

State of Minnesota

Minnesota's 'AAA' IDR and GO bond ratings reflect the state's steadily growing and broad-based economy, highly educated workforce, expanding population and a revenue structure well designed to capture economic growth. The ratings also reflect a low long-term liability burden and historically strong control over revenue and spending that, in conjunction with a sophisticated approach to reserve funding, leaves Minnesota well positioned to manage through economic cycles while maintaining a high level of financial flexibility.

The 'AA+' ratings on the general fund appropriation bonds, COPs and lease revenue bonds, one notch below the state's IDR, reflect the slightly higher degree of optionality associated with payments subject to annual appropriation.

The 'AA+' programmatic rating on the Minnesota School District Credit Enhancement Program reflects both supportive structural factors and the state's commitment to make timely debt service payments if a participating district is unable to, which Fitch views as similar to an annual appropriation debt security.

Public Finance

State General Obligation

United States

Ratings

Long-Term IDR	AAA
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Outlooks

Long-Term IDR	Stable
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New Issues

GO State Various Purpose Bonds, Series 2024A	AAA
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GO State Trunk Highway Bonds, Series 2024B	AAA
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GO Taxable State Various Purpose Bonds, Series 2024C	AAA
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GO State Various Purpose Refunding Bonds, Series 2024D	AAA
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GO State Trunk Highway Bonds, Series 2024E	AAA
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Sale Date

August 6, by competitive sale.

Outstanding Debt

General Obligation State Bonds	AAA
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General Obligation State Trunk Highway Bonds	AAA
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Legislative Office Facility Project Certificates of Participation	AA+
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Andersen Office Building Lease Revenue Bonds	AA+
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Freeman Office Building Lease Revenue Bonds	AA+
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Lewis and Clark Regional Water System Project State General Fund appropriation Bonds (Taxable)	AA+
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Minnesota School District Credit Enhancement Program (MN) School bond prog	AA+
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Applicable Criteria

[U.S. Public Finance State Governments and Territories Rating Criteria \(April 2024\)](#)

Related Research

[Fitch Rates Minnesota's \\$1.6B GO State Bonds 'AAA'; Outlook Stable \(July 2024\)](#)

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Key Rating Drivers

Revenue Framework - 'aaa'

Minnesota's revenue has shown solid growth even after adjusting for the estimated effect of tax increases. Fitch believes the state's revenue growth prospects remain strong. The state has complete independent legal authority to raise revenue.

Expenditure Framework - 'aaa'

Fitch expects that the natural pace of Minnesota's spending growth, driven by education and Medicaid funding demands, will be generally in line with to marginally above revenue growth and require ongoing budget management. The state has the ample flexibility to control spending common to most U.S. states.

Long-Term Liability Burden - 'aaa'

Minnesota's combined debt and net pension liability is a low burden on resources, in line with the median for U.S. states as measured against personal income. GO debt amortization is rapid and other post-employment benefit obligations are minimal.

Operating Performance - 'aaa'

Minnesota's finances have shown significant resilience through economic downturns and the state has demonstrated a strong commitment to bolstering its reserves during recoveries. The state has put in place mechanisms to set aside a portion of surplus revenue into its budget reserve fund annually to offset revenue volatility.

Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- Weakening of the state's budget management practices from adherence to well-developed reserve funding policies, such as the inability to rebalance revenue and expenditures in a timely manner.
- Expectations for a sustained slowing of the state's natural pace of revenue growth to below U.S. GDP growth.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- Not applicable for issuers with a 'AAA' rating.

Economic Resource Base

Minnesota's economy is diversified and resembles that of the nation, although the manufacturing, education and health services, and financial activities sectors are somewhat more important than the national average. The state's population of about 5.7 million is well educated, and wealth levels are high. The state's population is growing in line with the broader U.S. rate.

The Minneapolis-Saint Paul area serves as a major regional employment center, and robust growth in the educational and health services sector has made healthcare, biomedical research, medical device manufacturing and higher education increasingly important contributors to the state economy.

IDR Current Developments

Economic Update

Minnesota's post-pandemic jobs recovery has lagged national trends, though the labor market looks tight. Early in the pandemic, Minnesota's labor market suffered a decline in line with the nation's, with 14% of the state's jobs lost between February and April 2020. Since then, Minnesota has seen relatively slow employment growth, with June 2024 employment almost 1% higher than pre-pandemic levels and below the overall national employment recovery of 4%. Minnesota's headline unemployment rate of 2.9% in June 2024 was well below the 4.1% U.S. rate for the same month, whereas prior to the pandemic Minnesota's unemployment rate was roughly similar to the national rate. The state's employment to population ratio (EPOP, a measure of labor force utilization) was 65.8% as of June 2024, significantly below the February 2020 level of 67.5% but ahead of the national EPOP of 60.1%, which still lags the February 2020 level of 61.2%.

Fund Balance Draws Fund One-Time and Ongoing Expenses; Dedicated Budget Reserves Growing

Minnesota has leveraged recent rapid tax revenue growth, and the ample general fund surpluses that growth facilitated, to engage in \$9 billion in large expenditures and tax breaks, a mix of one-time and recurring programs. The use of one-time surpluses and fund balance to support recurring expenses creates potential future budgetary

pressure for the state. Fitch anticipates that Minnesota's continuing economic growth and broad authority to control expenditures will support a timely return to budgetary balance. Importantly, dedicated budget reserves (primarily the budgetary reserve and cash flow account) collectively increased at a rapid pace coming out of the pandemic even as the state spends down ending general fund balances.

As adopted in 2023, the 2024-25 biennial budget allocates \$71.0 billion in expenses against \$60.1 billion of net revenues, principally by employing existing surpluses towards \$9 billion of one-time expenditures over the biennium, including approximately \$1 billion each for a child income tax credit expansion, increased cash funding of the capital program, housing investments, and transportation programs. The biennial budget also includes over \$6 billion in recurring new costs, comprised of over \$3 billion for education, \$2 billion for health initiatives, \$1 billion in ongoing tax policy changes, and other major housing and public safety programs. The Spring 2024 legislative session fell in the middle of the biennium, and made relatively modest changes, appropriating \$450 million in mostly one-time expenditures, highlighted by \$100 million each for the Hennepin v. Tyler legal settlement and for health and human services.

Preliminary fiscal 2024 tax revenues ended at \$30.2 billion, 2.9% above fiscal 2023 levels, outperforming an initially-budgeted 4.3% decrease. This increase comes as declines in personal income tax receipts are offset by a slight increase in corporate income taxes. The drop in personal income taxes is attributable to the net effects of the \$1.1 billion one-time tax credit in fiscal 2024.

Credit Profile

Revenue Framework

Minnesota's general fund revenues are diverse, consisting of individual and corporate income, sales, and property taxes. Personal and income tax accounted for 55% of net general fund revenues, followed by sales tax at 26% and corporate income tax at 10%.

The state's income and sales taxes respond quickly to changes in economic conditions. On average, tax revenues have grown at a pace approximating the rate of national economic growth. Fitch expects this trend to continue.

Like most states, Minnesota's legislature has the independent legal ability to raise operating revenues without any external approval required.

Expenditure Framework

Minnesota's general fund spending is primarily for K-12 education (37% of fiscal 2023 expenditures) and health and human services (30%).

Spending growth, absent policy actions, will likely be in line with to marginally above revenue growth over time, requiring regular budget management.

The state has substantial flexibility to cut major expenditure items as needed, with the broad expense-cutting authority common to most U.S. states. Fixed carrying costs for debt and retiree benefits are low at less than 4% of governmental funds expenditures. In other major areas of spending such as education, Minnesota is able to more easily adjust the trajectory of growth and has done so both during and after prior downturns by delaying aid to school districts to control the pace of spending and conserve cash.

The fiscal challenge of Medicaid is common to all U.S. states. The program's nature and the federal government's rules place limits on states' ability to manage the pace of annual spending growth; Minnesota's health care costs have nevertheless come in below expected levels in recent years. Federal action to revise Medicaid's programmatic and financial structure does not appear to be a near-term priority of the current federal administration or congressional leadership. As with all federal initiatives, Medicaid remains subject to regulatory changes that could affect various aspects of the program.

Long-Term Liability Burden

On a combined basis, Minnesota's debt and net pension liabilities (NPLs) are very low relative to personal income. As of Fitch's 2023 report on states' long-term liability burdens ("2023 State Liability Report," dated November 2023), Minnesota's long-term liability burden totaled 3.3% of 2022 personal income, compared with the state median of 4.0%. Fitch recalculates reported NPLs using a standard 6% discount rate assumption. Using fiscal 2023 audited financial statements, Fitch estimates the combined burden of long-term debt and net pension obligations rose to 3.7% of 2023 personal income, reflecting a reversal of pension asset gains in 2022.

The state has well-established debt policies that control issuance and require rapid amortization of GO debt, which comprises just under half of the state's liability burden. Approximately 75% of outstanding GO debt matures in ten years. As per the state constitution, all GO debt must mature within 20 years.

The state participates in multiple defined benefit pension plans, with its obligation for state employees constituting the largest share of its obligations. Funding policy changes enacted since 2018 have strengthened pension contribution practices and increased the likelihood of improved asset-to-liability ratios, which would reverse growth in NPLs under GASB reporting.

Pension investment return assumptions and annual pension contributions in Minnesota are determined by state statute. Beginning in fiscal 2022, actual contributions began exceeding actuarially-recommended levels after years of falling below actuarially-recommended levels, although not by substantial amounts. Nonetheless, the relatively small size of Minnesota's overall pension obligations relative to its economic resource base would make a return to a slight underfunding relative to actuarially-recommended levels a relatively minor credit weakness.

Meaningful statutory changes and court rulings that established the state's legal right to adjust benefits, including a court-validated authority to reduce cost of living adjustments (COLAs), have strengthened the sustainability of the state's pension systems. Investment return assumptions for the state's major plans (except teachers) have been lowered to 6.5%, from 7.5%, as of their 2021 measurement dates; the teachers plan stands at 7%. Retiree health care benefits for Minnesota's state employees are very limited.

Operating Performance

Budget forecasting and management mechanisms are strong, with comprehensive reviews of economic and revenue forecasts occurring in February and November of each year, punctuated with monthly revenue updates and periodic releases of updated and revised revenue and expenditure forecasts.

Minnesota has a consistent record of cautious budget management, with a tendency toward one-time solutions in downturns followed by a rapid rebuilding of financial flexibility during recoveries. The governor has the power to reduce appropriations if the BRF is insufficient to close a deficit that emerges during a biennium; these reductions are one-time in nature (i.e., not carried over into the next biennium). The state can also utilize a portion of the BRF (currently at a new high of \$2.9 billion, or 10.4% of fiscal 2023 general fund expenditures) to cover some expenditures.

Given the availability of higher dedicated budget reserves, Fitch believes it less likely that Minnesota will need to resort to the extraordinary budgetary measures it has taken in the past, including delays in the distribution of K-12 education funding aid, to manage through future downturns. Minnesota's comprehensive and dynamic approach to reserve funding (discussed further below) serves to offset the economic sensitivity associated with its largely income-tax supported revenue system. Additionally, Minnesota pools cash in what the state terms its Statutory General Fund to facilitate inter-fund borrowing at various points during the fiscal year, thereby minimizing the need for any external cashflow borrowing.

The state's sophisticated focus on reserve levels and replenishment demonstrates its ability and willingness to rapidly rebuild financial flexibility at times of economic and revenue growth. Pursuant to state law, revenue over-performance during economic expansions is first applied to fund dedicated budget reserves up to their policy targets, then to reverse any prior payment deferrals.

Fitch believes the state materially enhanced its reserve funding practices during the last recovery, making revenue volatility the focus of a revised policy that introduced an automatic funding mechanism to grow the BRF. The reserve target is sized to provide a 95% level of confidence that a biennial deficit will not exceed dedicated reserve plus general fund balance. By statute, 33% of any above-forecast revenues during a biennium must be deposited in the BRF until the target level is reached. The 2024-2025 biennium budget targeted a fiscal 2025 year-end level of \$2.9 billion (4.1% of estimated biennial revenues, or 8.2% of annual revenues). Fitch anticipates the state will meet its target as it has every year for over a decade.

Fitch anticipates that following significant one-time expenditures drawing on unprecedented surpluses in the current biennial budget, Minnesota will rapidly rebalance its fiscal operations in a manner that controls the pace of spending growth compared to new revenue growth, allowing it to further augment reserves and cash and preserve budgetary flexibility for future downcycles.

Peer Analysis

Fitch's peer analysis compares Minnesota to economic peers, or states within the same decile of total GDP. Minnesota assesses favorably or on par with its peers along all Key Rating Drivers (KRDs). The state has among the highest assessments across the board—it is assessed at 'aaa' for all KRDs except "pace of spending growth," where it is at the

'aa' level. All the state's peers are also assessed at 'aa' for pace of spending growth. Minnesota's peer states are Indiana ('AAA'/Stable), Maryland ('AAA'/Stable), and Tennessee ('AAA'/Stable).

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