Scope of Report

This publication is intended to facilitate the understanding of city financial operations by citizens, local government officials, and other policy makers. The report summarizes, through data tables and charts, the financial operations of Minnesota cities for calendar year 2004. These cities are required to annually submit annual financial reports to the Office of the State Auditor.

For the third year, this publication combines both cities over and under 2,500 in population. The return to this format should allow readers to examine the trends in all cities rather than just for those over or under 2,500 in population.

The data presented in this report is divided into governmental funds and proprietary funds. The governmental funds consist of the General, Special Revenue, Capital Projects, and Debt Service Funds. The first section provides an overview of all cities and compares cities over and under 2,500 in population. The second section of the report presents a detailed overview of the financial operations of cities over 2,500 in population. The third section provides a detailed overview of the financial operations of cities under 2,500 in population.

Following the overviews, Tables 6 through 9 present a summary of the activities in the governmental funds of cities over 2,500 in population. Tables 10 through 12 present a summary of the activities in the governmental funds of cities under 2,500 in population. Tables 13 through 15 present the data by individual city.

The enterprise or proprietary funds of cities are presented separately from the governmental funds. Minnesota cities operate many types of public service enterprises. The enterprises furnish a variety of services and operate wholly or in large part with revenues derived from the sale of goods or services. Tables containing detailed information about the financial operations of the municipal public service enterprises can be found online at www.auditor.state.mn.us.

Table 16 lists the bonded and other long-term debt outstanding as of December 31, 2004, by individual city. Other long-term debt refers to liabilities such as long-term lease agreements, installment purchase contracts, and notes.

Tables 17 and 18 present an analysis of the 2003 and 2004 unreserved fund balances in the General and Special Revenue Funds of all cities reporting on a modified accrual basis. Table 17 details the actual unreserved fund balances, the percentage change in unreserved fund balances from 2003 to 2004, and a comparison to 2004 total current expenditures. Table 18 presents the fund balance data sorted by unreserved fund balances as a percent of total current expenditures. This table also classifies the fund balances based on standards set by the Office of the State Auditor. An analysis of unreserved fund balances for cities using a cash basis of accounting is not provided. Those cities using a cash basis of accounting report a single cash balance for all governmental funds at the end of the fiscal year. Cities using an accrual basis of accounting report separate fund balances for all of their governmental funds and denote the amounts that are reserved and unreserved. Because of the accounting differences, a comparative analysis of unreserved fund balances is not appropriate for cities that use a cash basis of accounting. Appendix B provides a more detailed discussion of fund balances.

Accounting Difference for Cities Over and Under 2,500 in Population

For cities in Minnesota, the classification as over or under 2,500 in population helps to determine the type of governmental accounting to which they must adhere. All cities over 2,500 in population must have an annual audit that follows Generally Accepted Accounting Principles (GAAP), which is a modified accrual basis of accounting. Accrual Basis Accounting recognizes an economic transaction or event as revenues in the operating statement when the revenues are both measurable and available to liquidate liabilities of the current period. Available means collectible in the current period or soon enough thereafter to be used to pay liabilities of the current period. Similarly, expenditures are generally recognized when an event or transaction is expected to draw on current spendable resources.

Cities under 2,500 may opt to use a cash basis of accounting. In 2004, 259 of the 644 small cities (40.2 percent) opted to use a cash basis of accounting. Cash basis accounting provides for the recording of revenues when received in cash and the recording of expenditures when paid in cash. While cash basis accounting may be allowed under Minnesota Statutes, it does not facilitate as accurate a reporting of financial position as generally accepted accounting principals.

The 2000 census decreased the number of cities classified as under 2,500 in population from 668 to 646. From 1991 to 2000, cities were classified as over or under 2,500 in population based on the 1990 census. This was true even if their estimated population changed. From 2001 through 2011, cities will be classified based on the 2000 census. Due to population growth, the following cities are no longer classified as under 2,500 in population: Albertville, Annandale, Appleton, Becker, Byron, Centerville, Chisago City, Cokato, Cold Spring, Greenfield, Lindstrom, Milaca, Montgomery, Perham, Rogers, Roseau, Spring Valley, St. Francis, Victoria, Wabasha, Watertown, Wyoming, Zimmerman, and Zumbrota. Two cities, Lauderdale and Osseo, lost population between the 1990 and 2000 census and are now included with the group of cities under 2,500 in population. Tables that present data for 1999 through 2000 were not adjusted to reflect the change in the number of cities classified as under 2,500 in population.

In June of 2002, the city of Pleasant Lake and the town of Rockville merged with the city of Rockville. The merger between the local governments increased the city of Rockville's population from 810 to 2,585. Because of the change in population, the city of Rockville is now classified as over 2,500.

In addition to this publication, an enhanced version of the report is available on the State Auditor's web site. The enhanced version provides additional tables and analysis of the data that were not included in the printed copy to save money. Also, the Office of the State Auditor maintains an interactive database containing several years of data that can be accessed through the State Auditor's web site. The database allows users to customize the presentation of data to their individual needs. For example, a user can select a group of cities they want to compare, the criteria on which to compare them, and the time frame in which to compare them. The query can then be viewed on screen or saved to a file for downloading. The State Auditor's web site address is www.auditor.state.mn.us.

Comparison and Overview
2004 Finances for All Minnesota Cities

Revenues

Total revenues of the governmental funds for all Minnesota cities amounted to $4 billion in 2004. This represents an increase of 4.2 percent from 2003 revenues. Total revenues of cities over 2,500 in population increased 4.3 percent, while revenues of cities under 2,500 in population increased 3.7 percent.

There are significant differences in how city services are funded between the two city types. Cities under 2,500 are much more dependent on intergovernmental revenues than cities over 2,500. In 2004, intergovernmental revenues accounted for 38.2 percent of total revenues for cities less than 2,500 in population compared to 27.3 percent for cities over 2,500 in population. Among all cities, intergovernmental revenues accounted for 28.3 percent of total revenues.

Large cities make up for the difference in intergovernmental revenues by taking advantage of other tax revenue streams such as tax increments from tax increment financing (TIF) districts, franchise, lodging, and local sales taxes. As a whole, tax revenue from all sources accounted for 41.4 percent of large city revenues in 2004, compared to 30.1 percent of small city revenues. Large cities also utilize tax increment financing to a much greater extent than small cities. Revenue derived from TIF districts accounted for 2.8 percent of small city total revenues compared to 6.5 percent for large cities.

Property taxes account for a similar share of total revenues for these two groups of cities. For large cities, property taxes accounted for 29.3 percent of total revenues compared to 26.9 percent for small cities. For all cities, property taxes accounted for 29.1 percent of total revenues.

On a per capita basis, large cities had total revenues of about $76 more than small cities ($973 to $897).

Expenditures

Total expenditures of the governmental funds for all cities totaled $4.78 billion in 2004. This represented an increase of 3.0 percent over 2003 and reflects an increase of 2.8 percent among large cities and 4.7 percent among small cities.

The spending priorities of cities under 2,500 in population differ from those cities over 2,500 in population. For example, cities under 2,500 tend to direct a greater percentage of their resources to general government (14.6%) and less to culture and recreation (6.9%) than cities over 2,500 (9.1% and 13% respectively). In addition, streets and highways are usually the largest category of spending for cities under 2,500 (21.6% in 2004) compared to public safety for those cities over 2,500. In 2004, however, large cities spent slightly more on streets and highways than on public safety (22.6% and 22.5% respectively), the result of a few cities with large capital outlay expenditures for streets and highways. Woodbury, Moorhead, Lakeville, and Maplewood all had significant increases in street and highway expenditures in 2004.

Long-Term Debt

Another area where small and large cities (under and over 2,500 in population) differ is in their use of debt. Overall, small cities tend to carry a greater debt burden than large cities. In 2004, small cities carried long-term debt of $948.7 million, or $2,344 per capita, compared to $7.18 billion, or $1,917 per capita for large cities.

Unreserved Fund Balances of the General and Special Revenue Funds

A clear difference between the two city types is in the level of unreserved fund balances. Small cities maintain significantly higher fund balances than large cities. In 2004, unreserved fund balances as a percent of current expenditures averaged 95.9 percent for small cities compared to 58.6 percent for large cities. The State Auditor's Office recommends that most cities keep their fund balance at between 35 and 50 percent of total current expenditures. Under the Auditor's guidelines, the average fund balance of small cities would be classified as "High" and that of large cities as "Moderately High".

Among the 259 small cities that use an accrual basis of accounting, 123 (47.4%) had an unreserved fund balance greater than 100 percent of total current expenditures. Among the 209 large cities, 42 cities (20.1%) had an unreserved fund balance greater than 100 percent of total current expenditures. Unreserved fund balances as a percent of total current expenditures among small cities ranged from –220.7 percent in Danvers to 1473.9 percent in Skyline. Among large cities, the range was from –16.9 percent in Independence to 449.8 percent in Albertville.

The State Auditor has concerns about the financial health of cities maintaining a fund balance below 20 percent of total current expenditures. These cities may not have enough reserves to carry them through financial downturns or unexpected contingencies. The Auditor also has concerns about cities that maintain fund balances far exceeding what is needed to carry them through financial downturns. Taxpayers in cities that have either low or high unreserved fund balances should press their local officials to explain the city's fund balance policy. It is also important to note that this analysis does not include the unreserved fund balances of capital project or debt service funds. These are the funds where one might expect to see higher fund balances, because they should be used to account for future capital projects or reserves to pay debt service.

Overview of Cities Over 2,500 in Population

Total Governmental Revenues

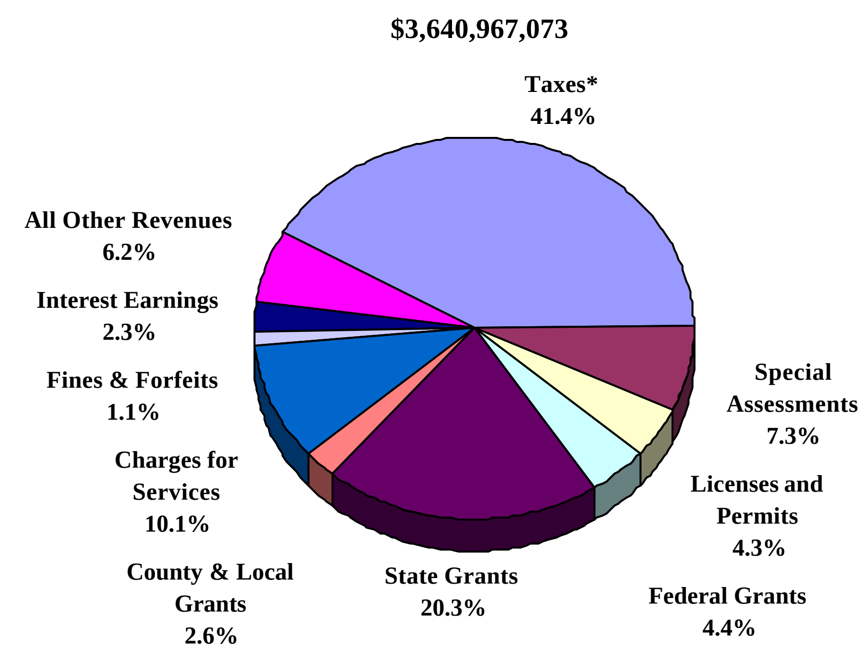
In 2004, cities over 2,500 in population raised total governmental revenues of $3.64 billion to finance city services. This represents an increase of 4.3 percent from the amount raised in 2003. The primary funding sources for cities were taxes and state aid. These two sources accounted for 61.7 percent of all city revenues.

The sources of large city revenue that grew at the greatest rate between 2003 and 2004 were: "all other revenues" (12.4%), licenses and permits (9.8%), and property taxes (8.9%). Those sources of revenue showing the greatest declines were: "all other" fees and service charges (-26.3%), county grants (-17.3%), and state aid (-7.4%). The dramatic increase in the library revenues (113%) is due to the fact that Minneapolis library revenues were not reported separately in 2003, which account for 50.5% of total library revenue.

The shares of total governmental revenues generally change very little from year-to-year. Two exceptions are property taxes and interest earnings. Over the past five years, property taxes have steadily increased as a percent of total revenues, increasing from 22.9 percent in 2000 to 29.3 percent in 2004 (a 40.6% change), while interest earnings decreased from 7.5 percent to 2.3 percent (a –66.5% change). To further examine five-year trends in revenues, refer to Table 4.

Figure 1 shows the relative shares of total governmental revenues by source. Underlying data for this figure is detailed in Table 4.

Figure 1: Total Governmental Revenues



* This category includes property, hotel/motel, sales, franchise, gravel, and gambling taxes, as well as tax increments.

Total Governmental Expenditures

Cities provide a variety of services to their citizens. Most expenditures for those services are accounted for in governmental funds. The governmental funds are classified as the General, Special Revenue, Capital Projects, Permanent, and Debt Service funds. In 2004, cities over 2,500 in population expended $4.3 billion from these various Governmental Funds to provide city services. This represents an increase of 2.8 percent over 2003 total governmental expenditures. Total governmental expenditures include current expenditures, capital outlays, and debt service. Current expenditures account for 54.1 percent of total government expenditures, while capital outlay accounts for 27.9 percent, and debt service accounts for 18 percent.

The largest category of current expenditures was public safety while streets and highways dominated capital outlay expenditures. Public safety current expenditures accounted for 38.8 percent of all current expenditures, more than double that of any other category. Streets and highways accounted for 58.4 percent of all capital expenditures, over three times greater than any other category of capital outlay.

Two areas showed very large increases in 2004. Library capital expenditures increased by 200.7% due to a $69 million increase in Minneapolis. Health capital outlay expenditures increased by 398.1% due to a sizeable capital outlay in St. Peter for a new health center.

Figure 2 shows the relative shares of total governmental expenditures by function. The underlying data for this figure is detailed in Table 5.

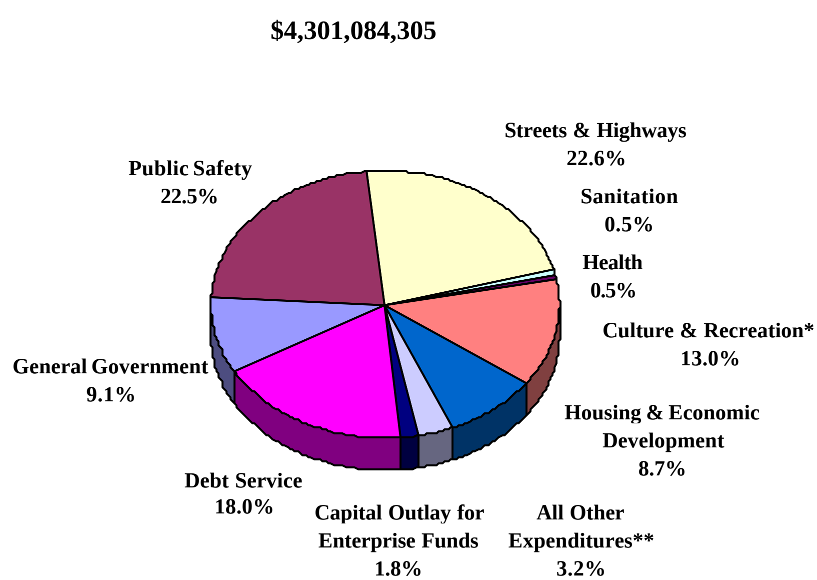


Figure 2: Total Governmental Expenditures

* Includes parks and recreation, and libraries

** Includes conservation of natural resources, airport, transit, unallocated insurance, and all other unallocated expenditures.

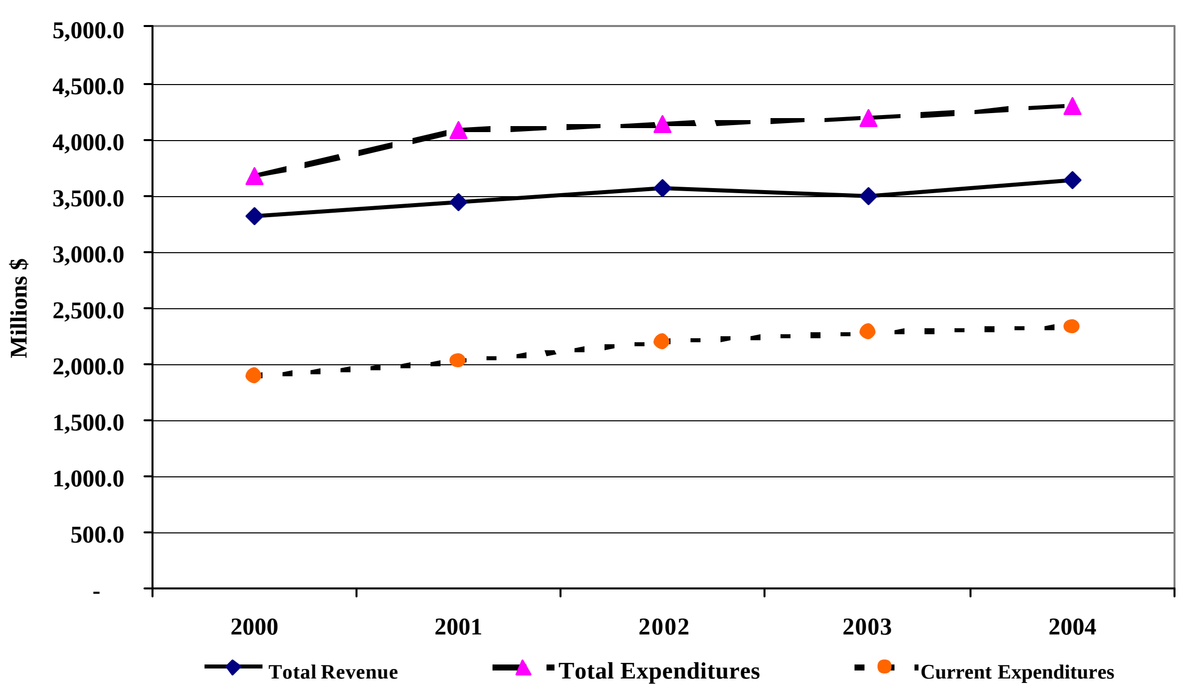
Total Revenues, Current and Total Expenditures

During the five-year period of 2000 to 2004, total governmental revenues increased every year but 2003. Current and total expenditures increased every year. Figure 3 below shows the yearly increases in revenues set against the current and total expenditures for large cities in Minnesota. Generally, revenues have kept pace with expenditures, with the exception of 2003.

Current expenditures have comprised between 49.1% and 54.4% of total expenditures over the period. The lowest percentage occurred in 2001, when cities spent a higher percentage on debt service. In 2004, current expenditures accounted for 54.1% of total expenditures, down slightly from 2003.

Figure 3 compares the trend in total current and total expenditures with the total governmental revenues of Minnesota's large cities.

Figure 3: Total Revenues, Current and Total Expenditures, 2000 to 2004



Capital Outlay Expenditures

Cities over 2,500 in population expended $1.20 billion on capital investments in 2004. This represents an increase of 3.0 percent from the level expended in 2003. 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 disasters.

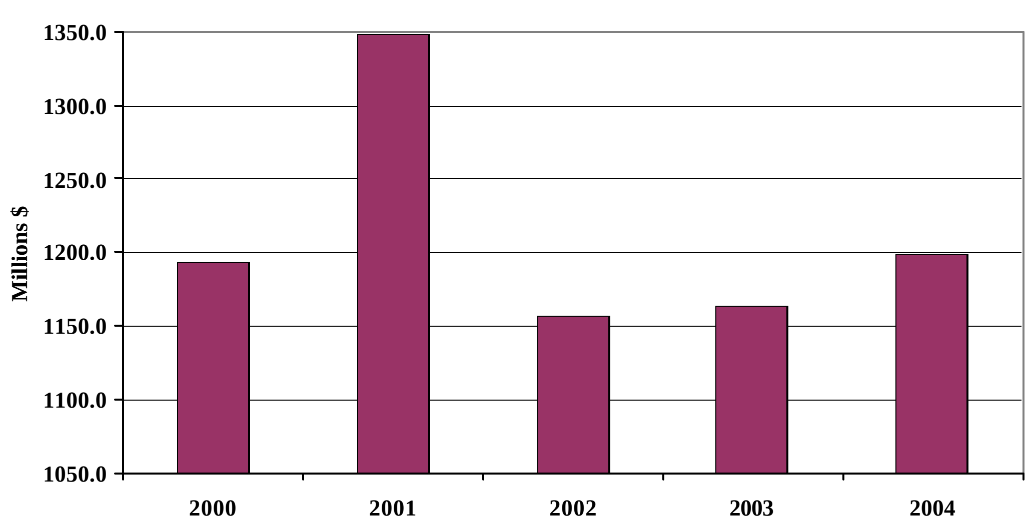
Table 1 shows total capital outlays in dollars and per capita for large cities. Figure 4 illustrates the trend in capital spending for the years 2000 through 2004.

Table 1: Total Capital Outlay Expenditures in Actual Dollars and Per Capita

Year	Total Capital Outlay (actual dollars)	Per Capita *
2000	$1,193,100,841	$343
2001	$1,347,940,294	$375
2002	$1,156,396,425	$317
2003	$1,163,674,824	$315
2004	$1,198,430,759	$320

* Per capita amounts are based on the total population of cities over 2,500 in population.

Figure 4: Total Capital Outlay Expenditures 2000 to 2004



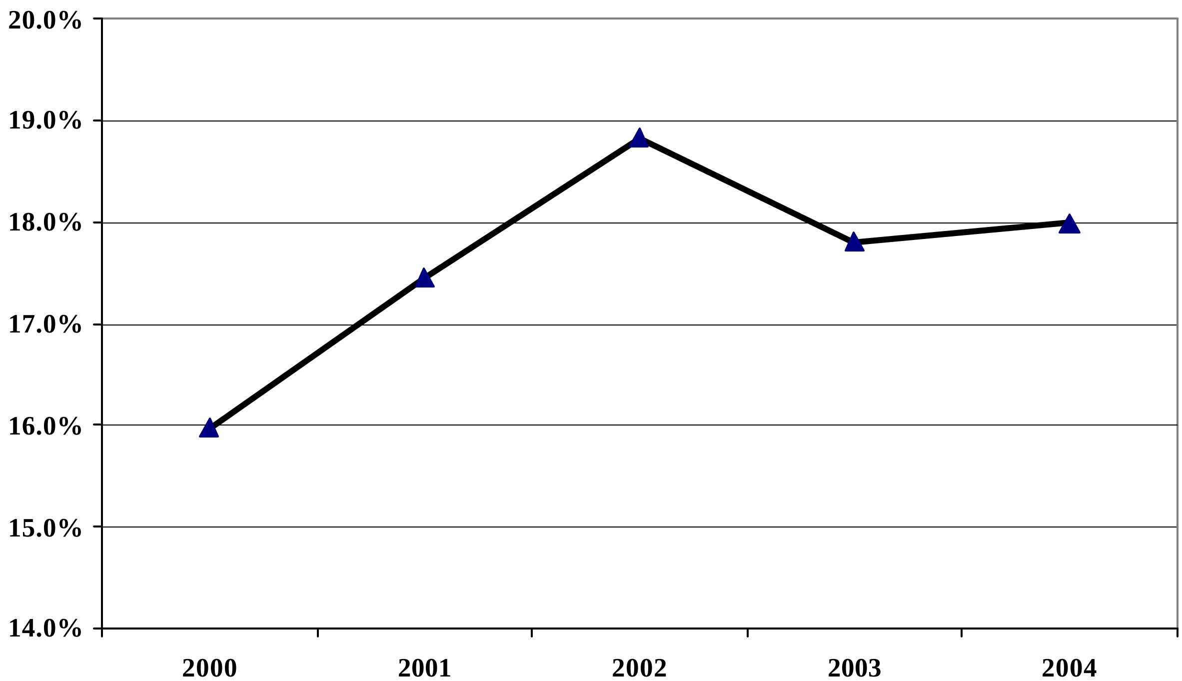
Debt Service

Debt Service includes expenditures for the principal and interest payments of loans incurred by cities. In 2004, large cities expended a total of $773.7 million on debt service, 18.0% of total expenditures. This level of debt service is a 3.8% increase over the 2003 level.

The level of debt service increased as population decreased among the larger cities in 2004. In the first class cities, those with populations over 100,000, debt service accounted for only 16.2% of total expenditures.[1] While fourth class cities, those with populations between 2,500 and 10,000, allocated 20.2% of total expenditures to servicing debt.

Figure 5 shows the trend in the percentage of total expenditures allocated to debt service.

Figure 5: Debt Service as a Percentage of Total Expenditures



1 There are only three first class cities in the state: Duluth, Minneapolis, and St. Paul.

Municipal Enterprises

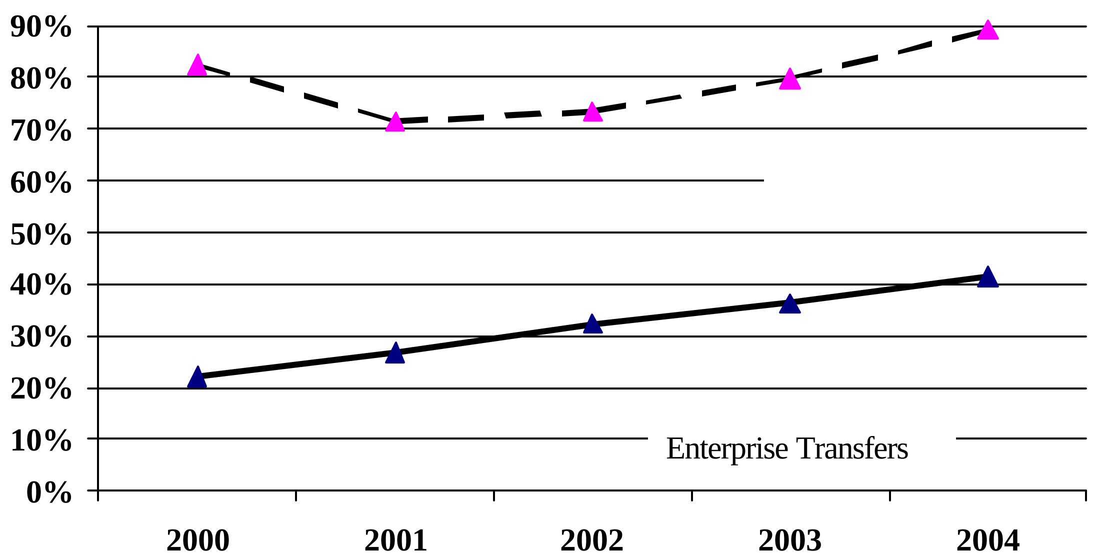
In addition to Governmental Funds, many cities establish Enterprise Funds to account for services that are financed and operated in a manner similar to private business enterprises. These enterprises are intended to be self-sustaining through fees and user charges. Although some enterprises may earn a net profit, most have the objective of breaking even. Enterprise fund accounting is also used to provide more detailed financial information on operations where there are public policy, accountability, management control, and other concerns. The most common enterprises created by large cities are for recreation, sewer, and water activities.

In aggregate, large city municipal enterprises posted modest decreases in both net income and net transfers between 2003 and 2004. The net income of large city municipal enterprises decreased 16.7 percent and transfers from enterprise funds to other governmental funds decreased 4.7 percent. An example of this type of transfer is when city officials transfer excess reserves from the water utility enterprise fund to the General Fund.

Municipal liquor stores, which are separated from other municipal enterprises because of accounting differences, saw a decrease of 1.5 percent in profits between 2003 and 2004. However, 2004 net transfers from municipal liquor operations increased 10.2 percent over the level transferred in 2003.

Figure 6 examines the five-year trend for large cities in net transfers from Enterprise and Municipal Liquor Store Funds as a percent of their net income. The chart helps illustrate that 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 6: Net Transfers from Enterprise and Municipal Liquor Store Funds as a Percent of Their Net Income, 2000 to 2004



Outstanding Long-Term Indebtedness

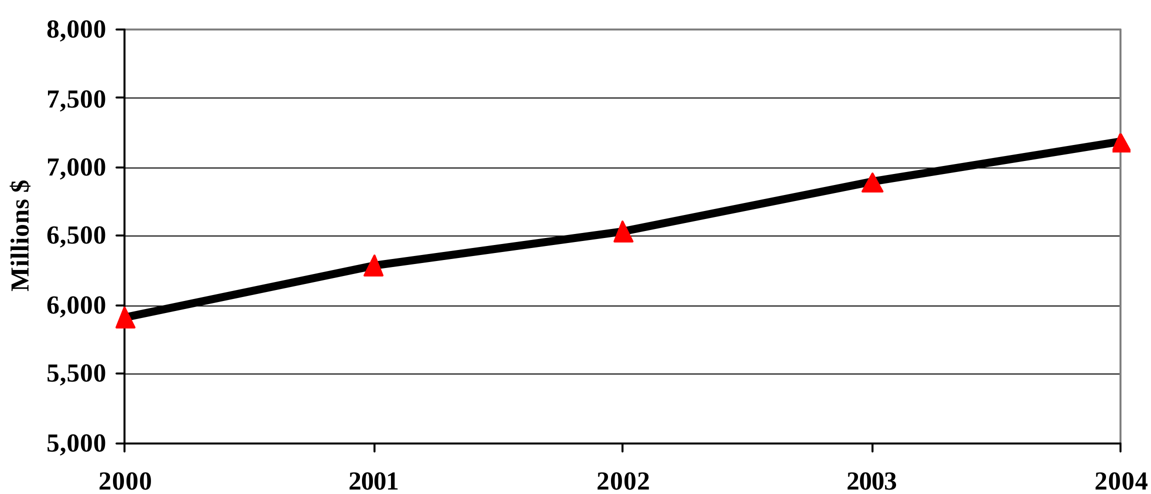
Cities over 2,500 carried long-term debt of $7.18 billion, $1,917 per capita, at the end of 2004. This represented an increase of 4.2 percent over the 2003 level. Cities incur long-term debt through the issuance of bonds and notes, certificates of indebtedness, and tax anticipation certificates. Long-term lease agreements are also classified as long-term debt. Cities may only borrow to finance capital projects and purchases; they are restricted by law from borrowing for current expenses. The amount of outstanding debt affects a city's current expenditures because cities must make principal and interest payments to service the debt.

Table 2 looks at outstanding bonded indebtedness for 2003 and 2004. Figure 7 shows the five-year trend of outstanding long-term debt for cities over 2,500 in population.

Table 2: Two-Year Summary of Outstanding Bonded Indebtedness

	2004 Amount	2003 Amount
General Obligation	$ 848,622,184	$ 776,424,187
G.O. Tax Increment	885,013,802	918,035,443
Revenue Tax Increment	209,014,433	192,544,954
Special Assessment	1,543,808,813	1,400,332,912
G.O. Revenue	1,888,139,032	1,741,883,409
Revenue	982,124,810	991,673,904
All Other	34,685,000	28,665,498
Total Bonded Indebtedness	**$ 6,391,408,074**	**$ 6,049,560,307**

Figure 7: Outstanding Long-Term Indebtedness 2000-2004



Unreserved Fund Balances of the General and Special Revenue Funds

The unreserved fund balances of large cities' General and Special Revenue Funds totaled $1.29 billion in 2004.[2] This represents an increase of 7.5 percent over the level reported in 2003. Most of this increase reflects large special revenue holdings in Brooklyn Center ($25.8 million) and Ramsey ($16.2 million), which increased the total unreserved fund balance for all cities.

Cities maintain cash reserves for several reasons. Cities should have relatively large fund balances at the end of the year because they must rely on them to meet expenditures during the first five months of the next fiscal year, until they receive the first property tax and state aid payments. Additional reasons include contingency funds for unforeseen needs and setting aside resources for future capital investments.

Comparing cities' unreserved fund balances to their total current expenditures helps put the fund balances into perspective and provides insight on the relative financial health of Minnesota's cities. City unreserved fund balances as a percent of total current expenditures averaged 55.6 percent in 2004 compared to 52.9 percent in 2003. If cities in this category are divided into their class number, it is interesting to note that as population decreases, the average increases. Class 1 (first class) cities average 35.8 percent of their unreserved fund balances as a percent of total current expenditures, while class 4 cities (populations 2,500 to 10,000) average 81.3 percent.

Figure 8 on the following page shows the five-year trend of the fund balances as a percent of total current expenditures for large cities. One line includes both total unreserved general and special revenue funds, and the other includes only total unreserved general funds.

Interestingly, the general revenue fund balance has remained about 31% of current expenditures since 2001, rising very slightly in 2004. Cities have managed to maintain general fund growth at the same rate as the increase in current expenditures, even as local government aid has decreased.

Appendix B provides an in-depth discussion of city fund balances.

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[2] Although this section discusses only two types of fund balances, Minnesota cities actually report three different classifications of fund balances in the General and Special Revenue Funds. The ***unreserved, undesignated fund balances*** include all funds remaining at the close of the fiscal year for which no legally binding commitment has been made, nor has the governing body passed a resolution designating those funds for a specific purpose. The ***unreserved, designated fund balances*** include all funds remaining at the close of the fiscal year for which no legally binding commitment has been made; however, these funds have been designated by the governing body for a specific future use. The ***reserved fund balances*** include all funds remaining at the close of the fiscal year for which there is a legally binding external commitment of those funds, such as a signed contract for services or equipment.

Figure 8: Unreserved Fund Balances of the General and Special Revenue Funds as a Percent of Total Current Expenditures 2000-2004

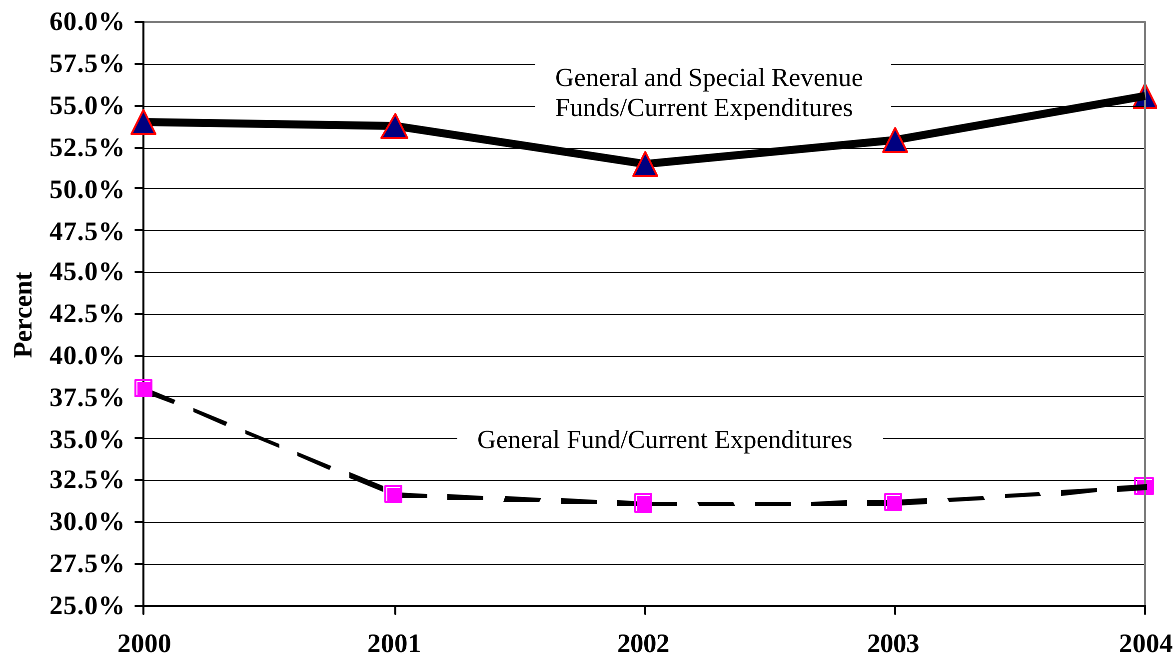


Table 25 shows the following levels of city unreserved fund balances. The State Auditor recommends an acceptable unreserved fund balance of 35 to 50 percent of total current expenditures for the General Fund and Special Revenue Funds.

Levels of Fund Balance	Range of Unreserved Fund Balance as a Percentage of Total Current Expenditures	Number of Cities
Extremely Low Fund Balance	Below 20 %	10
Low Fund Balance	20% to 35%	20
Acceptable Fund Balance	35% to 50%	36
Moderately High Fund Balance	50% to 65%	36
High Fund Balance	65% to 100%	66
Very High Fund Balance	100% to 150%	22
Extremely High Fund Balance	Above 150%	19

Property Taxes, Local Government Aid[3] and Fund Balances of All GAAP Cities

GAAP cities, or those following Generally Accepted Accounting Principals (GAAP), consist of all cities over 2,500 in population and those cities under 2,500 who opt to use the GAAP basis of accounting. Cities that follow the GAAP basis report their fund balances as reserved, unreserved designated, and unreserved undesignated for each fund they have.

This section examines the five-year trends in property taxes, local government aid/HACA and MVC[4] (hereafter referred to as LGA), current expenditures, and fund balances of the 468 cities (both large and small) that report on a GAAP basis. However, as the GAAP cities include the largest populations and financial centers, the trends for property taxes, local government aid, and current expenditures are very similar to the statewide trends.

Figures 9 and 10 on page 16 illustrate the five-year trends in property taxes, local government aid, current expenditures, and fund balances. Figure 9 demonstrates the trends in terms of percentages of total revenues and expenditures, while figure 10 presents the trends in actual dollar amounts.

From 2000 to 2004, property taxes increased as a percent of total revenues. Cities have become more reliant on property taxes as a source of revenue as local government aid has decreased. Local government aid held steady from 2000 to 2002, and then declined as a percent of total revenue in 2003 and 2004. At the same time, fund balances first decreased and then increased as a percent of current expenditures. The growth in the fund balance trend line means that cities increased the balances in 2003 and 2004 over and above the increase in current expenditures.

Because of their size, Minneapolis and St. Paul can influence the trend lines for the GAAP cities as a whole. Therefore, a closer look at the GAAP cities yields some interesting observations. Table 3 presents a breakdown of the trends in property taxes, local government aid, current expenditures, and unreserved fund balances.

Table 3. Percent Changes in Selected Financial Indicators

Region	Property Taxes		Total LGA*		Total Current Expenditures		Total Unreserved Fund Balance**	
	2000-2003 average	2004	2000-2003 average	2004	2000-2003 average	2004	2000-2003 average	2004
All GAAP Cities	7.6%	7.9%	-1.7%	-6.8%	6.1%	1.7%	5.9%	10.6%
Minneapolis/St. Paul	4.6%	10.5%	0.1%	-9.7%	7.3%	-2.1%	4.6%	2.5%
7 County Metro without Mpls/St. Paul	10.2%	7.6%	-16.6%	-14.7%	6.9%	3.3%	4.6%	8.6%

*Includes HACA and MVC.

** Unreserved fund balances include designated and undesignated general revenue and special revenue funds.

[3] Local government aid includes both state local government aid and homestead credit in 2000 and 2001 and market value credit in 2002 through 2004.

[4] HACA and Market Value Credit (MVC) are property tax credit programs. MVC replaced HACA in 2002.

Property Taxes

While the growth rate in property taxes in 2004 remained more or less constant for GAAP cities as a whole, Minneapolis and St. Paul experienced a change of more than double the average rate of growth for the four years prior, from 4.6% to 10.5%. That jump is hidden by the fact that the rate was lower for the rest of the seven-county metropolitan area than its average from 2000 to 2003, going from 10.2% to 7.6%.

Local Government Aid

Local government aid decreased by 6.8% for all GAAP cities, but was much more pronounced in the metro area. LGA decreased for Minneapolis and St. Paul by 9.7% in 2004. The seven-country metro area decreased by 14.7%, less than their four-year average of 16.6%. Though the metro area had a higher percentage decrease in LGA, because the dollar amounts are less, Minneapolis and St. Paul experienced a far greater cut in actual dollars.

Current Expenditures

The growth in current expenditures slowed dramatically for all GAAP cities, to 1.7% from 6.1%. Current expenditures in Minneapolis and St. Paul actually decreased by 2.1%, while the rest of the metro area showed a growth of 3.3%.

Fund Balances

Despite cuts in state aid, the unreserved fund balances of GAAP cities have continued to increase. GAAP cities as a whole showed an increase almost double the average rate of growth from 2000 to 2003, 10.6% compared to 5.9%. The metro area showed a similar increase of 8.6% compared with an average growth rate of 4.6% from 2000-2003. Minneapolis and St. Paul increased their fund balances, but at a lower rate than their average (2.5% compared with 4.6%).

In summary, Minneapolis and St. Paul have raised taxes and cut expenditures to cover the reductions in LGA, while the rest of the metro area seems to have adjusted simply by slowing the growth of current expenditures.

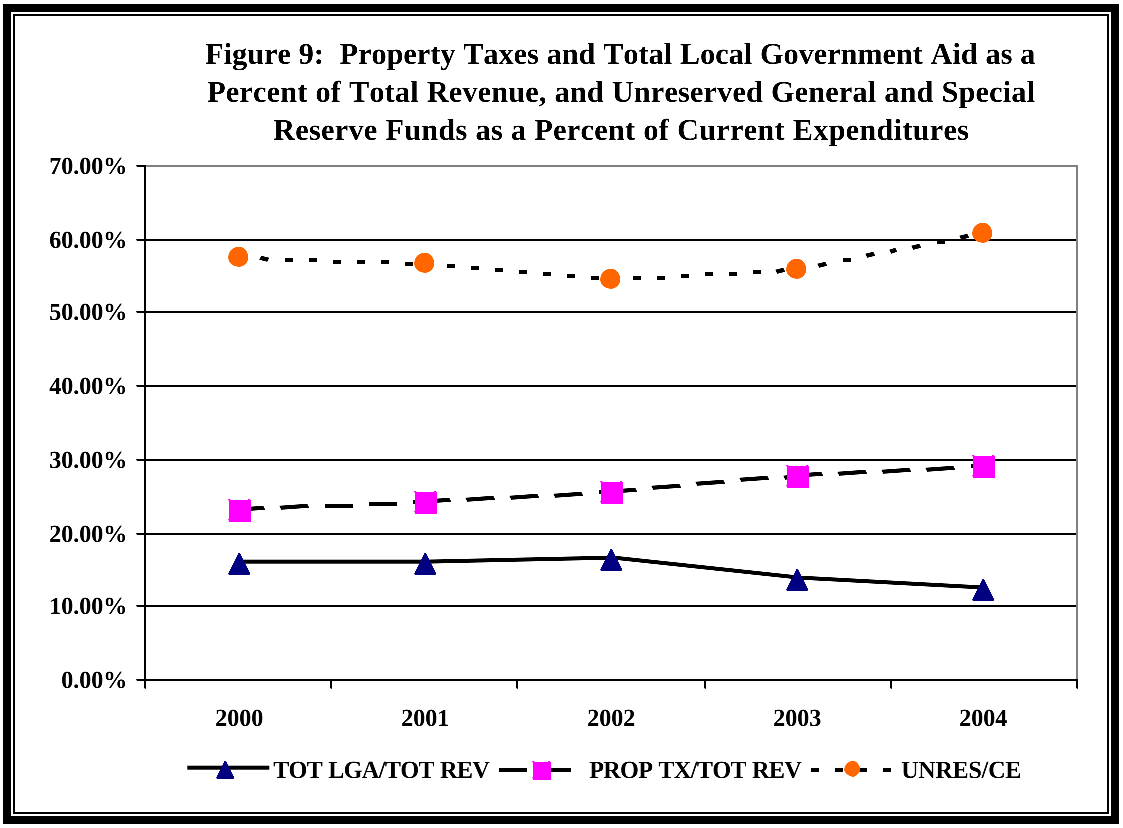


Figure 9: Property Taxes and Total Local Government Aid as a Percent of Total Revenue, and Unreserved General and Special Reserve Funds as a Percent of Current Expenditures
70.00%
60.00%
50.00%
40.00%
30.00%
20.00%
10.00%
0.00%
2000
2001
2002
2003
2004
TOT LGA/TOT REV
PROP TX/TOT REV
UNRES/CE

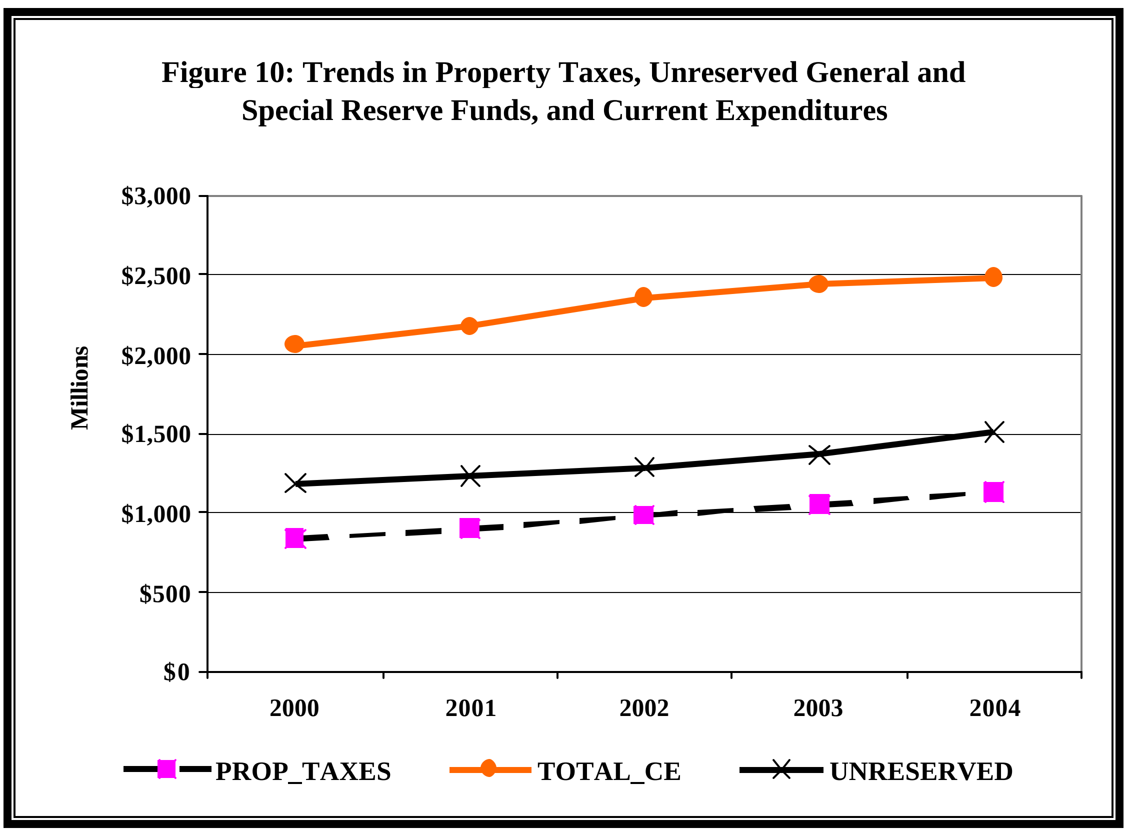


Figure 10: Trends in Property Taxes, Unreserved General and Special Reserve Funds, and Current Expenditures
Millions
$3,000
$2,500
$2,000
$1,500
$1,000
$500
$0
2000
2001
2002
2003
2004
PROP_TAXES
TOTAL_CE
UNRESERVED

Overview of Cities Under 2,500 in Population

Total Governmental Revenues

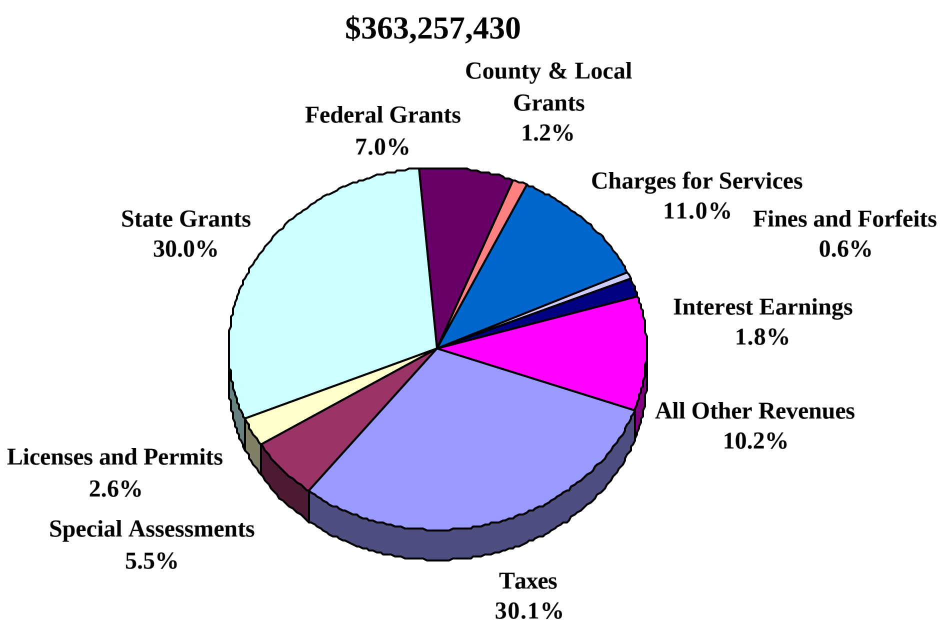
In 2004, cities under 2,500 in population raised total governmental revenues of $363.3 million to finance city services. This represents an increase of 3.7 percent from the amount raised in 2003.

The sources of revenue that grew at the fastest rate between 2003 and 2004 were: licenses and permits (13.8%), charges for services (12.9%), and taxes (9.4%). The categories showing the greatest decrease were: state and county highway money (-84.0% and –23.8% respectively), local grants (-14.0%), and interest earnings (-12.2%).

Between 2003 and 2004, the Legislature attempted to ease the prior year's reductions to local government aid (LGA) and other aid programs to cities. While LGA remained much the same, Market Value Credit increased by 5.9 percent. In addition, taconite aids that affected certain cities in the Iron Range made modest gains of 8.1 percent. Overall, however, state aid to Minnesota's smallest cities fell by 6.1 percent between 2003 and 2004.

The main sources of revenues for small cities in 2004 were state grants and taxes, which together accounted for 60.1 percent of all revenues. Taxes as a percent of total revenues increased from 28.5 percent in 2003 to 30.1 percent in 2004, while state grants as a percent of total revenues decreased from 33.1 percent in 2003 to 30.0 percent during the same period. Figure 11 shows the relative shares of total governmental revenues by source.

Figure 11: 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, Permanent, and Debt Service funds. In 2004, cities under 2,500 in population expended $475.4 million from Governmental Funds to provide city services. This represents an increase of 4.7 percent over 2003 total governmental expenditures.

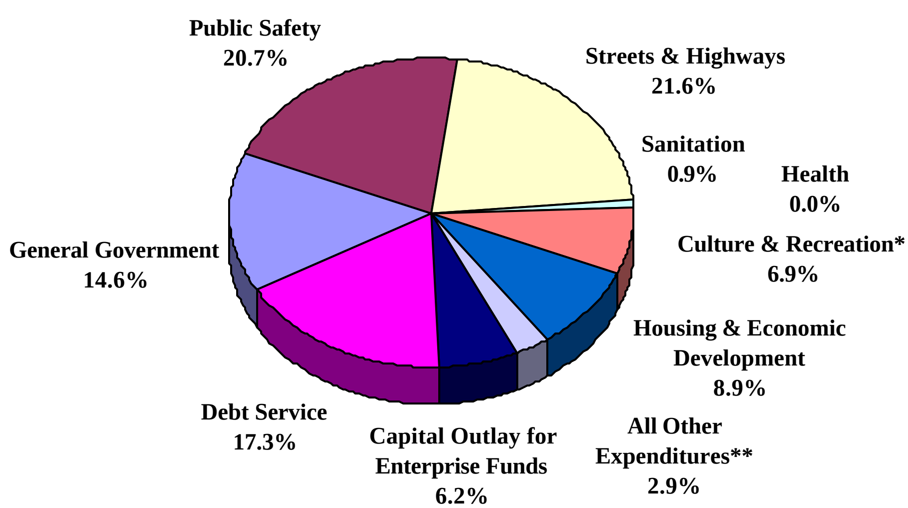
Between 2003 and 2004, the categories of expenditures that grew at the fastest rate were: housing (62.9%), public safety (14.2%), and general government (9.7%). The categories showing the greatest declines were: unallocated pension costs (-48.9%), capital outlays for enterprise funds (-9.3%) and streets and highways (-1.3%). The increase in the housing category reflects large expenditures by a handful of cities.

In 2004, 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 74.2 percent of all expenditures in 2004. All four categories increased as a percent of total expenditures between 2000 and 2004.

Figure 12 shows the relative shares of total governmental expenditures of small cities by function.

Figure 12: Total Governmental Expenditures

$475,350,521



* Includes parks and recreation, and libraries

** Includes conservation of natural resources, airport, transit, unallocated insurance, and all other unallocated expenditures.

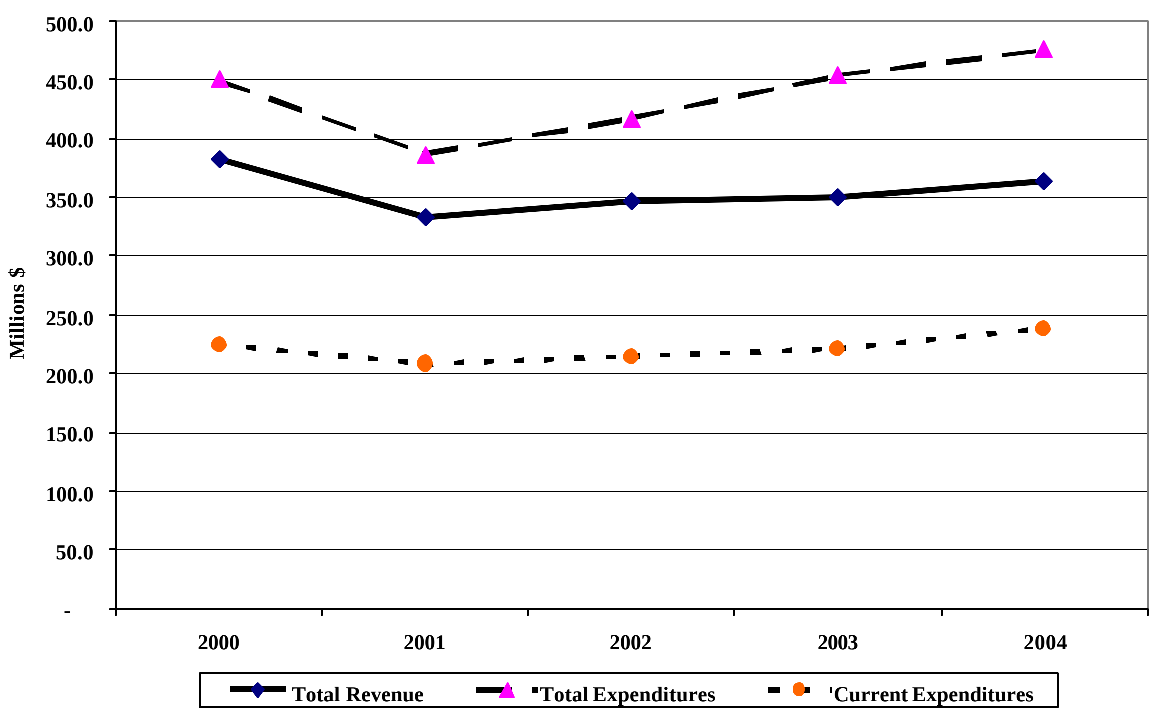
Total Revenues, Current and Total Expenditures

During the five-year period of 2000 to 2004, current expenditures, total expenditures, and total revenues of small cities increased every year between 2001 and 2004. There is a noticeable increase in the distance between the level of revenue and the level of total expenditures.

The decrease in revenues and expenditures in 2001 are the result of fewer cities classified as "small cities" beginning in 2001.[5]

Figure 13 compares the trends in current and total expenditures with total governmental revenues for small cities from 2000 to 2004. During this period, total expenditures increased more than revenue every year between 2001 and 2004.

Figure 13: Total Revenues, Current and Total Expenditures, 2000 to 2004



[5] Reclassification of cities was based on the 2000 census.

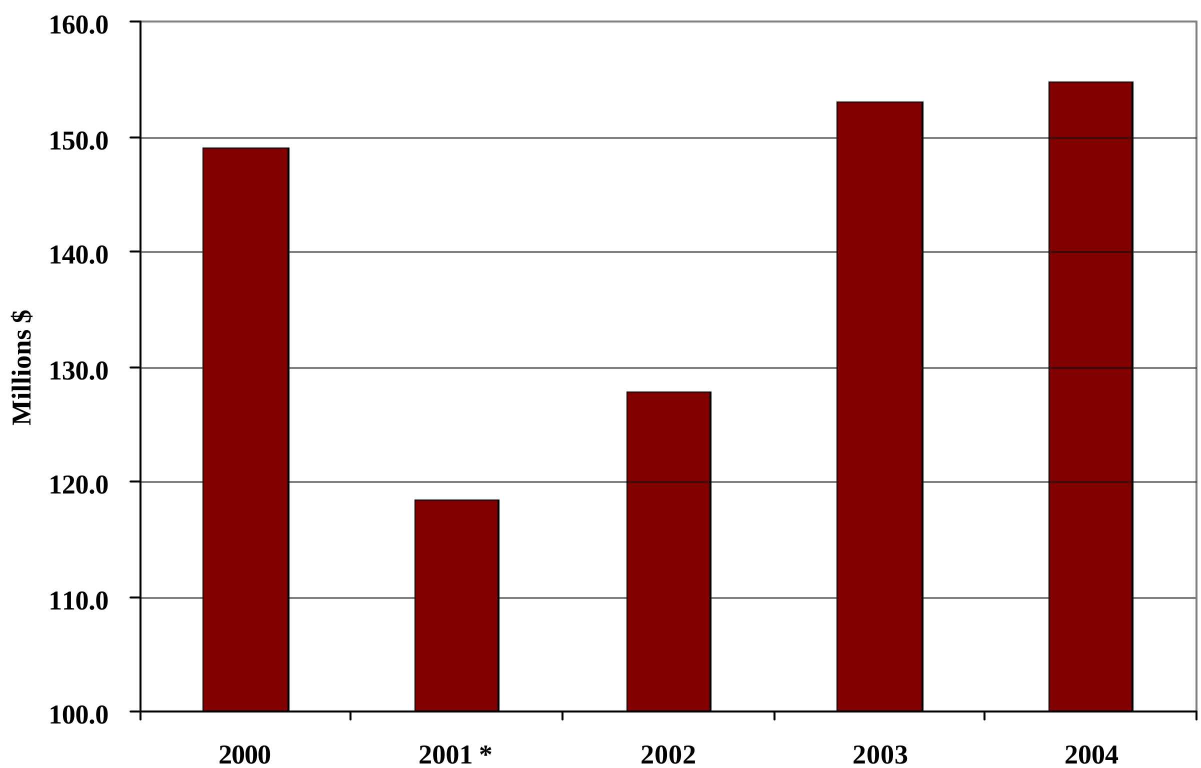
Capital Outlay Expenditures

Capital outlay expenditures account for the purchase, construction, or permanent improvements of buildings, equipment, machinery, and land. Small cities expended $154.8 million on capital investments in 2004. This represents an increase of 1.2 percent over the level expended in 2003.

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 14 illustrates the trend in capital spending of cities under 2,500 in population for the years 2000 through 2004.

Figure 14: Total Capital Outlay Expenditures, 2000 to 2004



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

Debt Service

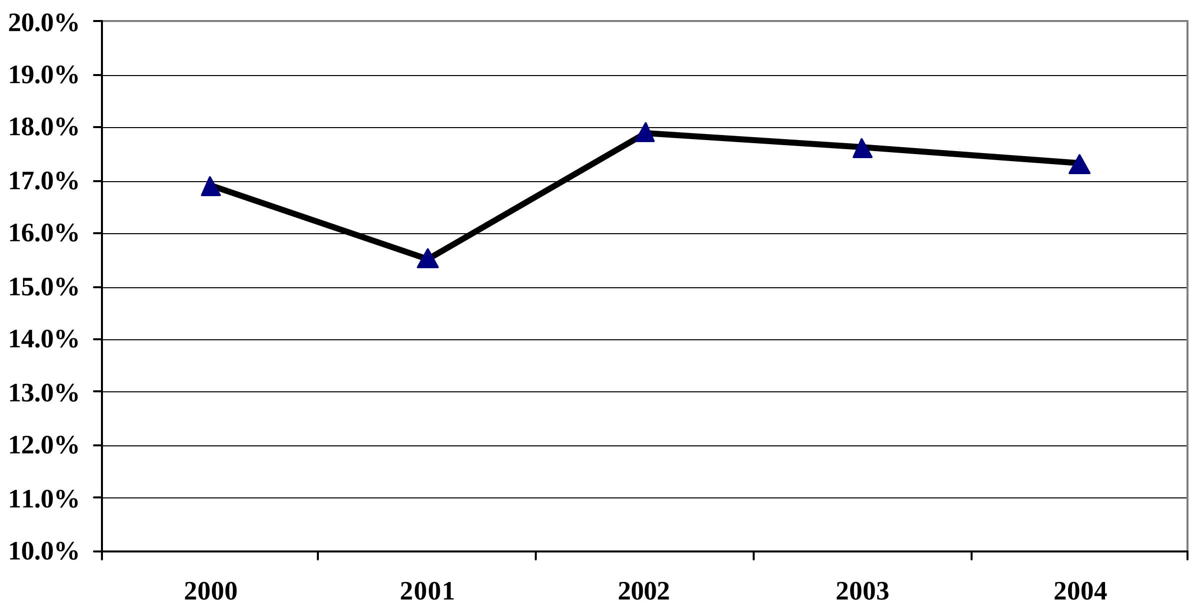
Debt Service includes expenditures for the principal and interest payments of loans incurred by cities. In 2004, small cities expended a total of $82.3 million on debt service, 17.3% of total expenditures.

The level of debt service decreased with population in 2004. In the smallest cities, those with populations under 500, debt service accounted for only 10.0% of total expenditures. While the larger cities, those with populations between 2,500 and 5,000, allocated 23.8% of total expenditures to servicing debt.

It is interesting to note that since 2002 the percentage of total expenditures allocated to debt service has decreased at the same time that long-term indebtedness has continued to increase in small cities.

Figure 15 shows the five-year trend in the percentage of total expenditures allocated to debt service.

Figure 15: Debt Service as a Percentage of Total Expenditures



Municipal Enterprises

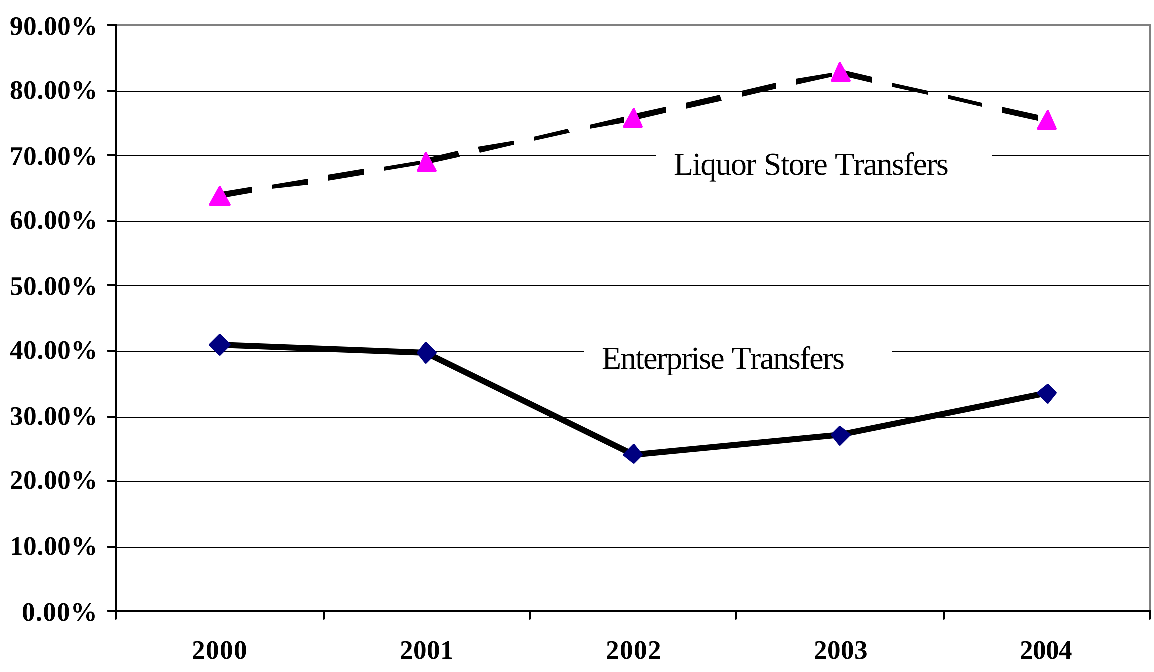
In addition to Governmental Funds, many cities establish Enterprise Funds to account for services that are financed and operated in a manner similar to private business enterprises. These enterprises are intended to be self-sustaining through fees and user charges. Although some enterprises earn a net 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 decreased 7.0 percent between 2003 and 2004 while net transfers (transfers out minus transfers in) from Enterprise Funds increased 15.4 percent between 2003 and 2004. 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 9.7 percent in net income and a decrease of 16.1 percent in net transfers between 2003 and 2004. 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 16 examines the five-year trend in net transfers from enterprise and municipal liquor store funds as a percent of net income.

Figure 16: Net Transfers from Enterprise and Municipal Liquor Store Funds as a Percent of Their Net Income, 2000 to 2004



Outstanding Long-Term Indebtedness

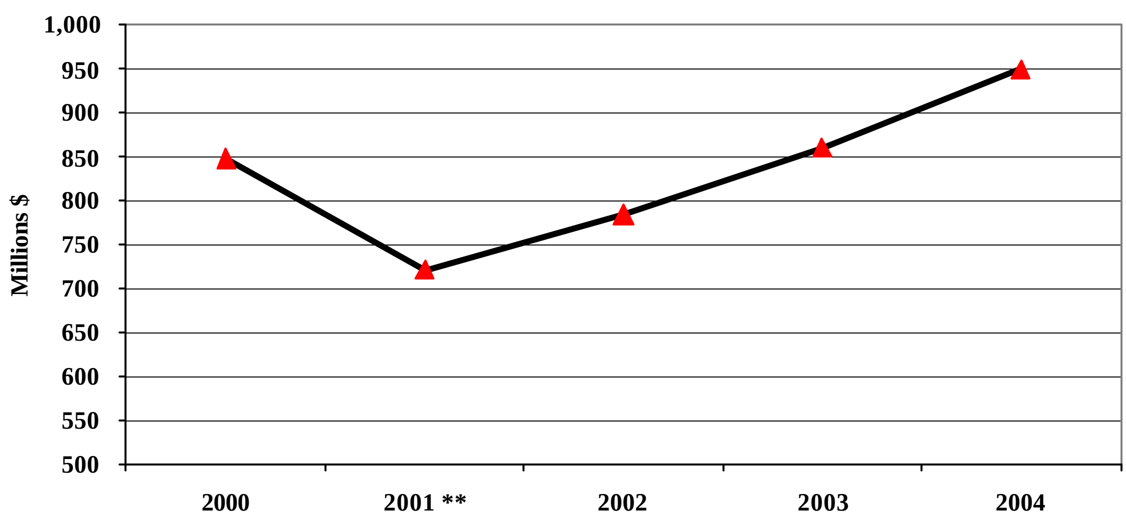
Cities incur long-term debt through the issuance of bonds and notes, certificates of indebtedness, and tax anticipation certificates. Long-term lease agreements are also classified as long-term debt. Cities may only borrow to finance capital projects and purchases. Cities are restricted by law from borrowing 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 4 looks at outstanding bonded indebtedness for 2003 and 2004. Figure 17 shows the five-year trend of outstanding long-term debt for small cities.

Table 4: Two-Year Summary of Outstanding Bonded Indebtedness

		2004 Amount		**2003 Amount**
General Obligation	$	41,054,712	$	38,933,997
G.O. Tax Increment		39,816,518		41,359,546
Revenue Tax Increment		186,932		186,932
Special Assessment		254,250,737		233,694,044
G.O. Revenue		280,095,463		250,052,707
Revenue		93,432,125		83,134,396
All Other		3,391,469		6,375,155
Total Bonded Indebtedness	**$**	**712,227,956**	**$**	**653,736,777**

Figure 17: Outstanding Long-Term Indebtedness as of December 31, 2004*



*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.