Special Study:

Municipal Enterprise Activities

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Government Information Division
Office of the State Auditor
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Deputy State Auditor
Tony Sutton

Government Information Staff
Karen Cook
John Jernberg
Andrea Johnson
David Kazeck
Wendy Murphy
Billi Sanders
Debbie Schultz

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Executive Summary

Municipal enterprise funds allow a city to generate revenue through user fees to cover the costs of providing a service to the public and allow those who use the service to pay for it directly. Local governments are encouraged to establish their enterprise activity as an enterprise fund when the costs of the activity are financed *primarily* through user charges.

In 2003, a bipartisan group of Minnesota legislators asked that the State Auditor's Office conduct a special study of municipally owned enterprises in the state. This report examines the financial information of enterprise fund operations from 1998 to 2002.

General Purpose of Enterprise Activities

In reviewing municipal enterprise funds, three broad purposes seem to exist for enterprise activity—necessary enterprises, quality of life enterprises and enterprises for profit.

Necessary enterprises provide an important public benefit regardless of the revenue they generate. Generally, necessary enterprises are those for which a private sector alternative either does not exist or would be impractical or uneconomical. These enterprises include, among others, sewer, water, electric utilities and hospitals. Necessary enterprises accounted for 78.1 percent of all enterprise funds included in this report. Necessary enterprises should strive to break even with fees covering the cost of provision plus any maintenance and renewal and replacement costs.

Quality of life enterprises are not as essential as necessary enterprises. Individual cities, however, may want to provide public amenities to improve the city's quality of life. These enterprises may or may not have a private sector equivalent available depending on the city's location. Such enterprises include, among other things, swimming pools, recreation programming, community centers and golf courses. Quality of life enterprises should strive to break even but may need to be subsidized in order to operate.

Enterprises for profit are those for which a private sector alternative either exists or reasonably could exist. Liquor stores are the largest example of these types of enterprises. These funds exist primarily to generate revenue to subsidize other city functions. If they fail to do so, they should not exist.

Trends in Municipal Enterprise Funds by Category

For the purpose of this report, enterprise funds were allocated into categories based on the nature of the activity. The categories include utilities, environmental, facilities, public safety, transportation, recreation, community development and miscellaneous.

Public utilities comprise the largest number of enterprises in the study. The number of utility enterprises in the state has increased from 1,583 in 1998 to 1,612 in 2002. It appears utilities overall are fiscally sound. Just over $85 million was transferred from utilities to other city funds in 2002, an increase of 51.7 % since 1998.

Environmental enterprises are non-utility enterprises that affect the environment including solid waste, storm sewer and recycling services. There were 352 such funds in 2002 as compared to 319 in 1998. Environmental funds are doing well and user fees are more than covering the cost of providing the service. A total of $7.2 million in net transfers was made from environmental funds in 2002, an increase of 38.4% since 1998.

Facility enterprise funds are buildings owned by cities that charge fees, but do not necessarily offer public programs, distinguishing them from recreation funds. The number of funds decreased from 144 in 1998 to 120 in 2002. Facility funds have not seen the same profit increases as other funds. Net transfers totaled a negative $2.3 million in 2002, reflecting the fact that these funds were heavily subsidized.

There were 51 **public safety enterprises** in 2002, no net change since 1998. Data shows that public safety enterprises are in reasonably good fiscal health. Net transfers totaled $573,000, an increase of 154.5% since 1998.

There were 33 **transportation funds** in 2002, up slightly from 32 in 1998. Transportation funds are expensive for cities to operate. While net income has increased significantly, operating income has fallen sharply. The discrepancy reflects the fact that transportation funds receive non-operating revenue in the form of property taxes and grants. Net transfers totaled almost a negative $2 million in 2002.

There were 62 **recreation enterprise funds** in 2002. Many other cities operate similar programs out of their general fund. Recreation enterprises are not in as good fiscal health as other categories. Operating income decreased 197.3 percent over the five-year period with a loss of $4.6 million in 2002. User fees are not covering the cost of providing the service. Net transfers did increase since 1998; as a result, the amount the funds are subsidized is decreasing.

Community development enterprise funds include Economic Development Authorities (EDAs), Housing and Redevelopment Authorities (HRAs) and Port Authorities. There were 119 such funds in 2002, an increase of 46.9% since 1998. EDA's net transfers decreased 138.0 percent over the last five years, while HRA's net transfers increased 62.7 percent during that same time frame.

Miscellaneous enterprises, which include leases, internet providers and retail operations decreased from 17 funds in 1998 to 15 funds in 2002. These funds are not as fiscally sound as they could be. Net transfers decreased by 34.5 percent over the five-year period.

Municipal liquor stores were listed in the survey as a part of the miscellaneous category, but were examined separately due to accounting differences. Between 1998 and 2002, municipal liquor stores increased profits by 23.9 percent and net transfers by 38.9 percent.

Enterprise Transfers

The premise of municipal enterprises is to provide a service where the costs are recovered primarily by charges to those who use the service. In theory, with the exception of for-profit enterprises, cities should not have a profit motive. Therefore, enterprises should be structured financially to break-even.

When profits are made, what to do with the proceeds becomes a public policy question. Given that transfers can relieve the tax burden for citizens and make cities less reliant on aid from other sources, it may be a sound way for cities to help provide other necessary services to residents. Cities that are too reliant on transfers, however, may jeopardize their ability to consistently offer services.

For "necessary enterprises" where excess user fees are designed to subsidize other city functions, taxpayers are paying too much for a service they are forced to use. The opposite type of transfer, a subsidy to an enterprise fund, may be necessary if the city determines the enterprise serves a needed public good. If the enterprise is not determined to be a public good, city officials need to determine how the enterprise can operate without subsidy or consider divesting itself of the fund.

In order to maintain transparency in city finances, the question that should be asked is whether the public is aware of how much is transferred, either as a profit to, or as a subsidy from, other city funds on an annual basis.

Survey Results

As part of this study, the State Auditor's Office designed a voluntary survey on enterprise activity. Of 853 cities surveyed, 466 cities responded to the survey. A total of 2,087 funds were reported. According to the survey:

- Of the 2,087 funds included in the study, 1,789 were managed by city directly; private companies managed 184 funds.

- 230 funds claimed to provide a service available from a private competitor.

- 935 funds are associated with a professional organization. A total of 771 funds receive best practices guidance from an association.

- Twenty-one cities responded that they had divested themselves of municipal enterprises in the last five years.

- Most cities stressed that the services provided are for the benefit of their residents, regardless of the profit margin. Most, however, said they strive to break even.

- Most cities responded they were receiving enough guidance from other entities. A number of mostly smaller cities stated a desire for more help and information with accounting and rate studies.

State Auditor's Recommendations

In light of this study of municipal enterprises, the State Auditor has the following recommendations to help improve the operation and management of city enterprises, and to help promote greater public oversight of enterprise activities.

1. Generally, services paid for primarily by user fees should be accounted for in an enterprise fund.

The State Auditor recommends that all cities establish activities primarily financed by user fees as enterprise funds. Doing this will give taxpayers, and local policy makers, a better idea of the true costs of the services provided.

2. Enterprises for profit should not lose money.

These enterprises are those for which there is generally (or reasonably could be) competition from the private sector, and are (or should be) designed to make a profit. Liquor stores, retail operations, and other for-profit enterprises should always make a profit. If they fail to do so, they should not exist.

3. Necessary enterprises should only break even.

Necessary enterprises should only charge enough to cover operating costs and the costs of renewal and replacement.

4. Cities should consider public-private partnerships where feasible.

Cities should explore the possible gains in efficiency by contracting with private management companies. Cities would retain control of the service, while benefiting from the expertise of an experienced provider.

5. Cities should set up enterprise transfer policies.

Cities should create a policy of how much they transfer from year to year during the budget process in order for the subsidy of city functions by enterprise activities to be more transparent to the taxpayer.

Overview and Background

In 2003, a bipartisan group of legislators requested that the Office of the State Auditor conduct a special study of municipal owned enterprises in the state[1]. This report examines the financial information of city enterprises from 1998 to 2002[2].

The financial information offered here is for activities specifically reported as enterprise funds. For the purposes of this study, enterprise funds are classified into categories determined by the State Auditor's Office. Each enterprise section defines the activities included in the category. Operations are examined based on the aggregate totals for a given activity. Individual activities for each city are listed in the tables in the Appendix. Some of the financial information on individual cities is also available in two annual reports recently issued by the State Auditor's Office; *Analysis of Municipal Liquor Store Operations for the Year Ended December 31, 2002* (issued January 13, 2004) and *Revenues, Expenditures, and Debt of Minnesota Cities for the Year Ended December 31, 2002*[3] (issued December 19, 2003).

Due to the public benefit nature of enterprise activity, the State Auditor's Office designed a survey that was mailed to cities to determine any historical and anecdotal reasons behind the creation of enterprise activities. The survey was also used to examine enterprise activities beyond the pure profit and loss level. The Office did not require the cities to respond to the survey, but with the assistance of the League of Minnesota Cities, fifty-four percent of cities responded. A copy of the survey is included in the Appendix section. Cities were able to complete the survey online or on paper.

Background of Enterprise Activity

An enterprise activity is a government good or service that is financed through user fees instead of taxes. According to the Governmental Accounting Standards Board (GASB), local governments are encouraged to establish their activity as an enterprise fund when the intent is that the costs of the activity are financed or recovered *primarily* through user charges. Accounting for the activity in this manner allows the fund to be treated more like a business.

Some cities also operate some enterprise type activities out of the general fund or in a special revenue fund. Many of these are recreation activities (i.e. golf courses, etc.). These are not included in this report because it is impossible, looking at an audit or financial statement, to get a complete picture of the profit/loss of enterprise type activities accounted for in this way.

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[1] The request was submitted to the State Auditor by Rep. Abrams, Rep. Dempsey, Rep. Krinke, Rep. Buesgens, Rep. Borrell, and Rep. Lenczewski.
[2] Primary data sources: *Revenues, Expenditures, and Debt of Minnesota Cities* reports for the years-ended 1998, 1999, 2000, 2001 and 2002.
[3] These reports are available online at www.auditor.state.mn.us

Enterprise funds allow governments to separate and track revenues, expenses[4] and net income of that particular activity. It also illustrates how much of the cost is covered by user fees. An enterprise fund effectively segregates the finances of this activity from all others, whereas, in the general fund, revenues are combined to cover all of the expenditures and generally not dedicated to a specific activity.

Simply put, enterprise type activity allows a government to generate revenue, through user fees, to cover the costs of providing a service to the public and allows those who use the service to directly pay for it.

Historically, enterprise funds have been created for public services such as utilities. However, as the desire for greater services has increased, so have the types of enterprises.

[4] Expenses include the cost of depreciation of fixed assets.

General Purposes of Enterprise Activities

Reviewing enterprises across the state, there seems to be three broad purposes for enterprise activity; necessary enterprises, quality of life enterprises, and enterprises for profit. They are defined in the chart below.

Purposes of Enterprise Activity Below are types of city enterprise funds. Please note that these are general groupings. The purpose may vary from one city to the next based on geography, access to private sector alternatives, etc.		
Necessary Enterprises – Generally regarded by the community as a necessity. *Should Break Even*	**Quality of Life Enterprises** – Provide a desired service that has little or no private sector competition. *Strive to Break Even – May Require Subsidy*	**Enterprises for Profit** – Provide revenue for other city services. *Should Always Earn a Profit.*
• Ambulance • Cemeteries • Electric • Forestry • Hospitals • Inspections • Medical Clinics • Natural Gas • Nursing Homes • Pest Control • Public Safety • Recycling • Registrar • Sewer • Solid Waste • Steam Heat • Storm Sewer • Water	• Airport • Arenas/Auditoriums • Cable • Campgrounds • Commercial Ports • Community Centers • Convention Centers • EDA • Golf Courses • HRA • Internet • Pools • Recreation Programming • Skate Park • Ski/Sledding Hills • Transit	• Leases • Retail Operations • Liquor Stores • Marinas • Parking

Necessary Enterprises

Most citizens and policy makers will agree there are enterprises that local governments engage in that provide an important public benefit regardless of the revenue they generate. For example, sewer and water service are regarded as a necessity by nearly all cities.

While something that is a necessity to one person may seem like a luxury to another, generally speaking, necessary enterprises are those enterprises for which there may be no private sector provider, or for which a private sector provider would be impractical or uneconomical. Also, the scale of the operation may render the enterprise too expensive for a private business to start up, or it may create a private monopoly in which consumers could pay too much for the service.

For example, in Mahnomen, the city operates a health care facility that it has attempted, unsuccessfully, to lease to a private provider. The private provider could not provide the service and stay profitable without cutting the service the city required. Since there is no viable private sector option, the city still operates the facility because it is necessary to the community.

Necessary enterprises should charge fees to cover the cost of provision plus any maintenance and renewal and replacement costs. Basically, they should break even. The law often prohibits excessive charging for specific services, because, with no private provider, taxpayers have no alternative but to use the service provided by the city.[5] In a necessary enterprise activity where excess user fees are designed to subsidize the other city functions with a transfer of utility profits, taxpayers are paying too much for a service they are forced to use. In addition to paying a higher cost for the service, non-business taxpayers are not able to deduct user fees from their personal income taxes, whereas property taxes are deductible from personal income taxes.[6]

The necessary enterprises listed in the table account for 78.1 percent of all enterprises in this report.

Quality of Life Enterprises

These enterprises, while not as important as utilities, etc., improve the quality of life in the community. The availability of private provision will depend on the geographic location of the city, and the feasibility of operations. This activity should strive to break even but may need to be subsidized. Whether or not the service is provided is a judgment call made by each individual city, which must weigh the options of providing the service versus the private sector alternative. While providing a subsidy to an enterprise activity, this money is not available for other city services.

For example, recreation programs benefit the direct users (mainly children) but also benefit the community. Numerous studies have shown that children engaged in extracurricular activities do better in school and tend not to engage in criminal behavior. Private recreation may not be economically feasible for all children, especially children

[5] *See* Minn Stat §§ 366.011, 415.01 (Cities and towns may impose a reasonable service charge for emergency services); Minn. Stat § 444.075 (charges for use and availability of water and sewer facilities must be just and equitable); State v. Northern Raceway Corp., 381N.W.2d 526 (Minn. Ct. App1986) (To be legal, licensing ordinances must be reasonable).
[6] *See* IRS Publication 530, Tax Information for First-Time Homebuyers.

most at risk. Other quality of life enterprises may attract new residents and businesses to the area, which could offset the subsidy provided to the activity.

Enterprises for Profit

These enterprises are those for which there is generally (or reasonably could be) competition from the private sector. These funds generate revenue to subsidize other city functions and as such, should never lose money. Liquor stores are the largest example of these types of enterprises. Our 2002 municipal liquor store report shows that 88.4 percent of stores are profitable. Minnesota state law requires cities to conduct a public hearing regarding liquor store operations if the store loses money in two out of three consecutive years.[7]

Summary of Enterprises

In this section, the enterprises are grouped according to category. Each category includes two tables, one for the aggregate total of enterprises and the percent change over the five-year period, and one for profitability, where aggregate totals for operating income, net income and net transfers are listed, along with the percent change over the five-year period.

Enterprise Categories

For the purposes of this study, enterprises were allocated into categories based on the nature of the activity. The table below provides a snapshot of the different categories of enterprises, profitability, growth level, and level of transfers between funds.

Enterprise Category	Profitability	Growth	Transfers
Utilities	Highly Profitable	Stable	Highly subsidizes other funds
Environmental	Profitable	Growing	Subsidizes other funds
Facilities	Mixed	Decreasing	Subsidized by other funds
Public Safety	Mildly Profitable	Stable	Mixed
Transportation	Unprofitable	Stable	Highly subsidized by other funds
Recreation	Unprofitable	Stable	Highly subsidized by other funds
Community Development	Mixed	Growing	Mixed
Miscellaneous	Unprofitable	Decreasing	Subsidized by other funds

[7] Municipal liquor stores serve certain regulatory functions but are also "normally a source of financial profit for the municipality." Hehn v. City of Ortonville 238 Minn. 428.57 N.W.20254 (1953); *see also* Minn Stat. § 340A.602 (Public hearing on municipal liquor store continuation required if net loss occurs in two of three consecutive years).

Profitability of Enterprise Activity

Appendices 1-8 illustrate the 5-year trend of profitability measures for the enterprise category aggregated by individual city. Appendix 9 shows the profitability of each enterprise fund by individual city. The tables in this section refer to aggregate amounts across each category over the five-year period. The profitability measures examined are:

- **Operating income = (Operating Revenue – Operating Expenses).**

    - If operating revenue is negative, the enterprise expenses, to provide the service, are greater than it receives from user fees. When a municipal enterprise reports a net profit or loss, the cost of depreciation has already been factored in as an operating cost. Depreciation is an accounting method that allocates the projected costs of replacing infrastructure and other capital assets over the life of the asset. Therefore, most of the net income that is generated could be transferred to other funds.

- **Net income = (Operating Income + Non-Operating Revenue) - Non-Operating Expenses.**

    - This is the pure profit for the enterprise as non-operating revenue and expenses account for all activity that does not arise from the ongoing operation of the enterprise. This includes revenues and expenses for interest, gains or losses on the sale of fixed assets, taxes, and state and federal grants. This amount should be the available to transfer to the general fund.

- **Net Transfers = (Transfers Out - Transfers In).**

    - If the net transfer is negative, it indicates that more money is being transferred into the fund than is being transferred out. This indicates that the user charges are not covering the cost of providing the service. The issue of transfers is discussed in greater detail later in the report.

Utility Enterprises

This category includes all public utilities and comprises the largest number of enterprises in the study. Most cities in the state offer at least one utility (usually water and/or sewer service). Cities set up this activity to provide a service, but are also mindful of the need to charge enough for maintenance and upkeep of their operations and equipment. Historically, many public utilities were started decades ago (in some cases over 100 years ago) in response to public health issues and a lack of private investment.

The chart below shows the number of utility enterprises by category from 1998-2002. Sewer and water are the largest enterprises, not only in this category, but also for all categories. There were a total of 1,612 utility enterprises in 2002, an increase of 0.1 percent from 2001, and a 1.8 percent increase over the five-year period.

Utility	1998	1999	2000	2001	2002	5 yr % ch
Cable	13	13	14	14	15	15.4%
Electric	128	128	128	128	126	-1.6%
Natural Gas	29	31	31	31	31	6.9%
Other*	16	18	18	18	18	12.5%
Sewer	686	683	695	700	705	2.8%
Steam Heat	10	10	10	10	10	0%
Telephone	2	2	3	3	4	100%
Water	698	704	701	705	702	0.6%
Combined	1	1	1	1	1	0%
Total	1,583	1,590	1,601	1,610	1,612	1.8%
* Includes streetlights, turbines, engineering, radios and antennas, utility charges and wireless technology						

Profitability of Utilities

The following table shows the profitability measures for the utility funds over the five-year period. Amounts for operating income, net income and net transfers is the aggregate amount of all the utilities. The table indicates that overall, utility enterprises are fiscally sound. Operating income indicates that user fees are exceeding expenses for utility funds, up 29.5 percent over the five-year period. Net income has increased 46.2 percent over the five-year period. In 2002, there was $221,360,228 in profits available to transfer out. Net transfers totaled $85,039,262 in 2002, up 51.7 percent, but the transfer amount was less than half of the net income amount.

Utilities	1998	1999	2000	2001	2002	5 yr. %ch
Operating Income	123,706,216	141,980,619	172,009,123	160,312,720	160,180,727	29.5%
Net Income	151,442,995	153,456,788	238,338,006	235,903,614	221,360,228	46.2%
Net Transfers	56,075,204	61,296,436	70,051,295	81,129,740	85,039,262	51.7%

Environmental Enterprises

This category includes all non-utility enterprises that directly affect the environment. Local governments are mandated by the state and federal governments to provide certain environmental services.[8] The chart below shows the number of environmental enterprises from 1998-2002. There were 352 funds in 2002, a 3.2 percent increase from the previous year and a 10.3 percent increase over the five-year period. Storm Sewer funds have shown the most growth in this category in the last five years with a 54.9 percent increase. This large increase is due to cities discovering they can charge user fees to fund this type of service.

[8] *See, e.g.,* Minn. Stat. § 144.381 (incorporating Federal Safe Drinking Water Act into state law).

Environmental	1998	1999	2000	2001	2002	5 yr % ch.
Forestry	2	3	3	3	3	50%
Other*	2	2	2	2	3	50%
Pest Control	1	2	2	2	2	100%
Recycling	19	19	21	19	20	5.3%
Solid Waste	244	242	246	248	245	0.4%
Storm Sewer	51	59	62	67	79	54.9%
Total	319	327	336	341	352	10.3%
*Includes incinerator, septic inspections, and water resources						

Profitability of Environmental Enterprises

The table indicates that environmental funds are doing well. Operating income is up 47 percent over the five-year period, indicating that; overall, user fees are covering the costs of providing the activities. Net income is up a substantial amount at 82.5 percent. The profit amount available to transfer in 2002 was $24,835,904 in net income. Net transfers totaled $7,196,283 in 2002, up 241.8 percent over the 5-year period, but over three times less than net income.

Environmental	1998	1999	2000	2001	2002	5 yr. %ch
Operating Income	8,522,304	9,243,003	13,092,702	11,424,722	12,524,772	47.0%
Net Income	13,607,941	13,729,839	19,798,939	21,490,291	24,835,904	82.5%
Net Transfers	2,105,432	3,988,907	3,612,317	8,088,427	7,196,283	241.8%

Facility Enterprises

This category focused on facilities owned by cities and rented out on a fee per use basis, but not necessarily offering any programs within the building. This was to distinguish them from programs such as recreation, which may offer both. There were 120 funds for facilities in 2002, down 9.3 percent from the previous year and down 16.7 percent over the five-year period. Hospitals showed a sharp decline over the five-year period, decreasing 44.4 percent, as did nursing homes at 20.0 percent.

Facility	1998	1999	2000	2001	2002	5-yr % ch.
Arenas & Auditoriums	21	18	20	21	22	4.8%
Campgrounds	2	2	2	2	2	0%
Cemeteries	7	7	8	9	8	14.3%
Community Centers	16	16	17	17	18	12.5%
Convention Centers*	2	2	1	3	4	100%
Hospital	27	24	23	20	15	-44.4%
Marinas	4	4	4	4	6	50.0%
Medical	8	5	4	4	3	-62.5%
Nursing Home	35	32	33	32	28	-20.0%
Other**	22	20	22	19	13	-40.9%
Skate Park	0	0	1	1	1	-
Total	144	130	135	132	120	-16.7%

* Does not include the Minneapolis Convention Center.
**Includes multi-purpose facilities, zoos, art centers and fitness centers.

Profitability of Facility Enterprises

This table indicates that facilities are not enjoying the same profitability as the previous two categories. There were fewer facilities in 2002 than there were in 1998 and it shows in the profitability measures. Operating income decreased 26.1 percent over the five-year period, but user fees still exceed expenses. The amount of profit available to transfer was $18,810,942, down 12.7 percent over the five-year period. Net transfers totaled negative $2,253,474, indicating that overall the subsidy these activities receive is greater than the amount they provide to other city functions. Many of the larger facilities have been financed with bonds, which affect non-operating revenue and expenses.

Facilities	1998	1999	2000	2001	2002	5-yr. %ch
Operating Income	7,881,664	6,512,179	3,531,352	5,134,449	5,826,593	-26.1%
Net Income	21,552,739	26,607,185	16,251,730	19,582,653	18,810,942	-12.7%
Net Transfers	-2,657,545	-12,866,691	-1,348,309	-1,368,682	-2,253,474	-15.2%

Public Safety Enterprises

This category includes all enterprise activity related to public safety, such as ambulance service and public inspections. Many public safety activities are operated out of the general fund, as user fees generally do not meet the fifty percent standard. In 2002, there were 51 funds, down 1.9 percent from the previous year and virtually unchanged over the five-year period.

Public Safety	1998	1999	2000	2001	2002	5-yr % ch
911	1	1	1	1	1	0%
Ambulance	26	25	26	25	25	-3.8%
Inspections	2	4	4	4	4	100%
Registrar	14	15	15	15	15	7.1%
Other*	8	7	7	7	6	-25%
Total	51	52	53	52	51	0%
*Includes fire, fire relief, contractual police, and impound lots.						

Profitability of Public Safety Enterprises

The table indicates that these enterprises are in fairly reasonable fiscal health. Operating income increased 163.2 percent over the five-year period, indicating that, as a whole, public safety activities that are in enterprise funds are charging enough in user fees overall to cover their costs. The amount of profits available to transfer in 2002 was $1,547,020, up 61.5 percent over the five-year period. Net transfers totaled $573,062, or 37.0 percent of the amount available. Fire funds in this category tended to be heavily subsidized, which could explain the discrepancy between the two amounts.

Public Safety	1998	1999	2000	2001	2002	5-yr. %ch.
Operating Income	364,630	813,846	616,224	915,466	959,763	163.2%
Net Income	958,140	1,159,861	1,067,168	1,422,263	1,547,020	61.5%
Net Transfer	225,190	104,327	267,691	297,715	573,062	154.5%

Transportation Enterprises

This category includes activity related to transportation[9] such as airports, transit, and parking. In 2002, there were 33 funds for transportation, identical to the previous year and up 3.1 percent over the five-year period.

Transportation	1998	1999	2000	2001	2002	5-yr % ch.
Airports	16	16	18	17	16	0%
Commercial Ports	1	1	1	1	1	0%
Parking	9	9	8	9	9	0%
Transit	6	6	6	6	7	16.7%
Total	32	32	33	33	33	3.1

Profitability of Transportation Enterprises

The table indicates that transportation funds are expensive for cities to operate. Operating income has decreased 93.8 percent over the five-year period. This indicates that user fees are not covering expenses. Net income has increased 1,099.4 percent, and totaled

[9] Does not include Metropolitan transit, which is funded through the Metropolitan Council.

$3,440,049 in 2002. This indicates that the non-operating revenues are sufficient to cover the expenses not covered by user fees. Transportation activities receive property taxes, and state and federal grants to cover the cost of the service. Net transfers totaled a negative $1,999,086, three times less than the amount available to transfer, and indicating that funds tended to be subsidized rather than transferring to support other city functions.

Transportation	1998	1999	2000	2001	2002	5-yr. % ch
Operating Income	-877,480	-1,714,840	2,678,887	1,599,433	-1,700,367	-93.8%
Net Income	286,815	-541,782	4,850,490	5,270,095	3,440,049	1,099.4%
Net Transfers	-3,295,728	-3,325,856	-2,717,216	-2,649,243	-1,999,086	39.3%

Recreation Enterprises

This category includes enterprises that would tend to offer programs as well as the use of the facility. This includes golf courses and pools. Many cities continue to offer culture and recreation programs through the general fund as it is not generally a service that generates much revenue, and the costs are not covered enough by user charges to warrant its classification as an enterprise fund. Many of the recreation programs and facilities that would be in this category are combined with other activities and are listed in the Other category in Facilities. In 2002, there were 62 funds for recreation, an increase of 3.3 percent over the previous year and a 6.9 percent increase over the five-year period. Municipal golf courses increased steadily over the five-year period.

Recreation	1998	1999	2000	2001	2002	5-yr % ch
Golf	41	41	42	43	46	12.2%
Other*	9	8	8	9	6	-33.3%
Pools	7	8	7	7	8	14.3%
Ski/Sled Hills	1	1	1	1	2	100%
Total	58	58	58	60	62	6.9%
*Includes recreation and athletic programming						

Profitability of Recreation Enterprises

This table indicates that recreation enterprises are not in as good fiscal health as other categories. Operating income decreased 197.3 percent over the five-year period, and showed a loss of $4,640,275 in 2002. User fees are not covering the costs of providing recreation services. In 2002 the net loss totaled $4,159,727, a 221.6 decrease over the five-year period. Much of this loss can be attributed to municipal golf courses, as a substantial number of funds showed operating and net loss greater than $100,000 in 2002. Net transfers increased 89 percent over the five-year period, though there is a greater amount of subsidy than profits.

Recreation	1998	1999	2000	2001	2002	5-yr. % ch.
Operating Income	4,768,362	3,870,180	1,620,937	-2,129,916	-4,640,275	-197.3%
Net Income	3,419,608	2,158,709	1,029,576	-1,769,972	-4,159,727	-221.6%
Net Transfers	-4,966,185	-1,798,375	499,411	-986,899	-547,960	89.0%

Community Development

Includes all enterprises that contribute to the growth and stability of the community such as economic development, housing (HRA and other) and port authorities. Economic development can be used to increase the tax base in struggling areas. In 2002, there were 119 development funds, an increase of 8.2 percent from 2001, and an increase of 46.9 percent in five years. HRA's increased to 77 funds in 2002, up 18.5 percent from 2001 and 63.8 percent over the five-year period.

Economic development funds decreased slightly to 42 in 2002, a 6.7 percent decrease over the previous year. Overall, economic development increased 23.5 percent in the five-year period. Community Development was the fastest growing category for enterprise fund usage. This may be attributable to the economic boom years in the late 1990s. Despite job loss over the five-year period, building has not yet leveled off. Additionally, cities looking to use development tools are often encouraged to set up a relevant authority for their development needs. Statutes provide economic development authorities with more flexibility in regards to development decisions than if cities undertook the task on their own.[10] The governing bodies of these authorities are typically comprised of the city council, or members appointed by the city council.

Community Development	1998	1999	2000	2001	2002	5-yr %ch.
Economic Development*	34	40	41	45	42	23.5%
Housing**	47	55	62	65	77	63.8%
Total	81	95	103	110	119	46.9%
*Includes EDA's and port authorities ** Includes regular housing and apartments and HRA's						

Profitability of Community Development Enterprises

Due to complex nature of EDAs and HRAs they were not analyzed at the aggregate level. For the EDA funds, the Minneapolis Community Development Agency and the Port Authority in St. Paul were substantially larger than the other EDAs and therefore the aggregate totals were skewed according to what occurred in these two funds. An aggregate table of EDA activity shows operating income totaling $9,721,059 in 2002, an increase of 1.0 percent over the five-year period. User fees appear to be covering the

[10] *See*, Minn. Stat. Ch 469.

costs of providing the service. Net income was $3,601,116 in 2002, a 475.2 percent increase over the five-year period. Net transfers totaled negative $4,646,190, indicating that these funds are heavily subsidized.

EDA Aggregate	1998	1999	2000	2001	2002	5-yr. % ch.
Operating Income	9,627,663	9,065,647	10,888,801	5,392,033	9,721,059	1.0%
Net Income	626,015	1,065,696	4,853,386	3,079,473	3,601,116	475.2%
Net Transfers	-1,952,163	-785,529	-1,911,451	-3,105,224	-4,646,190	-138.0%

A table of EDA activity with these two funds removed shows an operating loss of negative $944,741, a decrease of 133.3 percent over the five-year period. User fees are not covering the costs of providing the service for the other cities combined. Net income was $912,361, an increase of 74.7 percent over the five-year period. This indicates that government aids are funding this activity, and cities possibly levied property taxes to support the EDA activity. Net transfers totaled $2,653,190 indicating this activity is heavily subsidized.

EDA (minus MCDA and SPPA)	1998	1999	2000	2001	2002	5-yr. % ch.
Operating Income	-404,937	-183,711	-1,110,223	-1,879,567	-944,741	-133.3%
Net Income	522,374	3,092,665	-142,089	1,551,127	912,361	74.7%
Net Transfers	6,963,837	8,393,471	3,943,549	1,775,776	-2,653,190	-138.1%

In 2002, the table shows HRA's with an operating loss of negative $2,019,154, an increase of 14.9 percent over the five-year period. User fees are not covering the costs of providing the service. Since HRA's deal mainly with low income housing this is not uncommon. Net income totaled $272,832 indicating this type of activity is supported by grants and other government aids. Net transfers totaled $1,961,325 in 2002, an increase of 62.7 percent over the five-year period. Since operating income is negative this would indicate that transfers are comprised of earnings from prior years.

HRA	1998	1999	2000	2001	2002	5-yr. % ch.
Operating Income	-2,371,628	-5,640,811	-2,292,433	-7,391,781	-2,019,154	14.9%
Net Income	-3,429,581	-6,178,802	2,413,296	-1,962,889	272,832	108.0%
Net Transfers	1,205,461	1,736,043	980,047	-703,561	1,961,325	62.7%

Miscellaneous Enterprises

This category includes enterprises that could not be classified in the other categories. These include leases, and retail operations. In 2002, there were 15 miscellaneous funds, a decrease of 16.7 percent from the previous year and 11.8 percent over the five-year period.

Miscellaneous	1998	1999	2000	2001	2002	5-yr % ch.
Internet	0	1	1	1	1	-
Leases	6	8	8	7	5	-16.7%
Other*	5	3	5	4	5	0%
Retail Operations**	6	6	5	6	4	-33.3%
Total	17	18	19	18	15	-11.8%
*Includes all items not classified in any other category. **Includes grocery stores, cafes, and laundromats; excludes liquor stores.						

Profitability of Miscellaneous Enterprises

The table indicates that these enterprises, mostly for-profit, are not very fiscally sound. Over the five-year period, operating income decreased 135.7 percent, ending in an operating loss of negative $424,891 for 2002. This indicates that user fees for these operations are not covering the costs of providing the service. Net income decreased 120.5 percent over the five-year period ending in a net loss of negative $281,146. Net transfers decreased 34.5 percent over the five-year period, indicating that these enterprises continue to be subsidized rather than provide revenue.

Miscellaneous	1998	1999	2000	2001	2002	5-yr. %ch
Operating Income	1,188,774	207,817	236,383	-159,733	-424,891	-135.7%
Net Income	1,373,603	250,694	467,418	-28,906	-281,146	-120.5%
Net Transfers	-232,233	-204,203	683,880	-360,149	-312,387	-34.5%

Municipal Liquor Stores

Though listed in the survey as part of the miscellaneous category, liquor stores are examined separately due to differences in accounting. A greater analysis of liquor stores can be found in the State Auditor's *Analysis of Municipal Liquor Store Operations* report mentioned previously. The following is a condensed version of the findings of the most recent report.

Municipal liquor stores are city run monopolies of a product that is available through the private sector. The main purpose of a municipal liquor store is to generate revenue for the city.[11]

Advocates for municipal liquor stores dispute this by arguing that they are controlling the sale of liquor to minors, although it should be noted that private stores are also controlling the sale of liquor to minors through the same system of fines and inspections carried out by law enforcement agencies. Opponents of municipal liquor stores argue that

[11] See footnote five.

liquor profits are transferred into the general fund, which provides for public safety, including law enforcement and represents a conflict of interest.

Minnesota law authorizes cities of 10,000 or fewer people to own and operate on-sale and off-sale liquor establishments.[12] During 2002, 233 cities operated liquor stores, with 138 cities operating both on-sale and off-sale liquor establishments and 95 cities restricting their municipally owned establishments to off-sale liquor stores. While the majority of municipally owned liquor stores are located in small cities in Greater Minnesota, 22 cities within the metropolitan area own and operate liquor establishments.

The number of cities that own establishments referred to as on-sale and off-sale decreased in 2002. These types of operations offer retail sales as well as bar sales. They are generally less profitable than off-sale only (retail) stores. Between 1998 and 2002, net income decreased 1.4 percent and net transfers decreased 11.6 percent.

The number of cities having off-sale only (retail) operations stayed the same between 1998 and 2002. These types of operations generated considerably more profit than their on-sale and off-sale counterparts. Between 1998 and 2002, profits rose 23.9 percent and transfers rose 38.9 percent.

Municipal liquor operations located within the metropolitan area are considerably larger and more profitable than their Greater Minnesota counterparts. Although only 22 of the 233 cities (9.4 percent) that own and operate municipal liquor stores are located in the metropolitan area, they represented 38.2 percent of the total sales and 31.9 percent of the net income of municipal liquor operations in 2002.

Sales by metropolitan area establishments averaged $2.1 million in 2002 compared to average sales of $682,791 for Greater Minnesota municipal liquor stores.[13] The average net income of metropolitan stores was $137,616 in 2002, compared to an average of $59,282 for municipal liquor establishments in Greater Minnesota.

[12] Minn. Stat. § 340A.601, subd 1. Once a city with a population under 10,000 people has established a municipal liquor store, it may continue to operate the store regardless of its subsequent population growth.

[13] Minn. Stat. § 340A.601, subd 2. The 22 cities in the metropolitan area that have municipal liquor operations operated a total of 44 establishments selling liquor on-sale and/or off-sale. The 213 Greater Minnesota cities with municipal liquor stores operated a total of 218 establishments. Average sales and net income reflect calculations based on the number of stores rather than the number of cities.

Summary of 1998 to 2002 Liquor Store Operations

On-Sale and Off-Sale Stores

	1998	2002				
Number of Cities	147	138				
			Percent of Sales			Percent
	Amount	Amount	2001	2002	Variance	Change
Sales	$57,494,936	$68,675,044	100.0%	100.0%	11,180,108	19.45%
Cost of Sales	35,298,500	42,581,871	61.6%	62.0%	7,283,371	20.63%
Gross Profit	22,196,436	26,093,173	38.4%	38.0%	3,896,737	17.56%
Operating Expenses	19,274,515	23,008,599	32.9%	33.5%	3,734,084	19.37%
Income from Operations	2,921,921	3,084,574	5.5%	4.5%	162,653	5.57%
Nonoperating Revenues	1,433,439	1,304,100	2.3%	1.9%	(129,339)	-9.02%
Nonoperating Expenses	134,805	228,311	0.4%	0.3%	93,506	69.36%
Net Income Before Transfers	4,220,555	4,160,363	7.4%	6.1%	(60,192)	-1.43%
Transfers to Other City Funds	3,642,594	3,218,463	---	---	(424,131)	-11.64%

Off-Sale Only Stores

	1998	2002				
Number of Cities	95	95				
			Percent of Sales			Percent
	Amount	Amount	2001	2002	Variance	Change
Sales	$135,885,387	$172,192,070	100.0%	100.0%	36,306,683	26.72%
Cost of Sales	103,572,992	130,214,517	75.7%	75.6%	26,641,525	25.72%
Gross Profit	32,312,395	41,977,553	24.3%	24.4%	9,665,158	29.91%
Operating Expenses	21,317,997	27,970,412	15.9%	16.2%	6,652,415	31.21%
Income from Operations	10,994,398	14,007,141	8.4%	8.1%	3,012,743	27.40%
Nonoperating Revenues	1,633,923	1,539,470	1.2%	0.9%	(94,453)	-5.78%
Nonoperating Expenses	663,910	728,399	0.4%	0.4%	64,489	9.71%
Net Income Before Transfers	11,964,411	14,818,212	9.2%	8.6%	2,853,801	23.85%
Transfers to Other City Funds	7,811,724	10,849,303	---	---	3,037,579	38.88%

Total City Liquor Stores

	1998	2002				
Number of Cities	242	233				
			Percent of Sales			Percent
	Amount	Amount	2001	2002	Variance	Change
Sales	$193,380,323	$240,867,114	100.0%	100.0%	47,486,791	24.56%
Cost of Sales	138,871,492	172,796,388	71.7%	71.7%	33,924,896	24.43%
Gross Profit	54,508,831	68,070,726	28.3%	28.3%	13,561,895	24.88%
Operating Expenses	40,592,512	50,979,011	20.7%	21.2%	10,386,499	25.59%
Income from Operations	13,916,319	17,091,715	7.6%	7.1%	3,175,396	22.82%
Nonoperating Revenues	3,067,362	2,843,570	1.5%	1.2%	(223,792)	-7.30%
Nonoperating Expenses	798,715	956,710	0.4%	0.4%	157,995	19.78%
Net Income Before Transfers	16,184,966	18,978,575	8.7%	7.9%	2,793,609	17.26%
Transfers to Other City Funds	11,454,318	14,067,766	---	---	2,613,448	22.82%

Enterprise Fund Transfers

Very few cities have formal transferring policies. How cities transfer money ranges from not transferring out of the enterprise funds at all, transferring a set amount based on a percentage of profits, basing it on kilowatt usage, to transferring an amount equal to the administrative costs of operating the enterprise by the city. Generally, decisions on how much to transfer are determined at budget time and can change from year to year. Many cities require ordinances to transfer funds, and some enterprises are prohibited by law, charter, or bond covenant from transferring to other funds.

The premise of municipal enterprises is to provide a service where the costs are recovered primarily by charges to those who use the service. In other words, those who want the service pay for it. Some enterprises target a small group of users, while others, such as water or electric utilities, are used by almost everyone in the city. Theoretically, with the exception of for-profit enterprises, cities should not have a profit motive. Therefore, most enterprises should be structured financially to break even. We have found that this is not the case. Most enterprises either make money (some a little, some a great deal) or lose money.

If one of the stated or implied goals when establishing an enterprise was to provide additional revenues to the city, profits should be maximized and most of them transferred to other governmental funds.

In theory, the majority of profits generated by municipal enterprises should be available for transfers. By law, most of the necessary enterprises discussed previously are limited in the amount they may charge. If the city's goal was to provide the service at cost and not use taxpayer dollars, then charges should be set to be as close to break even as possible. Cities may also decide to direct some profits to improve the municipal enterprise's facilities or services through capital improvement, and renewal and replacement funds.

Municipal enterprises, like the private sector, are affected by business cycles. An economic recession can cause an unexpected drop in profits. If a city relies on transfers from enterprises to fund general city services, the drop in enterprise profits could force a city to cut back on services. Property tax revenues are not impacted as greatly by economic downturns and provide a more reliable source of funding for city services. As stated earlier, in a necessary enterprise activity where excess user fees are designed to subsidize the other city functions with a transfer of utility profits, taxpayers are paying too much for a service they are forced to use. In addition to paying a higher cost for the service, non-business taxpayers are not able to deduct user fees from their personal income taxes, whereas property taxes are deductible from personal income taxes.

Profits and Transfers – A Policy Problem

When a municipal enterprise is generating a net profit, what to do with the proceeds becomes a public policy question. Does the city lower the charges for the activity to make it a break-even operation? Does the city transfer the profits to other funds to help support city services that would otherwise be paid for with property taxes or other revenue sources? Should customers of municipal enterprises be forced to subsidize general city services?

Governments make the argument that transfers are necessary “in lieu of taxes”. If a private company provided the service, the government would receive taxes from that company. In this instance a transfer of funds from the enterprise makes up for lost tax revenue. The argument also exists as to whether governments should be entitled to a reasonable profit from operations.

Another question regarding transfers from enterprises concerns conflicts of interest. For example, a conflict may arise where another city department in the general fund regulates an enterprise fund activity.

Given that transfers can relieve the tax burden for citizens and make cities less reliant on aid from other sources (provided that users are not being charged an exorbitant amount), it may be a sound way for cities to provide necessary services to their residents. However, if a city is too reliant on transfers from municipal enterprises, it raises a number of questions. First, is there a lack of revenue diversification in the city that forces it to rely on enterprises for its revenue? For smaller cities, a stagnant or declining population would indicate that other methods to raise revenue are necessary. Second, is the city relying on transfers due to unwillingness to raise taxes or other user fees? While general city services may require subsidization from other funds, it should not be to an extent that the services being offered by the city cannot consistently be provided by property taxes.

The other type of transfer (subsidy), from governmental funds to enterprise funds, raises other issues. If a municipal enterprise is losing money, city officials must determine if the service should be subsidized, and if so, to what extent. Certain enterprises such as nursing homes and hospitals provide a necessary public good that officials determine should be retained even if they lose money.[14] Managers of these types of facilities must evaluate what charges the market can bear, and make recommendations to city officials on the level of subsidy needed to maintain the operation.

In order to maintain transparency in city finances, the question that should be asked is whether the public is aware of how much is transferred, either as profit or as a subsidy from the general fund on an annual basis. Furthermore, does the Council have a policy in place that enterprise funds transfer a set percentage, or amount, or are they transferring any amount in order to balance the budget? If the enterprise activity is not considered a necessary public good, city officials need to determine if the enterprise activity should continue and if so what level of subsidy the city can afford based on its budgeted priorities.

[14] Nursing homes and hospitals are also subject to insurance and Medicare/Medicaid reimbursement rates.

City Survey of Municipal Enterprise Activity

As mentioned, the State Auditor's Office designed a voluntary survey on enterprise activity and requested that cities share their enterprise experiences. In addition to individual fund information, the State Auditor's Office asked cities to share any lessons they had learned in operating enterprises and to indicate if there were areas where additional guidance was needed.

Respondents

Of the 853 cities surveyed, 466 cities responded to the survey (54%)[15]. Of the 466 cities, 40 reported no enterprise activity. The total amount of funds reported totaled 2,087[16]. Cities reported 892 Utilities, 291 Environmental, 265 Facilities, 124 Public Safety, 57 Transportation, 106 Recreation, 137 Community Development, and 195 Miscellaneous[17].

Private versus Public Management

Cities were asked by individual enterprise if the city managed the enterprise operations or whether they contracted out with a private management company. For the cities that responded to this category, city governments manage 1,789 funds and private companies managed 184 funds. Private management was used in many different categories including utility management companies, health care providers, and sanitation services to name a few. The most common reasons to use private management were:

- To expand service.
- Was more cost effective.
- More expertise in service delivery.
- Established company with equipment.
- Licensed personnel.
- Joint Powers Boards.
- Labor costs were lower.

Transfer Policies

In the survey, cities were asked if they had a formal policy in place regarding the transfer of profits from enterprise funds. Examples of some of the city responses are as follows[18]:

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[15] Some cities did not answer all the questions listed on the survey, as such, there are some N/A comments for some of the totals.
[16] This includes enterprise activity classified in any type of fund provided that 50% of the charges were covered by user fees or it was specifically designated as enterprise activity.
[17] As mentioned earlier, liquor stores were included in miscellaneous though are accounted for separately in the financial section.
[18] These are direct quotes from the surveys sent to the cities. Where possible, the attempt was made to choose responses that were indicative of more than one city's experience, and to highlight differences between cities.

- "Each year a certain amount is budgeted to transfer...this is done by ordinance."

- "Net profits are kept in the funds in which they are generated. That way they are available when large or unexpected expenses occur (normally capital expenditures such as repairing wells, repainting the water tower, replacing sewer or water mains, etc.)."

- "Liquor, water and sewer enterprise operations pay a administration fee along with transfer of a portion of its profits for tax relief. Amounts are set each year as part of the annual budget."

- "Clerical work is done by City staff for water & sewer and solid waste collection. Clerical wage transfer is based on average hours per month at current pay rate."

- "The dollar amount of fund transfers is determined during the budget process and is used in determining total general fund revenues and the amount of the tax levy needed to provide essential services."

- "The City Charter will allow only 25% of net revenue to be transferred from utilities to general fund and only if the requirements of a 10-year capital plan are met. Additional transfers must be approved by an ordinance."

- "The City's policy is to make no transfers of net profits to operating funds. Funds collected from an enterprise activity are used solely for the enterprise. Net profits would help fund necessary capital improvements or help maintain level user fees."

- "Determined by City Council during annual budget meetings."

- "Not an absolute percent or number of dollars, but generally as little as possible to provide governmental services while still providing good stewardship for the enterprise needs."

- "Net profits are transferred upon the recommendation of the auditor."

- "No, any profit made stays in the fund to help pay for future improvements to infrastructure or facilities used for that service."

- "Annually, a recommendation is made from our financial advisor of the dollar amount to transfer from the liquor fund to the general fund."

- "Our city charter authorizes a transfer in lieu of taxes from our utility fund to a maximum of 10% of gross revenue to our governmental funds."

- "Transfer an administrative fee from each of the enterprise funds to the General Fund on a yearly basis. Amounts range from 2%-8%."

"The city does not have a policy for transfer of net profits. However, by Ordinance, the Public Electric Utility pays a franchise fee to the general fund equal to 2 mils per kilowatt hour for retail sales to customers within the franchise area (city)."

- "Liquor transfer is $125,000 a year. Electric transfer is .00275/KWH sold."

Competition with Private Business

Cities were asked if their enterprise activity competed with the private sector in their area. Of the 2,087 funds listed, 230 funds were said to provide a service available from a private competitor. The main reasons for providing the service were:

- No private provider existed when service was originally started.
- To provide revenue for the general fund.
- To provide revenue for projects not easily funded with tax dollars (i.e. streets).
- City provides more efficient service than private provider.
- To offer more choice and keep prices competitive.
- Cemeteries - private cemeteries affiliated with churches were not available to all.
- Preserve green space.
- Profits stay in the community.
- Offering one large facility with many purposes cheaper than many private ones.
- To qualify as a grant recipient.
- Facility/land donated to city to be used for specific purpose.
- City merger, fund already existed in one city.
- Private provider located too far away from city.

Professional Associations and Best Practices

Cities were asked, by individual fund, if they belonged to a professional organization and if that association offered any sort of best practices[19] advice. Of the 2,087 funds, 935 are associated with a professional organization. A number of city respondents were not certain of the best practices option, but 771 funds reported best practice guidance from their organization. Many cities also responded that they rely on best practice advice and guidance from the League of Minnesota Cities. Appendix 10 shows the organizations provided by the cities to which they belong.

Divesting

Another question was in regards to whether or not the city had divested itself of one of its enterprise activities in the last five years. Some cities listed divested enterprises beyond that range. Twenty-one cities (Kensington divested itself of two enterprises) responded that they had abandoned or sold a specific enterprise activity during the time frame referenced. The chart below lists the cities that divested, the type of enterprise, and the reason given.

[19] Starting in 2004 the State Auditor's Office will be taking over the task of doing best practices reviews of the delivery of local government services. *See* Minn. Stat. § 6.78 (2003); 2003 Minn Laws, 1st Spec. Sess., ch.1, art.2, § 16. The Office of the Legislative Auditor had previously done this task.

City	Enterprise	Reason for Divesting
Blue Earth	Steam Heat	Was not breaking even, did not want to subsidize further.
Currie	Liquor Store	Sold to private owner due to lack of profit.
Hopkins	Skate Park	Was not covering costs.
Hoyt Lakes	Restaurant	Not financially viable.
Kensington	Liquor Store	Too expensive, lack of good help.
Kensington	Café	Too expensive, lack of good help.
Lafayette	Liquor Store	Manager resigned.
Lake Lillian	Liquor Store	Sold to private owner due to lack of profit.
Lanesboro	Clinic Building	Sold to private owner.
Luverne	Community Hospital	Struggling financially.
Mantorville	Liquor Store	Sold.
Marietta	Water	Now obtain from other entity and get better service.
Morgan	Liquor Store	Sold to private owner due to lack of good manager.
New Brighton	Driving Range	Offered only temporarily until redevelopment began.
North St. Paul	Ambulance	Eliminated to provide Advance Life Support.
Pine River	Liquor Store	Not much profit, did not feel comfortable selling liquor and then enforcing drinking ordinances.
Richfield	Golf Course	Closed for runway expansion.
St. Anthony	Liquor Operations	Got rid of on-sale bar/restaurant to allow for redevelopment of the area.
St Paul	Sports Dome	Could not cover costs.
Trimont	Liquor Store	No longer profitable.
Watertown	Liquor Operations	Got rid of on-sale liquor business, kept off-sale.
Wood Lake	Liquor store	Three consecutive years of losses, sold to private owner.

General Questions and Comments

Overall, the majority of cities are confident that they are providing the best service possible for their taxpayers and resent interference by other entities (i.e. State Government) in determining what is best for their locality. As one city stated “Our management is reviewed by the voters every two years.”

Most cities stressed that the services they provide are for the benefit of their residents and at the request of their residents, regardless of any profit. However, most said they strived to at least break even. Based on the financial analysis completed for this report, it seems that, for the most part, they are achieving their goals. There are relatively few enterprises that are purely for profit indicating that most cities are creating enterprises where there is no reasonable private sector alternative for the service desired.

Cities were asked what has worked for them in regards to their enterprise activity and what advice they would give to other cities engaging in the same activity. Examples of some of the kinds of responses are as follows:

- “Hire knowledgeable managers and allow them to provide the day-to-day operations.”

- “Review expenses annually for adjustments in user fees.”

- “Setting rates high enough to provide a capital outlay fund for future capital expenditures/raise rates a little each year rather than wait until a major change, which would cause a large increase in rates.”

- “City has enterprise funds to provide services not currently provided for or provided on a limited scale by the private sector.”

- “Continuous oversight and monitoring to insure outside management or employees are continually looking for ways to reduce expenses and improve service delivery.”

- “Having a local board appointed by elected officials make the day to day decision on how to run the businesses, what services to provide and the fees that are needed.”

- “At a minimum, all enterprise activities should have a dedicated account. These activities should not be grouped with the General Fund.”

- “Cities should only provide enterprise activities when there is no appropriate private service available.”

- “We have only had enterprise activities to provide a service to our residents. We have learned to keep our rates at a level where we can maintain a positive balance. Watch your expenses vs. rates.”

- “The city, on a yearly basis, needs to evaluate user fees and increase them before a problem is detected in order to pay all expenses of the enterprise activity.”

- “Annual profit/loss analysis to maintain adequate reserves for emergencies.”

- “We are raising our water and sewer rates to have the funds make enough revenue to provide for future renovations and repairs. These rate increases were not popular with the residents, but necessary.”

- “Keep it simple and use outside contractors for maintenance and improvements.”

- “In most cases enterprise activities need to be operated just like a private business. Always review operations for potential efficiency savings and cost reductions. Stay up to date on best practices through groups like LMC, CMMPA/MMUA and MMBA.”

- “It is critical to plan for the future. Infrastructure must be always monitored, maintained, and improved or replaced. Forecasting forward for five years is essential to ensure that services can be provided without substantial rate increases.”

Additional Support and Guidance

Cities were also asked if they felt they were getting enough guidance from other entities and organizations. Most cities responded that they were getting enough guidance. However, many were interested in more information on topics such as accounting and utility issues (for example, rate studies offered by professional organizations). Generally, smaller cities had a greater desire for more help and information. Examples of some city comments are listed below.

- “City Council and City Staff would like more input and more involvement with the operation of the PUC.”

- “We'd like to see the MPCA continue to offer training programs for wastewater operators. We'd like to see the Dept. of Health continue with their efforts in training in water issues and MN Rural Water continue its programs.”

- “For water, sewer, storm sewer, electric, rate studies are very useful.”

- “The City has enough involvement from other [state] agencies. Guidance and assistance from professional associations is welcome because they have operating management experience with similar facilities.”

- “Information on grant programs would be helpful. Updates on laws pertaining to these subjects would also be appreciated.”

- “We're receiving plenty of support from state agencies and city-related organizations. We're more interested in guidance from trade organization and citizen advisory boards and committees that have expertise in running such businesses.”

- “It is helpful to be able to access other city information.”

- “More emphasis should be placed on financial planning. Right now emphasis seems to be placed on past financial information and operating budgets. The Governmental Accounting Standards Board, due to concerns regarding debt and infrastructure reporting, adopted GASB 34. Cities need to place more emphasis on the effect that current actions have on future residents and consumers.”

- “State and federal mandates are very often broad and encompassing and do not address the uniqueness of individual facilities and cities.”

- “Information and examples of success stories and innovative practices would be very helpful. There are other organizations such as MMBA, Rural Water and others that do a good job of assisting cities in managing programs.”

- “Many small communities do not have the financial background to evaluate enterprises. We are told by the public to think more like a business, but often lack the training or expertise to, like a business, evaluate an activity before we take it on.”

- “There are no classes for Enterprise Funds, i.e. how to set one up, or maintaining one. It's something the new clerks have to learn.”

- “Better tools in accessing information from others in the business would be very useful. While we still need to be mindful of local economic conditions, knowing what works well for others could provide very useful data for our operations.”

- “[The League of Minnesota Cities] could sponsor a "technical day" to help city administrators grasp some of the vocabulary of water plants and the sewer process.”

Recommendations

In light of this study of municipal enterprises, the State Auditor has the following recommendations to help improve the operation and management of city enterprises, and to help promote greater public oversight of enterprise activities.

1. Generally, services paid for primarily by user fees should be accounted for in an enterprise fund.

When governments list fee-based activity in the general fund, other revenue in that fund may allow for subsidization of the activity that is unseen by the public, rendering it nearly impossible to monitor how much is actually being paid by the user. General and special revenue funds recognize expenditures rather than expenses, making it more difficult to determine the full cost of the activity. Citizens may not realize the true costs of the services they receive.

Therefore, the State Auditor's Office recommends that all cities establish activities primarily financed by user fees as enterprise funds. Doing this will give taxpayers, and local policy makers, a better idea of the true costs of the services provided.

2. Enterprises for profit should not lose money.

These enterprises are those for which there is generally (or reasonably could be) competition from the private sector. Liquor stores, retail operations, and other for-profit enterprises should always make a profit. If they fail to do so, they should not exist.

3. Necessary enterprises should only break even.

Necessary enterprises should only charge enough to cover operating costs and the costs of replacement. The law often prohibits excessive charges for public services.[20] This ensures that the public is not being charged an exorbitant amount for a service that they are essentially forced to purchase from the city.

4. Cities should consider public-private partnerships where feasible.

Cities should explore the possible gains in efficiency by contracting with private management companies. Cities would retain control of the service, while benefiting from the expertise of an experienced provider.

[20] See footnote five.

5. Cities should set up enterprise transfer policies.

Enterprise type activity allows the users of a service to pay for it, without using any property tax revenue. If enterprise activities generate excess profits that are continually transferred to the general fund, then the reverse is occurring, users are being indirectly taxed to subsidize other city services. Cities should create a policy of how much they transfer from year to year during the budget process in order for the subsidy of city functions, by enterprise activities, to be more transparent to the taxpayer.