Scope and Methodology

This publication is intended to help local government officials, policy makers, and the public understand city financial operations. The report summarizes, through data tables and charts, the financial operations of Minnesota cities for calendar year 2008.\(^1\) Minnesota cities are required to submit annual financial reports to the Office of the State Auditor pursuant to Minn. Stat. §§ 6.74-.75 and §§ 471.697-.698.\(^2\)

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, Permanent, 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, 2008, 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 2007 and 2008 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 2007 to 2008, and a comparison to 2008 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 A 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.

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\(^1\) The 2008 report includes one new city. Burns Township in Anoka County became the City of Nowthen in 2008.

\(^2\) Five cities failed to comply with the reporting requirements of Minn. Stat. §§ 6.74-.75 and §§ 471.697-.698 (see page 2 for list of cities). Failure to comply with reporting requirements results in the loss of local government aid (LGA).
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.

<table>
<thead>
<tr>
<th>Cities Failing to Report Their Financial Information in 2008</th>
</tr>
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<tbody>
<tr>
<td>Bena</td>
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</tbody>
</table>

* These cities also failed to report their 2007 data.

**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 of 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 in population may opt to use a cash basis of accounting. In 2008, 358 of the 637 small cities (56 percent) opted to use a cash basis of accounting.\(^3\) Cash basis accounting provides for the recording of receipts (revenues) when received in cash and the recording of disbursements (expenditures) when paid in cash.

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\(^3\) There are 642 small cities but the figure listed here reflects only the 637 cities that provided their 2008 financial information to the Office of the State Auditor.
Executive Summary

Current Trends – All Cities

- Total revenues of the governmental funds for all Minnesota cities totaled $4.66 billion in 2008. This represents a decrease of 1 percent from 2007 revenues. Total revenues of cities over 2,500 in population decreased 1 percent, while revenues of cities under 2,500 in population increased 2 percent (pg. 5).

- Total expenditures of the governmental funds for all cities totaled $5.53 billion in 2008. This represents an increase of 4 percent over 2007. Total expenditures of cities over 2,500 in population increased 4 percent, while total expenditures for cities under 2,500 increased 3 percent (pg. 5).

- The largest expenditure categories for both groups of cities are streets and highways and public safety. For large cities, streets and highways accounted for 20 percent of total expenditures, and public safety accounted for 26 percent. For small cities, streets and highways accounted for 24 percent of total expenditures, and public safety accounted for 21 percent (pgs. 5-6).

- The unreserved fund balances of large cities’ General and Special Revenue Funds totaled $1.39 billion in 2008. This represents an increase of 5 percent over the level reported in 2007. Large city unreserved fund balances as a percent of total current expenditures averaged 46 percent in 2008, compared to 48 percent in 2007 (pg. 17).

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

- For large cities, the sources of revenue that grew at the greatest rate between 2007 and 2008 were: hotel/motel taxes (76 percent), franchise taxes (50 percent), federal grants (28 percent), tax increments (8 percent) and property taxes (7 percent). Those sources of revenue showing the greatest decreases were: interest earnings (-26 percent), local sales taxes (-20 percent), state grants (-14 percent), and all other revenues (-14 percent). The large increases in the hotel/motel and franchise taxes categories, and the large decrease in the sales taxes category primarily reflects a reclassification of revenues by the City of Minneapolis. The large increase in federal grants reflects assistance the City of St. Paul received to enhance security for the 2008 National Republican Convention (pg. 11).

- For small cities, five sources of revenue grew between 2007 and 2008: county grants (46 percent), taxes (7 percent), federal grants (6 percent), state grants (3 percent), and charges for services (3 percent). The categories of revenues showing the greatest decrease between 2007 and 2008 were: local unit grants (-36 percent), interest earnings (-24 percent), licenses and permits (-24 percent), and all other revenues (-5 percent) (pg. 18).
• In 2008, small cities carried long-term debt of $1.21 billion, or $2,965 per capita, compared to $8.4 billion, or $2,152 per capita, for large cities (pg. 6).

**Ten-Year Trends – All Cities**

**Governmental Revenues**

• Over the ten-year period of 1999 to 2008, an examination of city finances shows that when adjusted for inflation\(^4\), 2008 revenue levels are below 1999 levels. Inflation-adjusted total city revenues decreased 7 percent between 1999 and 2008 (pg. 7).

• Between 1999 and 2008, actual revenues derived from property taxes grew 102 percent, compared to 10 percent for revenues derived from intergovernmental sources. When revenues are adjusted for inflation, the ten-year period shows a 37 percent increase in property tax revenues, while intergovernmental revenues decreased 25 percent (pg. 7).

• As 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. From 1999 to 2008, the proportion of total revenues derived from property taxes grew from 24 percent in 1999 to 35 percent in 2008. During this same time frame, revenues derived from intergovernmental sources decreased from 32 percent of total revenues to 25 percent (pg. 7).

**Governmental Expenditures**

• Total city expenditures grew from $4.01 billion in 1999 to $5.53 billion in 2008. This represents an increase of 38 percent. Over the ten-year period of 1999 to 2008, an examination of city finances shows that when adjusted for inflation, 2008 expenditure levels are below 1999 levels and decreased 7 percent over the ten-year period (pg. 9).

• When the three components of city spending (total current expenditures, total capital outlays, and total debt service) 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 33 percent, and total debt service expenditures decreased 13 percent (pg. 10).

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\(^4\)“Adjusted for inflation” and “constant dollars” refer to data adjusted for inflation using the Implicit Price Deflator for State and Local Governments setting 1999 as the base year (N.I.P.A. Table 1.1.9, December 2009).
Comparison and Overview

2008 Finances for All Minnesota Cities

Revenues

Total revenues of the governmental funds for all Minnesota cities totaled $4.66 billion in 2008. This represents a decrease of 1 percent from 2007 revenues. Total revenues of cities over 2,500 in population decreased 1 percent, while revenues of cities under 2,500 in population increased 2 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 2008, intergovernmental revenues accounted for 41 percent of total revenues for small cities, compared to 24 percent for large cities. Among all cities, intergovernmental revenues accounted for 25 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 49 percent of large city revenues, compared to 33 percent of small city revenues in 2008. Large cities also utilize tax increment financing to a greater extent than small cities. Revenue derived from tax increment accounted for 2 percent of small city total revenues, compared to 7 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 35 percent of total revenues, compared to 30 percent for small cities. For all cities, property taxes accounted for 35 percent of total revenues.

On a per capita basis, large and small cities had total revenues of $1,081.

Expenditures

Total expenditures of the governmental funds for all cities totaled $5.53 billion in 2008. This represents an increase of 4 percent over 2007. Total expenditures of cities over 2,500 in population increased 4 percent, while total expenditures for cities under 2,500 in population increased 3 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 (9 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 20 percent of total expenditures, and public safety accounted for 26 percent. For small cities, streets and highways accounted for 24 percent of total expenditures, and public safety accounted for 21 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 2008, small cities carried long-term debt of $1.21 billion, or $2,965 per capita, compared to $8.41 billion, or $2,152 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 2008, unreserved fund balances as a percent of current expenditures averaged 89 percent for small cities (98 percent in 2007), compared to 46 percent for large cities (down from 48 percent in 2007).

Among the 280 small cities that reported on a GAAP basis in 2008, 128 (46 percent) had an unreserved fund balance greater than 100 percent of total current expenditures. Among the 213 large cities, 33 cities (15 percent) had an unreserved fund balance greater than 100 percent of total current expenditures. In 2008, unreserved fund balances as a percent of total current expenditures among small cities ranged from -124 percent in Bigelow to 763 percent in Skyline. Among large cities, the range was from -31 percent in Caledonia to 338 percent in Worthington.

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.

The Office of the State Auditor recommends that each local government establish a formal policy on the level of unreserved fund balance that should be maintained in the General Fund and Special Revenue funds. The policy should be set by the governing body and should provide both a time frame and a specific plan for increasing or decreasing the level of unreserved fund balance. If the fund balance does not match the policy, a plan should be developed by the governing body that will allow for compliance with the policy.
Ten-Year Trends

Governmental Revenues

Over the ten-year period of 1999 to 2008, an examination of city finances shows that when adjusted for inflation⁵, 2008 revenue levels are below 1999 levels. Inflation-adjusted total city revenues decreased 7 percent between 1999 and 2008.

Between 1999 and 2008, actual revenues derived from property taxes grew 102 percent, compared to 10 percent for revenues derived from intergovernmental sources. When revenues are adjusted for inflation, the ten-year period shows a 37 percent increase in property tax revenues, while intergovernmental revenues decreased 25 percent.

In addition, the proportion of total revenues derived from property taxes grew from 24 percent in 1999 to 35 percent in 2008. During this same time frame, revenues derived from intergovernmental sources decreased from 32 percent of total revenues to 25 percent. Figure 1 below shows that as 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.

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⁵“Adjusted for inflation” and “constant dollars” refer to data adjusted for inflation using the Implicit Price Deflator for State and Local Governments setting 1999 as the base year (N.I.P.A. Table 1.1.9, December 2009).
An examination of city revenues from 1999 to 2008 shows that in actual dollars, revenues grew from $3.39 billion in 1999 to $4.66 billion in 2008, an increase of 38 percent. When put into constant dollars, the level of revenues in 2008 was 7 percent less than in 1999. Figure 2 below illustrates this trend.

![Figure 2: Growth in Total Revenues
Actual and Constant Dollars - 1999 to 2008](image)

Table 1 on the following page provides a summary of the trend in city revenues from 1999 to 2008 when adjusted for inflation. During the five-year period of 2004 to 2008, there was a significant decrease in revenues as compared to the 1999 to 2003 period. This trend reflects a significant reduction in state aid to cities. While property taxes and other sources of revenues were increased to counter the cuts in state aid, revenues did not grow at a rate to keep up with inflation.
### Table 1: Total City Revenues in Constant Dollars

<table>
<thead>
<tr>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxes</td>
<td>$1,231,906,634</td>
<td>$1,311,895,534</td>
<td>$1,357,690,724</td>
<td>$1,483,594,239</td>
<td>6.5%</td>
<td>9.3%</td>
<td>20.4%</td>
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<tr>
<td>Special Assessments</td>
<td>237,484,663</td>
<td>244,406,347</td>
<td>241,060,075</td>
<td>186,069,382</td>
<td>2.9%</td>
<td>-22.8%</td>
<td>-21.6%</td>
</tr>
<tr>
<td>Licenses and Permits</td>
<td>116,075,469</td>
<td>131,398,136</td>
<td>138,984,981</td>
<td>93,681,130</td>
<td>13.2%</td>
<td>-32.6%</td>
<td>-19.3%</td>
</tr>
<tr>
<td>Federal Grants</td>
<td>155,138,091</td>
<td>150,879,525</td>
<td>156,188,131</td>
<td>160,638,016</td>
<td>-2.7%</td>
<td>2.8%</td>
<td>3.5%</td>
</tr>
<tr>
<td>State Grants</td>
<td>863,276,516</td>
<td>798,909,086</td>
<td>712,645,054</td>
<td>577,002,664</td>
<td>-7.5%</td>
<td>-19.0%</td>
<td>-33.2%</td>
</tr>
<tr>
<td>Local Unit Grants</td>
<td>53,532,382</td>
<td>60,259,529</td>
<td>84,355,783</td>
<td>61,909,340</td>
<td>12.6%</td>
<td>-26.6%</td>
<td>15.6%</td>
</tr>
<tr>
<td>Charges for Services</td>
<td>279,795,068</td>
<td>335,675,534</td>
<td>341,849,947</td>
<td>297,764,384</td>
<td>20.0%</td>
<td>-12.9%</td>
<td>6.4%</td>
</tr>
<tr>
<td>Fines and Forfeits</td>
<td>33,608,095</td>
<td>35,052,911</td>
<td>35,163,356</td>
<td>29,657,051</td>
<td>4.3%</td>
<td>-15.7%</td>
<td>-11.8%</td>
</tr>
<tr>
<td>Interest Earnings</td>
<td>129,649,860</td>
<td>78,983,059</td>
<td>75,430,657</td>
<td>124,601,099</td>
<td>-39.1%</td>
<td>65.2%</td>
<td>-3.9%</td>
</tr>
<tr>
<td>All Other Revenues</td>
<td>289,572,300</td>
<td>209,864,598</td>
<td>221,186,549</td>
<td>145,080,313</td>
<td>-27.5%</td>
<td>-34.4%</td>
<td>-49.9%</td>
</tr>
<tr>
<td>Total Revenues</td>
<td>$3,390,039,078</td>
<td>$3,357,324,260</td>
<td>$3,364,555,257</td>
<td>$3,159,997,618</td>
<td>-1.0%</td>
<td>-6.1%</td>
<td>-6.8%</td>
</tr>
</tbody>
</table>

### Governmental Expenditures

Total city expenditures grew from $4.01 billion in 1999 to $5.53 billion in 2008. This represents an increase of 38 percent. Over the ten-year period of 1999 to 2008, an examination of city finances shows that when adjusted for inflation, 2008 expenditure levels are below 1999 levels and decreased 7 percent over the ten-year period. Figure 3 below shows the contrast between expenditures in actual and constant dollars.

![Figure 3: Growth in Total Expenditures](image-url)
When the three components of city spending (total current expenditures, total capital outlays, and total debt service) 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 33 percent, and total debt service expenditures decreased 13 percent.

Table 2 below provides a summary of expenditures from 1999 to 2008 in constant dollars. Those categories showing growth were airports (24 percent), public safety (18 percent), and sanitation (3 percent), while all other categories of expenditures decreased over this period.
Overview of Cities Over 2,500 in Population

Total Governmental Revenues

In 2008, cities over 2,500 in population, or large cities, had total governmental revenues of $4.22 billion. This represents a decrease of 1 percent from 2007 to finance city services. The primary revenue sources for cities were taxes and state aid, which accounted for 65 percent of all city revenues.

The sources of revenue that grew at the greatest rate between 2007 and 2008 were: hotel/motel taxes (76 percent), franchise taxes (50 percent), federal grants (28 percent), tax increments (8 percent) and property taxes (7 percent). Those sources of revenue showing the greatest decreases were: interest earnings (-26 percent), local sales taxes (-20 percent), state grants (-14 percent), and all other revenues (-14 percent). The large increases in the hotel/motel and franchise taxes categories, and the large decrease in the sales taxes category primarily reflects a reclassification of revenues by the City of Minneapolis. The large increase in federal grants reflects assistance the City of St. Paul received to enhance security for the 2008 National Republican Convention.

Although the relative shares of total governmental revenues generally change very little from year to year, a notable exception over the past several years has been the categories of property taxes and intergovernmental revenues. Over the past five years, property taxes as a percent of total revenues increased from 29 percent in 2004 to 35 percent in 2008, while intergovernmental revenues as a percent of total revenues decreased from 27 percent in 2004 to 24 percent in 2008.

Figure 4 shows the relative shares of total governmental revenues by source. Underlying data for this figure as well as five-year trends can be found in Table 8 on page 28.

![Figure 4: 2008 Total Governmental Revenues - Cities Over 2,500 in Population](image-url)

$4,222,781,330

Taxes* 49%

State Grants 17%

Charges for Services 9%

Special Assessments 6%

Federal Grants 5%

Fines and Forfeits 1%

All Other Revenue 4%

County & Local Grants 2%

Licenses and Permits 3%

Interest Earnings 4%

*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. 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 2008, cities over 2,500 in population expended $4.99 billion from these various governmental funds to provide city services. This represents an increase of 4 percent from 2007 total governmental expenditures. Total governmental expenditures include current expenditures, capital outlays, and debt service. Current expenditures accounted for 60 percent of total government expenditures, while capital outlay accounted for 24 percent, and debt service accounted for 16 percent.

The largest category of current expenditures for cities over 2,500 in population was public safety, while streets and highways was the largest capital outlays expenditure. Public safety accounted for 40 percent of all current expenditures—more than triple that of any other category. Streets and highways accounted for 52 percent of all capital expenditures, over five times greater than any other category of capital outlay.

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: 2008 Total Governmental Expenditures - Cities Over 2,500 in Population](image)

$4,991,255,912

- Public Safety 26%
- Streets & Highways 20%
- Debt Service 16%
- Culture & Recreation* 13%
- Housing & Economic Development 10%
- General Government 9%
- Capital Outlay for Enterprise Funds 1%
- All Other Expenditures 5%

* This category represents expenditures for libraries and parks and recreation.
Capital Outlay Expenditures

Cities over 2,500 in population expended $1.18 billion on capital investments in 2008. This represents a decrease of 6 percent from the level expended in 2007. While no one particular city was responsible for the decrease, the ten cities with the largest decreases in capital outlays accounted for 70 percent of the total decrease. 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. 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

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Capital Outlay (actual dollars)</th>
<th>Per Capita*</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>$1,198,430,759</td>
<td>$320</td>
</tr>
<tr>
<td>2005</td>
<td>$1,194,717,585</td>
<td>$315</td>
</tr>
<tr>
<td>2006</td>
<td>$1,418,495,255</td>
<td>$371</td>
</tr>
<tr>
<td>2007</td>
<td>$1,258,328,908</td>
<td>$328</td>
</tr>
<tr>
<td>2008</td>
<td>$1,184,065,833</td>
<td>$303</td>
</tr>
</tbody>
</table>

* Per capita amounts are based on the total population of cities with over 2,500 in population that reported their financial information.

Figure 6 illustrates the trend in capital outlays for the years 2004 through 2008.
Debt Service

In 2008, large cities expended a total of $790.1 million on debt service, which represented 16 percent of total expenditures. Debt service includes expenditures for the principal and interest payments of debt incurred by cities. Between 2007 and 2008, large city debt service expenditures increased $25.7 million, or 3 percent.

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

![Figure 7: Debt Service as a Percentage of Total Expenditures - Cities Over 2,500 in Population - 2004 to 2008](image)
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 generally 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.

In aggregate, large city municipal enterprises reported a net income of $187.2 million and net transfers (transfers out minus transfers in) of $124.3 million in 2008. This represents a decrease of 31 percent in net income and a 2 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. The large decrease in net income reflects several one-time grants or sale of assets that occurred in 2007 that were not repeated in 2008. Overall, net transfers represented 66 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.
Outstanding Long-Term Indebtedness

Cities over 2,500 in population carried long-term debt of $8.41 billion, or $2,152 per capita, at the end of 2008. This represents an increase of 2 percent over the 2007 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 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 below shows the outstanding bonded indebtedness for 2007 and 2008.

<table>
<thead>
<tr>
<th></th>
<th>2007 Amount</th>
<th>2008 Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Obligation</td>
<td>$1,106,265,767</td>
<td>$1,187,618,687</td>
</tr>
<tr>
<td>G.O. Tax Increment</td>
<td>769,892,452</td>
<td>721,859,631</td>
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<tr>
<td>Revenue Tax Increment</td>
<td>182,826,742</td>
<td>102,256,560</td>
</tr>
<tr>
<td>Special Assessment</td>
<td>1,938,205,505</td>
<td>2,031,875,405</td>
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<tr>
<td>G.O. Revenue</td>
<td>2,057,732,032</td>
<td>2,022,836,410</td>
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<tr>
<td>Revenue</td>
<td>1,262,683,092</td>
<td>1,307,473,218</td>
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<tr>
<td>All Other</td>
<td>79,620,745</td>
<td>102,376,971</td>
</tr>
<tr>
<td>Total Bonded Indebtedness</td>
<td>$7,397,226,335</td>
<td>$7,476,296,882</td>
</tr>
</tbody>
</table>

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 - 2004 to 2008

*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 $1.39 billion in 2008. This represents an increase of 5 percent over the level reported in 2007. 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 A on page 315 provides an in-depth explanation 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. Large city unreserved fund balances as a percent of total current expenditures averaged 46 percent in 2008, compared to 48 percent in 2007. The decrease in the ratio of unreserved fund balances to total current expenditures reflects strong growth in current expenditures compared to unreserved fund balances. 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 24 percent of their unreserved fund balances as a percent of total current expenditures, while class 4 cities (populations 2,500 to 10,000) average 70 percent (see Appendix A for further information and recommendations on city unreserved fund balances).

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 as a percent of total current expenditures, and the other shows only the unreserved fund balance of the General Fund as a percent of total current expenditures.
Overview of Cities Under 2,500 in Population

Total Governmental Revenues

In 2008, cities under 2,500 in population, or small cities, had total governmental revenues of $440.8 million to finance city services. This represents an increase of 2 percent over the amount raised in 2007.

Five sources of revenue grew between 2007 and 2008: county grants (46 percent), taxes (7 percent), federal grants (6 percent), state grants (3 percent), and charges for services (3 percent). The categories of revenues showing the greatest decrease between 2007 and 2008 were: local unit grants (-36 percent), interest earnings (-24 percent), licenses and permits (-24 percent), and all other revenues (-5 percent).

The main sources of revenues for small cities in 2008 were state grants and taxes, which together accounted for 66 percent of all revenues, up from 64 percent in 2007. Both taxes and state grants increased at a rate greater than overall revenues, which resulted in their share of total revenues increasing relative to other revenue sources.

Figure 11 shows the relative shares of total governmental revenues by source. The underlying data for this figure is in Table 12 on page 33.

Figure 11: 2008 Total Governmental Revenues - Cities Under 2,500 in Population

$440,774,754

*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 2008, cities under 2,500 in population expended $534.6 million from governmental funds to provide city services. This represents an increase of 3 percent from 2007 total governmental expenditures.

Between 2007 and 2008, the categories of expenditures that grew at the fastest rate were: housing and economic development (35 percent), all other expenditures (23 percent), sanitation (8 percent) and general government (6 percent). The categories showing the greatest decreases were: health (-54 percent), capital outlay for enterprise funds (-31 percent), and airports (-18 percent).

In 2008, 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 78 percent of all expenditures in 2008.

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 33.

*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 $137.7 million on capital outlay in 2008. This represents a decrease of 10 percent from the level expended in 2007.

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 2004 through 2008.
Debt Service

Debt service includes expenditures for the principal and interest payments on debt incurred by cities. In 2008, small cities expended a total of $93.4 million on debt service. This represented an increase of 6 percent from 2007. Overall, debt service expenditures accounted for 18 percent of total expenditures for small cities.

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

The total net income of small city enterprises in 2008 was $33.9 million, and the net amount transferred to other funds was $8.5 million. This represents a decrease in net income of 27 percent and a decrease in net transfers (transfers out minus transfers in) of 55 percent between 2007 and 2008. The large decrease in net transfers reflects a number of asset sales that occurred in 2007 and were not repeated in 2008 as well as transfers from other funds into enterprises funds to finance infrastructure improvements.

In 2008, the municipal enterprises of small cities transferred 25 percent of their net income to other funds. This was significantly less than the 41 percent of net income that was transferred in 2007.

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

Cities under 2,500 in population carried long-term debt totaling $1.21 billion at the close of 2008. This represents a 1 percent increase over the level in 2007. On a per capita basis, small cities carried $2,965 in long-term debt, compared to $2,152 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 2007 and 2008.

<table>
<thead>
<tr>
<th></th>
<th>2007 Amount</th>
<th>2008 Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Obligation</td>
<td>$106,894,839</td>
<td>$102,536,429</td>
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<tr>
<td>G.O. Tax Increment</td>
<td>34,415,730</td>
<td>31,216,377</td>
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<td>Revenue Tax Increment</td>
<td>820,986</td>
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<td>Special Assessment</td>
<td>317,667,102</td>
<td>333,908,419</td>
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<td>G.O. Revenue</td>
<td>348,249,691</td>
<td>360,041,534</td>
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<tr>
<td>Revenue</td>
<td>95,086,016</td>
<td>93,912,366</td>
</tr>
<tr>
<td>All Other</td>
<td>1,897,209</td>
<td>3,192,674</td>
</tr>
<tr>
<td><strong>Total Bonded Indebtedness</strong></td>
<td><strong>$905,031,573</strong></td>
<td><strong>$925,911,434</strong></td>
</tr>
</tbody>
</table>

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

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