

Rating Action: Moody's assigns UND Aa2 & ENH Aa2 ratings to Minneapolis S.S.D. 1, MN's GO bonds; UND outlook negative

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New York, November 09, 2018 -- Moody's Investors Service has assigned Aa2 underlying and Aa2 enhanced ratings to the Minneapolis Special School District No. 1, MN's \$42 million General Obligation School Building Bonds, Series 2018A and \$55 million General Obligation Long-Term Facilities Maintenance Bonds, Series 2018B. Moody's has affirmed the Aa2 rating on the district's outstanding General Obligation debt, the Aa2 rating on the Full Term Certificates of Participation (COPs) and the Aa3 rating on the annual appropriation COPs. The district has \$532 million of general obligation unlimited tax (GOULT) debt, including the current bonds; \$237 million of full term COPs outstanding, and \$33 million of annual appropriation COPs outstanding. The outlook on the underlying GOULT rating, the full term COPs, and the annual appropriation COPs remains negative.

RATINGS RATIONALE

The Aa2 underlying rating on the GOULT debt, including the current bonds, rating reflects a strong regional economy, substantial tax base, and relatively stable enrollment. These credit strengths are balanced against challenges including an operating reserve position that has materially weakened in recent years and an elevated pension burden.

The full term COPs are rated on parity with the district's underlying GOULT rating as lease payments are secured by a dedicated levy that is not subject to annual appropriation. The annual appropriation COPs are notched once from the district's underlying GOULT rating due to the risk of annual appropriation and the more essential nature of the asset, district headquarters.

The Aa2 enhanced rating on the current bonds reflects the security provided by the State of Minnesota's School District Enhancement (MSDCE) Program. The programmatic rating is notched once from the State of Minnesota's Aa1 stable GO rating to reflect sound program mechanics and the State of Minnesota's pledge of an unlimited appropriation from its General Fund should the district be unable to meet debt service requirements. The program's mechanics include a provision for third party notification of pending deficiency. If the school district does not transfer funds necessary to pay debt to the paying agent at least three days prior to the payment due date, the state will appropriate the payment to the paying agent directly.

RATING OUTLOOK

The negative outlook on the underlying GOULT rating, the full term COPs rating, and the annual appropriation COPs rating primarily reflects the district's trend of declining reserves from budget imbalances. Without a demonstrated reversal of its recent financial trends in audited results, the district's credit quality will likely diminish. We also expect that despite state-level reforms, teacher pension funding challenges will persist for Minnesota school districts.

FACTORS THAT COULD LEAD TO AN UPGRADE (underlying ratings)

- Substantial growth in operating reserves and liquidity
- Moderation of debt and pension burdens

FACTORS THAT COULD LEAD TO A DOWNGRADE (underlying ratings)

- Weakening of the tax base or socioeconomic profile
- Inability to rebuild reserves
- Increases in the debt burden or unfunded pension liabilities

LEGAL SECURITY

The GOULT bonds are secured by the district's pledge to levy a dedicated property tax unlimited as to rate and amount. The security benefits from a statutory lien.

The full term COPs are secured by the district's pledge to make lease payments from a separate, dedicated statutorily authorized lease levy. The obligation of the district to make rental payments on the full term COPs is absolute and unconditional and it is not subject to annual appropriation.

The GOULT bonds and full term COPs are additionally secured by the State of Minnesota's School District Enhancement (MSDCE) Program which provides for an unlimited advance from the state's General Fund should the district be unable to meet debt service requirements.

The annual appropriation COPs are secured by district's pledge to make rental payments, subject to annual appropriation. The pledged asset is the district headquarters building, which we deem to be a more essential asset.

USE OF PROCEEDS

Proceeds of the current bonds will finance various capital improvements throughout the district.

PROFILE

Minneapolis Special School District No. 1 is coterminous with the City of Minneapolis (Aa1 negative) and serves a resident population of more than 400,000. The district owns and operates eight high schools, seven middle schools, 44 elementary and K-8 schools, seven other academic sites, and seven locations for alternative school programs. Enrollment totals more than 35,000 students.

METHODOLOGY

The principal methodology used in the underlying ratings was US Local Government General Obligation Debt published in December 2016. The principal methodology used in the enhanced ratings was State Aid Intercept Programs and Financings published in December 2017. The principal methodology used in the lease ratings was Lease, Appropriation, Moral Obligation and Comparable Debt of US State and Local Governments published in July 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

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