

CITY OF ROCHESTER, MINNESOTA

COMPREHENSIVE ANNUAL FINANCIAL REPORT

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2018

DEPARTMENT OF FINANCE

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Members of the Government Finance Officers Association
of the United States and Canada

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CITY OF ROCHESTER, MINNESOTA
INTRODUCTORY SECTION
DECEMBER 31, 2018

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ROCHESTER

Minnesota

FIRST CLASS CITY • FIRST CLASS SERVICE



FINANCE DEPARTMENT
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June 14, 2019

To the Honorable Mayor, Members of the Common Council, and the Citizens of the City of Rochester:

Minnesota statutes require all cities to issue an annual report on its financial position and activity prepared in accordance with generally accepted accounting principles (GAAP), and audited in accordance with generally accepted auditing standards by a firm of licensed certified public accountants or the Office of the State Auditor. Pursuant to that requirement, we hereby issue the comprehensive annual financial report of the City of Rochester for the fiscal year ended December 31, 2018.

This report consists of management's representations concerning the finances of the City of Rochester. Consequently, management assumes full responsibility for the completeness and reliability of all the information presented in this report. To provide a reasonable basis for making these representations, management of the City of Rochester has established a comprehensive internal control framework that is designed both to protect the City's assets from loss, theft, or misuse and to compile sufficient reliable information for the preparation of the City of Rochester's financial statements in conformity with GAAP. Because the cost of internal controls should not outweigh their benefits, the City of Rochester's comprehensive framework of internal controls has been designed to provide reasonable rather than absolute assurance that the financial statements will be free from material misstatement. As management, we assert that, to the best of our knowledge and belief, this financial report is complete and reliable in all material respects.

The City of Rochester's financial statements, with the exception of the electric and water funds and the Destination Medical Center Corporation (DMCC), a blended component unit, have been audited by Smith, Schafer and Associates, Ltd., a firm of licensed certified public accountants. The electric and water funds have been audited by Baker Tilly, Ltd. The DMCC has been audited by CliftonLarsonAllen, LLP. These funds and component unit are included in this comprehensive report. The goal of the independent audit was to provide reasonable assurance that the financial statements of the City of Rochester for the fiscal year ended December 31, 2018, are free of material misstatement. The independent audit involved examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Smith Schafer and Associates concluded, based upon their audit, and relying on the audits of Baker Tilly and CliftonLarsonAllen, that there was a reasonable basis for rendering an unmodified opinion that the City of Rochester's financial statements for the fiscal year ended December 31, 2018, are fairly presented in conformity with GAAP. The independent auditor's report is presented as the first component of the financial section of this report.

The independent audit of the financial statements of the City of Rochester was part of a broader, federally mandated "Single Audit" designed to meet the special needs of federal grantor agencies. The standards governing Single Audit engagements require the independent auditor to report not only on the fair presentation of the financial statements, but also on the City's internal controls and compliance with legal requirements, with special emphasis on internal controls and legal requirements involving the administration of federal awards. These reports are available in the City of Rochester's separately issued Single Audit Report.

CITY OF ROCHESTER, MINNESOTA

GAAP requires that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The City of Rochester's MD&A can be found immediately following the report of the independent auditors.

PROFILE OF THE GOVERNMENT

The City of Rochester, incorporated on August 5, 1858, is located in the southeastern part of the State of Minnesota, which is considered to be one of the top growth areas in the state, and one of the top growth areas in the country. The City currently has a land area of nearly 55.52 square miles and serves a population of 116,145. The City of Rochester is empowered to levy a property tax on both real and personal properties located within its boundaries. It also is empowered by state statute to extend its corporate limits by annexation, which is done periodically when deemed appropriate by the governing council.

The City of Rochester is governed under a charter adopted August 22, 1904. Policy-making and legislative authority are vested in a governing council consisting of the mayor, the council president and six council members. The governing council is responsible, among other things, for passing ordinances, adopting the budget, appointing committees, and hiring both the City's administrator and attorney. The City's administrator is responsible for carrying out the policies and ordinances of the governing council, for overseeing the day-to-day operations of the City, and for appointing the heads of the various departments. The council is elected on a non-partisan basis. Council members, the president and mayor all serve four-year staggered terms, with four of these positions elected every two years. Six of the council members are elected by ward. The mayor and council president are elected at large.

The City has a blended component unit, the DMCC. The Corporation was established to benefit the City, and more broadly, Olmsted County and the State of Minnesota by researching, preparing, and implementing a master development plan, including facilitating public infrastructure projects and a variety of development and redevelopment projects, all to promote and provide for the establishment of the City, the County, and the State as a world destination medical center. Separate financial statements are issued by the DMCC.

The City of Rochester provides a full range of services including police and fire protection; construction and maintenance of streets and infrastructure; recreational facilities, library and cultural events; water, sewer, electric, storm water management, public parking, mass transit and airport services.

RELEVANT FINANCIAL POLICIES

In accordance with the City of Rochester's Financial Policies, the City strives to maintain a fund balance in the General Fund for working capital purposes equal to five months, or 42% of current year actual annual operating expenditures. The City also reviews and updates the schedule of fund balances, reserves and working capital in all other operating funds and determines the adequacy of those balances in conjunction with the budgets set annually.

The City of Rochester's Debt Policy restricts the use of long-term borrowing to planned capital improvements approved in the five-year Capital Improvements Plan and a limited use of short term debt for capital equipment outlay. The term of any bonds issued is limited to no more than the expected useful life of the asset being financed. The City strives to maintain a "pay-as-you-go" capital funding program, supporting capital spending without the use of debt whenever feasible. The City will not exceed a debt limit of 2% of taxable market value and will limit its tax levy for debt service to no more than 10% of the total tax levy plus annual State aids.

CITY OF ROCHESTER, MINNESOTA

BUDGET PROCESS

The annual budget serves as the foundation for the City of Rochester's financial planning and control. A budget workshop is held with council in April to establish strategic priorities. All departments and agencies of the City of Rochester submit requests for appropriation to the city administrator in May of each year in alignment with these council priorities. The city administrator uses these requests as the starting point for developing a proposed budget. The city administrator then provides this proposed budget to the council for review prior to August. Work sessions are then held with the council covering each department budget. The council is required to hold public hearings on the proposed budget and to adopt a final budget no later than December 31, the close of the City of Rochester's fiscal year. The appropriated budget is prepared by fund, function (e.g., public safety), and department (e.g., police). Department heads may make transfers of appropriations within a department. Any changes to the budget at the functional level (e.g. General Government, Public Safety, Public Works, etc.) must be by formal resolution of the City Council. Budget-to-actual comparisons are provided in this report for each individual governmental fund for which an appropriated annual budget has been adopted. For the general fund, this comparison is presented on page 26-27 as part of the basic financial statements for the governmental funds. For governmental funds, other than the general fund, with appropriated annual budgets, this comparison is presented in the governmental fund subsection of this report, which starts on page 98.

FACTORS AFFECTING FINANCIAL CONDITION

The information presented in the financial statements is perhaps best understood when it is considered from the broader perspective of the specific environment within which the City of Rochester operates.

Local economy. The third largest City in Minnesota, Rochester is located 78 miles southeast of Minneapolis and St. Paul. Rochester's strong economy is built around world-renowned health care, cutting-edge technology, agriculture and agribusiness. As home to the Mayo Clinic and IBM Rochester, the City has developed into an economic growth center and the cultural hub of southeastern Minnesota. Its many recreational and cultural activities draw people from southeastern Minnesota and northern Iowa. Add these benefits to a low crime rate and an exceptional school system and it is easy to see why Rochester continues to rank as one of the top places to live.

Recent indicators of Rochester's economic climate include:

- **Jobs.** Total Nonagricultural wage and salary employment for the Rochester Metropolitan Statistical Area (MSA) decreased over the last year at a rate of 0.2 percent. The decrease of 248 jobs brought the total employment down to 120,340 from last year's December level of 120,588. Through the first quarter of 2019, the total employment increased to 122,065 for a gain of 1,725 jobs. This is an increase of 1,477 jobs from last year's December level.
- **Unemployment.** The Rochester MSA unemployment rate increased by 0.2 percent from a year ago, ending first quarter of 2019 at 3.6 percent. The rates for January and February were 3.6 and 3.4 percent respectively. The Rochester average remains below the state and U.S. averages of 4.1 and 3.9 percent respectively.
- **Home Sales.** The average home in Rochester sold for \$211,538 during the first quarter of 2019, and the median sale price was \$198,000. There were 373 units sold during the first quarter and the average time on the market was 69 days. (source: SE Minnesota Association of Realtors)

CITY OF ROCHESTER, MINNESOTA

- **Building Activity.** Commercial and residential building permits issued for 2018 totaled \$587,794,238. Permit totals were up 12 percent from a year ago, up 32.7 percent over 2016, up 21.4 percent for 2015, and up 47.7 percent for 2014. Permits issued during the first quarter of 2019 totaled \$82,165,474. This represents a decrease of 27.2 percent over first quarter 2018 and an increase of 10.5 percent from 2017.
- **City Sales Tax.** Net sales tax collections by the City through its 0.75% local option sales and use tax during 2018 totaled \$18.6 million, up from \$17.7 million for 2017 collections.
- **City Lodging Tax.** Lodging tax collections by the City during 2018 totaled \$10.6 million, up from \$9.4 million for 2017 collections.

Long-term financial planning. The Rochester council is directing City staff on numerous projects that will affect the growth of the City. A partial list includes:

- Destination Medical Center (DMC). The State legislature approved the DMC law in 2014 a \$6 billion economic development initiative to secure Minnesota's status as a global medical destination center now and in the future. The legislation secured State, City and County funding of \$585 million to help construct the significant public infrastructure needed to support this growth. In April of 2015, the City Council and the Destination Medical Center Board formally adopted the DMC Development Plan, a comprehensive framework for the 20-year project to redefine downtown Rochester. The plan is a strategic business plan that addresses land use, transportation, infrastructure, business development, marketing and operational strategies over the 20 year period.

By May of 2019, there has been over \$690 million in private investment certified in the DMCC district area with at least 4 more large projects in various stages of the approval process. This private investment plus the City's contribution of \$46.3 million to date will trigger the second State payment to the City by September of this year.

- Sales Tax Projects. With most of the City facility projects authorized under the 2011 local option sales tax extension completed by early 2017, the majority of the sales tax funding is now focused on street construction projects by both the City and County with some assistance to higher education construction projects. The funds will also assist transit facility and airport projects as we move into 2019. Current estimates reflect this authorization should complete by 2024.
- Airport Improvements. Funding is being sought for important reconstruction work on the City's main runway 2/20 at the Rochester International Airport for current design with construction in 2020. This project is estimated to cost \$54 million and will require a mix of State, City and Federal funds to complete.

CITY OF ROCHESTER, MINNESOTA

AWARDS AND ACKNOWLEDGEMENTS

The Government Finance Officers Association (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Rochester, Minnesota for its comprehensive annual financial report for the fiscal year ended December 31, 2017. This was the forty-seventh consecutive year that the City has received this prestigious award. In order to be awarded a Certificate of Achievement, the government must publish an easily readable and efficiently organized comprehensive annual financial report. This report satisfied both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current report continues to conform to the Certificate of Achievement Program's requirements, and we are submitting it to GFOA to determine its eligibility for another certificate.

The preparation of this report could not be accomplished without the professional, efficient services of many dedicated people. We first express our appreciation to all members of the Finance department who assisted and contributed in preparing the report. We also thank the staff of Smith, Schafer and Associates, Ltd. for their assistance and review of the document. And finally, we acknowledge the Mayor and the members of the Common Council for their interest and support in planning and conducting the financial operations of the City in a responsible and progressive manner.

Respectfully submitted,



Dale R. Martinson
Director of Finance



Steve Rymer
City Administrator



Government Finance Officers Association

Certificate of
Achievement
for Excellence
in Financial
Reporting

Presented to

City of Rochester
Minnesota

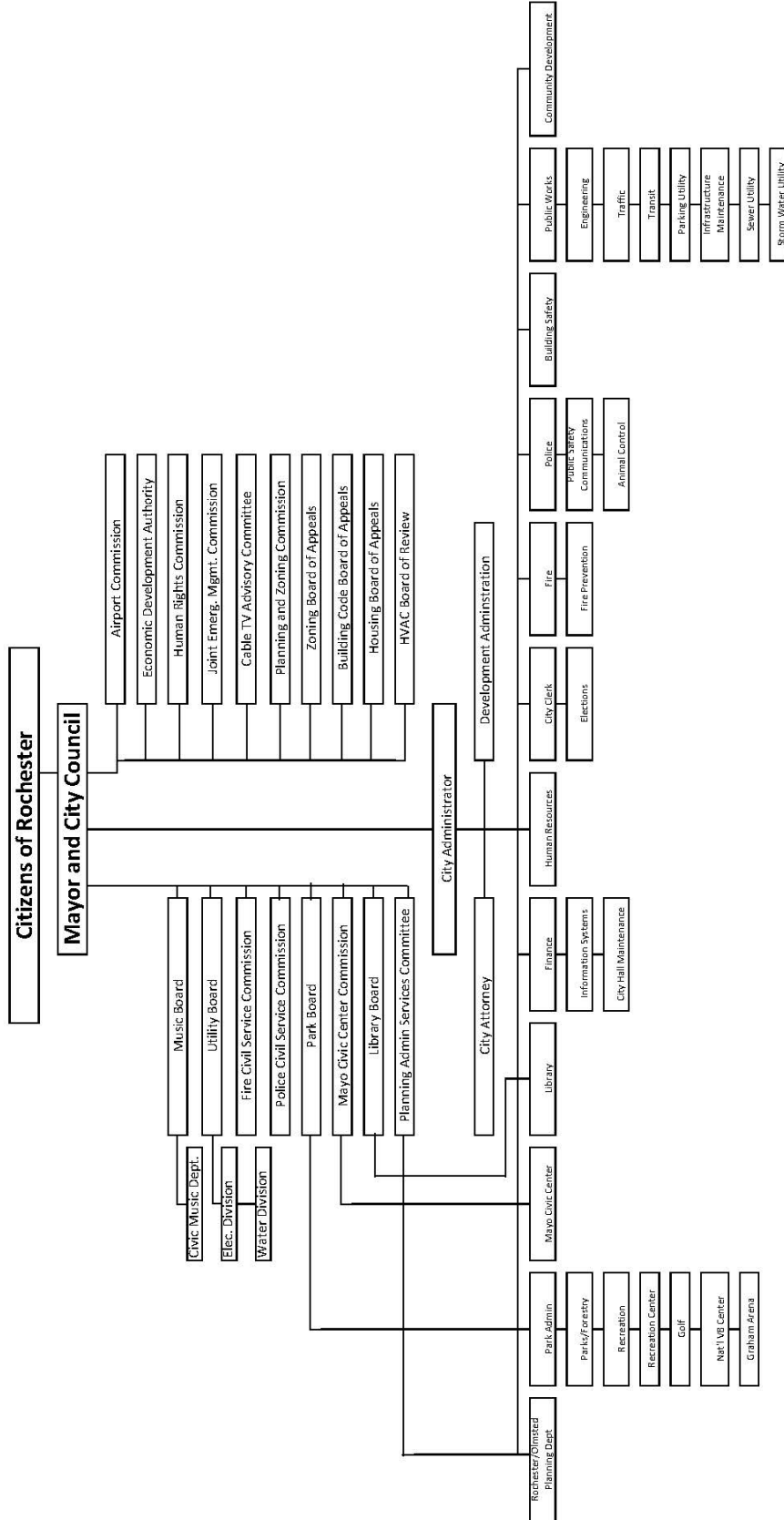
For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended

December 31, 2017

Christopher P. Morill

Executive Director/CEO

CITY OF ROCHESTER, MINNESOTA ORGANIZATIONAL CHART



**CITY OF ROCHESTER, MINNESOTA
LIST OF ELECTED AND APPOINTED OFFICIALS**

MAYOR - COUNCIL

	<u>Initial Term Commenced</u>	<u>Current Term Expires December 31</u>
Mayor, Ardell F. Brede	2003	2018
Council President, Randy Staver	2013	2020
Councilmember First Ward, Ed Hruska	2007	2018
Councilmember Second Ward, Michael Wojcik	2009	2020
Councilmember Third Ward, Nick Campion	2015	2018
Councilmember Fourth Ward, Mark Bilderback	2009	2020
Councilmember Fifth Ward, Mark Hickey	2014	2018
Councilmember Sixth Ward, Annalissa Johnson	2017	2020

CITY ADMINISTRATOR

Steve Rymer

DIRECTOR OF FINANCE – TREASURER

Dale R. Martinson

OTHER CITY OFFICIALS

City Attorney - Jason T. Loos
City Clerk - Anissa N. Hollingshead
Director of Public Works - Chris J. Petree
Director of Building Safety - Randy S. Johnson
Chief of Police - James L. Franklin
Fire Chief - Eric D. Kerska
Director of Human Resources - Linda K. Hillenbrand
Director Library Services - Audrey S. Betcher
Superintendent of Parks and Recreation - Paul D. Widman
Director of Community Development - Cynthia M. Steinhauser
Director of Mayo Civic Center - Donna M. Drews
General Manager - Music, Steven J. Schmidt
General Manager - Public Utilities, Mark R. Kotschevar