



## Fitch Rates Hennepin Co. Regional Railroad Auth., MN's \$80MM LTGOs 'AAA'; Outlook Stable

Fitch Ratings-New York-20 February 2019: Fitch Ratings has assigned a 'AAA' rating to the following Hennepin County, MN bonds:

--\$80 million Hennepin County Regional Railroad Authority (HCRRA) limited tax GO (LTGO) bonds, series 2019A at 'AAA';

Fitch has also affirmed the following ratings:

- The County's Issuer Default Rating (IDR) at 'AAA';
- \$1.1 billion unlimited tax general obligation (ULTGO) bonds at 'AAA';
- \$108.5 million first lien sales tax revenue refunding bonds, series 2017A at 'AAA';
- \$30 million HCRRA LTGO bonds, series 2010A at 'AAA';
- Up to \$250 million GO commercial paper (CP) certificates at 'F1+';

The Rating Outlook is Stable.

Additionally, Fitch Ratings has withdrawn the ratings for the following bonds due to prerefunding activity:

--Hennepin County (MN) (Ballpark Project) 1st lien sales tax revenue bonds series 2007A (prerefunded maturities only - 425538AM7) previous rating: 'AAA' / Outlook Stable.

The updated rating history for the above maturities is now reflected on Fitch's website at [www.fitchratings.com](http://www.fitchratings.com).

The 2019A bond proceeds will fund a portion of the METRO Green Line Extension Projects (the Southwest LRT Projects). The bonds are expected to sell via competition on February 26.

### SECURITY

The GO bonds are backed by the county's full faith and credit and unlimited taxing power. The HCRRA bonds are limited tax obligations of the county payable from the levy of ad valorem taxes on all taxable property within the county not to exceed the annual rate of 0.04835%. The county covenants that the annual levy will be at least 105% of principal and interest. The first lien sales tax bonds are special limited obligations of the county payable from certain proceeds of a county wide sales tax of 0.15% imposed by county ordinance as of Jan. 1, 2007.

The 'F1+' rating on the CP certificates is derived from the IDR of the county and strong self-liquidity, which provides 3.7x coverage of the maximum potential liquidity requirement from available liquid resources, well above Fitch's 1.25x criteria threshold for similarly-rated governments.

## ANALYTICAL CONCLUSION

The 'AAA' IDR, ULTGO and LTGO ratings reflect the county's strong and growing resource base, which underpins its solid revenue growth prospects and flexibility of main expenditures, low long-term liability burden, and the highest gap-closing capacity. The 'AAA' rating on the first lien sales tax bonds reflects the trend of solid revenue growth and very high financial resilience. The sales tax bonds benefit from the steady growth the revenue stream has enjoyed since the sales tax was imposed in 2007.

### Economic Resource Base

Hennepin County is the center of the Minneapolis-St. Paul metropolitan area. The area economy is broad and diverse and home to several large corporate headquarters, including United Health Group, Target, Best Buy and U.S. Bancorp. The county's wealth levels are above state and national medians, and personal income continues to demonstrate a positive trend given healthy population growth. The current population is roughly 1.3 million, which reflects an 8.6% increase since the 2010 Census.

## KEY RATING DRIVERS

### Revenue Framework: 'aaa'

Revenue growth is expected to continue to exceed inflation given ongoing development and growth in the property tax base. The county's independent legal ability to raise revenues is presently strong, although the state has enacted temporary tax levy caps in the past.

### Expenditure Framework: 'aa'

The pace of spending growth is expected to be marginally above the solid revenue growth prospects given the near-term increases in human service demands. Carrying costs related to debt and retiree benefits are moderate.

### Long-Term Liability Burden: 'aaa'

The long-term liability burden is low at approximately 6% of personal income. Fitch believes the debt burden will increase based on the county's capital improvement plans, but will remain low as the county has a history of repaying debt obligations at an accelerated rate.

### Operating Performance: 'aaa'

Fitch believes the county will maintain the highest financial resilience over time and throughout periods of economic decline based on its maintenance of strong reserves, superior budget flexibility, and history of conservative management practices.

## RATING SENSITIVITIES

**Revenue Growth Prospects:** The IDR is sensitive to the county's continued solid revenue growth prospects and maintenance of the highest financial resilience.

**Enactment of Revenue-Raising Constraints:** The rating is also sensitive to constraints that higher levels of government (i.e. the state of Minnesota) could place on the county's future revenue-raising ability by enacting tax rate and/or levy caps. Such measures would be assessed for their impact on the county's budget flexibility and could place negative pressure on the rating.

## CREDIT PROFILE

The local economy is large and diverse and includes several significant sectors that provide a strong

employment base, including healthcare, manufacturing, technology and financial services. Almost one third of all jobs in the state are located within Hennepin County. Historical unemployment rates have been below state and national averages and the county has seen annual job growth since 2011. The county has also seen an increasing trend in per capita personal income, which was almost 1.4x the national average in 2017. The county's taxable assessed value (TAV) growth trend has been very strong with a five-year compound annual growth rate of approximately 7.8% through 2018. Fitch expects tax base growth to continue at a healthy pace given the trends of growing population, increasing personal income and extensive economic activity occurring within the area.

#### Revenue Framework

Revenue growth within the county has been solid, and the county has significant legal ability to raise revenues. Property taxes accounted for approximately 60% of general fund revenue followed by intergovernmental revenue at 16% in 2017.

Fitch believes natural revenue growth (in the absence of policy action) will be above the rate of inflation through the medium term. General fund revenue growth has historically exceeded U.S. GDP due to growth in the tax base, policy actions taken by management and accounting changes. Average annual growth in taxable values was approximately 7.8% from 2013 through 2018.

The county is not currently subject to a limit on its property tax rate or levy. The county has the ability to adjust fees for providing a wide range of services including health and solid waste, which provides additional revenue flexibility.

In the past, Minnesota has enacted statewide limits to the property tax levies of its local governments. These limits have been temporary in nature, generally expiring after one year. The levy limitations have never been applied to taxes levied to pay debt service. There is no guarantee that the state will not enact similar levy limits in the future or enact limits of a more permanent nature. Minnesota has occasionally enacted multi-year tax levy caps, most recently for years 2009 to 2011. The county responded to the prior cap by controlling expenditures to maintain its high level of financial flexibility during this time.

#### Expenditure Framework

General fund spending is largely driven by public safety functions, which account for almost 50% of total expenditures, followed by general administration services at 28%, health and social services at 12% and public works at 11% for 2017.

Fitch expects the natural pace of expenditure growth to increase in the near term, partly due to increasing demand for human services, but believes spending will remain in line with to marginally above anticipated revenue growth over time. The county's spending pressures have been driven in part by increases in caseloads for public safety officers, social workers, health workers and other direct service team members. A portion of the recent spending growth has also been driven by the county hiring new employees to replace a large number of employees expected to retire over the next several years.

The county's expenditure flexibility is solid. Carrying costs for debt, pension and other retiree benefits (OPEB) account for a moderate percentage of 2017 governmental fund expenditures after adjusting for a one-time debt service payment to pay off transit bonds after the Counties Transit Improvement Board (CTIB) was dissolved (see discussion below). Fitch believes carrying costs attributable to pension contributions are somewhat overstated, as a portion of the annual pension costs are paid by the county's enterprise funds. However, the trajectory of contributions is expected to rise over time given reforms enacted in 2018 to improve the funded condition of state-administered plans.

The county has the authority to control the size of its workforce, which it generally manages through employee

attrition. Over 60% of county employees are represented by 17 labor unions. Wages and benefits for unionized employees are subject to collective bargaining and binding arbitration; however, under state law the arbitration decision must take into consideration existing levels of governmental services and an analysis of the fiscal impact on the municipality. County officials report strong relations with labor unions and have settled the largest contracts with moderate salary increases.

#### Long-Term Liability Burden

The long-term liability burden related to overall debt and the adjusted net pension liability is low at approximately 6% of personal income. Approximately 24% of the county's total direct debt burden is variable rate, \$222 million in GO bonds and a \$59 million unhedged third lien sales tax note issue directly placed with Wells Fargo with a Dec. 1, 2022 final maturity. The county's future borrowing plans include about \$300 million in new GO debt for projects included in the 2019 capital budget and additional transit debt associated with the dissolution of the CTIB. Fitch believes debt levels will increase but remain moderate, aided by the county's history of paying debt at an accelerated rate.

In June 2017, the CTIB passed a dissolution resolution including terms for the allocation of capital and operating costs for the transit lines to member counties. Hennepin County's capital contributions are projected to exceed \$1 billion over the next 10 years, which will be funded through a combination of the HCRRA limited property tax levy, which shall not exceed an annual rate of 0.04835%, the 0.5% sales taxes that became effective Oct. 1, 2017, and federal and state grants. After the CTIB dissolution, the Hennepin County board approved a 0.5% sales tax to replace the 0.25% sales tax imposed by the county under the CTIB agreement. The new tax is expected to yield \$125 million annually for operating and building new and existing transit lines.

The county has authorized a \$250 million CP program to provide short-term financing for capital projects (tax-exempt) and working capital (taxable) supported by self-liquidity. Currently, the county has \$100 million in CP balance outstanding including \$25 million maturing April 10 and \$75 million maturing May 10.

County employees participate in three plans within the state's Public Employees Retirement Association of Minnesota, a defined benefit multiple-employer system for public employees, police and fire and correctional officers. The 2017 reported net pension liability increased by 22%, which was mostly attributable to accounting changes under GASB 80. The new accounting changes required the county to report Hennepin Medical Center (HMC) as a major enterprise fund rather than a discretely presented component unit. The pension obligations have been restated to include the HMC obligations. The aggregate ratio of assets to liabilities was 64% using Fitch's 6% discount rate assumption as of Dec. 31, 2017, instead of the 7.5% rate used for the public employees and police and fire plans; the plan covering correctional officers was reported at a 5.96% discount rate, and hence the net pension liability was left unadjusted by Fitch.

The state of Minnesota passed a 2018 pension reform bill that included reductions in the assumed investment rate of return and cost-of-living adjustments, contribution increases and the elimination of subsidies for early retirement benefits. These changes are expected to minimize future growth in the net pension liability for the state and local governments over time, assuming revised statutory assumptions are met. Other post-employment benefits (OPEBs) are very low, and the county discontinued post-retirement healthcare benefits for new hires starting in 2008.

#### Operating Performance

The county's reserve balances combined with its superior level of budgetary flexibility provide the highest gap closing capacity to manage through economic downturns and related revenue volatility. Fitch believes that the county is well-positioned to face fiscal challenges given its strong track record of maintaining healthy unrestricted general fund reserves equal to more than 20% of general fund expenditures and transfers from 2011 through 2017.

Available reserve balances were 26% of general fund expenditures in 2017, which follow a modest use of reserves in years 2015 through 2017. The 2017 adopted general fund budget included a 2% budget-to-budget increase in the county's general fund tax levy, and a \$31 million (5% of spending) fund balance appropriation. The majority of the fund balance appropriation was replenished through expenditure reductions, resulting in an \$8.6 million net use of reserves.

Management conservatively projects revenues, includes contingency funds and has increased tax rates as needed to ensure positive financial outcomes. The 2018 budget assumed a 5.6% increase in the property tax levy and a \$29 million fund balance appropriation. Based on current projections, the county will likely utilize up to \$12 million (less than 2% of spending) in reserves due to spending pressures attributable to increasing children protective and other human service spending demands. The county has a track record of replenishing the majority of the fund balance appropriation by implementing strong expenditure controls. The 2019 adopted budget appropriates \$25 million in general fund balance and includes staffing reductions and a property tax levy increase of approximately 5%, reflecting AV growth. Management is in the process of addressing the growing cost of social services including improving service delivery operations and though expenditure controls. Fitch expects the county to maintain healthy financial operations and strong reserve balances given the county's strong operating history.

#### Revenue Stream Sensitivity

The sales tax bonds have benefitted from solid growth since the sales tax was imposed in 2007. Average annual growth from 2008 through 2018 exceeded the rate of inflation. Fitch believes that growth prospects will continue to be solid based on these historical trends and ongoing growth in the local tax base. The county has no plans to issue additional debt under the sales tax liens as they are effectively closed.

To evaluate the sensitivity of the dedicated revenue stream to cyclical decline, Fitch considers the results of the Fitch Analytical Sensitivity Tool (FAST), using a 1% decline in national GDP scenario, as well as assessing the largest decline in revenues over the period covered by the revenue sensitivity analysis. To sustain MADS coverage on the first lien ballpark revenue bonds, the current structure could tolerate a large 65% drop in sales tax revenues, 15x the scenario results and 16x the largest actual revenue decline in the review period. The lowest actual decline in Hennepin County's sales tax collections was approximately 4%, in 2009. Fitch believes that these results are consistent with a 'AAA' rating.

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The following issuer(s) did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure: Hennepin County (MN)

#### Applicable Criteria

U.S. Public Finance Short-Term Debt Rating Criteria (pub. 01 Nov 2017)

U.S. Public Finance Tax-Supported Rating Criteria (pub. 03 Apr 2018)

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