Scope and Methodology

This publication is intended to help citizens, local government officials, and other policy makers understand city financial operations. The report summarizes, through data tables and charts, the financial operations of Minnesota cities for calendar year 2006. Minnesota cities are required to submit annual financial reports to the Office of the State Auditor. (See Minn. Stat. §§ 6.74-.75 and §§ 471.697-.698).

The data tables presented in this report are 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 of the report 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 and 7 present a summary of the activities in the governmental funds of all cities. Tables 8 through 11 present a summary of the governmental funds of cities over 2,500 in population. Tables 12 through 14 present a summary of the governmental funds of cities under 2,500 in population. Tables 15 through 17 present the data by individual city.

Table 18 lists the bonded and other long-term debt outstanding as of December 31, 2006, by individual city. Other long-term debt refers to liabilities such as long-term lease agreements, installment purchase contracts, and notes.

Tables 19 and 20 present an analysis of the 2005 and 2006 unreserved fund balances in the General and Special Revenue Funds of all cities reporting on a modified accrual basis. Table 19 details the actual unreserved fund balances, the percent change in unreserved fund balances from 2005 to 2006, and a comparison to 2006 total current expenditures. Table 20 presents the fund balance data sorted by unreserved fund balances as a percent of total current expenditures.

Cities using a modified accrual basis of accounting report separate fund balances for all of their governmental funds and denote the amounts that are reserved and unreserved. Cities using a cash basis of accounting report a single cash balance for all governmental funds at the end of the fiscal year. An analysis of unreserved fund balances for cities using a cash basis of accounting is therefore not appropriate, and is not provided. Appendix B provides a more detailed discussion of fund balances.

Table 21 shows municipal enterprises by city. Minnesota cities operate many types of public service enterprises. These enterprises furnish a variety of services and operate wholly or primarily with revenues derived from the sale of goods or services.

In addition to this publication, the Office of the State Auditor maintains an interactive database containing several years of data that can be accessed through the website at: www.auditor.state.mn.us.

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 a financial statement in compliance with generally accepted accounting principles (GAAP), which is a modified accrual basis of accounting. Modified 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 expendable resources.

Cities under 2,500 may opt to use a cash basis of accounting. In 2006, 368 of the 645 small cities (57.1 percent) opted to use a cash basis of accounting. Cash basis accounting provides for the recording of receipts (revenues) when received in cash and the recording of disbursements (expenditures) when paid in cash.

Executive Summary

Current Trends – All Cities

- Total revenues of the governmental funds for all Minnesota cities amounted to $4.48 billion in 2006. This represents an increase of 6.4 percent over 2005 revenues. Total revenues of cities over 2,500 in population increased 6.2 percent, while revenues of cities under 2,500 in population increased 8.4 percent (pg. 5).

- Total expenditures of the governmental funds for all cities totaled $5.35 billion in 2006. This represents an increase of 7.6 percent over 2005. Total expenditures of cities over 2,500 in population increased 7.5 percent, while total expenditures for cities under 2,500 increased 8.5 percent (pg. 5).

- The largest expenditure categories for both groups of cities were streets and highways and public safety. For large cities, streets and highways accounted for 24 percent of total expenditures, and public safety accounted for 23 percent. For small cities, streets and highways accounted for 24 percent of total expenditures, and public safety accounted for 19 percent (pgs. 5-6).

- The unreserved fund balances of large cities' General and Special Revenue Funds totaled $1.48 billion in 2006. This represents an increase of 2 percent over the level reported in 2005. City unreserved fund balances as a percent of total current expenditures averaged 52 percent in 2006, compared to 51 percent in 2005 (pg. 153).

Current Trends – Cities Over and Under 2,500 in Population

- The largest category of current expenditures for cities over 2,500 in population was public safety, while streets and highways dominated capital outlay expenditures. Public safety accounted for 38 percent of all current expenditures, more than double that of any other category. Streets and highways accounted for 57 percent of all capital expenditures, over six times greater than any other category of capital outlay (pg. 12).

- In 2006, the four largest expenditure categories for cities under 2,500 in population were streets and highways, public safety, general government, and debt service. These four categories together accounted for 74 percent of all expenditures in 2006 (pg. 19).

- Cities under 2,500 carried long-term debt totaling $1.11 billion at the close of 2006. This represents an 8 percent increase over the level in 2005. On a per capita basis, small cities carried $2,674 in long-term debt compared to $1,979 for large cities. While there is no single reason for the higher level of indebtedness per capita among the smaller cities, a primary reason is that the high costs of projects, such as water and sewer line replacement, are spread across fewer people (pg. 23).

Ten-Year Trends – All Cities

Governmental Revenues

- While cities appear to have ended 2006 in good financial condition with strong growth in revenues, an examination of city finances between 1997 and 2006 reveal a noteworthy trend. In particular, when adjusted for inflation[1], revenue and expenditure levels remain near 1998 levels. Inflation-adjusted total city revenues grew just 1 percent between 1997 and 2006, while total city expenditures, when adjusted for inflation, grew 5 percent through the same period. In addition, during the last five years of this time frame, these trends were more pronounced. From 2001 to 2006, when adjusted for inflation, revenues *decreased* 6 percent and expenditures *decreased* 3 percent (pg. 7).

- Between 1997 and 2006, actual revenues derived from property taxes grew 90 percent compared to 19 percent for revenues derived from intergovernmental sources. When revenues are adjusted for inflation, the ten-year period shows a 35 percent increase in property tax revenues, while intergovernmental revenues decreased 15 percent. When put into constant dollars, the level of revenues in 2006 was less than in 1998 (pg. 7).

- As the federal and state governments have reduced the amount of aid to cities, the result has been a greater reliance on revenues derived from property taxes. The proportion of total revenues derived from property taxes grew from 23 percent in 1997 to 31 percent in 2006. During this same time frame, revenues derived from intergovernmental sources decreased from 33 percent of total revenues to 27 percent (pg. 7).

- During the five-year period of 2002 to 2006, there was a significant slowdown in the growth of revenues as compared to the 1997 to 2001 period. This was in part due to the State's fiscal crises in 2002 and 2003 when budget cuts were made in state aid to cities. While property taxes and other sources of revenues were increased to counter the cuts, revenues did not grow at a rate to keep up with inflation (pgs. 8-9).

Governmental Expenditures

- Total city expenditures grew from $3.62 billion in 1997 to $5.35 billion in 2006. This represents an increase of 48 percent. When adjusted for inflation, the increase was just 5.2 percent (pg. 9).

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[1]"Adjusted for inflation" and "constant dollars" refer to data adjusted for inflation using the Implicit Price Deflator for State and Local Governments setting 1997 as the base year (N.I.P.A. Table 1.1.9, May 2008).

Comparison and Overview

2006 Finances for All Minnesota Cities

Revenues

Total revenues of the governmental funds for all Minnesota cities amounted to $4.48 billion in 2006. This represents an increase of 6.4 percent over 2005 revenues. Total revenues of cities over 2,500 in population increased 6.2 percent, while revenues of cities under 2,500 in population increased 8.4 percent.

There are two central differences between cities over and under 2,500 in population as to how they fund services. Cities under 2,500 in population (small cities) are much more dependent on intergovernmental revenues than cities over 2,500 (large cities). In 2006, intergovernmental revenues accounted for 40 percent of total revenues for small cities compared to 26 percent for large cities. Among all cities, intergovernmental revenues accounted for 27 percent of total revenues.

The second difference is the reliance on tax revenues. Because large cities receive a much smaller portion of their revenues from intergovernmental sources, they more commonly utilize tax revenue streams such as tax increments, franchise, lodging, and local sales taxes. As a whole, tax revenue from all sources accounted for 43 percent of large city revenues compared to 30 percent of small city revenues in 2006. Large cities also utilize tax increment financing to a much greater extent than small cities. Revenue derived from tax increment accounted for 2 percent of small city total revenues compared to 6 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 31 percent of total revenues compared to 27 percent for small cities. For all cities, property taxes accounted for 31 percent of total revenues.

On a per capita basis, large cities had total revenues of $1,061, while small cities had total revenues of $1,009.

Expenditures

Total expenditures of the governmental funds for all cities totaled $5.35 billion in 2006. This represents an increase of 7.6 percent over 2005. Total expenditures of cities over 2,500 in population increased 7.5 percent, while total expenditures for cities under 2,500 increased 8.5 percent.

The spending priorities of cities under 2,500 in population differ from those cities over 2,500 in population. For example, small cities tend to direct a greater percentage of their resources to general government (16 percent) and less to culture and recreation (8 percent) than cities over 2,500 (10 percent and 13 percent respectively). The largest expenditure categories for both groups of cities are streets and highways and public safety. For large cities, streets and highways accounted for 24 percent of total expenditures and public safety accounted for 23 percent. For small cities, streets and highways accounted for 24 percent of total expenditures and public safety accounted for 19 percent.

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 2006, small cities carried long-term debt of $1.11 billion, or $2,674 per capita, compared to $7.57 billion, or $1,979 per capita for large cities. While there is no single reason for the higher level of indebtedness per capita among the smaller cities, a primary reason is that the high costs of projects, such as wastewater treatment facilities and water and sewer line replacement, are spread across fewer people.

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 2006, unreserved fund balances as a percent of current expenditures averaged 93 percent for small cities compared to 50 percent for large cities. Both of these percentages are down slightly from last year when the average for small cities was 94 percent and 51 percent for large cities.

Among the 277 small cities that report on a GAAP basis, 127 (46 percent) had an unreserved fund balance greater than 100 percent of total current expenditures. Among the 209 large cities, 33 cities (16 percent) had an unreserved fund balance greater than 100 percent of total current expenditures. In 2006, unreserved fund balances as a percent of total current expenditures among small cities ranged from –138 percent in Bigelow to 1,030 percent in Skyline. Among large cities, the range was from –11 percent in Caledonia to 321 percent in Bayport.

The Office of the State Auditor recommends that at year-end, local governments maintain an unreserved fund balance in their General Fund and Special Revenue Funds of approximately 35 to 50 percent of operating revenues, or no less than five months of operating expenditures. If the local government's unreserved fund balance is less than or greater than this recommendation, the local government should be able to explain the reason for the difference.

Ten-Year Trends

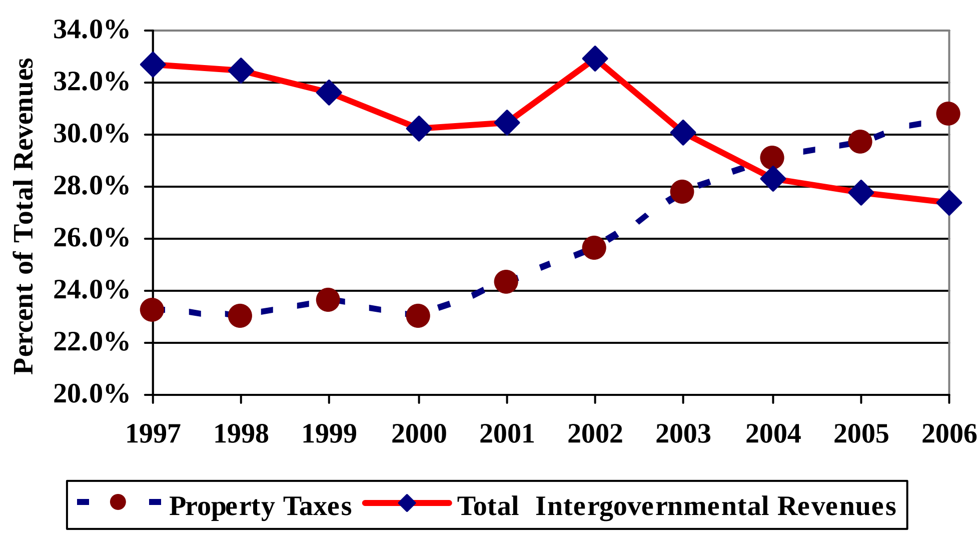
Governmental Revenues

While cities appear to have ended 2006 in good financial condition with strong growth in revenues, an examination of city finances between 1997 and 2006 reveal a noteworthy trend. In particular, when adjusted for inflation[2], revenue and expenditure levels remain near 1998 levels. Inflation-adjusted total city revenues grew just 1 percent between 1997 and 2006, while total city expenditures, when adjusted for inflation, grew 5 percent through the same period. In addition, during the last five years of this time frame, these trends were more pronounced. From 2001 to 2006, when adjusted for inflation, revenues *decreased* 6 percent and expenditures *decreased* 3 percent.

Between 1997 and 2006, actual revenues derived from property taxes grew 90 percent compared to 19 percent for revenues derived from intergovernmental sources. When revenues are adjusted for inflation, the ten-year period shows a 35 percent increase in property tax revenues, while intergovernmental revenues decreased 15 percent.

In addition, the proportion of total revenues derived from property taxes grew from 23 percent in 1997 to 31 percent in 2006. During this same time frame, revenues derived from intergovernmental sources decreased from 33 percent of total revenues to 27 percent. Figure 1 below shows that as the federal and state governments have reduced the amount of aid to cities, the result has been a greater reliance on revenues derived from property taxes.

Figure 1: Primary Sources of City Revenues as a Percent of Total Revenues - 1997 to 2006



[2]"Adjusted for inflation" and "constant dollars" refer to data adjusted for inflation using the Implicit Price Deflator for State and Local Governments setting 1997 as the base year (N.I.P.A. Table 1.1.9, May 2008).

An examination of city revenues from 1997 to 2006 shows that in actual dollars, revenues grew from $3.15 billion in 1997 to $4.48 billion in 2006, an increase of 42 percent. Between 2002 and 2003, there was an actual decrease in city revenues. When put into constant dollars, the level of revenues in 2006 was less than in 1998. Figure 2 below illustrates this trend.

Figure 2: Growth in Total Revenues
Actual and Constant Dollars

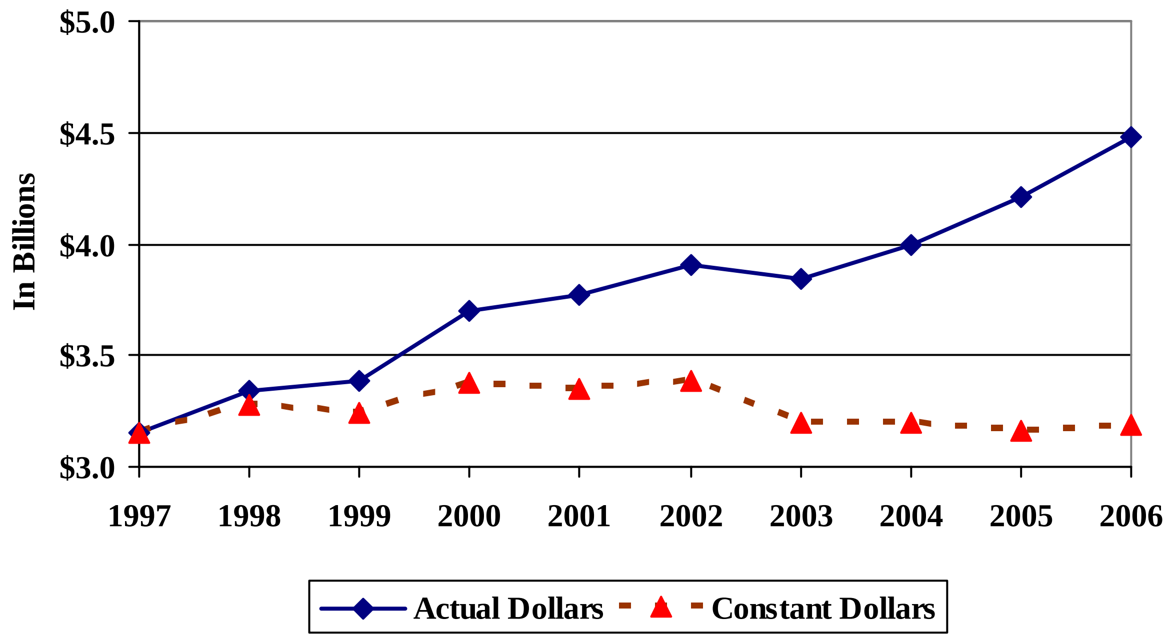


Table 1 on the following page provides a summary of the trend in city revenues from 1997 to 2006 when adjusted for inflation. During the five-year period of 2002 to 2006, there was a significant slowdown in the growth of revenues as compared to the 1997 to 2001 period. This was in part due to the State's fiscal crises in 2002 and 2003 when budget cuts were made in state aid to cities. While property taxes and other sources of revenues were increased to counter the cuts, revenues did not grow at a rate to keep up with inflation.

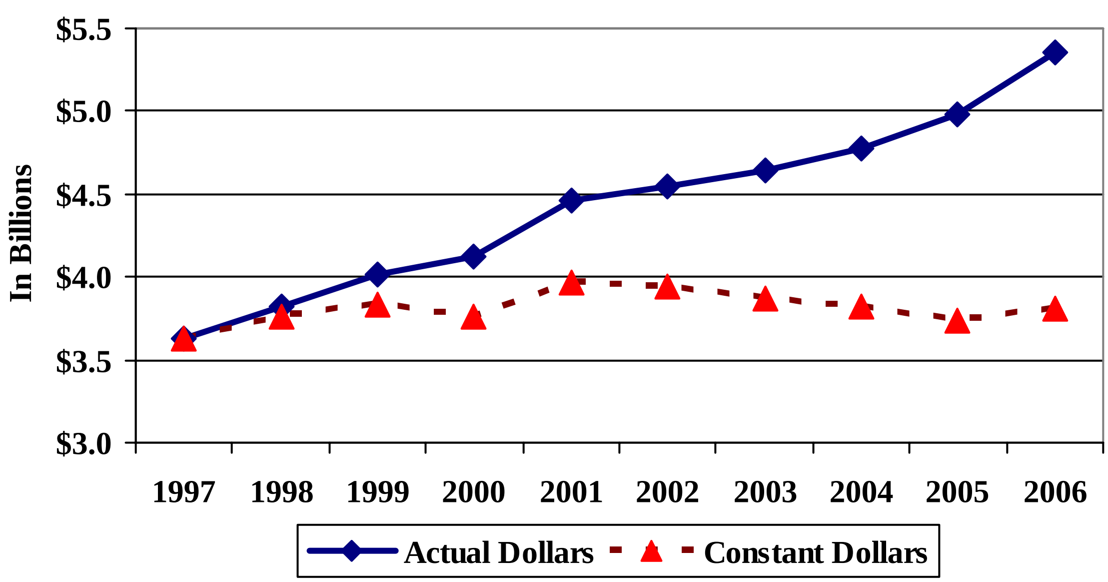
Table 1: Total City Revenues in Constant Dollars

Revenues	1997	2001	2002	2006	1997 - 01 5-Year Change	2002 - 06 5-Year Change	10-Year Change
Taxes	$1,141,170,818	$1,250,353,891	$1,214,511,874	$1,330,864,242	9.6%	9.6%	16.6%
Special Assessments	206,465,324	206,445,491	220,114,720	206,005,038	0.0%	-6.4%	-0.2%
Licenses and Permits	90,548,343	118,113,846	121,401,078	120,021,707	30.4%	-1.1%	32.5%
Federal Grants	169,428,747	116,294,490	119,077,549	132,822,326	-31.4%	11.5%	-21.6%
State Grants	813,417,028	845,684,848	936,233,341	685,738,380	4.0%	-26.8%	-15.7%
Local Unit Grants	47,239,675	59,957,083	59,353,141	54,068,349	26.9%	-8.9%	14.5%
Charges for Services	241,243,567	297,837,333	319,465,909	306,182,320	23.5%	-4.2%	26.9%
Fines and Forfeits	29,384,315	33,757,555	32,269,472	28,116,666	14.9%	-12.9%	-4.3%
Interest Earnings	193,998,864	184,494,760	133,651,329	136,346,096	-4.9%	2.0%	-29.7%
All Other Revenues	213,309,183	234,090,118	232,813,582	187,938,476	9.7%	-19.3%	-11.9%
Total Revenues	**$3,146,205,864**	**$3,347,029,416**	**$3,388,891,993**	**$3,188,103,600**	**6.4%**	**-5.9%**	**1.3%**

Governmental Expenditures

Total city expenditures grew from $3.62 billion in 1997 to $5.35 billion in 2006. This represents an increase of 48 percent. When adjusted for inflation, the increase was just 5.2 percent. Figure 3 below shows the contrast between expenditures in current and constant dollars.

Figure 3: Growth in Total Expenditures
Actual and Constant Dollars



Expenditures increased at a rate faster than revenues in part because capital spending is often financed through the issuance of debt, which is not included in the calculation of total revenues. By funding capital outlays in this way, cities were able to free up revenues for other types of spending. When the three components of city spending are looked at individually, only total current expenditures showed growth when adjusted for inflation. Over the ten-year period, when adjusted for inflation, total current expenditures grew 14 percent, while total capital outlays decreased 1 percent, and total debt service decreased 9 percent.

Table 2 below provides a summary of expenditures from 1997 to 2006 in constant dollars. Those categories showing the greatest growth were sanitation (65%), airports (40 percent), and streets and highways (25 percent), while those showing the greatest decreases were all other expenditures (-33 percent), health (-25 percent), and housing and economic development (-9 percent). When broken down into two five-year periods, no categories decreased from 1997 to 2001, but five categories declined from 2002 to 2006.

Table 2: Total City Expenditures in Constant Dollars

Expenditures	1997	2001	2002	2006	1997 - 01 5-Year Change	2002 - 06 5-Year Change	10-Year Change
General Government	$ 373,200,413	$ 403,307,100	$ 397,139,424	$ 404,616,999	8.1%	1.9%	8.4%
Public Safety	740,457,077	795,839,516	838,324,464	853,574,180	7.5%	1.8%	15.3%
Streets and Highways	732,704,787	794,555,981	817,983,421	915,471,373	8.4%	11.9%	24.9%
Sanitation	16,009,337	17,280,008	16,712,738	26,435,052	7.9%	58.2%	65.1%
Health	24,006,326	29,810,129	32,509,764	18,123,570	24.2%	-44.3%	-24.5%
Culture and Recreation	395,606,119	440,752,276	466,841,022	462,231,094	11.4%	-1.0%	16.8%
Housing/Economic Development	431,351,743	450,112,871	394,170,305	348,113,824	4.3%	-11.7%	-19.3%
Conservation of Natural Resources	---	2,909,112	2,520,382	2,647,987	---	5.1%	---
Airport	20,506,171	35,909,744	25,006,980	28,786,239	75.1%	15.1%	40.4%
All Other Expenditures	252,309,159	312,596,134	212,841,574	168,994,042	23.9%	-20.6%	-33.0%
Debt Service	637,628,522	686,095,105	739,074,403	581,795,256	7.6%	-21.3%	-8.8%
Total Expenditures	**$3,623,779,654**	**$3,969,167,975**	**$3,943,124,476**	**$3,810,789,615**	**9.5%**	**-3.4%**	**5.2%**
Total Current Expenditures	$1,833,261,611	$1,980,104,311	$2,090,616,715	$2,086,362,637	8.0%	-0.2%	13.8%
Total Capital Outlay	1,152,889,521	1,302,968,559	1,113,433,359	1,142,631,722	13.0%	2.6%	-0.9%
Total Debt Service	637,628,522	686,095,105	739,074,403	581,795,256	7.6%	-21.3%	-8.8%
Total Expenditures	**$3,623,779,654**	**$3,969,167,975**	**$3,943,124,476**	**$3,810,789,615**	**9.5%**	**-3.4%**	**5.2%**

Overview of Cities Over 2,500 in Population

Total Governmental Revenues

In 2006, cities over 2,500 in population, or large cities, had total governmental revenues of $4.06 billion. This represents an increase of 6 percent from the amount raised in 2005 to finance city services. The primary funding sources for cities were taxes and state aid. These two sources accounted for 63 percent of all city revenues.

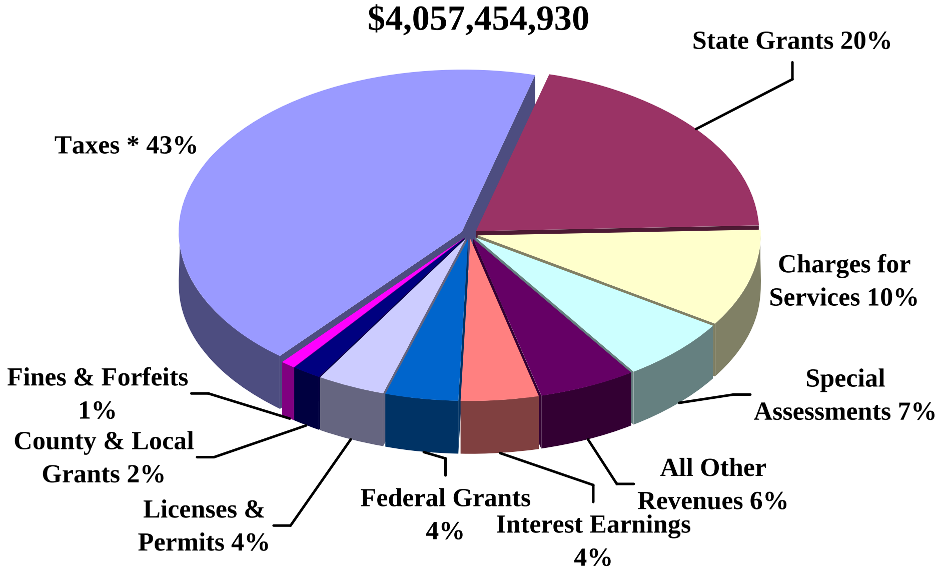
The sources of revenue that grew at the greatest rate between 2005 and 2006 were: interest earnings (61 percent), county grants (43 percent), hotel/motel taxes (12 percent), and property taxes (11 percent). Of those revenues showing the greatest increase, interest earnings have been the most volatile on a year-to-year basis. Those sources of revenue showing the greatest decreases were: gravel taxes (-16 percent), fines and forfeits (-8 percent), and charges for services (-2 percent).

The shares of total governmental revenues generally change very little from year-to-year. The two categories that have shown change are property taxes and intergovernmental revenues. Over the past five years, property taxes as a percent of total revenues increased from 26 percent in 2002 to 31 percent in 2006 and intergovernmental revenues which decreased from 32 percent in 2002 to 26 percent in 2006. To examine five-year trends in revenues, see Table 8 on page 26.

Figure 4 shows the relative shares of total governmental revenues by source. Underlying data for this figure is detailed in Table 8 on page 28.

Figure 4: 2006 Total Governmental Revenues - Cities Over 2,500 in Population **

$4,057,454,930



* This category includes property, hotel/motel, sales, franchise, gravel, and gambling taxes, as well as tax increments.
** Due to rounding, pie slices add up to more than 100 percent.

Total Governmental Expenditures

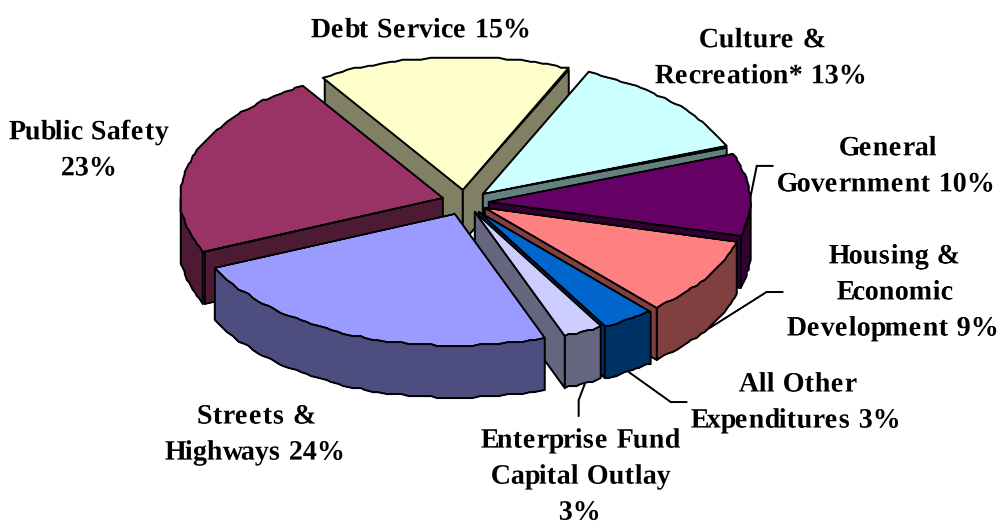
Cities provide a variety of services to their citizens. Most expenditures related to these services are accounted for in governmental funds. The governmental funds are classified as the General, Special Revenue, Capital Projects, Permanent, and Debt Service Funds. In 2006, cities over 2,500 in population expended $4.81 billion from these various governmental funds to provide city services. This represents an increase of 8 percent over 2005 total governmental expenditures. Total governmental expenditures include current expenditures, capital outlays, and debt service. Current expenditures accounted for 55 percent of total government expenditures, while capital outlay accounted for 30 percent, and debt service accounted for 15 percent.

The largest category of current expenditures for cities over 2,500 in population was public safety, while streets and highways dominated capital outlay expenditures. Public safety accounted for 38 percent of all current expenditures, more than double that of any other category. Streets and highways accounted for 57 percent of all capital expenditures, over six times greater than any other category of capital outlay.

Two areas showed very large changes in 2006. Capital outlays related to sanitation decreased by 79 percent as the result of a large capital project being completed in Eveleth, and airport-related capital outlays decreased by 56 percent as a result of projects completed in Rochester and Brainerd.

Figure 5 shows the relative shares of total governmental expenditures by function. The underlying data for this figure is detailed in Table 9 on page 29.

Figure 5: 2006 Total Governmental Expenditures - Cities Over 2,500 in Population $4,814,002,128



* This category represents expenditures for libraries and parks and recreation.

Capital Outlay Expenditures

Cities over 2,500 in population expended $1.42 billion on capital investments in 2006. This represents an increase of 19 percent over the level expended in 2005. 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 facilities caused by disasters. Table 3 below shows total capital outlays in actual dollars and per capita for large cities.

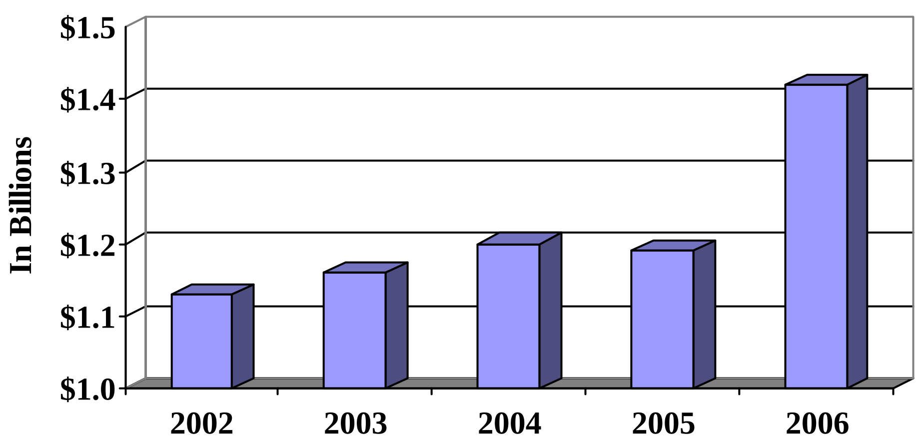
Table 3: Total Capital Outlay Expenditures in Actual Dollars and Per Capita

Year	Total Capital Outlay (actual dollars)	Per Capita *
2002	$1,156,396,425	$317
2003	$1,163,674,824	$315
2004	$1,198,430,759	$320
2005	$1,194,717,585	$315
2006	$1,418,495,255	$371

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

Figure 6 illustrates the trend in capital spending for the years 2002 through 2006.

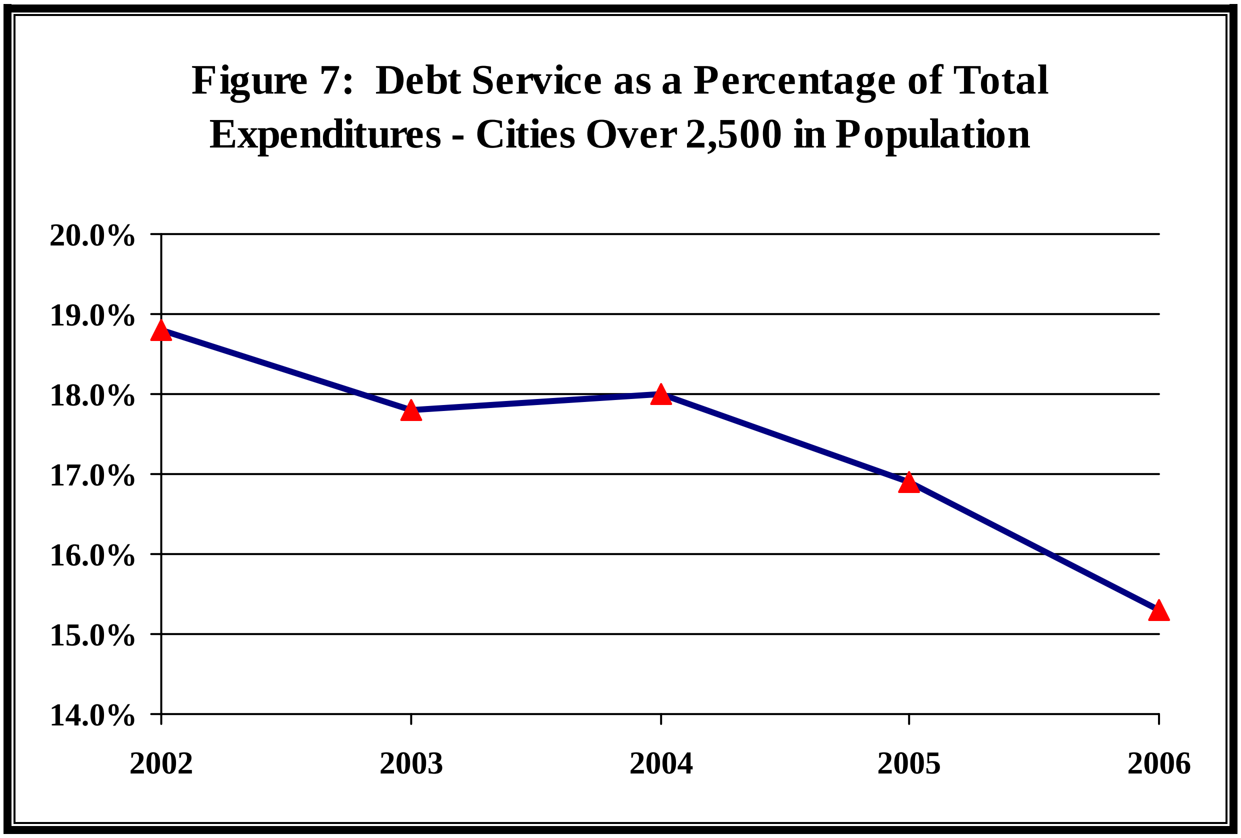
Figure 6: Capital Outlay Expenditures
Cities Over 2,500 in Population - 2002 to 2006



Debt Service

In 2006, large cities expended a total of $738.3 million on debt service, which was 15 percent of total expenditures. Debt service includes expenditures for the principal and interest payments of debt incurred by cities. Between 2005 and 2006, large city debt service expenditures decreased by 3 percent. It was the second year in a row that debt service expenditures decreased. The decrease appears to be related to the refinancing of existing debt earlier in the five-year period. When a city refinances its debt through the issue of refunding bonds, debt service payments appear high in the short run as large principal amounts are paid off but decease as the interest payments are reduced.

Figure 7 below shows the trend in the percentage of total expenditures allocated to debt service.



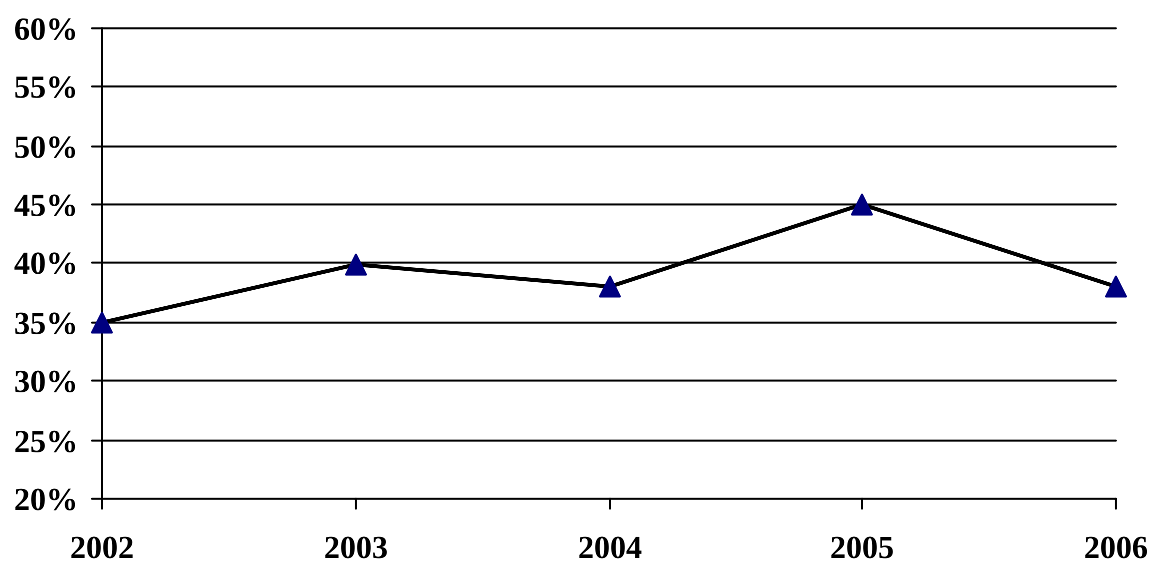
Municipal Enterprises

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. However, some municipalities choose to subsidize an enterprise that benefits the community as a whole. 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.[3]

In aggregate, large city municipal enterprises reported a net income of $298.4 million and net transfers (transfers out minus transfers in) of $114.8 million in 2006. This represents an increase of 44 percent in net income and a 24 percent increase in net transfers. An example of this type of transfer is when city officials transfer excess reserves from the Water Utility Enterprise Fund to the General Fund. Overall, net transfers were 38 percent of net profits among large city enterprises.

Figure 8 examines the five-year trend for large cities in net transfers from enterprise funds as a percent of their net income.

Figure 8: Large City Enterprise Fund Net Transfers as a Percent of Net Income - 2002 to 2006



[3] The Office of the State Auditor issues a separate report for municipal liquor stores entitled, "Analysis of Municipal Liquor Store Operations". The most recent report was issued in April 2008.

Outstanding Long-Term Indebtedness

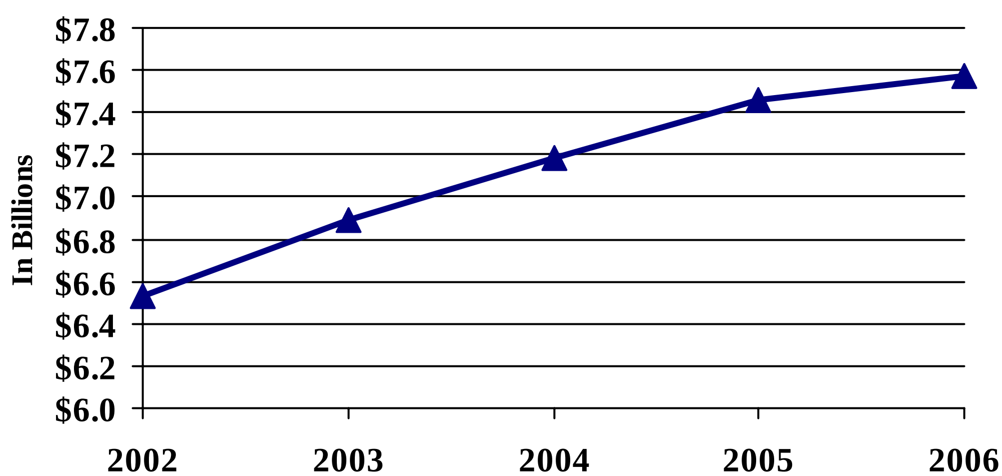
Cities over 2,500 carried long-term debt of $7.57 billion, or $1,979 per capita, at the end of 2006. This represents an increase of 1 percent over the 2005 level. Cities incur long-term debt through various ways such as the issuance of bonds and notes, certificates of indebtedness, and tax anticipation certificates. Long-term lease agreements are also classified as long-term debt. Cities may only borrow to finance capital projects and purchases but 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 4 below shows the outstanding bonded indebtedness for 2005 and 2006.

Table 4: Two-Year Summary of Outstanding Bonded Indebtedness

	2005 Amount	2006 Amount
General Obligation	$992,746,141	$1,115,964,338
G.O. Tax Increment	802,438,537	724,234,565
Revenue Tax Increment	189,896,193	182,174,411
Special Assessment	1,627,295,956	1,755,289,709
G.O. Revenue	1,866,168,907	1,946,839,231
Revenue	995,395,192	1,022,403,209
All Other	107,248,025	54,033,410
Total Bonded Indebtedness	**$6,581,188,951**	**$6,800,938,873**

Figure 9 shows the five-year trend of outstanding long-term debt for cities over 2,500 in population.

Figure 9: Outstanding Long-Term Indebtedness* for Cities Over 2,500 in Population



*Includes bonds and other types of debt such as certificates of indebtedness, long-term leases, and notes.

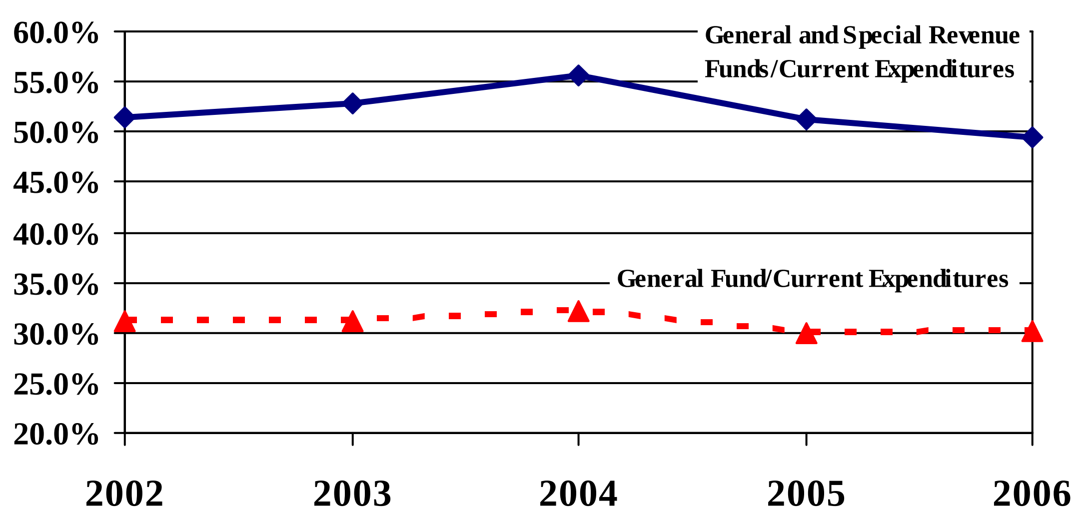
Unreserved Fund Balances of the General and Special Revenue Funds

The unreserved fund balances of large cities' General and Special Revenue Funds totaled $1.32 billion in 2006. This represents an increase of 2 percent over the level reported in 2005. Cities should have relatively large fund balances at the end of the year (December 31) 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. Appendix B on page 315 provides an in-depth discussion of city fund balances.

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 50 percent in 2006, compared to 51 percent in 2005. The decrease in the ratio of unreserved fund balances to total current expenditures reflects flat growth in fund balances combined with strong growth in current expenditures. 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 29 percent of their unreserved fund balances as a percent of total current expenditures, while class 4 cities (populations 2,500 to 10,000) average 75 percent.

Figure 10 below shows the five-year trend of the unreserved fund balances as a percent of total current expenditures for large cities. One line shows the combined unreserved fund balance of the General and Special Revenue funds, and the other shows only the unreserved fund balance of the General Fund.

Figure 10: Unreserved Fund Balances of the General and Special Revenue Funds as a Percent of Total Current Expenditures for Cities Over 2,500 in Population



Overview of Cities Under 2,500 in Population

Total Governmental Revenues

In 2006, cities under 2,500 in population, or small cities, had total governmental revenues of $419.5 million to finance city services. This represents an increase of 8 percent over the amount raised in 2005.

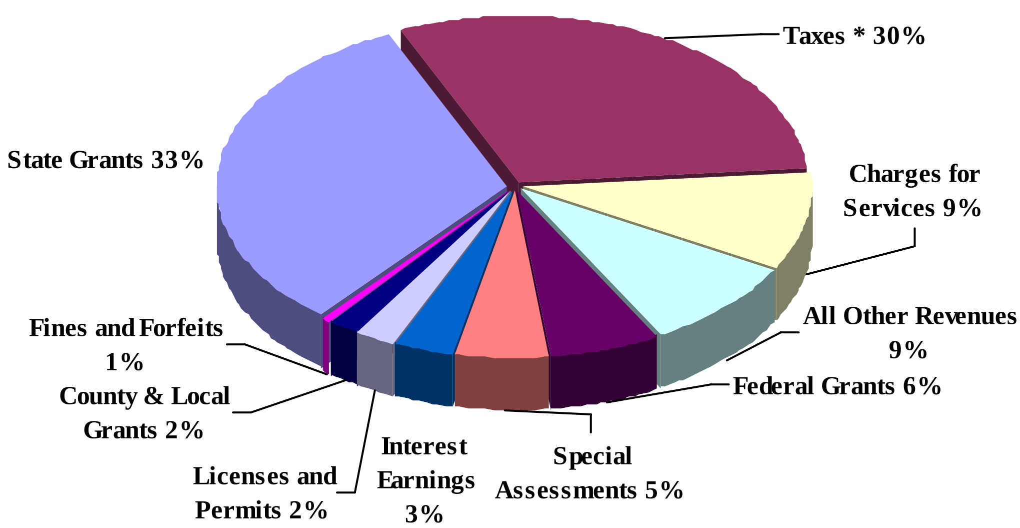
The sources of revenue that grew at the fastest rate between 2005 and 2006 were: local unit grants (124 percent), interest earnings (53 percent), county grants (39 percent) and state grants (19 percent). County and local unit grants are generally contributions from local government partners in large capital projects. The categories showing the greatest decrease between 2005 and 2006 were: federal grants (-12 percent), all other revenues (-3 percent) and charges for services (-2 percent).

The main sources of revenues for small cities in 2006 were state grants and taxes, which together accounted for 63 percent of all revenues, up from 59 percent in 2005. An increase in state grants pushed this percentage up.

Figure 11 shows the relative shares of total governmental revenues by source. The underlying data for this figure is in Table 12 on page 32.

Figure 11: 2006 Total Governmental Revenues - Cities Under 2,500 in Population

$419,506,501



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

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 2006, cities under 2,500 in population expended $537.4 million from governmental funds to provide city services. This represents an increase of 9 percent over 2005 total governmental expenditures.

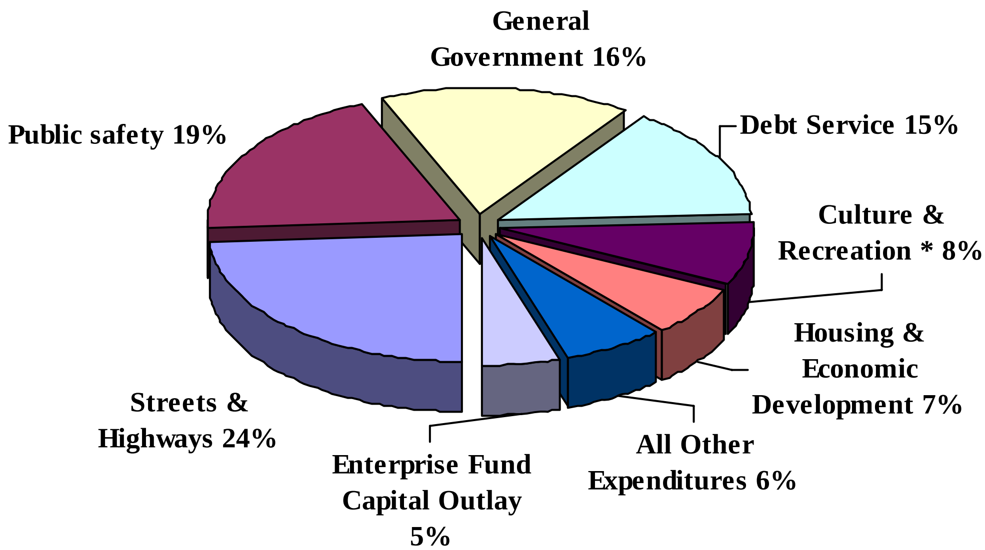
Between 2005 and 2006, the categories of expenditures that grew at the fastest rate were: sanitation (233 percent), health (193 percent), and parks and recreation (25 percent). The categories showing decreases were: airports (-21 percent) and housing and economic development (-19 percent). The increase in sanitation reflects a large sewer separation project in the City of Bird Island. The decrease in the airports category reflects the completion of large capital projects in Canby and Rush City.

In 2006, the four largest expenditure categories for cities under 2,500 in population were streets and highways, public safety, general government, and debt service. These four categories together accounted for 74 percent of all expenditures in 2006.

Figure 12 shows the relative shares of total governmental expenditures of small cities by function. The underlying data for this figure is in Table 12 on page 32.

Figure 12: 2006 Total Governmental Expenditures - Cities Under 2,500 in Population

$537,379,215



* This category represents expenditures for libraries and parks and recreation.

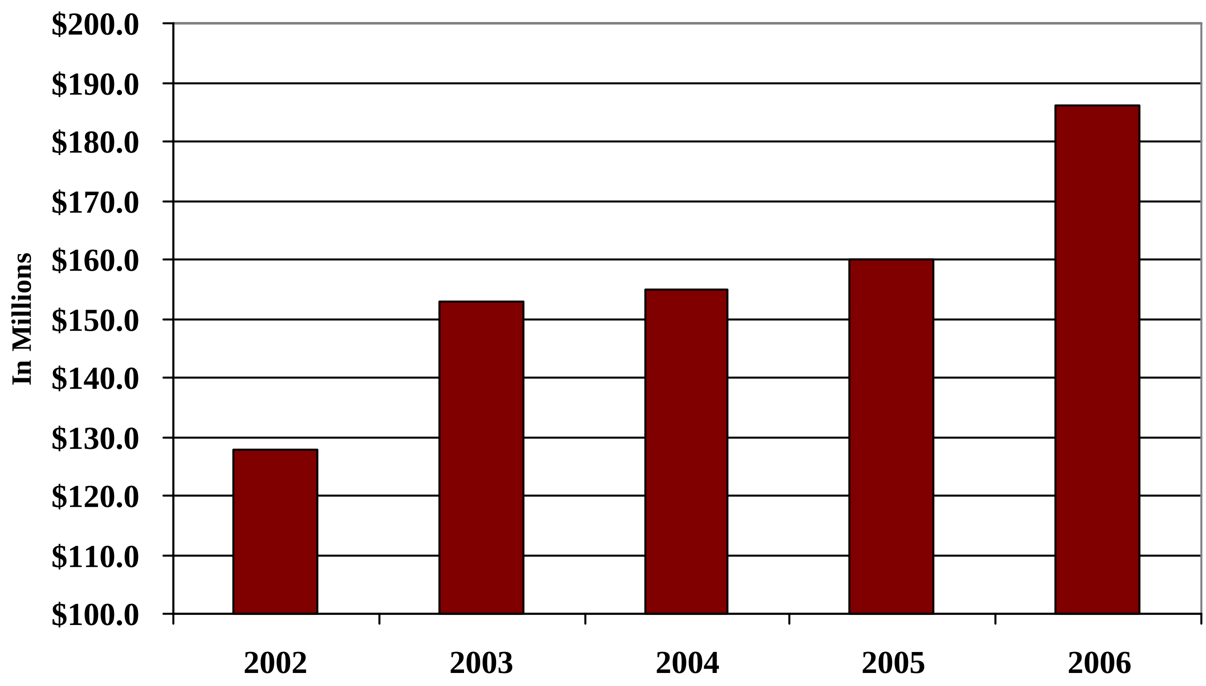
Capital Outlay Expenditures

Capital outlay expenditures account for the purchase, construction, or permanent improvements of buildings, equipment, machinery, and land. Small cities expended $186.1 million on capital outlay in 2006. This represents an increase of 16 percent over the level expended in 2005.

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 13 illustrates the trend in capital outlays of small cities for the years 2002 through 2006.

Figure 13: Total Capital Outlay Expenditures
Cities Under 2,500 in Population



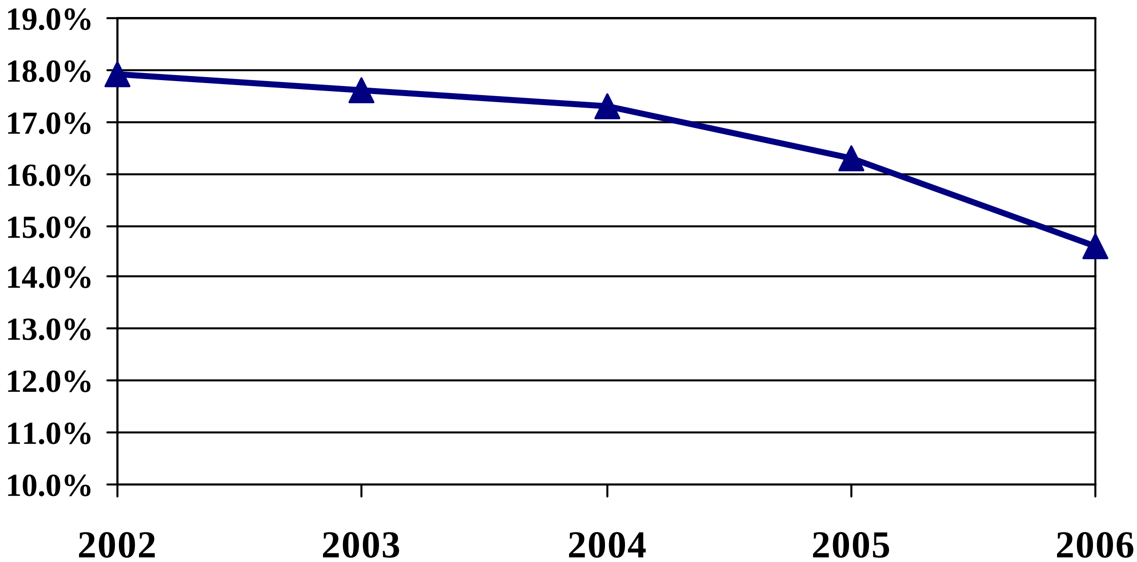
Debt Service

Debt service includes expenditures for the principal and interest payments on debt incurred by cities. In 2006, small cities expended a total of $78.7 million on debt service. This represented a decrease of 2 percent from 2005. Overall, debt service expenditures accounted for 15 percent of total expenditures for small cities.

Debt service expenditures as a percent of total expenditures declined yearly between 2002 and 2006. As explained earlier, this is the result of fewer refunding bonds being issued and more favorable interest rates as a result of earlier refinancing.

Figure 14 shows the five-year trend in the percent of total expenditures allocated to debt service.

Figure 14: Debt Service as a Percent of Total Expenditures - Cities Under 2,500 in Population



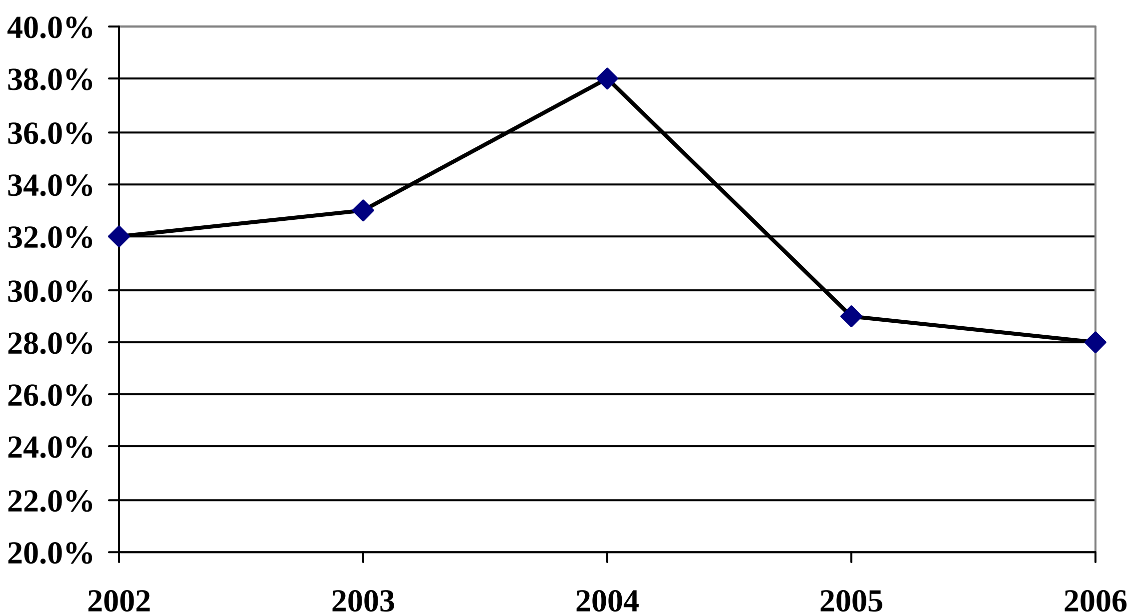
Municipal Enterprises

The total net income of small city enterprises in 2006 was $43.9 million and the net amount transferred to other funds was $12.1 million. This represents an increase in net income of 25 percent and an increase in net transfers (transfers out minus transfers in) of 17 percent between 2005 and 2006.

In 2006, the municipal enterprises of small cities transferred 28 percent of their net income to other funds. This was slightly less than the 29 percent transferred in 2005. The variance is often affected by substantial transfers in to water and sewer enterprises for large capital projects. Generally these revenues represent the proceeds of bond sales or grants from the state or federal governments. These transfers "in" reduce the overall net transfers because they are subtracted from transfers "out".

Figure 15 examines the five-year trend in net transfers from enterprise funds as a percent of net income.

Figure 15: Small City Enterprise Fund Net Transfers as a Percent of Net Income - 2002 to 2006



Outstanding Long-Term Indebtedness

Cities under 2,500 carried long-term debt totaling $1.11 billion at the close of 2006. This represents an 8 percent increase over the level in 2005. On a per capita basis, small cities carried $2,674 in long-term debt compared to $1,979 for large cities. While there is no single reason for the higher level of indebtedness per capita among the smaller cities, a primary reason is that the high costs of projects, such as water and sewer line replacement, are spread across fewer people.

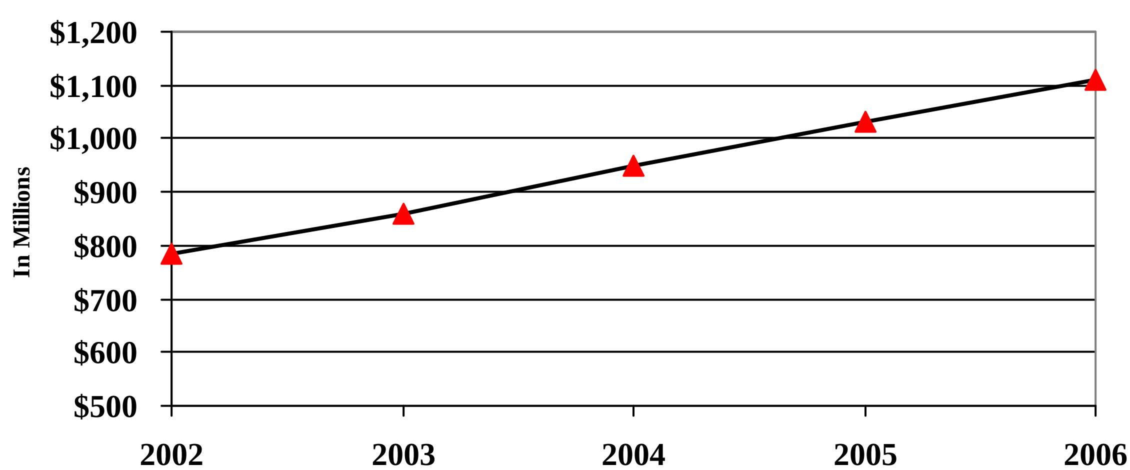
Table 5 looks at outstanding bonded indebtedness for 2005 and 2006.

Table 5: Two-Year Summary of Outstanding Bonded Indebtedness

	2005 Amount	2006 Amount
General Obligation	$50,358,736	$114,507,702
G.O. Tax Increment	35,783,895	34,715,071
Revenue Tax Increment	1,132,997	761,034
Special Assessment	283,020,934	295,385,856
G.O. Revenue	324,029,280	323,912,684
Revenue	94,233,813	97,709,231
All Other	2,944,864	1,622,287
Total Bonded Indebtedness	**$791,504,519**	**$868,613,865**

Figure 16 shows the five-year trend of outstanding long-term debt for small cities.

Figure 16: 2006 Outstanding Long-Term Indebtedness - Cities Under 2,500 *



* Includes bonds and other types of debt such as certificates of indebtedness, long-term leases, and notes.