

THE BOND BUYER

Minnesota gets S&P warning as it plots fixes to coronavirus-driven budget hole

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Minnesota's top rating from S&P Global Ratings is at risk over its COVID-19 budget hole and how the state might close the potential three-year, \$7 billion gap.

S&P moved the outlook on the state's AAA rating to negative from stable this week in a report ahead of a \$1.2 billion new money and refunding general obligation sale set for next week.

"The negative outlook reflects our view that there is at least a one-in-three chance we could lower our rating on Minnesota due to our view that the state will likely significantly rely on one-time measures and reserves, rather than structural adjustments, to address its structural deficit which we estimate to be \$3.5 billion (8% of revenue) for the two-year 2020-2021 biennium," S&P said.

The state reported Friday that prior estimates projecting a deficit of \$2.4 billion in the current biennium that runs through June 30, 2021 remains on target. It announced a first-time estimate of the pandemic's potential impact on the next biennium putting the gap at \$4.7 billion.

"We believe that a significant use of reserves in this biennium would diminish the state's flexibility to address the next biennium's projected gap, forecasted to be \$4.7 billion (10% of revenue), and react to any future revenue or expenditure volatility," said S&P Global Ratings credit analyst Cora Bruemmer.

"We view timely budget adjustments that prioritize structural balance rather than one-time measures, as characteristic of 'AAA' rated entities," Bruemmer said. "If, in our view, the state relies more heavily on nonrecurring revenue or spending actions rather than structural adjustments to address budget shortfalls or is unable to implement timely adjustments, we would likely lower the rating."

The state said it would tread carefully in balancing the budget. "Following years of sound fiscal management, Minnesota has built up our rainy day fund. There is no question that it is raining now and we will look at using our reserve along with all other tools at our disposal," said Minnesota Management and Budget representative Myron Fran. "We need to continue to be cautious, targeted, and focused on the choices we make to balance the biennial budget, including addressing spending and cost structures."

A growing economy and a 2013 income tax hike on top earners helped drive billion dollar surpluses in recent years, but past efforts to erase red ink amid political divisions largely relied on one-shots like reserve use and pushing off payments to schools.

The Senate is led by Republicans. The Democratic-Farmer-Labor Party holds a House majority and Gov. Tim Walz is a DFLer. The state has not yet laid out plans to address the gaps and is among those states pressing for federal relief for tax losses in the package under negotiation by Congress and the administration. Minnesota Management and Budget Commissioner Myron Frans has said the state expects to dip into the \$2.4 billion reserve but has cautioned against draining it.

The rating action impacts about \$6.4 billion of post-issuance GOs and also moral obligation and appropriation bonds along with the Minnesota School District Credit Enhancement Program for kindergarten through 12th grade districts and the Minnesota Credit Enhancement Program for cities and counties.

"We rate the bonds in the programs on par with our GO rating on the State of Minnesota, reflecting the state's commitment to pay debt service on behalf of a program participant (school district, city, or county) from its general fund if the participant fails to meet its debt service obligations for the qualified debt," S&P said.

Ahead of the sale, Fitch Ratings affirmed the state's AAA GO rating and Moody's Investors Service affirmed its Aa1 rating. Both assign a stable outlook.



Minnesota Gov. Tim Walz is seeking federal declarations to pave the way for help in rebuilding businesses damaged by civil unrest.

Adding to the state's strains are Twin Cities protests following the killing of George Floyd in police custody. Floyd's May death triggered civil unrest across the country and Minneapolis was hard hit with riots that led to infrastructure and business damage.

"We view the recent protests in the state, centered in Minneapolis, as an elevated social risk currently. We believe the protests and community unrest do not represent an immediate budget pressure for the state, but we will continue to monitor the longer-term implications for the state's budgetary performance, budget management framework, and economy," S&P said.

On Monday, Walz requested a U.S. Small Business Administration federal disaster declaration to free up low-cost loans for property owners efforts to rebuild after the civil unrest. Nearly 1,500 Twin Cities businesses were damaged by vandalism, fire, or looting. Current estimates of the damage exceed \$500 million.

On July 2, Governor Walz requested a major disaster declaration to provide public assistance and hazard mitigation assistance. It was denied last month. The state is appealing that decision. Walz said public infrastructure damage costs, including debris removal and damage to public buildings and equipment totaled \$15.6 million.

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