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Financial Condition Analysis of Minneapolis, MN

Introduction:

This financial condition analysis examines the years 2011, 2012 and 2013 for the city of Minneapolis, Minnesota. For each year, 8 solvency ratios were calculated: cash ratio, quick ratio, operating ratio, own source ratio, net asset ratio, long-term debt ratio, net assets per capita and long-term debt per capita. These ratios were then analyzed to examine their changes over time and thus, the overall financial condition of Minneapolis. Possible socioeconomic factors affecting these ratios are also discussed and recommendations are provided. The same 8 solvency ratios were calculated for St. Paul, Minnesota in 2011, 2012 and 2013 in order to provide a point of comparison from a city in a similar location and with similar characteristics.

Defining the Scope of the Analysis:

For this analysis, we focused on cash solvency, budgetary solvency, long-run solvency and service-level solvency. This analysis focused on the entire city government and its whole budget. This analysis also only used data that was available in the published Comprehensive Annual Financial Reports (CAFR) available on the city websites.

Description of Existing Financial Condition & Peer Comparison with Saint Paul:

Overall, Minneapolis looks to be in a strong financial position in 2011-2013 through a variety of measures. All of the solvency ratios calculated are reported in Table 1 and detailed calculations can be found in Appendix 1. The cash ratio and quick ratio are both staying consistently higher than 2 and 3, respectively, which indicates that Minneapolis has cash available to work with. This means that the city could pay off its current liabilities relatively easily with this cash if it needed to. The operating ratio is also strong as it is above 1 each year, which indicates that Minneapolis has enough revenue to cover its expenses. One possible trend of concern is that the operating ratio does decrease slightly over the course of 2011-2013. From the own-source ratio it is seen that Minneapolis is getting almost all of its revenue from its own sources. This shows that Minneapolis supports itself financially and is not highly dependent on local government aid. The net asset ratio is increasing over time, which indicates that

Minneapolis is in an increasingly strong financial position since they have good long-run solvency. The long-term debt ratio is decreasing, which is also a good sign since Minneapolis can more easily pay off its long-term debt. The net assets per capita are increasing in Minneapolis as well while the long-term debt per capita is decreasing. This is also an indication of strong financial health. Each ratio is also compared with its peer city of St. Paul. All of the solvency ratios for St. Paul are reported in Table 2 and detailed calculations can be found in Appendix 2.

Table 1: Minneapolis Solvency Ratios

Solvency Ratio	2011 Ratio	2012 Ratio	2013 Ratio
Cash Solvency: Cash Ratio	2.34	2.76	2.79
Cash Solvency: Quick Ratio	3.12	3.65	3.54
Budgetary Solvency: Operating Ratio	1.3	1.21	1.17
Budgetary Solvency: Own Source Ratio	0.99	0.95	0.95
Long-run Solvency: Net Asset Ratio	0.62	0.67	0.68
Long-run Solvency: Longterm Debt Ratio	0.81	0.81	0.81
Service-Level Solvency: Net Assets per Capita	5.35	5.78	6.07
Service-Level Solvency: Long-term Debt per Capita	2.3	2.34	2.19

Table 2: St. Paul Solvency Ratios

Solvency Ratio	2011 Ratio	2012 Ratio	2013 Ratio
Cash Solvency: Cash Ratio	1.5	1.5	1.37
Cash Solvency: Quick Ratio	2.69	2.64	2.28
Budgetary Solvency: Operating Ratio	1.02	1.03	1
Budgetary Solvency: Own Source Ratio	0.91	0.91	0.91
Long-run Solvency: Net Asset Ratio	0.62	0.62	0.6
Long-run Solvency: Longterm Debt Ratio	1.29	1.24	1.32
Service-Level Solvency: Net Assets per Capita	5.32	4.32	5.25
Service-Level Solvency: Long-term Debt per Capita	2.61	2.61	2.73

Since the cash ratio is larger than 1, larger than 2.3 in fact, this indicates that the government has enough money to pay its bills. This is important for financial solvency and should be expected in a city like Minneapolis. The cash ratio for Minneapolis increases overall from 2011-2013 with the largest increase in 2012. The quick ratio is more lenient since it includes receivables as well, so those ratios are even higher. If the city were in a crisis, they would theoretically have the additional cushion of the receivables that they could use as well. Cash and quick ratios above 1 also seen in the comparable city of St. Paul. However, the cash and quick ratios of St. Paul are notably lower than Minneapolis as the Minneapolis ratios are at least 1 point higher. Minneapolis has more cash on hand than St. Paul comparably.

The operating ratio is larger than 1 which indicates that the city of Minneapolis has a bit of a surplus. An operating ratio above 1 is an indicator of a healthy financial condition as Minneapolis has sufficient revenue for its expenditures. However, one possibly troubling trend is that the operating ratio is slightly decreasing over the course of these 3 years. This is something to monitor as it could be an indicator that Minneapolis would need to either increase its revenue or decrease its expenses in the

future. However, St. Paul's operating ratios are all very close to 1. Even though Minneapolis' operating ratio is decreasing slightly, it is still higher overall than St. Paul. This indicates that although Minneapolis has a trend that is potentially of concern, it is still doing well compared to its peer city.

The own-source ratio indicates that Minneapolis gets nearly all of its revenue from its own sources. This is an indicator of the city's good budgetary solvency as Minneapolis is not as dependent on outside sources of revenue. However, beginning in 2012, the own-source ratio decreases by .04. There was a notable increase in local government aid beginning in 2012, which could potentially be of concern as a long-term trend if this reliance were to continue. Compared to St. Paul, Minneapolis has a higher percentage of own-source revenue, even after the increase in 2012. This indicates that even though own-source revenue is decreasing and could potentially be of concern, Minneapolis is still more self-sufficient and financially robust than its peer city.

The net asset ratio is growing in Minneapolis, which is a good indication. This shows that Minneapolis' long-run solvency is getting better. Minneapolis will be better able to meet financial challenges if their total net assets are a higher percentage of their total assets. The net asset ratio grows from 0.62 to 0.68 from 2011-2013. Over this same time period, St. Paul's net asset ratio is the same in 2011 and 2012 and then decreases a bit in 2013, from 0.62 to 0.60. This also indicates that Minneapolis is in a stronger financial position than its peer due to its better long-term trend.

The long-term debt ratio in Minneapolis remains the same over the course of these 3 years, at 0.81. The long-term debt ratio examines debt in terms of the annual budget so the fact that it has not been increasing is a good sign. However, as the population of Minneapolis is growing, it would be an even better sign to see the long-term debt ratio decreasing. In St. Paul, the long-term debt ratio is fluctuating and ultimately increases a bit. It is also higher than in Minneapolis as it is consistently above 1.2. It may be an aspirational goal for Minneapolis to see its long-term debt ratio decrease but it is in a better financial position than St. Paul regardless.

The net assets per capita are increasing in Minneapolis, which is also a good sign. This indicates that Minneapolis has increased capacity to provide more services per person over the course of these 3 years. Net assets per capita increase over each of these 3 years, from 5.35 in 2011 to 6.07 in 2013. The net assets per capita are smaller in St. Paul and they fluctuate over the years, ultimately decreasing, from

5.32 to 5.25. For the per capita measures, it is notable that St. Paul's population is smaller and not growing as rapidly as Minneapolis. St. Paul may not be receiving as many new revenue sources, but it also does not have to manage the expenditures for a growing population.

The long-term debt per capita in Minneapolis increases in 2012 but then ultimately decreases over the course of these 3 years, from 2.30 to 2.19. This indicates that there is less long-term debt per person in 2013 as there was in 2011. This is also a positive trend. Paired with net assets per capita, there is less long-term debt per person in Minneapolis at the same time as increased net assets per capita during this time. The long-term debt per capita in St. Paul remains the same in 2011 and 2012 and then increases in 2013, from 2.61 to 2.73. The long-term debt per capita in St. Paul is trending upward rather than downward and is also higher overall than Minneapolis.

As compared to St. Paul, we see that Minneapolis' financial condition is healthy. Although Saint Paul is also financially healthy overall, it isn't doing as well as Minneapolis. A major socioeconomic factor that may contribute to this is that Saint Paul is a smaller city and it is not growing as fast as Minneapolis. St. Paul also has a smaller commercial tax base. There are other considerations that should be examined further for a more robust comparison between the 2 cities, but as a point of comparison, St. Paul underscores the financial health of Minneapolis.

Potential Solvency Concerns:

Overall, the solvency ratios indicate that Minneapolis is in a very strong financial position. There is only one point of very slight concern: Surprisingly, the operating ratio (indicating budgetary solvency) has been declining slightly in the past three years. It went from 1.30 in 2013 to 1.21 in 2012 and 1.17 in 2013. This means that the ratio between the amount of revenue the City is bringing in compared to the amount of expense is coming closer to 1. Were it not for Minneapolis' very strong financial health, indicted by all the other ratios as well as the socioeconomic trends described below, this might be of some concern. However, this pattern of declining budgetary solvency is the opposite of the pattern of the rest of the solvency ratios and the socioeconomic factors and in this context, we don't believe it to be of great concern. The economy is still recovering from the recession, and property values and the commercial tax base are still recovering. Hopefully with this slow but continuous recovery, Minneapolis can stabilize the

operating ratio. If it does not stabilize soon, Minneapolis should take proactive measures, as discussed at the end of this report.

Important Socioeconomic Factors that Influence Financial Condition of Minneapolis:

In all three years of this analysis, the authors of the CAFR stated that "The City's future financial outlook is strong." This is true, and reflected in the upward positive trend of most of the solvency ratios, and the decrease in the debt ratios. Minneapolis already has financial policies in place which will help address funding pressures it will face in the future, such as personnel costs, pension obligations, and internal service fund debt. In addition to projecting property tax needs for ten years, the City, since 2002, supports it long term financial planning with the creation of the Five-Year Financial Direction. This plan reflects the City's ongoing commitment to long-term financial planning, and this long term planning has clearly paid off given Minneapolis' strong financial position.

Minneapolis' budget was growing during the 2011-13 time period, and they planned to continue growing. The Council Adopted Budget for all City funds for the 2014 budget had a 3.5% increase from the 2013 budget. Even as the budget is growing, the property tax levy has declined. There was a 1% decrease from 2013 to 2014. Both these factors indicate economic health for the city, given the City felt comfortable enough with it's financial condition to warrant a decrease in the property tax levy. In 2013, Minneapolis continued to have solid growth in population, housing, jobs, and commercial construction as it did in 2011 and 2012. These socioeconomic factors combined collectively strengthened the already strong economic base. They contributed to a higher than projected tax base growth and building fee revenue. We will discuss some of the strongest socioeconomic factors contributing to Minneapolis' strong financial position below.

Population Growth: Demographic trends and a growing employment base have contributed to a quickly growing population since the 2010 Census. "In mid-2013, the Metropolitan Council reported that the City had added 9,430 residents since 2010, for an estimated 2012 population of 392,008, a 2.5% increase."[1] Minneapolis added more population than any other city in the Twin Cities metro area, and the "two year growth rate of 2.5% was higher than the comparable growth rate of 2.2% for the 25 largest

[1] Minneapolis 2013 CAFR

metro areas."[2] *How does this affect financial health?* As the Minneapolis population grows, its tax base grows. This means that Minneapolis can take in additional revenue when population grows. In fact, in 2012 the Minneapolis population was estimated to be 392,768 by the US Census Bureau. The total revenue for that year was 1,009,894,000. Therefore the revenue per capita was approximately $2,571. On the other hand, the total expenses for 2012 was $819,786,000 and the per capita expenses were therefore approximately $2087. That means the net revenue gain for each additional person was $2571-$2087 or $484. This means that (as a rough estimate) on average, for every new resident in Minneapolis, Minneapolis could potentially see an additional $484 annually of net gain. This positive figure indicates that the city may gain net revenue by bringing in more people. Of course, additional members of the population will also require more services and therefore more expenses for the city. But on the whole the additional population is resulting in more revenue for the City than expenses. This is probably due to the fact that many people come here to take jobs and so join the workforce immediately and do not need many services. This population growth therefore can improve the city's budget solvency ratio.

Job Growth: Minneapolis has been very successful in creating job growth since the great recession. In mid-2013, the City had 302,839 jobs, well above its pre-recession high of 296,000 and the highest quarterly total since 2001. The City also added jobs at a faster annual rate – 1.9% - than the 7 county metro area and the state. "The average annual unemployment rates for both the City and the 7-county metro area have been lower than those for the state as a whole and for the nation for the last ten years; for 2013, the City's average annual unemployment rate was 4.9%, about the same as the metro area (4.8%), and below the state (5.1%) and national (7.4%) unemployment rates."[3] *How does this affect financial health?* The more jobs there are, the lower the unemployment rate is, and therefore the less people who need City services. Also, the more jobs there are, the more people there are working. The more people there are working means more individual incomes which results in more consumption of fee or charge-based city services and products, and therefore increased revenue for the City. It's likely as well that the increase of jobs results in increase of personal income, which can lead to increased real

[2] Minneapolis 2013 CAFR
[3] Minneapolis 2013 CAFR

estate consumption[4] (for example, renovation of homes, and the purchase of land and houses). This may lead to increase in assessed property values and increase the property tax base for the City.

Construction Growth: Two trends have combined to create the highest level of construction growth in over 10 years in Minneapolis: 1) The population and job growth have combined to create a huge residential building boom. Minneapolis leads the metro area in residential housing units permitted. “In 2013 a total of 3,552 new residential units were permitted, the second straight year of 3500+ units. Residential Building Permit Valuation increased from $309.8 million in 2011 to $636.3 million in 2012 to $723.8 in 2013.[5] 2) There has also been a steady growth of commercial construction. Commercial Permit Valuation has steadily increased from $366.6 million in 2011 to $453.8 million in 2013.[6] *How does this affect financial health?* This boom in construction has led to increased revenue for Minneapolis in the General Fund (through the permit fees).

Real Estate Trends: Nearly two-thirds of the value of the City’s tax base is made up of residential property, and therefore it has a significant impact on the City’s overall estimated market value. “In 2013, the median residential sales price as reported by the Realtor’s Association was $189,000 in 2013, a $49,000 or 35 percent increase from $140,000 reported in 2011.”[7] This is a steep increase. However, median sales prices are still not back to their pre-recession level and growth will continue to happen. This recovery in residential value is reflected in the City’s overall market value. The Estimated Market Value (EMV) for residential property in 2014 is $21.6 billion.[8] *How does this affect financial health?* As property values go up, so do property taxes, a major source of revenue for the City of Minneapolis.

Commercial Tax base: Minneapolis has the highest concentration of commercial office buildings in all of Minnesota. The City’s commercial tax base grew by 2.9% in 2013, which is modest, but hopeful given that the country is still recovering from the great recession. This tax base is projected to grow slowly over the next several years. There were several notable commercial projects that initiated in 2013, and even more large ones were set to initiate in 2014, including the new Viking stadium, Downtown East, and

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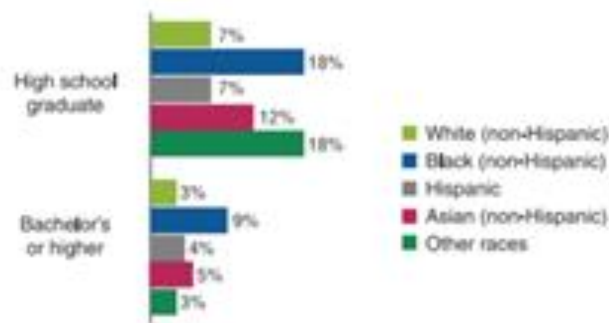
[4] Wang, 2006
[5] Minneapolis 2013 CAFR.
[6] Minneapolis 2013 CAFR.
[7] Minneapolis 2013 CAFR.
[8] Minneapolis 2013 CAFR

the renovation of Block E. Another good economic sign is that the vacancy rates in the Minneapolis Central Business District declined slightly from 17% to 16.3% in the fourth quarter of 2012. *How does this affect financial health?* Commercial buildings are an important contributor to Minneapolis taxes, and the recovery of the commercial tax base is important for Minneapolis' current and future financial growth (though not as important as the residential tax base).

Recommendations and Conclusion:

Since Minneapolis' solvency ratios for the most part indicate a very healthy economic situation, and the socioeconomic factors also indicate a growing economy (and therefore growing revenue sources for the City), we conclude that Minneapolis should keep doing what it's doing. It should continue to work to make Minneapolis a family-friendly City with a high-standard of living in order to attract both businesses and employees. Minneapolis' growing population has a positive effect on the City's financial condition, so Minneapolis should strive to continue growing its population at this point, but in a sustainable manner. The one issue of small concern was the slightly declining operating ratio. This ratio will hopefully stabilize as property values and the commercial tax base return to their pre-recession levels. However, Minneapolis should keep an eye on this ratio and take steps to ensure that it stabilizes within a few years. Steps could include finding ways to increase revenues slightly and decrease expenditures slightly. Given that Minneapolis has been decreasing the property tax rate, stabilizing or even increasing the rate could help stabilize the operating ratio.

Another issue that is of major concern are the racial disparities in Minneapolis, and in Minnesota in general. Trends that make Minnesota the envy of states across the country -- living-wage jobs, low unemployment rates and high rates of homeownership and high school graduation -- are not transferring over to many residents of color. Though jobs are growing, and the unemployment rate is falling, some communities are being left out of these economic opportunities. In fact, The Twin Cities Metro has some of the highest racial disparities of the nation. For example, the unemployment rate in the Twin Cities Metro between 2006 and 2010 was 18% for African Americans, while it was only 7% for whites.



There are also large disparities between whites and people of color in the areas of homeownership and poverty in the Twin Cities Metro. "Today in our region, only 6 percent of white people live in poverty -- that is one of the best rates in the country...But 25 percent of people of color in this region live in poverty -- one of the worst rates in the country."[9]

The Minneapolis-Saint Paul economy is vibrant, due in large part to excellent human capital. For generations, the region's business leaders have taken pride in doing the right thing – for their employees, their investors, and their communities, and it has paid off. Minneapolis and St. Paul are recognized for its high quality of life, educated workforce, and low poverty rate.[10] However, because of the racial disparities, MSP is not reaching its full potential, and many communities are suffering--as is the whole economy as talented people of color decide to move away from the Metro Area. The region is at risk of becoming a net exporter of qualified workers due to these racial disparities. In addition, demographics are shifting. Currently in the Twin Cities metro 25% of the population is people of color. That percentage is projected to rise to 41% by 2040.[11] The competitive advantages of a more diverse workforce are well documented, including a stronger connection with a more diverse customer base, more innovation, and better financial results.[12] In order to continue the economic growth and healthy financial condition, as well as keep a regional competitive advantage, Minneapolis must immediately address its unacceptable racial disparities.

[9] http://www.twincities.com/localnews/ci_25004196/minnesotas-racial-poverty-disparities-must-be-addressed-met
[10] http://www.theitascaproject.com/20150316%20EmployOpp%20Final.pdf
[11] U.S. Census Bureau, Metropolitan Council
[12] http://www.theitascaproject.com/20150316%20EmployOpp%20Final.pdf

Appendix 1: Minneapolis Solvency Ratios

Solvency Ratio	2011 Ratio	2012 Ratio	2013 Ratio
Cash Solvency: Cash Ratio	2.34	2.76	2.79
Cash Solvency: Quick Ratio	3.12	3.65	3.54
Budgetary Solvency: Operating Ratio	1.3	1.21	1.17
Budgetary Solvency: Own Source Ratio	0.99	0.95	0.95
Long-run Solvency: Net Asset Ratio	0.62	0.67	0.68
Long-run Solvency: Longterm Debt Ratio	0.81	0.81	0.81
Service-Level Solvency: Net Assets per Capita	5.35	5.78	6.07
Service-Level Solvency: Long-term Debt per Capita	2.3	2.34	2.19

Minneapolis Solvency Equations

Solvency Ratio	2011 Equation	2012 Equation	2014 Equation
Cash Solvency: Cash Ratio	281245555/187129528	284190528/189072313	283120665/206068130
Cash Solvency: Quick Ratio	504306718/187129528	499202281/189072313	469017836/206068130
Budgetary Solvency: Operating Ratio	584249251/570552580	611914880/594974498	610871263/611167610
Budgetary Solvency: Own Source Ratio	529774286/584249251	558170660/611914880	556962127/610871263
Long-run Solvency: Net Asset Ratio	1535450113/2475354619	1537259232/2485607987	1546962200/2557725190
Long-run Solvency: Longterm Debt Ratio	752774978/584249251	759276442/611914880	804694860/610871263
Service-Level Solvency: Net Assets per Capita	1535450/288726	1537259/291,039	1546962/294873
Service-Level Solvency: Long-term Debt per Capita	752775/288726	759276/291039	804695/294873

Appendix 2: St. Paul Solvency Ratios

Solvency Ratio	2011 Ratio	2012 Ratio	2013 Ratio
Cash Solvency: Cash Ratio	1.5	1.5	1.37
Cash Solvency: Quick Ratio	2.69	2.64	2.28
Budgetary Solvency: Operating Ratio	1.02	1.03	1
Budgetary Solvency: Own Source Ratio	0.91	0.91	0.91
Long-run Solvency: Net Asset Ratio	0.62	0.62	0.6
Long-run Solvency: Longterm Debt Ratio	1.29	1.24	1.32
Service-Level Solvency: Net Assets per Capita	5.32	4.32	5.25
Service-Level Solvency: Long-term Debt per Capita	2.61	2.61	2.73

St. Paul Solvency Equations

Solvency Ratio	2011 Equation	2012 Equation	2013 Equation
Cash Solvency: Cash Ratio	552472/236096	585600/211843	684014/245158
Cash Solvency: Quick Ratio	735813/236096	772831/211843	868079/245158
Budgetary Solvency: Operating Ratio	1097168/842868	1127677/932200	1085933/930948
Budgetary Solvency: Own Source Ratio	1088662/1097168	1071080/1127677	1029361/1085933
Long-run Solvency: Net Asset Ratio	2075083/3327341	2271509/3400544	2427078/3548928
Long-run Solvency: Longterm Debt Ratio	892939/1097168	917192/1127677	876692/1085933
Service-Level Solvency: Net Assets per Capita	2075083/388101	2271509/392,768	2427078/400070
Service-Level Solvency: Long-term Debt per Capita	892939/388101	917192/392,768	876692/400070