FitchRatings

Testimony Before the Minnesota State Senate – Capital Investment Committee

March 4, 2025

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1

What is a Credit Rating?

What is a credit rating?

Communicates the *creditworthiness* of an entity or security

- Ratings (‘AAA’ through ‘D’), with + or – modifiers below ‘AAA’
  - Opinions of relative ranking of vulnerability to default
  - Explicitly forward-looking, “through-the-cycle”
  - Entity rating (“issuer default rating”—IDR) and security rating
  - Assignment based on explicit criteria

- Outlooks and Watches express future direction of ratings
  - Outlooks - Stable/Positive/Negative/Evolving
  - Watches – Positive/Negative/Evolving

2

The Ratings Process

Fitch Credit Rating Process

Professional service

Step 1

Initiate rating process
- Primary and back-up analyst assigned
- Determination of whether additional industry analyst expertise is required
- Analysts have a range of backgrounds, with the majority recruited from banks, insurance companies, investment houses & financial departments of major companies

Step 2

Collect publicly available information
- Company financial & operational statistics
- Reports filed with regulatory agencies
- Industry & economic reports
- Other data & insights

Thorough pre-analysis

Step 3

Perform pre-analysis & request non-public information, if appropriate
- Information provided directly by the issuer, arranger, sponsor or other involved party
- Can include background data, forecasts & other communications

Step 4

Prepare detailed questionnaire
- Prepare main topics for discussion & key questions
- Establish detailed agenda to ensure productive dialogue

Independent perspective

Step 5

Hold meeting with entity management & other stakeholder
- Face-to-face meetings, site visit and/or teleconference, when appropriate

Step 6

Perform in-depth analysis

Transparent methodology

Step 7

Hold ratings committee
- Committee members review package
- Information considered
- Consensus decision on appropriate rating, including, where appropriate, a Rating Outlook or Rating Watch designation
- Minimum size for committee is five analysts
- Committees frequently include analysts from outside the immediate asset class, sub-sector or geography since peer analysis is a central element of the process
- Committee considers relevant quantitative & qualitative issues

Step 8

Assign ratings write & publish commentary
- Once prepared, report is shown to issuer to check for factual accuracy and presence of non-public information
- Initial ratings actions
- Report published
- Commentary distributed

Ongoing surveillance

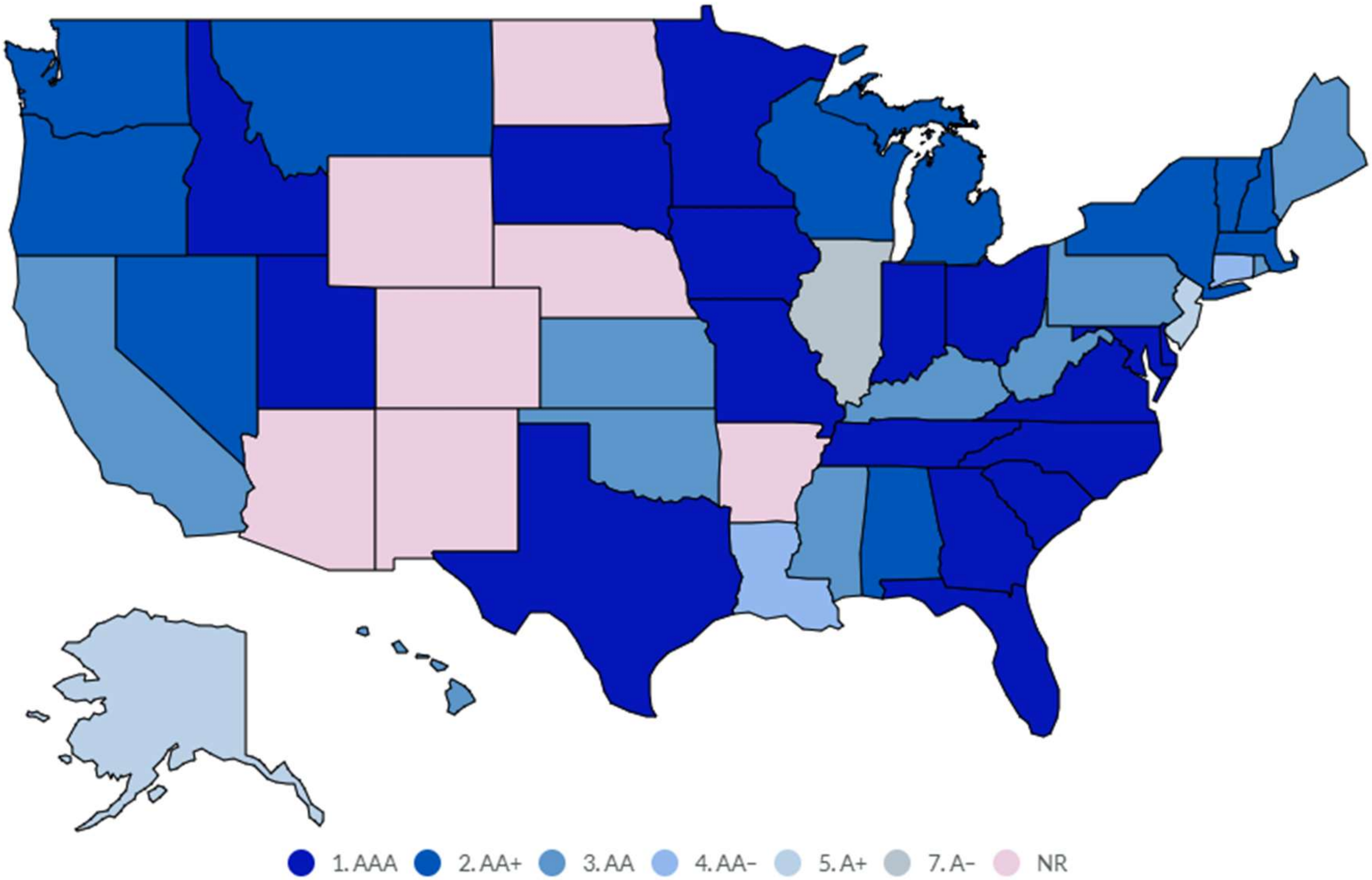
Step 9

Conduct ongoing surveillance
- Continual review of market events
- Formalized periodic review
- Continuing evaluation of industry issues & macro economic considerations

3

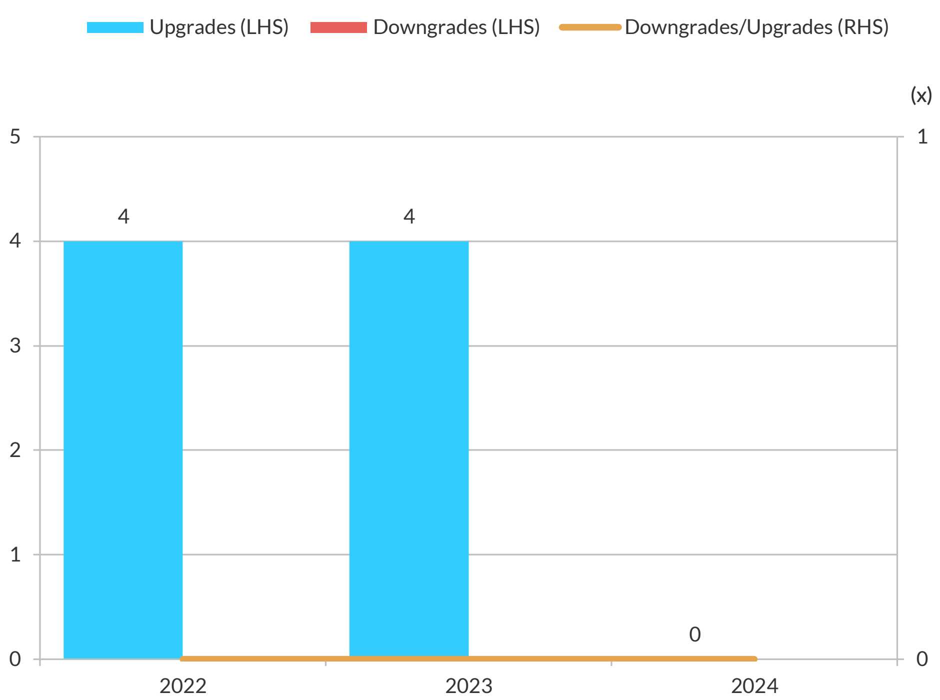
State Ratings Distribution

State Ratings Distribution



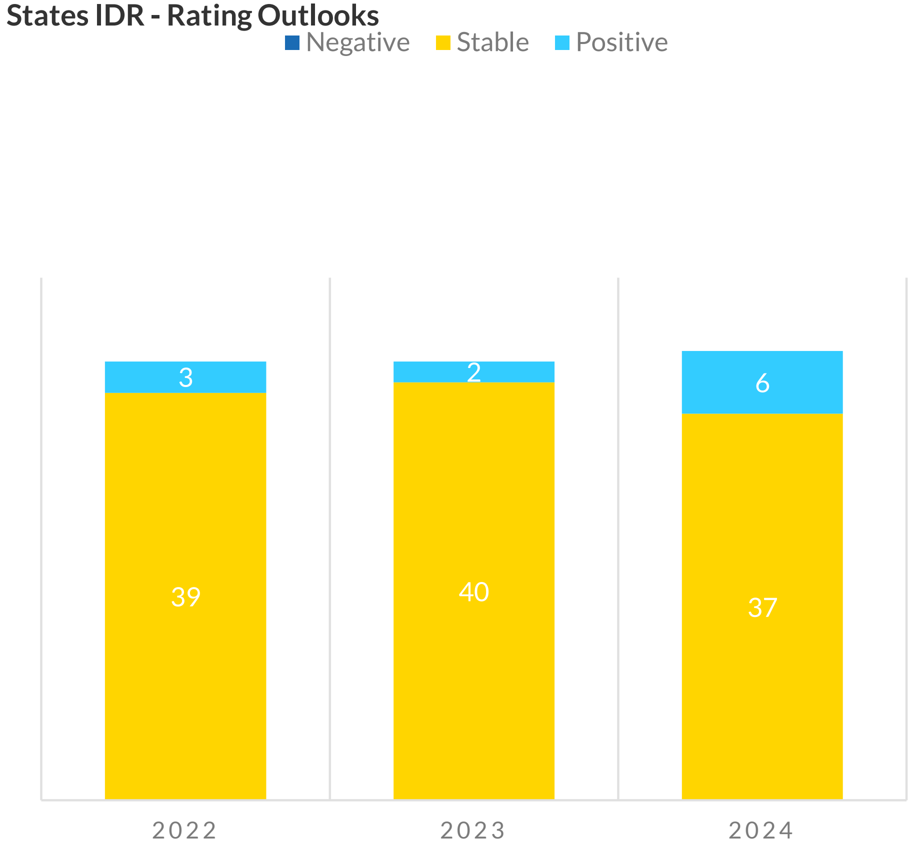
State Ratings Distribution

States IDR - Rating Changes



Source: Fitch Ratings

States IDR - Rating Outlooks



Source: Fitch Ratings

4

State Rating Criteria

State Rating Criteria

FitchRatings

Public Finance
State Obligations
U.S.A.

U.S. Public Finance State Governments and Territories Rating Criteria

Master Criteria

Scope

This report outlines the criteria that apply to the rating of new and existing debt issued by or on behalf of U.S. state governments and territories. *Section 1* of the report details the criteria used to determine the general credit quality of the entity responsible for repaying the debt. *Section 2* addresses how Fitch Ratings determines ratings for specific security structures. The criteria can also support the assessment of dedicated tax bonds for certain tax-supported special districts, local governments or other enterprises with tax support, in conjunction with relevant sector criteria, in cases where the state approach to dedicated tax bonds is applicable. The FAST Econometric API — Fitch Analytical Stress Test Model (FAST), discussed on page 17 and in *Appendix A*, and the rating approach for appropriation-backed bonds discussed in the *Appropriation-Backed Bonds* section can also be used in assigning ratings in other U.S. public finance sectors where applicable.

Key Rating Drivers

The ultimate rating outcome is the result of consideration of issuer-specific qualitative and quantitative factors. There is no standard weighting of factors. The significance of risk elements can shift quite rapidly over time and/or differ markedly across issuers. However, given the significance of the operating performance considerations to overall credit quality, the assessment of operating performance is particularly important to determining the final rating.

Table of Contents

This report updates and replaces "U.S. Public Finance State Governments and Territories Rating Criteria," dated April 2, 2024 as it relates to U.S. state government and territory IDRs.

State Rating Criteria

- Strong ‘sector risk profile’
- Economic resource base is the foundation
  - Growth trend and level
- Four key rating drivers
  - Revenue framework
  - Expenditure framework
  - Long-term liability burden
  - Operating performance
- Assessed on a ‘aaa’ – ‘b’ scale with guidance metrics

Key Rating Drivers

Revenue Framework	aaa	aa	a	bbb	bb	b
Growth Prospects for Revenues without Revenue-Raising Measures	Strong Growth in line with or above U.S. economic performance (GDP)	Solid Growth below U.S. economic performance but above inflation level	Slow Growth approximately in line with inflation level	Stagnant Growth below inflation level or flat performance	Negative Declining revenue trajectory	Very Negative Sharply declining revenue trajectory without clear indication of management’s ability to halt or reverse the decline
Independent Legal Ability to Raise Operating Revenues without External Approval (in Relation to Normal Cyclical Revenue Decline)	High Unlimited legal ability, or maximum revenue increase at least 300% of scenario revenue decline	Substantial Maximum revenue increase at least 200% of scenario revenue decline	Satisfactory Maximum revenue increase at least 100% of scenario revenue decline	Moderate Maximum revenue increase at least 50% of scenario revenue decline	Limited Maximum revenue increase less than 50% of scenario revenue decline	Extremely Limited Maximum revenue increase less than 25% of scenario revenue decline.
Asymmetric Rating Driver Consideration	The requirement for periodic reauthorization of existing revenue streams is a negative consideration.					
Expenditure Framework						
Natural Pace of Spending Growth Relative to Expected Revenue Growth (Based on Current Spending Profile)	Slower to equal	Marginally above	Above	Well above	Very high	Potential to be unsustainably high
Flexibility of Main Expenditure Items (Ability to Cut Spending through the Economic Cycle)[a]	Ample	Solid	Adequate; legal or practical limits to budget management may result in manageable cuts to core services at times of economic downturn.	Limited; cuts likely to meaningfully, but not critically, reduce core services during times of economic downturn.	Constrained; adequate delivery of core services may be compromised during times of economic downturn.	Very constrained; adequate delivery of core services likely to be compromised during times of economic downturn.
Asymmetric Rating Driver Considerations	Significant potential funding pressures, including outstanding or pending litigation, internal service fund liabilities and contingent obligations, can be a negative consideration in the expenditure framework assessment.					
Long-Term Liability Burden						
Combined Burden of Debt and Net Pension Liabilities in Relation to Resource Base	Low Liabilities less than 10% of personal income	Moderate Liabilities ≥10% and <20% of personal income	Elevated but Still in Moderate Range Liabilities ≥20% and <40% of personal income	High Liabilities ≥40% and <60% of personal income	Very High Liabilities ≥60% and <80% of personal income	Extremely High Liabilities ≥80% of personal income
Asymmetric Rating Driver Considerations	The liability burden assessment can be negatively affected by high levels of derivatives exposure; short-term, variable-rate or bullet maturity debt; or an exceptionally large OPEB liability without the ability or willingness to make changes to benefits. An exceptionally large accounts payable backlog can also negatively affect the long-term liability burden assessment.					
Operating Performance						
Financial Resilience through Downturns (Based on Interpretation of Scenario Analysis)	Superior gap-closing capacity; expected to manage through economic downturns while maintaining a high level of fundamental financial flexibility	Very strong gap-closing capacity; expected to manage through economic downturns while maintaining an adequate level of fundamental financial flexibility	Strong gap-closing capacity; financial operations would be more challenged in a downturn than for higher rating levels, but expected to recover financial flexibility	Adequate gap-closing capacity; financial operations could become stressed in a downturn, but expected to recover financial flexibility	Limited gap-closing capacity; financial operations could become distressed in a downturn	Very limited gap-closing capacity; financial operations likely to become distressed in a downturn
Budget Management at Times of Economic Recovery	Rapid rebuilding of financial flexibility when needed, with no material deferral of required spending/nonrecurring support of operations	Consistent efforts in support of financial flexibility, with limited to no material deferral of required spending/ nonrecurring support of operations	Some deferral of required spending/ nonrecurring support of operations	Significant deferral of required spending/ nonrecurring support of operations	Deferral of required spending/nonrecurring support of operations that risks becoming untenable given tools available to issuer	Deferral of required spending/nonrecurring support of operations that is unsustainable and requires immediate action by the issuer
Asymmetric Rating Driver Considerations	The operating performance assessment can be negatively affected by: liquidity or market access concerns (in general, liquidity becomes a concern if the governmentwide days cash on hand metric has or is expected to fall below 60 days); the risk of an outside party (e.g. another level of government) having a negative effect on operations; or evidence of an exceptional degree of taxpayer dissatisfaction, particularly in environments with easy access to the voter-initiative process.					
Asymmetric Additional Risk Considerations	In addition to the key rating driver assessments discussed above, the final rating assigned also considers certain additional risk factors that may affect the rating conclusion. These additional risk factors work asymmetrically, where only below-standard features are factored into the final rating levels. For U.S. state governments and territories, these risk factors are management and economic characteristics that are significantly outside the U.S. norm.					

[a]Additional metric guidance for this assessment can be found in the Flexibility of Main Expenditure Items table on page 9. OPEB – Other post-employment benefits
Source: Fitch Ratings

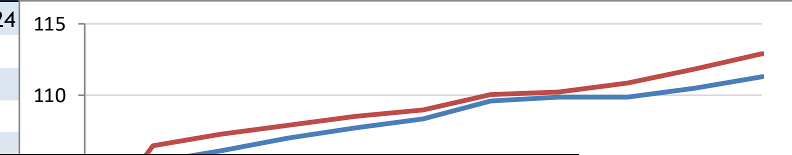
5

Minnesota's Credit Rating

Minnesota's Credit Rating – Economic Resource Base

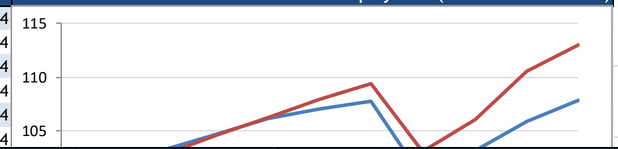
POPULATION & EDUCATION	Minnesota		U.S.	
Total Population	5,793,151.0	2024	340,110,988.0	2024
Pop. Growth, 1990-2000	12.4%		13.2%	
Pop. Growth, 2000-2010	7.8%		9.7%	
Pop. Growth, 2010-Present	9.2%		10.2%	
Population by Age				
Population Depe				
<18 Population				
18-64 Populatio				
>64 Population				
Median Age				
Y-o-Y Population				
Net Internal Mig				
Net Internationa				
Total Net Migra				
Net Natural Incr				
Total Populatior				
Educational Attair				
% with HS Degre				
% with Bachelor				

I. Total Population (Indexed: 2007 = 100)



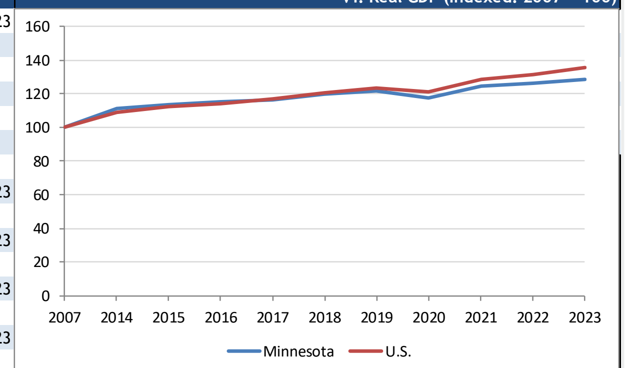
EMPLOYMENT	Minnesota		U.S.	
Nonfarm Employment	3,031,700	Dec-2024	159,943,000	Dec-2024
Monthly Y-o-Y Growth	1.2%	Dec-2024	1.3%	Dec-2024
3-Month Moving YOY Growth	1.2%	Dec-2024	1.2%	Dec-2024
Labor Force	3,090,964	Dec-2024	167,746,000	Dec-2024
Monthly Y-o-Y Growth	0.7%	Dec-2024	0.7%	Dec-2024
3-Month Moving Y-o-Y Growth	0.4%	Dec-2024	0.4%	Dec-2024
Unemployment Rate (annual				
As % of National				
1-Year Prior				
1-Year Prior as % of Nationa				
Unemployment Rate (monthl				
1-Year Prior				
Components of Employment				
Natural Resources & Mining				
Percent of Total				
Construction				
Percent of Total				
Manufacturing				
Percent of Total				
Trade, transportation, and				
Percent of Total				
Information				
Percent of Total				
Financial Activities				
Percent of Total				
Professional & Business Ser				
Percent of Total				
Educational and Healthcare				
Percent of Total				
Leisure & Hospitality				
Percent of Total				
Other Services				
Percent of Total				
Government				
Percent of Total				
Hachman Index				

II. Total Non-farm Employment (Indexed: 2007 = 100)

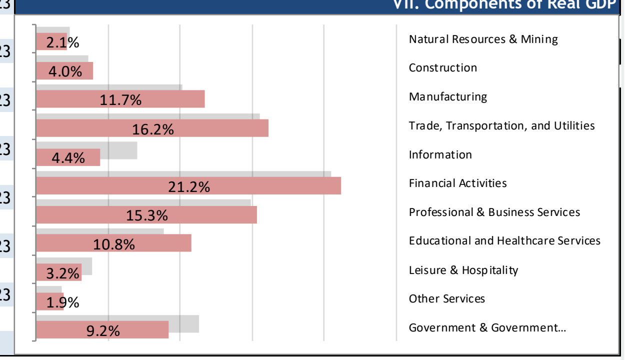


REAL GDP		Minnesota		U.S.	
Real GDP ('000)		390,907,900	2023	22,671,096,000	2023
2024Q3	*quarterly growth*	2.0%		3.1%	
2024Q2	*quarterly growth*	1.3%		3.0%	
2024Q1	*quarterly growth*	-2.8%		1.6%	
2023Q4	*quarterly growth*	2.7%		3.2%	
Components of Real GDP ('000)					
Natural Resources & Mining		8,365,600	2023	533,936,900	2023
Percent of Total		*2.1%*		*2.3%*	
Construction		15,635,800	2023	821,062,000	2023
Percent of Total		*4.0%*		*3.6%*	
Manufacturing		46,010,600	2023	2,317,923,000	2023
Percent of Total		*11.7%*		*10.2%*	
Trade, transportation, and utilities		63,537,100	2023	3,532,920,700	2023
Percent of Total		*16.2%*		*15.5%*	
Information		17,323,000	2023	1,605,851,000	2023
Percent of Total		*4.4%*		*7.0%*	
Financial Activities		83,293,600	2023	4,676,163,000	2023
Percent of Total		*21.2%*		*20.5%*	
Professional & Business Services		60,220,100	2023	3,391,773,000	2023
Percent of Total		*15.3%*		*14.9%*	
Educational and Healthcare Services		42,346,100	2023	2,021,153,000	2023
Percent of Total		*10.8%*		*8.9%*	
Leisure & Hospitality		12,432,400	2023	889,845,000	2023
Percent of Total		*3.2%*		*3.9%*	
Other Services		7,443,100	2023	414,225,000	2023
Percent of Total		*1.9%*		*1.8%*	
Government		36,242,000	2023	2,582,255,000	2023
Percent of Total		*9.2%*		*11.3%*	
Hachman Index		**0.98**			

VI. Real GDP (Indexed: 2007 = 100)



VII. Components of Real GDP



Minnesota's Credit Rating – Economic Resource Base

Economic Data Overview

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	10-year CAGR
Total nonfarm employment (% change)												
Minnesota	1.8	1.4	1.6	1.4	1.4	0.9	0.7	-6.6	2.5	2.7	1.8	0.7
U.S.	1.6	1.9	2.1	1.8	1.6	1.6	1.3	-5.8	2.9	4.3	2.2	1.3
Labor force (% change)												
Minnesota	0.4	0.6	0.9	0.6	1.6	0.1	1.2	0.3	-2.3	0.7	0.9	0.5
U.S.	0.3	0.3	0.8	1.3	0.7	1.1	0.9	-1.7	0.3	1.9	1.7	0.7
Unemployment rate (% labor force)												
Minnesota	5.0	4.3	3.8	3.9	3.5	3.0	3.3	6.3	3.7	2.6	2.8	3.7
U.S.	7.4	6.2	5.3	4.9	4.4	3.9	3.7	8.1	5.3	3.6	3.6	5.1
Personal income (% change)												
Minnesota	0.8	4.9	4.7	2.1	4.5	5.2	3.7	6.4	10.1	3.6	4.2	4.9
U.S.	1.1	5.1	4.7	2.7	4.9	5.1	4.8	6.8	9.2	3.1	5.9	5.2
Real GDP (% change)												
Minnesota	2.7	2.7	2.0	1.5	1.2	2.8	1.3	-3.3	5.7	1.8	1.6	1.7
U.S.	2.1	2.5	2.9	1.8	2.5	3.0	2.6	-2.2	6.1	2.5	2.9	2.4

Source: Fitch Ratings; DIVER by Solve, U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics

Minnesota's Credit Rating

Revenue Framework – 'aaa'

Growth Prospects for Revenues

Metrics to Support Assessment

State Governments and Territories

Historical performance of tax revenues (adjusted for estimated effect of changes in tax policy) in comparison to growth in national GDP and inflation

Note: Alternatively, or in conjunction with the above, Fitch may compare key economic and demographic trends exhibited by the issuer relative to national levels. Historical performance is used as a factor for consideration of future performance. Fitch may incorporate different historical periods in its analysis, including the use of five-year, 10-year and/or 20-year CAGRs, to provide a broader perspective. Expectations for growth in line with or above the level of U.S. economic performance without the need for tax increases are consistent with a 'aaa' assessment; growth below U.S. economic performance but above the level of inflation, 'aa'; growth approximately in line with the level of inflation, 'a'; growth below the level of inflation or flat performance, 'bbb'; and a declining revenue trajectory, 'bb'.
Source: Fitch Ratings

REVENUE GROWTH	2021	2022	2023		2021	2022	2023
10-Year CAGRs, Revenues and GDP (%)				**10-Year CAGRs, Revenues and CPI (%)**			
Policy-Adjusted Revenues (Issuer)	5.1	5.4	4.7	Policy-Adjusted Revenues (Issuer)	5.1	5.4	4.7
Nominal GDP (US)	4.3	4.8	5.1	CPI (US)	1.9	2.5	2.7
Difference	*0.8*	*0.6*	*(0.4)*	*Difference*	*3.2*	*2.9*	*2.0*
Unadjusted Revenues (Issuer)	5.3	5.4	4.7	Unadjusted Revenues (Issuer)	5.3	5.4	4.7
Nominal GDP (US)	4.3	4.8	5.1	CPI (US)	1.9	2.5	2.7
Difference	*1.0*	*0.6*	*(0.4)*	*Difference*	*3.4*	*2.9*	*2.0*

Source: Fitch Records & Lumesis

Minnesota's Credit Rating

Expenditure Framework – 'aaa'

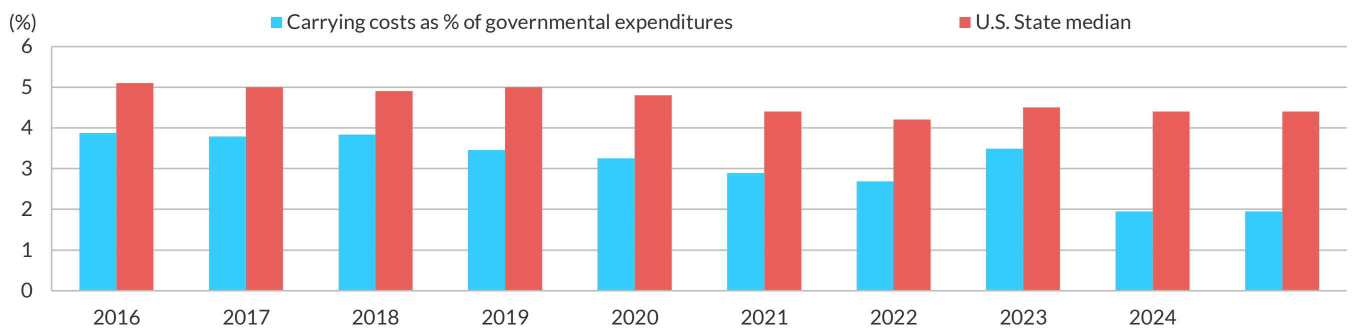
Flexibility of Main Expenditure Items
Metrics to Support Assessment

State Governments and Territories
Carrying cost: Governmental debt service + pension ADC + OPEB actual payment/governmental expenditures (most recent year)
Workforce evaluation: When workforce is a notable expense driver, consideration of an issuer's control over workforce spending based on factors such as management's independent control of headcount, compensation and work rules, existence/terms of contractual agreements with labor, and laws covering collective bargaining and the ability to strike

- The carrying cost metric isolates spending that is a more fixed obligation. Fitch considers a carrying cost metric of less than 10% to be consistent with a 'aaa' assessment; ≥ 10% and < 20%, 'aa'; ≥ 20% and < 25%, 'a'; ≥ 25% and < 30%, 'bbb'; and ≥ 30%, 'bb', while noting that the carrying cost metric is only one consideration in the assessment of expenditure flexibility.
- The workforce evaluation highlights a government issuers' relative ability to control labor costs. State governments generally have ample flexibility to cut spending because of both largely sovereign powers under the U.S. governmental system and the fact that states generally provide funding that is used by other entities, often local governments, to provide services rather than the state providing services directly. Labor costs are more inflexible and represent a large part of some territory budgets.

ADC – Actuarily determined employer contribution
Source: Fitch Ratings

Minnesota, State of (MN) — Carrying Costs

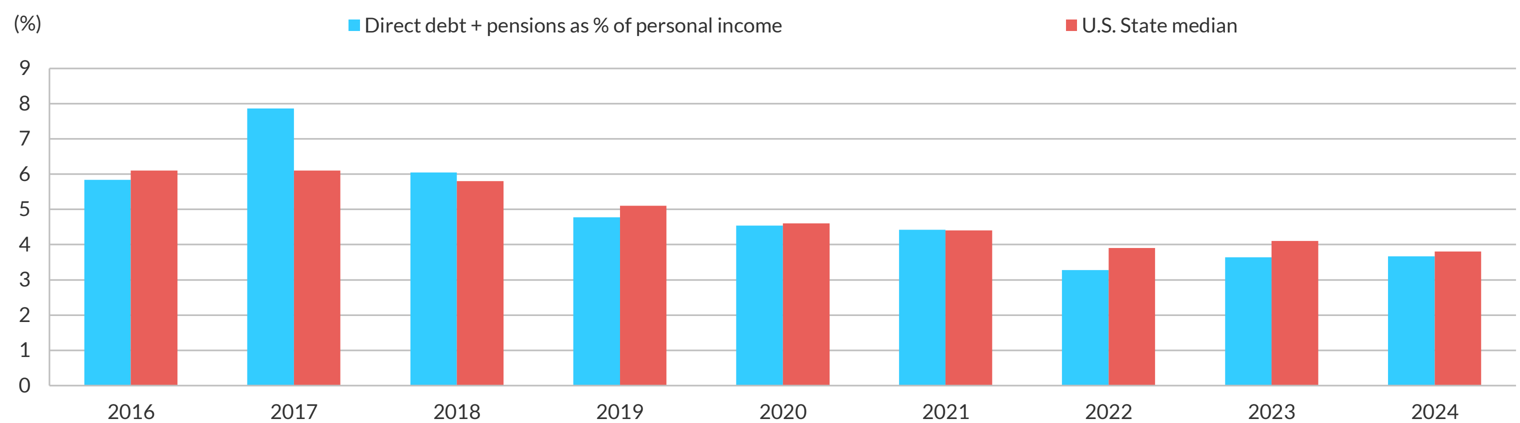


Minnesota's Credit Rating

Long-term Liability Burden – 'aaa'

Long-Term Liability Burden Metrics to Support Assessment
State Governments and Territories
Direct debt + Fitch-adjusted net pension liability as a percentage of personal income and of GDP
• The liabilities as a percentage of resident personal income metric indicates the burden on the economic base and is the primary metric for analysis in most cases. Fitch considers a liabilities-to-income metric of less than 10% to be consistent with a 'aaa' assessment; less than 20%, 'aa'; less than 40%, 'a'; and less than 60%, 'bbb'.
• Using current metrics as a base, analysis focuses on expectations for the future, incorporating expectations of capital plans/needs and the pace at which debt is paid down, the adequacy of current pension contribution policies and economic expectations.
• Fitch also considers the liability burden as a percentage of a state's or territory's GDP for state governments and territories whereby personal income does not fully reflect the resource base. For these states and territories, Fitch uses a similar scale as with personal income analysis and considers a total liabilities to GDP metric of less than 10% to be consistent with a 'aaa' assessment; ≥ 10% and < 20%, 'aa'; ≥ 20% and < 40%, 'a'; ≥ 40% and < 60%, ''bbb'; and ≥ 60%, 'bb'.
Source: Fitch Ratings

Minnesota, State of (MN) — Long-Term Liability Burden

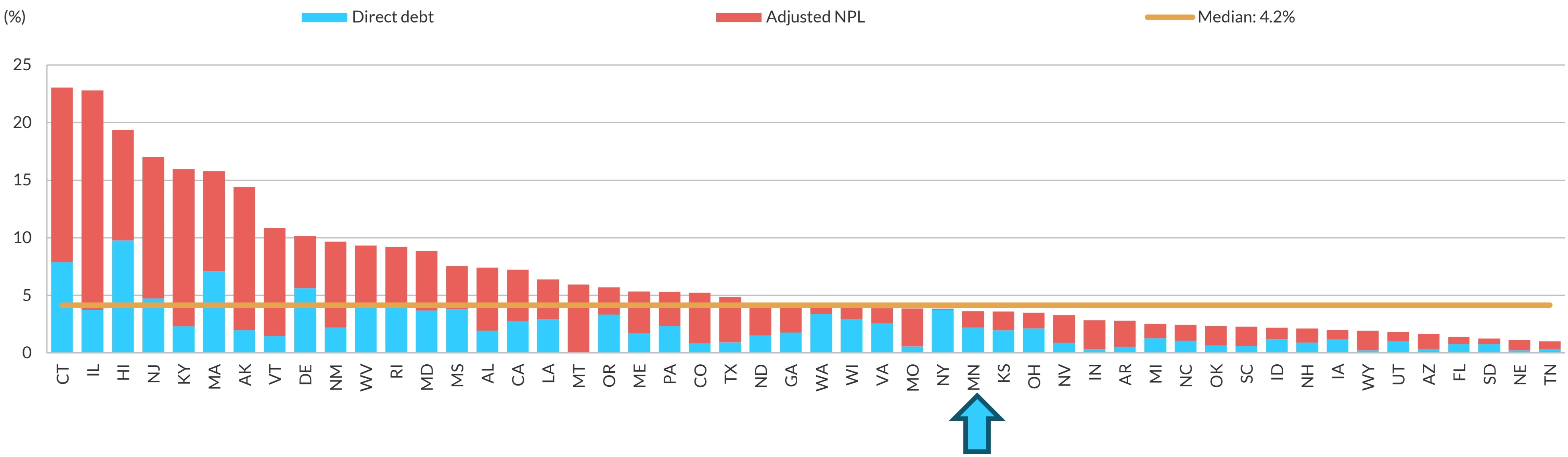


Source: Fitch Ratings, State of California Annual Comprehensive Financial Reports

Minnesota's Credit Rating

Long-term Liability Burden – 'aaa'

State Direct Debt and Adjusted Pension Liabilities
(% of personal income, fiscal 2023)



Note: California, Illinois and Nevada figures based on available disclosure, given the absence of annual comprehensive financial statements.
NPL – Net pension liability.
Source: Fitch Ratings, Fitch Solutions, state and pension annual comprehensive financial reports, state bond documents, U.S. Bureau of Economic Analysis

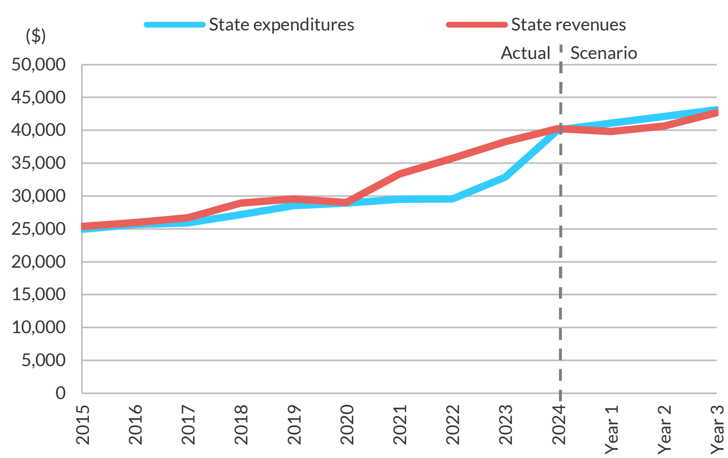
Minnesota's Credit Rating

Operating Performance – 'aaa'

Financial Resilience through Downturns Metrics to Support Assessment
• Interpretation of [Scenario Analysis](#) is an important driver of the financial resilience assessment for state governments and territories.
Source: Fitch Ratings

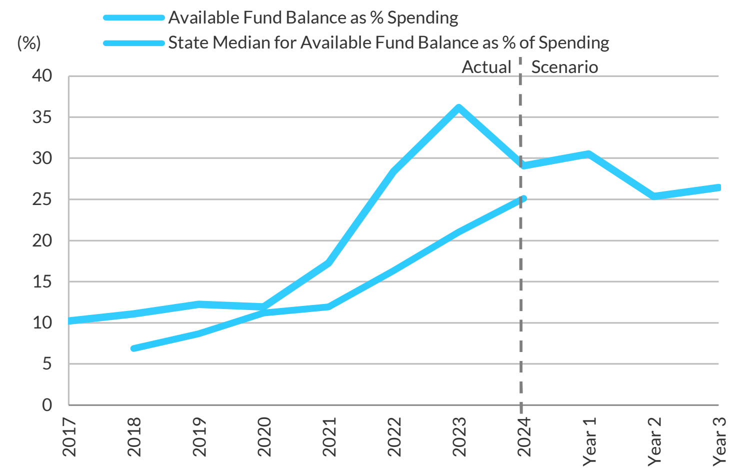
Budget Management in Times of Economic Recovery Metrics to Support Assessment
State Governments and Territories
Consideration of historical and expected budgeting practices
• Dollar difference between pension ADC and actual pension contribution as a percentage of spending.
Source: Fitch Ratings

State Revenues and Expenditures in an Unaddressed Stress



Source: Fitch Ratings, Minnesota, State of (MN) Annual Comprehensive Financial Reports

Available Fund Balance as % of Spending in an Unaddressed Stress



Source: Fitch Ratings, Minnesota, State of (MN) Annual Comprehensive Financial Reports

Q&A

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