

**What Drives the Property Tax?**  
**A Holistic Examination of City and County Budgets in Minnesota**

Aaron Twait and Mark Haveman

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**Lincoln Institute of Land Policy**  
**Working Paper**

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**Lincoln Institute Product Code: WP09AT1**

## **Abstract**

Property tax levy increases are a policy concern for state and local governments nationally. It is conceptually appealing to examine state-level aggregate data to discern trends and explanations for increases. However, aggregate level can distort what is actually happening in the unique budgeting context of individual local governments. The difficulty of reasonably assigning responsibility for property tax increases to the independent but interconnected part of the system adds to the confusion. This research explores these issues, looking at budget materials for two counties and six cities in Minnesota over a five-year period. We confirm that cities and counties responded very differently to state aid cuts. We find that changes in property valuation had significant impacts for how new property tax levies were distributed in urban areas. We also find that spending increases have largely been driven by health care and retirement costs, and mandated spending in the case of counties. We conclude that an understanding of the root causes of property tax increases remains far beyond the capacity of most citizens, absent a desire by local government officials to foster it.

## About the Authors

**Aaron Twait** is Research Director of the Minnesota Taxpayers Association. He served as the Association's Research Associate from 2003-2006 and as Research Director since 2008. He has also worked in the Minnesota Department of Revenue's Tax Research Division. He received his B.A. from the University of Iowa and an M.P.P. from the University of Minnesota.

**Mark Haveman** is Executive Director of the Minnesota Taxpayers Association. He joined the organization in 2002 as part of an effort to revitalize its research and education arm, the Minnesota Center for Public Finance Research. Previously, Haveman was vice president of a policy and technology consulting firm specializing in environmental protection and resource conservation issues. He has also served on policy and project advisory boards for the U.S. Environmental Protection Agency, the National Institute for Standards and Technology, as well as for several state agencies, academic institutions, and private foundations. He received his B.A. from Calvin College and an MBA from the University of Michigan.

### **Aaron Twait**

Research Director  
Minnesota Taxpayers Association  
85 E. 7<sup>th</sup> Place, Ste 250  
Saint Paul, MN 55101  
651-224-7477 ext 104  
atwait@mntax.org

### **Mark Haveman**

Executive Director  
Minnesota Taxpayers Association  
85 E. 7<sup>th</sup> Place, Ste 250  
Saint Paul, MN 55101  
651-224-7477 ext 102  
mhaveman@mntax.org

We thank the Lincoln Institute of Land Policy and the National Association of Industrial and Office Properties, Minnesota Chapter, for financial support of this research. We thank Lindsay Alexander for her substantial contributions with regard to the cities of Minneapolis and Saint Paul. We thank Lori Lewandowski for excellent research assistance.

**Table of Contents**

Introduction..... 1

Methodology..... 2

City of Minneapolis: Paying for Past Mistakes ..... 4

City of Saint Paul: Anything But Property Taxes..... 10

City of Eden Prairie: You Can't Lose What You Don't Get ..... 14

City of Albert Lea: Lots of Eggs in the General Purpose Aid Basket ..... 19

City of Brainerd: Keeping the Lid on Costs Isn't Enough..... 23

City of Detroit Lakes: Enterprise Funds Make a Bad Situation Better..... 27

Hennepin County: Please Stop the Unfunded Mandates ..... 32

Ramsey County: No, Really, Please Stop the Unfunded Mandates ..... 38

Conclusions..... 43

References..... 50

# **What Drives the Property Tax?**

## **A Holistic Examination of City and County Budgets in Minnesota**

### **Introduction**

*“Why do my property taxes keep going up?”*

It’s a question asked by taxpayers around the country but a question that is increasingly difficult to answer. One of the theoretical advantages of the property tax as a cornerstone of local government finance is its transparency and accountability. However these benefits are undercut by the growing complexity of the tax in practice. Features like assessment limitations and differential tax treatment of property types render an already challenging tax to understand even more difficult to decipher. Complex state and local financial relationships and the current era of volatile real estate conditions introduce even more potential for confusion.

It is conceptually appealing -- and often politically advantageous -- to hold particular culprits like state aid cuts or growth in local spending responsible for tax increases. Nonetheless the reality of changing property tax burdens proves much more complex. For example, prompted by a major budget deficit, Minnesota cut \$157 million of general purpose aids to cities in 2003. Conventional wisdom since that time has firmly laid the blame for resulting property tax increases on these cuts. However, in a study of Minnesota cities Anderson (2006) documented tremendous diversity in how municipalities actually responded to them. From 2002-2004 the median lost aid replaced by new property tax revenue was 61%. Yet, the range of replacement rates for the middle 50% of responses fell between 16% and 160%. Put another way, half of cities either replaced less than 16% or more than 160% of their lost aid with new property tax revenue. Notably, nearly one in five cities that lost general purpose aid from 2002-2004 actually *reduced* their property tax collections.

With respect to other non-property tax revenues, the message was the same. Even though collections of other general purpose non-property tax revenues increased by \$29 million in the aggregate, about half of cities either increased ‘other own source revenues’ by over 243% or *reduced* them by more than 69%. Expenditure data also demonstrated significant diversity in responses. Aggregate data suggested total real per resident expenditures fell by \$51. Yet over half of cities experienced an increase in real per-resident expenditures and in one-quarter of cities, expenditures increased by more than 20%. Anderson concludes that aggregate data does a very poor job of illuminating the widespread effects of property tax policies. The real answer lies within the each local unit of government’s unique budget making contexts.

Our investigation was designed to take an in-depth look at several of these Minnesota cities to gain a better understanding of the fundamental reasons why property taxes did or did not go up. In the process, we sought to determine whether or not it is indeed possible for taxpayers to go beyond political rhetoric and reasonably assign responsibility for property tax increases to the independent but interconnected parts of the system.

## Methodology

Table 1 presents the local jurisdictions included in our investigation and summary information on spending and property tax changes. In addition to six cities we also included two major Twin Cities metropolitan area counties.

**Table 1: Total Spending and Property Tax Levy Changes, 2002-2006**

	<b>Spending</b>	<b>Property Taxes</b>
<b>Minneapolis</b>	8.0%	32.7%
<b>Eden Prairie</b>	22.9%	14.2%
<b>Hennepin County</b>	11.9%	16.9%
<b>Ramsey County</b>	5.2%	22.9%
<b>Detroit Lakes</b>	(2.4%)	33.8%
<b>Albert Lea</b>	11.1%	169.4%
<b>Saint Paul</b>	7.5%	1.2%
<b>Brainerd</b>	22.0%	97.3%

Our dataset includes the budget materials for calendar years 2002 through 2006. When necessary, supplementary data was obtained via city or county websites, or through contact with city or county finance staff.

The analysis of changes in city and county revenue was undertaken in two discrete parts. We examined the effect of changes in the overall revenue portfolio (“revenue mix”) of the local units of government in the study by creating an alternate 2006 revenue portfolio where actual 2006 revenues were allocated to the different revenue streams based on their 2002 revenue shares. In essence, this alternate scenario supposes that all revenues changed at the same rate from 2002 to 2006. One assumption is implicit in this analysis: that spending would remain unchanged, regardless of revenue portfolio’s composition.

The second part of the revenue analysis includes research into the effects of shifts in value between residential and non-residential property classes. To examine the effect of inter-class shifts in valuations, we created an alternate 2006 levy distribution where the actual 2006 levy was allocated to residential and non-residential properties based on their shares of 2002 net tax capacity. We then examined the combined effect of revenue and valuation shifts.

Expenditure changes over the period were analyzed by spending area, generally defined by the governing entity itself. We also analyzed spending changes by spending category, or “object code”. Many entities did not include this information in their budget materials. Fewer still included any detail, for example, personnel costs were almost always presented in the aggregate, without individual detail for salaries or fringe benefits.

In some cases, city staff provided data on salary and individual fringe benefit expenditures that, when summed, did not match the totals provided in the budget materials. The discrepancies generally arose from the accounting treatment of internal service funds—an issue highlighted several times in our investigation

We analyzed personnel cost changes on a per-employee basis to control for changes in the local unit of government's total employment during the period. Costs were measured per-full-time equivalent (FTE). We compared those per-FTE changes to changes between the first quarter of 2002 and the fourth quarter of 2006 in the Employment Cost Index, a quarterly economic series published by the Bureau of Labor Statistics measuring the costs of labor for U.S. businesses. No Minnesota-specific data is available. We compared changes in per FTE spending to the changes in the Employment Cost Index, since both account for changes in total employment.

## City of Minneapolis: Paying for Past Mistakes

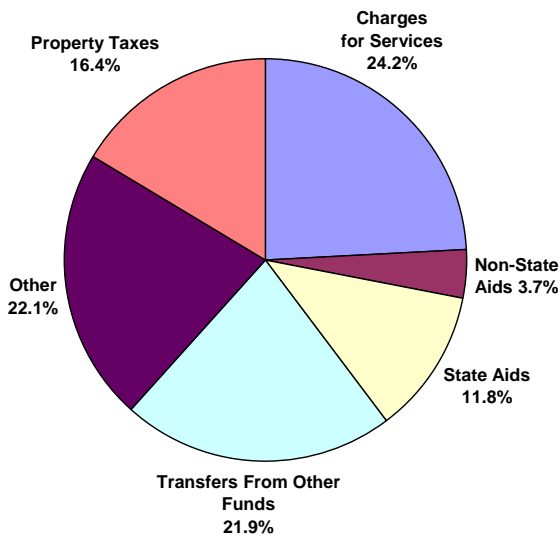
As Minnesota’s largest city, Minneapolis receives significant attention from state politicians. The attention is compounded by the fact that it receives more general purpose state aid than any other city in Minnesota and has had a recent history of budget anomalies, including pension fund and internal service fund difficulties.

The city experienced financial difficulties during this period, both from a spending (23.6% per employee rise in personnel costs) and revenue (9.2% decline in state aids) perspective. The City addressed this problem largely through increased property taxes. Per capita property tax growth was relatively high (40.2% between 2002 and 2006, ranking 68<sup>th</sup> of 209 cities with population over 2,500). Revenues from charges for services also increased sharply during this period, but this is largely attributable to the recategorization of spending associated with Minneapolis’ internal service funds. The City’s ability to reallocate current appropriations was hampered by the negative balances in its internal service funds (to which the City transferred almost \$100 million between 2002 and 2006) and by obligations to its closed pension funds. Making matters worse for homeowners; their share of the property tax burden rose by 28% over the period, giving them a larger share of an increasing levy.

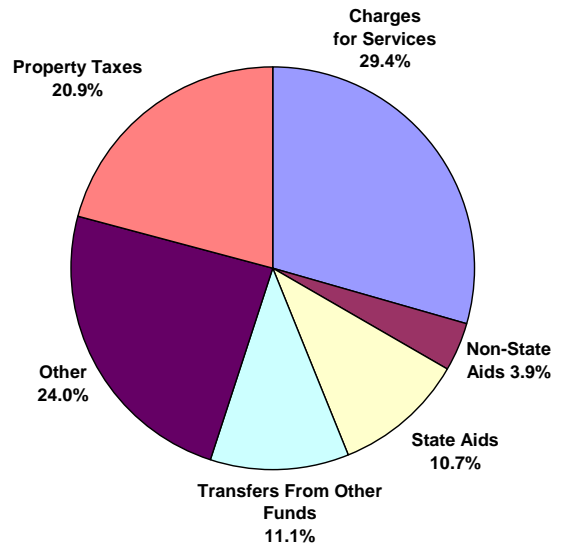
### Revenue Portfolio Analysis

In total, budgeted revenues increased \$48.5 million from 2002 to 2006. Minneapolis property taxes increased \$68.8 million (32.7%) between 2002 and 2006, from \$210.0 million to \$278.8 million. In part, this was driven by changes in the relative shares of the City’s revenue sources. Non-property tax revenues fell \$12.2 million, or 1.1%.

**Figure 1: Budgeted Minneapolis Revenues by Share of Total, 2002**



**Figure 2: Budgeted Minneapolis Revenues by Share of Total, 2006**





As the figures indicate, state aids and fund transfers declined as a share of total revenues, while federal and local aids, charges for services, and other non-property tax revenues<sup>1</sup> increased. The decline in share of fund transfers was offset somewhat by charges for services growth; in part due to the implementation of rate models for services associated with the city's internal service funds, which moved spending on these services from fund-level transfers into non-personnel expense categories (i.e., Charges for Services).

Our revenue portfolio analysis is presented in Table 2. As the table shows, the actual 2006 levy is \$60.8 million larger than the alternate 2006 levy, and a 32.7% increase over 2002. Under the alternate scenario, the levy would have increased from \$210.0 million in 2002 to only \$217.9 million in 2006 (3.8% change). The impact caused by the decline in fund transfers' share of the City's revenue budget is quite noticeable.

**Table 2: Alternate and Actual 2006 Revenues, City of Minneapolis, by Source**

Revenues by Source	Alternate 2006 Revenues		Actual 2006 Revenues	
	Dollar	% Change from 2002	Dollar	% Change from 2002
<b>Total Revenue</b>	<b>\$1,332,192,828</b>	<b>3.8%</b>	<b>\$1,332,193,828</b>	<b>3.8%</b>
<b>Charges for Services</b>	\$322,852,114	3.8%	\$391,614,250	25.9%
<b>Non-State Aids</b>	49,431,290	3.8%	52,255,103	9.7%
<b>State Aids</b>	156,704,645	3.8%	142,318,057	(5.8%)
<b>Transfers From Other Funds</b>	291,471,751	3.8%	147,648,214	(47.4%)
<b>Other</b>	293,801,051	3.8%	319,593,531	12.9%
<b>Property Taxes</b>	<b>\$217,931,977</b>	<b>3.8%</b>	<b>\$278,763,673</b>	<b>32.7%</b>

### Property Valuation Analysis

Changes in tax bills were also driven by changes in "tax capacity" shares (broadly, the taxable portion of a property's value). According to the city, residential tax capacity for grew by 76.1% from payable 2002 to payable 2006, faster than the citywide total (38.1%). Therefore, the share of property taxes paid by homeowners increased from 42.8% for payable 2002 to 54.7% for payable 2006. Our Minneapolis valuation analysis is presented in Table 3.

**Table 3: Effect of Relative 2002-2006 Tax Capacity Changes on Minneapolis Levy**

Property Type	2006 Budgeted Property Taxes		Levy Impact
	Alternate	Actual	Total
<b>Residential</b>	\$121,284,503	\$154,712,147	<b>\$33,427,644</b>
<b>Non-Residential</b>	\$165,579,170	\$132,151,526	<b>(\$33,427,644)</b>

Relative changes in property values (a market-driven phenomenon) shifted \$33.4 million of the 2006 tax levy from non-residential to residential properties<sup>2</sup>, four times the impact of the \$8.7 million reduction in state aids.

<sup>1</sup> Includes fines and forfeitures, interest income, licenses and permits, rental income, franchise fees, sales and other taxes, charges for sales, special assessments, and other.

<sup>2</sup> The Library referendum levy was allocated on changes in referendum market value, not tax capacity.

Table 4 details the cumulative effects of both relative valuation and revenue source shifts. These shifts resulted in 63.2% higher residential property taxes (\$58.2 million) and a 2.1% higher levy (\$2.6 million) for non-residential properties than would have been the case if relative valuations and revenue sources had remained unchanged (the alternate scenario). The differential between the residential and non-residential percentage changes is attributable to shifting valuation between these classes; otherwise, property taxes on both types of property would have risen 27.9% from the revenue portfolio change alone.

**Table 4: Combined Effect on Minneapolis Property Taxes by Property Type from Relative Changes in Valuation and Property Tax Reliance, 2002 – 2006**

	Residential Properties		Non-Residential Properties	
	Alternate*	Actual	Alternate*	Actual
Total 2006 Revenues	\$1,332,192,828	\$1,332,192,828	\$1,332,192,828	\$1,332,192,828
Share from Property Tax	16.36%	20.93%	16.36%	20.93%
Property Tax Revenues	\$217,931,977	\$278,763,673	\$217,931,977	\$278,763,673
Non-Referendum Property Tax Revenues	\$211,599,555	\$270,663,663	\$211,599,555	\$270,663,663
Tax Capacity Shares	41.86%	53.59%	58.14%	46.41%
<i>Non-Referendum Total</i>	<i>\$88,568,672</i>	<i>\$145,039,667</i>	<i>\$123,030,884</i>	<i>\$125,624,006</i>
Referendum Tax Revenues	\$6,332,421	\$8,100,000	\$6,332,421	\$8,100,000
Referendum Market Value Shares	56.83%	65.83%	43.17%	34.17%
<i>Referendum Total</i>	<i>\$3,598,631</i>	<i>\$5,331,959</i>	<i>\$2,733,790</i>	<i>\$2,768,041</i>
<b>Total 2006 Property Tax</b>	<b>\$92,167,303</b>	<b>\$150,371,626</b>	<b>\$125,764,674</b>	<b>\$128,392,047</b>
<b>Effect of Changes (Dollar)</b>	<b>\$58,204,324</b>		<b>\$2,627,373</b>	
<b>Effect of Changes (Percent)</b>	<b>63.2%</b>		<b>2.1%</b>	

\* Combines both previous alternate scenarios.

### Changes in Spending

Table 5 presents Minneapolis' budget from an object code (major category) perspective. While city-wide internal transfers decreased 30%, or \$75 million, non-personnel expenses increased by \$75 million. As mentioned earlier, this was due in part to the implementation of rate models which moved spending from fund-level transfers into non-personnel expense categories (i.e., Charges for Services).

**Table 5: Minneapolis Changes in Expenditures by Major Category (\$ millions): 2002-2006**

Major Category (Object Code)	Total Budget		Change: 2002-2006	
	2002	2006	Total (\$)	Percent
<b>Personnel</b>	\$348.3	\$397.6	\$49.3	14.2%
<b>Non-Personnel</b>	338.7	414.6	75.9	22.4%
<b>Capital and Equipment</b>	167.4	168.2	0.8	0.5%
<b>Debt Service</b>	140.3	189.3	49.0	34.9%
<b>Transfers</b>	250.1	175.0	(75.1)	(30.0%)
<b>Total Expenditures</b>	<b>\$1,244.8</b>	<b>\$1,344.7</b>	<b>\$99.9</b>	<b>8.0%</b>

Personnel expenditures increased \$49.3 million (14.2%) during this period, despite a 7.7% fall in full-time equivalents (FTE). As Table 6 indicates, the main components were: salaries (\$23.1 million; or 8.5%), and fringe benefits (\$26.2 million; or 33.6%). When measured per FTE salary spending increased 17.5% and fringe benefit spending increased 44.8%. While no substantial benefit improvements were made, employee health plans were restructured to decrease city costs and slow the rate of increase. Personnel costs increased from 28.0% of the City's 2002 budget to 29.3% of its 2006 budget.

**Table 6: Changes in Minneapolis Personnel Costs, Total and Components, 2002-2006**

Compensation Component	Personnel Cost Change: 2002-2006		Personnel Cost Change per FTE		Employment Cost Index Change: 2002-2006	
	Total (\$ millions)	Percent	Total (\$)	Percent	Private Industry	State & Local Government
<b>Salaries</b>	\$23.1	8.5%	\$7,773	17.5%	13.9%	14.1%
<b>Fringe Benefits</b>	\$26.2	33.6%	\$8,713	44.8%	25.6%	33.5%
<b>Total</b>	<b>\$49.3</b>	<b>14.2%</b>	<b>\$13,486</b>	<b>23.6%</b>	<b>17.1%</b>	<b>19.7%</b>

For comparative purposes, Table 6 presents data on the change in the Employment Cost Index<sup>3</sup> (ECI) from the first quarter of 2002 to fourth quarter of 2006. The per FTE increase in total personnel spending was greater than the ECI's change for either the private or public sector. The main drivers behind increased fringe benefit costs generally were related to health care and retirement. Table 7 lists fringe benefit expenses that changed more than \$500,000 over the period. Health Insurance spending grew in total by 69.9% and by 84.0% on a per FTE basis.

<sup>3</sup> A quarterly economic series detailing changes in the labor costs for U.S. businesses. We present the seasonally adjusted figures, for private industry workers (all workers) and state and local government workers (all workers).

**Table 7: Changes in Selected Minneapolis Health Fringe Benefit Costs, 2002-2006**

Fringe Benefit Expenditure	Spending (\$000)		Change	
	2002	2006	(\$000)	Percent
<b>Health Insurance</b>	\$25,693	\$43,656	\$17,693	69.9%
<b>PERA<sup>4</sup></b>	14,153	18,604	4,451	31.5%
<b>Workers Compensation</b>	14,510	17,701	3,191	22.0%
<b>FICA</b>	9,169	11,011	1,842	20.1%
<b>Medicare</b>	3,048	3,619	571	18.7%
<b>MERF<sup>5</sup></b>	(505)	891	1,396	NA

## Debt Service

As Table 5 indicated, budgeted debt service increased by \$49 million (34.9%). Pension obligation, internal service fund and library referendum debt were contributing factors.

- Between 2002 and 2006 debt attributed to the Library referendum totaled \$128 million; debt service on those bonds during that time totaled \$26 million.
- In 2002, the City issued \$36 million in pension obligations bonds to finance its 2003 contributions to three closed pension plans. Between 2002 and 2006, \$119 million in pension obligation bonds was issued. As Table 8 indicates, the debt service on these bonds totaled \$30 million during the five year period.

**Table 8: City of Minneapolis Closed Pension Funds:  
Obligations, Tax Levy and Debt Service for Pension Bonds, 2002-2006**

Item	Spending per Year (millions)				
	2002	2003	2004	2005	2006
<b>Closed Pension Fund Obligations<sup>6</sup></b>	\$17.6	\$54.2	\$42.2	\$34.5	\$20.0
<b>Property Tax Levy for Closed Pension Funds</b>	\$7.4	\$7.0	\$7.0	\$3.0	\$6.5
<b>Debt Service on Pension Bonds</b>	\$0	\$1.8	\$6.5	\$12.8	\$8.4

## Internal Service Funds

Issues with the city’s six Internal Service Funds also contributed to higher debt service costs. These Internal Service Funds accumulate and allocate costs internally among various governmental functions. According to the City, it “uses Internal Service Funds to account for its property management services, fleet of vehicles, management information systems, central stores, engineering lab and asphalt plant, city attorney, workers’ compensation, and unemployment benefits.”<sup>7</sup>

In the 1990s, the City used primarily fund-level transfers to finance Internal Service Fund operations. The revenue to the Internal Service Funds did not cover their expenses. As a result, at year-end 2000 the six Internal Service Funds had a combined net asset deficit of (\$54 million). In part, this led credit rating services to lower the city’s credit rating, resulting in higher borrowing (and therefore debt service) costs.

<sup>4</sup> Public Employees Retirement Association (pension fund). Includes Police and Fire PERA.

<sup>5</sup> 2002 MERF spending is negative because spending has been combined with the budget offset.

<sup>6</sup> Differences between the pension obligation and the property tax levy were financed with bond proceeds.

<sup>7</sup> 2002 CAFR, page 5.

In 2001, the City Council passed several financial “workout” plans for the Internal Service Funds. These “workout” plans called for:

- General Fund transfers to the Internal Service Funds (mainly the Information Technology and Equipment Services funds)
- The creation of rate models to fully and accurately account for the internal services consumed by City departments.

In addition, the city increased the base funding level for internal city services each year between 2002 and 2006. As Table 9 shows, by 2006, the combined net asset deficit of the internal service funds was (\$3.3 million)<sup>8</sup>, mostly eliminating the deficit.

**Table 9: Various Statistics, Minneapolis Internal Service Funds, 2002-2006 (\$ millions)**

	2002	2003	2004	2005	2006
<b>Fund Transfers to Internal Service Funds</b>	\$18.1	\$21.4	\$22.9	\$16.4	\$20.1
<b>Additions to Base ISF Funding Levels<sup>9</sup></b>	\$2.0	\$5.5	\$9.2	\$13.1	\$17.1
<b>Combined Net Assets (Deficit)</b>	(\$30.2)	(\$34.0)	(\$28.9)	(\$21.9)	(\$3.3)

### **Summary: Pre-Existing Financial and Structural Problems Hampered the City**

In Minneapolis, struggles with escalating health care and pension cost control were exacerbated by sins of budgets past. To eliminate the internal service fund deficits, the City transferred a total of \$98.9 million from its general fund to its internal service funds over the period from 2002 to 2006. During this same period, the City increased its property tax levy by a cumulative \$187.2 million.<sup>10</sup> Table 10 provides details. The \$98.9 million used to eliminate this deficit was not available to the City for funding its budget. Had this cash been available for general use, the cumulative property tax increase between 2002 and 2006 could have been cut by roughly half.

**Table 10: City of Minneapolis General Fund Transfers to Internal Service Funds and Cumulative Increases in Property Taxes, 2002-2006 (\$ millions)**

Year	General Fund Transfers	Property Tax Increase Over Base Year 2002
2002	\$18.1	\$0.0
2003	\$21.4	\$21.1
2004	\$22.9	\$42.1
2005	\$16.4	\$55.3
2006	\$20.1	\$68.8
<b>Total</b>	<b>\$98.9</b>	<b>\$187.2</b>

Note: Numbers may not add due to rounding.

<sup>8</sup> Internal service fund combined net asset and deficit data from 2002-2006 City of Minneapolis CAFR.

<sup>9</sup> Above base year 2001.

<sup>10</sup> Differential between property taxes levied 2003-2006 and property taxes levied 2002.

## City of Saint Paul: Anything But Property Taxes

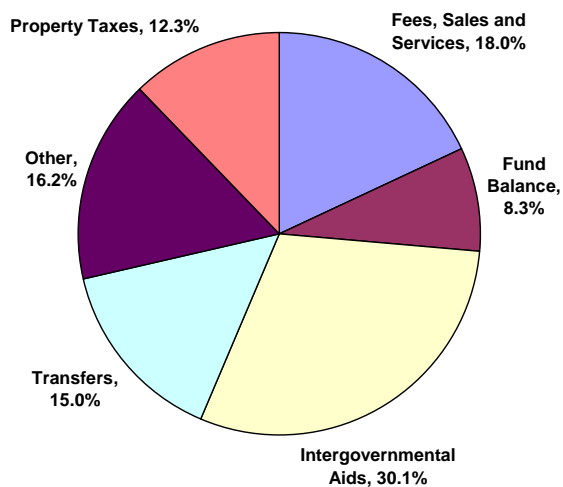
Minnesota’s second-largest city provides a useful comparison to the Minneapolis experience. Like its “twin” St. Paul receives a significant amount of state general purpose aid and also faced the challenges of significant aid cuts (\$14 million in Local Government Aid and \$30 million in other state and federal aids). However, per capita property tax growth was relatively low (19.2% between 2002 and 2006, ranking 160<sup>th</sup> of 209 cities with population over 2,500). Instead of property taxes, St. Paul chose to rely on an aggressive switch to user fees and use of fund balances.

### Revenue Portfolio Analysis

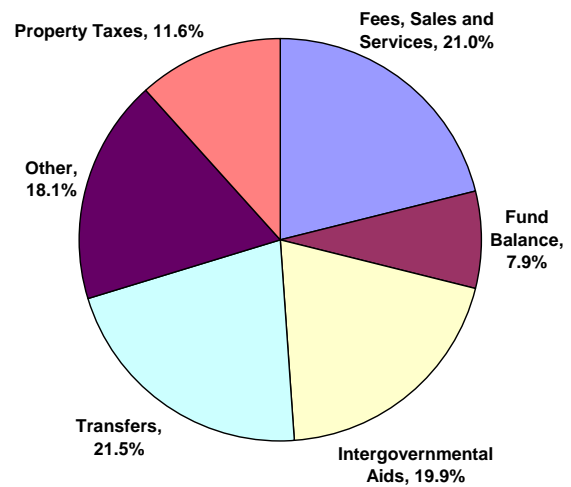
In total, budgeted revenues increased \$38.7 million from 2002 to 2006. Total property taxes remained essentially constant during the period, increasing \$0.8 million, from \$63.4 million to \$64.2 million (1.2%). In part, this was driven by changes in the relative shares of the City’s revenue sources. Non-property tax revenues grew \$38.0 million (8.4%). Figure 3 and Figure 4 detail the changes by category.

The largest single aid decrease was the \$14 million reduction in Local Government Aid; the other \$30 million reductions in aids included the Municipal State Aid and federal highway funds that financed the City’s capital budget. Fees, Sales and Services revenues increased as the City raised a variety of fees, including paramedic fees, parking meter fines, and central service charges. The increase in Transfers is related to capital budget financing, which changed significantly. State and federal funding for capital decreased by \$26 million; other local sources of financing increased by a similar amount principally through bonds issued by the City supported by a ½% sales tax. The City also used fund balance during this period to finance budgets and avoid increasing the property tax levy.

**Figure 3: Budgeted Saint Paul Revenues by Share of Total, 2002**



**Figure 4: Budgeted Saint Paul Revenues by Share of Total, 2006**



St. Paul's revenue portfolio analysis is presented in Table 11. As the table shows, the actual 2006 levy was 1.2% (\$64.2 million) higher than in 2002. In the alternate scenario, the levy would have increased from \$63.4 million in 2002 to \$68.2 million in 2006 (7.5% change). The property tax levy in the alternate scenario is larger than the actual levy because property taxes as a share of Saint Paul's overall revenues declined from 2002 to 2006. The City's increasing reliance on fee revenues is apparent. Also note the increasing use of transfer revenues related to changes in capital budget financing.

**Table 11: Alternate and Actual 2006 Revenues, City of Saint Paul, by Source**

Revenues by Source	Alternate 2006 Revenues		Actual 2006 Revenues	
	Dollar	% Change from 2002	Dollar	% Change from 2002
<b>Total Revenue</b>	<b>\$554,045,869</b>	<b>7.5%</b>	<b>\$554,045,869</b>	<b>7.5%</b>
<b>Fees, Sales and Services</b>	\$99,656,397	7.5%	\$116,515,168	25.7%
<b>Fund Balance</b>	46,129,034	7.5%	43,835,875	2.2%
<b>Intergovernmental Aids</b>	166,997,471	7.5%	109,993,898	(29.2%)
<b>Transfers</b>	83,130,831	7.5%	119,260,479	54.8%
<b>Other</b>	89,960,095	7.5%	100,247,344	19.8%
<b>Property Taxes</b>	<b>\$68,172,042</b>	<b>7.5%</b>	<b>\$64,193,105</b>	<b>1.2%</b>

### Property Valuation Analysis

As in Minneapolis, St. Paul experienced significant homestead value appreciation resulting in a larger share of tax burden falling on residential property. According to the City, residential tax capacity grew by 73.1% from payable 2002 to payable 2006<sup>11</sup>. Since residential tax capacity grew faster than the citywide total (65.2%); the residential share of net tax capacity, and therefore, homeowners' share of property taxes, increased from 49.7% for payable 2002 to 58.5% for payable 2006.

Table 12 presents St. Paul's valuation analysis. Relative property value changes (a market-driven phenomenon) shifted \$3.7 million of the 2006 tax levy from non-residential to residential properties.

**Table 12: Effect of Relative 2002-2006 Tax Capacity Changes on Saint Paul 2006 Levy**

Property Type	2006 Budgeted Property Taxes		Levy Impact
	Alternate	Actual	Total
<b>Residential</b>	\$31,878,269	\$35,591,887	<b>\$3,713,618</b>
<b>Non-Residential</b>	\$32,314,836	\$28,601,218	<b>(\$3,713,618)</b>

Table 13 details the cumulative effects of both relative valuation and revenue source shifts. These shifts resulted in 5.1% higher property taxes (\$1.7 million) for residential properties and a 16.7% lower levy (\$5.7 million) for non-residential properties than would have been the case if relative valuations and the revenue portfolio shares had

<sup>11</sup> The City's budget documents do not provide complete property valuation data; this data is from the City's 2006 CAFR (unaudited data).

remained unchanged (the alternate scenario). The differential between the residential and non-residential percentage changes is attributable to shifting valuation between these classes; otherwise, taxes on both types of property would have fallen 5.8% from the revenue portfolio change alone.

**Table 13: Combined Effect on Saint Paul Residential Property Taxes by Property Type from Relative Changes in Valuation and Property Tax Reliance, 2002 – 2006**

	Residential Properties		Non-Residential Properties	
	Alternate*	Actual	Alternate*	Actual
Total 2006 Revenues	\$554,045,869	\$554,045,869	\$554,045,869	\$554,045,869
Share from Property Tax	12.30%	11.59%	12.30%	11.59%
Property Tax Revenues	\$68,172,042	\$64,193,105	\$68,172,042	\$64,193,105
Tax Capacity Shares	49.66%	55.45%	50.34%	44.55%
<b>Total 2006 Property Tax</b>	<b>\$33,854,207</b>	<b>\$35,591,887</b>	<b>\$34,317,835</b>	<b>\$28,601,218</b>
<b>Effect of Changes (Dollar)</b>	<b>\$1,737,680</b>		<b>(\$5,716,617)</b>	
<b>Effect of Changes (Percent)</b>	<b>5.1%</b>		<b>(16.7%)</b>	

\* Combines both previous alternate scenarios.

### Changes in Spending

City spending (including the Library Agency) increased 7.5%, or \$38.8 million, between 2002 and 2006. An object code spending analysis indicates that non-personnel operating expenses for Police, Fire and Public Works activities account for 50% of the increase. In the Police operating (General & Special Funds) budget, the largest non-personnel increase was debt service on the new police headquarters building. The largest increase in non-personnel Fire expenses (General & Special Funds) was attributable to the replacement of fire trucks and equipment. Much of the increase in public works expenses can be attributed to spending on street repair and cleaning funded by the Right-of-Way maintenance assessment.

Increased personnel costs contributed the other half of the increase in citywide spending, some \$19.7 million, between 2002 and 2006. At the same time, the City's budgeted FTE employee count fell by 2.7% (from 3,042.4 to 2,961.5 FTE). As Table 14 indicates, this increase was broken down between salaries (\$9.9 million; or 6.3%) and fringe benefits (\$9.8 million; or 21.2%). When measured as spending per FTE, salaries increased 9.2%, while fringe benefits increased 24.5%.

**Table 14: Changes in City of Saint Paul Personnel Costs, Total and Components, 2002-2006**

Compensation Component	Personnel Cost Change: 2002-2006		Personnel Cost Change per FTE		Employment Cost Index Change: 2002-2006	
	Total (\$ millions)	Percent	Total (\$)	Percent	Private Industry	State & Local Government
<b>Salaries</b>	\$9.9	6.3%	\$4,741	9.2%	13.9%	14.1%
<b>Fringe Benefits</b>	\$9.8	21.2%	\$3,737	24.5%	25.6%	33.5%
<b>Total</b>	<b>\$19.7</b>	<b>9.7%</b>	<b>\$8,479</b>	<b>12.7%</b>	<b>17.1%</b>	<b>19.7%</b>

Note: Numbers may not add due to rounding.



For comparative purposes, Table 14 presents the change in the ECI from the first quarter of 2002 to fourth quarter of 2006. Saint Paul’s per FTE increase for total personnel spending (12.7%) compares favorably to both the public- and private-sector averages.

Retirement and health-care spending drove increased fringe benefit costs. Table 15 lists selected fringe benefit expenses and their changes over the period.<sup>12</sup>

**Table 15: Changes in Selected City of Saint Paul Fringe Benefit Costs, 2002-2006**

Fringe Benefit Expenditure	Spending (\$000)		Change	
	2002	2006	(\$000)	Percent
<b>Health Insurance</b>	\$18,684	\$28,124	\$9,440	50.5%
<b>Police/Fire Pensions</b> <sup>13</sup>	5,581	7,328	4,451	31.3%
<b>Medicare</b> <sup>14</sup>	1,788	1,970	182	10.2%
<b>PERA</b> <sup>15</sup>	4,761	5,098	336	7.1%
<b>Social Security</b>	5,648	5,295	(354)	(6.3%)

### Summary: The End of the “Alternative Revenue Source” Rope

While Minneapolis’ ability to use fund balances to close funding gaps was limited, Saint Paul was much more able to engage in this sort of financial engineering. During the period from 2002 to 2006, the City imposed new charges for certain services, increased charges for other services, and spent from its fund balance to mitigate the effects of reduced intergovernmental aids. The City also moved certain items off the property tax levy; for example, it began to use assessments to fund right-of-way maintenance rather than property tax proceeds. This allowed the City to maintain its property tax levy at the same amount until 2006, when it increased by 3% (the first levy increase since 1993).

However, it is unlikely that the City will be able to mitigate further aid cuts in the same way, at least in the short-term. In particular, the City’s ability to use its fund balance is severely curtailed. As Saint Paul’s 2006 budget document states:

*“Historically, dollars from the City’s fund balance have been used to finance past budgets and avoid an increase in the City’s property tax levy. In 2005, the City’s bond raters cautioned against further use of fund balance to finance current services, as the City was approaching a benchmark statistic for percent of fund balance on hand compared to the General Fund budget.<sup>16</sup> In the short term, at least, Saint Paul will be much more likely to address budget concerns with higher property taxes.”*

<sup>12</sup> Note that these costs are offset in part by increases in the city’s budget offset for fringe benefit spending.

<sup>13</sup> Includes both Police and Fire PERA and Police and Fire Relief Association spending.

<sup>14</sup> All City departments.

<sup>15</sup> Public Employees Retirement Association (pension), both Basic and Coordinated Plans. Does not include police or fire employees.

<sup>16</sup> City of Saint Paul 2006 Adopted Budget, Summary Documents.

## City of Eden Prairie: You Can't Lose What You Don't Get

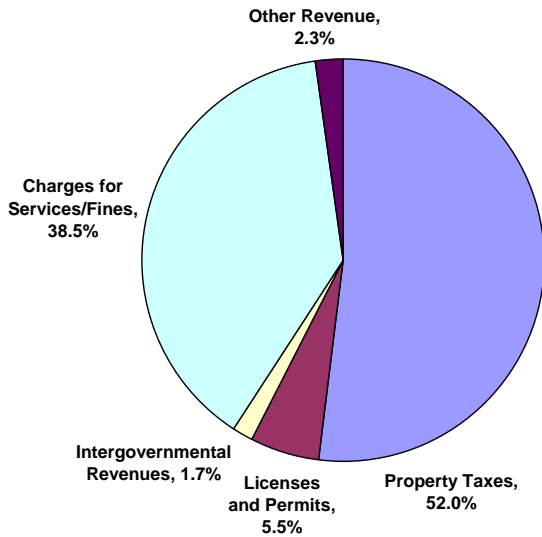
Located 25-30 minutes southwest from downtown Minneapolis, Eden Prairie is one of the Twin Cities' larger and more affluent suburbs. 2000 Census data indicates that the median household income for 1999 was 64% higher than the statewide average. Not surprisingly, Eden Prairie received virtually no general purpose state aids from 2002 to 2006.

Despite the lack of state assistance, per capita property taxes actually fell by 1.1% decline between 2002 and 2006 (ranking the city 204<sup>th</sup> of 209 cities with population over 2,500). Spending grew by 11.9%, but the estimated 7.6% population growth (and attendant property tax base growth) resulted in minimal impact. However, city residents could not escape market-based burden shifts as homeowners' share of the property tax burden did rise by some 18% during this period.

### Revenue Portfolio Analysis

Total property taxes increased from \$24.5 million to \$28.0 million (\$3.5 million, or 14.2%). In part, this was driven by changes in the relative shares of the City's revenue sources. Non-property tax revenues grew \$4.3 million (18.9%).

**Figure 5: Budgeted Eden Prairie Revenues by Share of Total, 2002**



**Figure 6: Budgeted Eden Prairie Revenues by Share of Total, 2006**

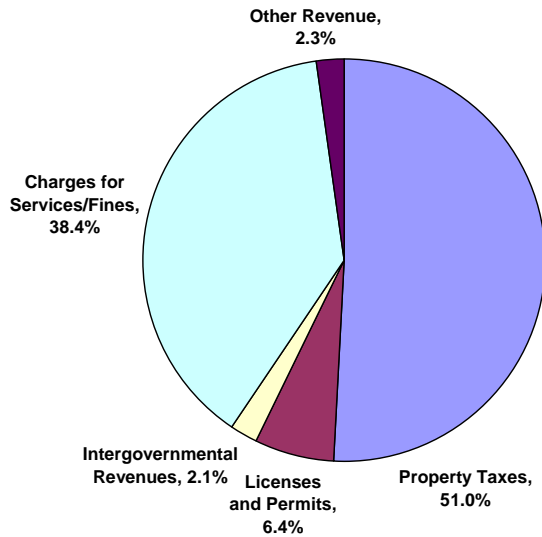


Figure 5 and Figure 6 detail the changes by category. There is relatively little change in other revenues<sup>17</sup> and charges for services and fines' share of total revenues;

<sup>17</sup> "Other Revenue" includes court fines, investment earnings, other revenues, and other financing sources (excluding transfers).

intergovernmental revenues and licenses and permits rose. In total, budgeted revenues increased \$7.8 million overall from 2002 to 2006.<sup>18</sup>

Our revenue portfolio analysis is presented in Table 16. As the table indicates, the actual 2006 levy was 14.2% higher (\$3.5 million) higher than in 2002. However, this is a lower figure than the 2006 alternate scenario. In the alternate scenario, the levy increased to \$28.6 million in 2006 (a 16.4% boost). As with Saint Paul, the levy in the alternate scenario is larger than in the actual scenario since in reality property taxes declined as a share of all revenues.

**Table 16: Alternate and Actual 2006 Revenues, City of Eden Prairie, by Source**

Revenues by Source	Alternate 2006 Revenues		Actual 2006 Revenues	
	Dollar	% Change from 2002	Dollar	% Change from 2002
<b>Total Revenue</b>	<b>\$55,008,773</b>	<b>16.4%</b>	<b>\$55,008,773</b>	<b>16.4%</b>
<b>Licenses and Permits</b>	3,027,026	16.4%	3,493,378	34.4%
<b>Intergovernmental Aids</b>	941,444	16.4%	1,127,824	39.5%
<b>Charges for Services/Fines</b>	21,178,698	16.4%	21,113,104	16.1%
<b>Other</b>	1,283,765	16.4%	1,246,300	13.0%
<b>Property Taxes</b>	<b>\$28,577,840</b>	<b>16.4%</b>	<b>\$28,028,167</b>	<b>14.2%</b>

Even though Eden Prairie was not a recipient of general purpose state aids (\$59,630 budgeted in 2002, none thereafter), it is the only city in the study with increased reliance on intergovernmental aids during this time period; from 1.7% of 2002 revenues to 2.1% of 2006 revenues. However, the State provided other aids<sup>19</sup>, as Table 17 demonstrates.

**Table 17: Changes in State Aids Provided to Eden Prairie, 2002-2006**

State Aid	Budgeted (\$)		Change	
	2002	2006	Dollar	Percent
<b>Police Pension Aid</b>	320,000	425,000	105,000	32.8%
<b>Fire Relief Association Aid</b>	221,000	457,000	236,000	106.8%
<b>State Street Aid</b>	60,000	64,440	4,440	7.4%
<b>School Liaison Aid</b>	75,500	105,000	29,500	39.1%
<b>Police Training</b>	15,000	24,000	9,000	60.0%
<b>Civil Defense</b>	5,000	0	(5,000)	(100.0%)
<b>Local Government Aid</b>	59,630	0	(59,630)	(100.0%)
<b>PERA Aid</b>	52,384	52,384	--	--
<b>Total</b>	<b>808,514</b>	<b>1,127,824</b>	<b>319,310</b>	<b>39.5%</b>

<sup>18</sup> Consistent with accepted practice, the City considers transfers between funds as expenditures from one fund and a revenue for the other. This is appropriate when examining funds individually. However, from a city-wide cash flow perspective, this practice inflates revenues and expenditures, since it essentially allows for double-counting. We eliminated any revenues or expenditures attributable to fund-to-fund transfers when undertaking city-level analyses.

<sup>19</sup> The State provides Police Pension and Fire Relief Association Aids because the city's police and fire employees operate their own pension plans and do not participate in the statewide plan.

## Property Valuation Analysis

Eden Prairie’s residential tax capacity grew by 66.4% from payable 2002 to payable 2006, faster than the citywide total of 41.4%. Therefore, homeowners’ share of property taxes increased from 54.2% for pay 2002 to 63.8% for pay 2006. Our valuation analysis (Table 18) indicates the change in share (a market-driven phenomenon) shifted \$2.7 million of the 2006 tax levy from non-residential to residential properties.

**Table 18: Effect of Relative 2002-2006 Tax Capacity Changes on Eden Prairie Levy**

Property Type	2006 Budgeted Property Taxes		Levy Impact
	Alternate	Actual	Total
<b>Residential</b>	\$15,192,456	\$17,877,206	<b>\$2,684,750</b>
<b>Non-Residential</b>	\$12,835,711	\$10,150,961	<b>(\$2,684,750)</b>

The cumulative effects of both relative valuation and revenue source shifts are shown in Table 19. These shifts resulted in 15.4% higher residential property taxes (\$2.29 million) and a 22.4% drop in the non-residential levy (\$3.03 million) than would have been the case if relative valuations and the revenue portfolio shares had remained unchanged (the alternate scenario). The differential between the residential and non-residential percentage changes is attributable to shifting valuation between these classes; otherwise, property taxes on both types of property would have fallen 1.9% from the revenue portfolio change alone.

**Table 19: Combined Effect on Eden Prairie Property Taxes by Property Type from Relative Changes in Tax Capacity Share and Property Tax Reliance, 2002 – 2006**

	Residential Properties		Non-Residential Properties	
	Alternate*	Actual	Alternate*	Actual
Total 2006 Revenues	\$55,008,773	\$55,008,773	\$55,008,773	\$55,008,773
Share from Property Tax	51.95%	50.95%	51.95%	50.95%
Property Tax Revenues	\$28,577,840	\$28,028,167	\$28,577,840	\$28,028,167
Tax Capacity Shares	54.20%	63.78%	45.80%	36.22%
<b>Total 2006 Property Tax</b>	<b>\$15,490,402</b>	<b>\$17,877,206</b>	<b>\$13,087,438</b>	<b>\$10,150,961</b>
<b>Effect of Changes (Dollar)</b>	<b>\$2,286,804</b>		<b>(\$2,936,477)</b>	
<b>Total Effect</b>	<b>15.4%</b>		<b>(22.4%)</b>	

\* Combines both previous alternative situations.

## Changes in Spending

Increased personnel costs<sup>20</sup> added \$1.2 million in spending (6.2%) between 2002 and 2006 (Table 20) and comprised just over one-third (33.7%) of the total increase in citywide spending between 2002 and 2006—all during a period in which fulltime equivalent employee count fell by 0.5% (from 273.25 to 271.80). Data provided by the City in response to our request indicates that total compensation costs increased 19.9% from 2002 to 2006 (compared to the 17.5% increase in budgeted compensation costs).

<sup>20</sup> Referred to in City budget documents as “personal services”.

**Table 20: Changes in City of Eden Prairie Budgets, by Object Code, 2002-2006**

Object Code	Spending		Change: 2002-2006	
	2002	2006	Dollar	Percent
<b>Personal Services</b> <sup>21</sup>	\$19,877,062	\$23,345,768	\$3,468,706	17.5%
<b>Commodities and Supplies</b>	1,939,390	3,150,378	1,210,988	62.4%
<b>Contracted Services</b>	4,749,629	9,095,945	4,346,316	91.5%
<b>Repair and Maintenance/ Utilities</b>	6,757,059	5,801,570	(955,489)	(14.1%)
<b>Capital Outlay</b>	1,537,768	1,897,614	359,846	23.4%
<b>Depreciation</b>	212,450	1,058,319	845,869	398.1%
<b>Cost of Goods Sold</b>	6,283,400	7,615,260	1,331,860	21.2%
<b>Debt Service</b>	2,887,000	3,000,724	113,724	3.9%
<b>Other</b> <sup>22</sup>	693,022	269,000	(\$424,022)	(61.2%)
<b>Total</b>	<b>\$44,936,780</b>	<b>\$55,234,578</b>	<b>\$10,297,798</b>	<b>22.9%</b>

As Table 21 indicates, this 19.9% increase was broken down between wages (\$3.0 million increase; or 19.6%) and fringe benefits (\$0.8 million; or 25.6%). When measured as spending per FTE<sup>23</sup> salaries increased 19.8%, while fringe benefits increased 19.6%.

**Table 21: Changes in Eden Prairie Personnel Costs, Total and Components, 2002-2006**

Compensation Component	Personnel Cost Change: 2002-2006		Personnel Cost Change per FTE		Employment Cost Index Change: 2002-2006	
	Total (\$ millions)	Percent	Total (\$)	Percent	Private Industry	State & Local Government
<b>Salaries</b>	\$3.03	19.6%	\$11,001	19.8%	13.9%	14.1%
<b>Fringe Benefits</b>	\$0.84	21.3%	\$2,435	19.6%	25.6%	33.5%
<b>Total</b>	<b>\$3.87</b>	<b>19.9%</b>	<b>\$13,436</b>	<b>19.8%</b>	<b>17.1%</b>	<b>19.7%</b>

Note: Numbers may not add due to rounding.

For comparative purposes, Table 21 presents data on the change in ECI from the first quarter of 2002 to fourth quarter of 2006. On a per-FTE basis, total compensation cost growth has been roughly equivalent to other state and local governments, although Eden Prairie has had much lower growth in fringe benefit costs.

Increased health care and retirement costs are the main drivers behind increased fringe benefit spending. Table 22 lists fringe benefit expenses as provided to us by the City.

<sup>21</sup> We classify volunteer firefighter pension expenditures as “Personal Services” to facilitate comparisons of total compensation.

<sup>22</sup> As mentioned earlier, this excludes “transfer” expenditures.

<sup>23</sup> As with certain other cities, since volunteer firefighters are employed “on call”, it is very difficult to translate these positions into full-time equivalents, and so the City does not present them as such. According to the City’s budget materials, the City volunteer fire wages as “services” rather than “personal services”, so the only adjustment needed was to eliminate payments to the fire relief association for volunteer firefighters. We also eliminated wages paid to “volunteers”, under the assumption that volunteer positions are not recorded as FTEs.

**Table 22: Changes in Eden Prairie Fringe Benefit Costs, 2002-2006**

Fringe Benefit Expenditure	Spending		Change	
	2002	2006	Dollar	Percent
<b>Pension Plans</b> <sup>24</sup>	\$1,851,752	\$2,263,676	\$411,924	22.2%
<b>Health Insurance</b> <sup>25</sup>	1,188,913	1,516,991	328,078	27.6%
<b>Fire Relief Pension</b> <sup>26</sup>	550,000	747,000	197,000	35.8%
<b>Dental Reimbursement</b>	86,050	156,469	70,419	81.8%
<b>Other Fringe Benefits</b>	266,936	99,946	(166,990)	(62.6%)
<b>Total</b>	<b>\$3,943,336</b>	<b>\$4,784,082</b>	<b>\$840,746</b>	<b>21.3%</b>

**Summary: Affluence and Self-Reliance Creating a Stable Property Tax Environment**

Many rapidly growing communities find that the cost of expanded services to support growing populations can exceed the revenue raising capacity of a community even after factoring in the larger property tax base. Eden Prairie’s relative affluence appears to have compensated for this potential effect. However, the city likely also benefited from having no legacy spending enabled by state aids which create additional local budget pressured in times of state fiscal stress.

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<sup>24</sup> Assumed to include PERA and FICA (Social Security).

<sup>25</sup> Assumed to include Medicare.

<sup>26</sup> Volunteer firefighters operate a pension fund separate from PERA.

## City of Albert Lea: Lots of Eggs in the General Purpose Aid Basket

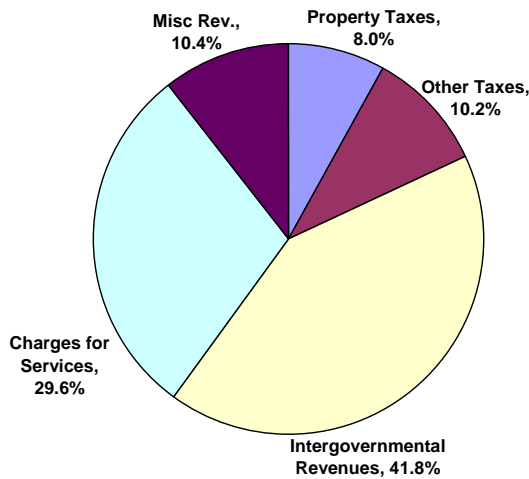
Albert Lea, a regional center of about 18,000 in south-central Minnesota experienced the higher per capita property tax growth (169.7%) between 2002 and 2006 of any Minnesota city with at least 2,500 people. The community lost 5.5% of its population between 1970 and 2000, in part due to a significant loss of its industrial base during that same period.

Over our period of study total spending rose 11.1%, coupled with a sharp (18.3%) decline in inter-governmental revenues. The City responded in part by spending some \$1.5 million in fund balance over these five years (about 9% of its beginning 2002 fund balance); but also increased its property tax levy 169.4% during this period to finance its operations. However, unlike metro area communities, residential and non-residential properties experiences similar increases on a percentage basis, since there was little valuation shifting between these types of properties.

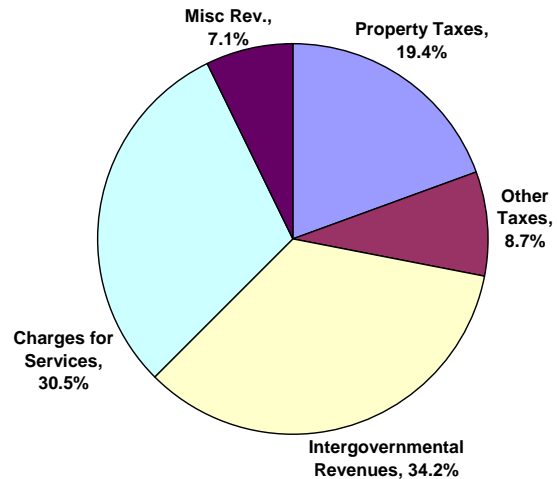
### Revenue Portfolio Analysis

From 2002-2006 Albert Lea budgeted revenues increased \$1.79 million but property taxes increased \$2.31 million. In part, this was driven by changes in the relative shares of the City's revenue sources.

**Figure 7: Budgeted Albert Lea Revenues by Share of Total, 2002**



**Figure 8: Budgeted Albert Lea Revenues by Share of Total, 2006**



As the figures generated from city data<sup>27</sup> indicate, intergovernmental revenues (largely Local Government Aid), other taxes<sup>28</sup>, and miscellaneous revenues<sup>29</sup> all declined as a

<sup>27</sup> The City provided its 2004 and 2006 budgets in response to our request for budget data. The 2004 budget document provided archive 2002 and 2003 budget data; the 2006 budget document provided archive 2005 budget data. Potentially, there is 2002, 2003, or 2005 budget information not included in this report.

<sup>28</sup> Includes the City's lodging tax and franchise fees.

share of total revenue. In actual dollar terms, intergovernmental revenues fell roughly \$693,000 (9.7%), other tax revenues fell \$88,500 (5.1%), and miscellaneous revenues fell some \$441,000 (24.7%). The only non-property tax revenue stream to grow was charges for services. As non-property tax revenues declined in total, the City became much more dependent on property tax revenues, especially when financing new spending.

Budgeted revenues do not match budgeted expenditures; most likely because the City does not report spending of fund balances with revenues. We estimate that between 2002 and 2006, the City spent \$1.5 million from its fund balance.

The revenue portfolio analysis (Table 23) shows that the actual 2006 city levy was 169.4% higher than the actual 2002 levy, and \$2.16 million higher (143.9%) than the alternate scenario levy. In the alternate scenario, the levy increased only 10.5% above 2002, from \$1.36 million to \$1.50 million. The impact of changes in intergovernmental revenues (primarily Local Government Aid) is particularly noticeable.

**Table 23: Alternate and Actual 2006 Revenues, City of Albert Lea, by Source**

Revenues by Source	Alternate 2006 Revenues		Actual 2006 Revenues	
	Dollar	% Change from 2002	Dollar	% Change from 2002
<b>Total Revenue</b>	<b>\$18,865,087</b>	<b>10.5%</b>	<b>\$18,865,087</b>	<b>10.5%</b>
<b>Other Taxes</b>	\$1,920,359	10.5%	\$1,650,000	(5.1%)
<b>Intergovernmental Revenues</b>	7,892,873	10.5%	6,452,214	(9.7%)
<b>Charges for Services/Fines</b>	5,579,039	10.5%	5,754,593	13.9%
<b>Miscellaneous Revenues</b>	1,969,613	10.5%	1,342,280	(24.7%)
<b>Property Taxes</b>	<b>\$1,503,204</b>	<b>10.5%</b>	<b>\$3,666,000</b>	<b>169.4%</b>

### Property Valuation Analysis

Residential tax capacity grew by 30.2% from payable 2002 to payable 2006. Since residential tax capacity grew faster than the citywide total (27.9%); residential share of net tax capacity, and therefore, homeowners' share of property taxes increased slightly from 63.5% for pay 2002 to 64.6% for pay 2006.

Not surprisingly, relative changes in property values shifted only \$41,143 of the 2006 tax levy from non-residential to residential properties; a much smaller shift compared to other jurisdictions in this study, as Table 24 demonstrates.

**Table 24: Effect of Relative 2002-2006 Tax Capacity Changes on Albert Lea Levy**

Property Type	2006 Budgeted Property Taxes		Levy Impact
	Alternate	Actual	Total
Residential	\$2,256,307	\$2,297,451	<b>\$41,143</b>
Non-Residential	\$1,299,193	\$1,258,049	<b>(\$41,143)</b>

<sup>29</sup> Includes licenses and permits, fines and forfeits, interest income, rental income, sales of fixed assets, and contribution/public enterprise revenues.



Table 25 shows the cumulative effects of revenue source shifts and relative valuation changes. These changes resulted in 148.3% higher property taxes (\$1.42 million) for residential properties and a 136.2% higher levy (\$0.75 million) for non-residential properties than would have been the case if relative valuations and the revenue portfolio shares had remained unchanged (the alternate scenario). Since very little shifting of value occurred between residential and non-residential properties, most of the change is attributable to changes in the City's reliance on property taxes, driven largely by declines in Local Government Aid and other revenues.

**Table 25: Combined Effect on City of Albert Lea Property Taxes from Relative Change in Valuation and Property Tax Reliance, by Property Type, 2002 – 2006**

	Residential Properties		Non-Residential Properties	
	Alternate*	Actual	Alternate*	Actual
Total 2006 Revenues	\$18,754,587	\$18,754,587	\$18,754,587	\$18,754,587
Share from Property Tax	7.97%	19.43%	7.97%	19.43%
Property Tax Revenues	\$1,503,204	\$3,666,000	\$1,503,204	\$3,666,000
Tax Capacity Shares	63.46%	64.62%	36.54%	35.38%
<b>Total 2006 Property Tax</b>	<b>\$953,928</b>	<b>\$2,368,852</b>	<b>\$549,276</b>	<b>\$1,297,148</b>
<b>Total Effect</b>	<b>\$1,414,924</b>		<b>\$747,872</b>	
<b>Percent Change</b>	<b>148.3%</b>		<b>136.2%</b>	

\* Combines both previous alternate scenarios.

## Changes in Spending

Table 26 provides an overview of Albert Lea's budget from a categorical (object code) perspective.

**Table 26: Changes in Albert Lea Expenditures by Category (\$ thousands): 2002-2006**

Category (Object Code)	Total Budget		Change: 2002-2006	
	2002	2006	Total (\$)	Percent
Personal Services	\$9,488	\$10,118	\$631	6.6%
Supplies	1,083	1,197	115	10.6%
Other Services and Charges	6,070	7,205	1,136	18.7%
Capital Outlay	384	392	8	2.2%
<b>Total Expenditures</b>	<b>\$17,024</b>	<b>\$18,913</b>	<b>1,889</b>	<b>11.1%</b>

Personnel expenditures increased roughly \$630,000 (6.6%) during this period, despite a 5.4% fall in employment as measured by FTE. As Table 27 indicates, the main components were: salaries and wages (\$0.21 million; or 3.0%), and fringe benefits (0.42 million; or 18.6%). When spending is measured per FTE salaries increased 8.9% and fringe benefits increased 25.4%; notably lower than the index for government or private industry.

**Table 27: Changes in Albert Lea Personnel Costs, Total and Components, 2002-2006**

Compensation Component	Personnel Cost Change: 2002-2006		Personnel Cost Change per FTE		Employment Cost Index Change: 2002-2006	
	Total (\$ millions)	Percent	Total (\$)	Percent	Private Industry	State & Local Government
<b>Salaries and Wages</b>	\$0.21	3.0%	\$4,160	8.9%	13.9%	14.1%
<b>Fringe Benefits</b>	\$0.42	18.6%	\$3,682	25.4%	25.6%	33.5%
<b>Total</b>	<b>\$0.63</b>	<b>6.6%</b>	<b>\$7,842</b>	<b>12.8%</b>	<b>17.1%</b>	<b>19.7%</b>

Note: Numbers may not add due to rounding.

As a share of total expenses, personnel costs fell from 55.7% of the City’s 2002 budget to 53.5% of its 2006 budget. As with other cities and counties, the main drivers behind increased fringe benefit costs relate to health care and retirement. Health Insurance spending grew in total by 19.5% and by 26.4% on a per FTE employee basis.

As Table 26 indicates, the largest expenditure change in dollar terms was in the “other services and charges” category, which increased 18.7%, or \$1.14 million. Almost two-thirds of this increase (some \$714,000) came from the city’s four enterprise funds (Water, Sewage Disposal, Solid Waste Management, and Parking). One major driver behind this increase: depreciation costs associated with these four funds increased by almost \$415,000 from 2002 to 2006. Costs related to the City’s sanitary sewer treatment plant were the other main cost driver; increased professional services, public utilities, and repair and maintenance expenditures totaled \$266,000 during this period.

**Summary: Excessive Reliance on State Aids Spells Trouble When Times Get Tough**

In 2002, a mere 8% of the Albert Lea budget was based on the local property tax while over 40% was based in state aids. Given the city’s exposure to state aids, subsequent general purpose aid cuts hit Albert Lea much harder than many other cities. By our measures, the city implemented good controls on wages and fringe benefits (major cost drivers, as we have seen). However, without growth in the property tax base or other forms of revenue to turn to, even small budget increases resulted in real financial difficulties for Albert Lea.

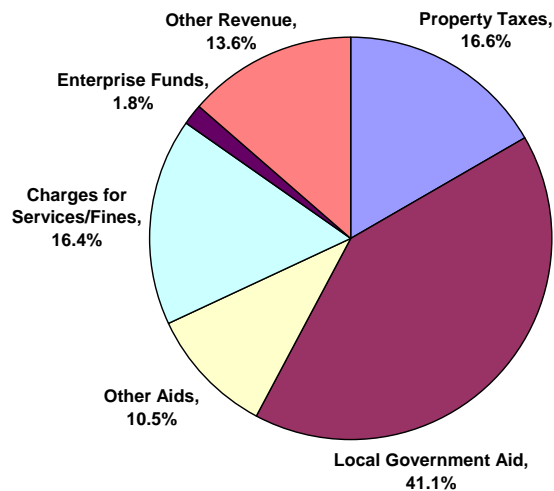
## City of Brainerd: Keeping the Lid on Costs Isn't Enough

Brainerd, a regional center in west-central Minnesota with an estimated 2006 population of nearly 14,000, is one of Minnesota's resort centers. Its popularity as a tourist destination and place for recreational cabins and second homes triggered substantial commercial growth during the study period. As a result of growth pressures per capita property taxes rose 91.2% between 2002 and 2006, placing Brainerd 6<sup>th</sup> of 209 cities with population over 2,500. Concurrently, intergovernmental aids to the city declined sharply.

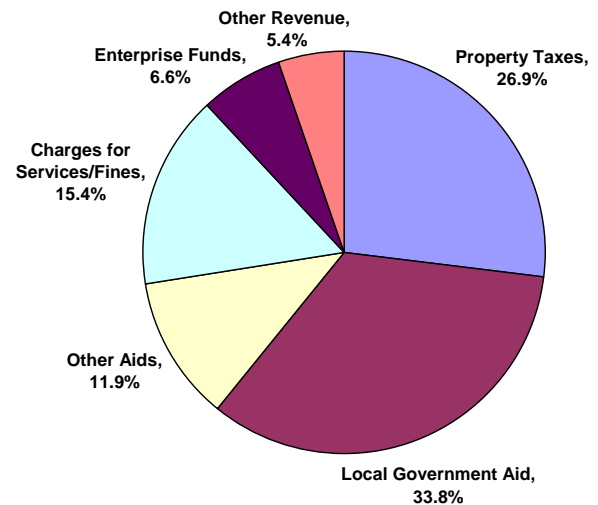
### Changes in Revenue Portfolio

Brainerd's budgeted revenues increased from \$9.8 million to \$11.9 million (\$1.9 million) between 2002 and 2006. Total property taxes over this period increased by a nearly equivalent amount (\$1.6 million); however, this represented a 97% increase.

**Figure 9: Budgeted Brainerd Revenues by Share of Total, 2002**



**Figure 10: Budgeted Brainerd Revenues by Share of Total, 2006**



Share of revenues from LGA<sup>30</sup>, charges for services/fines, and other revenues<sup>31</sup> fell, while reliance on revenues from other (non-LGA) aids and enterprise funds increased.<sup>32</sup>

Table 28 presents our revenue portfolio analysis for Brainerd. As it indicates, the actual 2006 levy was 97.3% larger than the 2002 levy. Had the shares of the revenue portfolio remained unchanged (the alternate scenario), the levy would have increased only by

<sup>30</sup> Note that total budgeted local government aid revenues increased slightly during the period (0.4%), from \$4,005,088 in 2002 to \$4,019,438 in 2006.

<sup>31</sup> Includes other tax collections, interest income, contributions and donations, special assessments, and miscellaneous.

<sup>32</sup> Brainerd's 2002 budget documents accidentally reported \$221,712 of money transferred from the Permanent Improvement Fund to the Construction Fund as revenues and expenditures. We have corrected this error; therefore, our revenue and expenditure figures will differ from those presented by the City.

21.9% (\$0.35 million) between 2002 and 2006. The analysis indicates that changes in the City's revenue portfolio resulted in a \$1.22 million larger property tax levy for 2006. Much of this change is attributable to a lower share of intergovernmental revenue (primarily Local Government Aid) and other revenues.

**Table 28: Alternate and Actual 2006 Revenues, City of Brainerd, by Source**

Revenues by Source	Alternate 2006 Revenues		Actual 2006 Revenues	
	Dollar	% Change from 2002	Dollar	% Change from 2002
<b>Total Revenue</b>	<b>\$11,881,469</b>	<b>21.9%</b>	<b>\$11,881,469</b>	<b>19.1%</b>
<b>Local Government Aid</b>	\$4,880,360	21.9%	4,019,438	0.4%
<b>Other Intergovernmental Aids</b>	1,241,936	21.9%	1,409,033	38.2%
<b>Charges for Services/Fines</b>	1,953,978	21.9%	1,832,384	14.3%
<b>Enterprise Funds</b>	219,337	21.9%	784,000	335.6%
<b>Other Revenues</b>	1,611,232	21.9%	638,614	(51.7%)
<b>Property Taxes</b>	<b>\$1,974,627</b>	<b>21.9%</b>	<b>\$3,198,000</b>	<b>97.3%</b>

### Changes in Property Valuation

Residential tax capacity for grew by 61.6% from payable 2002 to payable 2006, faster than the citywide total of 57.8%. Therefore, homeowners' share of property taxes increased slightly from 49.5% for pay 2002 to 50.7% for pay 2006. Home value appreciation in this desirable area of the state essentially kept pace with the growth in property value from commercial development. As Table 29 indicates, relative property value changes shifted \$38,252 of the 2006 tax levy from non-residential to residential properties; a relatively small amount compared to other jurisdictions in this study.

**Table 29: Effect of Relative 2002-2006 Tax Capacity Changes on Brainerd Levy**

Property Type	2006 Budgeted Property Taxes		Levy Impact
	Alternate	Actual	Total
<b>Residential</b>	\$1,583,543	\$1,621,795	<b>\$38,252</b>
<b>Non-Residential</b>	\$1,614,457	\$1,576,205	<b>(\$38,252)</b>

Table 30 details the cumulative effects of these revenue sourcing and relative valuation changes. These changes resulted in 65.9% higher property taxes (\$0.64 million) for residential property and a 58.1% higher levy for non-residential property (\$0.58 million) than would have been the case if relative valuations and the revenue portfolio shares had remained unchanged (the alternate scenario). The differential between the residential and non-residential percentage changes is attributable to shifting valuation between these classes; otherwise, taxes on both types of property would have risen by 62.0% from the revenue portfolio change alone. Since very little shifting of value occurred between residential and non-residential properties (see Table 29), most of the change is attributable to changes in the City's reliance on property taxes, driven largely by declines in Local Government Aid and other revenues.

**Table 30: Combined Effect on City of Brainerd Property Taxes by Property Type from Relative Changes in Tax Capacity Share and Property Tax Reliance, 2002 – 2006**

	Residential Properties		Non-Residential Properties	
	Alternate*	Actual	Alternate*	Actual
Total 2006 Revenues	\$11,881,469	\$11,881,469	\$11,881,469	\$11,881,469
Share from Property Tax	16.62%	26.92%	16.62%	26.92%
Property Tax Revenues	\$1,924,627	\$3,198,000	\$1,974,627	\$3,198,000
Tax Capacity Shares	49.52%	50.71%	50.48%	49.29%
<b>Total 2006 Property Tax</b>	<b>\$977,770</b>	<b>\$1,621,795</b>	<b>\$996,857</b>	<b>\$1,576,205</b>
<b>Effect of Changes (Dollar)</b>	<b>\$644,026</b>		<b>\$579,347</b>	
<b>Effect of Changes (Percent)</b>	<b>65.9%</b>		<b>58.1%</b>	

\* Combines both previous alternate scenarios.

### Changes in Spending

Brainerd spent \$1.88 million (19.2%) more in 2006 than it did in 2002, far outpacing budgeted LGA growth of \$14,350 (0.4%). Spending for Public Safety increased dramatically, both in total dollar and percentage terms. When looking at budget changes from an object code perspective, as Table 31 does, it is clear that increased personnel costs<sup>33</sup> added \$1.3 million in spending (25.8%) between 2002 and 2006. For comparison, the City’s budgeted FTE count<sup>34</sup> rose by 10.7% (from 93.76 to 103.83) during the same period.

**Table 31: Changes in Brainerd Approved Budgets, by Broad Object Code, 2002-2006**

Object Code	Spending		Change: 2002-2006	
	2002	2006	Dollar	Percent
Personal Services	\$5,089,869	\$6,402,544	\$1,312,675	25.8%
Supplies	\$467,507	\$524,955	\$57,448	12.3%
Services	\$2,025,563	\$2,708,861	\$683,298	33.7%
Capital	\$473,270	\$443,809	(\$29,461)	(6.2%)
Transfers	\$125,350	\$143,300	\$17,950	14.3%
Levy/TIF <sup>35</sup> Pass Through	\$399,542	\$644,000	\$244,458	61.2%
Debt Service	\$978,415	\$790,758	(\$187,657)	(19.2%)
<b>Total</b>	<b>\$9,559,516</b>	<b>\$11,658,227</b>	<b>\$2,098,711</b>	<b>22.0%</b>

The City of Brainerd’s budget materials provide not only total personnel costs<sup>36</sup>, but also (unlike many local budgets) provide comprehensive detail on the individual personnel cost components, such as wages and salaries or fringe benefits. As Table 32 indicates, the \$1.3 million increase in personnel costs was broken down between salaries (some

<sup>33</sup> The City classifies payments to its pension plan for volunteer firefighters as “Services” expenditures. Since the City classifies payments to the full-time firefighter pension plan (PERA) as “Personal Services” expenditures, we have reclassified volunteer firefighter pension expenditures as “Personal Services” for purposes of comparing total compensation.

<sup>34</sup> The City does not include FTE counts in its budget. City staff indicated to MCPFR that employment data as published in the city’s 2006 CAFR was sufficient for purposes of this report.

<sup>35</sup> Tax Increment Financing.

<sup>36</sup> Referred to in City budget documents as “personal costs”.

\$765,000; a 20.1% increase) and fringe benefits (roughly \$547,000; or 42.9%). When measured as spending per FTE<sup>37</sup> we calculate that salaries increased 7.9% over the period, and fringe benefits increased 24.3%, with personnel costs increasing by 11.8%.

**Table 32: Changes in Brainerd Personnel Component Costs, 2002-2006**

Compensation Component	Personnel Cost Change: 2002-2006		Personnel Cost Change per FTE		Employment Cost Index Change: 2002-2006	
	Total (\$000)	Percent	Total (\$)	Percent	Private Industry	State & Local Government
<b>Salaries</b>	\$765	20.1%	\$3,111	7.9%	13.9%	14.1%
<b>Fringe Benefits</b>	\$547	42.9%	\$2,984	24.3%	25.6%	33.5%
<b>Total</b>	<b>\$1,313</b>	<b>25.8%</b>	<b>\$6,095</b>	<b>11.8%</b>	<b>17.1%</b>	<b>19.7%</b>

Note: Numbers may not add due to rounding.

For comparative purposes, Table 32 presents data on the change in the ECI from the first quarter of 2002 to fourth quarter of 2006. The City’s per FTE increases for total compensation (including both the salaries and fringe benefits components) compare favorably to the national average for both the public and private sectors.

**Summary: Necessary, but Not Sufficient – Keeping the Lid on Costs**

Communities that rely heavily on state aids to finance operations have greater risks during times of state fiscal stress. Brainerd, like many Minnesota cities, exercised good financial management by keeping the lid on costs. Unlike many areas in rural Minnesota, commercial growth was extensive. However, absent other readily available revenue sources, even communities that benefit from property tax base growth and low per-employee personnel cost increases have little recourse but to finance (at least in part) budget problems with higher property taxes.

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<sup>37</sup> Since volunteer firefighters are employed “on call”, it is very difficult to translate these positions into full-time equivalents, and so the City does not present them as such. We therefore exclude volunteer firefighter spending and employment data from the per-FTE spending analysis.

## **City of Detroit Lakes: Enterprise Funds Make a Bad Situation Better**

Detroit Lakes, with an estimated 2006 population of 8,195, represents one of Minnesota's "sub-regional centers" – medium-sized greater Minnesota cities with high per capita commercial/industrial market value. Per capita property tax increases have been very close to the median of 30.2% (31.8% between 2002 and 2006, ranking 94<sup>th</sup> of 209 cities with population over 2,500).

Although total city spending **decreased** by 2.4% during this period, spending on current operations increased by 4.5%.<sup>38</sup> Spending on personnel increased by 25.1% in the aggregate (18.8% when measured per employee), placing further strain on city finances. Compounding the issue, LGA fell from \$1.55 million to \$1.19 million. The city's enterprise funds became a larger source of general fund revenue, although it is not entirely clear if charges for these services were increased to subsidize general fund operations. Detroit Lakes' response to these financial problems included a 33.8% in the overall property tax levy.

### **Revenue Portfolio Analysis (Governmental Funds only)**

In total, budgeted revenues increased \$1.0 million from 2002 to 2006. Total property taxes increased just over \$608,000 (33.8%) during the period, from \$1.8 million to \$2.4 million. In part, this was driven by changes in the relative shares of the City's revenue sources. Non-property tax revenues fell by more than \$770,000 (16.3%).

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<sup>38</sup> Detroit Lakes operates five enterprise funds, which they report in the budget materials. Our analysis will include only those enterprise fund revenues that are transferred to other city funds, since those can be considered as profits used to subsidize other government operations. Otherwise, we are excluding these funds from the analysis because the remaining revenues finance the cost of providing goods and services, and can be thought of in many ways as pass-through revenues. Moreover, as self-supporting entities, these enterprises are not intended to be supported by property tax revenues.

Figure 11 and Figure 12 detail the changes by category<sup>39</sup>.

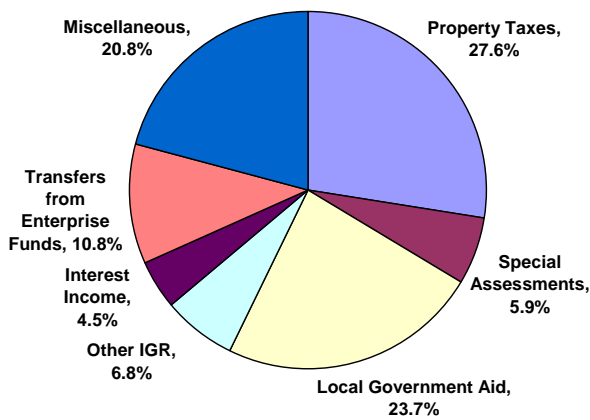
State general purpose aids fell by some \$360,000 (23.1%) during this period, and other intergovernmental revenues also fell dramatically. However, the decline is misleading: the City received two large one-time intergovernmental grants in 2002 (\$1,563,272 from the federal government for airport improvements; \$925,000 from an undisclosed governmental entity for development related to the Graystone Annex) which inflate its intergovernmental revenue totals for that year. Disregarding these one-time revenues, “other” intergovernmental revenues remained nearly unchanged as a share of the citywide budget, decline from 2.3% in 2002 to 2.2% in 2006.

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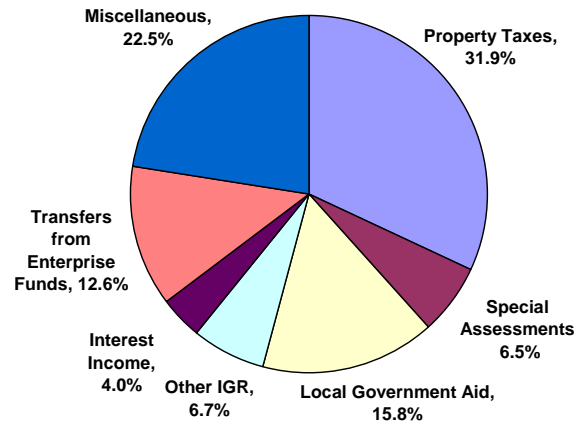
<sup>39</sup> “Miscellaneous” includes miscellaneous, bond proceed, state loan proceed, fines and forfeit, charges for service, building permit, storm water charge, licenses and permit, franchise fee, and lodging tax revenues.



**Figure 11: Budgeted Detroit Lakes Revenues by Share of Total, 2002**



**Figure 12: Budgeted Detroit Lakes Revenues by Share of Total, 2006**



The City’s business-type enterprises are rather profitable – transfers from them supported 10.8% of governmental fund spending in 2002 and 12.6% of such spending in 2006. As Table 33 shows, these profits come entirely from City’s electrical and liquor operations.

**Table 33: Detroit Lakes Enterprise Fund Transfers to Governmental Funds, 2002-2006**

Fund	2002	2003	2004	2005	2006
Electrical Utility	\$465,000	\$519,400	\$529,660	\$529,660	\$549,040
Liquor	\$239,500	\$275,697	\$276,816	\$376,816	\$401,816 <sup>40</sup>
<b>Total</b>	<b>\$704,500</b>	<b>\$795,097</b>	<b>\$806,476</b>	<b>\$906,476</b>	<b>\$950,856</b>

Our revenue portfolio analysis is presented in Table 34.<sup>41</sup> As the table shows, the actual 2006 levy is 33.8% higher than the actual 2002 levy and some \$325,000 (15.6%) higher than the alternate 2006 levy.

**Table 34: Alternate and Actual 2006 Revenues, City of Detroit Lakes, by Source (Governmental Funds Only)**

Revenues by Source	Alternate 2006 Revenues		Actual 2006 Revenues	
	Dollar	% Change from 2002	Dollar	% Change from 2002
<b>Total Revenue</b>	<b>\$7,548,977</b>	<b>15.7%</b>	<b>\$7,548,977</b>	<b>15.7%</b>
Special Assessments	\$445,976	15.7%	\$493,000	28.1%
Local Government Aid	1,790,206	15.7%	1,189,099	(23.1%)
Other Intergovernmental Aid	510,458	15.7%	505,429	14.6%
Interest Income	338,274	15.7%	301,248	3.1%
Transfers from Enterprise Funds	815,443	15.7%	950,856	35.0%
Miscellaneous Revenues	1,566,659	15.7%	1,701,816	25.7%
<b>Property Taxes</b>	<b>\$2,081,962</b>	<b>15.7%</b>	<b>\$2,407,129</b>	<b>33.8%</b>

<sup>40</sup> Note: an additional \$369,300 was transferred to the Capital Projects Fund for capital improvements.

<sup>41</sup> Note: we exclude the large one-time intergovernmental revenues received in 2002 (previously discussed), since they render a 2002-to-2006 trend analysis useless.

In the alternate scenario, where revenue shares are held constant, the levy increases only 15.7%, or \$283,000. This is generally attributable to a lower share of Local Government Aid.

### Property Valuation Analysis

Residential tax capacity grew by 57.2% from payable 2002 to payable 2006. Since overall citywide tax capacity growth was 45.4%, the residential share of net tax capacity, and therefore, homeowners' share of property taxes, increased from 49.0% for pay 2002 to 53.0% for pay 2006.

Table 35 presents Detroit Lakes' valuation analysis. Relative property value changes (a market-driven phenomenon) shifted almost \$100,000 of the 2006 tax levy from non-residential to residential properties.

**Table 35: Effect of Relative 2002-2006 Tax Capacity Changes on Detroit Lakes Levy**

Property Type	2006 Budgeted Property Taxes		Levy Impact
	Alternate	Actual	Total
<b>Residential</b>	\$1,180,143	\$1,275,686	<b>\$95,543</b>
<b>Non-Residential</b>	\$1,226,986	\$1,131,442	<b>(\$95,543)</b>

Table 36 details the cumulative effects of these revenue sourcing and relative valuation changes. These changes resulted in 25.0% higher property taxes (\$254,963) for residential properties and a 6.6% higher levy (\$70,204) for non-residential properties than would have been the case if relative valuations and the revenue portfolio shares had remained unchanged (the alternate scenario). The differential between the residential and non-residential percentage changes is attributable to shifting valuation between these classes; otherwise, taxes on both types of property would have risen 15.6% from the revenue portfolio change alone.

**Table 36: Combined Effect on City of Brainerd Property Taxes by Property Type from Relative Changes in Tax Capacity Share and Property Tax Reliance, 2002 – 2006**

	Residential Properties		Non-Residential Properties	
	Alternate*	Actual	Alternate*	Actual
Total 2006 Revenues	\$7,548,977	\$7,548,977	\$7,548,977	\$7,548,977
Share from Property Tax	27.58%	31.89%	27.58%	31.89%
Property Tax Revenues	\$2,081,962	\$2,407,129	\$2,081,962	\$2,407,129
Tax Capacity Shares	49.03%	53.00%	50.97%	47.00%
<b>Total 2006 Property Tax</b>	<b>\$1,010,723</b>	<b>\$1,275,686</b>	<b>\$1,061,239</b>	<b>\$1,131,443</b>
<b>Effect of Changes (Dollar)</b>	<b>\$254,963</b>		<b>\$70,204</b>	
<b>Effect of Changes (Percent)</b>	<b>25.0%</b>		<b>6.6%</b>	

\* Combines both previous alternate situations.

## Changes in Spending

Table 37 provides an overview of changes in City spending on an object code basis.<sup>42</sup> Personnel costs were much higher during the period; made all the more significant because the other large spending increases (by object code) represent increased costs of “business” inputs (electricity and liquor) that are sold at a profit. Total compensation costs increased by 25.8% (almost \$1.1 million) between 2002 and 2006. At the same time, the City’s budgeted FTE employee count (excepting volunteer firefighters) rose by 5.3% (from 76 to 80 FTE).

**Table 37: Detroit Lakes Changes in Expenditures by Category (\$ thousands): 2002-2006**

Category (Object Code)	Total Budget		Change: 2002-2006	
	2002	2006	Total (\$)	Percent
<b>Personal Services</b>	\$4,200	\$5,284	\$1,084	25.8%
<b>Supplies</b>	888	1,006	118	13.3%
<b>Other Services and Charges</b>	4,177	2,678	(1,499)	(35.9%)
<b>Capital Outlay</b>	6,443	4,721	(1,721)	(26.7%)
<b>Electrical Generation Costs</b>	5,411	6,860	1,449	26.8%
<b>Cost of Liquor Sold</b>	2,250	2,869	619	27.5%
<b>Debt Service<sup>43</sup></b>	3,010	2,325	(685)	(22.8%)
<b>Total Expenditures</b>	<b>\$26,378</b>	<b>\$25,743</b>	<b>(\$635)</b>	<b>(2.4%)</b>

As Table 38 indicates, this increase was broken down between salaries (\$643,000; or 19.7%) and fringe benefits (\$393,113; or 45.8%). When measured as spending per FTE, salaries increased 13.6%, while fringe benefits increased 38.4%. For comparative purposes, Table 38 presents data on the change in the ECI from the first quarter of 2002 to fourth quarter of 2006. The City’s per FTE increases for total compensation compare favorably to the national average for state and local governments, although fringe benefits did increase faster than the benchmark national rate.

**Table 38: Changes in Detroit Lakes Personnel Costs, Total and Components, 2002-2006**

Compensation Component	Personnel Cost Change: 2002-2006		Personnel Cost Change per FTE		Employment Cost Index Change: 2002-2006	
	Total (\$000)	Percent	Total (\$)	Percent	Private Industry	State & Local Government
<b>Salaries</b>	\$643	19.7%	\$5,935	13.6%	13.9%	14.1%
<b>Fringe Benefits</b>	\$393	45.8%	\$4,397	38.4%	25.6%	33.5%
<b>Total</b>	<b>\$1,036</b>	<b>25.1%</b>	<b>\$10,332</b>	<b>18.8%</b>	<b>17.1%</b>	<b>19.7%</b>

Note: Numbers may not add due to rounding.

Table 39 reports fringe benefit expense changes over the period. Increased health care and retirement costs are the main drivers behind these changes. Health insurance,

<sup>42</sup> Object code categorizations appear to differ from fund to fund. MCPFR has attempted to adjust the object code reporting for inter-fund consistency. These adjustments render totals found in this table different from the totals reported in the City’s budget materials.

<sup>43</sup> Includes non-debt TIF reimbursements.

payments to the pension plan for county employees (PERA), and FICA costs accounted for \$336,000 in increased fringe benefit spending; or 85% of the total.

**Table 39: Changes in City of Detroit Lakes Fringe Benefit Costs, 2002-2006**

Fringe Benefit Expenditure	Spending (\$000)		Change	
	2002	2006	(\$000)	Percent
<b>Health Insurance</b>	\$371	\$604	\$233	62.7%
<b>PERA</b> <sup>44</sup>	192	254	62	32.1%
<b>Workers Compensation</b>	50	98	48	96.2%
<b>FICA (Social Security and Medicare)</b>	307	248	41	19.9%
<b>All Other</b>	38	47	9	24.4%

**Summary: Enterprise Funds Soften the Blow**

Compared to the other rural cities in this study, Detroit Lakes had far less exposure to the risks inherent in state funding for its budget. The city also appears to have had greater ability to engage in financial engineering to close funding gaps. During the period from 2020 to 2006, it increased reliance both on special assessments and transfers from enterprise fund operations. It is not clear whether the assets transferred represent fund balance of some sort, profits from increased charges, or something else. What is clear is that Detroit Lakes, like many other communities, used their enterprise funds to soften the property tax blow on residents and businesses alike.

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<sup>44</sup> Public Employees Retirement Association (pension fund). Includes Police and Fire PERA.

## Hennepin County: Stop the Unfunded Mandates

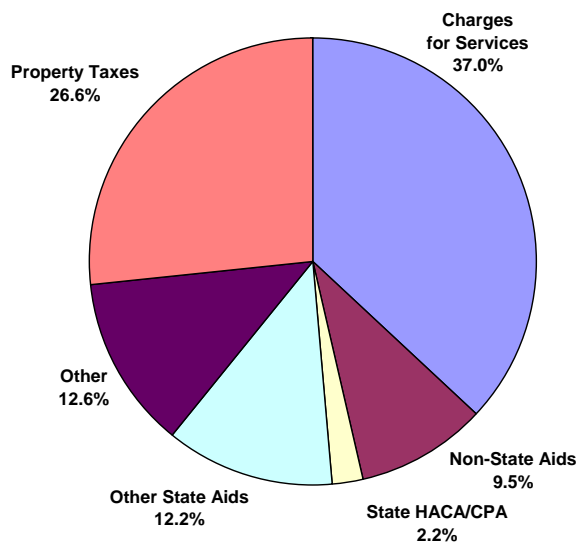
Counties are substantially different units of government than cities. Unlike cities, counties serve a two-fold purpose: they are not only local units of government; they also serve as administrative agents of the state, and so administer many state programs.

Hennepin County is Minnesota's most populous. Like Minneapolis, it receives significant attention from state lawmakers. The county experienced an 11.9% spending increase during this period, with personnel spending increasing by 14.1% in total and by 21.6% when measured per employee. Not only did the State reduce general purpose aids by 18.2% during this period, it also reduced program-related aids by 20.8%, creating a number of so-called unfunded mandates. While the county used approximately \$170 million of fund balance to finance its operations over this period, it still had to rely more heavily on property taxes with a 16.9% increase in the 2006 levy over 2002. Since the residential share of the property tax base rose by nearly 20% during this period, homeowners ended up paying an even larger share of this higher tax burden.

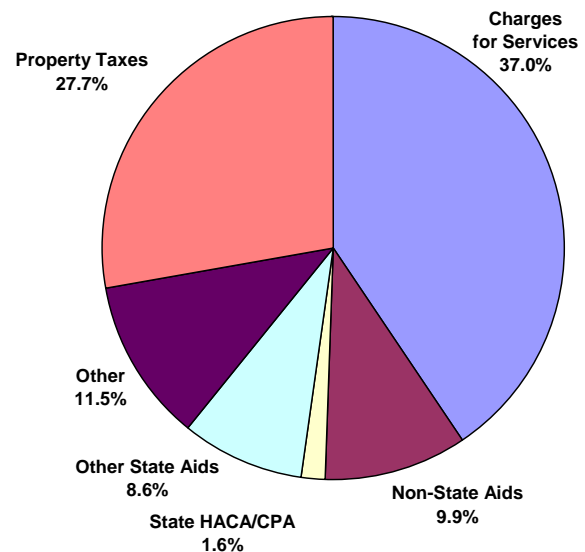
### Revenue Portfolio Analysis

Hennepin County's budgeted revenues increased from \$1.69 billion to \$1.90 billion (\$202.1 million) between 2002 and 2006. Property taxes increased \$76.0 million (16.9%), from \$449.9 million to \$525.8 million. In part, this was driven by changes in the relative shares of the County's revenue sources. Non-property tax revenues rose 7.4% (\$126.1 million).

**Figure 13: Budgeted Hennepin County Revenues by Share of Total, 2002**



**Figure 14: Budgeted Hennepin County Revenues by Share of Total, 2006**



As Figure 13 and Figure 16 detail, the county became more dependent on federal and local aids and charges for services and less dependent on state aids and other non-property tax revenues<sup>45</sup>. The county had considerable charges for service revenues; nearly 60% were generated by Hennepin County Medical Center (HCMC). Note that while fund balance changed very little as a share of total revenues during this period, the County effectively spent some \$170 million of its savings to finance its operations.

Our revenue portfolio analysis for Hennepin County is presented in Table 40. As it indicates, the actual 2006 levy was 16.9% larger than the 2002 levy. Had the revenue portfolio share remained unchanged (the alternate scenario), the levy would have increased only by 11.9% (\$53.7 million) from 2002 to 2006. The analysis indicates that changes in the county's revenue portfolio resulted in a \$22.2 million (4.4%) larger 2006 property tax levy. Interestingly, state program aids changes had nearly six times the effect of state general purpose aids changes.

**Table 40: Alternate and Actual 2006 Revenues, Hennepin County, by Source**

Revenues by Source	Alternate 2006 Revenues		Actual 2006 Revenues	
	Dollar	% Change from 2002	Dollar	% Change from 2002
<b>Total Revenue</b>	<b>\$1,895,331,674</b>	<b>11.9%</b>	<b>\$1,895,331,674</b>	<b>11.9%</b>
<b>Charges for Services</b>	700,376,019	11.9%	770,423,946	23.1%
<b>Non-State Aids</b>	179,363,480	11.9%	187,138,828	16.8%
<b>State HACA/CPA</b>	42,286,457	11.9%	30,887,212	(18.2%)
<b>Other State Aids</b>	230,519,238	11.9%	163,119,212	(20.8%)
<b>Other</b>	239,220,435	11.9%	217,922,841	2.0%
<b>Property Taxes</b>	<b>\$503,566,044</b>	<b>11.9%</b>	<b>\$525,839,635</b>	<b>16.9%</b>

### Property Valuation Analysis

Residential tax capacity grew by 68.1% from payable 2002 to payable 2006, faster than the countywide total (41.7%). Therefore, the share of property taxes paid by homeowners, increased from 52.1% for payable 2002 to 61.8% for payable 2006.

Our Hennepin County valuation analysis is presented in Table 41. As it indicates, relative property value changes (a market-driven phenomenon) shifted \$51.1 million of the 2006 tax levy from non-residential to residential properties.

**Table 41: Effect of Relative 2002-2006 Tax Capacity Changes on Hennepin County Levy**

Property Type	2006 Budgeted Property Taxes,		Levy Impact
	Alternate	Actual	Total
<b>Residential</b>	\$274,059,570	\$325,202,259	<b>\$51,142,689</b>
<b>Non-Residential</b>	\$251,780,065	\$200,637,376	<b>(\$51,142,689)</b>

<sup>45</sup> Includes fines and forfeitures, interest income, licenses and permits, bond proceeds, interfund revenues, miscellaneous, other tax collections, changes in net assets, uses of fund balance and prior year carryovers.

Table 42 details the cumulative effects of these revenue sourcing and relative valuation shifts. These changes resulted in 23.9% (\$62.8 million) higher residential property taxes and a 16.9% lower (\$40.5 million) non-residential levy than would have been the case if relative valuations and the revenue portfolio shares had remained unchanged (the alternate scenario). The differential between the residential and non-residential percentage changes is attributable to shifting valuation between these properties; otherwise, taxes on both types of property would have risen 4.4% from the revenue portfolio change alone.

**Table 42: Combined Effect on Hennepin County Residential Property Taxes from Relative Changes in Tax Capacity Share and Property Tax Reliance, 2002 – 2006**

	Residential Properties		Non-Residential Properties	
	Alternate*	Actual	Alternate*	Actual
Total 2006 Revenues	\$1,895,331,674	\$1,895,331,674	\$1,895,331,674	\$1,895,331,674
Share from Property Tax	26.57%	27.74%	26.57%	27.74%
Property Tax Revenues	\$503,566,044	\$525,839,635	\$503,566,044	\$525,839,635
Tax Capacity Shares	52.12%	61.84%	47.88%	38.16%
<b>Total 2006 Property Tax</b>	<b>\$262,450,915</b>	<b>\$325,202,259</b>	<b>\$241,115,129</b>	<b>\$200,637,376</b>
<b>Effect of Changes (Dollar)</b>	<b>\$62,751,344</b>		<b>(\$40,477,753)</b>	
<b>Effect of Changes (Percent)</b>	<b>23.9%</b>		<b>(16.9%)</b>	

\* Combines both previous alternate scenarios.

### Changes in Spending – By Program Area

Hennepin County spent \$202.1 million (11.9%) more in 2006 than it did in 2002. Table 43 details the changes in the County’s spending and tax levy by major program area. Notably, spending for Health increased by \$159.9 million, or 31.9%.<sup>46</sup> HCMC accounted for the largest share of this increase, \$92.2 million, 60% of which came from increased personnel costs. Hennepin County’s HMO, the Metropolitan Health Plan, accounted for another \$59.2 million of the Health budget increase. Major cost drivers included increased health care costs, the expansion of programs (especially those related to Medicare) and the decision to begin providing administrative services to PrimeWest, a county-based purchasing initiative of ten counties in western Minnesota.

Two program areas saw reduced spending. Public safety spending fell in large part because the State in 2003 assumed responsibility for financing district courts, relieving the County of that burden. Human services spending fell by \$29.9 million in part from reductions in federal and state program aids. Importantly, even with this reduced spending, Hennepin County still levied \$12.2 million more in property taxes for Human Services purposes in 2006 than it did in 2002 – a direct effect of state mandates.

<sup>46</sup> Hennepin County reported Community Health in the Health program services area in 2002 and in the Human Services program area in 2003 through 2006. To facilitate consistent comparisons, we report Community Health in the Human Services program area for all years.

**Table 43: Changes in Hennepin County Spending and Property Taxes Levied, By Major Program Area, 2002-2006**

Program Area	Spending Change		Property Tax Change	
	Dollar	Percent	Dollar	Percent
<b>General Government</b>	\$22,556,723	14.7%	\$11,232,196	9.5%
<b>Public Safety</b>	(\$18,331,737)	(7.7%)	\$8,145,639	5.0%
<b>Public Works</b>	\$27,904,888	32.7%	\$3,831,144	22.0%
<b>Human Services</b>	(\$29,851,357)	(5.5%)	\$12,221,211	6.3%
<b>Libraries</b>	\$4,221,609	12.2%	\$3,953,278	12.2%
<b>Health</b>	\$159,855,116	31.9%	\$10,347,143	56.0%
<b>Capital Investment</b>	\$35,758,950	25.7%	(\$617,000)	(23.1%)
<b>Subtotal (before financing)</b>	<b>\$202,114,192</b>	<b>11.9%</b>	<b>\$49,113,611</b>	<b>16.9%</b>

There are two revenue streams that Table 43 does not document. The County uses countywide revenues<sup>47</sup> and general purpose aids as a direct offset against its property tax levy. In 2006, there was an additional \$3.5 million in countywide revenues for offset purposes and \$30.3 million less in available HACA/CPA.

However, total HACA/CPA revenues declined by only \$15.0 million from 2002 to 2006. The discrepancy occurs because the County spent some of its 2005 and 2006 aid (\$24.2 million and \$23.5 million, respectively) on infrastructure investment, rather than to offset the property tax levy. The County’s explanation for this use of general purpose aids was that, “due to the still unstable nature of the State of Minnesota’s finance, the County board chose not to budget the funds for new or expanded County programs, which could lead to service disruption and lay-offs should state funding fail to materialize.”<sup>48</sup> In essence, the county treated a portion of its general purpose aids as one-time money rather than as a dependable source of revenues, with a direct effect on property taxes.

### Changes in Spending – By Object Code

Table 44 presents Hennepin County’s budget by object code. Increased personnel costs added \$89.4 million in spending between 2002 and 2006 at the same time that the County’s budgeted FTE count fell by 6.2% (from 11,652.8 to 10,932.0).

**Table 44: Changes in Hennepin County Approved Budgets, by Object Code, 2002-2006**

Object Code	Spending		Change: 2002-2006	
	2002	2006	Dollar	Percent
<b>Personal Services</b>	\$739,859,410	\$829,722,582	\$89,863,172	12.1%
<b>Commodities</b>	86,609,898	100,007,596	13,397,698	15.5%
<b>Services</b>	286,471,782	350,320,114	63,848,332	22.3%
<b>Public Aid/Assistance</b>	269,684,270	252,893,454	(16,790,816)	(6.2%)
<b>Furniture &amp; Equipment</b>	10,267,465	7,843,190	(2,424,275)	(23.6%)
<b>Other Charges</b>	300,324,687	354,544,739	54,220,052	18.1%
<b>Total</b>	<b>\$1,693,217,512</b>	<b>\$1,895,331,675</b>	<b>\$202,114,163</b>	<b>11.9%</b>

<sup>47</sup> Revenues generated by the County that are not specially linked to a particular department or division.

<sup>48</sup> 2005 Budget Book, Hennepin County, p 45.



Hennepin County’s budget materials provide total personnel costs, but no complete detail on the individual components. Upon request, finance staff provided this data for 2002 through 2006. However, we discovered that the county-provided data did not match the information published in the County’s budget materials. After consulting with county financial staff, it appears that much of the discrepancy results from the manner in which the county reports internal service funds.<sup>49</sup> Given the difficulties involved with a complete resolution of this issue (other issues include treatment of retiree health costs); discrepancies between Table 44 and Table 45 will simply have to stand.

County finance department data indicates that budgeted personnel costs increased by \$109.4 million (14.1%) from \$774.9 million in 2002 to \$884.3 million in 2006. As Table 45 indicates, salaries rose (\$48.2 million), fringe benefits increase (\$56.8 million), and other personnel costs<sup>50</sup> grew (\$4.4 million). When measured per FTE salaries increased 15.3% over the period, fringe benefits increased 44.6%, and other personnel costs increased 26.3%. Total personnel costs increased from 45.7% of the 2002 budget to 46.7% of the 2006 budget.

For comparative purposes, Table 45 presents data on the change in the ECI from the first quarter of 2002 to fourth quarter of 2006. The per FTE increase in the County’s total personnel spending (including both the salary and fringe benefits components<sup>51</sup>) is greater than the change in the ECI for the private and public sectors.

**Table 45: Changes in Hennepin County Personnel Component Costs, 2002-2006**

Compensation Component	Personnel Cost Change: 2002-2006		Personnel Cost Change per FTE		Employment Cost Index Change: 2002-2006	
	Total (\$ millions)	Percent	Total (\$)	Percent	Private Industry	State & Local Government
Salaries	\$48.2	8.1%	\$7,755	15.3%	13.9%	14.1%
Fringe Benefits	\$56.8	35.6%	\$6,096	44.6%	25.6%	33.5%
Other	\$4.4	18.5%	\$539	26.3%	NA	NA
<b>Total</b>	<b>\$109.4</b>	<b>14.1%</b>	<b>\$14,390</b>	<b>21.6%</b>	<b>17.1%</b>	<b>19.7%</b>

Increased health care and retirement costs are the main drivers behind fringe benefit changes. Table 46 details the five health care and retirement fringe benefit expenses that changed by \$1 million or more over the period. These five items contributed \$59.9

<sup>49</sup> Hennepin County’s budget documents show the internal service funds’ revenues and expenditures, but unlike the other jurisdictions in this study, it does not include them in the overall totals. This practice accurately states total cash flows in and out of the County treasury and eliminates potential “double-counting” issues that arise when the same dollar is counted twice in one budget year. In this respect, the practice is commendable. However, because the County reports departmental spending to internal service funds rather than internal service fund spending itself, county-wide budget totals (as presented in budget materials) overstate actual spending on services and understate actual personnel costs, since total compensation paid to employees from the internal service funds is not reported.

<sup>50</sup> Accounts for payments for personal services not otherwise classified. According to Hennepin County staff, the vast majority is related to physician relationships with Hennepin County Medical Center.

<sup>51</sup> It is unclear if or how “other personnel benefits” should be allocated between salaries and fringe benefits. However, any possible allocation of “other personnel benefits” does not alter per FTE growth in salaries or fringe benefits to the point that growth drops below the change in the Employment Cost Index.

million to increased fringe benefit spending. The largest piece relates to health insurance spending for current employees. As Table 46 indicates, total Health Insurance spending grew by 66.1% during the period, and by 77.1% on a per-employee basis.

**Table 46: Changes in Selected Hennepin County Fringe Benefit Costs, 2002-2006**

Fringe Benefit Expenditure	Spending (\$000)		Change	
	2002	2006	(\$000)	Percent
<b>Health Insurance</b>	\$50,066	\$83,184	\$33,118	66.1%
<b>Retiree Health Insurance</b>	2,486	17,694	15,208	611.8%
<b>Workers Compensation</b>	2,984	7,577	4,593	153.9%
<b>PERA (pension)</b>	33,294	37,560	4,267	12.8%
<b>FICA (Social Security and Medicare)</b>	41,059	43,770	2,711	6.6%
<b>All Other</b>	29,521	26,407	(3,115)	(10.6%)
<b>Subtotal</b>	<b>\$159,410</b>	<b>\$216,192</b>	<b>\$56,782</b>	<b>35.6%</b>

Hennepin County offers retirees health care coverage, and budgeted for this on a “pay-as-you-go” basis through 2005. However, in June 2004 GASB began requiring state and local governments to pre-fund various post employment benefits as employees accrue them. The County’s retiree health insurance costs increased by \$13.9 million between 2005 and 2006 (from \$3.8 million to \$17.7 million); likely as a result of this requirement. The County’s budget does not indicate the actuarial costs of its retiree health care commitments, how much unfunded liabilities it has, or how long the County has to make good on the unfunded liabilities (the amortization period, similar to the period over which mortgage payments are made).

**Summary: When Fewer Aids Doesn’t Translate to Fewer Mandates, There’s Trouble in River City.**

Like other local governments, Hennepin County struggles with escalating health care costs and decreased general purpose state aids. Far more insidious, though, has been the State’s reduction in program-related aids. As Table 47 indicates, federal program-related aids increased from 2002 to 2006, but state program-related aids fell. It is extraordinarily difficult for counties to absorb program-related aid cuts if they have no control over the relative generosity of benefits, eligibility requirements, or service delivery methods. Even though the county cut human service spending, funding shortfalls required increased property tax support. Since local governments have more when in responding to general purpose aid cuts, counties often have much more difficult budget choices than cities, who receive far fewer program-related aids.

**Table 47: Changes in Program-Related Aids, Hennepin County, 2002-2006**

County	Aids Payable		Change: 2002-2006	
	2002	2006	Dollar	Percent
Federal Aids	\$151.8	\$174.8	\$22.9	15.1%
State Aids	\$197.8	\$163.1	(\$34.7)	(17.5%)
<b>Total Aids</b>	<b>\$349.6</b>	<b>\$337.9</b>	<b>(\$11.7)</b>	<b>(3.4%)</b>

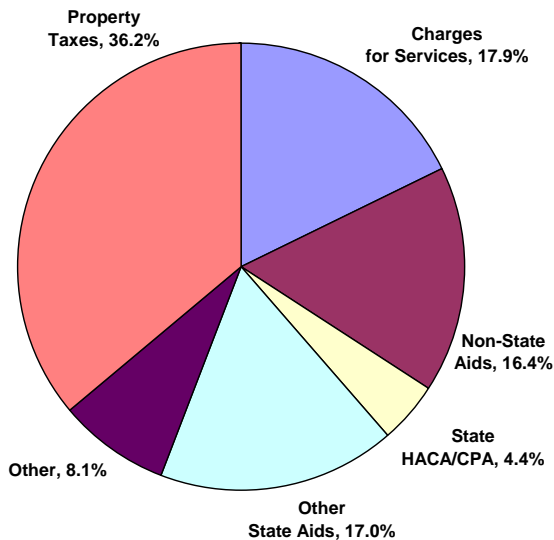
## Ramsey County: No, Really, Please Stop the Unfunded Mandates

As mentioned earlier, the selection of Ramsey County was determined when the City of Saint Paul was included. Ramsey County experienced a modest 5.2% spending increase during this period, with personnel spending increasing by 11.7% in total and by 15.0% per employee. As with Hennepin County, the State sharply reduced (22.4%) general purpose aids during this period and also reduced program-related aids by 18.9%, creating a number of unfunded mandates. While the county also dipped into its fund balance to finance operations (almost \$46 million in total), it also responded with a 22.9% increase in the property tax levy. Since the residential share of the property tax base rose by over 15% during this period, homeowners paid a larger share of this higher burden.

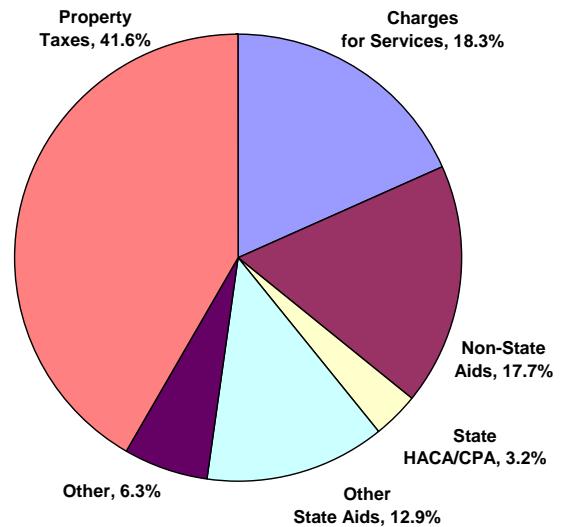
### Revenue Portfolio Analysis

Budgeted Ramsey County revenues increased \$32.8 million (6.9%) from 2002 to 2006. Property taxes increased \$39.7 million (22.9%), from \$173.0 million to \$212.7 million. In part, this was driven by changes in the relative shares of the County's revenue sources. Non-property tax revenues fell \$6.9 million, or 1.4%.

**Figure 15: Budgeted Ramsey County Revenues by Share of Total, 2002**



**Figure 16: Budgeted Ramsey County Revenues by Share of Total, 2006**



As the figures indicate, Ramsey County's reliance on state aids and other revenue sources<sup>52</sup> fell, reliance on property taxes and non-state (federal and local) aids increased, and reliance on charges for services<sup>53</sup> remained relatively unchanged.

<sup>52</sup> Includes fines and forfeitures, grants and donations, licenses and permits, sales, interest income, use of rental income, recovery of expenses, CHS program recoveries, and other tax collections.

<sup>53</sup> Includes the Waste Management Fee presented separately by the County in 2002.

Table 48 shows our revenue portfolio analysis. As the table shows, the actual 2006 levy is 22.9% larger than in 2002. Had the revenue portfolio share remained unchanged (the alternate scenario), the levy would have increased only by 6.9% (\$11.9 million) from 2002 to 2006. The analysis indicates that changes in the county's revenue portfolio resulted in a \$27.8 million (15.0%) larger 2006 property tax levy. Note that the effect on property taxes from the change in state program aids is roughly three times larger than the impact from state general purpose aids.

**Table 48: Alternate and Actual 2006 Revenues, Ramsey County, by Source**

Revenues by Source	Alternate 2006 Revenues		Actual 2006 Revenues	
	Dollar	% Change from 2002	Dollar	% Change from 2002
<b>Total Revenue</b>	<b>\$510,811,816</b>	<b>6.9%</b>	<b>\$510,811,816</b>	<b>6.9%</b>
<b>Charges for Services</b>	\$91,348,869	6.9%	\$93,303,708	9.2%
<b>Non-State Aids</b>	83,701,660	6.9%	90,367,753	15.4%
<b>State HACA/CPA</b>	22,658,767	6.9%	16,449,520	(22.4%)
<b>Other State Aids</b>	86,919,100	6.9%	65,935,468	(18.9%)
<b>Other</b>	41,291,093	6.9%	32,059,906	(17.0%)
<b>Property Taxes</b>	<b>\$184,892,327</b>	<b>6.9%</b>	<b>\$212,695,461</b>	<b>22.9%</b>

### Property Valuation Analysis

Residential tax capacity grew by 71.3% from payable 2002 to payable 2006, growing faster than the county-wide total (52.4%). Therefore, homeowners' share of property taxes increased from 53.5% for payable 2002 to 60.1% for payable 2006.

Our Ramsey County valuation analysis is presented in Table 49. Relative property value changes (a market-driven phenomenon) shifted \$14.1 million of the 2006 tax levy from non-residential to residential properties.

**Table 49: Effect of Relative 2002-2006 Tax Capacity Changes on Ramsey County Levy**

Property Type	2006 Budgeted Property Taxes		Levy Impact
	Alternate	Actual	Total
<b>Residential</b>	\$113,768,707	\$127,901,250	<b>\$14,132,543</b>
<b>Non-Residential</b>	\$98,926,754	\$84,794,211	<b>(\$14,132,543)</b>

Table 50 details the cumulative effects of these relative valuation and revenue source shifts. These changes resulted in 29.3% (\$29.0 million) higher residential property taxes and a 1.4% lower levy (\$1.2 million) for non-residential properties than would have been the case if relative valuations and the revenue portfolio shares had remained unchanged (the alternate scenario). The differential between the residential and non-residential percentage changes is attributable to shifting valuation between these classes; otherwise, taxes on both types of property would have risen 15.0% from the revenue portfolio change alone.

**Table 50: Combined Effect on Ramsey County Residential Property Taxes from Relative Changes in Tax Capacity Share and Property Tax Reliance, 2002 – 2006**

	Residential Properties		Non-Residential Properties	
	Alternate*	Actual	Alternate*	Actual
Total 2006 Revenues	\$510,811,816	\$510,811,816	\$510,811,816	\$510,811,816
Share from Property Tax	36.20%	41.64%	36.20%	41.64%
Property Tax Revenues	\$184,892,327	\$212,695,461	\$184,892,327	\$212,695,461
Tax Capacity Shares	53.49%	60.13%	46.51%	39.87%
<b>Total 2006 Property Tax</b>	<b>\$98,897,084</b>	<b>\$127,901,250</b>	<b>\$85,995,242</b>	<b>\$84,794,211</b>
<b>Effect of Changes (Dollar)</b>	<b>\$29,004,166</b>		<b>(\$1,201,032)</b>	
<b>Effect of Changes (Percent)</b>	<b>29.3%</b>		<b>(1.4%)</b>	

\* Combines both previous alternate scenarios.

### Changes in Spending – By Program Area

Table 51 details the changes between 2002 and 2006 in the county’s spending and tax levy, by major program area. Spending for General County Purposes increased the most, with these increases are generally attributable to the County’s need to partially fund its liability for post employment benefits (discussed later in more detail). One item of interest: although Health and Human Services spending increased by only \$2.7 million, the County raised an additional \$7.0 million in property taxes to fund these programs – the effect of cuts in state program aids.

**Table 51: Changes in Ramsey County Spending and Property Taxes Levied, By Functional Area, 2002-2006**

Functional Area	Spending Change		Property Tax Change	
	Dollar	Percent	Dollar	Percent
<b>Finance, Personnel and Management</b>	\$1,172,850	2.6%	(\$289,213)	(1.6%)
<b>Public Safety and Justice</b>	\$192,697	0.2%	\$4,910,463	5.9%
<b>Public Works and Recreation</b>	\$2,421,009	10.2%	(\$275,210)	(3.1%)
<b>Health and Human Services</b>	\$2,703,224	1.9%	\$6,998,410	8.7%
<b>General County Purposes</b>	\$17,221,054	54.6%	\$6,637,317	26.6%
<b>Subtotal (before financing)</b>	<b>\$25,771,909</b>	<b>5.2%</b>	<b>\$17,981,767</b>	<b>10.4%</b>
<b>Unallocated Revenues</b>	NA	NA	\$21,702,690	NA
<b>Total</b>	<b>\$25,771,909</b>	<b>5.2%</b>	<b>\$39,684,457</b>	<b>22.9%</b>

Another notable change is in Unallocated Revenues, revenues that are not attributable to any particular department or division. Ramsey County uses these revenues to offset its property tax levy. Effectively, the county incurred a \$21.7 million property tax increase between 2002 and 2006 by having fewer Unallocated Revenues. Table 52 details the change for each revenue source.

**Table 52: Ramsey County Use of Unallocated Revenues and Fund Balances Against Levy, 2002-2006**

Revenue Source	Spending per Year (\$ millions)					Total Change
	2002	2003	2004	2005	2006	
Indirect Cost Reimbursements	\$3.8	\$3.9	\$4.4	\$2.8	\$3.4	(\$410,043)
Investment Income <sup>54</sup>	\$13.8	\$12.9	\$8.4	\$8.4	\$8.4	\$8,400,000
Special Taxes	\$2.8	\$2.8	\$2.8	\$2.8	\$2.8	--
HACA	\$13.6	\$9.5	--	--	--	(\$13,629,527)
County Criminal Justice Aid	\$4.1	\$4.3	--	--	--	(\$4,082,377)
County Program Aid	--	--	\$4.1	\$4.1	\$4.7	\$4,745,385
Recording Fees	--	--	--	--	\$0.2	\$267,101
Fund Balance	\$5.7	\$5.1	\$1.8	\$5.1	\$2.3	(\$3,417,231)
<b>Total</b>	<b>\$43.6</b>	<b>\$38.4</b>	<b>\$21.5</b>	<b>\$23.2</b>	<b>\$21.9</b>	<b>(\$21,702,690)</b>

Note: Numbers may not add due to rounding.

### Changes in Spending – By Object Code

We also analyzed Ramsey County budget changes on an object code basis. Increased personnel costs contributed \$27.4 million in added spending between 2002 and 2006 – for sake of comparison, the entire budget increased by only \$25.7 million during this period. At the same time, the County’s budgeted full-time equivalent (FTE) employee count fell by 2.9% (from 3,783.16 to 3,674.23 FTE). As Table 53 indicates, this increase was broken down between salaries (\$12.1 million) and fringe benefits (\$15.4 million). When measured as spending per FTE salaries increased 9.7%, while fringe benefits increased 34.2%. The County’s personnel costs increased from 47.9% of its 2002 budget to 50.8% of its 2006 budget.

**Table 53: Changes in Ramsey County Personnel Costs, Total and Components, 2002-2006**

Compensation Component	Personnel Cost Change: 2002-2006		Personnel Cost Change per FTE		Employment Cost Index Change: 2002-2006	
	Total (\$ millions)	Percent	Total (\$)	Percent	Private Industry	State & Local Government
Salaries	\$12.1	6.5%	\$4,747	9.7%	13.9%	14.1%
Fringe Benefits	\$15.4	30.3%	\$4,592	34.2%	25.6%	33.5%
<b>Total</b>	<b>\$27.5</b>	<b>11.7%</b>	<b>\$9,338</b>	<b>15.0%</b>	<b>17.1%</b>	<b>19.7%</b>

Note: Numbers may not add due to rounding.

For comparative purposes, Table 53 above presents data on the change in the ECI from the first quarter of 2002 to fourth quarter of 2006. The per FTE increase in Ramsey County’s total personnel spending is less than that in the private and public sectors generally. The County’s per FTE increase in wages is substantially below that seen in the private and public sectors. While the per FTE increase in fringe benefits is substantially greater than in the private sector, it is only slightly more than for governments generally.

<sup>54</sup> Reported by Ramsey County under the Finance, Personnel and Management area in 2002, moved for purposes of making consistent comparisons.

The main driver behind fringe benefit cost change is the increase in health care costs. Table 54 lists health care-related fringe benefit expenses that changed more than \$100,000 over the period – these items alone contributed \$13.2 million to the increased fringe benefit spending. As Table 54 indicates, total Health Insurance spending grew by 63.4% during the period, and grew by 68.2% on a per FTE employee basis.

**Table 54: Changes in Ramsey County Health Care-Related Fringe Benefit Costs, 2002-2006**

Fringe Benefit Expenditure	Spending (\$000)		Change	
	2002	2006	(\$000)	Percent
<b>Health Insurance</b>	\$16,546	\$27,035	\$10,489	63.4%
<b>Early Retirees Health Insurance</b>	1,690	3,636	1,947	115.2%
<b>Retirees Health Insurance</b>	4,544	5,173	629	13.8%
<b>Medicare B Coverage</b>	525	680	155	29.5%
<b>All Other</b>	27,474	29,663	2,189	8.0%
<b>Subtotal</b>	<b>\$50,779</b>	<b>\$66,188</b>	<b>\$15,409</b>	<b>30.3%</b>

Note: Numbers may not add due to rounding.

Ramsey County was also required to pre-fund its retiree health care benefits rather than utilizing a “pay-as-you-go” system. The county decided to use \$12.5 million of its general purpose aids in 2005 and \$10.7 million in 2006 to provide partial funding. Like Hennepin County, Ramsey County chose to treat a portion of its general purpose aids as one-time revenues, and used them to fund post employment benefits. This in turn had a direct impact on 2005 and 2006 property tax bills, since it directed state aid away from property tax relief.

**Summary: Unfunded Mandates and a Rocky State-Local Relationship Hampered the County**

The story of Ramsey County is largely the story of Hennepin County. Program-related aids fell by \$6.8 million, and especially in the case of human service programs, the county had little choice but to raise property taxes, as we have demonstrated. We suspect that recreating this analysis for Minnesota’s 85 remaining counties would yield similar findings.

Our Ramsey County analysis reinforces an interesting finding – a profound change in how counties perceive their financial relationship with the State. Minnesota increased general purpose aids to counties in 2005, yet Ramsey (and Hennepin) County didn’t use these new revenues to offset property tax levies, as they had done in the past. Rather, they treated these as one-time revenues, using them for specific one-time projects. Counties may no longer trust the State to make good on its aid promises, and by spending these revenues on one-time projects, they can avoid the budget-cutting pain that inevitably follows aid reductions.

## Conclusions

Our small sample of Minnesota city and county experiences reinforces the notion that property tax changes are intensely local affairs. Unfortunately, property tax policy is often determined by conventional wisdom backed by state level aggregate data which can significantly distort what is actually transpiring in cities and counties.

### Relative Valuation Changes Had Profound Influence on Property Tax Burdens

During the period from 2002 to 2006, residential property's share of the total tax base (known as "tax capacity") grew much faster than did the non-residential share. Table 55 shows the ratio of residential-to-non-residential net tax capacity growth<sup>55</sup> in the eight jurisdictions in this report.

**Table 55: Ratio of Growth Rates in Residential and Non-Residential\* Net Tax Capacity, 2002-2006**

Jurisdiction	Ratio
Minneapolis	7.76
Eden Prairie	5.60
Hennepin County	5.28
Ramsey County	2.33
Saint Paul	1.96
Detroit Lakes	1.68
Albert Lea	1.27
Brainerd	1.14

\* Includes apartments.

Three factors explain much of the differential between residential and non-residential value growth. First and foremost is the appreciation of home values, most significantly felt in and around major urban areas. Second is the declining share of residential property value subject to the state's assessment limitation program, in part due to the scheduled phase-out of the program, which increased the amount of taxable value of many residential properties. Finally, reductions made in class rates (used to convert market value to tax capacity) for apartments during the 2001 legislative session were phased-in through taxes payable 2004; reductions for other properties took effect for taxes payable 2002. This redistributed tax capacity from apartments onto other properties, including residences. The impact of these two policy changes was much more modest than market appreciation.

Relative growth in tax capacity directly impacted the distribution of additional tax levies between 2002 and 2006. As Table 56 indicates, cities with higher ratios in Table 55 passed along a greater share of property tax increases to residential properties. In some jurisdictions (Eden Prairie, Hennepin County, and Saint Paul) relative value shifts were so significant that the property tax burden for non-residential properties was smaller in

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<sup>55</sup> Calculated as the percentage growth in residential net tax capacity to the percentage growth in non-residential net tax capacity.



2006 than in 2002; burdening residential properties not only with all the new (post 2002) property tax levies but with some of the non-residential pre-2002 levy as well. During this time period, much attention was given to the impact of aid cuts on local budgets and property tax increases. Yet we calculate that in Minneapolis, changes in market valuation alone shifted \$33.4 million of the 2006 levy from non-residential to residential properties (see Table 3); generating nearly four times the impact on residential class property taxes than did the \$8.7 million in Local Government Aid cuts. When the impact of those aid cuts are allocated to the property types, the impact of market forces is even greater.

**Table 56: Actual Residential and Non-Residential Levy Changes between 2002 and 2006**

Jurisdiction (City or County)	Residential Levy Change		Non-Residential Levy Change	
	Dollar	Pctg	Dollar	Pctg
Minneapolis	\$62,470,992	71.1%	\$6,289,135	5.2%
Eden Prairie	4,574,022	34.4%	(1,088,554)	(9.7%)
Hennepin County	90,738,555	38.7%	(14,765,746)	(6.9%)
Ramsey County	35,359,368	38.2%	4,325,089	5.4%
Saint Paul	4,106,223	13.0%	(3,315,636)	(10.4%)
Detroit Lakes	393,835	44.7%	214,588	23.4%
Albert Lea	1,505,262	174.3%	799,888	160.9%
Brainerd	1,038,091	100.9%	539,423	91.1%

These valuation shifts may have implications moving forward. The Case-Shiller Home Price Index for Minneapolis has fallen from its September 2006 high of 171.12 to 140.51 in September 2008; a 17.9% decline in two years. Slumping residential property values have the potential to shift tax capacity, and therefore tax burden, to non-residential properties. However, because of Minnesota's classified property tax system, a smaller decline (in percentage terms) in non-residential property values may offset a larger decline in home values. If commercial real estate mirrors the residential experience and trends down significantly, homeowners may find little property tax relief from lower home values.

### **Health Care Reform May be Property Tax Reform in Disguise**

Often lost in the debate over property tax increases are the influence of specific cost drivers. Since most cities report only spending by general program area, it is often difficult to obtain insights into any specific city-or county-wide changes causing spending to increase.

Personnel costs (wages and fringe benefits) are one of the largest areas of spending by cities and counties (in some cases, the largest area by far) typically comprising 60-80% of current expenditures. Table 57 shows the per employee (FTE) change in total personnel costs and for the wage and fringe benefit components. We analyze per employee changes to control for employment changes during the period.

**Table 57: Comparison of Change in per FTE Personnel Costs and Change in the Employment Cost Index: 2002-2006**

	<b>Wages</b>	<b>Fringe Benefits</b>	<b>Personnel Costs</b>
<b>Minneapolis</b>	<b>17.5%</b>	<b>44.8%</b>	<b>23.6%</b>
<b>Eden Prairie</b>	<b>19.8%</b>	19.6%	<b>19.8%</b>
<b>Hennepin County</b>	13.3%	<b>42.1%</b>	19.5%
<b>Detroit Lakes</b>	13.6%	<b>38.4%</b>	18.8%
<b>Ramsey County</b>	9.7%	<b>34.2%</b>	15.0%
<b>Albert Lea</b>	8.9%	25.4%	12.8%
<b>Saint Paul</b>	9.2%	24.5%	12.7%
<b>Brainerd</b>	7.9%	24.3%	11.8%
<b>State and Local Government</b>	<b>14.1%</b>	<b>33.5%</b>	<b>19.7%</b>
<b>Private Industry</b>	<b>13.9%</b>	<b>25.6%</b>	<b>17.1%</b>

Bolded numbers indicate greater change than the Employment Cost Index for state and local government (not seasonally adjusted).

Nationally, state and local government fringe benefit expenses grew over this period at a 7.5% annual rate – highly difficult to sustain over the long term. Half of the eight jurisdictions exceeded this rate of growth, although in three cases wage growth lagged national average to keep total compensation trends below national averages for state and local governments. Health care costs were the primary driver of these high fringe benefit cost increases. National health care reform may be property tax reform in disguise.

Further investigation revealed significant differences across governments with respect to the relative generosity of health care plans. Under a “pure” levy-driven local property tax system, such discrepancies in plans would not be a particular cause for concern since it could be argued that local citizens (through elected officials) are the ultimate arbiter regarding how generous these plans should be and how total compensation should be structured. However, the introduction of state general purpose aid into the local revenue system complicates relationships dramatically. Measures of “need” which drive the allocation of these state aids in Minnesota do not control for the generosity and structure of fringe benefit plans. Given its influence on city and county budgets, greater transparency on health plan details should be a part of every budget document.

### **General Purpose Aids: Different Jurisdictions, Different Responses, Different Perspectives**

What does general purpose aid really accomplish? Does it provide property tax relief? Or does it enable higher levels of spending than would otherwise exist?

Between 2002 and 2005 the amount of money provided to cities through this program was reduced by 22.7% (\$128.3 million); \$47.8 million of the cuts were restored for 2006. Total LGA<sup>56</sup> (Table 58) fell between 2002 and 2006 for five of the six cities in our study;

<sup>56</sup> As budgeted for by each city, may differ slightly from actual LGA paid.

the increase for the other city (Brainerd) was negligible. LGA declined as a share of each city's budget; significantly so, in some cases.

**Table 58: Residential and Non-Residential Levy Changes from 2002 to 2006, Selected Jurisdictions**

City	2002-2006 LGA Change		LGA as Share of Revenues		
	Dollar	Pctg	2002	2006	Reduction in Share
Eden Prairie	(\$59,630)	(100.0%)	0.1%	0.0%	<b>(0.1%)</b>
Minneapolis <sup>57</sup>	(\$17,600,000)	(15.9%)	8.6%	7.0%	<b>(1.6%)</b>
Detroit Lakes <sup>58</sup>	(\$357,545)	(23.1%)	7.2%	5.1%	<b>(2.2%)</b>
Saint Paul	(\$14,009,500)	(19.0%)	14.3%	11.1%	<b>(3.2%)</b>
Brainerd	\$14,350	0.4%	41.1%	33.8%	<b>(7.2%)</b>
Albert Lea	(\$771,541)	(12.1%)	37.5%	29.8%	<b>(7.6%)</b>

There was no single response to LGA reductions – each city responded differently based on the ability to curtail spending, raise revenues, or spend from savings. Table 59 compares reductions in LGA revenue shares and increases in per employee personnel costs. Interestingly, officials in Brainerd and Albert Lea, facing LGA reductions that were large relative to their budgets, kept personnel cost increases much lower than the national average and other cities in this study. Would these increases have been so small if these cities had continued to receive the same amount of LGA? The answer can never be known for certain, but it's very possible that some of the additional LGA would have paid for higher fringe benefit costs and been diverted away from property tax relief.

**Table 59: Comparison of LGA Reductions and Increases in per-Employee Personnel Costs, 2002-2006**

City	2002-2006 Change	
	Reduction in LGA Revenue Share	Increase in per FTE Personnel Costs
Eden Prairie	(0.1%)	19.8%
Minneapolis	(1.6%)	23.6%
Detroit Lakes	(2.2%)	18.8%
Saint Paul	(3.2%)	12.7%
Brainerd	(7.2%)	11.8%
Albert Lea	(7.6%)	12.8%

The two county governments included in our investigation reflect an alternative approach to general purpose aids. Historically, Hennepin and Ramsey County treated their general purpose aids as a clear substitute for property tax revenues. Each county set its budget as though the general purpose aids did not exist, and then used them to offset the property tax levy dollar for dollar.

From 2002-2004 both counties saw their general purpose aids reduced by over 80%. In 2005, the State reversed these cut in part. Notably, neither Ramsey nor Hennepin County

<sup>57</sup> Generally, Minneapolis presents budget information in rounded, rather than actual, numbers.

<sup>58</sup> LGA is shown as a share of all revenues, including those generated by the city's enterprise funds.

used this increase in general purpose aid for its historic purpose: to offset the property tax levy. Instead, each County used the money to fund one-time expenditures such as funding for new post employment benefits liabilities now on the books or selected infrastructure project improvements. County commissioners chose not to budget the aid for new or expanded programs, since future state funding cutbacks could lead to service disruption or lay-offs.

Why did cities continue to build base budgets around volatile aid distribution while counties begin to treat general purpose aid as an occasional gift to be put to good use? One possible explanation lies in the size of the cuts. City aid cuts, while disagreeable, were still often small enough to manage around. On the other hand, the magnitude of county cuts triggered fundamental change in budgeting perspective.

### The Increasing Influence of Unfunded Mandates

Our two county examples illustrate the influence of unfunded mandates. In Minnesota, counties provide a variety of services that are mandated by either the state or federal governments (federal mandates are often passed to the counties by the state). In recent years, Minnesota has also transferred a number of responsibilities to counties without adequate reimbursement -- most of which are related to health, human services, and public safety programs. Moreover, there are different sorts of mandates. For instance, the state may mandate that counties offer a service, but counties may have freedom to use whatever delivery method they deem appropriate. In other instances, both the service and the delivery method itself may be mandated.

State and federal aids for specific county programs are often tied to some sort of mandate and can serve as proxy for their influence on property taxes. Federal aids to Hennepin and Ramsey County increased during this period, while state program-related aids fell. As Table 60 indicates, total federal and state program-related aids fell by 3.4% in Hennepin County and by 3.8% in Ramsey County.

**Table 60: Changes in Federal and State Program-Related Aids, Hennepin and Ramsey Counties, 2002-2006**

County	Aids Payable		Change: 2002-2006	
	2002	2006	Dollar	Percent
<b>Hennepin</b>				
Federal Aids	\$151.8	\$174.8	\$22.9	15.1%
State Aids	\$197.8	\$163.1	(\$34.7)	(17.5%)
<b>Total Aids</b>	<b>\$349.6</b>	<b>\$337.9</b>	<b>(\$11.7)</b>	<b>(3.4%)</b>
<b>Ramsey</b>				
Federal Aids	\$77.2	\$86.5	\$9.3	12.0%
State Aids	\$81.3	\$65.9	(\$15.4)	(18.9%)
<b>Total Aids</b>	<b>\$158.5</b>	<b>\$152.4</b>	<b>(\$6.1)</b>	<b>(3.8%)</b>

Reductions proved extraordinarily hard for counties to absorb, especially when the county must provide the same level of service or benefits to the same pool of eligible

people with little or no discretion over the delivery method. In these cases, most or all of the aid reductions must be backfilled through the property tax levy.

### **Is “Real” Property Tax Understanding Still a Goal Within Taxpayers Reach?**

Given the size and complexity of most local government budgets, what level of property tax understanding and literacy among citizens is reasonable to expect? Our Minnesota based experience suggests an understanding of the root causes of property tax increases remains far beyond the capacity of most citizens, absent a desire by local government officials to foster it.

City and county budget documents reviewed for this study -- including the smaller communities -- were very lengthy, dense, and clearly portrayed an aura of both completeness and full transparency. However most documents could be described as “data heavy” but starved for information and understanding. Even if citizens are motivated to look through budget documents to attempt to assemble the “story” of their community and the reason for tax increases, the nature and presentation of the information presents enormous challenges.

It is relatively effortless to understand where revenues come from or how much a county or city spends at a department-by-department level. Such information is certainly important in providing a sense of local government priorities with respect to the use of its revenues. However, the key to understanding property taxes is an understanding on how revenues and expenses are related to each other. It is here where budget documents consistently fell short. The fungible nature of money, the use of special funds, and different accounting and reporting treatments makes it extraordinarily difficult to trace revenues through the system to their ultimate use.

Another source of complexity involves interfund transfers. While often an essential accounting element, fund transfers can be extremely difficult to understand, much less follow. Transfers can encompass hundreds of millions of dollars (in Minneapolis they represent 7% of the 2008 expense budget; 17% in St. Paul) and are an essential part of a jurisdiction’s financial picture. Our experience suggests cities and counties have a difficult time tracking transfers for their own purposes, much less reporting them to taxpayers.

A related concern has to do with the way revenues and expenditures are recorded when a city or county makes a payment to itself for a service. Many local units of government operate internal service funds to account for a centrally-provided service (such as information technology or motor pool) that the government entity charges itself for. However, dollars that pass through internal service funds are often double-counted as revenues (both when they originally paid to the city or county, and again when received by the internal service fund), and double-counted as expenditures (when paid into the internal service fund by a city or county department, and again when the internal service fund makes a payment, often for salary or benefits). While this practice accurately states

total cash flows in and out of individual city or county funds, it can inflate jurisdiction-wide revenue and expenditure statements. Ideally, the accounting adjustment would eliminate the payments to and from the internal service fund to show the original source of the dollars and their final use by the city or county.

In some cases, budget documents lacked jurisdiction-wide revenue or expenditure summaries or spending totals for individual funds, which we then calculated by hand. Trend data was often lacking and when supplied typically had no narrative explanation or analysis.

Perhaps the most significant omission was the absence of information on compensation costs. These are significant pieces of jurisdiction's budgets and major cost drivers since fringe benefits are one of the fastest growing areas of expense. Only Ramsey County and Brainerd provided comprehensive detail on salaries and fringe benefits in their budget documents. No jurisdiction disclosed any descriptive information on the make-up of the benefit and post employment benefit plans or the linkages between their rates of inflation and property tax levy changes.

"Truth-in-taxation" laws have been in place in Minnesota since 1991. Their promise is based on the idea that they provide an opportunity for local input into budget decision-making. The problem with truth-in-taxation laws in practice is that the underlying trends, causes, and relationships shaping tax burdens remain hidden behind program data and statistics. As a result, it is essentially impossible to tease out the property tax price of services provided. A refocusing of truth-in-taxation efforts into a more detailed truth-in-levy exercise would make substantial progress toward restoring the ideal of the property tax as a transparent and accountable revenue stream.

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