personal services costs and public assistance for children in out-of-home placements. Management has indicated that cost-control measures should yield a smaller deficit in fiscal 2018 than in the prior year, and we note that the fund still has healthy reserves should it continue to operate at a deficit, thereby, in our view, lessening the likelihood of material general fund support. We adjusted governmental fund expenditures to exclude capital outlays financed through bond proceeds and debt service related to the early

redemption of outstanding debt and the refinancing of several of the county's sales tax bonds in 2017.

The fiscal 2018 general budget was structured with incremental changes over 2017, including a 4.9% increase in current revenue, a 4.4% increase in expenditures, and a $29 million use of reserves. Management estimates year-end results falling closer to break-even, though with a deficit in the high single-digit millions still likely. The fiscal 2019 budget includes a similar levy increase to 2018's and a deficit of $25 million (3.7% of proposed spending), though as in prior years, we expect the actual deficit to be much smaller by year-end. Management has indicated that the county will likely work toward closing the general fund's structural budget gap within the next few years, though it could see a few more years of deficits in the interim.

Despite what we consider a fairly modest and surmountable structural budget deficit in the county general fund, we expect overall budgetary performance to remain adequate through the next two years, potentially improving in the medium term as the county works to eliminate the structural gap. We note as well that the county's available fund balance remains very strong and in excess of where it has been historically, which, in our view, gives the county some latitude to continue operating at a modest deficit without pressuring the rating. Should the structural gap widen materially or persist to a degree that pressures reserves to levels that are inconsistent with peers, the rating could be pressured, though we consider this prospect unlikely.

Very strong budgetary flexibility

Hennepin County's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2017 of 27% of operating expenditures, or $163.0 million.

The unassigned and assigned general fund balance at the end of fiscal 2017 totaled $163 million, or 27% of expenditures. Though, as noted, management estimates a modest drawdown in fiscal 2018 and perhaps afterward, we do not see significant operating pressure leading to a material reduction in reserves within at least the next few years and, accordingly, believe that the county has capacity to operate at a modest deficit for a limited timeframe without significantly compromising credit quality. The county board does not have a formal reserve policy or informal target, though it has historically sustained a fund balance that we consider very strong and, in recent years, well in excess of 20% of its operating budget.

Very strong liquidity

In our opinion, Hennepin County's liquidity is very strong, with total government available cash at 52.3% of total governmental fund expenditures and 11.7x governmental debt service in 2017. In our view, the county has exceptional access to external liquidity if necessary.

Management anticipates relatively stable cash levels in fiscal years through at least the end of 2019, and we expect the county's liquidity to remain very strong. The county is a frequent debt issuer and has a history of accessing the market to issue debt consisting of both GO- and non-GO-related securities, including sales tax revenue debt, lease debt, variable-rate demand obligations, and its CP program, which supports our view that it has exceptional access to external liquidity if needed. Most of the county's investments are in U.S. government and agency bonds, so we do not believe it is exposed to liquidity risk stemming from an aggressive investment portfolio. The county's series 2017D third-lien variable-rate sales tax refunding notes were a direct placement with Wells Fargo. Though the notes include what we consider permissive events of default and allow the bank the option to tender the notes on default, the

county's internal liquidity is ample to cover the notes, and so we do not consider them a significant source of liquidity risk.

Its variable-rate series 2017B are supported by a SBPA with U.S. Bank scheduled to expire on July 5, 2022, and its series 2018B bonds are supported by a SBPA with TD Bank expiring on Nov. 1, 2023. The SBPAs include events of default that could result in immediate termination or termination within 30 days, though we believe the likelihood of these events occurring is remote. And regardless, we believe the county has ample internal liquidity to cover accelerated payments on the bonds if needed, and so we do not consider them a significant liquidity risk. The county does not have any swaps or hedges associated with its variable-rate debt and does not anticipate using any.

Strong debt and contingent liability profile

In our view, Hennepin County's debt and contingent liability profile is strong. Total governmental fund debt service is 4.5% of total governmental fund expenditures, and net direct debt is 76.0% of total governmental fund revenue. Overall net debt is low at 1.9% of market value, which is, in our view, a positive credit factor.

The county currently has just over $1.3 billion in direct debt outstanding. Its CIP calls for the issuance of approximately $336 million in new-money debt GO debt in 2019 and 2020, though the prospective new-money issuance is unlikely to significantly change our view of the debt profile.

Hennepin County's combined required pension and actual other postemployment benefit (OPEB) contributions totaled 5.6% of total governmental fund expenditures in 2017. Of that amount, 4.8% represented required contributions to pension obligations, and 0.8% represented OPEB payments. The county made its full annual required pension contribution in 2017.

The county participates in three cost-sharing, defined-benefit pension plans administered by the Public Employees' Retirement Assn. (PERA) and for which annual contributions and benefit provisions are set by state statute and can only be modified by the state legislature. The plans include the General Employees Retirement Funds (GERF), the Public Employees Police and Fire Fund (PEPFF), and the Public Employees Correctional Fund (PECF). Recent pension reform legislation passed by the state legislature and signed into law by the governor last year will increase the county's net pension liability in the coming year, while better positioning the PERA plans to improve funding in the long run. While we expect the county's contributions to increase as the result of the reform legislation, we note that they are still relatively modest as a share of total spending and, in our view, unlikely to create budgetary pressure in the near future.

As of the most recent actuarial valuation, on June 30, 2017, the county's proportionate share of the net pension liability was $871.1 million for GERF (79.5% funded based on the June 30, 2018 plan-level GASB valuation), $55.6 million for PEPFF (88.8%), and $49.4 million for PECF (97.6%). The county also administers a supplemental, defined-contribution plan to which it contributes a small amount annually.

The county has not offered retiree health care benefits to new hires since 2007 for unorganized employees and 2008 for organized employees. Retirees after those years can remain on the health insurance plan, but are responsible for paying the entire insurance premium. Previously hired employees receive health care benefits until age 65. As of Jan. 1, 2016, the county's unfunded actuarially accrued liability for OPEBs was $154.9 million.

Strong institutional framework

The institutional framework score for Minnesota counties with a population greater than 5,000 is strong.

Outlook

The stable outlook reflects our view of Hennepin County's very strong economy--given its place in the center of the regional economy, deep and growing tax base, and robust and diverse employment base--along with its history of sustaining a strong financial position and an adequate-to-strong liability profile. While we have noted some potential for the county to use reserves to support operations and some modest budgetary pressure in its human services fund, we expect these challenges to remain manageable without compromising its very strong reserves position or liquidity. Therefore, we do not expect to lower the rating within the two-year outlook horizon.

Downside scenario

We could lower the rating if, in our view, the county's budgetary performance and overall financial position were to weaken or if substantial new-money debt issuance were to materially weaken its debt profile.

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 February 20, 2019)		
Hennepin Cnty CP		
Short Term Rating	A-1+	Affirmed
Hennepin Cnty GO		
Long Term Rating	AAA/A-1+/Stable	Affirmed
Hennepin Cnty GO		
Long Term Rating	AAA/Stable	Affirmed
Hennepin Cnty GO		
Long Term Rating	AAA/A-1+/Stable	Affirmed
Hennepin Cnty GO		
Long Term Rating	AAA/Stable	Affirmed
Hennepin Cnty GO		
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.

Copyright © 2018 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.