Overview of Cities Under 2,500 in Population

Total Governmental Revenues

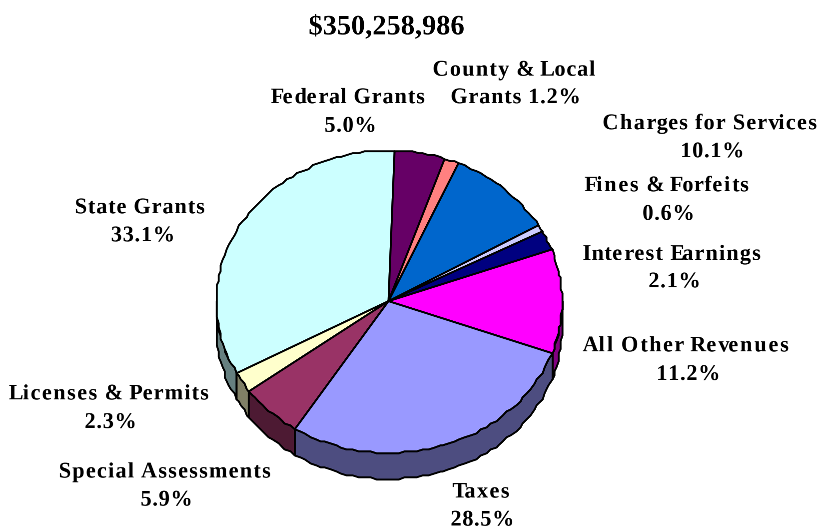
In 2003, cities under 2,500 in population raised total governmental revenues of $350.3 million to finance city services. This represents a decrease of 1.0 percent from the amount raised in 2002.

The sources of revenue that grew at the fastest rate between 2002 and 2003 were: federal grants (41.9%), taxes (13.2%), and charges for services (12.8%). The categories showing the greatest decrease were: interest earnings (-30.3%), state grants (-9.9%), and all other revenues (-6.1%).

Between 2002 and 2003, the Legislature helped balance the state budget by reducing local government aid (LGA) and other aid programs to cities. The reductions in LGA resulted in a net loss of $10.8 million or 12.6 percent in aid to small cities. In addition, there were other reductions to taconite aids that affected certain cities in the Iron Range. In all, state aid to Minnesota's smallest cities fell by 9.9 percent between 2002 and 2003.

The main sources of revenues for small cities in 2003 were state grants and taxes, which together accounted for 61.6 percent of all revenues. Taxes as a percent of total revenues increased from 25.5 percent in 2002 to 28.5 percent in 2003, while state grants as a percent of total revenues decreased from 37.1 percent in 2002 to 33.1 percent during the same period. Figure 8 shows the relative shares of total governmental revenues by source.

Figure 8: Total Government Revenues



Total Governmental Expenditures

Most city services are accounted for in governmental funds. The governmental funds are made up of the General, Special Revenue, Capital Projects, and Debt Service funds. In 2003, cities under 2,500 in population expended $453.8 million from Governmental Funds to provide city services. This represents an increase of 8.8 percent over 2002 total governmental expenditures

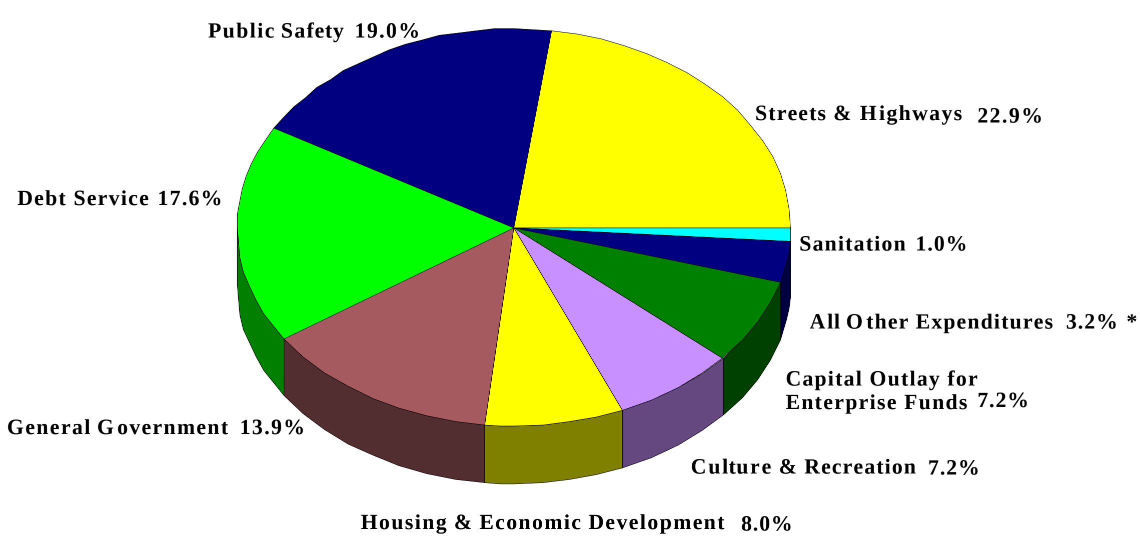
Between 2002 and 2003, the categories of expenditures that grew at the fastest rate were: capital outlays for enterprise funds (71.3 %), streets and highways (16.3 %), and debt service (7.1%). The categories showing the greatest declines were: health (92.0%), "all other expenditures" (6.3%) and housing and economic development (4.3%). There was a large one-time capital outlay for health in 2002 that greatly inflated the figure for that year. The decline in health expenditures reflects a return to historical norms.

In 2003, the four largest expenditure categories for cities under 2,500 in population were streets and highways, public safety, debt service and general government. These four categories together accounted for 73.4 percent of all expenditures in 2003. Between 1999 and 2003, debt service as a percent of total expenditures decreased, while general government, public safety, and streets and highways increased.

Figure 9 shows the relative shares of total governmental expenditures of small cities by function.

Figure 9: Total Governmental Expenditures **

$453,834,388



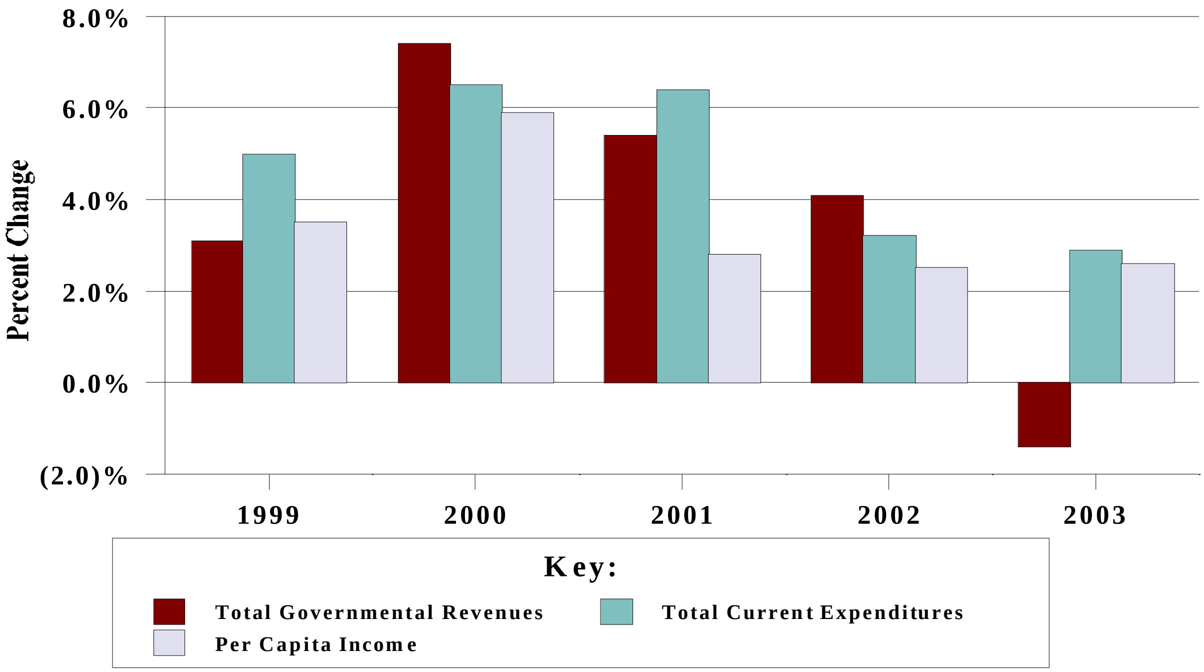
* Includes airport, health, unallocated insurance, and all other unallocated expenditures.
** Includes current expenditures, capital outlays, and debt service, but excludes transfers to Enterprise Funds.

Growth in Government

During the five-year period of 1999 to 2003, total current expenditures of small cities increased every year while total revenues increased every year but 2003.[5] The rate at which they grew varied from negative 1.4 percent to a positive 7.4 percent. To place this growth in perspective, Figure 10 below includes a bar showing the growth in per capita personal income for Minnesotans.[6] Per capita income is an indicator of the ability of citizens to pay for governmental spending. When expenditures grow faster than per capita personal income, citizens must spend a greater proportion of their income on governmental services.

Figure 10 compares the growth in total current expenditures and total governmental revenues to the change in Minnesota per capita personal income from 1999 to 2003. During this period, total current expenditures grew faster than per capita income every year.

Figure 10: Percentage Change - Total Governmental Revenues, Total Current Expenditures, and Per Capita Income - 1999 to 2003



[5] The chart excludes capital outlays, as this category is more prone to yearly fluctuations. The chart also excludes revenues derived from borrowing, because cities are prohibited from borrowing for current expenditures. Most capital projects are funded through the issuance of bonds or other types of borrowing, such as certificates of participation.

[6] Per capita income is calculated by dividing Minnesota total personal income by its total mid-year population. The figure is calculated by the Bureau of Economic Analysis, which is a part of the U. S. Census Bureau.

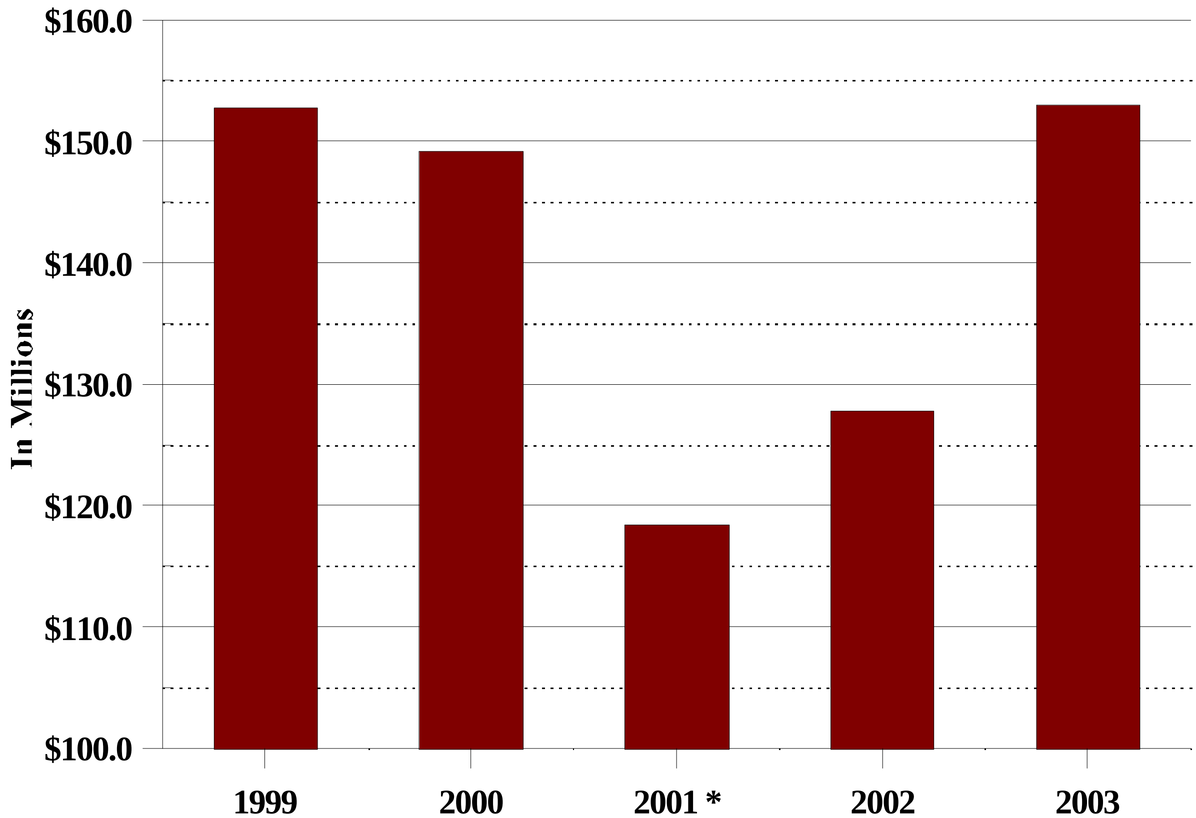
Capital Outlay Expenditures

Capital outlay expenditures account for the purchase, construction, or permanent improvements of buildings, equipment, machinery, and land. Small cities expended $153.0 million on capital investments in 2003. This represents an increase of 19.7 percent over the level expended in 2002.

Capital outlays are more likely than current expenditures to vary significantly from one year to the next. The reason for this is that capital projects tend to be large in size, but the associated costs are short-term. Some of the factors that influence the level of capital investments include: demands for public meeting places and facilities, the need to replace aging infrastructure, public safety concerns, infrastructure improvements for new developments, and damage to public facilities caused by fire, floods, and storms.

Figure 11 illustrates the trend in capital spending of cities under 2,500 in population for the years 1999 through 2003.

Figure 11: Total Capital Outlay Expenditures, 1999 to 2003



* The large decrease in 2001 reflects the smaller number of cities under 2,500 in population in 2001

Municipal Enterprises

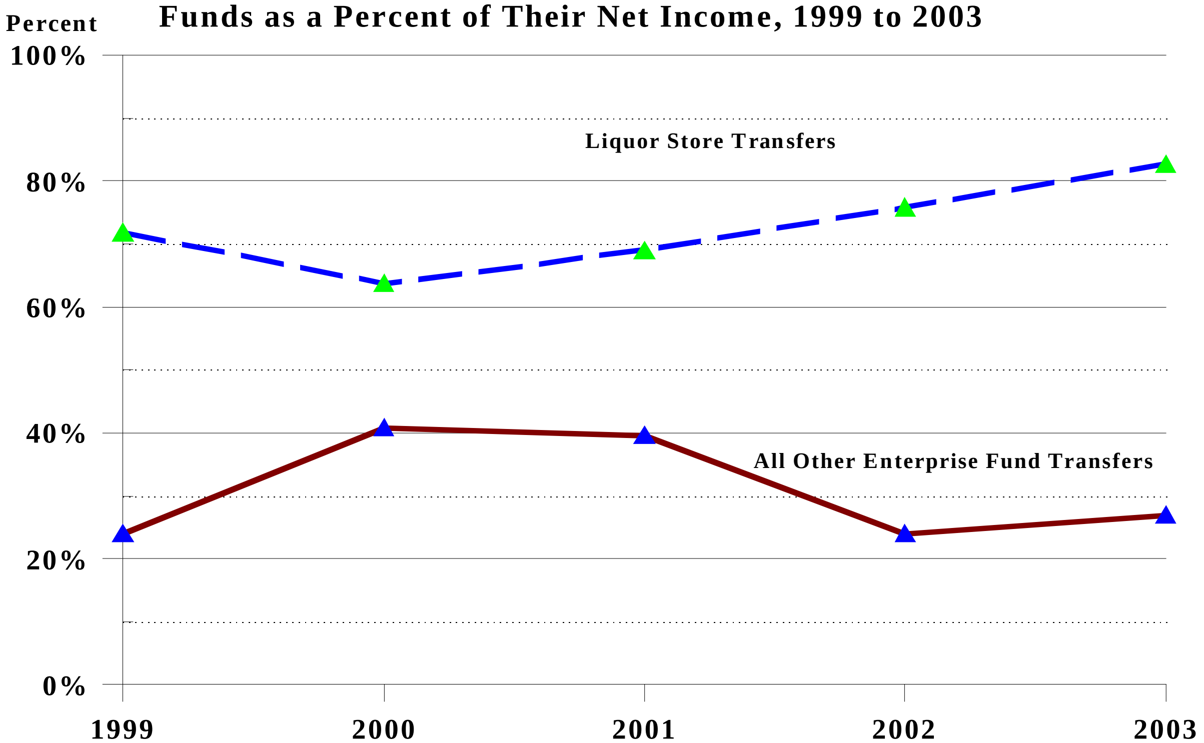
In addition to Governmental Funds, many cities establish Enterprise Funds to account for services that are financed and operated in a manner similar to private business enterprises. These enterprises are intended to be self-sustaining through fees and user charges. Although some enterprises earn a net income, most have the objective of breaking even. The most common enterprises created by cities are electric, gas, sewer, water, and heat utilities.

The net income of municipal enterprises increased 19.2 percent between 2002 and 2003 while net transfers (transfers out minus transfers in) from Enterprise Funds increased 33.6 percent between 2002 and 2003. An example of this type of transfer is when a city transfers excess reserves from its water utility enterprise fund to the city's General Fund.

Municipal liquor stores, which are separated from other municipal enterprises because of accounting differences, showed a decrease of 13.5 percent in net income and a decrease of 5.0 percent in net transfers between 2002 and 2003. The primary purpose of municipal liquor stores is to provide additional revenues to cities, whereas other types of municipal enterprises primarily exist to provide a particular service for the city and citizens.

Figure 12 examines the five-year trend in net transfers from enterprise and municipal liquor store funds as a percent of net income. Tables 14 through 22 provide additional details on municipal enterprises.

Figure 12: Net Transfers from Enterprise and Muncipal Liquor Store Funds as a Percent of Their Net Income, 1999 to 2003



Outstanding Long-Term Indebtedness

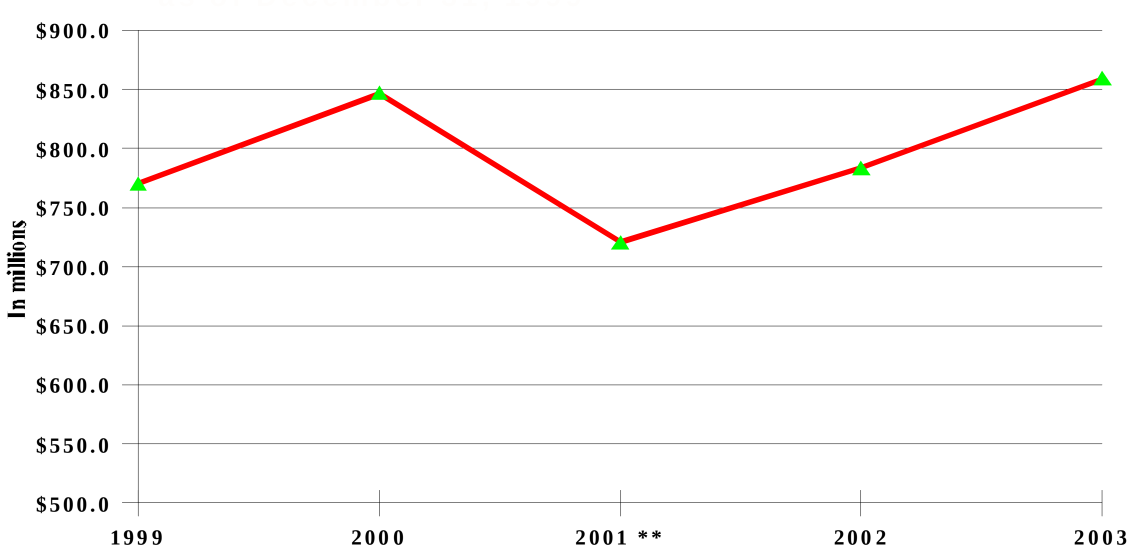
Cities incur long-term debt through the issuance of bonds and notes, certificates of indebtedness, and tax anticipation certificates. Long-term lease agreements are also classified as long-term debt. Cities may only borrow to finance capital projects and purchases. Cities are restricted by law from borrowing for current expenditures. The amount of outstanding debt affects a city's current expenditures because cities must make principal and interest payments to service the debt.

Table 3 looks at outstanding bonded indebtedness for 2002 and 2003. Figure 13 shows the five-year trend of outstanding long-term debt for small cities.

Table 3: Two-Year Summary of Outstanding Bonded Indebtedness

	2003 Amount	2002 Amount
General Obligation	$38,933,997	$ 34,920,987
G.O. Tax Increment	41,359,546	44,834,634
Revenue Tax Increment	186,932	62,000
Special Assessment	233,694,044	211,754,696
G.O. Revenue	250,052,707	226,148,685
Revenue	83,134,396	77,514,107
All Other	6,375,155	3,380,901
Total Bonded Indebtedness	**$653,736,777**	**$598,616,010**

Figure 13: Outstanding Long-Term Indebtedness as of December 31, 2003



* Includes bonds and other types of debt such as certificates of participation, long-term leases, and notes.
** The large decrease reflects the smaller number of cities under 2,500 in population in 2001.

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