

**CITY OF MINNEAPOLIS
MANAGEMENT'S DISCUSSION AND ANALYSIS
REQUIRED SUPPLEMENTARY INFORMATION**

This section of the City of Minneapolis' comprehensive annual financial report presents a discussion and analysis of the City's financial performance during the fiscal year ended December 31, 2004. Please read it in conjunction with the transmittal letter at the front of this report and the City's basic financial statements following this section. All dollar amounts are expressed in thousands unless otherwise indicated.

FINANCIAL HIGHLIGHTS

- Assets of the City of Minneapolis exceeded liabilities at the close of the 2004 fiscal year by \$770,947 (net assets). Of this amount, a deficit of \$176,424 (unrestricted net assets) resulted primarily from prior period losses in the internal service funds, debt related to unfunded pension liabilities, Parking fund shortages, and other debt issued by the City to finance assets owned by the City's component units. Additionally, \$89,168 is restricted for specific purposes (restricted net assets) and \$858,203 is invested in capital assets net of related debt.
- The City's total net assets increased by \$22,149. Governmental activities increased the City's net assets by \$23,004, however, the business type activities decreased the net asset balance by \$855.
- As of December 31, 2004, unreserved fund balance for the general fund was \$60,472, or about 26.6% of total general fund expenditures.
- The City's total long-term bond and note liability increased by \$31,801 from the prior year. Total debt issued in 2004 was \$223,385 and total debt retirement was \$191,584, including current refunding transactions. Major new debt issuances included \$40,970 for various infrastructure improvements in the five year capital plan, \$28,000 for library improvements, \$29,710 for unfunded pension obligations and \$25,000 for a new water treatment plant.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the City's basic financial statements. The City's basic financial statements include 3 components; 1) Government-wide financial statements; 2) Fund financial statements; and 3) Notes to the basic financial statements. This report also contains other supplementary information in addition to the basic financial statements.

Government-wide Financial Statements—Government-wide financial statements are designed to provide readers with a broad overview of City finances, in a manner similar to a private-sector business.

The statement of net assets presents information on all City assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

The statement of activities presents information showing how net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

(All dollar amounts are expressed in thousands unless otherwise indicated.)

Both of these government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are intended to recover all or, in part, a portion of these costs through user fees and charges (business-type activities). The governmental activities of the City include general government, public safety, public works, culture and recreation, health and welfare, and community and economic development. The business-type activities of the City include sewer, solid waste and recycling, water works, community and economic development, and parking.

The government-wide financial statements include not only the City of Minneapolis (known as primary government), but also legally separate entities for which the City is accountable. For the City of Minneapolis, component units are included in the basic financial statements of the City, and consist of legally separate entities for which the City is financially accountable (discretely presented component units) and have substantially the same board as the City or provide services almost entirely to the primary government (blended component units). An example of a blended component unit is the Board of Estimate and Taxation (BET). Examples of discretely presented component units include the Minneapolis Library Board (Library Board), Minneapolis Park and Recreation Board (Park Board), and the Municipal Building Commission (MBC).

The government-wide financial statements can be found on pages 28-29 of this report.

Fund Financial Statements—A fund is a grouping of related accounts that are used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other state and local governments, uses fund accounting to ensure and demonstrate finance-related legal compliance. All of the funds in the City can be divided into three categories - governmental funds, proprietary funds, and fiduciary funds.

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented in governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financial decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balance provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The City of Minneapolis maintains 16 individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balance for the General Fund, the Community Planning and Economic Development Special Revenue Fund, the Convention Center Special Revenue Fund, and the Permanent Improvement Capital Projects Fund, all of which are considered to be major funds. Data from the other 12 governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these non-major governmental funds is provided in the form of combining statements elsewhere in this report. The governmental funds' financial statements can be found on pages 30-33 of this report.

Proprietary Funds—The City of Minneapolis maintains two different types of proprietary funds. Enterprise funds are used to report the same functions presented as business-type activities in the

government-wide financial statements. The City of Minneapolis uses the enterprise funds to account for its Sewer, Solid Waste and Recycling, Water Works, Community Planning and Economic Development, and Parking activities. The City uses internal service funds to account for its property management services, equipment services, business information systems, central stores, engineering lab, outside purchase of asphalt and cement services, city attorney, workers' compensation, unemployment benefits and other payroll related services. Because these services predominately benefit governmental rather than business-type functions, they have been included within governmental activities in the government-wide financial statements. Internal Service Funds are an accounting device used to accumulate and allocate costs internally among the City's various functions.

The proprietary funds' financial statements can be found on pages 34-37 of this report.

Fiduciary Funds—Fiduciary funds are used to account for resources held for the benefit of parties outside of the government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the programs of the City.

The fiduciary fund financial statements can be found on page 39 of this report.

Notes to the Financial Statements—The notes to the financial statements provide additional information that is essential to a full understanding of the information provided in the government-wide financial statements.

The notes to the financial statements can be found on pages 43-78 of this report.

Required Supplementary Information—In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information.

Required supplementary information can be found on pages 79-82 of this report.

The combining statements referred to earlier, in connection with non-major governmental funds and internal service funds, are presented immediately following the required supplementary information.

Combining and individual fund statements and schedules can be found on pages 83-133 of this report.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Statement of Net Assets:

The City's assets exceeded liabilities by \$770,947 at the close of the fiscal year ending December 31, 2004, compared to \$748,798 at the end of the previous year.

Statement of Net Assets
December 31, 2004

	<u>Governmental Activities</u>		<u>Business-type Activities</u>		<u>Total</u>	
	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>
Current and other assets	\$ 575,575	\$ 585,346	\$ 153,285	\$ 182,496	\$ 728,860	\$ 767,842
Capital assets	883,151	813,714	935,776	886,858	1,818,927	1,700,572
Total assets	<u>1,458,726</u>	<u>1,399,060</u>	<u>1,089,061</u>	<u>1,069,354</u>	<u>2,547,787</u>	<u>2,468,414</u>
Current and other liabilities	291,429	208,134	83,679	22,317	375,108	230,451
Long-term liabilities	955,808	1,002,441	445,924	486,724	1,401,732	1,489,165
Total liabilities	<u>1,247,237</u>	<u>1,210,575</u>	<u>529,603</u>	<u>509,041</u>	<u>1,776,840</u>	<u>1,719,616</u>
Net assets:						
Invested in capital assets, net of related debt	353,750	276,744	504,453	480,562	858,203	757,306
Restricted net assets	49,028	47,504	40,140	42,906	89,168	90,410
Unrestricted net assets	(191,289)	(135,763)	14,865	36,845	(176,424)	(98,918)
Total net assets	<u>211,489</u>	<u>188,485</u>	<u>559,458</u>	<u>560,313</u>	<u>770,947</u>	<u>748,798</u>
Total liabilities and net assets	<u>\$ 1,458,726</u>	<u>\$ 1,399,060</u>	<u>\$ 1,089,061</u>	<u>\$ 1,069,354</u>	<u>\$ 2,547,787</u>	<u>\$ 2,468,414</u>

The largest component of the City's net assets, \$858,203, reflects its investment in capital assets (e.g. land, buildings, machinery, and equipment), net of related debt outstanding used to acquire those assets. Capital assets net of related debt increased by \$100,857 from \$757,306 at the end of 2003. This increase is primarily due to conversion of construction in progress into capital assets. The City uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although the City's investments in capital assets are reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

Another component of the City's net assets are unrestricted net assets of (\$176,424), which, if positive, would be used for meeting the City's short and long-term obligations. The negative balance is a result of several factors. If not for these factors, the City would have a positive unrestricted net asset balance. These factors include prior period losses within the internal service funds of approximately \$76,000 and debt obligations with no corresponding capital assets of approximately \$373,000. The nature of the debt obligations include approximately \$118,000 in pension bonds, tax increment bonds issued on behalf of the Community Planning and Economic Development Fund (CPED) of approximately \$135,000, and debt issued on behalf of the City's discrete component units of approximately \$120,000. The City is responsible for issuing and reporting all bonded debt related to the Park Board, Library Board, and Municipal Building Commission (MBC). However, the capital assets financed by these debt proceeds are reported as capital assets of the Park Board, Library Board, and MBC.

The remaining component, restricted net assets of \$89,168, represents resources that are subject to external restrictions on how they may be used.

(All dollar amounts are expressed in thousands unless otherwise indicated.)

Statement of Activities:

The following table presents the changes in net assets for governmental and business-type activities:

	Statement of Activities For the Year Ended December 31, 2004					
	Governmental Activities		Business-type Activities		Total	
	2004	2003	2004	2003	2004	2003
Revenues:						
Program revenues:						
Charges for services	\$ 91,860	\$ 67,889	\$ 220,309	\$ 205,458	\$ 312,169	\$ 273,347
Operating grants and contributions	52,288	65,751	-	1,537	52,288	67,288
Capital grants and contributions	35,637	19,793	-	-	35,637	19,793
General revenues:						
Property taxes	124,485	109,340	-	-	124,485	109,340
Property tax increment	64,118	67,506	-	-	64,118	67,506
Franchise fees	25,112	24,083	-	-	25,112	24,083
Convention center taxes	52,169	48,908	-	-	52,169	48,908
Other taxes	273	341	-	-	273	341
Local government aid	81,722	88,818	-	-	81,722	88,818
Grants and contributions not restricted to programs	-	2,689	-	-	-	2,689
Unrestricted interest and investment earnings	6,152	14,251	1,236	2,181	7,388	16,432
Miscellaneous	1,031	20,500	2,270	4,786	3,301	25,286
Total revenues	534,847	529,869	223,815	213,962	758,662	743,831
Expenses:						
General government	75,530	123,139	-	-	75,530	123,139
Public safety	202,334	168,976	-	-	202,334	168,976
Public works	20,691	68,296	-	-	20,691	68,296
Culture and recreation	49,968	26,346	-	-	49,968	26,346
Health and welfare	9,905	23,502	-	-	9,905	23,502
Community & economic development	105,676	107,061	18,551	14,962	124,227	122,023
Interest on long-term debt	56,283	44,014	-	-	56,283	44,014
Sewer	-	-	53,690	56,746	53,690	56,746
Solid waste and recycling	-	-	26,007	23,568	26,007	23,568
Water works	-	-	50,683	46,757	50,683	46,757
Municipal parking	-	-	67,195	62,832	67,195	62,832
Total expenses	520,387	561,334	216,126	204,865	736,513	766,199
Excess (deficiency) before transfers	14,460	(31,465)	7,689	9,097	22,149	(22,368)
Transfers	8,544	7,308	(8,544)	(7,308)	-	-
Change in net assets	23,004	(24,157)	(855)	1,789	22,149	(22,368)
Net assets - January 1,	188,485	212,642	560,313	558,524	748,798	771,166
Net assets - December 31,	\$ 211,489	\$ 188,485	\$ 559,458	\$ 560,313	\$ 770,947	\$ 748,798

Governmental Activities—Governmental activities increased the City’s net assets by \$23,004, compared to a decrease of \$24,157 in 2003.

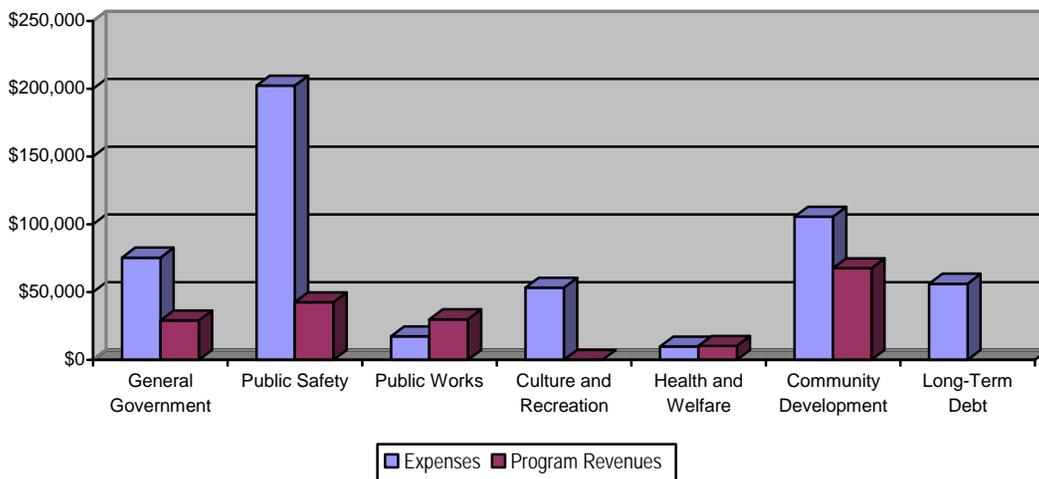
(All dollar amounts are expressed in thousands unless otherwise indicated.)

Governmental activities are supported by charges for services, grants, and contributions. Additionally, general revenues cover any net expense after program specific revenues are applied. In 2004, the City relied primarily on taxes and local government aid for funding governmental activities. Specifically, property tax increment revenues supported economic development activities.

A significant expense in the statement of activities, compared to the fund statements, is depreciation. Current year depreciation for governmental activities was \$35,669.

**Summary of expenses and program revenues - Governmental Activities
For the Year ended December 31, 2004**

Functions/Programs	Expenses	Program Revenues	Net(Expense) Revenue by Program
General government	\$ 75,530	\$ 29,123	\$ (46,407)
Public safety	202,334	42,515	(159,819)
Public works	20,691	30,014	9,323
Culture and recreation	49,968	27	(49,941)
Health and welfare	9,905	10,398	493
Community & economic development	105,676	67,708	(37,968)
Long-term debt	56,283	-	(56,283)
	<u>\$ 520,387</u>	<u>\$ 179,785</u>	(340,602)
General revenues supporting governmental activities			<u>363,606</u>
Change in net assets			23,004
Net assets - January 1,			<u>188,485</u>
Net assets - December 31,			<u>\$ 211,489</u>



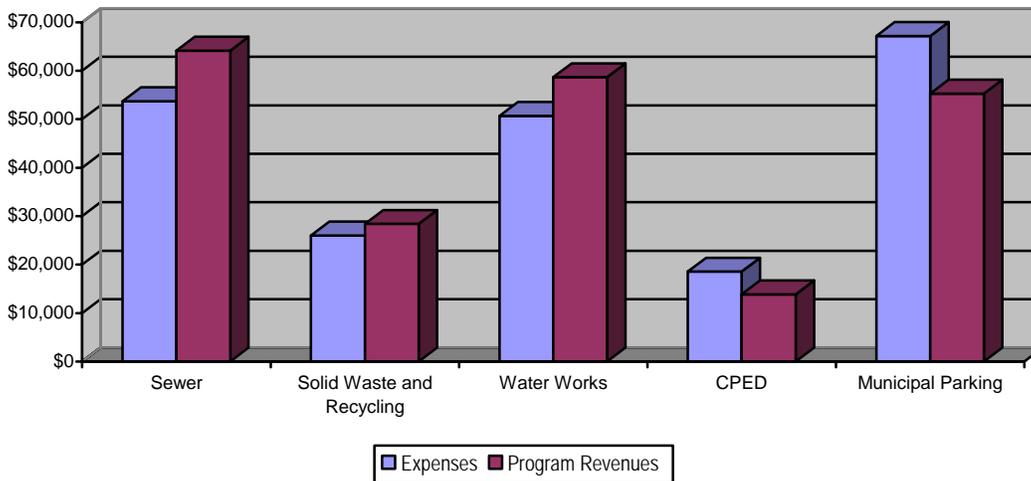
Business-Type Activities—Business-type activities decreased the City’s net assets by \$855 in 2004, compared with an increase of \$1,789 in 2003. The Sewer, Solid Waste and Recycling, and Water Works funds experienced increases in net assets. However, the Municipal Parking and Community Planning and Economic Development (CPED) funds ended the year with decreases in net assets. Decreases in the

(All dollar amounts are expressed in thousands unless otherwise indicated.)

Municipal Parking Fund were due primarily to local economic conditions, causing fewer parkers in the ramps, and an increase in long-term debt. The CPED fund's decrease in net assets was primarily the result of debt related expenses.

**Summary of Expenses and Program Revenues - Business-Type Activities
For the Year ended December 31, 2004**

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Program Revenues</u>	<u>Net (Expense) Revenue by Program</u>
Sewer	\$ 53,690	\$ 64,132	\$ 10,442
Solid waste and recycling	26,007	28,396	2,389
Water works	50,683	58,669	7,986
Community & economic development	18,551	13,838	(4,713)
Municipal parking	67,195	55,274	(11,921)
	<u>\$ 216,126</u>	<u>\$ 220,309</u>	4,183
General revenues supporting business-type activities			<u>(5,038)</u>
Change in net assets			<u>(855)</u>
Net assets - January 1, 2004			<u>560,313</u>
Net assets - December 31, 2004			<u>\$ 559,458</u>



FINANCIAL ANALYSIS OF THE CITY'S FUNDS

As noted earlier, the City of Minneapolis uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds—The general government functions are contained in the General, Special Revenue, Debt Service, and Capital Project Funds. The focus of the City's governmental funds is to provide information on near term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the City's financial requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

(All dollar amounts are expressed in thousands unless otherwise indicated.)

During 2004, four governmental funds including the General Fund are presented as major funds. These funds include two Special Revenue Funds (Community Planning and Economic Development Fund, and Convention Center Fund), and the Permanent Improvement Capital Projects Fund.

At December 31, 2004, the City's governmental funds reported combined ending fund balances of \$477,360, a decrease of \$22,779 compared with the prior year. Approximately 52 percent of this total amount, \$245,827, constitutes unreserved fund balance, which is available for spending at the City's discretion. The following represents the amounts of unreserved balances by various fund types:

<u>Fund Type</u>	<u>Unreserved Balance</u>
General fund	\$ 60,472
Special revenue funds	93,908
Debt service funds	49,028
Capital projects	<u>42,419</u>
Total	<u>\$ 245,827</u>

The remainder of the fund balance is reserved to indicate that it is not available for new spending because it has already been committed 1) to liquidate contracts and purchase orders of the prior period (\$48,077), 2) to pay for land development and specific projects (\$168,574) or 3) for a variety of other restricted purposes (\$14,882).

The following tables provide an overview of revenues by source and expenditures by function for all governmental funds, from 2003 to 2004:

<u>Revenues by Source</u>	Revenues by Source Governmental Funds				Increase (Decrease)
	2004		2003		Amount
	Amount	Percent of Total	Amount	Percent of Total	
Taxes	\$ 265,672	47.87	\$ 248,584	46.38	\$ 17,088
Licenses and permits	24,780	4.46	22,915	4.28	1,865
Intergovernmental revenues	161,820	29.16	164,600	30.71	(2,780)
Charges for services and sales	43,798	7.89	34,192	6.38	9,606
Fines and forfeits	9,641	1.74	8,704	1.61	937
Special assessments	11,091	2.00	10,921	2.04	170
Interest	6,141	1.11	14,455	2.70	(8,314)
Miscellaneous revenue	32,042	5.77	31,603	5.89	439
Total	<u>\$ 554,985</u>	<u>100.00</u>	<u>\$ 535,974</u>	<u>100.00</u>	<u>\$ 19,011</u>

(All dollar amounts are expressed in thousands unless otherwise indicated.)

**Expenditures by Function
Governmental Funds**

Expenditures by Function	2004		2003		Increase (Decrease)
	Amount	Percent of Total	Amount	Percent of Total	Amount
	General government	\$ 57,557	8.84%	\$ 98,201	15.55%
Public safety	190,638	29.29%	160,750	25.45%	29,888
Public Works	40,049	6.15%	33,542	5.31%	6,507
Culture and recreation	49,968	7.68%	26,346	4.17%	23,622
Health and Welfare	9,403	1.44%	22,856	3.62%	(13,453)
Community & economic development	106,348	16.34%	110,576	17.51%	(4,228)
Capital Outlay	63,365	9.73%	59,714	9.45%	3,651
Debt service - principal retirement	76,175	11.70%	67,329	10.66%	8,846
Debt service - interest payment	57,462	8.83%	52,263	8.28%	5,199
Total	\$ 650,965	100.00%	\$ 631,577	100.00%	\$ 19,388

In 2004, general government expenditures decreased by \$40,644 compared to the previous year. This is primarily due to a reduction in the amount of pension payments made to the Minneapolis Employee Retirement Fund (MERF) (\$39,047) from the Employee Retirement Special Revenue Fund and the reclassification of inspections and licenses and consumer services subfunctions (\$13,416) to the public safety function. Another major difference compared to the previous year is the increase of \$23,622 in the culture and recreation function, due to increased payments to the Library Board from the capital project fund.

The following table provides a summary of assets, liabilities, revenues, expenditures, other financing sources (uses), and fund balances of the various major governmental funds.

**Major Governmental Funds
Summary of Assets, Liabilities, Revenues, Expenditures,
Other Financing Sources (Uses) and Fund Balance**

	General Fund		Special Revenue Funds				Permanent Improvement Capital Project Fund	
	2004	2003	CPED		Convention Center		2004	2003
			2004	2003	2004	2003		
Cash	\$ 64,332	\$ 52,543	\$ 159,362	\$ 167,912	\$ 12,491	\$ 9,049	\$ 2,436	\$ 73,815
Assets	80,921	69,761	259,348	269,711	33,567	27,431	61,026	78,695
Liabilities	19,569	16,214	10,839	12,313	3,643	3,032	18,530	10,930
Revenues	254,034	232,424	102,428	114,811	66,463	61,775	32,927	21,295
Expenditures	227,137	220,690	62,502	83,359	28,982	27,049	111,995	86,831
Other Financing Sources and (Uses)	(19,092)	(4,276)	(48,815)	(54,955)	(31,956)	(34,548)	53,799	104,635
Fund Balances	61,352	53,547	248,509	257,398	29,924	24,399	42,496	67,765

(All dollar amounts are expressed in thousands unless otherwise indicated.)

General Fund:

The General Fund is the general operating fund of the City. As of December 31, 2004, unreserved fund balance in the General Fund was \$60,472, while total fund balance reached \$61,352. The fund balance of the City's General Fund increased by \$7,805 during the current fiscal year. As a measure of the General Fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 26.6% of total fund expenditures, while total fund balance represents 27% of total expenditures. Thus, the year-end fund balance is in compliance with the City's policy of maintaining a minimum fund balance of 10% of current expenditures for the General Fund.

The following table provides the changes in revenues by source from 2003 to 2004.

General Fund Revenues by Source					
Revenues by Source	2004		2003		Increase (Decrease)
	Amount	Percent of Total	Amount	Percent of Total	
Taxes	\$ 111,126	41.66	\$ 88,702	35.04	\$ 22,424
Licenses and permits	24,148	9.05	22,205	8.77	1,943
Intergovernmental revenues	77,469	29.04	88,818	35.09	(11,349)
Charges for services and sales	28,182	10.57	19,980	7.89	8,202
Fines and forfeits	8,910	3.34	8,026	3.17	884
Special assessments	2,628	0.99	2,723	1.08	(95)
Interest	541	0.20	1,432	0.57	(891)
Miscellaneous revenues	1,030	0.39	538	0.21	492
Total revenues	254,034	95.24	232,424	91.82	21,610
Transfers in	12,698	4.76	20,713	8.18	(8,015)
Total revenues and other financing sources	<u>\$ 266,732</u>	<u>100.00</u>	<u>\$ 253,137</u>	<u>100.00</u>	<u>\$ 13,595</u>

In 2004, General Fund revenues and transfers increased slightly from the previous year. Some highlights included:

- Tax revenue increased by \$22,424 or 25%. This increase was primarily due to an increase in general property tax revenue of \$18,259; total assessed market value increased 9.1%. Also, fiscal disparities revenue received by the City allocated to the General fund increased by \$3,268, or 37% in 2004. This increase was due to an increase in the statewide fiscal disparities pool (6%), an increase in the City's share of the statewide pool (8%), and an increase in the general fund's portion of the City's tax levy (7%).
- Intergovernmental revenues decreased by \$11,349 or 13%. The majority of this decrease was accounted for as follows:
 - Local government aid decreased by \$7,525, or 10.2%.
 - Other state aid decreased by \$3,560 or 85%.
 - Low income housing aid decreased by \$473, or 100%.

(All dollar amounts are expressed in thousands unless otherwise indicated.)

The following table provides the changes in expenditures by function from 2003 to 2004.

**General Fund
Expenditures by Function**

Expenditures by Function	2004		2003		Increase/ (Decrease) Amount
	Amount	Percent of Total	Amount	Percent of Total	
General government	\$ 32,123	12.41	\$ 49,402	20.11	\$ (17,279)
Public safety	152,803	59.01	134,331	54.68	18,472
Public works	35,686	13.78	33,542	13.65	2,144
Culture and recreation	900	0.35	-	-	900
Health and family support	3,446	1.33	3,415	1.39	31
Community & economic development	2,179	0.84	-	-	2,179
Total expenditures	227,137	87.72	220,690	89.83	6,447
Transfers out	31,790	12.28	24,989	10.17	6,801
Total expenditures and other financing uses	\$ 258,927	100.00	\$ 245,679	100.00	\$ 13,248

Overall, general fund expenditures increased by \$6,447 or 2.9% from the previous year.

Despite the overall increase, expenditures for the General Fund are less than inflationary measures. This result was primarily due to the various cost reduction actions adopted by the Mayor and City Council in response to the significant reduction in local government aid from the State of Minnesota indicated above, as well as other financial pressures faced by the City from recent economic activity. With these actions to reduce expenditures, spending levels by City departments were 6% below the adopted budgets.

In 2004, transfers-out increased \$6,801 from the previous year. Of this amount, \$3,400 was due to an increase in transfers to the Intergovernmental Internal Service fund for information technology charges and shifts.

General Fund Budgetary Highlights: The final budget for the City's General Fund represents the original budget, any previously appropriated funds set aside for the purpose of honoring legally incurred obligations (prior year encumbrances and commitments), and any additional supplemental appropriations that may occur during the fiscal year. In 2004, the following were significant budget actions:

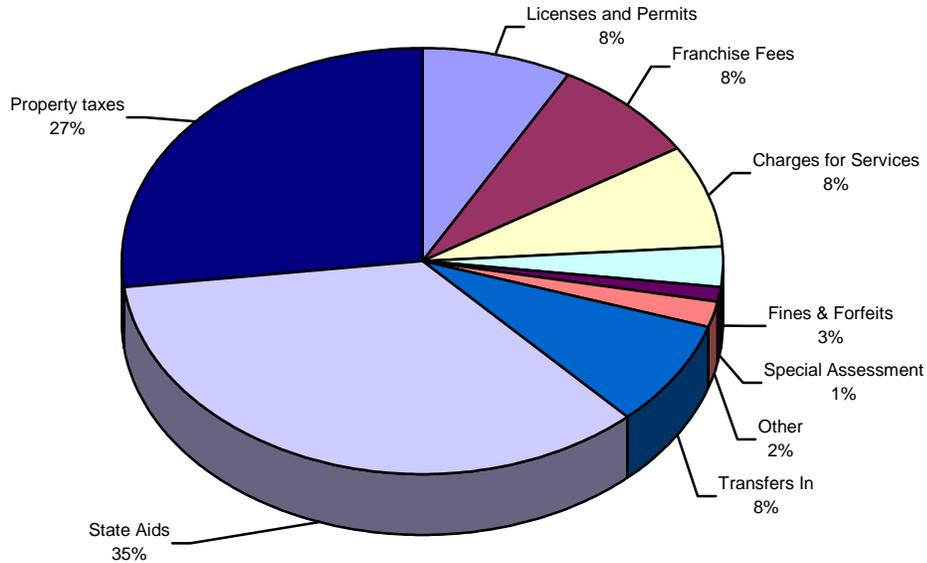
- \$37,000 reduction in local government aid from the state,
- \$12,500 transfer from the Hilton Legacy Fund to reduce pension debt, saving the City \$1,500 in property tax levy obligations by reducing annual debt service payments,
- \$1,000 reduction in the transfer from the Parking Fund to the General Fund, consistent with a workout plan for the Parking Fund, which was approved by the Council in 2004,
- 2.8 percent decrease in total personnel expenditures from \$372,900 to \$362,500, and
- \$32,300 increase in health and dental benefits expenditures, an increase of 3.9 percent.

(All dollar amounts are expressed in thousands unless otherwise indicated.)

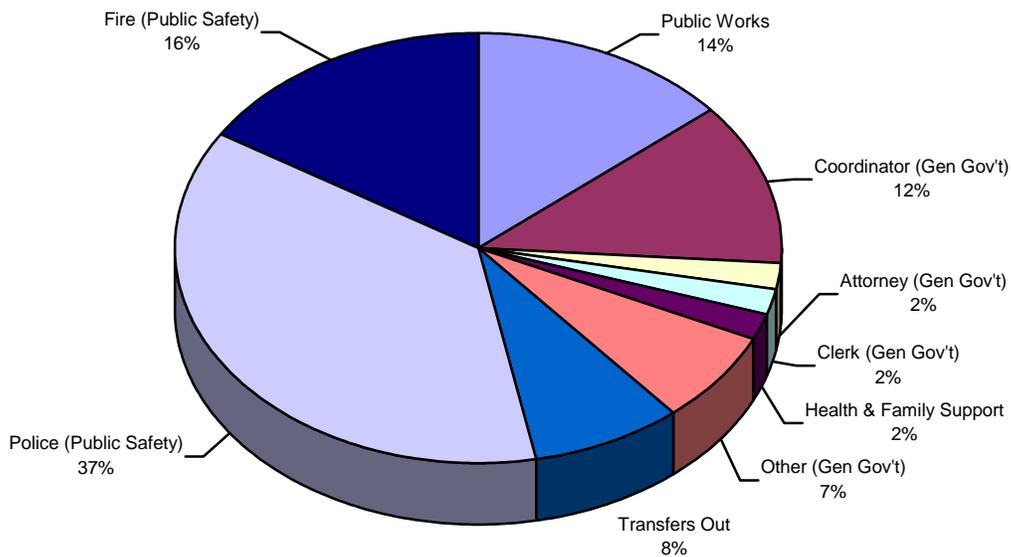
The original General Fund appropriation for fiscal year 2004 was \$264,571, which included projected transfers out of \$29,863. The final appropriation was \$275,922, including transfers out of \$31,790. General revenues and other resources were originally estimated at \$265,322, which included projected transfers in of \$20,500. The final revenue estimate was \$262,082 including transfers in of \$14,100.

Current fiscal year revenue and expenditure budgets for the General Fund by major category or function are as follows:

Revenue Budget by Major Category



Expenditure Budget by Department/Function



(All dollar amounts are expressed in thousands unless otherwise indicated.)

Community Planning and Economic Development (CPED) Special Revenue Fund:

The CPED Special Revenue Fund accounts for governmental fund proceeds that are legally restricted to expenditures for specific purposes in a range of housing and economic development programs. The range of programs operated within this fund are created to increase the City's economic competitiveness, to ensure an array of attractive housing choices, to support strong and diverse neighborhoods, and to preserve the City's historic structures. These programs are financed primarily through federal, state, and local grants, tax increment financing, and administrative fees collected for the issuance of housing and economic development revenue bonds. A development account program provides loans and grants to outside organizations within the City to assist commercial and housing development. The program is capitalized with residual equities and loan payments from development projects.

Total revenues of the CPED Special Revenue fund in 2004 were \$102,428. 62% of the fund's revenue was derived from property tax increment. An additional 11% of the revenue was from intergovernmental grants. The remaining revenue was derived from a variety of miscellaneous sources. The fund's revenue decreased 10.8% in 2004, the result of declining property tax increment collection, the discontinuance of the general property tax levy for development programs, and lower interest earnings. There was a corresponding decline in fund expenditures. The expenditures for this fund in 2004 were \$62,502. The fund's expenditures are primarily for contractual services for the housing and economic programs operated within the fund and for the personnel related costs to monitor and deliver these programs.

In 2004, notes payable in the amount of \$6,500 were issued to support the tax increment financing activities of the fund. There were transfers of \$10,914 into the fund during the year. Nearly all the transfers were pass-through grant proceeds from other City funds. The fund's transfers out of \$66,229 were to provide resources for the debt service of obligations issued by the City for community development programs, and to pay for neighborhood revitalization projects.

At year-end, the fund balance was \$248,509, a decline of 3.5% from the previous year. This decrease was primarily due to the use of fund resources to meet debt service requirements, and the disposition of land held for development. The unreserved portion of the fund balance at December 31, 2004 was \$65,208. The remaining fund balance was reserved primarily for property held for development, encumbrances, or for specific development projects.

Minneapolis Convention Center Special Revenue Fund:

Operations of the Minneapolis Convention Center are reported as a Special Revenue Fund in the fund statements. The Convention Center activity is funded from local taxes and Convention Center operating revenue. Local taxes for convention center activities include:

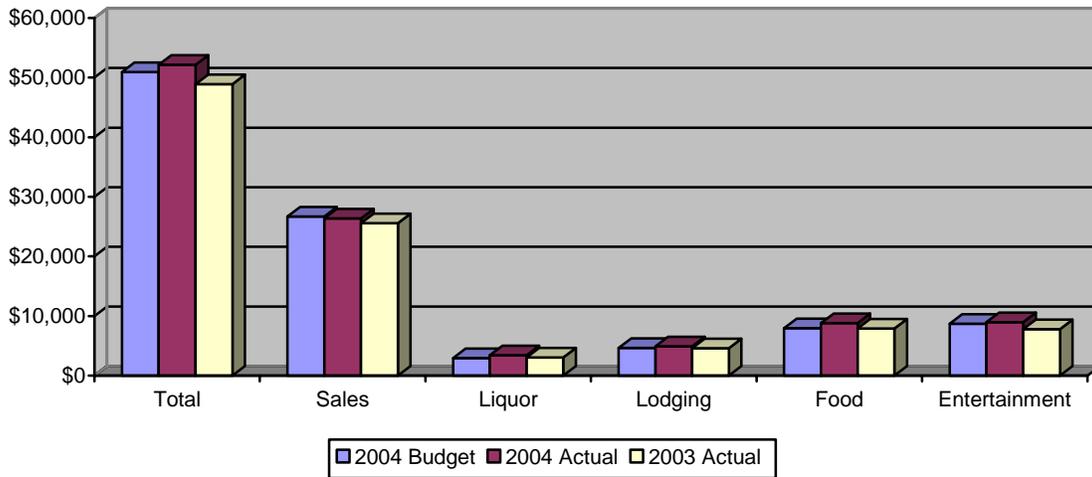
- .5 % citywide sales tax;
- 3 % food and liquor tax applied to core downtown establishments;
- 3 % citywide entertainment tax;
- 3 % citywide lodging tax for motels and hotels with 50 units or more.

Overall, tax proceeds for 2004 exceeded 2003 levels by 7%, with sales taxes exceeding 2003 levels by 3%.

**Minneapolis Convention Center
Tax Revenue - Budget and Actual**

Taxes	2004		2003
	Budget	Actual	Actual
Sales	\$ 26,047	\$ 26,366	\$ 25,562
Liquor	2,843	3,432	3,065
Lodging	4,545	4,899	4,595
Food	7,754	8,802	7,907
Entertainment	8,470	8,670	7,779
Total	<u>\$ 49,659</u>	<u>\$ 52,169</u>	<u>\$ 48,908</u>

**Minneapolis Convention Center
Tax Revenue - Budget and Actual**



During 2004, the Convention Center negotiated contracts for a business center and wireless internet services to attract and retain customers and add to revenue commissions. Total revenues of the Convention Center increased 8% in 2004. In addition to revenue increasing, expenditures and transfers out were under budget by 10%. According to the final budget, the Convention Center Fund was to decrease by 17%. However, with the cost saving measures implemented at the Convention Center and a \$5,600 savings of debt service payments due to low interest rates on variable rate debt, the revenue increases and expenditure savings resulted in a \$5,525 increase in the fund balance, with a total fund balance at December 31, 2004 of \$29,924.

Permanent Improvement Capital Project Fund:

Revenues for the Permanent Improvement Capital Project Fund are derived primarily from two sources. One source consists of bonds that are issued by the City for capital projects. The other source comes from the State of Minnesota. State aid revenues are primarily used for capital assets including bridges, streets, street lighting, traffic signals and other specific projects.

(All dollar amounts are expressed in thousands unless otherwise indicated.)

The Permanent Improvement Fund is used to build infrastructure for the City including bridges, streets, traffic signals, street lights, and fund other capital projects. During 2004, \$63,365 of capital outlays occurred. The key assets constructed with these funds included:

- Bridges - \$2,875
- Streets - \$17,140
- Street lighting - \$2,238
- Traffic signals - \$2,903
- Bike trails- \$1,304
- Convention Center expansion - \$173
- Heritage Park - \$14,755
- Property Service \$7,940

The fund balance decreased from \$67,765 in 2003 to \$42,496 in 2004. This decrease was due to the issuance of bonds in 2003 for the construction of the new library that were used during 2004.

Proprietary Funds—The City’s proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail.

As discussed previously, the City reports two types of proprietary funds - enterprise funds and internal service funds. The following sections describe the key balances and transactions for the different fund types.

Enterprise Funds:

The City operates five enterprise funds: Sewer Rental, Solid Waste and Recycling, Water Works, Community Planning and Economic Development (CPED), and Municipal Parking.

Overall, the enterprise funds had a positive net asset balance of \$574,692 at December 31, 2004. Total net assets for all enterprise funds increased by \$3,730 during 2004.

The following table provides a summary of the changes in cash balances, total assets, total liabilities, operating income, changes in net assets, and net asset balances for each of the enterprise funds, from 2003 to 2004:

Enterprise Funds
Account Balances and Operating Activities

	<u>Sewer Rental</u>		<u>Solid Waste & Recycling</u>		<u>Water Works</u>		<u>CPED</u>		<u>Parking</u>		<u>Totals</u>	
	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003
Cash	\$ 8,963	\$ 14,265	\$ 12,785	\$ 10,675	\$ 4,103	\$ 14,473	\$ 5,811	\$ 4,265	\$ 5,094	\$ 15,569	\$ 36,756	\$ 59,247
Assets	346,090	343,015	20,031	18,389	236,798	197,992	149,153	159,067	361,433	363,152	1,113,505	1,081,615
Liabilities	48,032	48,461	2,190	2,036	106,645	72,628	90,197	96,007	291,749	291,521	538,813	510,653
Operating Income (loss)	5,967	3,131	2,107	3,683	8,700	15,730	(2)	1,564	1,079	3,590	17,851	27,698
Change in net assets	3,504	889	1,488	3,141	4,789	13,752	(4,104)	(787)	(1,947)	(8,602)	3,730	8,393
Net Assets	298,058	294,554	17,841	16,353	130,153	125,364	58,956	63,060	69,684	71,631	574,692	570,962

Sewer Rental Fund

The Sewer Rental Fund accounts for contractual payments to the Metropolitan Council Environmental Services (MCES) for sewage interceptor and treatment services. This fund also accounts for storm water management activities, including the Combined Sewer Overflow (CSO) program, which separates the remaining storm sewer lines that are connected to sanitary sewer lines. The decrease in cash is partially due to a temporary year-end loan of \$8,402 to fund the cash deficit in the Municipal Parking Fund. A change in the procedure of recognizing bond proceeds for construction purposes also contributed to the decrease. The Sewer Rental Fund had an increase in net assets of \$3,504 for 2004. Operating revenues increased \$3,392 from the previous year. Fee increases accounted for \$1,100 of the increase, which is less than what was budgeted due to lower than expected water consumption (sewer rates based on water consumption). The remainder of the revenue increase can be attributed to state grants and overhead reimbursements from projects. Operating expenses increased by \$556 over the previous year. Overall, the net asset balance as of December 31, 2004 was \$298,058.

Solid Waste and Recycling Fund

The Solid Waste and Recycling Fund accounts for solid waste collection, disposal and recycling operations. The fund also includes “clean city” activities such as neighborhood clean sweeps, litter and graffiti removal, and litter control in the business districts. City crews provide approximately one-half of the solid waste collection services, while the remaining services are provided through contracts with private operators. The fund reported an increase in net assets of \$1,488 for 2004. The fund’s net asset balance at December 31, 2004 was \$17,841.

Water Works Fund

The Water Works Fund accounts for the operation and maintenance of a water delivery system for the City and several suburban city customers. The City sells water directly to the cities of Bloomington, Columbia Heights, Hilltop, Golden Valley, New Hope, Crystal, and Edina. Net assets increased \$4,789 for the year, resulting in a net asset balance at December 31, 2004 of \$130,153.

Community Planning and Economic Development Enterprise Fund (CPED)

The CPED Fund operates a series of business-type activities designed to enhance housing options and economic development within the City. Within this fund there are programs that provide low interest home mortgages financed through the sale of bonds. There is also a program in which revenue bonds are issued to finance economic development. The program obtains lease or loan agreements from developers to meet the debt service requirements of the financing. This fund also operates a river terminal facility and three downtown theatres. Substantially all operating revenues are derived from fees charged to the

(All dollar amounts are expressed in thousands unless otherwise indicated.)

users of the services provided. The river terminal and the theatres account for the investment in capital assets of the fund.

Both total assets and total liabilities declined from 2003 to 2004, as fund resources were used to reduce long-term debt in mature mortgage programs.

Net assets decreased by \$4,104 during the year. Both the theatres' operation and the river terminal facility experienced losses in 2004. Operating revenues of the river terminal facility were down 36%. In addition, there was a substantial reduction in interest earned on investments for the year.

Municipal Parking Fund

The Municipal Parking Fund accounts for the operation and maintenance of parking ramps, lots, on-street parking meters, a municipal impound lot, and traffic/parking control system. Operating revenues increased \$2,308 from 2003, but a \$4,819 increase in operating expenses for the same period resulted in a decrease of \$2,511 in operating income from the previous year. Transfers from the Parking Fund to other funds decreased by \$7,263, including a one-time \$6,400 reduction in transfers to the General Fund as approved in the work out plan. The year-end operating cash deficit was funded by an \$8,402 loan from the Sewer Fund. The decrease in total year-end cash balance and the increase in expenses for the year are mainly due to an \$8,500 payment made to the State of Minnesota from the Fund's revenue and restricted net assets pertaining to Third Avenue Distributor Garages, which are owned by the State but operated by the City. The net asset balance for December 31, 2004 was \$69,684, which is a decrease of \$1,947 from 2003.

A parking fund financial plan was developed to address declining results of operations and cash deficits within the fund. The plan includes a business strategy to address the diminishing use of City parking facilities; updates to aging revenue control equipment; management practices; maintenance to prevent future capital expense; and a strategy to maximize revenue on the existing programs. During 2004, as part of a workout plan, initiatives such as automation and centralization of operations and security systems have been implemented. Regarding on-street parking, management has addressed issues such as new meter rates and enforcement times.

Internal Service Funds:

The City operates six internal service funds: Engineering Materials and Testing; [Intergovernmental Services](#); Property Services; Equipment Services; Public Works Stores; and the Self Insurance fund. Internal service funds charge user fees to recover the cost of operations and accumulate equity for purposes of maintaining the on-going operations provided to the government.

While the financial condition of the internal service funds continue to represent a major financial challenge for the City, key financial management measures taken in 2001 appear to have marked a turning point for these funds. Over the last eight years, the financial condition of these funds has deteriorated, reaching a low point at year-end 2000 when the combined net asset deficit had declined to (\$54,407). In 2002, the operational loss trends were arrested, and the combined net asset deficit in the internal service funds improved to (\$32,215). This improvement resulted primarily from a change in accounting principle and prior period adjustments of \$17,555 from 2001, resulting from the implementation of GASB Statement No. 34. The restatement resulted in recognizing assets previously unrecorded within the internal service funds.

Compared to the net asset deficit of (\$54,407) in 2000, net assets improved by \$25,497 to (\$28,910) at the end of 2004.

(All dollar amounts are expressed in thousands unless otherwise indicated.)

The following table provides a summary of cash balances, total assets, total liabilities, operating income, changes in net asset and net asset balances for each of the internal service funds:

Internal Service Funds
Account Balances and Operating Activities

	Engineering Materials & Testing	Inter- govern- mental Services	Property Services	Equipment Services	Public Works Stores	Self Insurance	Total	
	2004	2004	2004	2004	2004	2004	2004	2003
Cash	\$ 633	\$ -	\$ 341	\$ 1,752	\$ -	\$ 299	\$ 3,025	\$ 2,111
Assets	726	26,390	41,890	61,035	3,683	1,258	134,982	129,454
Liabilities	126	63,877	11,814	47,769	1,068	39,238	163,892	163,417
Operating Income(loss)	(229)	(18,704)	(547)	(648)	148	(5,533)	(25,513)	(33,553)
Changes in net assets	(180)	2,307	(152)	(59)	134	3,003	5,053	(3,777)
Net Assets	600	(37,487)	30,076	13,266	2,615	(37,980)	(28,910)	(33,963)

Engineering Materials and Testing Fund

This fund is used to account for operations of the City's engineering laboratory testing and inspection services, along with the purchases of asphalt and ready-mix concrete. In 2003, the City Council took action to indefinitely discontinue operations of the asphalt plant. As a result, the Fund continues to account for outside purchases of asphalt and ready-mix concrete.

As a result of discontinuing operations of the asphalt plant, certain assets were disposed, resulting in a loss of \$709 in 2003. The fund again reported a net asset decrease of \$180 in 2004. As a result of these two years of losses, the net asset position of the Fund as of December 31, 2004, is \$600, down from a more favorable position of \$1,489 at the end of 2002.

Intergovernmental Services Fund

This Fund accounts for information technology services, central mailing and printing services, and telecommunication operations. In 2003, the fund's beginning net asset balance was restated by \$7,866 to reflect corrections made to accurately present the fund's capital assets, accumulated depreciation, and related liability amounts. This positive adjustment reduced the beginning net asset deficit from (\$40,850) to (\$32,984). A loss in 2003, coupled with a net asset increase of \$2,307 in 2004, leaves the net asset deficit at (\$37,487). This (\$4,503) reduction in net assets between January 1, 2003 and December 31, 2004 compares closely to the (\$4,461) reduction from the deficit reduction plan for the same time period.

Property Services

This fund accounts for the City's property and maintenance, including parking ramp maintenance, security, and space and asset management. During 2002, some of the City's properties were transferred to this fund from governmental funds, resulting in additional depreciation expense being incurred. Currently, the Property Services Fund does not have rental and other recovery rates sufficient to fully cover depreciation, which has resulted in a net asset decrease of \$152 for 2004. The net asset balance decreased to \$30,076 at the end of 2004.

(All dollar amounts are expressed in thousands unless otherwise indicated.)

Equipment Services

The Equipment Services Fund is used to account for the City's fleet of vehicles and related equipment and accessories. The fund reported a decrease in net assets of \$59 in 2004 and closed the year with a net asset balance of \$13,266.

A decision to accelerate the purchase of fire equipment added an additional \$3.5 million in bonds issued for this fund in 2003, which was offset by a corresponding decrease to the bonds sold in 2004 and 2005. There is an incentive for the customer to take care of the equipment or vehicles in the newly devised plan implemented in 2004, which charges actual expenses related to their vehicles.

Public Works Stores

This fund is used to account for the centralized procurement, warehousing, and distribution of stocked inventory items, and the purchase of special goods and services. For 2004, the fund reported a net asset increase of \$134, with an ending net asset balance of \$2,615.

Self Insurance

This fund accounts for employee medical, dental, and life insurance benefits programs; occupational health services; severance payments; tort liability program; workers' compensation program; and the related administrative costs. Net assets increased \$3,003 in 2004, which benefited the fund's net asset position by reducing the total net asset deficit balance to \$(37,980) at year-end.

BUDGET PROCESS:

In preparation for the 2004 budget, the Mayor and City Council continued to take a long-term view of the City's financial pressures. Significant future costs were anticipated for funding gaps in the City's pension obligations and in its internal service funds. Another factor was employee wages and benefits, which make up about 75 percent of the City's general fund expenses. Health care costs are increasing and, during the past five years, City employees received pay increases that averaged greater than four percent annually. In 2000, Minneapolis voters approved a levy to build a new Central Library and fund improvements to the community libraries. Minneapolis also has significant pressures on its general city resources due to reductions in local government aid (LGA) from the state, beginning in 2003.

Increased pension costs associated with City's three closed pension plans - Minneapolis Employee Retirement Fund (MERF), Minneapolis Fire Relief Association (MFRA), and Minneapolis Police Relief Association (MPRA) - continues to have a significant impact on the budget. The City's contributions to these funds have significantly increased, due to increased costs associated with these three plans. MERF members have been retiring at a faster pace and at higher costs than originally forecast by MERF actuaries. The City has been issuing general obligation bonds since 2002 to cover the estimated costs of retirement and expects to continue issuing bonds for these costs. The MPRA's unfunded liability has also increased, primarily due to the negative performance of the stock market. The City has to increase its contribution to cover the unfunded liability by issuing bonds. The MFRA, although previously 100 percent funded, now is experiencing a reduction in its funding levels due to poor investment performance. The City will have to issue bonds, starting in 2005, to increase its contributions for this funding shortage.

A major part of the budget planning efforts concentrated on consolidating all demands on the property tax into a ten-year projection. In order to continue to fund all of the City's current operations and debt service obligations, it is estimated that property tax revenues collected by the City would have to triple by 2010. (This increase does not include revenue to provide additional services - these amounts reflect commitments for current programs only.) In this context, in July 2002, the elected officials adopted a property tax policy, which limited annual increases for the City's share of property taxes to a maximum of 8%. Half of this increase is dedicated to supporting the City's debt payments for increased pension

(All dollar amounts are expressed in thousands unless otherwise indicated.)

obligations, internal service fund deficits, and increased library capital projects as called for in a voter approved referendum in 2000. The other half of the increase is for the cost of providing existing services. This policy was also adopted by the City's Board of Estimate and Taxation, thus capping the annual operating increase for the Minneapolis Park and Library boards at 4%. These policies remained in place for 2004.

The Mayor's recommended 2005 budget also relies on the 2002 tax policy and a five-year financial outlook. The Mayor and City Council conducted strategic planning in the fall of 2002, setting goals and expectations for departments. In January 2003, the Mayor and City Council adopted a five-year financial direction and commitment to business planning. This direction established resource constraints within which departments were to prepare business plans for providing services with reduced funding. The combination of reduced spending and limited growth in property taxes addressed the City's existing challenges. The elected officials also adopted a 2% cap on wage increases for City employees.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets:

The City's investment in capital assets for its governmental and business-type activities, as of December 31, 2004, was \$1,818,927 (net of accumulated depreciation). This investment in capital assets includes land, buildings and systems, improvements, machinery and equipment, roads, highways, and bridges. The total increase in the City's investment in capital assets for the current fiscal year was 7% (an 8.5% increase for governmental activities and a 5.5% increase for business-type activities).

The following table summarizes capital assets for governmental and business-type activities for 2004 and 2003:

	Capital Assets (Net of depreciation)					
	<u>Governmental</u>		<u>Business-Type</u>		<u>Total</u>	
	2004	2003	2004	2003	2004	2003
Land and easements	\$ 111,288	\$ 111,291	\$ 136,425	\$ 136,425	\$ 247,713	\$ 247,716
Infrastructure	122,478	134,252	261,043	265,613	383,521	399,865
Construction in progress	169,993	88,240	157,360	110,193	327,353	198,433
Structures and improvement	418,775	424,011	373,176	365,897	791,951	789,908
Equipment	<u>60,617</u>	<u>55,920</u>	<u>7,772</u>	<u>8,730</u>	<u>68,389</u>	<u>64,650</u>
Total	<u>\$ 883,151</u>	<u>\$ 813,714</u>	<u>\$ 935,776</u>	<u>\$ 886,858</u>	<u>\$ 1,818,927</u>	<u>\$ 1,700,572</u>

Major capital asset transactions and events during the current fiscal year included:

- In 2002, the Water Department began an ultra filtration program with projected costs of approximately \$144,900 (expected completion date of 2007). This new system of water filtration will give the City's water system necessary plant improvements. The ultra filtration program is the most extensive program that the Water Department has ever started.
- The Parking Fund began construction on the Guthrie and Mill Quarter ramps in 2004.
- The new Central Library Project started in 2002 with a budget of about \$125,826. The library project is in the construction stage and will be located on the same block as the old library. Construction of the new library began in 2003, with completion scheduled for 2006.

(All dollar amounts are expressed in thousands unless otherwise indicated.)

- During 1998, the City embarked on a \$72,350 nine-year flood control program. This program targets specific areas in the City and creates holding ponds and additional storm drains that are designed to mitigate the effects of flash floods.
- In 1998, the City began the Supervisor Control and Data Acquisition (SCADA) program for the Water Department. The SCADA program automates the water control system from one point so that all gates, pumps, monitors, and controls will be in one controlled area. The SCADA project is expected to exceed the original estimated cost by \$5,800, due to security and increased concerns over levels of monitoring and automation. Total project costs are estimated to be \$18,800, with completion in 2005.
- The Heritage Park project has a budget of \$76,605, with costs to date totaling \$48,442. This project has an estimated completion date of 2007. The Heritage Park project is for the affordable housing, environmental recommitment, and neighborhood-scaled development.

Long-Term Debt:

As of December 31, 2004, the City had total long-term bonds outstanding of \$1,394,028 compared to \$1,390,820 in the prior year. Of this amount, \$966,370 related to governmental activities and \$427,668 related to business activities. The City had \$247,670 or 17.8% of the outstanding bonds in variable rate mode at year-end. In addition to bonded debt, the City had \$94,145 of long-term revenue notes outstanding at December 31, 2004, of which \$41,988 related to governmental activities and \$52,157 related to business activities.

The table below shows various classifications of the City's bonded debt at December 31, 2004 and the amount of principal due in 2005.

Summary of Outstanding Bonded Indebtedness

	<u>Balance</u> <u>1/1/2004</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance</u> <u>12/31/2004</u>	<u>Due in 2005</u>
General Obligation (GO) Bonds:					
Property Tax Supported	\$ 222,390	\$ 74,530	\$ 28,805	\$ 268,115	\$ 27,345
Self Supporting	274,230	39,740	47,170	266,800	8,460
Special Assessment	43,683	10,240	4,625	49,298	5,421
Tax Increment	214,440	-	8,130	206,310	9,350
Internal Service Fund Related	102,615	8,990	10,450	101,155	12,140
Enterprise Fund Related	374,243	33,830	51,795	356,278	29,683
Total General Obligation Bonds	<u>1,231,601</u>	<u>167,330</u>	<u>150,975</u>	<u>1,247,956</u>	<u>92,399</u>
Revenue Bonds:					
Economic Development	77,102	11,470	13,890	74,682	12,962
Other Community Development Related Bonds	82,117	2,475	13,202	71,390	3,080
Total Outstanding Bonds	<u>\$ 1,390,820</u>	<u>\$ 181,275</u>	<u>\$ 178,067</u>	<u>\$ 1,394,028</u>	<u>\$ 108,441</u>

The City maintained an "AAA" rating from Standard & Poor's and Fitch and an "Aa1" rating from Moody's for its general obligation debt throughout 2004.

Additional information on the City's long-term debt can be found in Note 5 on pages 59-63 of this report.

(All dollar amounts are expressed in thousands unless otherwise indicated.)

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

Budget Outlook:

The City's future financial outlook is strong, but will require continued diligence in the management of significant funding pressures, including personnel costs, pension obligations, and internal service fund debt. The City has several policies in place to help address these pressures.

With the 2005 Budget, the City adopted a revised five-year financial direction, including a two percent wage policy. Specifically, growth in salary and wages are budgeted at two percent. Health and dental insurance expenditures are budgeted to increase 12 percent from the 2004 adopted budget, from \$32.3 million to \$36.2 million. The five-year financial direction includes an estimated 19 percent annual benefit increase for departments.

Increases in the City's pension liabilities continue to put pressure on the City's financial situation. With obligations of approximately \$180 million in the next five years, the City currently issues bonds to meet its pension obligations. The 2005 budget includes an increase of \$2.3 million over the 2004 budget to meet additional debt service requirements for these obligations. The City is pursuing legislative changes to the structure of its payments to the Minneapolis Employees Retirement Fund (MERF), which, if adopted, would end the practice of bonding for the pension payments.

Although the City continues to have a deficit in its Internal Service Funds, future budgets will continue to address these deficits through the Council-adopted workout plans. The 2005 budget includes an additional \$3.9 million in funding for internal city services: self insurance (*i.e.*, workers compensation, general liability), equipment services (squad cars, fire trucks, and computers), and information technology services. The Equipment Services Fund is no longer experiencing a deficit.

Economic Outlook and Tax Trends

Minneapolis has historically had a strong commercial and industrial tax base. For taxes payable in 1996, Minneapolis commercial and industrial property paid 54.7 percent of the total taxes for the city, with the central business district alone paying almost 40 percent. After the 2001 property tax changes, for taxes payable in 2005, the proportion of taxes paid by commercial and industrial tax payers declined to 38.1% of the City's total, with the central business district paying approximately 28 percent. For property taxes payable in 2010, the commercial/industrial share of taxes is projected to further decline, to a level of 34.1 percent. Corresponding percentages for residential property (defined as 1-3 dwelling units) show that this class paid 33.6 percent of the city's taxes in 1996, increasing to 43.7 percent for taxes payable in 2005, and projected to be 56.3 percent for taxes payable 2010. This represents almost a complete reversal in the share of the City's tax burden between the two property types. This shift highlights the local property tax burden on the residential homeowner.

Downtown Office Space—Vacancy Rate:

Because of the importance of real estate taxes as a source of local government revenue, real estate statistics are an important economic gauge for municipalities. Several commercial real estate companies compile and report real estate statistics. Colliers International reports on local real estate conditions twice annually. Collier's statistics indicate an increase in vacancy rates in the Minneapolis Central Business District (CBD). Compared to 2003, the CBD Direct vacancy rate in 2004 increased from 17.3% to 21.2%. However, the overall vacancy rate for the Twin Cities Office market went down slightly from the 2003 rate of 18.9% to 18.2%.

Lower rental rates, excess space, and higher concessions imply lower cash flows from office buildings, which, in turn, lowers their taxable value. Lower taxable values on business properties increases the amount of the real estate tax levy borne by residential properties. These factors were considered in preparing the City's budget for the 2004 fiscal year.

The downtown office vacancy rate continues to exacerbate the financial problems of the City's Parking Fund. The City Council adopted a workout plan in 2004 to address the deficiencies in this fund.

Employment:

The unemployment rate for the City of Minneapolis at the end of 2004, as released by the Minnesota Department of Employment and Economic Development, is 4.4%. This economic indicator is on par with comparisons including the State of Minnesota (4.3%) and the national unemployment rate (5.1%).

REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of the City of Minneapolis' finances. Questions concerning any of the information provided in this report or the requests for additional financial information should be addressed to the City's Finance Officer at The City of Minneapolis, 350 South Fifth Street, Minneapolis, Minnesota, 55415. The annual financial report is also available on-line at www.ci.minneapolis.mn.us.